

# Chart Pack for ECB FXCG Meeting

November 2023



# FX Market conditions in G7

## Volumes up and spreads tighter

It provides a basic assessment of liquidity by looking at interbank spread, visible top of book (TOB) volume, market volatility and interbank traded (ECN) volume.

**Market Spread** – average top of book spread of primary market (If this index goes higher, it means that the spread is tighter and therefore liquidity should be better)

**TOP Volume** – average top of book visible size available on Primary Venue (If this index rises, the top of book volume is higher, indicating better liquidity)

**Volatility** – 5-minute logarithmic return of price (If the index increases, the volatility is going high, which represents the deterioration of liquidity)

**ECN Volume** – daily trading volume on all the trading venues HSBC has access to that provides volume data (If this index is high, it suggests that interbank volume is high and therefore better liquidity)

Overall, the higher the index, the better the liquidity

**YTD, G7 liquidity has improved significantly based on our Liquidity Index by about 30%**



**Overall, the rise in top of book volume, drop in volatility and tighter spread all contribute to better liquidity.**



# FX Market conditions in EM

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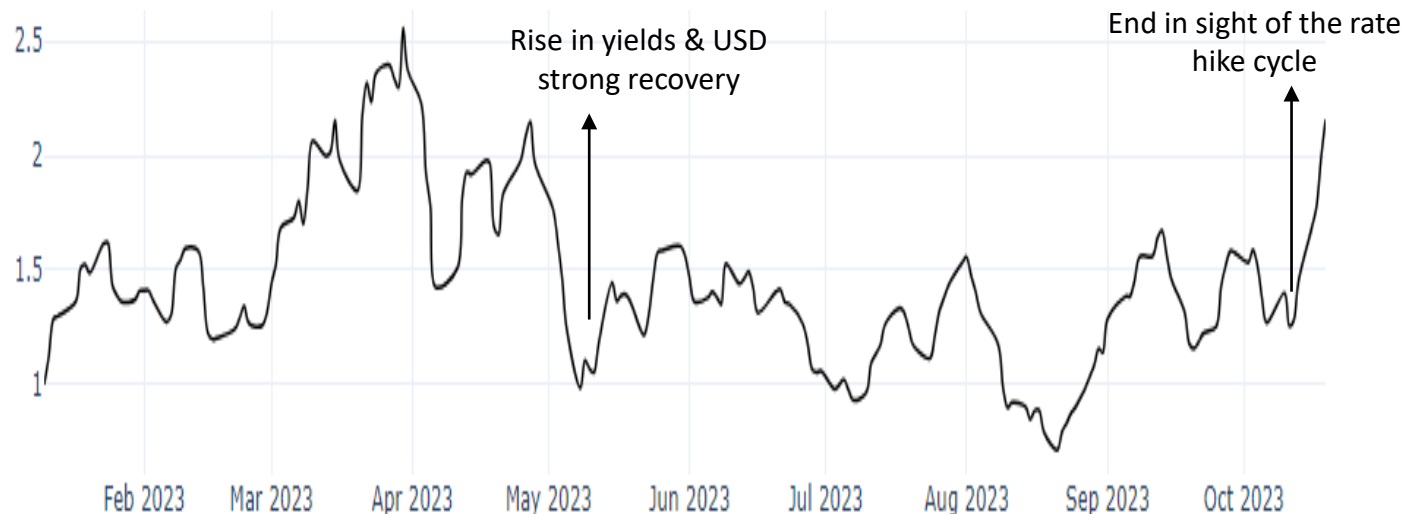
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**Liquidity Index this year has doubled for EM pairs (USDZAR, USDILS, USDMXN and USDRUB).**



**After aggregation, the drop in volatility, the rise in ECN volume and better spread jointly lead to higher Liquidity Index.**



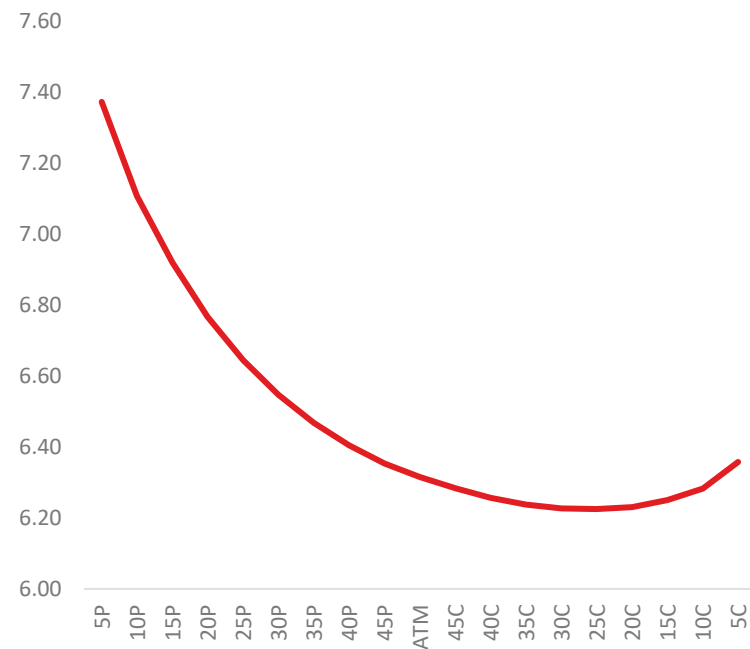
# HSBC Research forecasts EURUSD at 1.05 for YE2023 and 1.02 for YE2024

- ◆ **The rise in US rates**, more important than in other regions, supports the dollar.
- ◆ **Weak global growth** prospects weigh on the economy and strengthen the dollar.
- ◆ **The Eurozone cyclical recovery** is starting to run out of steam and this tends to benefit the dollar as well
- ◆ The recovery of the Chinese economy, disappointing, mechanically appreciates the dollar

EURUSD Spot Past 12M



3M EURUSD Volatility Smile in favor of EUR Put

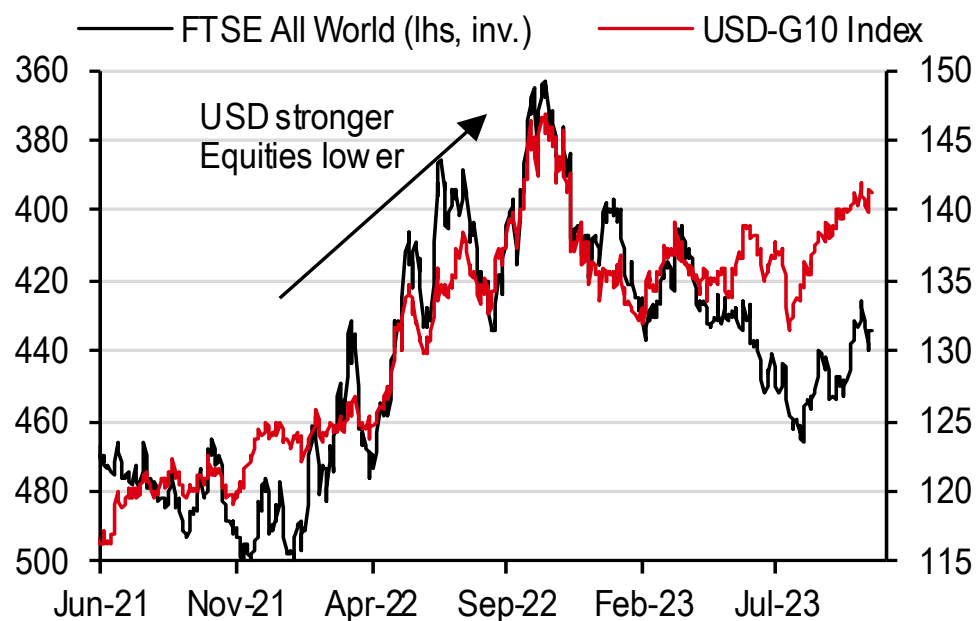


Consensus Forecasts	Q423	Q124	Q224	Q324
Median	1.06	1.08	1.09	1.10
High	1.11	1.15	1.17	1.20
Low	1.03	1.02	1.02	1.03
Forwards	1.09	1.09	1.10	1.10
<b>HSBC Forecasts</b>	<b>1.05</b>	<b>1.03</b>	<b>1.02</b>	<b>1.02</b>

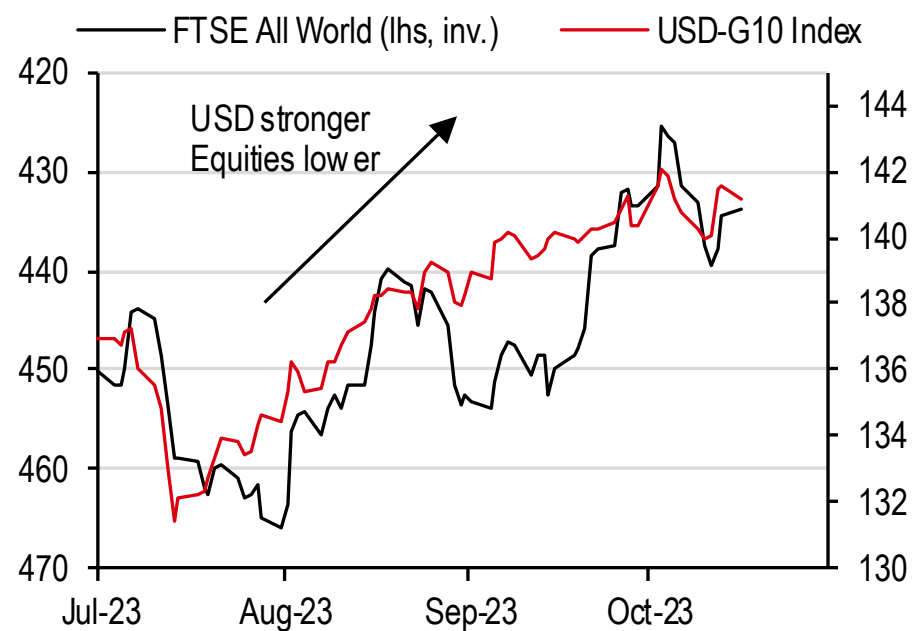


# Increasingly close relationship between USD and equities

Inverse relationship with equities and USD diverged in 2023...



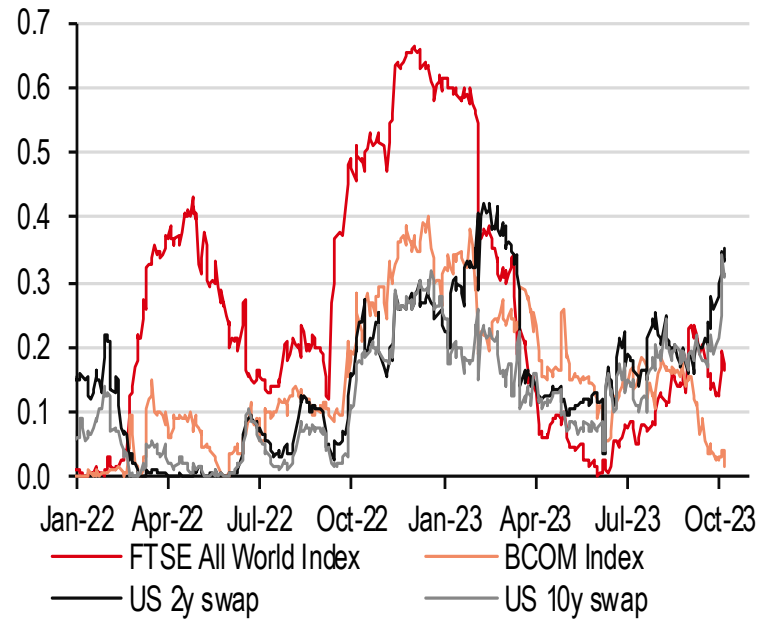
...but a more recent time frame suggests a closer relationship



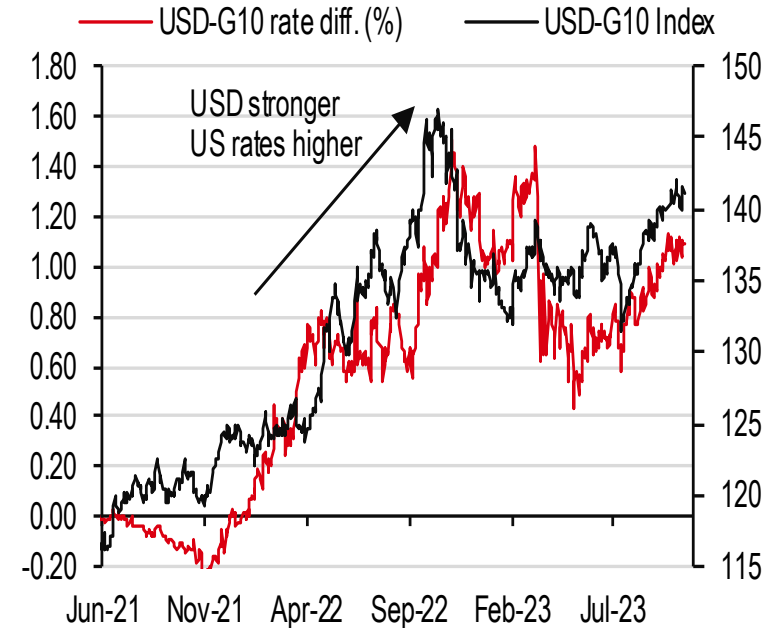
# US yields act as the global driver

- ◆ The resilience of US dollar is largely explained this year by the rise in US rates.
- ◆ In 2022, weak global equity and US bond markets performance has fuelled a rapid rise in the dollar.
- ◆ This year, only yields have been the dominant factor in the market.

The USD's drivers show the changes in US yields matter more lately...



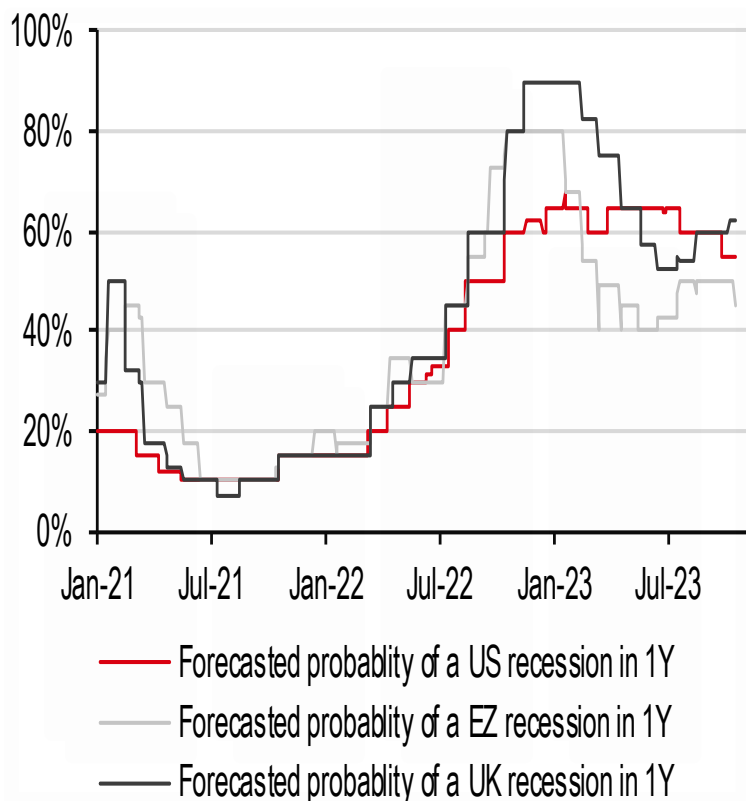
...but so do the level of US yields compared to others



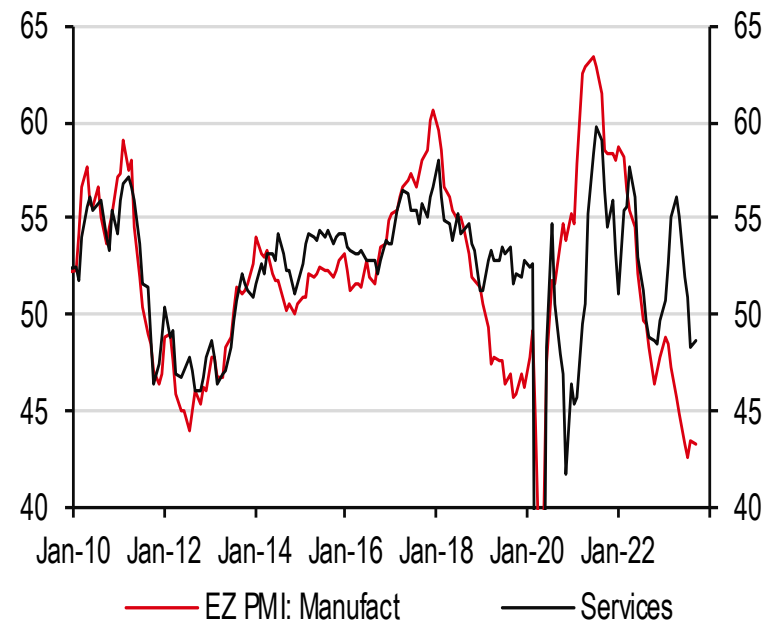
# Recession odds stabilised but remain high

- ◆ Fears about a recession have increased recently, which has also helped the dollar appreciate.
- ◆ This is normally the case when the global economy slows down.
- ◆ Overall, recession probabilities have recently stabilized but remain high for some major economies.
- ◆ At the same time, other cyclical indicators point to persistent sluggishness in Europe and elsewhere, notably in China.
- ◆ This keeps the US Dollar in a dominant position.

**Recession probabilities have receded for the US, UK and Eurozone economies for now**



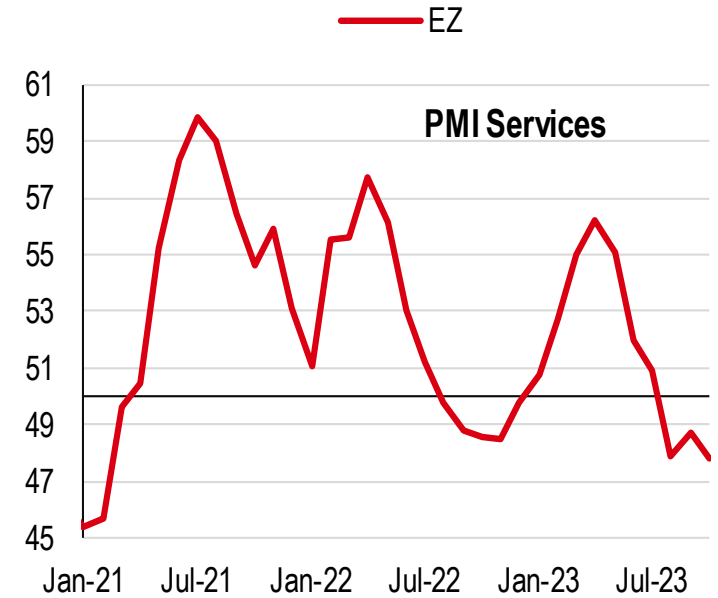
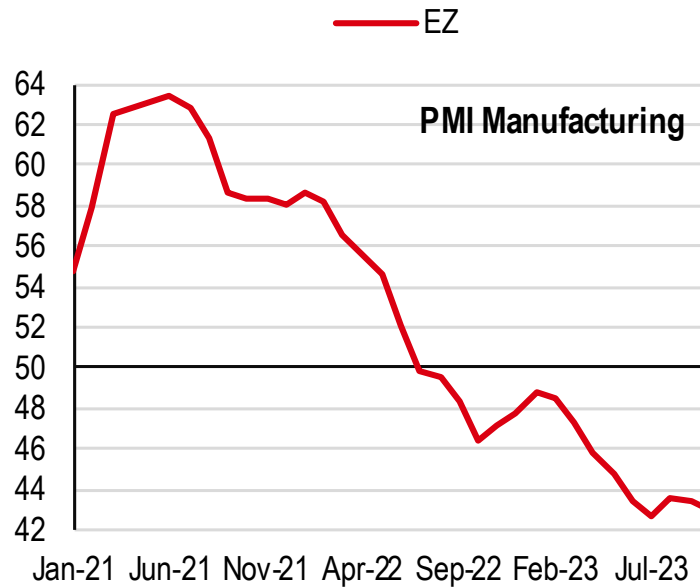
**Eurozone cyclical indicators have been stuck in a slow gear**



# Business sentiment weakening in EZ

- ◆ Global factors that once supported the EUR – growth dynamics, risk sentiment, easing supply chains, falling energy prices – have become less positive
- ◆ European rebound in consumer and business confidence is waning, credit growth has turned lower, and labour markets are softening

Business surveys pointing to weaker output in both manufacturing and now services

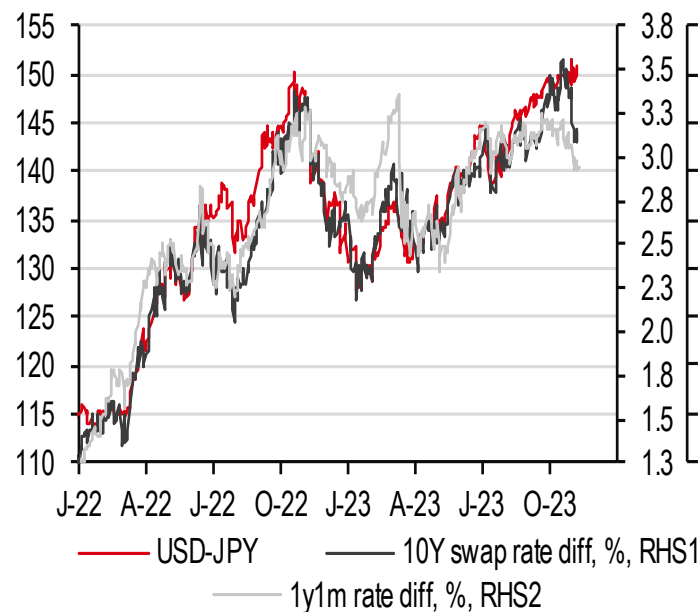




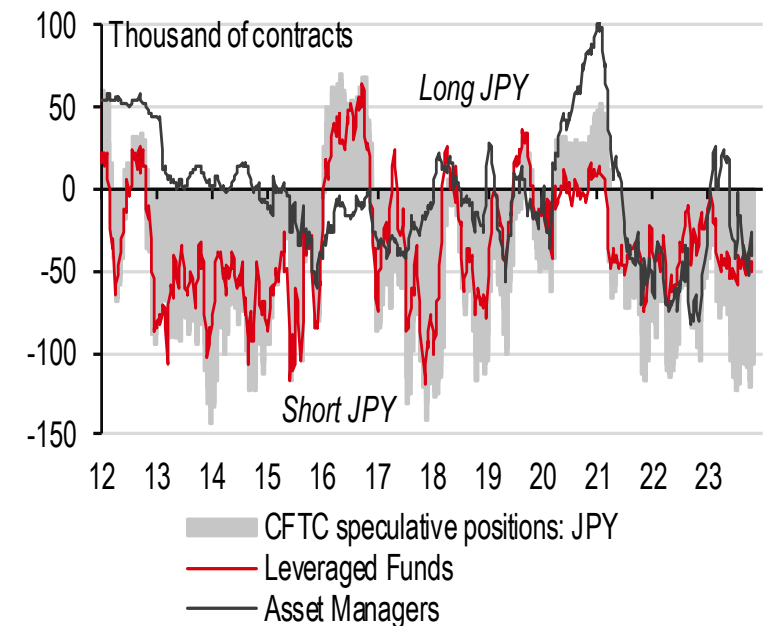
# HSBC Research forecasts USDJPY at 150 for YE2023 and 142 for YE2024

- ◆ Primarily driven by yield story
- ◆ Positioning across the market is short JPY
- ◆ Japanese households see their circumstances worsening due to high inflation, which is partly due to the weak JPY
- ◆ The cost of miscalculation is rising for both the MoF and BoJ
- ◆ We see USD-JPY fluctuating around 150 with risks skewed to the downside, especially if risk aversion intensifies

Peak US yields = Peak USD-JPY

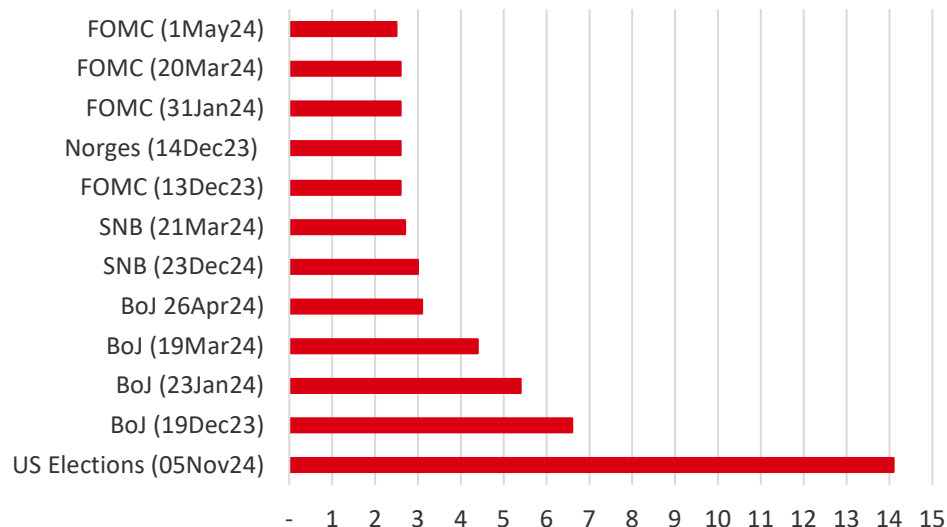


Short JPY positions look stretched

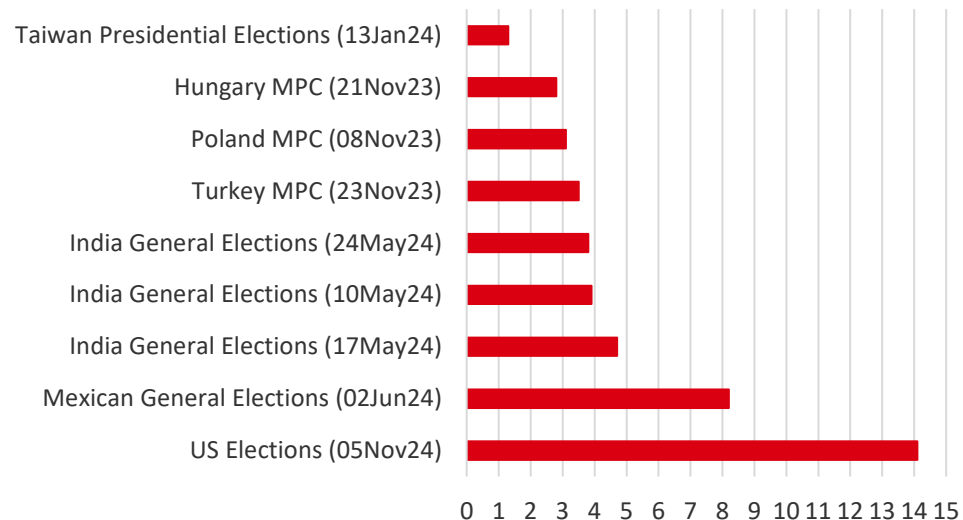


# Event Weights

## G10 Event Risks in Days of Variance



## EM Event Risks in Days of Variance



- ◆ **US election is the highest risk** on the horizon, an event now captured by 1Y vols
- ◆ Outside of US elections, the market is essentially focused on Central Bank action.
- ◆ Highest risks are assigned to the **upcoming BoJ meetings**.
- ◆ While not shown here, any economic figures susceptible to influence central bank action is risk weighted albeit at a weight inferior to those shown above (eg. CPI, PMI, employment numbers etc...).
- ◆ Missing: **UK elections (unknown date)**

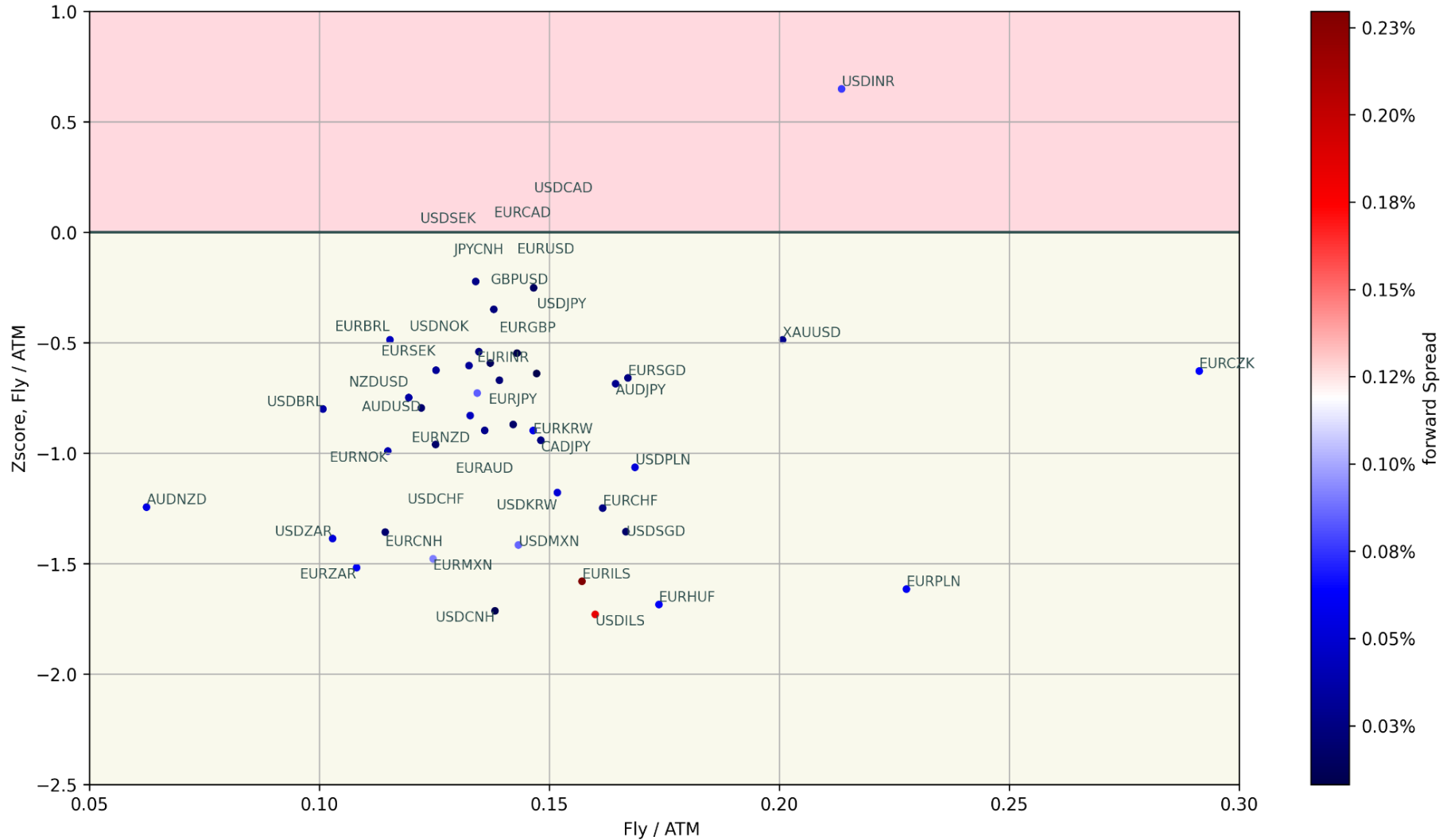
- ◆ Political risk emerges in EM risks too. Polish elections were a mover: next: Taiwan, India, Mexico.

Overall, no large measurable event risk on the horizon. However the list of tail risks keeps on growing:

- ◆ Inflation stickiness. Potential recessions, shift in credit risk appetite
- ◆ Sovereign/household debt in a rising rate environment
- ◆ China growth
- ◆ Middle-East crisis
- ◆ Fragile geopolitics
- ◆ Real estate bubbles? (eg. Sweden, Canada, Australia etc...)



# Tail risk is under-priced 1Y 10-delta fly



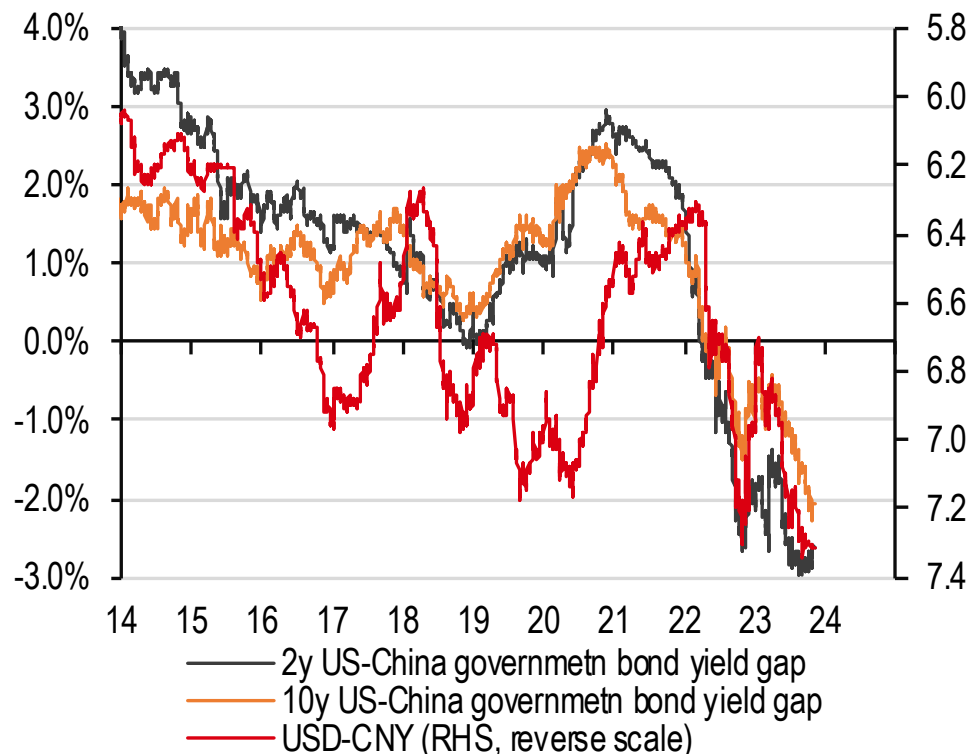
Note: current 1Y 10-delta fly/ ATM implied volatility, zscore vs 5Y lookback period  
 negative zscore: current fly/ATM below 5Y average; positive zscore: current fly/ATM above 5Y average  
 as of 18 Oct 2023, (close of previous day)  
 Source: HSBC FXO Strats



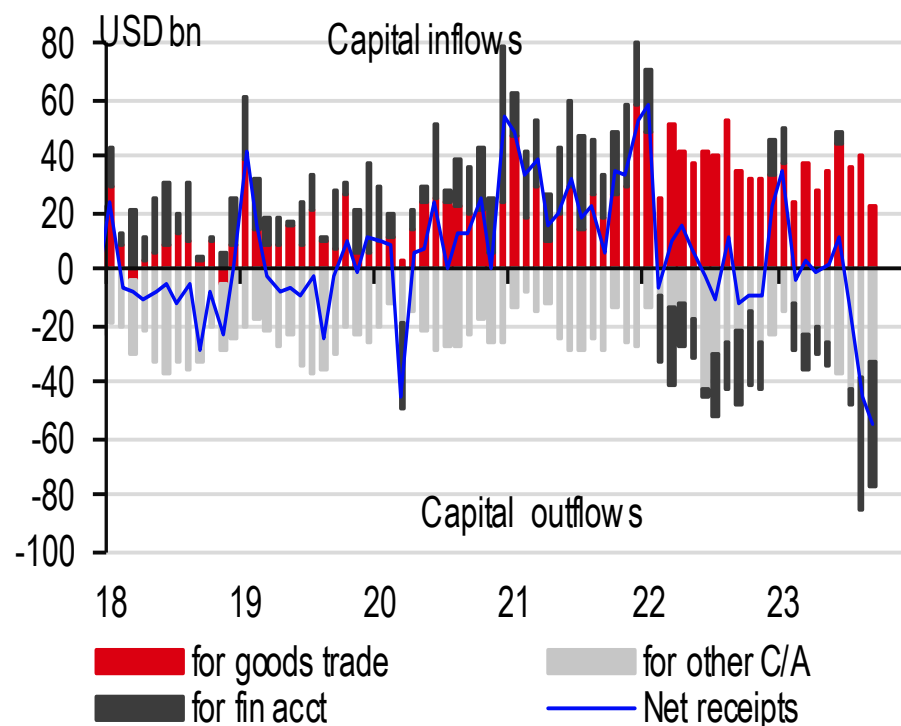
# RMB has been one of the worst-performing EM Asian currencies YTD

HSBC Research forecasts USDCNH at 7.30 for YE2023 and 7.30 for YE2024

The RMB's yield advantage may be narrow, but will remain large in 2024



Weak sentiment stems from both cyclical issues and structural concerns



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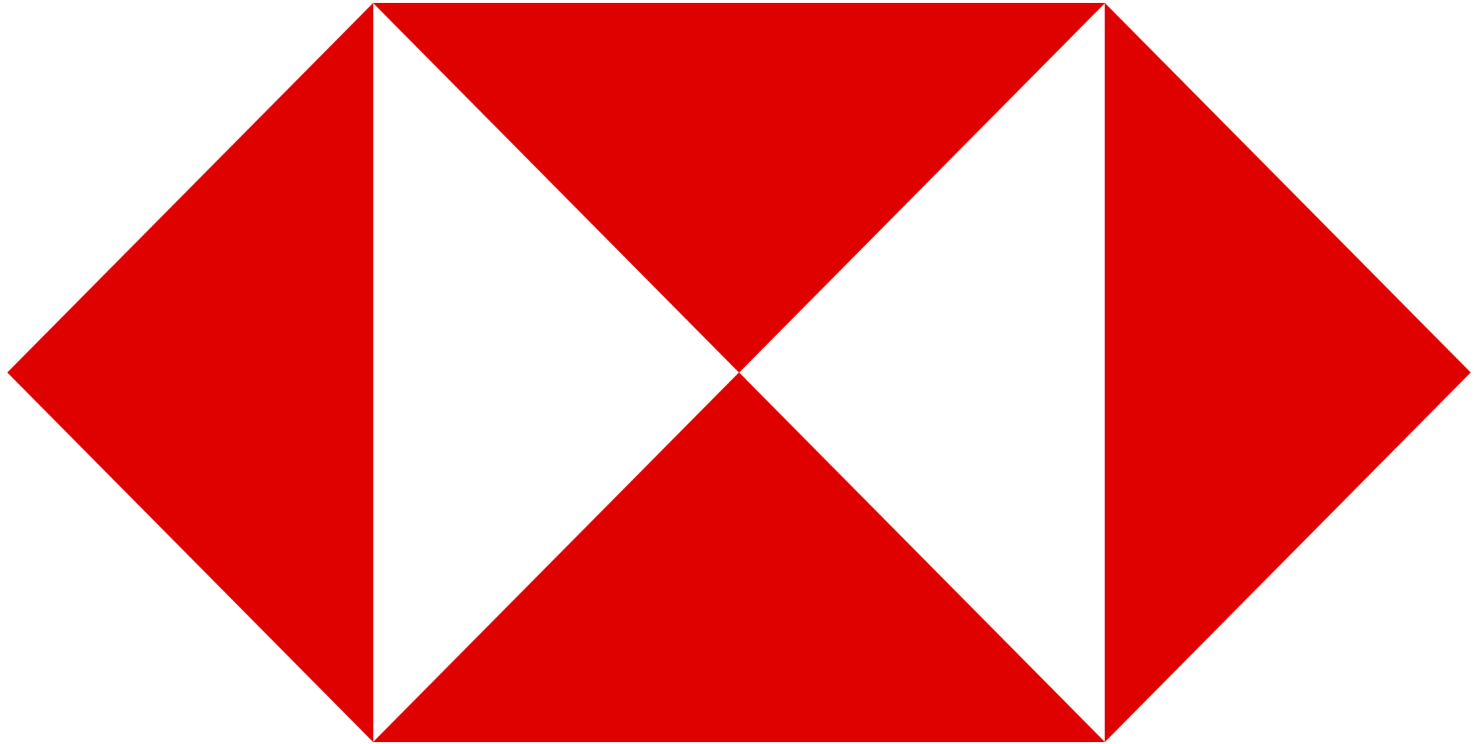
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# Brent futures pull back as geopolitical risk premium deflates, but Saudi 'extra' voluntary output cuts put a floor under prices.



# Key takeaways for oil's outlook: geopolitics, OPEC+ supply cuts and resurgence of economic concerns



## Oil prices geopolitical concerns induced risk premium

- **Hamas' unprecedented attack in scale and scope in Israel raised the geopolitical risk premium in oil prices** should the conflict spread, notably to Iran, a sponsor of Hamas. To date, neither oil production nor transit of oil is overly affected by the conflict, thus risk premia have deflated somehow, as evidenced by lower prices into November and a considerably weaker Call option skew.
- For now, there is no indication of a change in the soft US sanction policy stance vs Iran, while the US has temporarily lifted sanctions on Venezuela for a period of 6 months. US foreign policy in relation to these two countries allows for incremental oil onto the market, but this only marginally offsets curtailment elsewhere within the OPEC+ producers.



## The latest OPEC+ Joint Ministerial Monitoring Committee (JMMC) does not signal a change in supply policy

- Falling US crude stocks, Saudi's extra 1 mb/d restraint **should provide a price floor to oil**
- The Saudi Press Agency said that the Kingdom will continue its voluntary cut of 1 mb/d until the end of December.
- Russian Deputy Prime Minister Alexander Novak said that Russia would continue curbs on its crude exports.

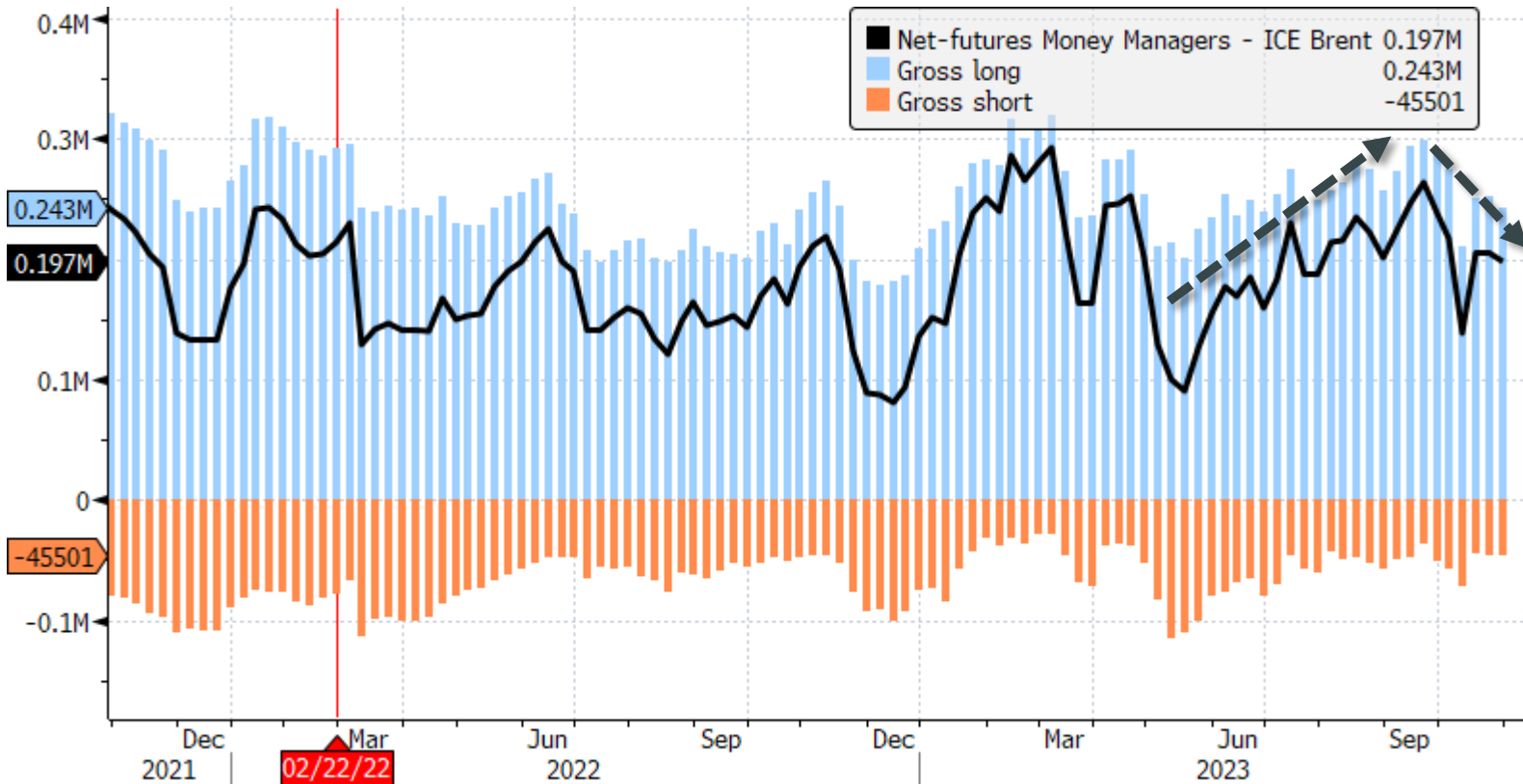
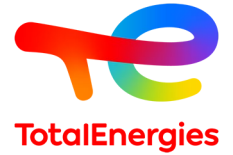


## PMI data in China, the US and Europe are weak, raising concerns over the evolution of oil demand in the near term.

- **Chinese October PMI data came in below expectations** as both the Official and Caixin manufacturing PMIs fell below 50 and services missed expectations. This reflects weaker domestic demand – the new orders component fell and is now below 50. Downward pressure on foreign demand increased as well – the export orders component edged down.
- Although traffic data displayed strength, as did domestic and international flights, **year-end Chinese oil demand is still at risk**, suggesting that given current refinery run rates, last-minute new product export quotas will need to be issued or that China's state and independent refiners will need to reduce processing rates, thus crude demand.
- Also, Oil prices retreated in early October with the resurgence of economic concerns as US yields marched higher, raising prospects of a recession or severe slowdown in the US.
- Yet, downward pressure exerted by financial conditions has relented with the Fed choosing to keep its policy rates steady.

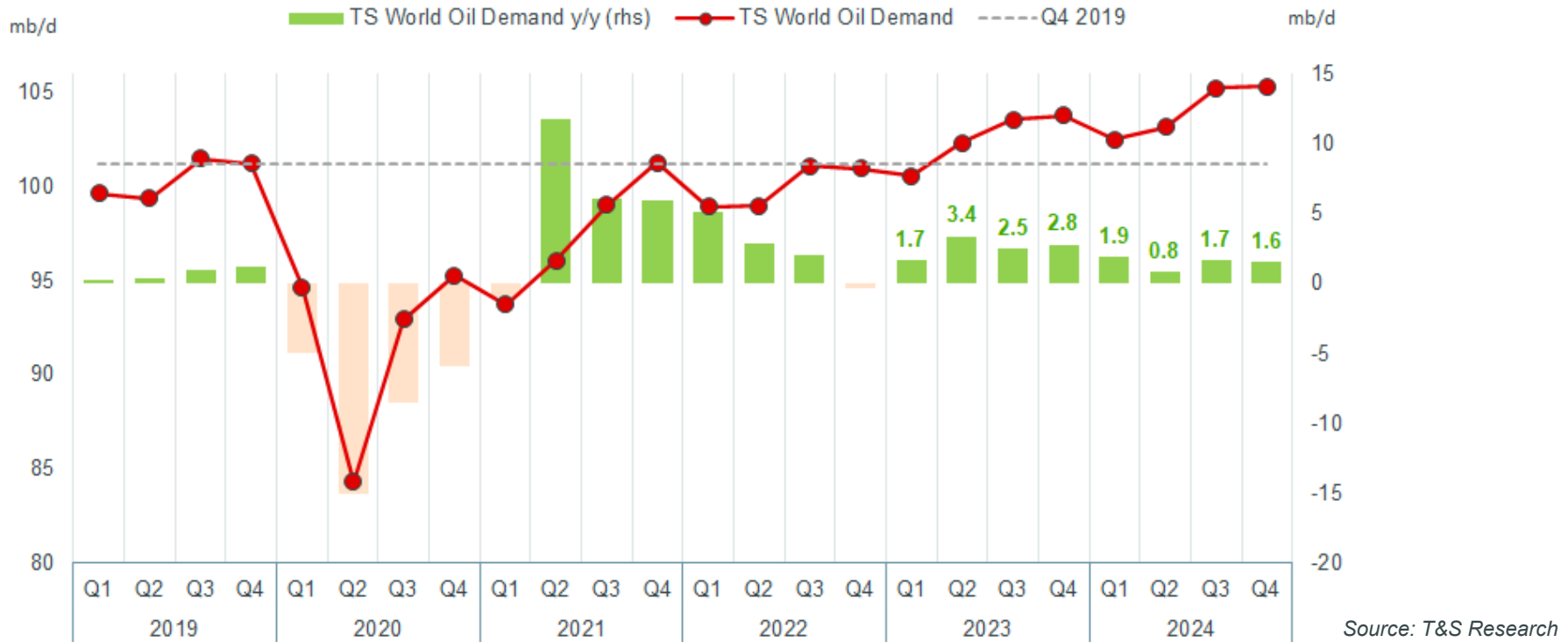


# Funds pare net-long positioning on oil as the Israel/Hamas war appears to be “contained” for now



*Pre-Russia invasion of Ukraine position*

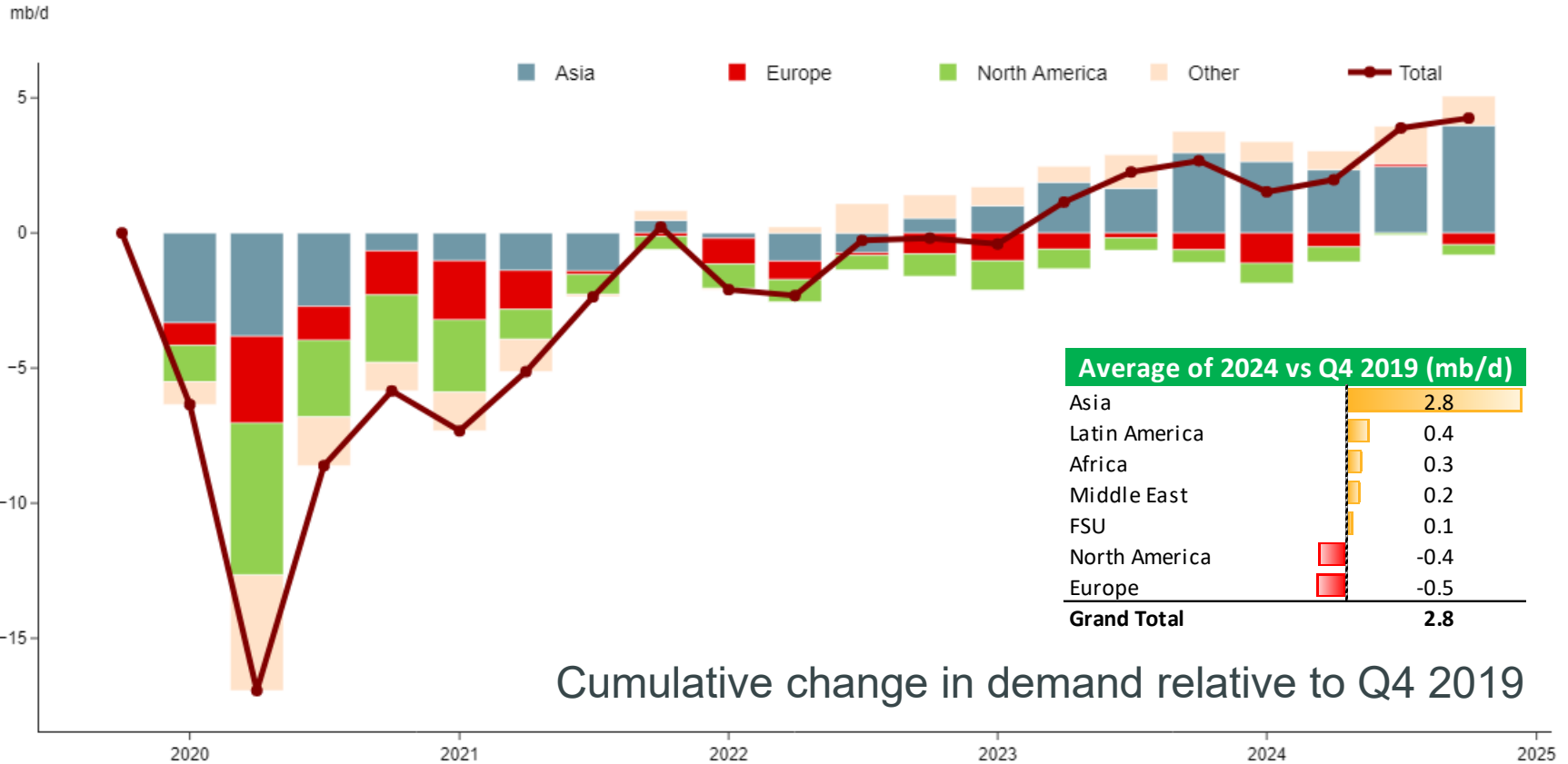
# Global oil demand: slowing growth from 2023 to 2024



## Global oil demand growth moderates in 2024 from 2023

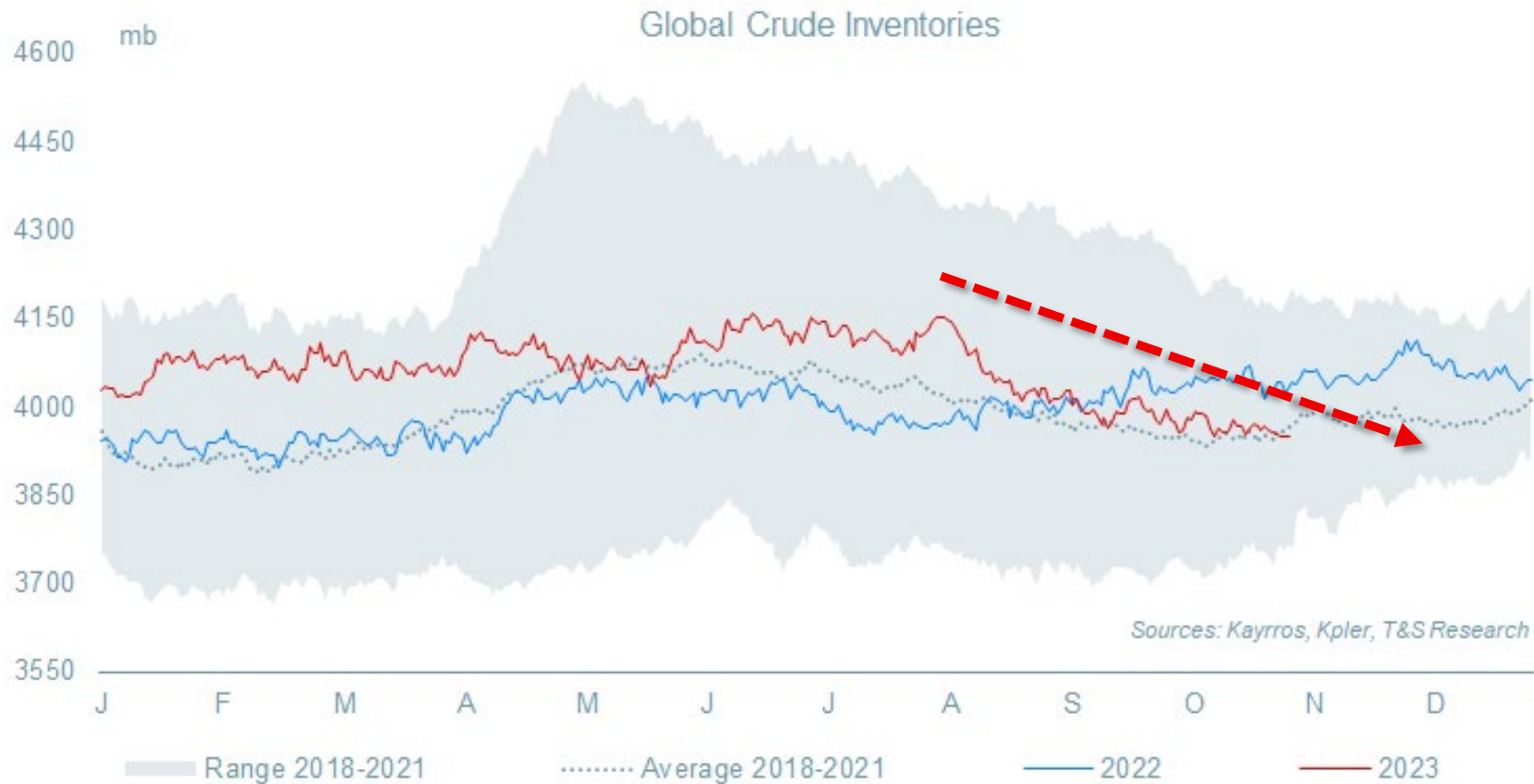
- **Global oil demand growth in 2024 moderates to 1.5 mb/d vs. 2.6 mb/d in 2023.**
- Oil demand growth in 2024 is expected to **revert closer to trend**, following economic activity as the post-pandemic recovery component of growth would have largely run its course.
- **Asia mostly drives oil demand growth in 2023 and 2024.** Asia contributes 86% of world oil demand growth in 2023 and 67% of growth in 2024.

# Global oil demand: recovery to pre-COVID levels driven by Asia, but highly dependent on China's performance



The 'other' region is the sum of the Middle East, Latin America, FSU and Africa

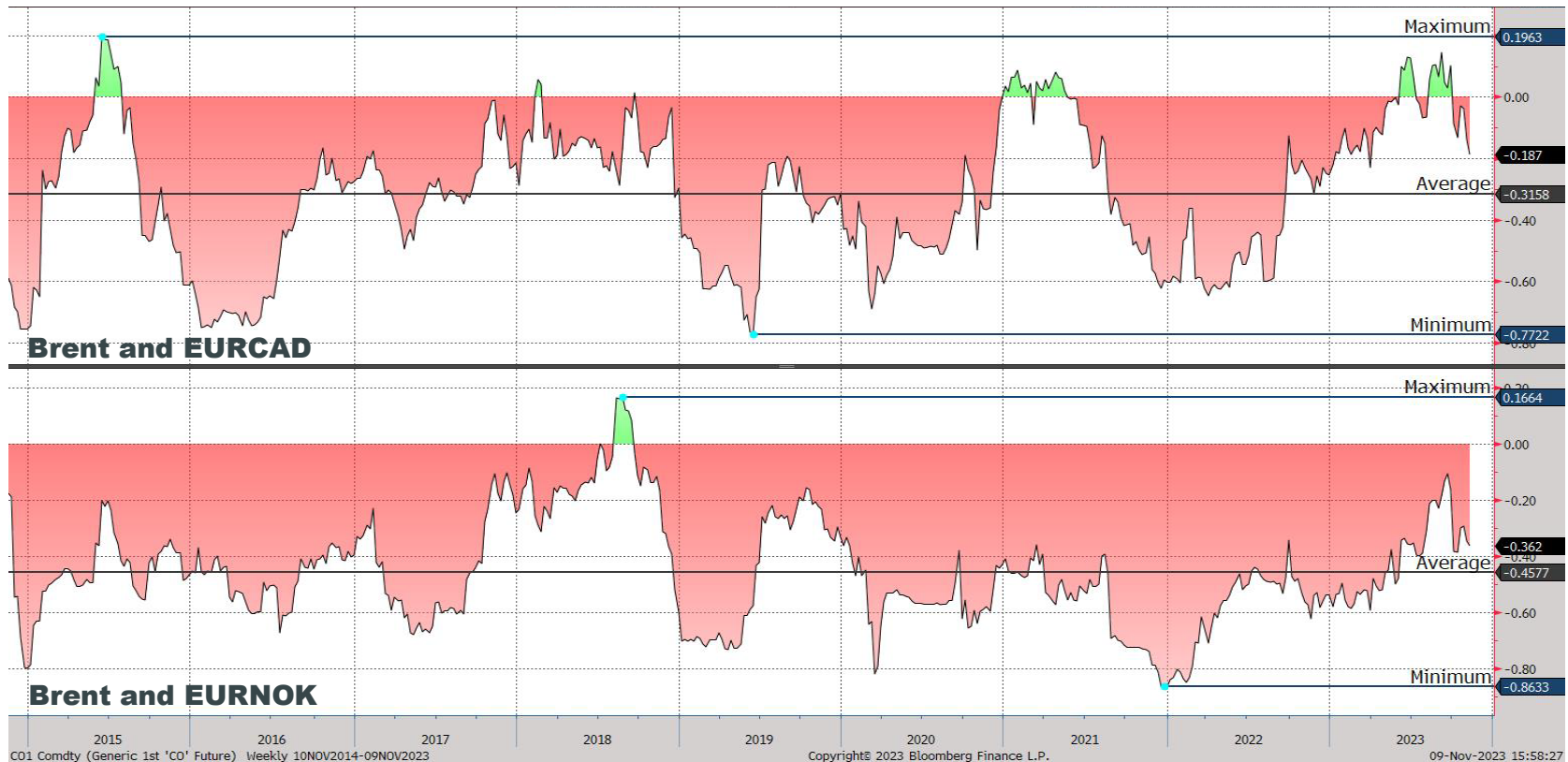
# Global crude oil stocks are trending lower, and are likely to fall below seasonal averages by year-end



## Potential vulnerability : the Market is left with a low buffer against unplanned supply outages.

- In terms of forward demand, OECD summer stocks of 2812mb cover 61.2 days, towards the low end of the 58-78 days 2018-2022 range.

# Oil-related currencies have been weak this year as growth momentum outside of the US has disappointed



**Correlation between Brent and EURCAD / EURNOK – based on Weekly returns on rolling 6 months window**

- There has been this year a weak correlation between commodity currencies and crude oil, which is typically the case when price rises are predominantly related to supply rather than demands dynamics.
- The correlation has been rising lately with the combined effect of lower oil prices and softer economic momentum outside the US, which typically also impacts commodity currencies negatively.

## Discussion Points

- ◆ Going forward, which factors would you see as driving major foreign exchange (FX) currencies?
- ◆ Which currencies would you see as attractive going forward?
- ◆ What potential impacts do you foresee for the oil and natural gas market stemming from the risks associated with the Middle East conflict?