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FX Daily: No trigger in sight for a dollar reversal

A range of indicators suggests the dollar rally is becoming stretched. But with no clear macro or market catalyst in sight, we see little reason to call for an imminent reversal. We have lowered our EUR forecasts to reflect a more durable fiscal risk premium, while increasing prospects of a BoE hike should keep EUR/GBP under pressure for longer



Dollar strength continues to climb, supported by firmer oil prices

We have published the October edition of FX Talking: Au revoir, euro bulls, with updated FX forecasts and views.

USD: Overbought signals not that relevant for now

The start of the week has brought more dollar strength. Firmer oil prices, following increased military activity in the Gulf, have helped keep the dollar on solid footing. Today's calendar is unlikely to be particularly impactful, with the NFIB survey and home sales figures the main highlights.

That said, several technical indicators point to an increasingly stretched USD rally. Our short-term valuation model shows the dollar overvalued against every G10 currency except GBP,

where it's at fair value. On an equally weighted basis, USD is 1.1% overvalued versus G10. EUR, SEK and NZD stand out as particularly cheap, undershooting fair value by 1.5-2.5% and sitting beyond the 1.5 standard deviation threshold.

Positioning tells a similar story. Excluding JPY, where long positions remain unusually elevated, net long USD positioning versus G10 reached 24% of open interest as of last Tuesday. Options markets are sending the same signal, with 3m DXY-weighted risk reversals near the peaks seen in March 2025 and March 2026.

Is this enough to call for a reversal in dollar momentum? We do not think so. In March 2025, it took a Sell-America shock to derail an overbought USD. In March 2026, expectations of a static Fed prevented the dollar from benefiting from geopolitical tensions. A clear macro or market catalyst is needed for a reversal, and we do not see one. Fed tightening expectations remain stickier than those for most other central banks, limiting USD downside even if oil prices retreat. At the same time, weakness across global bond markets continues to support demand for a liquid defensive currency. Consensus is already looking for a modest 0.2% core CPI MoM print tomorrow, limiting the scope for a negative USD reaction.

Further ahead, US midterms may represent a somewhat underappreciated USD risk. However, markets have long priced in the possibility of Republicans losing control of Congress, and any precautionary, potentially USD-negative positioning ahead of the vote may not emerge until late October anyway.

Francesco Pesole

EUR: 1.13 is our new year-end target

EUR/USD is around 1.5% undervalued relative to short-term fundamentals. This suggests a moderate build-up in France-related risk may be becoming entrenched in the euro, but also that the risk premium could expand further if French bonds continue to lose value.

For now, that's not our baseline. While it's early to call for a retightening of the OAT-Bund 10yr gap, expectations that this year's budget can be passed via decree may help contain the spread below 150-160bp.

It's hardly a welcoming environment for EUR bulls, though. Beyond several ECB appearances, including Lagarde's, there are few other domestic drivers for the euro this week. Markets are already fully priced for a December hike, leaving limited scope for additional hawkish support, while an October move still looks unlikely.

A test of 1.110 remains the risk for EUR/USD, even if we expect some stabilisation today. We have revised our EUR/USD forecast lower to 1.13 for 4Q26 and 1Q27.

Francesco Pesole

GBP: On firmer ground

We have lowered our EUR/GBP forecast and now expect the pair to trade in a 0.84-0.85 range for at least several more months. Idiosyncratic risks surrounding the euro are unlikely to fade anytime soon, and the Bank of England has sent a clear enough signal that it is prepared to hike.

We still think BoE rate expectations are too hawkish for 2027 (100bp by July), but one or two hikes are looking increasingly likely. The dovish shift may have to wait until well into 2027, underpinning GBP strength.

The UK budget on 28 October represents a potential risk for sterling, as markets are pricing in little fiscal concern. Even so, Chancellor John Healey and Prime Minister Andy Burnham have appeared mindful of market sensitivities. While the budget will be closely scrutinised, we do not currently expect it to trigger significant bond volatility or leave a lasting negative mark on GBP.

Francesco Pesole

CEE: Energy headwinds keeps EM under pressure

Romanian inflation rose from 6.2% to 6.6% in September, exceeding market expectations and reversing part of August's sharp decline. We and the central bank expect a modest further increase through year-end before disinflation resumes next year.

Czech September inflation is expected to be confirmed at 2.5% later today, shifting attention to the breakdown and core reading. We estimate core inflation edged up from 3.0% to 3.1-3.2%, above the CNB's 2.9% forecast. The CNB has long viewed 3.0% as a potential trigger for rate hikes. With headline inflation also above forecast, we expect the CNB to raise rates again in November.

CEE trading was subdued yesterday amid US market closures, leaving our outlook largely unchanged. Rising global energy prices and fresh lows in EUR/USD point to continued pressure on emerging markets today, supporting our bearish view on CEE currencies. The Czech koruna remains the exception: a hawkish inflation breakdown could provide a catalyst, while we still see 24.250 as fair value given current hawkish rate pricing.

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