Article | 26 October 2026

FX Daily: BRL set to suffer on surprise Lula win

FX markets face a busy week full of central bank meetings, data releases and politics. With energy prices firm and expectations growing that the US and Israel will launch another attack on Iran, we expect central banks to stay hawkish. This should keep the dollar supported on dips. Expect Brazilian assets to sell off today on President Lula's surprise win



Brazilian assets look set to correct lower after President Lula's surprise win on Sunday

USD: Geopolitical environment remains dollar positive

The dollar is starting a busy week relatively supported. It is a week that includes key events such as Wednesday's FOMC meeting, third-quarter earnings from big tech companies and geopolitical events, including tomorrow's elections in Israel. There are also a whole host of central bank meetings across G10 currencies, including those in the eurozone, Japan, Canada and New Zealand.

The balance of risks suggests that the dollar can probably hold onto its gains. Yes, interest rate spreads have moved a little against the dollar as the recent US tech wobble has pared back Federal Reserve tightening expectations. But energy prices remain at their highs, and the arrival of a third US aircraft carrier group in the Gulf makes further escalation in the Middle East

more likely than not.

Barring some clearly underwhelming 3Q results from the likes of Alphabet and Microsoft on Wednesday, we think higher energy prices and a hawkish Fed can keep the dollar supported this week. That means the DXY dollar index can probably stay in a 101.45 to 101.85 range today. We don't really see the need for it to correct lower to 101.25 unless US tech drags US equities sharply lower.

Chris Turner

EUR: Business sentiment surprisingly resilient

Friday's release of flash October PMIs for the eurozone remained surprisingly resilient and pointed to some decent third-quarter growth figures. The exception was France, however, where weak growth is hardly going to help the country's fiscal malaise. Separately, OAT-Bund spreads have narrowed this morning after Moody's maintained France's Aa3 rating on Friday. This means France retains at least one AA rating. While welcome news in the short term, we will need to see concrete and material progress on the French budget over the coming months to take pressure off the euro. That seems unlikely, and high energy prices are hardly helping.

On the subject of energy, last week's release of the eurozone current account surplus for August at just €8.7bn (the lowest since the start of 2023) provided a reminder of the toll higher energy prices are taking on the bloc's external position. This, alongside a U-turn in Fed policy, had contributed to a very weak EUR/USD at the time.

Today's session is expected to see stable German Ifo business sentiment, where the important expectations component is seen at a healthy level near 90. Any downside surprise here could hit the euro. And while the recent 10bp narrowing in EUR/USD two-year swap differentials might make the case for a slightly higher EUR/USD, we see plenty of justification for a 1-2% risk premium to stay in the euro.

We favour 1.1250/70, capping EUR/USD upside in the near term, and see the 1.1180 support level as vulnerable this week.

Chris Turner

CEE: Zloty remains the weak link

The significant deterioration in global sentiment last week has only intensified existing pressure on emerging market currencies, and we remain bearish on the CEE region. The calendar is light this week, with attention focused on the upcoming Fed and European Central Bank meetings.

The first notable data releases will arrive on Friday, featuring October inflation figures for Poland as well as 3Q GDP data for the Czech Republic and Hungary. Inflation in Poland is expected to fall from 4.1% to 3.7% year-on-year, largely due to the introduction of a government price cap on fuel. GDP figures should confirm a slowdown in the Czech Republic to just under 2.0%, while showing a continued recovery in Hungary to similar levels.

In the Czech Republic, a blackout period begins on Thursday ahead of the Czech National Bank's November meeting. We saw some initial statements last week and expect more in the coming days. We anticipate a rate hike at the November meeting, with the CNB currently preparing the market for such a move.

On Friday, EUR/PLN tested new highs since 2023 and broke through the key 4.400 level. We have long identified the zloty as the most vulnerable currency in the region, and given its rate outperformance relative to CEE peers, there is likely further upside for EUR/PLN. Friday's inflation data from Poland could help stabilise the market. EUR/CZK also decoupled from the interest rate differential; a hawkish CNB should help the pair return to the 24.250–24.300 range. EUR/HUF is gradually approaching 368, a level where we expect new sellers to emerge.

Frantisek Taborsky

BRL: Lula comes back from the brink

In a huge surprise, incumbent Brazilian President Luiz Inácio Lula da Silva has won the presidential election run-off with 51.8% of the vote. This is the first time since 1989 that a second-placed candidate has come from behind to win the run-off. The victory is not without its controversy, however. The opposition candidate, Flavio Bolsonaro, wants the election result annulled since a Supreme Court judge extended polling hours at the last minute. Some polls had already closed, and claims are that the polls that were extended tended to be in Lula's voting base in the Northeast of the country. Early indications are that key authorities have no interest in re-running the election.

Important for local financial markets will be how quickly Bolsonaro accepts the result – or at least allows the constitution to run its course. That is what his father did 44 hours after losing to Lula in 2022, a move that provided some calm to markets.

For today, however, expect Brazilian markets to be hit hard. USD/BRL gapping 5-7% higher at the open to the 5.20/25 area should be no surprise, while the local Bovespa equity index looks set for double-digit losses. The moves could turn out to be larger if the external environment deteriorates again and US Treasury yields spike. The fiscal side has always been Brazil's Achilles heel, and a 7-8% budget deficit and 70% net debt-to-GDP ratio leave Brazil vulnerable in a global bond sell-off. Instead of fiscal consolidation under Bolsonaro, Brazilian assets are instead going to have to contend with Lula's campaign pledges, including a shorter working week.

Chris Turner

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

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