FX Outlook

Presentation for ECB FXCG
Exchange rate volatility around the 2006/07 lows

Similar picture in DM and EM vols

Commerzbank FX Vol Index
3M implied vols of the 20 most actively traded G10 currency pairs and of the 19 most actively traded EM currency pairs; weighting according to BIS Triennial Survey; percent annualized

Source: Commerzbank Research
Low volatility across all financial markets
Near to the 2007 lows

Commerzbank ARPI²: index of global risk perception (i.e. vols)
Long-term average: zero

Source: Commerzbank Research
How does expansionary CB policy depress volatilities?

Two channels

**Forward guidance / zero lower bound**

- Near the zero lower bound CB policies become “passive”, i.e. are under-reacting on inflation / growth shocks.
- Forward guidance makes CB policies independent from marginal shocks.
- The marginal impact of surprises in inflation / growth on CB policies shrinks.

**QE**

- Central banks conducting QE take risky assets off the market (T-notes: duration risk, MBS: credit risk etc.)
- They enforce high levels of low-yielding, low-risk excess reserves (as long as net lending is restricted).
- The result:: hunt for yields, i.e. ample capital supply.
- Leverage effect: Ample capital supply reduces re-financing risks of governments and companies.
- Factors affecting re-financing demand are irrelevant for credit risks and don’t cause volatility.

**The Fed’s QE increases excess reserves**

USD trillion

Source: Federal Reserve System
Is the FX market complacent?
Market complacency increased steadily after the end of the crisis

Conditional on the vol level, the EUR-USD vol curve is getting flatter
EUR-USD: 12M/1M vol calendar spread, 1M vol level; percent cf. percentage points annualized

Sources: Bloomberg, Commerzbank Research
The effect of ECB's measures on EUR exchange rates
The intensified QE discussion, not the actual ECB measures, caused EUR weakness

EUR weakness masked by USD weakness
EUR-USD and idiosyncratic EUR factor ytd

EUR weakness since discussion about €QE intensified
USD exchange rate moves since April 2\textsuperscript{nd}

Sources: EBS, Commerzbank Research
The “new normal” of USD-CNY?
Depreciation instead of appreciation, higher volatility

USD-CNY
Spot, PBoC “Fixing” and permitted band

Sources: PBoC, Bloomberg L.P.
CNY weakness: managed or enforced?
PBoC continues to accumulate reserves

China’s FX reserves
trillion USD

China’s balance of payments
quarterly, USD billions

Sources: Peoples Bank of China, National Bureau of Statistics, Commerzbank Research
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