Market Spotlight

Market Spotlight is our publication
that looks at key market drivers

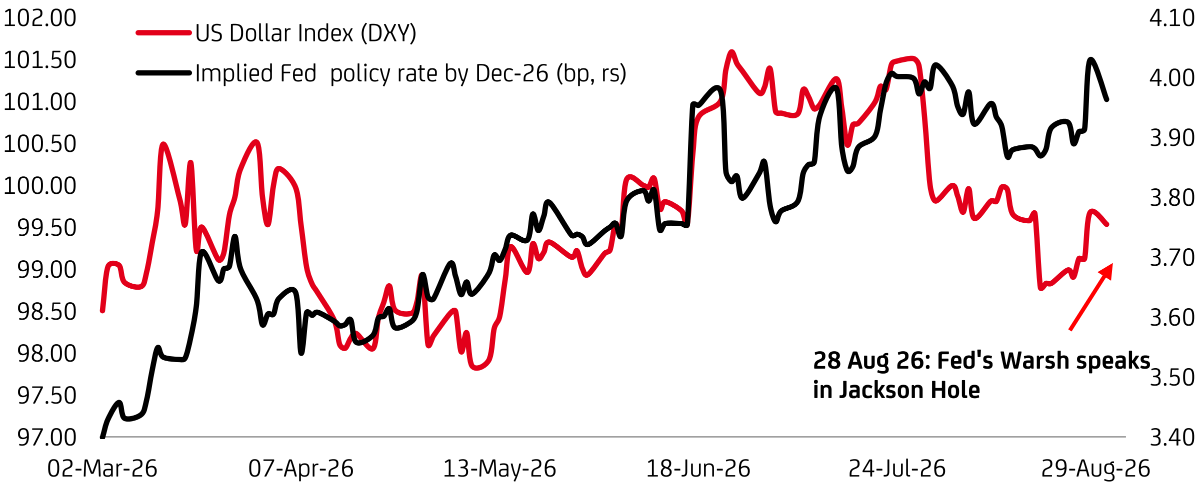
USD: What if the US Treasury and the Fed collide?

31 August 2026

Fed Chair Kevin Warsh's implicit warning at Jackson Hole that further rate hikes may be needed could complicate Treasury efforts to manage the rising US debt burden. Although the USD has gained from the repricing of overly dovish rate expectations, a collision between fiscal and monetary policy could emerge as a medium-term drag on the currency.

THE USD HAS APPRECIATED AS MARKETS HAVE REPRICED RATE-HIKE EXPECTATIONS AFTER WARSH

US DOLLAR INDEX (DXY) AND FED FUNDS LEVEL IN DECEMBER, AS CURRENTLY IMPLIED BY FORWARD RATES



Source: LSEG, The Investment Institute by UniCredit

THE NOISE ...

The still-hawkish stance of Fed Chair Warsh in his keynote speech at the Jackson Hole Economic Symposium last Friday – stating that “the Fed has work to do” – threatens to put US fiscal and monetary policies on a collision course if opposing objectives are pursued regarding the direction of interest rates in the run-up to the US midterm elections (on 3 November).

This risk may represent a negative medium-term factor for the USD – potentially triggering fresh “sell America” trades or resuming the de-dollarization story, with gold once again serving as a natural alternative to the US currency – thereby reversing the USD’s moderate appreciation sparked by “harsh Warsh” last Friday.

... AND THE SIGNAL

The US budget deficit is on track to reach 6.3% of GDP this year. US public debt has surpassed the record threshold of USD 40tn, reaching its highest level since the end of WWII as GDP ratio. Given this backdrop, it is reasonable for the US Treasury to seek to limit the damage, with the primary goal of reducing borrowing costs and flattening the UST yield curve – particularly at the long and ultra-long ends (i.e., 10Y, 20Y and 30Y maturities).

This rationale underpins the buyback announcement made on 19 August; the operation is set to begin on 9 September and conclude on 4 November – the day after the midterm elections. The US Treasury intends to finance the operation via a "twist" across the curve's maturity, with purchases of long and ultra-long-term US Treasuries to be funded by issuing short-term bills. This strategy could become complicated if the Fed were to start hiking rates in the meantime. However, the US Treasury could still draw on the Treasury General Account (TGA, the operating account held at the Fed), which stands at approximately USD 950bn – instead of issuing new securities.

The USD's reaction has been exactly as expected, as Warsh's speech has forced investors to reprice expectations regarding US monetary tightening – correcting the excessive optimism regarding limited rate-hike prospects following a series of weak US macro-data releases earlier this month. The US forward curve has returned to pre-August levels and a hike by December is fully priced in, as shown in the chart above.

That said, forward curves are unlikely to price in more aggressive monetary moves unless US data surprise sharply to the upside or the Fed signals an even more hawkish stance regarding the timing and magnitude of its tightening strategy. This is probably why the USD has risen, albeit modestly, as markets have so far merely adjusted expectations for a moderate tightening rather than returning to pricing in a particularly aggressive one. EUR-USD has dipped to a low of just 1.1573 after a monthly peak of 1.1711, while USD-JPY is back around 160, roughly five big figures above the low of 155.24 reached after the joint BoJ and US Treasury intervention at the end of July.

However, the risk of a collision course between US fiscal and monetary policies may increase significantly if they were to pursue opposing goals on interest rates. This could act as a headwind for the USD in the medium term – regardless of signs of potential escalation in the Middle East – by further fuelling "sell America" trades and the de-dollarization process. This involves moving out of the greenback into real assets (such as real estate,) safe-havens (like gold and silver) and – at the extreme end of the spectrum – Bitcoin and cryptocurrencies.

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