FX Daily: Tentative calm fuels dollar rebound

Concerns about the US credit market have eased further since the weekend, prompting a hawkish repricing in the Fed curve and justifying a stronger dollar. EUR/USD may slip all the way to 1.160 in the next few days, but it may require a hot US CPI print to extend the drop. Elsewhere, Japan's new PM Takaichi was confirmed by parliament this morning

USD: Credit concerns keep easing

FX volatility has moderated at the start of this week, with US equities extending the rebound on eased credit market concerns. Zions Bank's earnings report was solid outside of the losses linked to fraud, even though scrutiny remains high on any other signs of credit stress in the system.

The dollar has shaken up last week's banking concerns and is now only 0.7% off its 10 October high. Given the strict link between Fed easing expectations and credit market sentiment at this stage, the rebound is being largely underpinned by a hawkish repricing in the USD OIS curve, with the two-year rate rising 7bp yesterday.

Not much is moving on US-China trade tensions ahead of the end-of-month scheduled meeting between Trump and Xi. Yesterday, the US signed a deal with Australia to access its rare earth reserves, which might give the US slightly stronger leverage in negotiations with Beijing. But all this is playing a very secondary role for FX at the moment, with the approach seemingly being a wait-and-see one mixed with some cautious optimism that Trump will get a deal out of China.

Elsewhere, the yen is emerging as an underperformer this week. That appears more related to the unwinding of safe-haven JPY positions as US market concerns ease, and much more marginally due to political events in Japan. This morning, Sanae Takaichi was confirmed as prime minister by the parliament, four votes clear of the majority needed. That shows for the moment that she has the support of enough policymakers outside of her LDP-Ishin coalition, which is two votes short of a parliamentary majority. The nature of the minority government means Takaichi will find it hard to implement aggressive fiscal expansion, and market pricing for the BoJ (15bp by year-end) shows high uncertainty about the effective spending/debt implications of the new leadership. In our view, there is still a possibility of a 30 October hike (4bp priced in), also due to yen weakness. If not, December looks quite likely in our view. Unless the BoJ moves in October or USD comes under new idiosyncratic pressure, USD/JPY may stay above 150.0 as some debt concerns and carry funding continue to weigh on the yen.

Francesco Pesole

EUR: Eyes back on 1.160

EUR/USD remains almost entirely driven by US credit/equity sentiment: here, further stabilisation could take EUR/USD all the way to 1.160. Levels below that will be harder to justify unless the US CPI on Friday comes in hotter than expected.

Meanwhile, the 10-year OAT-Bund spread widened back to almost 80bp yesterday morning before settling at 78bp. It's a signal that markets were surprised by S&P's unscheduled downgrade on Friday, but also that political stability is so far successfully sweetening the pill of budgetary issues for investors.

On the ECB front, we heard from two hawks yesterday: Austria's Schnabel and Germany's Nagel. Nothing new on rates – as expected – but Schnabel did stress the importance of strengthening the international role of the euro. The ongoing "global euro" campaign by the ECB remains, however, very much tied to any improvements in politically-driven capital market integration, and it seems unlikely to result in major short-term spot appreciation barring another USD confidence crisis. Incidentally, not all the Governing Council may be entirely comfortable with an even stronger euro, even if direct comments on FX have been rather rare of late.

One final theme for the euro amid data scarcity: Ukraine-Russia truce speculation, after reports over the weekend about Trump pushing harder for Ukraine to accept Russia's territorial conditions for peace ahead of a potential three-way (Trump, Putin, Zelenskiy) summit in Budapest in the coming weeks. Even in a scenario where peace conditions are suboptimal for Ukraine, the euro (and even more, higher beta European currencies) could get a decent boost should a truce be agreed on in the coming weeks. For now, FX markets have kept the Ukraine story rather sidelined, and will probably require some tangible progress on peace negotiations to actively trade it.

On a different note, we recommend our UK economist's guide to the UK Budget here.

Francesco Pesole

CAD: Inflation figures shouldn't change the picture

Canada releases inflation figures for September today. Headline CPI should have rebounded above 2.0%, but that won't matter too much for the Bank of Canada as long as core measures (trim and median) remain anchored around 3.0%. Anyway, the Bank of Canada (BoC) has been firmly focused on growth and job risks associated with tariffs, and much less on inflation.

Despite stronger-than-expected jobs data earlier in October, markets are pricing in 19bp of easing ahead of next week's BoC meeting. The BoC's Business Outlook Survey for the third quarter (published yesterday) offered more evidence of prolonged drag from US tariffs, plenty of uncertainty leading to slow investments and muted hiring intentions. The BoC echoes a lot of business concerns included in its survey when it cut rates when it cut rates in September. It would need to find a compelling story for signs of resilience or inflation concerns to stay on hold on 29 October.

CAD remains our least favourite G10 currency. Higher chances of an October cut and little room for the BoC to signal the end of the cycle just yet can keep eroding CAD's carry and maintain a risk premium on the loonie based on economic/tariff uncertainty. We still expect USD weakness to take USD/CAD back below 1.40 and to September levels before year-end, but in the crosses, we see little upside for the loonie.

Francesco Pesole

HUF: Hawkish NBH and promise of Ukraine deal support further FX gains

The National Bank of Hungary will very likely leave rates unchanged at 6.50% today, in line with expectations. Today's meeting will not be so much about rates but rather about forward guidance. On the one hand, inflation remains above the tolerance band, and government measures are cutting a significant part (1.5pp). On the other hand, the economy is weak and continues to surprise downwards. Despite some political noise, we believe that the central bank will remain hawkish and the hawkish tone from previous meetings will be confirmed today.

The market is pricing in roughly one full cut by the end of March 2026 with a high probability for February as well. However, overall, the market expects only 80bp of rate cuts and the priced terminal rate has returned to 5.70%, well above our forecast. Although we expect a hawkish stance today, the risk for the market is more on the dovish side if we take into account this market pricing. If the central bank were to indicate a dovish shift, the market would certainly go for more rate cuts. However, we believe this will come later, given the weaker inflation figures in Q1 next year.

For now, at the same time, HUF is also supported by some expectations regarding progress in the ceasefire negotiations between Ukraine and Russia. Therefore, overall, we are bullish on HUF now, and we can probably test the current lows at 388 EUR/HUF.

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