

**STABILITY
ISN'T SAFETY:
NAVIGATING CURRENCY
RISK IN Q1 2026**

Behind our Q1 insights



Market commentary by **Jamie Jemmeson**, **Head of Structured Products**, with 18+ years specialist experience of commercially-focused, results-orientated FX solutions.

And by **Lloyd Eagles**, **Dealing Director**, with a decade of experience delivering high-impact FX risk solutions across UK and Europe.

The forecasted trends of GBPEUR, GBPUSD and EURUSD interbank rates will be circumstantial depending on various outcomes such as the global economy, rate decisions from central banks and geopolitical factors. This means that there are a variety of contrasting views from respected institutions, highlighting the difficulty in trying to call the markets.

The following data has been taken from LSEG Data & Analytics in January 2026 and interpreted from forecasts from over 40 financial institutions. Rather than showing individual forecasts, we have taken the high, the mean and the low. Whilst the data is subjective, it does highlight the vast divergence of views based on the current environment.

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Growth slows and policies shift

2026 begins with two drivers shaping FX outlook: slow-moving economic strain and sharp political noise. While markets appear steadier than last year, currency moves remain meaningful for margins, pricing and budget planning at globally exposed businesses.

This means FX risk is shifting for UK companies. Rather than headline-driven shocks, exposure is increasingly influenced by the accumulation of smaller moves

against a backdrop of weaker demand – as already observed by US President Trump's headline-making push to acquire Greenland. As those moves build, the impact often depends less on the market itself and more on the internal assumptions that underpin budget rates and hedging strategy.

This report explores what's driving sterling, dollar and euro markets today – and why your organisation's internal alignment may matter as much as market moves themselves.



WHAT TO WATCH



Domestic fragility leaves sterling exposed

Slowing household demand, tight fiscal policy and rising political noise leave the UK with little momentum. Sterling moves are likely to be driven by external developments rather than domestic improvement, limiting the reliability of GBP strength as a basis for pricing or planning.



Dollar direction hinges on policy timing

US growth remains hard to judge as easing begins amid patchy data and an approaching Fed leadership change. For UK businesses with USD exposure, uncertainty complicates forecasting and outlines the importance of strategy over directional views.



Euro moves driven from outside the bloc

With growth subdued and few near-term domestic drivers, the euro enters 2026 relatively stable. Movements are more likely to reflect dollar and sterling dynamics than eurozone developments, and analysts don't expect much opportunity for currency-driven gains.



Will a fragile backdrop leave UK businesses exposed?

UK economic signals heading into Q1 follow a familiar pattern: slowing demand, cautious fiscal policy and an even more volatile political landscape. With global rate cycles diverging, sterling-linked businesses are navigating a market shaped as much by Washington as by Westminster.

ECONOMIC OUTLOOK: HOUSEHOLD SQUEEZE CAPS GROWTH

The UK enters 2026 with little improvement in its underlying fragility. GDP rose just 0.1% in the three months to September¹, following 0.7% in Q1 and 0.3% in Q2. Inflation has fallen to 3.6%² and is likely to drift lower in early 2026, largely due to sustained pressure on disposable incomes.

The Autumn Budget (Budget) offered households limited support, announcing tax threshold freezes and tight fiscal conditions, while unemployment has edged up to 5%³.



"British people simply don't have money in their pockets at the moment. Consumer debt across credit cards and car finance is rampant, leaving households more exposed to any slowdown. Unless real incomes improve, demand is likely to stay weak well into 2026."

Lloyd Eagles
Dealing Director

Reform UK's recent lead in YouGov polling⁴ and rising pressure on Chancellor Reeves add a layer of political tension to an already fragile backdrop. For businesses with sterling exposure, the risk ahead is a soft domestic market and short-lived shifts in sentiment while political noise intensifies.

INTEREST RATES: EASING BEGINS AT A CAREFUL PACE

The Bank of England (BoE) closed 2025 with a widely anticipated 25bp cut, bringing Bank Rate to 3.75%.

Bank of England⁵

Current interest rate

3.75%

Month of next fully priced in cut

June 2026

Year-end projection

3.27%

Markets expect only a shallow easing cycle through 2026, with at present only one cut fully priced in across the year as policymakers remain cautious around services inflation and a softening labour market. It seems easing has started, but the pace will remain data dependent.

1. <https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpfirstquarterlyestimateuk/julytoseptember2025>
2. <https://www.ons.gov.uk/economy/inflationandpriceindices>
3. <https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/unemployment>
4. <https://yougov.co.uk/politics/articles/53059-yougov-mrp-shows-a-reform-uk-government-a-near-certainty-if-an-election-were-held-tomorrow>
5. <https://www.lseg.com/en/data-analytics>



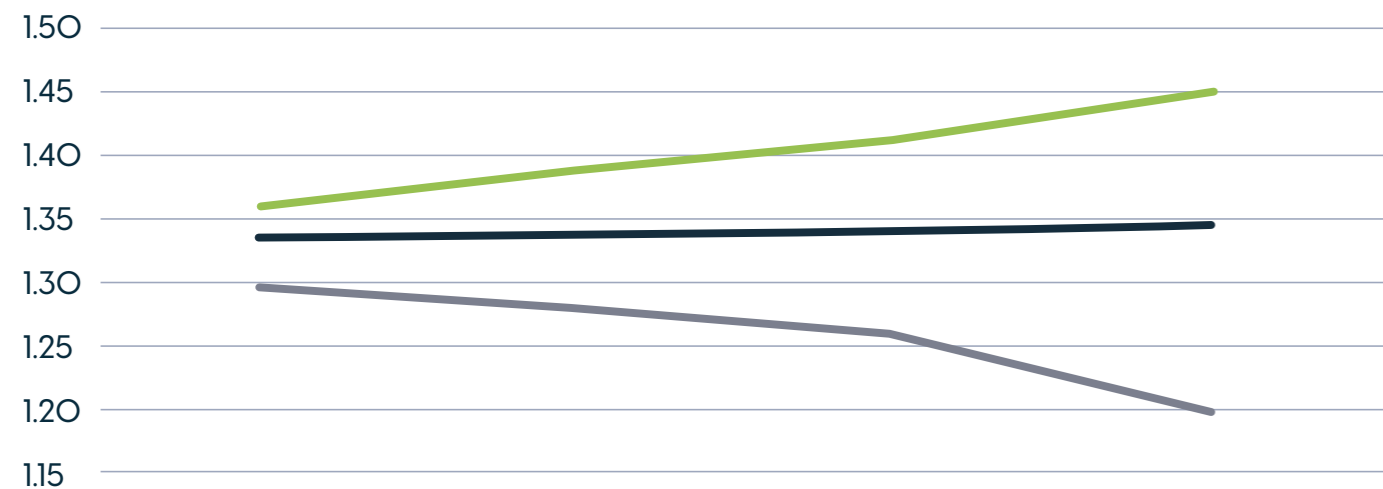


STERLING: STABILITY MASKS LIMITED UPSIDE

Sterling spent Q4 trading broadly in the low-mid 1.30s against the dollar, with a pre-Budget sell-off followed by a swift rebound once measures were announced.

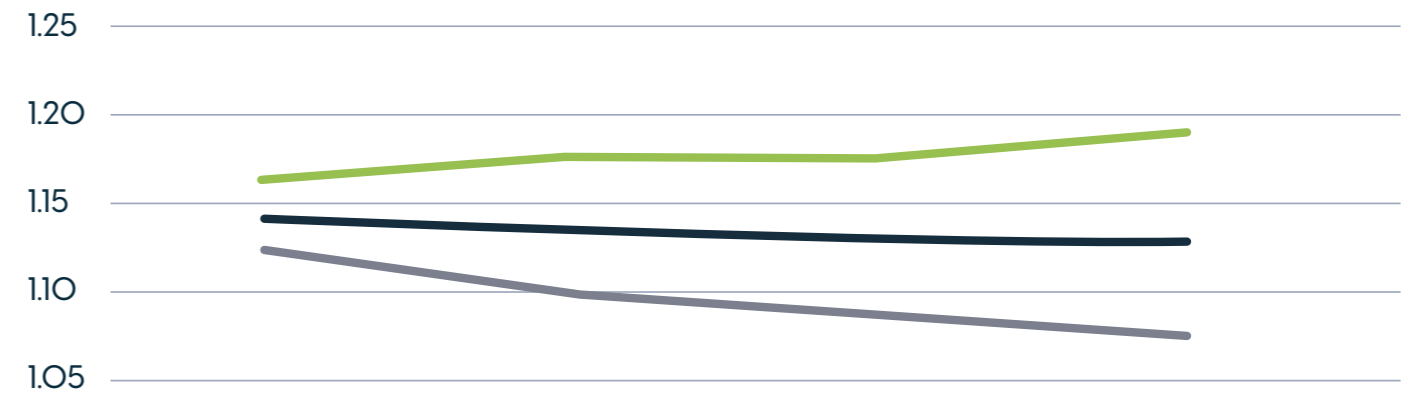
As domestic indicators remain weak into 2026, sterling's ability to build sustained momentum is limited. The dominant driver for cable is the prospect of a softer dollar as US policy loosens.

GBPUSD RATE FORECAST RANGES*



	1 month	3 months	6 months	12 months
High	1.1628	1.1765	1.1765	1.1905
Mean	1.1417	1.1342	1.1297	1.1276
Low	1.1236	1.0989	1.0870	1.0753

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Against the euro, sterling continues to trade within a narrow multi-year range around recent levels, with little in upcoming ECB policy to break that pattern in the weeks ahead. For

companies with sterling exposure, early-2026 movements are likely to remain externally driven.

KEY BUSINESS HIGHLIGHTS

- 1** Soft demand limits sterling support as the cost-of-living bites
- 2** BoE cuts stay slow, with 1–2 cuts priced in for 2026
- 3** For sterling-exposed businesses, **Q1 movements are expected to be brief and sentiment-driven**; staying prepared remains essential

*Source: LSEG FX forecasts reflect mean institutional predictions of interbank rates. They are not indicative of live nor guaranteed rates available for transactions. Economic data is subject to revision and market conditions change rapidly.



What does the dollar's direction mean for 2026 planning?

The dollar enters 2026 with its episodic strength fading. Last year's tariff-related swings proved short-lived, with markets increasingly discounting Washington's "threat-and-climbdown" pattern, and two rate cuts already in place. What will matter for USD pairs early this year is how the Fed manages the next stage of easing ahead of its mid-year leadership transition.

ECONOMIC OUTLOOK: MOMENTUM HARD TO READ

Growth still appears resilient after a 3.8% GDP rebound in Q2⁶, but visibility has deteriorated: the federal government shutdown in October halted data collection for Q3.

Previous data and experts point to softer momentum. Unemployment rose to 4.4% in September⁷ and CPI is running at 3% year-on-year, with monthly price pressures easing in September and expectations it will continue to lower into 2026⁸.

This combination – slower hiring and gradual disinflation – leaves the true strength of the US economy difficult to judge, complicating Q1 budget rates and hedge timing for firms with dollar exposure.



"It seems markets are becoming more familiar with the way President Trump communicates policy, leading to reduction in some of the sharp, short-lived swings we saw earlier in 2025. Even so, volatility will remain higher next year than in 2024, given the broader geopolitical backdrop."

Jamie Jemmeson
Head of Structured Products

INTEREST RATES: BACK-TO-BACK CUTS SET TONE

The Federal Reserve (the Fed) delivered a second rate cut in December, following September's initial move, to a range of 3.50 - 3.75%⁹. Policymakers have indicated scope for at least one further reduction in early 2026, perhaps two.

Federal Reserve¹⁰

Current interest rate
3.5–3.75%

Month of next fully priced in cut
June 2026

Year-end projection
3.10%

How quickly the Fed moves from here will hinge on whether price pressures stabilise and growth cools further, and the pending change in Fed leadership mid-2026. The key variables lie in the timing and depth of cuts, not the direction of travel.

6. <https://www.bea.gov/index.php/news/2025/gross-domestic-product-state-and-personal-income-state-2nd-quarter-2025-and-personal>
7. <https://www.bls.gov/news.release/pdf/empst.pdf>
8. <https://www.bls.gov/news.release/cpi.nr0.htm>
9. <https://www.federalreserve.gov/newsevents/pressreleases/monetary20251210a.htm>
10. <https://www.lseg.com/en/data-analytics>

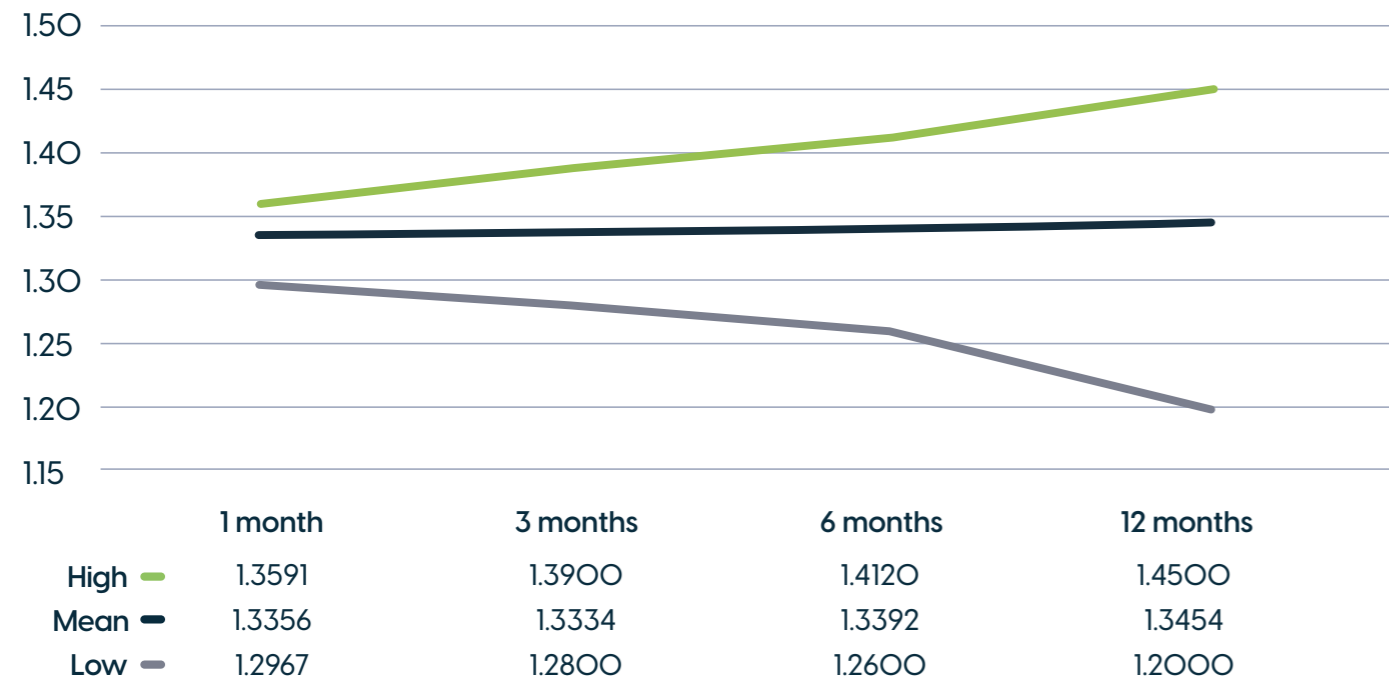




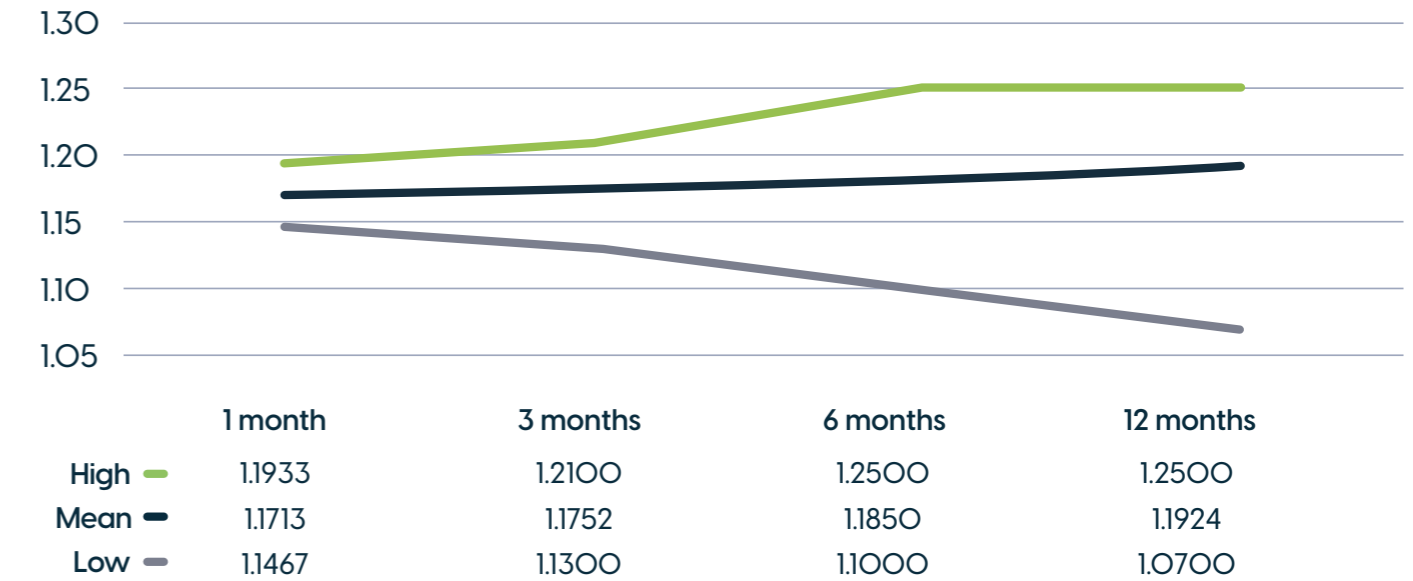
DOLLAR PERFORMANCE: SOFTER DOLLAR LEADS MAJOR PAIRS

2026 is a softer start for the dollar after two Fed cuts and a shift away from the peak-USD environment that dominated the last two years. Forecasts for cable cluster in the mid-1.30s, pointing to a weaker dollar throughout the year. Both cable and euro-dollar are expected to be driven primarily by US-side dynamics.

GBPUSD RATE FORECAST RANGES*



EURUSD RATE FORECAST RANGES*



With volatility still elevated and budgets being finalised, locking in portions of expected flows early – rather than waiting for clarity – remains the most reliable way to protect margins as US-driven moves dominate FX markets.

KEY BUSINESS HIGHLIGHTS

- 1 Growth outlook clouded by **missing data and rising unemployment**
- 2 **Interest rates expected to ease further in 2026**
- 3 **Mid-2026 Fed leadership change may add an additional policy variable** for firms with USD exposure



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Could a steady euro meaningfully reduce FX risk?

A muted eurozone outlook sets the tone for Q1 – most focus remains on external drivers, with defence investment emerging as a key meaningful domestic variable to watch.

ECONOMIC OUTLOOK: DEFENCE SPEND OFFERS HOPE

The bloc economy appears to be ticking over rather than accelerating. Euro-area output grew 0.2% in Q3 and 1.4% year-on-year¹¹ – enough to avoid recession, but not enough to drive meaningful change. Inflation has eased to 2.2%¹², close to the European Central Bank's (ECB) target, reflecting subdued demand rather than renewed strength in the economy.

Analysts are closely watching defence spending as geopolitical pressure requires Europe to shoulder more of its own security burden. If this results in faster-than-expected GDP growth, we're likely to see the funds flow most visibly through Germany's industrial supply chain.



"If Germany is pushed to accelerate defence capability, the effects would extend well beyond defence firms – you'd expect wider industrial supply chains and regional confidence to lift too. It's one of the few developments that could shift the eurozone from flat to mildly supported."

Jamie Jemmeson
Head of Structured Products

Into 2026, demand conditions across the eurozone are likely to remain steady but subdued.

INTEREST RATES: ECB HOLDS STEADY

The ECB enters 2026 with policy on hold, keeping the deposit rate at 2% after completing its 2024 easing cycle. With inflation close to target but wage growth still firm, markets see no cuts priced for the year ahead, leaving the eurozone as the least reactive of the major central banks.

European Central Bank¹³

Current interest rate

2.00%

Month of next fully priced in cut

None set

Year-end projection

1.93%

As the BoE and Fed move gradually lower, the policy gap will continue to narrow – a dynamic that typically lends the euro quiet support in cross-border planning and FX risk assessments.

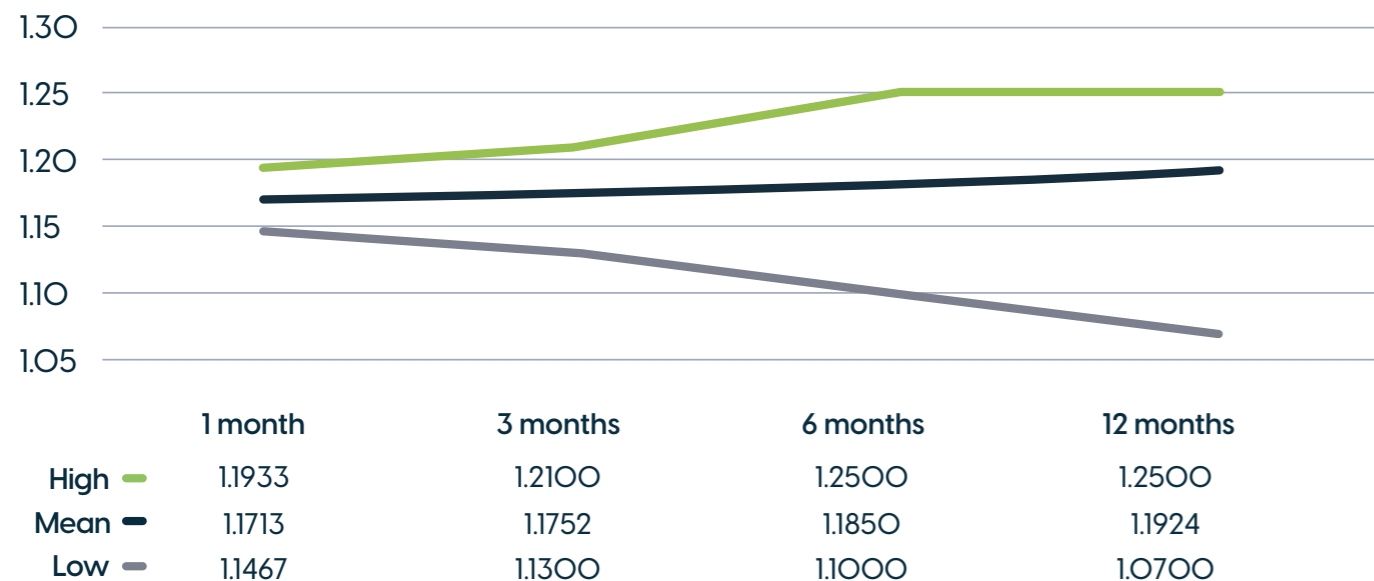
11. <https://ec.europa.eu/eurostat/web/products-euro-indicators/w/2-30102025-ap?>
12. <https://ec.europa.eu/eurostat/web/products-euro-indicators/w/2-02122025-ap>
13. <https://www.lseg.com/en/data-analytics>



EURO PERFORMANCE: DOLLAR WEAKNESS DRIVES SMALL GAIN

EUR/USD climbed back toward the mid-1.16s in late 2025, completing a roughly 10% recovery over the year as markets priced a softer US dollar¹⁴.

EURUSD RATE FORECAST RANGES*



Most major institutions expect this drift to continue through 2026 as the Fed eases and the ECB stays parked, with some projecting 1.20–1.24 in a soft-dollar environment. But conviction is thin.

pairs remains unusually low. For businesses with euro exposure, conditions may favour disciplined hedging around budget levels rather than positioning for further dollar weakness.

Eurozone momentum is subdued, foreign demand is weak and volatility across euro

KEY BUSINESS HIGHLIGHTS



1 GDP grew 0.2% keeping demand conditions soft

2 Interest rates held and no cuts are priced in for 2026

3 EUR/USD shifts are likely to be dollar-led, reinforcing the benefits to businesses of base pricing and budgets on secured rates



*Source: LSEG FX forecasts reflect mean institutional predictions of interbank rates. They are not indicative of live nor guaranteed rates available for transactions. Economic data is subject to revision and market conditions change rapidly.

14. <https://tradingeconomics.com/euro-area/currency?>

Internal misalignment could be your largest currency risk in 2026

By Lloyd Eagles



FX risk is now embedded in most commercial decisions UK firms make, yet many are entering 2026 without a single source of truth for how that exposure should be created, measured or protected.

The cost of that internal misalignment isn't visible on a Bloomberg screen, but it shows up quickly in margins.

Most organisations expect market volatility. A typical year still delivers a 10-15% range in sterling-dollar – a £100,000 swing on a \$1m exposure. What many don't anticipate is how internal behaviour can amplify that risk long before the market does.

THE COST OF FX SILOS

When pricing, procurement and treasury teams base exposure on different assumptions – or cost contracts against different budget rates – the business begins, unintentionally, to run competing FX strategies. That divergence, rather than market movement itself, is often what turns routine currency fluctuations into margin erosion.

The root cause is almost always the same: governance, not markets.

In many organisations, there is no single owner of FX risk. This lack of leadership means no defined risk appetite and no agreed methodology for setting internal planning rates which govern commercial decisions from pricing to hedging. In that vacuum, competing objectives and assumptions multiply.

This internal misalignment compounds over time, quietly reshaping the exposure the business thinks it has.

Sales teams end up costing multi-month contracts on one outdated costing rate while procurement commits to suppliers at spot. Meanwhile, finance plans performance on HMRC's monthly exchange rate, which bears no relation to either.

Treasury is then asked to hedge an exposure that no longer reflects the business's commercial reality. The result is not one FX position but several; each pulling the business in a different direction.

So, despite believing they have minimised FX risk because they are hedged, firms quickly discover the margin they think they are protecting no longer exists.

Once internal assumptions have eroded the economics, little room is left to secure rates on the firm's terms. The hedge merely ends up protecting what is left.

ALIGNMENT IN PRACTICE

For firms entering 2026 – a year where uncertainty is already priced into boardroom thinking – there is a significant advantage in eliminating any internal volatility.

But this isn't achieved simply by hedging more or watching markets more closely. It's by defining, in advance and across the business, the economics you are trying to protect...and then ensuring every FX decision is anchored to that definition.

Without this alignment, even the most carefully constructed hedging strategy simply reinforces inconsistencies that have already taken root in the business.

Effective FX frameworks tend to have clear senior ownership and board-level agreement on how it should affect margins, volatility and growth. Risk appetite is usually defined in commercial terms – how much margin volatility the business is prepared to tolerate – and used to set a set of internal reference rates that govern behaviour. For example:

- Budget rates carry explicit tolerance ranges, so movement beyond them triggers action rather than discussion.
- Hedge coverage follows forecast certainty, not market views, translating those assumptions into realised outcomes.
- Treasury's role is execution within agreed parameters, not reactive judgment calls made in isolation.

Once developed, your framework should be stress-tested against adverse FX scenarios by modelling the impact on cash flows and margins. You can then assess whether your parameters clearly dictate when to absorb, hedge or reprice currency moves.

The firms that do this should enter 2026 not just hedged against surprises, but positioned to exploit them, offsetting currency revenues and costs with faster decisions and healthier margins.

Currency strategy, tailored to your business

Award-winning currency risk management specialist, providing bespoke FX solutions to over 2,500 businesses across the globe.

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