FX Daily: Options market suggests active engagement in dollar rally

As the dust settles after last week's US election results, global markets are settling into core trades of a firmer dollar, higher US equities and higher terminal rate from the Fed. Importantly in the FX market, traded volatility is picking up, suggesting active engagement in this dollar rally. It's a quiet day for data, but we have some Fed and BoE speakers

The 'Atlantic' spread as some traders call it has widened even further

USD: Don't fight the trend

US equity markets continue to plough ahead. There is an emerging narrative that unlike in 2016, when Donald Trump was unprepared for office, this time around he plans to hit the ground running in January. To some degree that supports the extension of the Trump trades right now and tends to subdue the investment thesis that it will take his administration a year to deliver any major initiatives – as was the case in 2017.

The above is reflected in the FX options market. Traded levels of volatility fell sharply last

Wednesday after it quickly became clear that the Republicans would win big. The idea here was that the major event risk was out of the way – and perhaps the market would sit around waiting for the next big trend. But what we have seen so far this week are early signs of active engagement in a new dollar bull trend. Traded levels of volatility are rising notably as it seems the market is actively positioning (investors) or hedging (corporate treasurers) in expectation of a stronger dollar. All we would say here is not to fight this emerging trend.

Today we will see the October update of the NFIB small business optimism index. This is expected to remain off early-year lows and presumably could pick up over coming months on the Republican win and what it means for corporate taxes. And at 1600CET we have a speech from the Fed's Christopher Waller. Presumably, he will follow Chair Jerome Powell's lead from last week and not get drawn into questions about how the Fed will react to Trump's proposed agenda.

DXY has some resistance here at 105.70, but the highs of the year near 106.50 are very much in focus.

Chris Turner

EUR: 'Atlantic spread' moves wider still

The 'Atlantic' spread as some traders call it has widened even further. Two-year EUR:USD swap differentials have now widened beyond 180bp in favour of the dollar. We haven't seen this kind of level since 2022, when EUR/USD was trading close to parity. Admittedly those parity levels in 2022 were partly caused by the surge in energy prices and the terms of trade impact on the euro – a negative factor that is not present today. Still.

EUR/USD looks ready to test 1.0600, below which our end-year target at 1.05 beckons. As above, one month implied EUR/USD volatility is being brought back up towards 8% having been offered near 6.50% last week. The only events of note on the European calendar today are ECB speakers (Olli Rehn and Robert Holzmann), who will probably not stand in the way of an ECB rate cut in December. The question is, will it be 25bp or 50bp? The market prices 30bp. Our eurozone team think it will be 50bp.

Chris Turner

GBP: Focus on Huw Pill speech

Today's September release of UK earnings data has come in slightly stronger than expected and it looks like the downward momentum in private sector pay has started to slow. However, this data set has fallen out of favour with the Bank of England (and hence the market).

More interesting today should be a 10CET panel appearance today from Chief Economist Huw Pill. The subject of the panel is: 'Reversing the great global tightening – how far and how fast?' Pill dissented from the BoE decision to cut rates in August and is therefore seen more as a centre/hawk on the MPC. The market is already pricing in only a modest BoE easing cycle from here – just three rate cuts next year. And unless there is a major surprise from Pill today, that pricing can stay intact. If so, EUR/GBP will struggle to sustain a move over 0.8300/8315 now and should continue to head lower.

Chris Turner

CEE: Romania and Hungary complete the inflation picture

After yesterday's inflation number in the Czech Republic came in line with central bank expectations, this morning we received the numbers in Romania and Hungary for October. This completes the picture in the CEE region. In Romania, headline inflation rose slightly and was marginally above market expectations. Yesterday's presentation of the National Bank of Romania inflation report showed a hawkish stance by central bankers and essentially a wait-and-see approach due to the November elections, an unclear fiscal picture, and a higher inflation projection.

In Hungary, headline inflation rose from 3.0% to 3.2% YoY, below market expectations and two-tenths below the National Bank of Hungary forecast (3.4%). However, the main variable at the moment is EUR/HUF, which yesterday moved above 410 after two days of post-election relief. Thus, the central bank will remain on the hawkish side regardless of inflation. If EUR/HUF continues to move higher, the market will increase bets on additional National Bank of Hungary (NBH) measures in the form of liquidity tightening or an eventual rate hike. We believe the NBH is more resilient than in the past, but levels above 410 will raise questions of a policy response again and it will be hard to reverse course in the current negative conditions for CEE, as we discussed yesterday. We expect more pressure on the region in the days ahead.

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