

Forex Flash

The Great Realignment

- The global foreign exchange market is undergoing a period of profound restructuring, driven by the most severe bond sell-off in decades.
- Yields on US Treasuries have risen sharply over the past month, driven primarily by an increase in the real component resulting from the repricing of expectations regarding Fed rate rises.
- The intensity of the current UST sell-off suggests that the rise in the term premium may be due to a sharp rise in inflation, greater uncertainty over the Fed's moves, the shift from QE to QT, and the rise in the public deficit.
- Next week, the market will digest the US employment report, US Treasury auctions, a packed schedule of speeches by Federal Reserve officials, and the reopening of Chinese markets following the Golden Week holiday.

The global foreign exchange market is undergoing a period of profound restructuring, driven by the most severe bond sell-off in decades. The yield on the 10-year US Treasury reached a 24-year high of 5.34 per cent, following the sharpest quarterly rise in 32 years, dragging European and Japanese sovereign yields up to multi-decade highs. The US dollar is the main beneficiary, with the DXY index nearing 17-month highs, whilst the euro has plummeted to its lowest levels since May 2025, hit in particular by French fiscal concerns that have pushed the OAT-Bund spread above 140 basis points – the widest level since 2012.

Yields on US Treasuries have risen sharply over the past month, driven primarily by an increase in the real component. In turn, the rise in real yields is largely explained by the repricing of expectations regarding Fed rate hikes; there is, in fact, a direct and significant correlation between these two variables.

However, the intensity of the current UST sell-off suggests that additional factors have come into play (see [Interest Rate Strategy – Treasury sell-off: beyond the fundamentals](#)). The term premium measured by the ACM model on US Treasuries has risen significantly, likely driven by the sharp rise in inflation, greater uncertainty over the Fed's moves, the shift from QE to QT, and the increase in the public deficit. Furthermore, thanks to the AI boom, markets are gradually realigning their expectations regarding the level of neutral interest rates. Given its impact on labour productivity, this latest technological advance is expected to have a positive effect on the potential growth rate, justifying a higher level of equilibrium real yields.

US Dollar: Back on the Rise

The greenback has firmly re-established itself as the dominant currency on global markets. The DXY index is hovering around 102, at a 17-month high, up for the third consecutive week (+1.1%).

The main driver is the surge in US bond yields: the 10-year US Treasury yield rose to 5.25 per cent after hitting 5.34 per cent in the previous session. Markets continue to price in a second rate rise by the Federal Reserve by the end of the year, with the probability of a move in October standing at 25 per cent, whilst a December hike is still fully priced in.

2 October 2026

Weekly Note

Research Department

Rates, FX & Commodities
Research

Sergio Capaldi

Rates & Forex Strategist

Euro: French Budget Crisis Sends the Euro Plummeting

Inflation in the eurozone accelerated significantly in September. In France, harmonised inflation rose to 3.4 per cent from 2.6 per cent in August; in Italy, it jumped to 4.1 per cent from 3.2 per cent; and inflation in five German Länder rose sharply.

The BTP-Bund spread is at its highest since 2012, whilst the yield on the 10-year French OAT recorded its largest quarterly rise in nearly four decades.

The EUR/USD pair attempted a rally to 1.1380 on the back of soft US PCE data but soon reversed course, signalling that the bearish momentum persists. Italian Prime Minister Giorgia Meloni has called for flexibility in EU budget rules to offset the impact of energy inflation.

The EUR/USD exchange rate stands at 1.1259, having hit a low of 1.1215 during Thursday's session – its lowest level since May 2025. The euro's decline in recent weeks has been dramatic: it has lost around **200 pips** from its late-August high of 1.1679. The fall has accelerated due to a number of factors:

- **French fiscal crisis:** the budget presented by Paris has failed to allay investors' concerns about the debt trajectory. The OAT-Bund spread has widened to over 140 basis points – the widest level since 2012 – triggering aggressive selling of the euro.
- **Soaring Bund yields:** the German 10-year yield rose to 3.52 per cent, a 17-year high, from 2.93 per cent at the start of July – a rise of around 59 basis points in three months.
- **ECB comments:** Olli Rehn, Governor of the Bank of Finland, stated that energy prices are approaching the ECB's adverse scenario, but that the rise in long-term rates could slow the transmission of inflation to the real economy.

The Swiss Franc: The Ultimate Safe Haven

The USD/CHF exchange rate stands at 0.8274. However, the real story was the movement in EUR/CHF: the euro fell by 1.3 per cent against the Swiss franc on Thursday, its worst day since April 2025, with the cross slipping to a low of 0.9325. The Swiss franc has also strengthened against the dollar, rising from around 0.8119 at the start of July to 0.8282. The unwinding of EUR/CHF carry trade positions signals growing risk aversion linked to the turmoil in the European bond market.

British Pound: The Gilt Test

Stronger-than-expected UK GDP growth figures for Q2 have supported the pound, but caution remains high ahead of the UK budget. Prime Minister Andy Burnham has suggested that Britain should consider options regarding its future ties with the EU, including a possible return, which has provided modest support for the pound against the euro.

The yield on the 10-year UK gilt rose to 5.40 per cent, peaking intraday at 5.51 per cent – the highest level since 2007. The 30-year gilt touched 6.03 per cent, its highest since 1998. The cable is trading at 1.3210, recovering slightly after hitting a 14-week low of 1.3182 on Thursday.

The pound was supported by the favourable yield spread but weighed down by four factors specific to the UK:

- **the fiscal risk** linked to the 28 October budget,

- the credibility of the Bank of England, which **has not yet raised rates** unlike the ECB,
- the burden of **energy imports**,
- **political uncertainty**.

The Japanese Yen: Between the BOJ and Global Yields

The USD/JPY cross is trading at 157.77, down slightly from its weekly highs. The yen has experienced sharp fluctuations: the strong appreciation in mid-September, linked to the BOJ's rate rise to 1.25 per cent, has been partially reversed by the rise in global yields. The 10-year JGB has reached 3.10 per cent, close to 30-year highs, with the 30-year bond rising to 4.21 per cent, a record high.

Core inflation in Tokyo accelerated to 2.7 per cent year-on-year in September, reinforcing expectations of further rate rises by the BOJ, with the market now anticipating the next move in December. The Bank of Japan is in a "new phase" focused on preventing inflationary risks, according to Governor Kazuo Ueda. The policy rate currently stands at 1.25 per cent, and former board member Makoto Sakurai forecasts a rise to 2 per cent by June 2027.

The USD/JPY cross has settled around 157.50, but the risks of intervention and further tightening by the BoJ are holding back further weakness in the yen. Seasonal factors in Q4 tend to be negative for the yen, but repatriation flows and hawkish signals from the BoJ could support a recovery.

Australian and Canadian Dollars: Under Pressure

The AUD/USD cross fell to a two-month low of 0.6947, with any attempt at a rally quickly sold off. Australian inflation in August came in below expectations, reducing the probability of an RBA rate rise in November to below 26 per cent. The **USD/CAD** stands at 1.4222.

Next Week

Next week will see the release of mixed US macroeconomic data. August's core PCE fell to 3.0% year-on-year, below expectations of 3.3%, and 40 basis points below the Fed's forecast for the end of 2026 (3.4%). Second-quarter GDP was revised upwards from +1.5% to +2.2% annualised, driven by consumer spending and investment in artificial intelligence infrastructure.

The week of 5–9 October 2026 is not expected to bring any particular volatility to the foreign exchange market, with the market digesting the US employment report on Friday 3 October (90,000 new jobs expected), US Treasury auctions totalling an estimated USD 119 billion (3-, 10- and 30-year maturities), a packed schedule of speeches by Federal Reserve officials, and the reopening of Chinese markets following Golden Week. The backdrop is characterised by bond yields at their highest levels since 2007, core PCE inflation softer than expected at 3.0% y/y, the US-Iran conflict keeping Brent above USD 100 per barrel, and a 63% probability that the Fed will keep rates unchanged at its October meeting.

US Treasury auctions: The Treasury will issue a refunding package estimated at USD 58 billion in 3-year Treasuries (6 October), USD 39 billion in 10-year re-issues (7 October) and USD 22 billion in 30-year re-issues (8 October), alongside T-bill auctions for tens of billions more. These auctions will be crucial: 10-year yields have reached 5.30 per cent, their highest level since June 2007, and 30-year yields have hit 5.65 per cent, their highest since June 2002.

Fed speeches expected this week: Several Fed officials are due to speak, including Dallas Fed President Lorie Logan (voting member, hawk), New York Fed President John Williams (voting member, centrist), and several others. Minneapolis Fed President Neel Kashkari stated on 30 September that "inflation is still too high" and that he expects further rate rises.

China: Reopening after Golden Week

Chinese markets will be closed from 1 to 7 October for national holidays, reopening on Thursday 8 October. The Shanghai Composite Index recorded a quarterly fall of 6.1 per cent – its worst performance in over four years – due to stimulus measures deemed insufficient by investors. The reopening could trigger significant volatility in USD/CNH and related Asian currencies.

Data Calendar

At the start of the week, the market will react to the non-farm payrolls report on Friday 3 October. Economists expect an increase of 90,000 jobs in the non-farm sector, with the unemployment rate holding steady at 4.1 per cent. The September ISM Services Index is also due on Monday 5 October and is expected to remain broadly stable. On Friday 9 October, the University of Michigan's consumer confidence index is also due to be published; the markets will pay particular attention to the 5-year expectations index: a significant rise could lead to higher expectations of Fed rate hikes.

Geopolitical Risks: Iran-US Conflict and Oil

The US-Iran conflict, now in its eighth month, remains the main geopolitical risk factor for currency markets. Brent crude settled at USD 103.50 per barrel, with a monthly gain of 14 per cent in September – the largest since July.

Iran has proposed reopening the Strait of Hormuz within seven days of the US lifting its blockade, but Trump has stated that he has rejected the proposal. However, Iran has claimed to have received a US response via Qatari mediators. The parties agree on the necessary steps but disagree on the sequence.

OPEC+ producer countries are likely to keep production targets for November unchanged at Sunday's meeting.

High oil prices are fuelling global inflation, forcing central banks to keep interest rates high. This supports the dollar (given the relative resilience of the US economy), weighs on the currencies of net energy-importing countries (EUR, JPY, INR), and potentially favours the currencies of exporting countries (NOK, CAD). A potential diplomatic breakthrough could rapidly reverse these dynamics.

Summary Table of This Week's Events

Date	Event	Expected FX Impact
Sun 4 Oct	OPEC+ meeting	All currency pairs
Mon 5 Oct	Analysis of US NFP and ISM Services data	USD, all G10 currency pairs
Tue 6 Oct	3-year Treasury auction (USD 58 bn)	Treasury yields → USD
Wed 7 Oct	10-year Treasury auction (USD 39 bn), Fed speakers	USD/JPY, EUR/USD
Thu 8 Oct	Chinese markets reopen, 30-year Treasury auction (USD 22 bn)	USD/CNH, AUD/USD
Fri 9 Oct	China trade data, Fed speakers	AUD/USD, EUR/USD

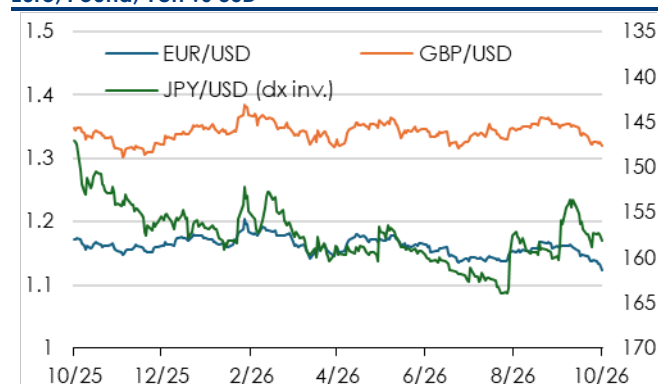
Conclusions and Risk Factors

The overarching theme is clear: **the bond market is driving the currency market**. The global surge in yields – fuelled by persistent inflationary expectations, record debt issuance and geopolitical tensions in the Middle East that are keeping oil above \$100 a barrel – has redirected capital flows in favour of the US dollar and the Swiss franc, weighing on the euro and emerging market currencies.

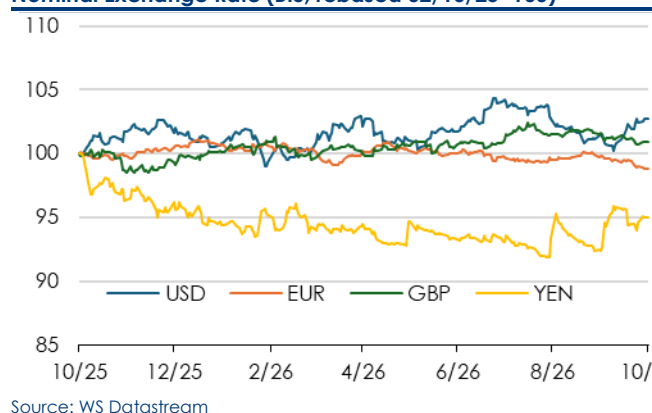
In summary, next week will be characterised by:

1. **US interest rate divergence vs the rest of the world:** With the Fed in tightening mode and core PCE still at 3.0 per cent, the yield spread remains favourable to the dollar, barring any negative surprises from employment data.
2. **Geopolitical risk:** Any progress in the Iran-US negotiations could trigger a sharp fall in oil prices, easing global inflationary pressures and weakening the dollar. Conversely, an escalation would drive capital flows towards the dollar as a safe-haven asset.
3. **China's Reopening:** The reaction of Chinese markets to stimulus measures and quarterly weakness could trigger significant volatility in Asian currencies and the AUD.
4. **US Treasury Auctions:** The absorption of nearly USD 119 billion in new issuance in a single week, with yields at multi-decade highs, will be a decisive test of demand for the dollar and the stability of long-term yields.

Euro, Pound, Yen vs USD



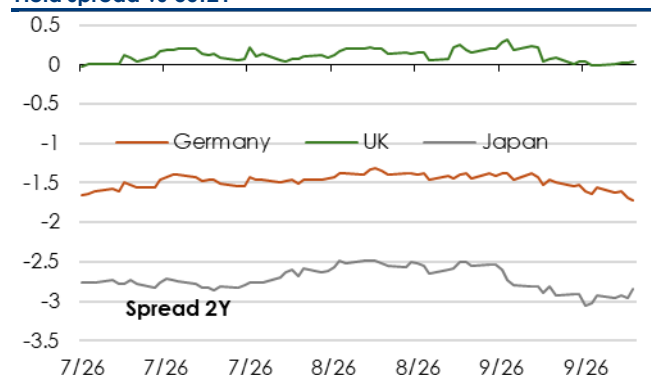
Nominal Exchange Rate (BIS, rebased 02/10/25=100)



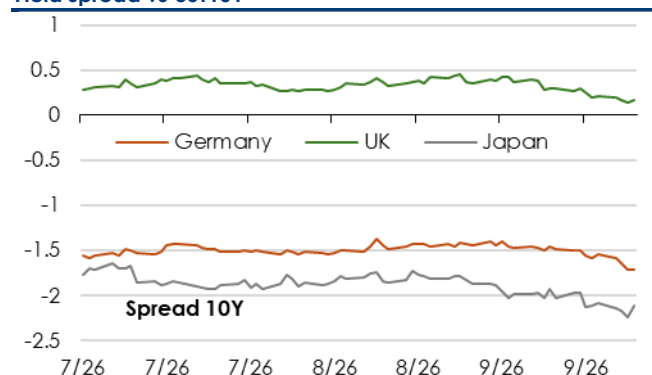
Forex Forecasts

	Q3 2026	Q4 2026	Q1 2027	Q2 2027	Q3 2027	Q4 2027	Q1 2028	2026	2027
WD EUR/USD	1.1459	1.1277	1.1294	1.1462	1.1581	1.1568	1.1648	1.1598	1.1269
WD EUR/GBP	0.8563	0.8684	0.883	0.8866	0.8911	0.8923	0.894	0.8637	0.8792
WD EUR/NOK	11.0345	10.9309	10.8257	10.726	10.6706	10.6158	10.5509	11.1277	10.8555
WD USD/CAD	1.4066	1.4319	1.433	1.4105	1.3954	1.3934	1.382	1.3874	1.4356
WD USD/JPY	159.7091	159.7902	159.5413	155.7251	149.7483	145.6032	143.5761	158.6287	160.03
WD EUR/CHF	0.9284	0.9243	0.926	0.9219	0.9209	0.9193	0.9183	0.9214	0.926
WD EUR/SEK	10.9652	10.8592	10.7283	10.5072	10.3504	10.2194	10.1496	10.849	10.7873
WD USD/CHF	0.81	0.8196	0.82	0.8043	0.7952	0.7947	0.7884	0.7945	0.8218
WD AUD/USD	0.7053	0.7047	0.7049	0.7142	0.7185	0.7147	0.715	0.7035	0.7037
WD GBP/USD	1.3386	1.2986	1.279	1.2927	1.2997	1.2964	1.3029	1.3431	1.2817
WD NZD/USD	0.587	0.5878	0.5993	0.6186	0.6299	0.6314	0.6346	0.5871	0.594
WD EUR/AUD	1.6254	1.6004	1.6022	1.6048	1.6119	1.6186	1.629	1.6498	1.6013
WD EUR/CAD	1.6122	1.6148	1.6185	1.6166	1.616	1.6119	1.6096	1.609	1.6177
WD EUR/JPY	183.0808	180.1947	180.1875	178.4847	173.4246	168.4352	167.2297	183.9769	180.3309
WD EUR/NZD	1.9529	1.9185	1.8846	1.853	1.8385	1.832	1.8353	1.9763	1.8971
WD EUR/HKD	8.9745	8.8153	8.8032	8.9229	9.0147	9.0045	9.0664	9.077	8.7919
WD EUR/CNY	7.7795	7.7989	7.7989	7.7683	7.75	7.7109	7.7	7.9331	7.8021
WD EUR/HUF	361.0493	361.293	361.3416	358.624	355.8708	352.9359	351.8473	368.6642	361.6245

Yield spread vs UST2Y



Yield spread vs UST10Y



Appendix

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Intesa Sanpaolo SpA Research Department – Head of Research Gregorio De Felice

Macroeconomic Analysis

Luca Mezzomo (Head)

luca.mezzomo@intesasnpaolo.com

Rates, FX & Commodities Research

Chiara Manenti (Head)

chiara.manenti@intesasnpaolo.com

Sergio Capaldi (Rates and FX)

sergio.capaldi@intesasnpaolo.com

Stefano Di Domizio (Rates)

stefano.didomizio@intesasnpaolo.com

Asmara Jamaleh (FX)

asmara.jamaleh@intesasnpaolo.com

Daniela Corsini (Commodities)

daniela.corsini@intesasnpaolo.com