Global Rebound in Implied Volatilities

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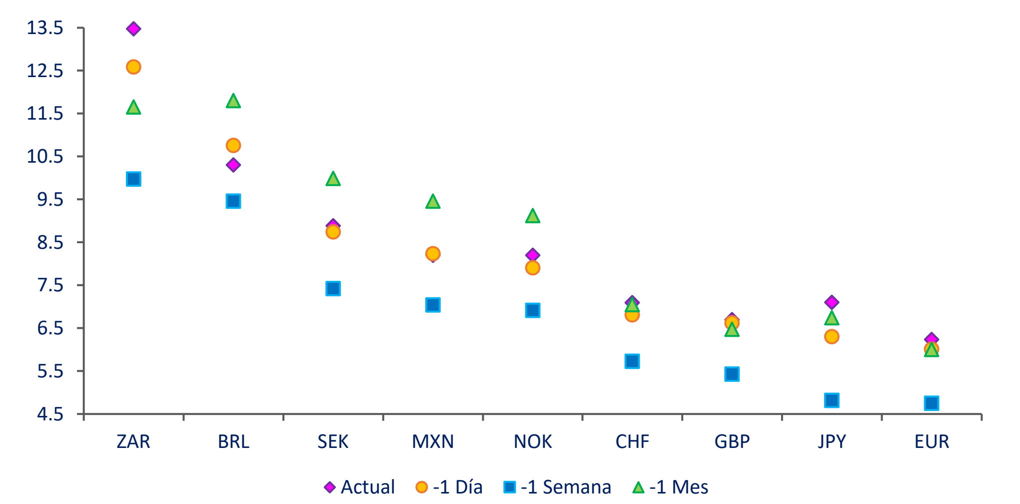
Escalation of geopolitical conflict affects the foreign exchange market

At the end of the week, the performance of the global foreign exchange market remained strongly conditioned by the evolution of the geopolitical conflict in the Middle East, which has accumulated 13 sessions of continuous hostilities. This environment prompted WTI oil futures to post a weekly advance of 15.9%, hitting a six-week high at $93.2 per barrel. The resulting risk premium exacerbated concerns about potential supply chain disruptions and inflationary pressures, resulting in a generalized steepening and rise in the short stretch of the implied volatility (VI) curves globally.

In the one-week node, the South African rand (ZAR) led the increases in the sample of the most liquid currencies in derivatives markets (+3.50 pp), followed by the Japanese yen (JPY, +2.19 pp) and the euro (EUR, +1.39 pp). In Latin America, the Brazilian real (BRL) faced additional pressure after the imposition of 25% tariffs by the US on various local products, as part of an investigation into unfair practices. For its part, although the Mexican peso (MXN) was in the lower half of increases in its one-week VI, the temporal structure of its curve reflects a clear inversion in the short section, where the nodes of one, two and three weeks exceed the one-month term (7.94%), which shows a nervousness concentrated in the very short-term horizon.

On the other hand, global risk aversion boosted demand for safe-haven assets, as gold advanced 0.9% on a weekly basis and the dollar, as measured through the DXY Index, gained 0.7%. In tune, in the US fixed income market, the yield on the two-year bond (sensitive to changes in the Fed's monetary policy expectations) increased by 15 bps, while the 30-year node stood at around 5.16%, reaching levels not seen since 2007.

One-week implied volatility per currency against the dollar (%)



Source: Own elaboration with Bloomberg data.

Despite this complex outlook, the Mexican peso showed remarkable resilience in the face of the strengthening of the dollar, shaping up to close the week with its largest accumulated gain since June (0.22%). This behavior was supported by the development of the third round of bilateral negotiations of the USMCA, where the moderate rhetoric of the U.S. Trade Representative, Jamieson Greer, towards Mexico contrasted with the more restrictive stance towards Canada (a country on which tariffs of up to 50% were imposed), which helped to temporarily mitigate the local risk premium.

Change by safe-haven asset

Plazo	Oro	DXY	CHF/USD	EUR/USD	Bono 10Y [1]	Bono 30Y [1]
Acumulado 2026	-6.1%	3.2%	-3.2%	-3.2%	0.51	0.32
1Y	20.4%	4.2%	-2.8%	-3.2%	0.28	0.23
6M	-18.7%	4.0%	-4.7%	-3.9%	0.45	0.34
3M	-13.9%	3.0%	-4.1%	-3.0%	0.38	0.26
1M	1.4%	-0.1%	-0.8%	0.1%	0.29	0.32
1W	0.9%	0.7%	-1.4%	-0.6%	0.13	0.09
1D	0.1%	0.0%	-0.2%	-0.1%	-0.01	0.00

Source: Own elaboration with Bloomberg data.
[1] Change expressed in percentage points

What to expect?

Although the duration and extent of the conflict in the Middle East are uncertain, the experience of recent episodes of geopolitical tension confirms the persistence of high-risk premiums on the currencies of emerging economies. To the extent that this environment of risk aversion and greater upward pressures on global inflation prevails, we believe that the dollar and sovereign yields in the US will maintain an upward bias.

In this context, when evaluating the current levels of implied volatility at one week (8.12%) and the spot USD/MXN exchange rate ($17.48), we estimate with 65% confidence (+/- 1 standard deviation) a trading range of $17.28 to $17.68 for the next five days. Additionally, on the technical level, signs of exhaustion are observed after the bullish momentum of the previous session, so, if less nervousness consolidates among traders, we identify support at $17.40, $17.35 and $17.26, while resistances are located at $17.56, $17.62 and $17.68 (level where the 200-day moving average converges).

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