GLOBAL FX TRADER

From Boost to Drag

Our thoughts on USD, EUR, ILS, GBP, FX and Terms of Trade & Frontier FX

- **USD: What got you there also got you here.** For much of this year, we have argued that strong US economic and equity performance have been important AI-driven tailwinds to the Dollar. The AI boom has raised capital expenditures and near-term inflationary pressures. With the US disproportionately affected by these channels, this has shifted rate differentials in the Dollar's favor. We think the broad pattern of FX moves this week is most consistent with elements of this framework now coming under renewed scrutiny, rather than a negative currency reaction to the FOMC's emphasis that there is no 'urgency' to hike at the October meeting (though we still see dovish policy preferences as a more medium-term limitation on the Dollar). The Dollar's underperformance this week amid renewed AI concerns and a sharp tech sell-off closely resembles the "DeepSeek sell-off" last January, which was also a clear negative Dollar event in real time—the flipside of the US's outsized exposure to this theme. Notably though, DXY fell by *more* this time around than it did during the "DeepSeek episode" despite *less* US equity underperformance. We think this largely reflects an element of rate relief in European assets. European equities outperformed and EUR and its satellites have seen some reversal after concerns over European credit eased somewhat on the back of the rally in global duration, which has been a much larger factor in this episode (Exhibit 1 and Exhibit 2). Moving forward, we expect the Dollar to continue to be captive to these forces in both directions. On the one hand, a significant reduction in expected AI-related demand would weigh on the Dollar over time given its exposure and lofty valuation. This scenario would uniquely benefit the Yen, which we still think is a good portfolio hedge for this environment despite more mixed performance this week. On the other hand, signs of more durable capital expenditure in the US than in much of the rest of the world, as Chairman Warsh also highlighted, could bring renewed upward pressure on the Dollar. We still think the latter is the predominant risk to our forecast, but we stick with our baseline of relatively tight ranges in most major crosses, firm currency management in Asia, and a strong carry component to total returns against a background of firm global economic activity, relatively synchronized policy in the G10, and fading inflationary pressures.

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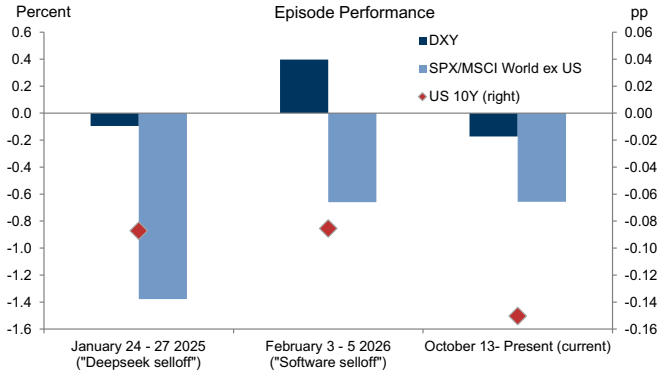
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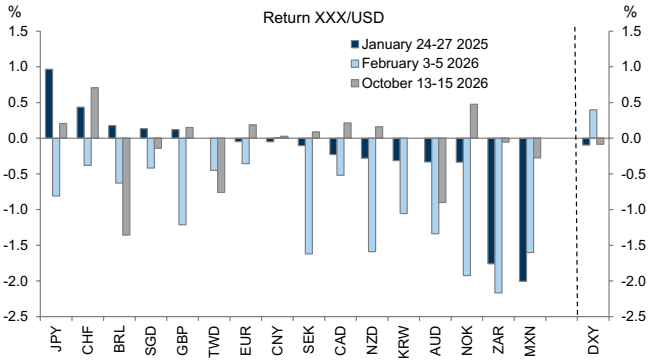
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Exhibit 1: DXY fell by more this time around than it did during the "DeepSeek episode" despite less US equity underperformance...



Source: Bloomberg, Goldman Sachs Global Investment Research

Exhibit 2: ...reflecting an element of rates relief in European assets.

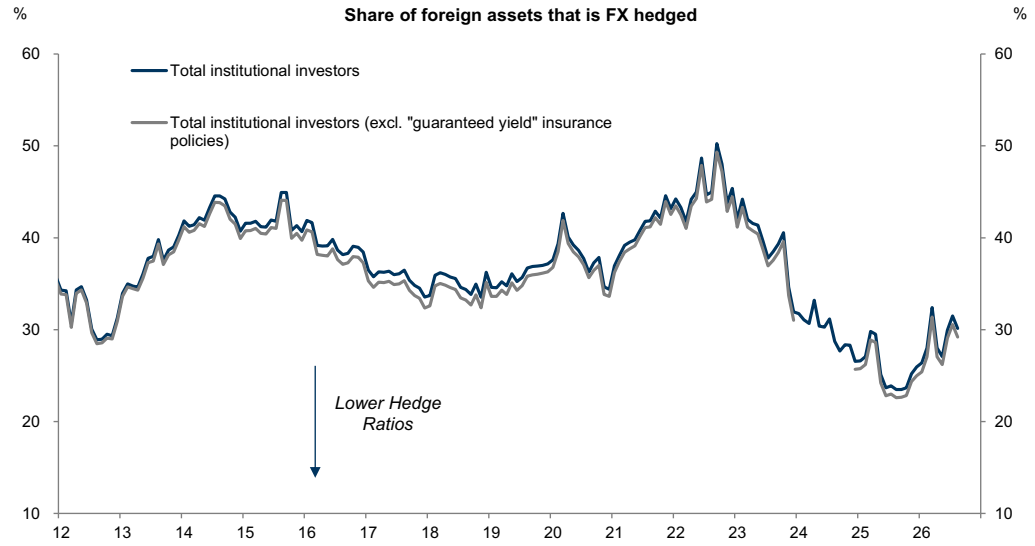


Source: Bloomberg, Goldman Sachs Global Investment Research

- **EUR: What could possibly go wrong.** The Euro has found some relief from the global rally in duration, and the earlier contagion in sovereign spreads has partly relaxed. Through the "ups" of August and "downs" of the last few weeks, we have maintained our forecasts for the Euro to trade around 1.12-1.14 over the coming year because we think solid global growth and broadly synchronized policy should translate to relatively limited FX spot returns, and European fundamentals today are very different to past episodes of EA sovereign credit stress. We still see some challenges ahead, but over the next few months clarity on natural gas reserves for winter and a firmer foothold from global duration on the back of cooling US inflation pressures should be tailwinds for the Euro. That said, we think FX investors are right to focus on the recent stresses in sovereign yields and explore the downside tail in the Euro. Sovereign spread widening is particularly negative for a currency because it can lead to both (i) a shift in the mix of tightening away from monetary policy (a lower path for the policy rate and lower-risk real yields), and (ii) reduced foreign investor appetite. We have argued that FX vol would reset higher if there are signs of rising recession risk or divergence, and sovereign credit stress activates both of these powerful channels. This is why FX moves tend to be larger in these episodes, as the resulting market moves tend to compound—widening rate differentials, local asset underperformance, and foreign investors demanding a higher credit risk premium. The Euro's swift reaction over the last few weeks followed the same playbook, with the currency responding once there were signs of contagion. The bottom line is that, despite our more benign baseline, we recognize that downside risks to the Euro stemming from wider spreads would likely also entail a higher vol FX regime. We think this discontinuity creates value in EUR/USD downside hedges, particularly when measured against other asset classes where vol is already elevated.
- **ILS: Election now, tech later.** The Shekel has been trending weaker over the past couple of months and has now reversed most of its appreciation since early April. While some of this move has been driven by broader risk sentiment—and the Shekel's high beta to tech stocks—the Bank of Israel's more dovish rate policy and outright FX market interventions have also played a role, in our view. With legislative elections coming up on October 27, focus has also shifted to whether an outcome

that is seen as improving country-specific risk premium could drive ILS meaningfully stronger. In that context, issues such as the judicial reform process could be of particular importance to FX markets, as we saw in early 2023. Moreover, the lesson from other elections this year has been that FX markets can move substantially on expectations alone before any policy shift is implemented. Nevertheless, we think there are a few reasons not to expect a sustained appreciation of the Shekel. First, current polling points to a tight race between the incumbent and opposition blocs, keeping the odds of an unclear, higher-uncertainty outcome still high. Second, while market perception could shift under different election outcomes, economic policy proposals are relatively similar across the board. Plus, while the judicial reform discussions drove ILS weaker in 2023, it is difficult to argue that there is still a substantial country-specific premium priced in when the Shekel is trading near its strongest levels over the past 30 years. Third, and relatedly, the Bank of Israel has been pushing back against currency appreciation, and we would expect this to still be the case if ILS were to appreciate meaningfully post-elections, especially as inflation dynamics remain quite benign. In particular, the central bank intervened in FX markets in May and June, but not since then, which could imply some sensitivity around the 3.00 level for USD/ILS. Additionally, the more dovish stance on rate policy stands out in a context of higher global rates and a hiking Fed. Having said that, the key factor that could push ILS meaningfully stronger, and bears close monitoring, would be a shift in the hedge ratio of local institutional investors. These ratios declined in early 2023 around the period when the judicial reform was in focus, so a reversal of these risks could argue for a shift in these ratios (Exhibit 3). Still, the latest data suggests that hedge ratios have increased year-to-date, yet there is no clear imprint on the Shekel. Overall, while local developments can be in the driver's seat over the election window, we think the Shekel's global betas will dominate over the medium term. Therefore, we think ILS remains an attractive hedge for portfolios highly levered to tech stocks on account of its high sensitivity to these stocks, its overvaluation signal, the positive carry for being short, and growing policy pushback against a stronger currency. In that context, we would see ILS appreciation post-election as providing an attractive entry point to re-engage with shorts.

Exhibit 3: Hedge ratios for institutional investors have increased year-to-date but remain below their pre-2023 average



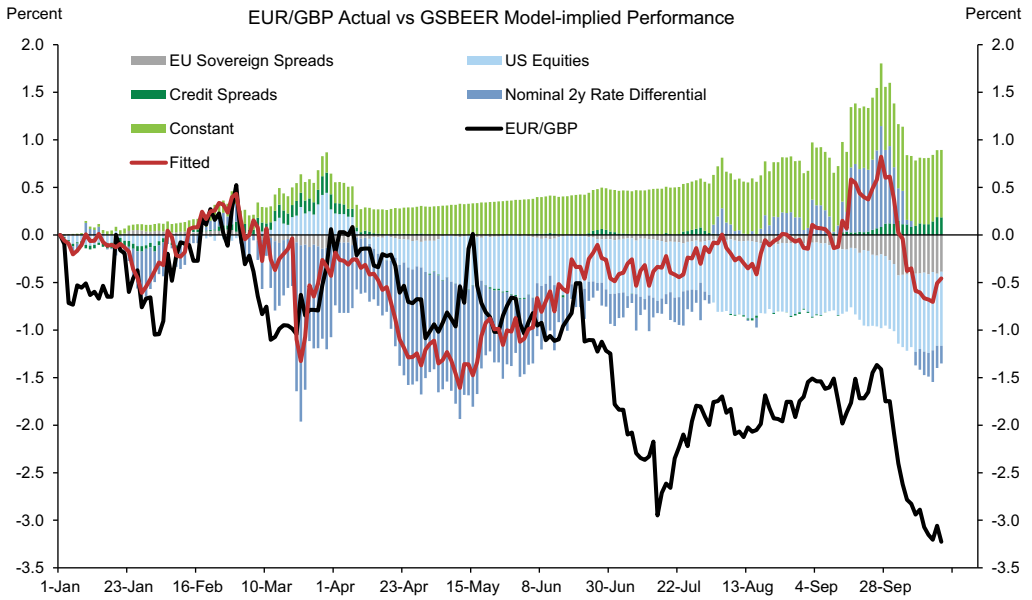
Hedge ratio calculated as ratio between foreign currency derivative assets and the balance sheet assets in foreign currency

Source: Bank of Israel, Goldman Sachs Global Investment Research

- **GBP: Narrow risks from the Autumn budget.** The Government's signalling in recent weeks points to a cautious approach to the Autumn budget, with an aim to rebuild headroom and fund temporary cost of living relief through a series of smaller, targeted tax measures. Chancellor Healey has placed a clear emphasis on fiscal restraint, and many of the larger, more ambitious spending projects and flagship policies are expected either after a 2027 spending review or for a policy platform into the next general election. Spending pressures into these future events still appear meaningful, with higher defence spending requirements a key issue, alongside welfare spending projects (particularly on social care). But it is far from clear that the balance of recently unveiled policy initiatives are a net negative for Sterling. EU reintegration would stand to be a significant positive for the currency through a boost to growth, albeit a very slow-moving process. And the Government's revealed preference to tackle the politically sensitive triple lock on pensions is the type of step that should help shore up their fiscal credibility. Perhaps most importantly, these signs of spending restraint and newfound political stability come at a time when fiscal premia are rising in other major markets (see EUR bullet). All of this should help reduce the risks to Sterling on the fiscal front. And as we have shown before, even where these risks do flare up, the imprint on Sterling tends to be fleeting. What remains more challenging for the currency is that a lot of this better news already appears priced. After a substantial premium compression over the summer, EUR/GBP remains well below levels implied by our cyclical GSBEER model (Exhibit 4), which we think limits Sterling's upside potential on a market-friendly budget delivery. Looking further ahead, structural Sterling overvaluation and downside risks to BoE hike pricing keep a drift higher in EUR/GBP as our central expectation. At the same time, the distribution of risks on European sovereign credit

has shifted, and the spillovers to Sterling have proved more contained than usual in this latest episode. A further widening in European sovereign spreads is a substantial downside risk to the cross in the months ahead, but we think the overall set of macro and fiscal risks point to better downside value in EUR/AUD and EUR/NOK.

Exhibit 4: The recent sell-off in EUR/GBP has been consistent with cyclical fundamentals, but a valuation gap remains from the summer months



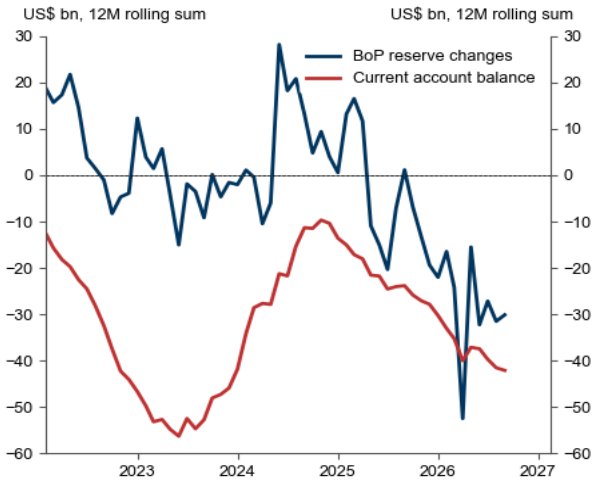
Source: Goldman Sachs FICC and Equities, Goldman Sachs Global Investment Research

- **FX and Terms of Trade.** Terms of trade have been a key market theme—and a dominant driver of FX returns—for much of this year amid the ongoing conflict in the Middle East. We recently conducted the annual update of our GSTOT Index weights to account for shifts in relative importance of each commodity. In this year's update we also implement two additional modifications: (1) chain-linked indexing to preserve continuity in the series by minimizing level shifts arising from annual changes in weights and (2) the use of "mirror data"—the sum of the trade data reported by all trading partners rather than the reporting country itself—for Switzerland's gold exports and imports from 1998-2011 to improve data quality. Our GSTOT indices continue to show that NOK, CAD, COP, and AUD screen as the top beneficiaries of an energy price shock whereas TWD, THB, and KRW screen as the most vulnerable, consistent with realized FX returns over the course of the ongoing conflict in the Middle East. Looking across other commodities, when copper prices rally, CLP and PEN stand out as the clearest beneficiaries, though the impact elsewhere is minimal. Meanwhile, increases in agricultural product prices tend to benefit NZD and BRL the most. Ongoing concerns around another escalation in the Middle East will likely keep energy prices elevated, supporting the case for continued exposure to energy terms-of-trade winners versus losers. AUD, NOK, and COP screen as some of the biggest energy exporters on our GSTOT framework and, combined with attractive carry, therefore remain some of our preferred expressions of this theme. That said, we have found that energy prices have recently become less

of a dominant and pervasive driver of FX moves than earlier in the year, consistent with other drivers, particularly rate differentials and relative equity performance, moving to the fore.

- **Frontier FX: Narrowing exposure; long an 'oil-neutral' basket with EGP and NGN.** Carry exposure via Frontier FX has been a key theme for us for much of this year, reflected in long-standing recommendations to be long EGP, TRY, NGN and KZT versus the Dollar. However, we see both global and local arguments for narrowing the breadth of that exposure. From a global standpoint, a pick up in rate volatility and an unwind in risk sentiment both argue for a more selective approach and we are narrowing the longs to EGP and NGN. We are taking profits on our short USD/EGP trade recommendation, for a potential total return of 5.3%, as well as on our recommendation to be long TRY, NGN and KZT against the USD, for a potential total return of 10.3%. We then initiate a trade recommendation to go long EGP and NGN against the USD, as an equally weighted basket, with a potential total return target of 7%, and a stop of -3%, and with a 12-month nominal carry of ~13%. We see this basket as an 'oil-neutral' expression as it contains currencies on opposite sides of the energy price shock, and these are the two currencies where we still see scope for spot appreciation in more constructive states of the world. In the case of TRY, reserves have declined meaningfully alongside a deterioration in the current account (Exhibit 5), and the potential resumption of the easing cycle could further increase pressures on reserves and prompt a faster path of Lira depreciation, making us more cautious overall. In turn, the recent run stronger in KZT has likely pushed it further outside of the central bank's preferred range, amidst limited official support for the currency over the last few months. By contrast, we still see the EGP carry trade as attractive at this juncture, with solid reserve, carry and valuation buffers and increased policymaker credibility through the conflict so far that we think can offset rising spot losses from bouts of geopolitical volatility. Further, we like exposure to the asymmetry towards deep spot appreciation in a de-escalatory scenario given the recent price action having brought USD/EGP near post-war highs, in line with our bullish USD/EGP forecast at 49 in 3 months versus current levels at around 53.5. On the other side of the terms-of-trade shock, we remain constructive on the Nigerian Naira. The recent stable currency path suggests that the central bank is still leaning against the currency appreciation pressures from historically elevated FX reserves, higher oil prices and continued portfolio inflows in high-carry instruments, and in line with our 3-month forecast at 1,300, we continue to see potential for spot upside from here given current levels at ~1,330.

Exhibit 5: Turkiye's reserves have been declining as the current account deficit keeps widening



BoP reserve changes exclude gold valuation effects.

Source: Haver Analytics, Goldman Sachs Global Investment Research

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Global FX Forecasts

	Current Spot	3-Month Horizon		6-Month Horizon		12-Month Horizon	
		Forward	Forecast	Forward	Forecast	Forward	Forecast
G10							
EUR/$	1.12	1.13	1.14	1.13	1.12	1.14	1.12
£/$	1.33	1.33	1.33	1.33	1.29	1.33	1.28
AUD/$	0.69	0.69	0.72	0.69	0.73	0.69	0.74
NZD/$	0.56	0.56	0.60	0.57	0.61	0.57	0.62
$/CAD	1.42	1.41	1.40	1.41	1.38	1.39	1.38
$/CHF	0.83	0.82	0.83	0.81	0.86	0.79	0.87
$/NOK	9.47	9.48	9.56	9.49	9.55	9.49	9.38
$/SEK	9.95	9.90	9.65	9.85	9.73	9.75	9.55
$/JPY	158	157	158	156	155	153	150
EMEA							
$/CZK	21.7	21.6	21.5	21.6	21.8	21.6	21.6
$/HUF	324	325	311	326	313	326	308
$/PLN	3.89	3.89	3.77	3.89	3.79	3.89	3.79
$/RON	4.76	4.78	4.69	4.80	4.82	4.83	4.96
$/RUB	86.15	86.15	80.0	88.61	85.0	93.71	90.0
$/UAH	44.9	46.1	46.0	47.3	48.0	49.8	52.0
$/TRY	49.47	53.52	51.0	57.38	53.0	66.35	59.0
$/ILS	3.10	3.08	3.00	3.07	3.05	3.03	3.10
$/EGP	53.5	55.8	49.0	57.7	48.0	61.3	46.0
$/ZAR	16.50	16.60	16.50	16.70	16.00	16.91	15.75
$/NGN	1331	1368	1300	1402	1275	1472	1250
Americas							
$/ARS	1514	1596	1500	1683	1600	1909	1800
$/BRL	5.10	5.18	4.70	5.27	4.75	5.43	4.80
$/MXN	18.42	18.53	16.75	18.64	17.00	18.85	17.25
$/CLP	981	980	920	979	900	977	860
$/PEN	3.42	3.43	3.40	3.44	3.35	3.46	3.30
$/COP	3169	3229	3350	3292	3300	3424	3200
Asia							
$/CNY	6.69	6.64	6.70	6.59	6.60	6.48	6.40
$/HKD	7.85	7.82	7.80	7.80	7.80	7.77	7.80
$/INR	95.06	96.13	96.00	97.22	97.00	98.87	97.00
$/KRW	1343	1339	1390	1335	1370	1328	1350
$/MYR	4.08	4.07	4.00	4.05	3.95	4.02	3.90
$/SGD	1.28	1.27	1.26	1.27	1.25	1.25	1.24
$/TWD	32.3	32.3	31.5	32.3	31.3	32.2	31.0
$/THB	33.50	33.42	33.50	33.28	33.00	32.89	33.00
$/IDR	17938	18023	18200	18106	18300	18259	18500
$/PHP	63.06	63.23	62.00	63.43	61.00	63.82	61.00
Euro Crosses							
EUR/GBP	0.85	0.85	0.86	0.85	0.87	0.86	0.88
EUR/CHF	0.93	0.92	0.95	0.91	0.96	0.90	0.97
EUR/NOK	10.63	10.68	10.90	10.73	10.70	10.82	10.50
EUR/SEK	11.17	11.15	11.00	11.14	10.90	11.12	10.70
EUR/CZK	24.34	24.38	24.50	24.44	24.40	24.57	24.20
EUR/HUF	364	366	355	368	350	372	345
EUR/PLN	4.37	4.38	4.30	4.40	4.25	4.44	4.25
EUR/RON	5.34	5.38	5.35	5.42	5.40	5.50	5.55
EUR/RUB	96.7	97.0	91.2	100.2	95.2	106.8	100.8

Note: Spot values are as of Thursday's close.

See dynamic table here (or click image above): https://publishing.gs.com/content/themes/fx-forecasts.html

Source: Goldman Sachs Global Investment Research

Return Forecasts & Valuations

	Current Spot	Forecast: 12-Month Return (%)				GSDEER			GSFEER			Average Estimate	PPP*
							Misalignment			Misalignment			
		Spot	Carry	Total	NEER	Estimate	Bilateral	Trade-Weighted	Estimate	Bilateral	Trade-Weighted		
G10													
EUR/$	1.12	-0.2	-1.6	-1.7	-0.6	1.18	-5%	6%	1.17	-4%	-1%	1.18	1.52
GBP/$	1.33	-3.6	0.0	-3.6	-3.8	1.18	12%	27%	1.28	3%	7%	1.22	1.50
AUD/$	0.69	6.9	0.3	7.2	4.2	0.78	-11%	10%	0.69	1%	10%	0.74	0.70
NZD/$	0.56	10.3	-1.0	9.2	7.3	0.63	-11%	3%	0.61	-8%	-3%	0.62	0.67
$/CAD	1.42	2.8	-1.8	1.0	1.9	1.23	-14%	-8%	1.39	-2%	0%	1.29	1.17
$/CHF	0.83	-4.5	-4.4	-8.7	-4.6	0.85	3%	12%	0.795	-4%	-1%	0.83	0.92
$/NOK	9.47	1.0	0.2	1.2	0.6	6.46	-32%	-23%	9.14	-3%	-3%	7.53	8.87
$/SEK	9.95	4.2	-2.0	2.1	3.9	7.31	-27%	-17%	9.31	-6%	-5%	8.11	8.26
$/JPY	158.0	5.3	-3.0	2.2	3.3	96	-39%	-29%	130	-18%	-13%	110	93
EMEA													
$/CZK	21.69	0.4	-0.6	-0.2	0.2	25.7	18%	28%	21.2	-2%	1%	23.91	15.82
$/HUF	324	5.2	0.7	6.0	5.3	329	2%	11%	331	2%	4%	330	261
$/PLN	3.89	2.6	-0.1	2.5	2.7	4.12	6%	16%	3.83	-2%	2%	4.01	2.43
$/RON	4.76	-4.0	1.6	-2.6	--	--	--	--	5.45	15%	16%	--	--
$/RUB	86.1	-4.3	8.8	4.1	-4.7	77.66	-10%	4%	75.17	-13%	-7%	76.66	40.15
$/UAH	44.91	-13.6	11.0	-2.7	--	--	--	--	--	--	--	--	--
$/TRY	49.47	-16.1	34.1	12.4	-16.1	36.86	-26%	-25%	48.75	-1%	1%	41.61	29.15
$/ILS	3.10	0.0	-2.3	-2.3	0.5	3.68	19%	32%	3.14	1%	6%	3.46	4.70
$/EGP	53.47	16.2	14.6	30.8	--	--		--	--	--	--	--	--
$/ZAR	16.50	4.8	2.5	7.4	3.5	13.37	-19%	-11%	16	-1%	2%	14.59	18.40
$/NGN	1331	6.5	10.6	17.1	--	--	--	--	--	--	--	--	--
Americas													
$/ARS	1514	-15.9	26.1	10.2	-18.3	--	--	--	--	--	--	--	--
$/BRL	5.10	6.2	6.6	13.2	5.1	4.33	-15%	-1%	5.28	4%	6%	4.71	5.28
$/MXN	18.42	6.8	2.3	9.3	5.8	19.76	7%	16%	17.28	-6%	-3%	18.77	20.29
$/CLP	981	14.1	-0.4	13.6	12.0	681	-31%	-19%	826	-16%	-12%	739	787
$/PEN	3.42	3.7	1.0	4.7	1.8	2.92	-15%	-4%	3.06	-10%	-7%	2.98	4.24
$/COP	3169	-1.0	8.0	7.0	-2.6	3632	15%	31%	3697	17%	16%	3658	3298
Asia													
$/CNY	6.69	4.5	-3.2	1.2	2.8	4.99	-25%	-15%	5.92	-12%	-6%	5.36	5.82
$/HKD	7.85	0.6	-1.0	-0.4	-2.3	6.91	-12%	9%	6.60	-16%	-8%	6.78	5.85
$/INR	95	-2.0	4.0	1.9	-3.1	87.48	-8%	1%	87.41	-8%	-7%	87.45	57.50
$/KRW	1343	-0.6	-1.1	-1.6	-3.0	1102	-18%	0%	1071	-20%	-17%	1089	929
$/MYR	4.08	4.7	-1.5	3.1	2.5	3.26	-20%	-4%	3.95	-3%	3%	3.53	1.95
$/SGD	1.28	3.4	-2.7	0.6	1.3	1.35	5%	24%	1.30	1%	9%	1.33	0.57
$/TWD	32.3	4.2	-0.3	3.9	1.5	24.90	-23%	-6%	23.70	-27%	-22%	24.42	13.21
$/THB	33.50	1.5	-1.8	-0.3	-0.9	32.63	-3%	18%	33.71	1%	7%	33.06	18.82
$/IDR	17938	-3.0	1.8	-1.3	-5.6	14280	-20%	-4%	16295	-9%	-2%	15086	10885
$/PHP	63.06	3.4	1.2	4.6	1.0	60.76	-4%	18%	62.24	-1%	10%	61.35	52.56
Euro Crosses													
EUR/GBP	0.85	-3.4	1.5	-1.9	-3.8	1.00	18%	27%	0.91	7%	7%	0.96	1.01
EUR/CHF	0.93	-4.4	-2.8	-7.2	-4.6	1.00	8%	12%	0.93	0%	-1%	0.97	1.40
EUR/NOK	10.63	1.2	1.8	3.0	0.6	7.64	-28%	-23%	10.65	0%	-3%	8.84	13.46
EUR/SEK	11.17	4.4	-0.5	3.9	3.9	8.64	-23%	-17%	10.85	-3%	-5%	9.53	12.54
EUR/CZK	24.34	0.6	0.9	1.5	0.2	30.39	25%	28%	24.75	2%	1%	28.14	24.02
EUR/HUF	364	5.4	2.3	7.7	5.3	389	7%	11%	386	6%	4%	388	396
EUR/PLN	4.37	2.8	1.5	4.3	2.7	4.88	12%	16%	4.46	2%	2%	4.71	3.68
EUR/RON	5.34	-3.9	3.1	-0.7	--	--	--	--	6.35	19%	16%	--	--
EUR/RUB	96.7	-4.1	10.3	6.2	-4.7	91.88	-5%	4%	87.6	-9%	-7%	90.2	--
Addendum													
USD	--	-1.8	-1.4	-3.0	-2.7	--	--	15%	--	--	6%	--	--

Note: USD returns average of all other currencies (except ARS, NGN and UAH) with opposite sign; *EM estimates adjusted for per capita income. Spot values as of Thursday.

See dynamic table here (or click image above): https://publishing.gs.com/content/themes/table.html?criteriaKey=1k2HGqqS2h

Source: Goldman Sachs Global Investment Research