Euro-Pound Hedging Costs Rise on Brexit Trigger, French Election

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By Vassilis Karamanis

(Bloomberg) -- Expectations for euro volatility against the pound over the coming month have climbed to the highest level since mid-February amid renewed Brexit concerns and ahead of the French presidential elections.

One-month euro-sterling implied volatility has rebounded to

8.80 percent from the year’s low of 7.05 percent on March 16 after U.K. Prime Minister Theresa May invoked Article 50 of the Lisbon Treaty on Wednesday, triggering the formal process of leaving the European Union.

The premium on one-month options over the rate of actual market swings remains near a 10-week high set on Tuesday. It may increase further should Brexit-related negativity be less than feared in the near term, which would reduce realized volatility, and also as the implied rate should rise on capturing the second round of the French elections due May 7.

Realized volatility could find support as the euro-pound pair’s prospects look increasingly bearish on charts, with current market positioning significantly skewed toward sterling declines. Leveraged net short positions in the pound this month are at the highest level since November.

Not all investors have given up on the pound, with the British economy performing better than expected. BlackRock Inc., which reduced some of its exposure to sterling ahead of the triggering of Article 50, has said it is still marginally long as an expected slowdown of the U.K. hasn’t materialized.

With the latest reports suggesting that the European Central Bank isn’t anywhere close to reducing economic stimulus, a short-squeeze on the pound could materialize.

* Vassilis Karamanis is a foreign-exchange and rates strategist who writes for Bloomberg. The observations he makes are his own and are not intended as investment advice.

To contact the reporter on this story:

Vassilis Karamanis in Athens at vkaramanis1@bloomberg.net To contact the editors responsible for this story:

Ven Ram at vram1@bloomberg.net

Anil Varma, Keith Jenkins