Volatility Starts To Reemerge

- This spring has seen a slightly earlier recovery in realized volatility than in four of past five years
- Yield support is no longer there in many currency pairs
- Established ranges beginning to be threatened

Since the start of the month signs of life have started to return to pockets of the currency markets.

The most obvious place to see this has been in APAC where the USD has staged some of the sharpest 12-day moves against the CNY, TWD, & KRW seen in the past five years, while realized volatility over the period in all three pairs has either already reached the five-year average or is rapidly approaching it.

Similarly, while the rise in volatility in AUD/JPY has been less marked when compared to the five-year average, the AUD has still staged one of its largest 12-day declines seen since the summer of 2016.

Although it’s easy enough to see that the driving force behind these moves has been the collapse of the US/China trade talks at the start of the month, it should be noted that this is not the only place that movement has started to emerge.

GBP has just staged one of its larger 12 day drops against the USD since 2014 (see chart below) as political
uncertainty returns while, if the reference time frame is widened out slightly, over the past 45 trading days the EUR has staged once of its sharpest rallies against the HUF since 2011.

This suggests a market that might not have been particularly well-prepared for the return of volatility seen post-Golden Week.

There are several interesting points to be highlighted. The first is that in four out of the past five years the drop seen in spring in realized volatility (using 21-day realized vol in the USD Index as a proxy) has lasted through until at least mid-June and in two cases (2015 and 2017) until mid-to-late July.

2. **UK**: The BBC reports there is a new push (led by MP Nigel Evans) to oust the PM “ASAP” in order that she does not get the chance to put her proposed bill forward. (via Reuters) >

3. **US/China**: The New York Times reports (citing “people familiar with the matter”) that the US administration is considering limits to Hikvision’s ability to buy American technology. >

4. **Indonesia**: Six people die and around 200 are been injured after clashes in Jakarta. This follows the official announcement that incumbent Joko Widodo has won the presidential elections. >

5. **Australia**: Prime Minister Scott Morrison meets with RBA Governor Phillip Lowe as part of a scheduled post-election briefing. An unnamed source “familiar with details of Tuesday’s meeting” tells Reuters that the governor briefed the prime minister on the
The only exception was last year when the uncertainty surrounding the Italian election saw volatility return in late April. This suggests a market that might not have been particularly well-prepared for the return of volatility seen post-Golden Week.

The second point is that the yield differentials that would once have provided some cushion against volatility are simply no longer there. The yield gap between two-year JGBs and the equivalent Australian government paper now stands at just 136 bps.

Not only is this the narrowest this has reached in the modern era but it also stands in sharp contrast to the 500 bp plus gap that typically was available in the decade running up to the global financial crisis.

Similarly, the yield advantage for the USD over the KRW and TWD stands close to the widest it has been for over a decade. Even for GBP (where the yield gap has been narrowing since late last year) the lack of support when compared to the norm of a decade ago is startling.

The yield differentials that would once have provided some cushion against volatility are simply no longer there.

The final point is that the current moves are either threatening to take these pairs outside of the trading ranges that have dominated - in some cases for the past 12 months - or have already done so (hence the debate on CNY 7.00).

This combination of an unseasonal burst of volatility, a lack of yield support and the risk of moving into unfamiliar territory after an extended period of quiet trading is a potent one, and suggests caution in the weeks ahead.

Please direct questions or comments to:

AerialView@BNYMellon.com
BNY Mellon is the corporate brand of The Bank of New York Mellon Corporation and may be used as a generic term to reference the corporation as a whole and/or its various subsidiaries generally. This material and any products and services may be issued or provided under various brand names in various countries by duly authorized and regulated subsidiaries, affiliates, and joint ventures of BNY Mellon, which may include any of the following. The Bank of New York Mellon, at 225 Liberty St, NY, NY USA, 10286, a banking corporation organized pursuant to the laws of the State of New York, and operating in England through its branch at One Canada Square, London E14 9AL, UK, registered in England and Wales with numbers FC005522 and BR000818. The Bank of New York Mellon is supervised and regulated by the New York State Department of Financial Services and the US Federal Reserve and authorized by the Prudential Regulation Authority. The Bank of New York Mellon, London Branch is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. The Bank of New York Mellon SA/NV, a Belgian public limited liability company, with company number 0806.743.159, whose registered office is at 46 Rue Montoyerstraat, B-1000 Brussels, Belgium, authorized and regulated as a significant credit institution by the European Central Bank (ECB), under the prudential supervision of the National Bank of Belgium (NBB) and under the supervision of the Belgian Financial Services and Markets Authority (FSMA) for conduct of business rules, and a subsidiary of The Bank of New York Mellon. The Bank of New York Mellon SA/NV operates in England through its branch at 160 Queen Victoria Street, London EC4V 4LA, UK, registered in England and Wales with numbers FC029378 and BR014361. The Bank of New York Mellon SA/NV (London Branch) is authorized by the ECB and subject to limited regulation by the Financial Conduct Authority and subject to regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Financial Conduct Authority and Prudential Regulation Authority are available from us on request. The Bank of New York Mellon SA/NV operating in Ireland through its branch at 4th Floor Hanover Building, Windmill Lane, Dublin 2, Ireland trading as The Bank of New York Mellon SA/NV, Dublin Branch, is authorized by the ECB and is registered with the Companies Registration Office in Ireland No. 907126 & with VAT No. IE 9578054E. The Bank of New York Mellon, Singapore Branch, subject to regulation by the Monetary Authority of Singapore. The Bank of New York Mellon, Hong Kong Branch, subject to regulation by the Hong Kong Monetary Authority and the Securities & Futures Commission of Hong Kong. If this material is distributed in Japan, it is distributed by The Bank of New York Mellon Securities Company Japan Ltd, as intermediary for The Bank of New York Mellon. If this material is distributed in, or from, the Dubai International Financial Centre (“DIFC”), it is communicated by The Bank of New York Mellon, DIFC Branch, regulated by the DFSA and located at DIFC, The Exchange Building 5 North, Level 6, Room 601, P.O. Box 506723, Dubai, UAE, on behalf of The Bank of New York Mellon, which is a wholly-owned subsidiary of The Bank of New York Mellon Corporation. This material is intended for Professional Clients only and no other person should act upon it. Not all products and services are offered in all countries.

The information contained in this material is intended for use by wholesale/professional clients or the equivalent only and is not intended for use by retail clients. If distributed in the UK, this material is a financial promotion.

This material, which may be considered advertising, is for general information purposes only and is not intended to provide legal, tax, accounting, investment, financial or other professional advice on any matter. This material does not constitute a recommendation by BNY Mellon of any kind. Use of our products and services is subject to various regulations and regulatory oversight. You should discuss this material with appropriate advisors in the context of your circumstances before acting in any manner on this material or agreeing to use any of the referenced products or services and make your own independent assessment (based on such advice) as to whether the referenced products or services are appropriate or suitable for you. This material may not be comprehensive or up to date and there is no undertaking as to the accuracy, timeliness, completeness or fitness for a particular purpose of information given. BNY Mellon will not be responsible for updating any information contained within this material and opinions and information contained herein are subject to change without notice. BNY Mellon assumes no direct or consequential liability for any errors in or reliance upon this material.

This material may not be distributed or used for the purpose of providing any referenced products or services or making any offers or solicitations in any jurisdiction or in any circumstances in which such products, services, offers or solicitations are unlawful or not authorized, or where there would be, by virtue of such distribution, new or additional registration requirements.

The terms of any products or services provided by BNY Mellon to a client, including without limitation any administrative, valuation, trade execution or other services shall be solely determined by the definitive agreement relating to such products or services. Any products or services provided by BNY Mellon shall not be deemed to have been provided as fiduciary or adviser except as expressly provided in such definitive agreement. BNY Mellon may enter into a foreign exchange transaction, derivative transaction or collateral arrangement as a counterparty to a client, and its rights as counterparty or secured party under the applicable transactional agreement or collateral arrangement shall take precedence over any obligation it may have as fiduciary or adviser or as service provider under any other agreement.

Pursuant to Title VII of The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 and the applicable rules thereunder, The Bank of New York Mellon is provisionally registered as a swap dealer with the Commodity Futures Trading Commission ("CFTC") and is a swap dealer member of the National Futures Association (NFA ID 0420890).

BNY Mellon (including its broker-dealer affiliates) may have long or short positions in any currency, derivative or instrument discussed herein. BNY Mellon has included data in this material from information generally available to the public from sources believed to be reliable. Any price or other data used for illustrative purposes may not reflect actual current conditions. No representations or warranties are made, and BNY Mellon assumes no liability, as to the suitability of any products and services described herein for any particular purpose or the accuracy or completeness of any information or data contained in this material. Price and other data are subject to change at any time without notice.

Rates: neither BNY Mellon nor any other third party provider shall be liable for any errors in or delays in providing or making available the data (including rates, WM/Reuters Intra-Day Spot Rates and WM/Reuters Intra-Day Forward Rates) contained within this service or for any actions taken in reliance on the same, except to the extent that the same is directly caused by its or its employees' negligence. The WM/Reuters Intra-Day Spot Rates and WM/Reuters Intra-Day Forward Rates are provided by The World Markets Company plc ("WM") in conjunction with Reuters. WM shall not be liable for any errors in or delays in providing or making available the data contained within this service or for any actions taken in reliance on the same, except to the extent that the same is directly caused by its or its employees' negligence.

The products and services described herein may contain or include certain “forecast” statements that may reflect possible future events based on current expectations. Forecast statements are neither historical facts nor assurances of future performance. Forecast statements typically include, and are not limited to, words such as "anticipate", "believe", "estimate", "expect", "future", "intend", "likely", "may", "plan", "project", "should", "will", or other similar terminology and should NOT be relied upon as accurate indications of future performance or events. Because forecast statements relate to the future, they are subject to inherent uncertainties, risks and changes in circumstances that are difficult to predict.

This document is intended for private circulation. Persons accessing, or reading, this material are required to inform themselves about and to observe any restrictions that apply to the distribution of this information in their jurisdiction.

Currency Administration is provided under and subject to the terms of a definitive agreement between BNY Mellon and the client. BNY Mellon exercises no investment discretion or fiduciary or adviser except as expressly provided in such definitive agreement. BNY Mellon may enter into a foreign exchange transaction, derivative transaction or collateral arrangement thereunder, but acts solely pursuant to the instructions in such agreement or otherwise provided by the client. Unless provided by definitive agreement, BNY Mellon is not an agent or fiduciary thereunder, and acts solely as principal in connection with related foreign exchange transactions.

All references to dollars are in US dollars unless specified otherwise.

This material may not be reproduced or disseminated in any form without the prior written permission of BNY Mellon. Trademarks, logos and other intellectual property marks belong to their respective owners.

The Bank of New York Mellon, member FDIC.

© 2017 The Bank of New York Mellon Corporation. All rights reserved.