

The FX Trader Fresh turmoil turns the tables on the USD bears

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Summary: Fresh market turmoil on the triple threat of AI growth concerns, high bond yields and a fresh spike in oil prices have sent the US dollar higher as global risk sentiment has cratered. This kind of risk off backdrop can continue to work in the US dollar's favor in the nearest term, but the FOMC looks unlikely to deliver USD-positive developments.

The US dollar has rallied here, partially on the CPI release Friday, but more clearly on classic risk-off drivers. We saw a confusing market reaction to the US August CPI release on Friday. At first, the slightly hotter than expected core month-on-month number (+0.3% vs. 0.2% expected) seemed to inspire a USD resurgence, but much of this was quickly wiped away and the market even seemed to use the modest USD rally as an excuse to find liquidity to establish new short USDJPY positions as the pair quickly reversed its brief spike higher to nearly 154.50 to trade below 153.50 at one point. And yet, outside of USDJPY, the US dollar finished the day not far from where it started, suggesting little overall impact from the CPI number, even as odds of an FOMC hike by the end of the day shifted toward “near certainty” from a “more-likely-than-not” level.

We went into the weekend, then, with global bond yields still generally higher and with the Japanese yen on the bid, while oil prices were retreating on hopes that a Monday meeting in Oman between GCC members and Iran would address the situation in the Strait of Hormuz. Then at the weekend two events conspired to change the plot:

- The GCC meeting with Iran scheduled for today was cancelled and oil prices blasted higher after Saudi announced the closure of its multi-million-barrel-a-day East-West Pipeline on damage from attacks coming from Iraq. Meanwhile, in Yemen fresh Houthi aggression saw the rebel group making strong territorial gains and showing apparent intent to control shipping routes through the Bab el-Mandeb strait connecting the Red Sea to the Indian Ocean with the seizure of islands.
- Anthropic CEO Dario Amodei spoke in favour of a slowdown in AI development, supposedly for safety reasons, and other prominent AI figures chimed in with supportive comments. Whatever the reason for any possible slowing down (and there are many theories), equity risk sentiment was spooked on the news.

Key takeaways and what to watch for from here: A sudden risk-off vibe centered on fresh energy price concerns (more acute outside of the US) and on the status of AI investments has inspired some broad risk-off behavior, the kind that has often supported the US dollar in the past. With positioning recently having tilted sharply in the Japanese yen's favour and against the US dollar, there is perhaps heightened danger of the US dollar continuing higher as long as these new concerns deepen. This could stress-test the recent USDJPY move, especially if the important 155.00 level gives way – and we have a painfully long wait until the Friday BoJ, which may have a hard time delivering beyond what is already priced in (a 25-bp BoJ hike is fully priced, with guidance for more to come, if not immediately.) Still, the FOMC doesn't look likely to deliver USD-positive developments either, as discussed below.

Chart focus: EURUSD We'll switch gears here away from USDJPY and take a look at EURUSD after the Friday test and now Monday break of the key local support near 1.1570. This theoretically opens up the range down to the 1.1325 low of 2026, but the round 1.1500 level is the next area of note to watch. That 1.1500 area has supported EURUSD, save for the significant slippage in June and July, since May of last year. Note that the event that seemed to inspire the slip below the 1.1500 level in EURUSD was the June 17 FOMC meeting, which helped drive US yield expectations higher at the time. Will this FOMC meeting serve as a similar catalyst? Recently, the Europe-US yield spreads have been quite stable as ECB and FOMC rate-hike expectations have moved higher in parallel. It is hard to believe that this FOMC will drive a notable divergence in spreads in the US dollar's favour, as Fed Chair Warsh says he wants to avoid forward guidance. So EURUSD direction may have to come from other developments beyond the FOMC meeting. More on the FOMC below.

Elsewhere, EURSEK backed up to new cycle highs on the general risk off tone and perhaps at the margin on the Swedish election results, which could see the country set for a long period of awkward coalition building and political uncertainty if the left-leaning "red bloc" ekes out a narrow win that the 94% vote count currently projects. A key centre-left party has said it won't support a government with the most left-leaning party in the bloc, making coalition building cumbersome. I suspect the weak SEK has far more to do with the weak risk sentiment backdrop and headwinds for the EU growth outlook from high oil and gas prices.

Wednesday: FOMC meeting. What to watch: Now we have a 25-bp hike almost fully priced, with another hike fully priced for the December meeting. We have a hard time seeing Fed Chair Warsh signaling anything that can take US rate expectations higher independently of rate expectations from other central banks that are largely linked to the oil price, especially given Warsh's avowed intent to avoid forward guidance. The surprise scenarios in our view tilt to the dovish side – concerns linked to the impact of a supply shock or foregoing a rate hike entirely (not our base case, but would likely prove a significant shock to the USD.). Still, theoretically the dot plot or economic projections could suggest more hawkishness than we anticipate.

Thursday: Bank of England meeting What to watch: The coming budget plans under PM Andy Burnham are likely seen as paramount for the BoE's forecasts for growth and inflation and won't be known until the Autumn Budget statement on October 28, so any BoE move not likely until the November 5 meeting.

Friday: Bank of Japan meeting. What to watch: This meeting is fully priced to deliver a 25-basis point hike, with uncertainty around the pace of hikes beyond that meeting (The market is priced for most of a second hike through the December 18 BoJ meeting). Squeeze danger for JPY crosses ahead of the BoJ above 155.00 in USDJPY if the US dollar continues to strengthen in the near term, with the next key resistance zone into the 157-158.00 zone.

The huge JPY reading only indicates how much backfilling JPY crosses can afford without neutralizing the trend that has developed – stay tuned through the BoJ this Friday. The USD bounceback has nearly neutralized the broader USD picture, but it wouldn't take much of a USD sell-off to encourage USD bears again. Elsewhere, SEK is the weakest currency in the G10 and CHF and NZD are competing for next-weakest status.

Table: NEW FX Board Trend Scoreboard for individual pairs.

The EURUSD "up-trend" was built on the big August rally that peaked more than three weeks ago – it is in danger of falling if EURUSD remains here or lower in the coming few days. Gold is also in danger of reverting to a negative trend as key support below 4,300 is under fire. EURCHF has come in for some

heavy selling today after posting a new cycle high on Friday – that suggests position squaring, possibly as the sudden risk-off tone since Friday weighs on carry trades.

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