

FX Daily: The dollar's rally may only be on pause

The dollar lost some ground yesterday on a correction lower in Treasury yields, but upside risks from the US election persist. Donald Trump's seemingly stronger momentum should translate to higher implied volatility and a supported dollar. The election result may also have implications for the ECB's decision on whether to cut 25 or 50bp in December



Donald Trump's seemingly stronger momentum should translate to higher implied volatility and a supported dollar.

USD: Dollar rally may only be temporarily halted

The loss of momentum in the dollar rally we saw yesterday doesn't seem to be the beginning of a broader trend. US yields were probably due an adjustment lower after the recent Treasury selloff, and that was mainly behind the slight dollar softening. Looking at both the US macro and political dynamics, the greenback can continue to find good support for the next few days.

Latest US data releases sent some contrasting signals on the jobs market, as jobless claims surprisingly fell while continuing claims rose. Remember that these figures are still being affected by the recent severe weather events and should probably be taken with a pinch of salt. On the activity side, high-frequency indicators have remained strong, and yesterday's S&P Global

composite PMI printed a surprise acceleration. The growth divergence with a struggling eurozone remains a key underlying dollar-positive theme and will hardly turn in the opposite direction anytime soon.

Today, the US calendar includes durable goods orders for September and a speech by FOMC's Susan Collins. Fed officials have not given away much during the IMF week in Washington, suggesting they are – like the market – in a wait-and-see mode ahead of labour and inflation data that will determine whether to cut once or twice before year-end.

The lack of crucial developments on the macro side probably means a greater focus on election-related news. The latest batch of polls confirmed Donald Trump is slightly ahead in the swing states and has gained some momentum in surveys about his handling of the economy and general approval ratings. Kamala Harris held a large campaign event in Georgia, which, apart from Arizona, is the swing state where she is polling the worst (Trump leads by around 1.6 points). Looking at the latest polls aggregate, Harris has gained some traction in Wisconsin and Michigan. These two states combined give 25 electoral votes out of the 44 she needs to win the election, assuming no 'lock or lean' Democrat state flips.

The polls are clearly telling us the election is too close to call, but markets and betting odds are leaning increasingly in favour of Trump. This may be due to the experience of the past two elections, where Trump was underestimated by polls, but also by greater hedging demand for a Trump presidency, which is seen as a more impactful macro/market event due to protectionism, tax cuts, strict migration policies and risks to the Fed independence. As discussed in this [note](#), we see both dollar upside risks and wider implied-historical volatility spread into Election Day.

Francesco Pesole

📌 EUR: ECB now in “gut feeling” phase

Bundesbank president Joachim Nagel was asked on two separate occasions during his stay in Washington whether he would consider a 50bp cut in December, and both times, he refrained from explicitly pushing back. This is a perfect case in point in the latest (substantial) shift in the ECB's communication: Nagel is one of the most hawkish members of the Governing Council and would have probably answered with a clearer “no” only a month ago.

Our ECB watcher Carsten Brzeski explains [here](#) how the ECB has shifted from a data-based to a “gut feeling” approach, with much greater emphasis on growth sentiment. Yesterday's PMIs weren't as bad as expected in Germany but were below consensus in France and still in contraction territory for the eurozone as a whole. One aspect of this shift to a “gut feeling” approach is that the US election can now have a greater bearing on the ECB's December decision. A Trump win and associated tariff risks could tilt the balance to a 50bp cut unless data firmly suggests otherwise.

Markets are probably applying similar reasoning to ECB pricing, and we think there is a bit of Trump risk now embedded into those 35bp of easing factored in by year-end. Surely, neither PMIs nor ECB speakers have done much to disincentivise dovish bets this week. Today, we will hear from Governing Council member Villeroy and take a look at the September inflation expectations figures published by the ECB.

EUR/USD is back above 1.0800, but we doubt there is much more room for a rebound. A wide short-term rate gap and the imminent US election risk still point to a short-term move to the

1.0750 area.

Francesco Pesole

📉 GBP: Reeves triggers first gilt shake-up

Unlike her ECB colleagues, Bank of England hawk Catherine Mann stuck to her usual tone yesterday, staying relatively pessimistic on disinflation and pointing to risks the BoE may cut too much too early. Three speeches by Governor Andrew Bailey this week have instead yielded little to no headlines. There is one last chance for Bailey to talk monetary policy at a Saturday event, so beware of some early Monday reaction in the pound.

Yesterday's PMIs in the UK were softer than expected, and while still looking decent compared to the eurozone, they are probably adding a bit of extra pressure to the BoE. Still, the gilt market and the pound are now laser-focused on next Wednesday's UK budget announcement.

Yesterday, Chancellor Rachel Reeves confirmed that she will change the fiscal rule to increase investments, which will pave the way to a potential increase in borrowing in the order of tens of billions. We discuss all this and the market sensitivity to the theme in our detailed [UK budget preview](#). Gilts underperformed other developed market bonds after the fiscal rule announcement, and there seems to be a consensus view that UK yields have extra room to rise on budget news. From an FX market perspective, what matters is whether any gilt underperformance turns into uncontrolled volatility. Given the pound is pricing in no risk premium, the downside risks for the currency would be very large.

For now, we reiterate a bearish bias on GBP/USD, which can suffer from defensive positioning ahead of the combined UK budget and US election risks. Our view remains that 1.28 can be reached in the near term.

Francesco Pesole

➔ CEE: CNB seems confident about inflation

The region's currencies tried to stabilise yesterday after the painful previous days, but as we mentioned earlier, it seems that we have to get used to higher volatility and depreciation pressure, at least until the outcome of the US election. In the Czech Republic, yesterday, we saw the first statement from the Czech National Bank (Jan Prochazka) ahead of the start of the blackout period next week on Thursday. The interview suggests a continuation of the current pace of rate cuts of 25bp per meeting despite the CNB seeing the possibility of inflation exceeding 3% in December. This seems dovish given the recent upside surprises in inflation, and we can assume that other statements may be similar given that board members have already had a chance to see the central bank's new draft forecast. Our economists see a pause in December due to higher inflation and we will still see two more inflation prints between the November and December meetings which may change the picture given the upside risks at the moment, however, yesterday comments suggest a confident CNB.

The market has turned very hawkish in recent weeks due to the global sell-off and even after yesterday's correction is only pricing in roughly 35bp rate cuts for the next two meetings combined. Yesterday's dovish comment is in line with the global dovish narrative, so the result has been a bigger rally in rates than elsewhere. On the other hand, the Czech koruna remains the only

currency in the region resilient to global volatility, touching 25.20 EUR/CZK yesterday, the lowest since late September. As we mentioned earlier, the CZK is our favourite currency in the region at the moment, and it seems to be working well. On the other hand, the Polish zloty and Hungarian forint remain on the defensive side with some stabilisation yesterday, but we still believe that current global conditions do not support the fading of previous losses at the moment.

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