

The FX Trader Worrying about Europe and the new Sick Man

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Summary: While EURUSD is hitting its lowest levels in over a year, most of that is down to USD strength. More broadly speaking, the euro has only just begun to smell the trouble in Eurozone debt markets as France's yields continue to blow higher ahead of a 2027 budget proposal to be unveiled today. Could the single currency be in for a rough ride here?

Worrying about Europe and its new Sick Man, France. Markets are worried about the populist direction of both France and the continent, with odds high that the RN's Marine Le Pen will make it to the run-off in the presidential election after the April election and Macron, the anyone-but-Le Pen candidate, can't run for a third term, leaving Le Pen the possible winner against an unelectable candidate like the far left's Melenchon. Even as bond yields came off a bit in Europe Tuesday and Wednesday, longer yields in France continue to push higher, taking the Germany-France 10-year yield spread to over 130 basis points this morning. That is up from around 85 bps since the beginning of September. For perspective, the worst the 10-year Germany-France spread got on a daily closing basis during the Eurozone sovereign debt crisis was 189 basis points, and then only briefly (There was less focus on that spread than on the "periphery", especially Italy. The Germany-Italy 10-year spread widened to as much as 550 basis points during the crisis.)

Takeaway: It looks like European equities are finally getting spooked yesterday and today with the massive blowout in France's yields as its 10-year rate closes in on 5%. The euro itself is surprisingly and even staggeringly calm. Yes, we have hit new lows in EURUSD today, and EURGBP is trading lower, but EURCHF has only just woke up to the risks a bit this morning and EURJPY has bounced together with USDJPY. I am concerned that the negative focus on the euro itself from this sovereign stress angle could pick up sharply if the French yields don't come down. Today, France presents its 2027 budget proposal, something that will serve as a further credibility test for French debt.

A lot getting thrown at the USD bullish case - but not much sticking. So far this week, we have seen more negative than positive data thrown after the USD bullish case and even got a dovish turn from FOMC Vice Chair and NY Fed President John Williams. The latter weighed in Tuesday with comments suggesting no urgency to follow up the September rate hike with a further hike (helping to lower October FOMC rate hike odds) and suggested that conditions may be appropriate for one more rate hike this year. This has helped keep short US treasury yields tamed. As for other data, only the ADP payrolls change numbers and real personal spending data looked on the strong side of market expectations. Elsewhere, the September Consumer Confidence headline and Present Situation readings were the lowest outright readings in over 12 years, while the Expectations component was the worst since the month of the meltdown over the Liberation Day tariffs in early 2025. The optimists will tell us that the weak confidence readings are merely the product of record diesel and near-record petrol prices, but cost of living is a significant concern for most Americans not holding US tech stocks. The August JOLTS Job Openings survey was also far weaker than expected, even if it is plagued by spiky readings and poor survey response rates. Finally, the formerly all-important, now somewhat important PCE inflation reading for August was softer than expected - see more below. ("somewhat" because of Warsh's task forces and

confusing focus shift on which inflation measures are most important). And yet, the USD is pushing on new cycle highs, as we discuss in the Key Takeaways below.

August PCE print, revised data (lower) grab the spotlight The August US PCE inflation release caused a stir, not least because of the somewhat chunky downward revisions of prior data as the BEA released revisions based on a new calculation methodology. The methodology, if not the actual data, was flagged before the fact and the market was expecting a downward revision, but the new releases were even lower than many projected while the August release itself surprised on the soft side for the core month-on-month number, if not the headline. For August, the market was looking for 0.3% MoM and 3.7% YoY but got 0.3%/3.4% with year-on-year lower due to the lower revisions. The core MoM number came in at 0.2% vs. 0.3% expected and the YoY was 3.0% vs. 3.3% expected, again on earlier revisions, with the July number also revised lower to 3.0% from 3.3%. If we annualize the revised month-on-month core numbers of 0.13% for June, 0.13% for July and 0.247% (0.003 from a 0.3% print!) for August, we have an annualized core PCE inflation rate barely running at above 2.0%, even if that is doing a bit of cherry-picking.

Key takeaways and what to watch for from here: Unfortunately, we can't take much away from the data points so far this week and not even the market reaction to a degree as Wednesday was also month- and quarter-end. With the US 10-year yield and US dollar hitting cycle highs here, it would seem the US treasury market is in the driver's seat. If data has any say in what is going on here, which is debatable, we'll need a look at this Friday's jobs report at minimum, if not also the ISM Manufacturing (Today) and ISM Services (Monday). But inflation risks as well as overall debt market dynamics are the chief focus and on the inflation front, it's a long wait for the US September CPI print from the BLS on Wednesday October 14, a number that can trump all of the others, as could oil prices. (No revisions set for the CPI data series, by the way).

Chart focus: EURUSD EURUSD has broken down through the old range low of 1.1325, which could open up for a test of the key range of the 2023-24 period above 1.1200. If that area fails to hold the USD back, the focus could shift to various Fibonacci retracements, particularly the 1.0880 area 61.8% retracement as a kind of "final" support level if the 1.1000 psychological level can't support.

Elsewhere: The RBA surprised this week with a dovish hike, clearly wanting to buy a bit of time before possibly tightening policy further. This caught the market off-guard, with weaker metals prices not helping the Aussie either. AUDUSD has slipped further below its 200-day moving average that continues to rise well above the psychologically important 0.7000 level, though we are still embedded in the big range down to around 0.6850.

GBP and Burnham. Burnham spoke forcefully in favour of a new Labour agenda, with a much heavier hand to come from government in power, transportation, energy and housing policy, if not with the sense that he is arguing for an old-school nationalization of these industries. There was a pragmatic tone on energy (North Sea oil and gas) which is certainly positive for the UK economic outlook The most expensive idea afoot was his call for a "free at point of use" National Care Service for adult and especially elder care. So far, sterling is absorbing this relatively well, but let's have a look at the autumn budget statement late this month for a fuller test of the UK gilt market and sterling.

CHF has been weak – but is it pivoting today? Again, on the Eurozone sovereign debt focus, it has been a surprise not to see broader based EUR weakness as sovereign debt spreads within Europe blow wider. EURCHF is the classic instrument to monitor that kind of stress, and it was busy looking at new cycle highs as recently as early today before possibly finally smelling some trouble. EURJPY has also turned a bit lower, but the angle there is less "pure" from a sovereign debt stress angle as Japan

grapples with its own fiscal stability issues.

The USD (and CNH) strength stand out as the most prominent positive trend, while NZD and SEK have been the weakest of late. The euro is very quiet, but there could be a sudden wake upcall if the sovereign debt stress issue spreads to the currency as it did during the Eurozone sovereign debt crisis, when even NOK and SEK were seen as safe havens from the single currency.

Table: NEW FX Board Trend Scoreboard for individual pairs.

EURGBP is looking heavy and has flipped to a negative trend until proven otherwise, while EURNOK and EURAUD has done the opposite – hard to believe that the latter two are worth emphasizing if the sovereign debt issue continues to plague the euro.

Source: <https://www.home.saxo/content/articles/forex/the-fx-trader-worrying-about-europe-and-the-new-sick-man-01102026>