FI and FX Daily Brief

FI and FX Daily Brief - EUR drops again

Summary

The EUR fell on a broad basis, when the FX market opened Sunday evening. EUR/USD fell below 1.12 and thus reversed the rise on Friday, EUR/JPY below 177 and EUR/CHF below 0.9250. EUR/NOK and EUR/SEK also opened the week lower. Last week, ended with flatter yield curves in US and Germany, while a main focus for the market was upwards pressure on energy prices with the price on Brent crude rising to USD109/bbl and the price on TTF natural gas to EUR88/Mwh. Brent crude opened lower overnight.

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The front Brent oil future rose sharply on Friday evening, close to the USD 110 per bbl mark, but notably, US yields traded lower during the later part of the US session and despite the higher-than-expected CPI and PPI prints last week, the 10Y UST closed 17bp lower on the week with the 2s10s curve 9bp flatter. The decline in yields during Friday's session can likely be attributed to speculation that the US Treasury might reduce long-term issuance in the upcoming QRA published 4 November, as the US Treasury sent out a survey to primary dealers. Both oil and US yields traded slightly lower during the Asian trading hours.

EUR swaps also closed lower last week in a flattening move, but to a lesser extent than in the US, with the 10Y swap 5bp lower and the 2s10s curve 3bp flatter. The 10Y OAT-Bund spread hovered around 140bp over the week. Friday's flash PMI may reveal how the developments in the bond market, but also the recent violent protests in France, have affected economic sentiment.

With the IMF meetings in Bangkok behind us, we summarize the message from GC members as being that a hike from the ECB in December is the base case, while October is deemed to be too soon, given the limited spillover effects from higher energy prices to core inflation. Wunsch said it was reasonable for markets to expect additional tightening, and Nagel said that he "can't exclude we may need to hike again". According to Simkus, the ECB will have more information in December, making it a more appropriate time for the next decision. However, members also noted that the "trade-offs for monetary policy are getting more tricky", as Kazaks put it, given the level that policy rates have now reached. The ECB is therefore increasingly considering the downside risks to growth from further hikes and noting the lack of second-round effects. A "measured response" from the ECB is therefore still the most appropriate, according to Lagarde. In our view, the comments support a pause in October and a 25bp hike in December, but not the additional 75bp worth of hikes that markets are pricing in by September 2027.

The data calendar is thin today, and in terms of issuance we only have Lithuania and Slovakia with scheduled supply. Tomorrow, we will see issuance from UK, Germany and Finland.

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Broad USD weakened further on Friday, as EUR/USD traded all the way up to 1.1260 before ending the day near 1.1240. While US tech stocks continued selling off, and UST yields declined further, in FX markets it was the cyclicals (NZD, NOK) that led the gains. This supports the notion that the recent equity market jitters reflect idiosyncratic concerns related to the AI theme, rather than a macro-driven risk-off sentiment.

French fiscal concerns seem to have stabilized for now, and markets are still pricing some 4bp for the Fed's October meeting. If the FOMC remains on hold as we expect, the USD weakness could persist for the next couple of weeks. But we do not expect it to turn into a more persistent trend, as macro fundamentals still favour stronger USD in the long-run. Rising energy prices pose a key downside risk to EUR/USD, as oil prices rose back to USD110/barrel and both LNG and natural gas prices reached YTD highs at the end of last week.

This week will be quiet in terms of both macro and central banks. The Fed entered blackout already on Saturday, but there's still a handful of ECB speeches scheduled before the meeting. The main event will be the October flash PMIs on Friday, which will mark the final key data release ahead of next week's rate decisions.

Scandies

The NOK strengthened sharply on Friday, gaining almost 1% against the USD and ending the week as the best-performing G10 currency, with USD/NOK closing around 9.43 and EUR/NOK around 10.59. The move was mainly driven by broad USD weakness after Fed Chair Kevin Warsh gave no new policy signals, lower US yields over the week and continued support from elevated oil prices, with Brent above USD 109 per barrel. Overall, the move appears to have been a USD-driven rally amplified by oil support rather than a response to domestic data or Norges Bank signals.

With the economic data calendar empty, the SEK will take its cues from international developments. In parliament, the quest for a new government continues. As the Social Democrats have now lost the first prime ministerial vote. Up to four votes can be held before a snap election is triggered. We don't see the difficulties in forming a government as a factor for the SEK, but should we move closer to a snap election, the market's attention to the matter may increase.

Tactical views

FX

EUR/USD - On a structurally declining trend

EUR/NOK - Tactically neutral. Strategically bullish.

EUR/SEK - Back at our 1M target, a buy-on-dips from hereon

EUR/GBP - Tactically neutral and strategically bullish

USD/JPY - Looking for strategic selling opportunities

EUR/DKK - DN to cap EUR/DKK around the 7.4760 peak from August

USD/CNY - Tactically sell on rallies, strategically bearish

Fixed Income

Europe - Bund ASW-spreads to tighten

US - 10Y US Treasury yield at 5.20% in 12M

Sweden - Look for SEK underperformance vs EUR

Norway - Look to enter steepeners in the coming month

Denmark - Long high-coupon callables versus DGBs and swaps

Commodities

Oil - to stay elevated near-term on tight supply conditions

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Report completed: 19 October 2026, 07:00 CET

Report first disseminated: 19 October 2026, 07:15 CET

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