

European Rates Alpha

Updating US vs EUR top left vol view

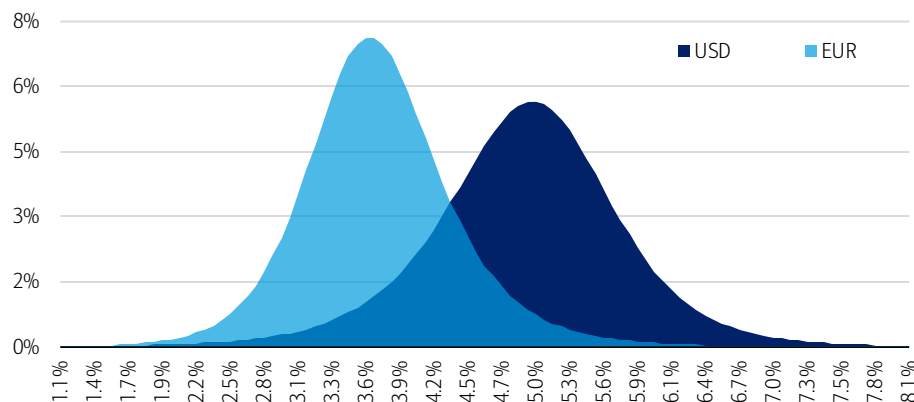
Close long 1y1y EUR straddle vs US

In our [Global Rates Year-Ahead](#), we called for higher implied volatility in the top left of the EUR grid vs the US. Our view was that realised vol in EUR rates would be better supported as the Euro Area was less advanced than the US in the tightening cycle, and guidance from the ECB was prone to more changes. Since then, we saw implied vol in both regions decline, but our long 1y1y straddle in EUR vs USD was able to perform, supported by the delta & currency exposures. We close the trade, paying €100K (having initially received €180K). We believe the re-acceleration potential can cause US vol to outperform EUR vol. We already started to observe this with rising US implieds in the past 2 weeks, but there is scope for more (the vol market is still not embracing higher rates – see the report [Re-acceleration risk](#)).

Buy 6m1y US payer spd, funded by OTM EUR 6m1y payer
Instead, we now recommend selling OTM payers in EUR top left, to finance a payer spread in USD. Specifically, we like selling ATM+27bp 6m1y EUR payer, to buy a USD ATM+20/ATM+70bp payer spread in 6m1y (strikes of 5.12%/5.62%). The trade is costless. We target a P&L of 20bp, with a stop at -10bp. The position expresses the view that there is potential for Fed expectations to reprice higher, while it will be hard for the market to price in an ECB Depo rate averaging c.3.75% until 2H24 without a major Fed repricing. The position also leverages the fact that the skew is still on the receiver side in 6m1y USD while it is on the payer side in EUR (Exhibit 1). The trade is slightly long delta at inception, which cushions the position for some retracement of the recent move. The risk is a tightening of the 2y US-EUR spread.

Exhibit 1: Implied distribution of 6m1y rate from the vol market in US and EUR

The skew is on the right hand side in EUR, while it is on the left hand side in USD



Source: BofA Global Research

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For a list of our open trades as well as those closed over the past 12 months, please see our latest [Global Rates Weekly](#)

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