

Article | 5 October 2026

FX

FX Daily: Euro repriced for fiscal woes

Independent euro weakness is the dominant story in FX markets as investors adjust positions for French fiscal risk. With the ECB tightening cycle far more vulnerable to repricing than the Fed's, EUR/USD looks set to remain under pressure. Elsewhere, Brazilian asset markets are expected to rally today after Sunday's election results



French fiscal risk is demanding a weaker euro

↑ **USD: Dollar holds gains**

DXY dollar index is pushing smartly to new highs of the year. It is being propelled by the sell-off in the euro, which represents 58% of the DXY basket. 102.85 would seem to be the next upside target here.

Friday's [softish September jobs data](#) failed to materially dent prospects for the dollar. Instead, it seems the market is pretty comfortable pricing in unchanged Fed policy at the late October meeting and then a hike at the December meeting. In terms of how this week will play out for short-dated US rates, the focus will probably be on today's ISM services data and then the release of the FOMC minutes on Wednesday evening. Both look positive for the dollar, with the latter providing some colour on why so many Fed members were forecasting a second Fed hike this year in their Dot Plot submissions.

Core support for the dollar should continue to come from the fact that expectations for the

monetary policy tightening cycle remain far more resilient for the Fed than for overseas central banks – especially the ECB. Since late September, 30bp has been removed from the ECB's expected tightening cycle compared to just 13bp for the Fed.

Chris Turner

📉 EUR: Catching a falling knife

All eyes will remain on French debt this week. Whether last week's sell-off prompts a more fiscally supportive stance from either the right or left in French politics remains to be seen, but for the time being it looks like investors will steer clear of French debt. And presumably there will be intense focus on whether last week's [French budget submission](#) makes any progress in a deeply divided parliament.

EUR/USD broke lower in Asia overnight on broad euro selling. The big declines in EUR/CHF and EUR/GBP point to a larger risk premium going into the euro on the back of these fiscal woes. This is something my colleague Francesco Pesole [warned about last Thursday](#). We stick with our [1.1100/1120 EUR/USD target](#) for the time being, with the risk of an extension to the 1.10 area.

The eurozone data calendar is pretty light this week, but focus today will be on ECB comments emerging from a monetary policy conference in Frankfurt. The ECB has a difficult job in terms of talking tough to keep a [lid on inflation](#), while at the same time being expected to step in at some point should the French debt sell-off get out of hand.

In terms of the bigger picture for EUR/USD, the cyclical story looks negative for the coming months. The only surprise positive we can see would be the US mid-term election results prompting some kind of policy response from the White House, which would unnerve a buy-side which is now overweight in dollars.

Chris Turner

➔ CEE: Inflation tests central banks stance

Regional inflation data will take centre stage this week. Turkey's September release is due today; we expect monthly inflation to edge up from 1.8% to 2.0%, while annual inflation falls to 30.0%. Food and education should drive the moderate monthly increase despite higher transport costs, while a strong base effect should lower the annual rate. Czech inflation is due tomorrow, and we expect it to rise from 1.9% to 2.5%, mainly on higher fuel prices. This would exceed the Czech National Bank's August forecast of 2.2% for the first time in a while. Core inflation should also edge up from 3.0% to 3.1%, supporting our call for a November rate hike.

On Wednesday, Hungarian inflation is expected to climb from 1.3% to 2.0%, again largely due to fuel prices and above the National Bank of Hungary's September forecast of 1.7%. The

National Bank of Poland should keep rates unchanged at 3.75%, with Thursday's press conference likely to remain cautious. However, we believe new government fuel measures will delay any rate hike until the first quarter of 2027. The National Bank of Romania should also hold rates at 6.50% on Thursday, with markets focused on comments about last week's EUR/RON moves.

Despite significant volatility in the rates space last week, regional FX remained relatively stable. Nevertheless, our bearish bias proved justified, and the global narrative has seen little change over the past week. EUR/USD continues to seek new lows, and energy prices remain uncomfortably high. At the same time, despite the collapse in EUR rates, we did not see significant widening of rate differentials.

As we noted on Friday, we favour the Czech koruna within the region; it hit new lows last week, but higher inflation this week should trigger a more hawkish stance from the CNB and shift market pricing. Moreover, the koruna is less tied to the global narrative and should outperform its CEE peers. Conversely, the National Bank of Poland and NBH remain relatively dovish in the global inflationary context, leaving their currencies exposed.

Frantisek Taborsky

BRL: Surprisingly strong performance for Bolsonaro

Brazilian assets look set to rally today following presidential election results on Sunday, which showed Flavio Bolsonaro gaining 47% of the popular vote to President Lula's 45%. Both will go to a run-off on 25 October, but markets will assume that the remaining 8% of the vote will be directed more towards the Bolsonaro camp. Investors had been expecting a very tight race, but it seems that Bolsonaro has performed better in the first round than many expected.

With Bolsonaro running on a ticket of fiscal austerity and deregulation, expect both the currency and bond market to rally. A few investors might be looking for the currency to replicate some of the sensational gains seen by the Colombian peso earlier this year, after the right-wing candidate, Abelardo de la Espriella, did well in the first round in May and then won the run-off in June. Currently, however, the stronger dollar environment and surging US Treasury yields are creating a more difficult external environment for emerging market currencies than earlier this year.

USD/BRL could open near 5.10, but a move back to the lows of the year at 4.90 looks too aggressive right now. But expect the real to continue outperforming the steep forward curve.

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