FX Daily: Markets preparing for high volatility

Within 24 hours we may or may not know the identity of the 47th president of the United States. FX options markets have priced in a respectful level of exceptionally high volatility over the coming week. Results should start to come in around 03/0400 CET tomorrow morning. Only a Red Sweep outcome can probably add to the dollar's upside.

USD: Markets pricing a respectful level of volatility

With an exceptionally close US election upon us, plus the outcome likely to deliver a binary impact on currency markets, the FX options market is trading at a respectful level of volatility. In absolute terms, USD/JPY trades on the highest one-week volatility in the G10 space near 19%. These are close to levels seen during the height of the carry trade unwind in early August this year. With the next highest one-week volatilities come the typical high-beta currencies of NOK, AUD, NZD and SEK.

However, looking at ratios of traded volatility to realised volatility it is EUR/USD, USD/CAD and

AUD/USD which stand out. For example, EUR/USD one-week volatility trades at 2.2 times its realised volatility. We think this makes sense and reflects the view that a Trump 2.0 would not merely punish China with tariffs, but also pursue universal tariffs which would very much hit open economies like the eurozone and Canada. The Canadian dollar had quite a good Trump 1.0 since the NAFTA trade deal was renegotiated quickly. The market is more fearful of the USMCA trade deal this time around – as evidenced in USD/MXN one-week volatility trading at 45%!

Polls in the seven swing US states close around 03/0400 CET tomorrow morning and we would expect markets to be moving around that time. Given the run-up in the dollar in October, we think we need to see a Red Sweep for the dollar to push on much further. A Harris win would seem a benign outcome and prove a dollar negative – those three currencies: the euro, the Canadian and the Australian dollars could do well here. The more difficult outcome for the market would be Trump without the House of Representatives or a contested election. IMF analysis in its recent World Economic Outlook warned that the US economy could be 1% weaker than baseline in 2026 if Trump delivers on tariffs but could not offset it with tax cuts. For this reason, and given market positioning into the election, we think the dollar could come lower unless there is a Red Sweep.

Ahead of the election, today's US data calendar has ISM services for October. This is expected to soften a little. And were it not for the election, we believe this week's Fed meeting would also prove dollar negative too.

Chris Turner

EUR: Praying for a miracle

EUR/USD is just about holding onto gains made over the last few days. Remember these gains have been delivered on the back of, i) some ECB pushback against a 50bp cut in December, ii) Friday's soft US jobs report and iii) yesterday's poll result in Iowa which suggested Harris might be performing better than expected. As above, the FX options market is primed for a big move in EUR/USD. And assuming that a clear election result emerges this week, we are primed to deliver new multi-quarter EUR/USD forecasts – having kept a multi-quarter profile from the fourth quarter onwards flat at 1.10 from April this year.

The threat of Trump and protectionism has sharpened the senses in European political circles and may be hurrying German political leaders to compromise on the budget side. But for this week, expect the fall-out from US elections to dominate. Ultimately, a Trump win without the House could be the worst scenario for EUR/USD by late 2025, where global growth would be finding no insulation from US tax cuts and the ECB might be forced to cut rates deeper into accommodative territory.

It is after the European close tonight, but let's see whether the ECB's Isabel Schabel again pushes back against a 50bp ECB cut in December. Currently the market prices 29bp of cuts.

Chris Turner

AUD: Could be the big winner of a Harris victory

It is not a surprise to hear of some hedge funds buying AUD/USD call spreads structures in the FX options market. The Australian dollar could be the big winner should Harris keep Trump out of the White House. Under such a scenario, the China tariff threat would be reduced considerably. At the same time, Chinese asset markets are starting to perform a little better on the recent stimulus measures – as well as in anticipation of some further fiscal stimulus details emerging from China this week.

At the same time, the Reserve Bank of Australia seems in no mood to join its peers in easing policy. Last night's policy meeting led with a message that underlying inflation is too high, even though it was forecast marginally lower at 2.8% by the end of next year.

As such it would be no surprise to see AUD/USD deliver some substantial gains were Harris to win this week.

Chris Turner

CEE: Final position adjustment

Inflation in Turkey surprised slightly to the upside yesterday (2.9% MoM vs 2.5% expected). Although the year-on-year reading continues to fall further, slower disinflation may again weigh on the Central Bank of Turkey's caution in the timing of the first rate cut. Our economists still expect a first cut in December but Friday's inflation report and the Governor's presentation could tell us more.

TRY remains unchanged and the US election doesn't seem to change the set trajectory either. Market pricing of rate cuts is gradually shifting from this year to next year. Although the market reacted little to the higher inflation number, we will likely see more repricing later. Despite further upside surprises in inflation and the postponement of the first rate cut, it is clear that we are approaching a period where rate cuts will be on the table. Although the US election should not affect the TRY market, we believe it is safer to be in the spot market for carry collection in FX, while forwards may prove more volatile in current conditions.

Elsewhere in the region today, the calendar is empty. The CEE market remains significantly volatile with yesterday's strong rally in PLN assets. Although FX across the region saw buyers yesterday morning, following the EUR/USD move higher, it closed almost unchanged at the end of the day. On the other hand, rates and bonds saw some rallies, especially in the PLN market, which after last week's sell-off may seem like the cheapest option in case of a Harris victory in the US election. Thus, today should be in a similar fashion as a last chance to adjust positions before the risk event.

Frantisek Taborsky

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

Disclaimer