Article | 3 September 2026 FX

FX Daily: Nervousness continues

The FX space was shaken by a sharp move in USD/JPY yesterday, which prompted intervention fears. Today's calendar includes US ISM services. Our view remains that risks are mostly on the upside for the dollar. Czech wages numbers and Turkish August inflation test hawkish pricing

August inflation figures are due in Turkey today

USD: Upside risks persist

A sharp jump in the yen yesterday, potentially due to another intervention (more in the JPY section below), had a knock-on negative impact on the dollar across the board. But towards the end of the session, only currencies backed by positive domestic stories (AUD, CAD) had hung onto gains, with the move fading elsewhere.

On the data side, ADP payrolls came in at 38k, leaving few marks. Market conviction on a September hike decreased slightly yesterday, with pricing declining from 18bp to 15bp, but that was likely due to the oil rally stalling. Today, the ISM services report is in focus, and expected to flatten at 54.1. The bar to drive the Fed away from a September hike looks fairly high, especially for second-tier data.

We retain a preference for the upside in the dollar, as front-end rates and higher energy prices both point up. The main risk remains that higher back-end yields can prompt more interventionism by the Treasury and a revamp of the debasement trade.

Elsewhere, CAD had a rare domestic boost after the Bank of Canada delivered a hawkish hold. The bank now sees inflation risks rising on the back of the prolonged US-Iran conflict (but not tariffs) and Governor Tiff Macklem explicitly opened the door for rate hikes. Markets are pricing in 22bp by December, but we still aren't convinced. Core inflation is at target and the activity/jobs impact of the trade spat with the US can be substantial. We still expect USD/CAD to rise above 1.390 as the tariff premium remains underpriced.

Francesco Pesole

EUR: Markets look too hawkish on ECB

Our macro team has published a preview of next week's ECB meeting, when a hike is widely expected. Our take is that policymakers may be more concerned about widening European bond spreads than second-round inflation risk at this point, which argues for a less hawkish message than what markets may be expecting.

The EUR swap curve is now embedding three hikes by April 2027, which seems overly hawkish considering core inflation has remained so well behaved. But energy price increases (European TTF gas touched €75/MWh yesterday) probably argue against any dovish repricing until receiving input from the ECB itself.

We still feel risks are condensed to the downside in EUR/USD and expect a return to the 1.150-1.155 range in the near term.

Francesco Pesole

JPY: Intervention jitters linger

The near 1% fall in USD/JPY over a couple of minutes yesterday afternoon, and another slide overnight, sparked talk of another round of intervention. This follows the $96bn sold by the Bank of Japan in late July/early August. Traders seemed to doubt that this was an intervention, given the lack of dislocation in the FX electronic matching systems at the time.

US and Japanese authorities must be satisfied by yesterday's price action and keen to encourage a sense of urgency for those long USD/JPY and EUR/JPY above 160 and 186, respectively. And the Swiss National Bank will probably be happy if those pursuing carry trade strategies choose to fund in Swiss francs rather than yen.

That said, a Fed hike in mid-September looks likely to keep USD/JPY relatively bid this month and any sustainable turn lower in USD/JPY now probably requires a much more hawkish Bank of Japan and some new initiatives to encourage domestic investment in Japan.

Chris Turner

CEE: Czech wages and Turkish inflation test hawkish pricing

In the Czech Republic, markets will focus on today's second-quarter wage data ahead of next week's central bank meeting. After a strong upside surprise in the first quarter, both the market and the Czech National Bank expect wage growth to slow from 8.1%. We forecast 6.5%, below the central bank's 7.3% August projection. A softer reading could ease the market's hawkish pricing. We see a growing risk of an additional rate hike in November or later, reflecting higher global energy prices and this week's announcement of a larger-than-expected fiscal deficit for next year.

Even so, we consider the nearly 100bp currently priced in excessive. With CEE rates still closely linked to oil and gas prices, however, hawkish pricing is unlikely to fade soon. This should push EUR/CZK closer to 24.150.

Turkey will release August inflation today. We expect monthly inflation to ease from 1.8% to 1.6%, below the market consensus of a slight increase to 1.9%. Last week, the Central Bank of Turkey resumed one-week repo auctions as part of its Turkish lira liquidity-management framework, reversing the suspension introduced on 1 March. The move restores policy-rate funding at 37.0% and brought the effective funding cost back towards the one-week repo rate.

Today's inflation data may indicate whether the central bank saw scope for renewed disinflation and easier monetary conditions. For now, however, the FX regime remains unchanged, while the central bank again allowed less carry in August through a larger USD/TRY adjustment.

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