Global Markets Research

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MUFG Bank
Global Markets

USD debasement – a fleeting focus or a sign of what's to come?

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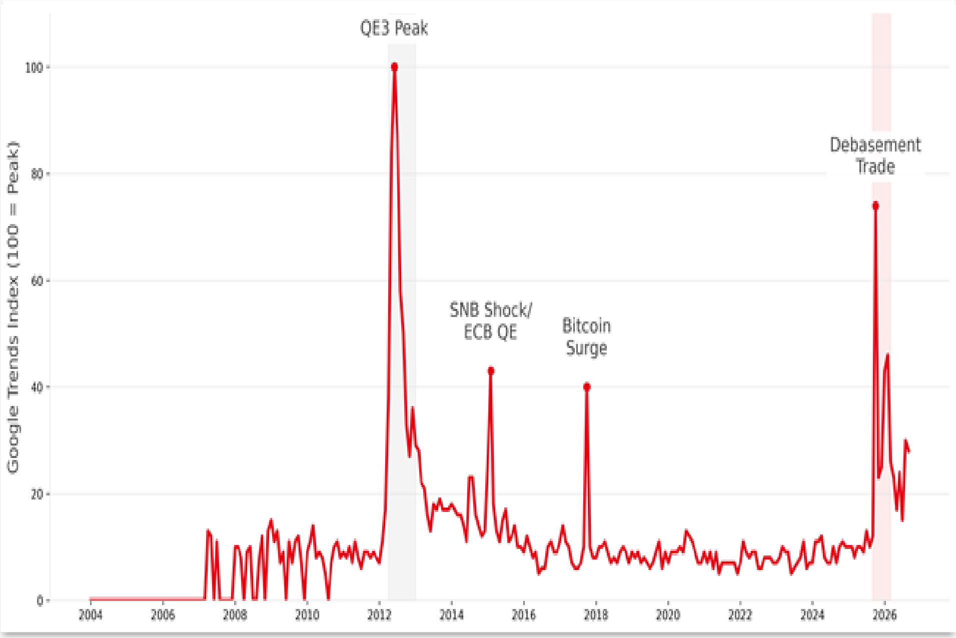
USD policy | Gold/USD correlation strengthens on debasement fears

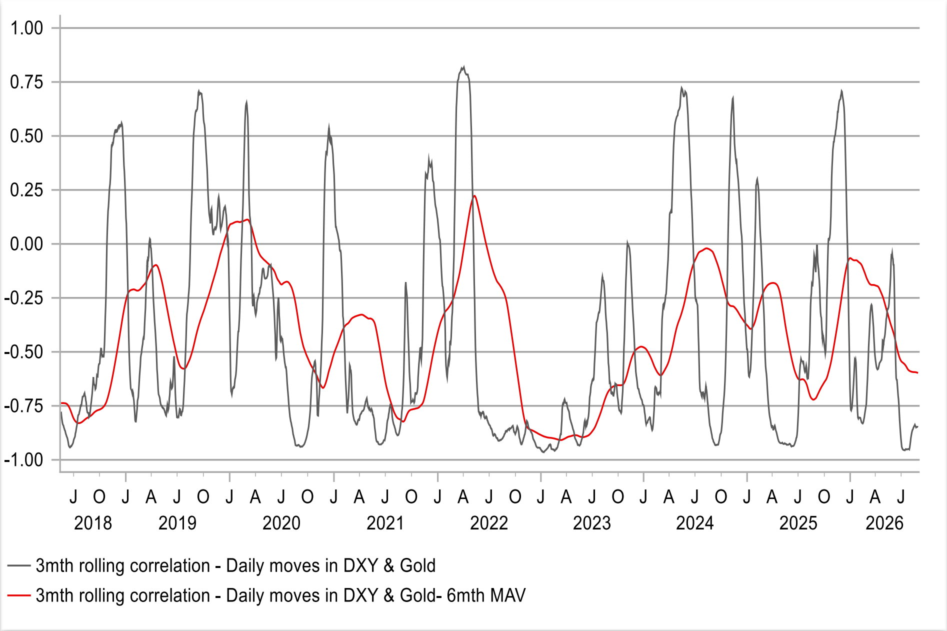
Debasement lowers the intrinsic value of a currency, through excessive monetary easing such as large-scale balance sheet expansion or persistent fiscal deficits that fuels concerns over inflation or substantial currency weakness and pushes investors into hard assets or alternative stores of value.

The USD / Gold correlation tends to be always negative but at times of "debasement" fears it usually strengthens and tends to be triggered by a policy development that raises doubts over FX objectives

Google Trends – "Debasement" mentions



Gold/USD rolling 3mth daily corr & 6mth avg



Source: MUFG GMR; Bloomberg; Macrobond Google Trends as of 1st September 2026.

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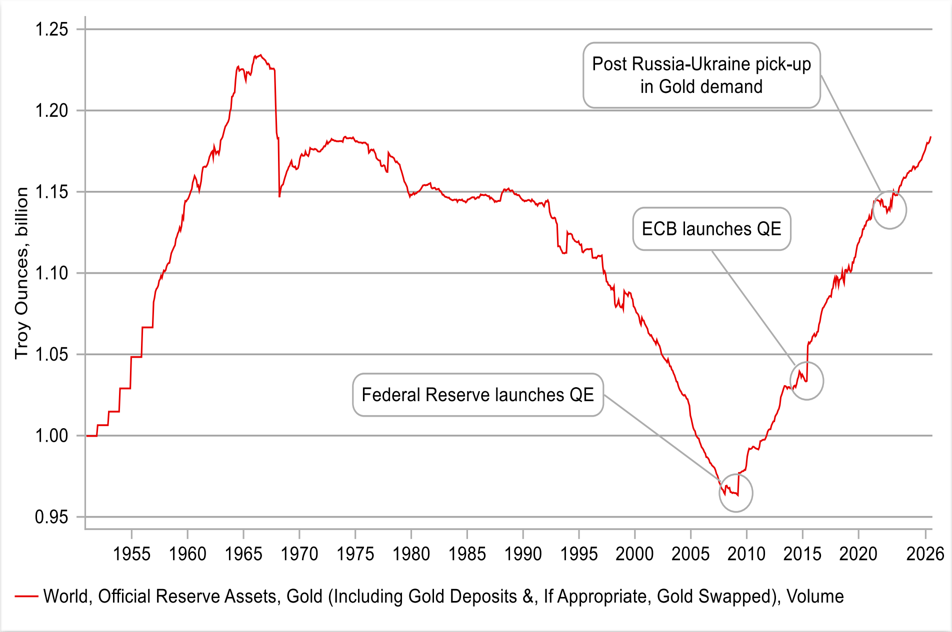
De-dollarisation | Gold demand increase coincided with QE launch

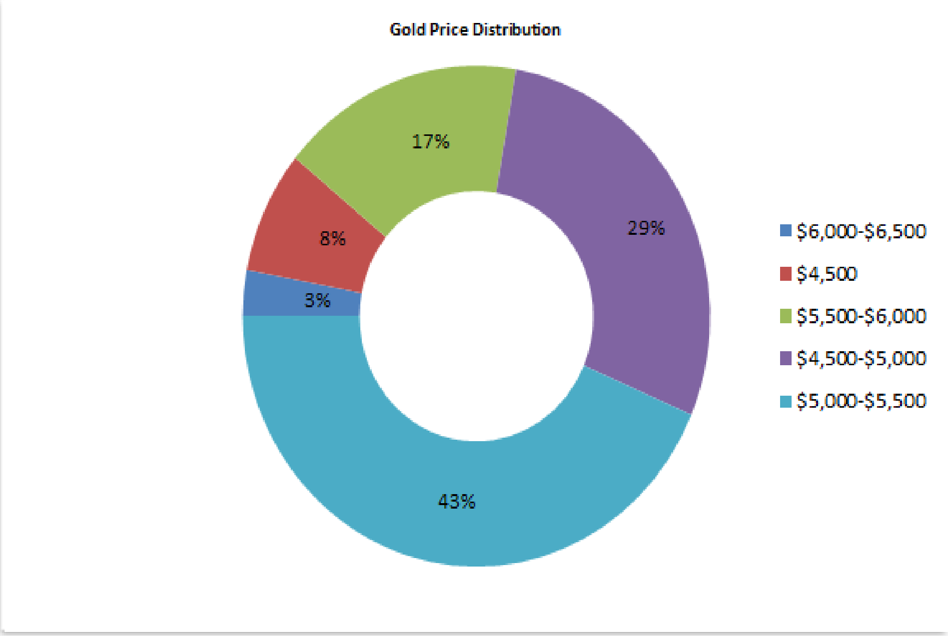
Global reserve managers turned to gold on a sustainable basis after the GFC in 2008-10 when QE became widespread & pace picked up again in 2022

Global reserve holdings of gold



OMFIF Global Public Investor survey 2026 indicated strong bullish expectations for gold price amongst key global reserve managers

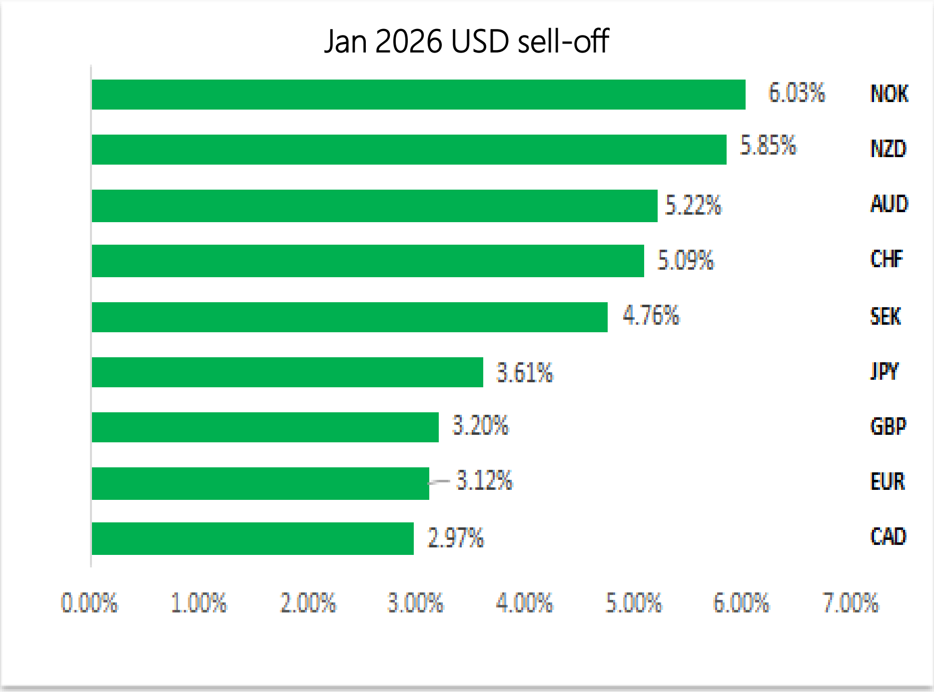
Global Public Investor Survey 2026 – expected price of gold by June 2027

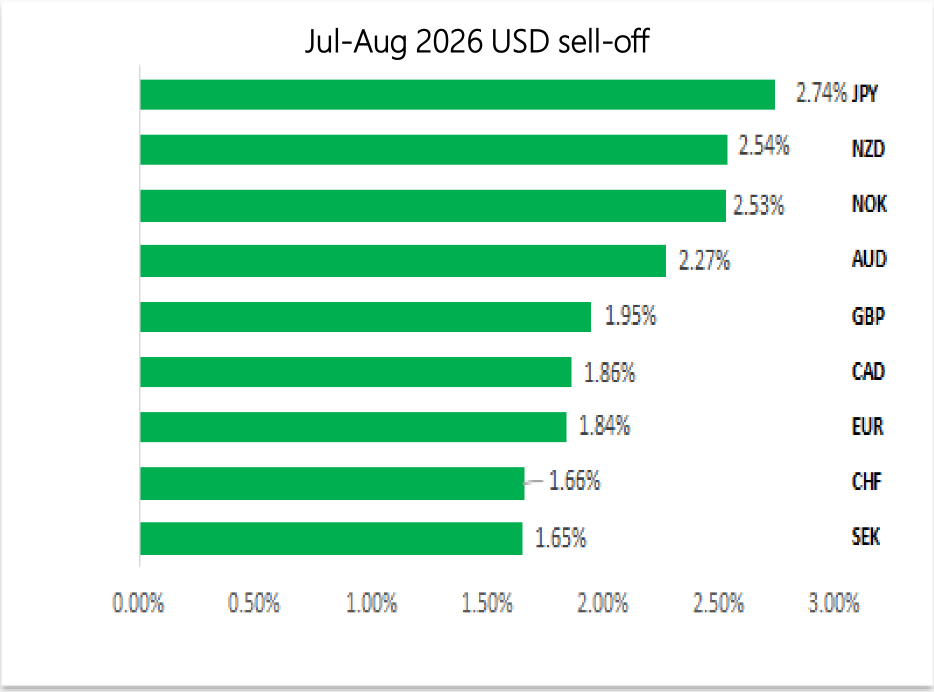


USD debasement | Two episodes when 'debasement' theme emerged

The initial trigger for renewed focus on "US dollar debasement" as a theme triggers a large initial FX reaction and usually translates to largest gains for high-beta G10 and/or commodity related FX. JPY performed well in Jul-Aug episode due to intervention

G10 FX versus USD during two episodes of renewed focus on USD debasement theme in January and Jul-Aug



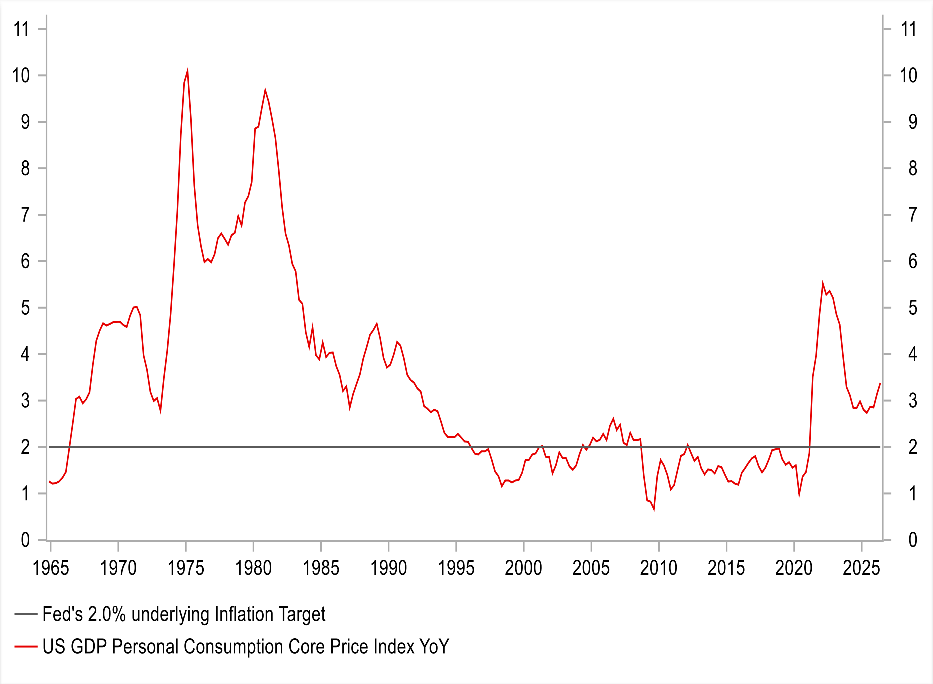


Source: Bloomberg, Macrobond MUFG GMR

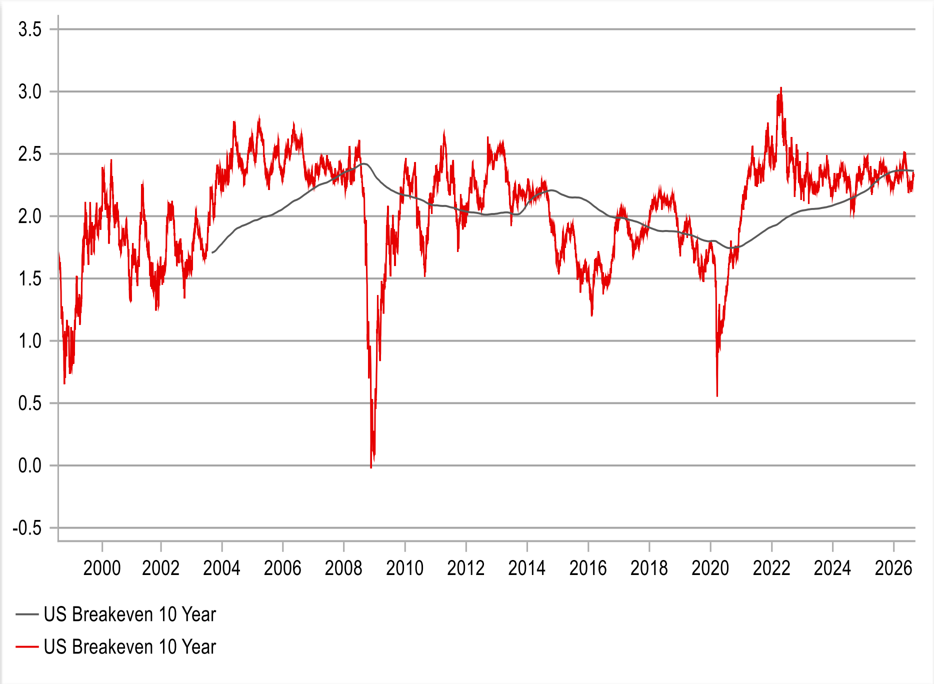
Inflation risks | Underlying sticky inflation raises debasement fears

The core PCE YoY inflation gauge has been above the 2.0% level for over 5yrs now, but long-term inflation expectations have been broadly stable but at higher levels – the 5yr avg is highest since pre-GFC

US core PCE YoY rate & Fed's inflation target



10-year US breakeven rate & 5yr moving avg

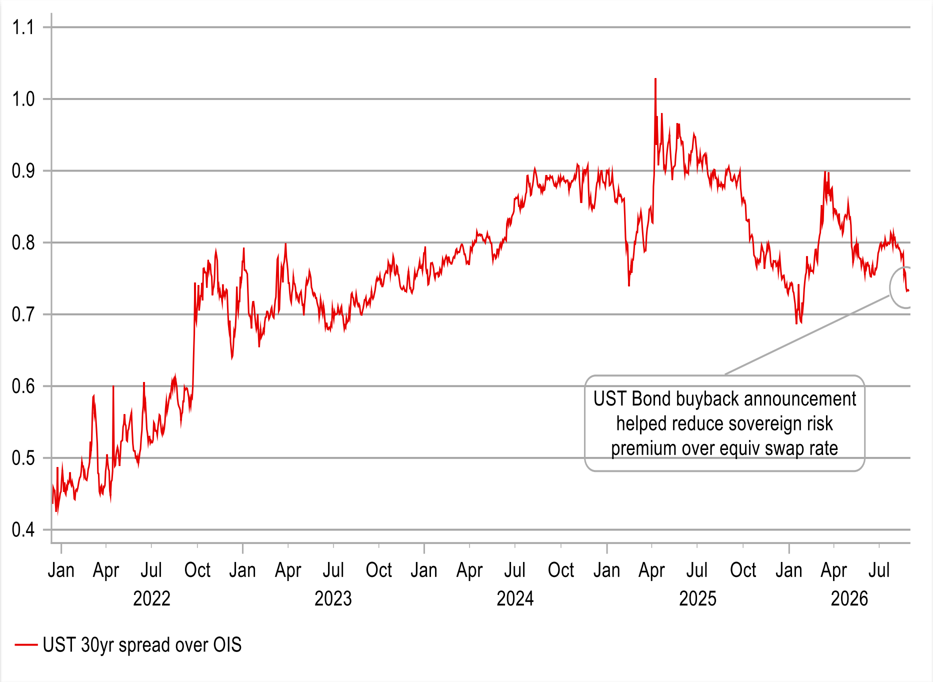


Source: Bloomberg, Macrobond MUFG GMR

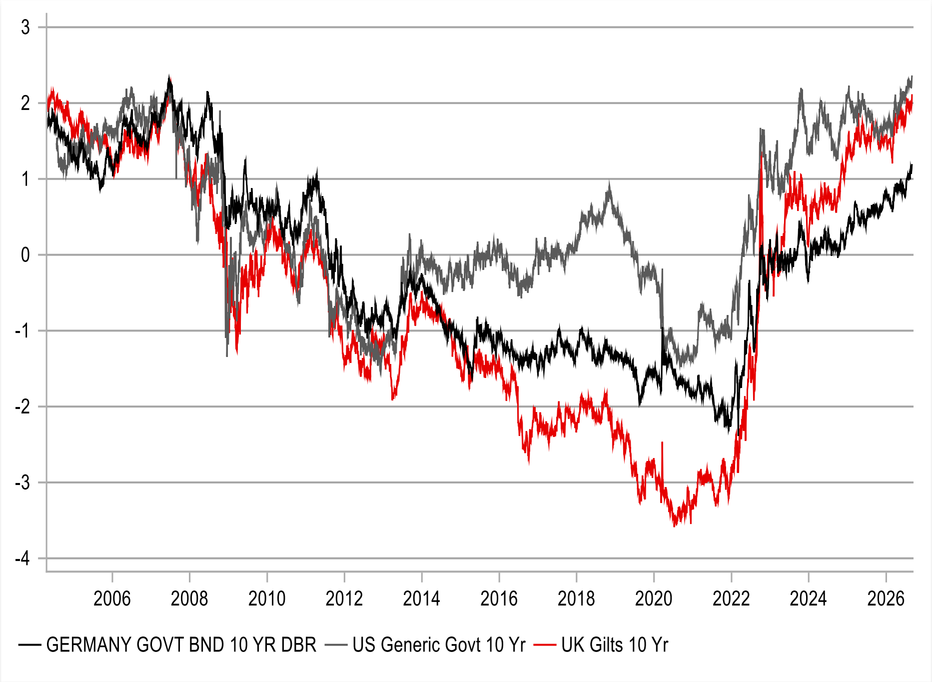
Yields | Fiscal risks have not worsened, real yields hit highs

The US sovereign 30-year yield spread over the equivalent swap rate does not indicate a recent deterioration in fiscal risks. The buyback announcement has also seen that spread narrow. Real yield rises appear related to factors other than inflation & fiscal risks

30-year UST yields over 30-year swap rate



10-year real yields – US, UK and Germany

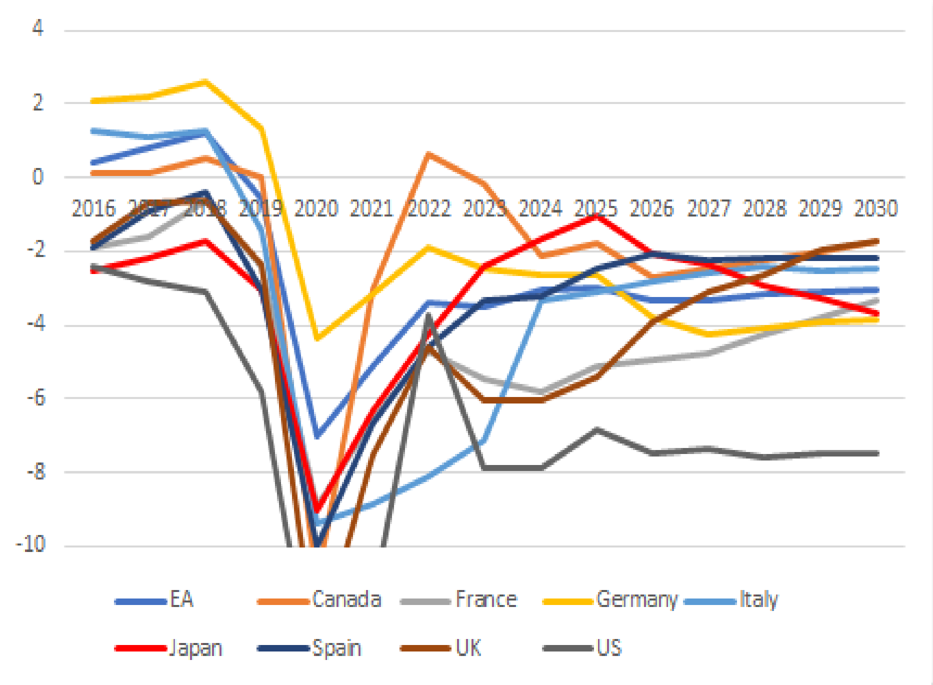


Source: Bloomberg, Macrobond MUFG GMR

USD debasement | Fiscal risks for US continue to build

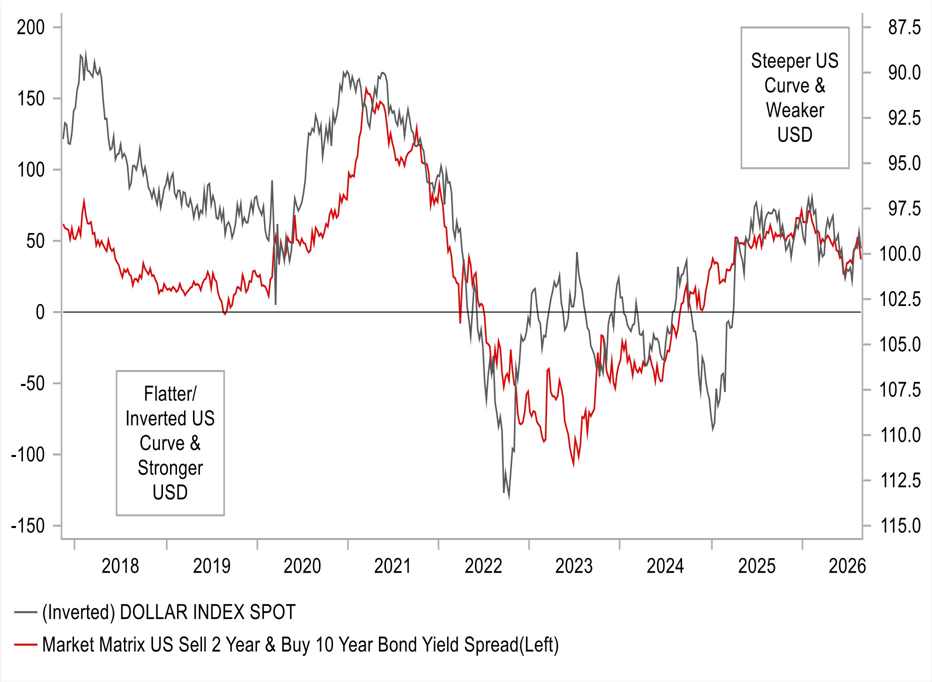
Fiscal uncertainties a key risk globally, but the US outlook remains the worst both for its primary budget and debt servicing costs

Fiscal Balances as a % of GDP for Advanced Economies



A steeper yield curve in the US seems likely (CPI decline can help contain steepening) as supply concerns sees front-end rates drop 2s10s to 80bps will weigh on USD

DXY vs 2s10s yield curve

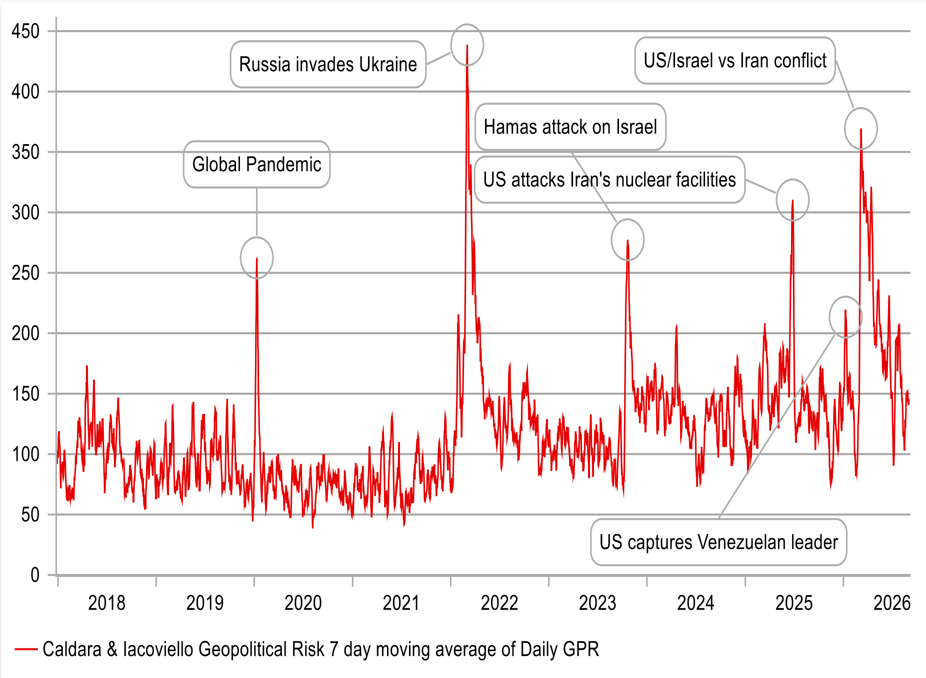


Source: Bloomberg, Macrobond MUFG GMR & IMF Fiscal Monitor April 2026

USD asset risks | Trump's policy uncertainties & USD hedging risks

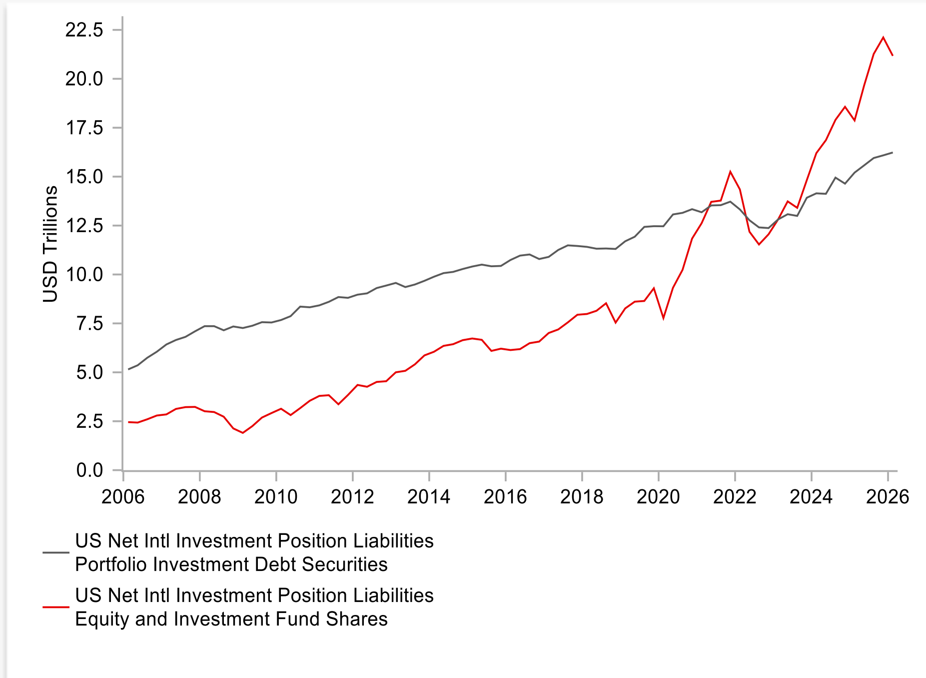
Geopolitical events have escalated under Trump 2.0 and pronounced uncertainties are set to persist

7-day moving average of geopolitical risk index & key recent geopolitical events



Foreign investors own USD 21.2trn worth of US equities and USD 16.2trn worth of US debt securities (as of Q1 2026)

Total held US portfolio assets by foreign investors



Source: Bloomberg, Macrobond & MUFG GMR

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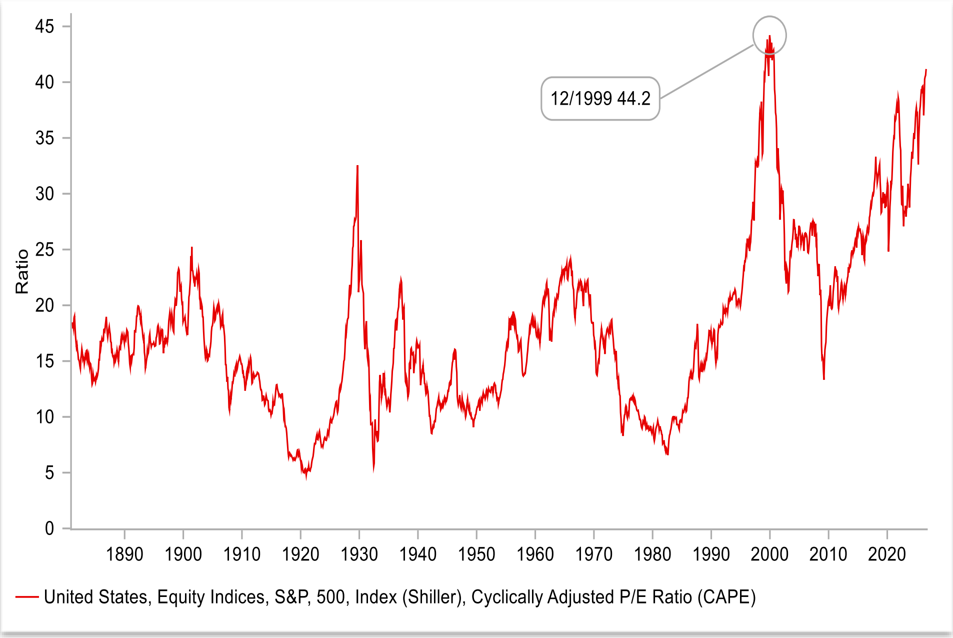
AI risks | AI-related capital demand pushing yields & valuation

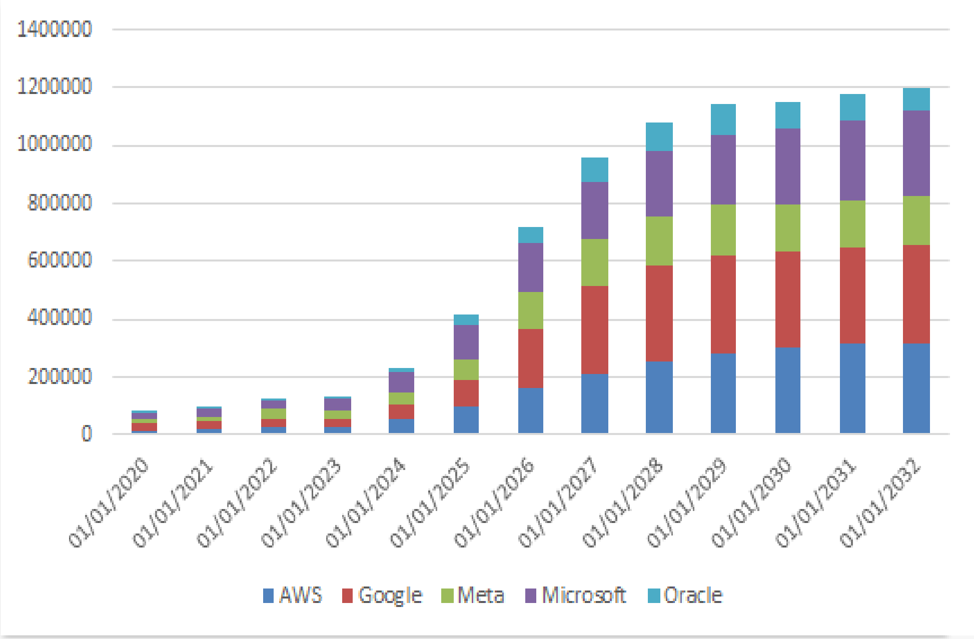
The period since Warsh FOMC communication in July has seen the largest widening of the 2s10s UST spread since period after Liberation Day

Cyclically-adjusted P/E ratio – S&P 500



US hyper-scalers are ramping up investments this year and in 2027 and modestly further through to 2032

US hyper-scalers – Top 5 investment plans through to 2032



Source: MUFG GMR; Bloomberg; Macrobond;

FOMC under Warsh | What is the Fed's reaction function?

FOMC Board of Governors


Kevin Warsh


Philip Jefferson


Jerome Powell


Lisa Cook


Michelle Bowman


Christopher Waller


Stephen Barr


John Williams

Former Fed Chair Powell unusually decided to remain on the Board of Governors after his term as Fed Chair ended. This meant that Stephen Miran was forced off the Board to make way for Kevin Warsh.

Net-net, this makes the Board of Governors a little more hawkish without Miran. However, on balance the Board of Governors remains neutral to dovish given the rhetoric of a number of Governors.

2026 Voting Fed Presidents


Beth Hammack


Lorie Logan


Neel Kahskari


Anna Paulson

Investors unclear on Fed's reaction function


Kevin Warsh

Kevin Warsh has now conducted two FOMC press conference and presented his first semi-annual testimony to Congress. The financial markets have been left with a lack of clarity over what the Fed's reaction function is. Investors fear a more laissez-faire approach by allowing market rates to do more of the Fed's work than in the past. Greater uncertainty means a large term premium, a steeper yield curve and a weaker US dollar.

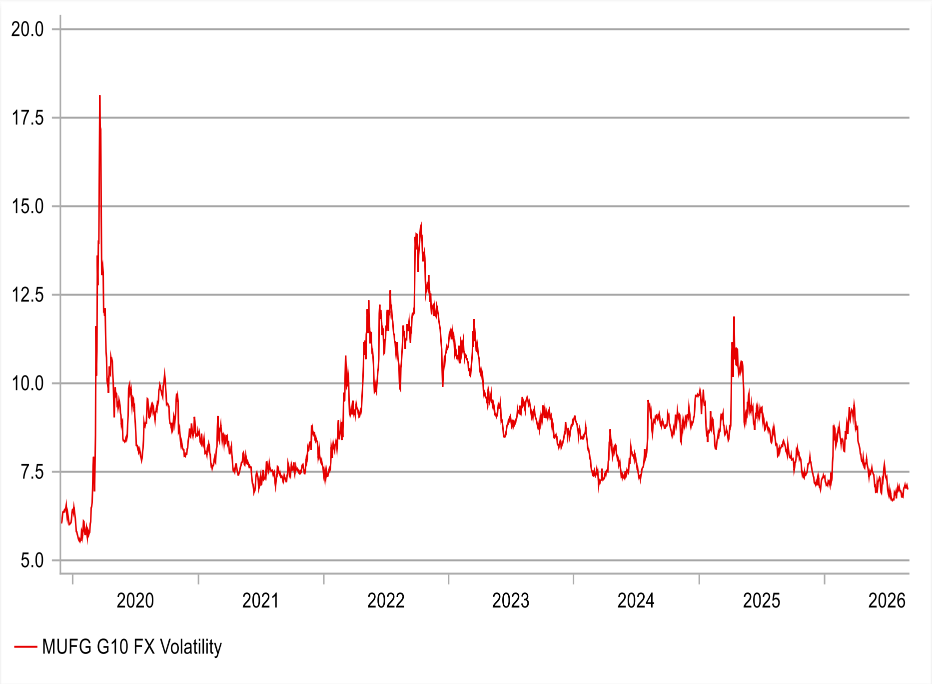
|

Source: Federal Reserve; MUFG GMR

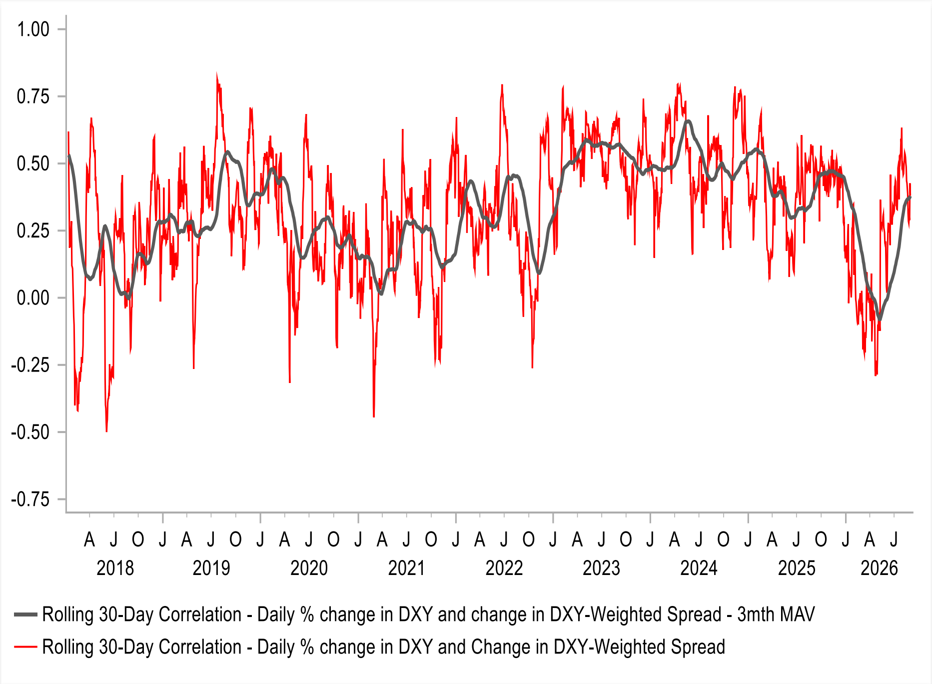
FX Drivers | Rate spreads playing a bigger role once again

Remarkably low levels of FX volatility have continued with vol now back at levels last seen prior to Russia's invasion of Ukraine. As a result, FX is again increasingly being driven by spreads as carry strategies resume

MUFG G10 FX Volatility Index



30-day rolling correlation of daily change in DXY (%) and change in DXY 2yr spread (bps)



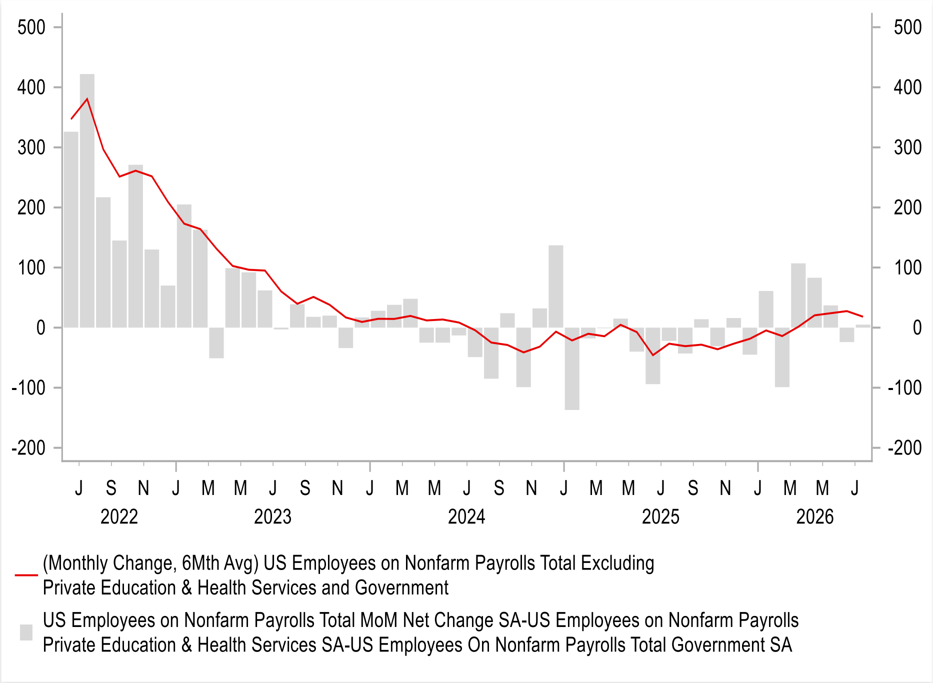
Source: Bloomberg, Macrobond MUFG GMR

US labour mkt | Underlying labour market is weak & non-inflationary

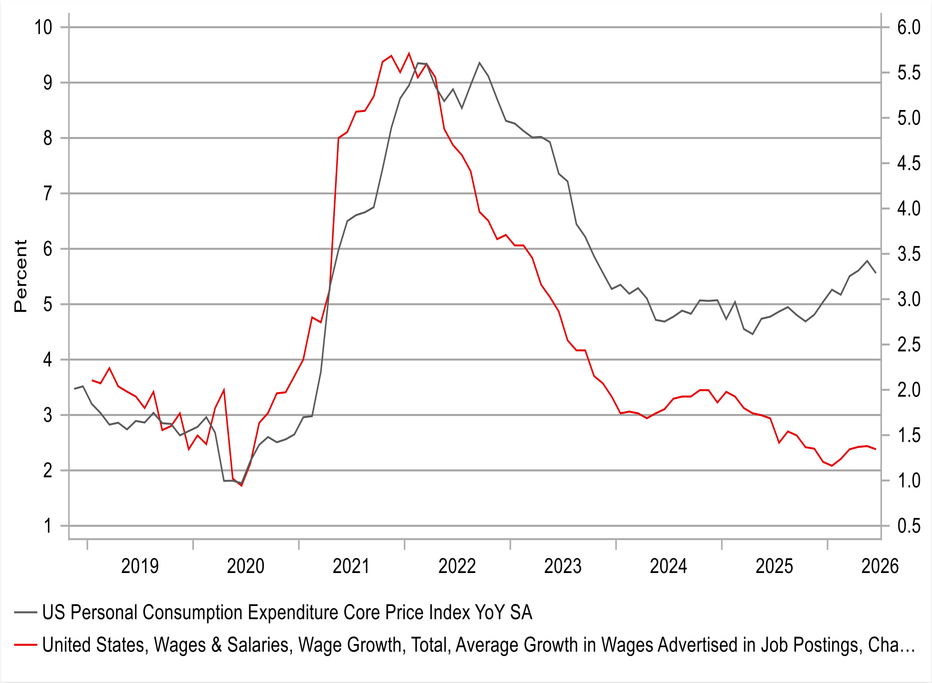
Jobs growth had temporary spurt but excluding non-cyclical employment (health & Educ) private employment growth is weak

US wage pressures have subsided given two years of more subdued employment growth and is consistent with easing inflation

Nonfarm payrolls, excluding government & health & education, & 6mth average



US Indeed Wage Growth index versus annual core PCE rate

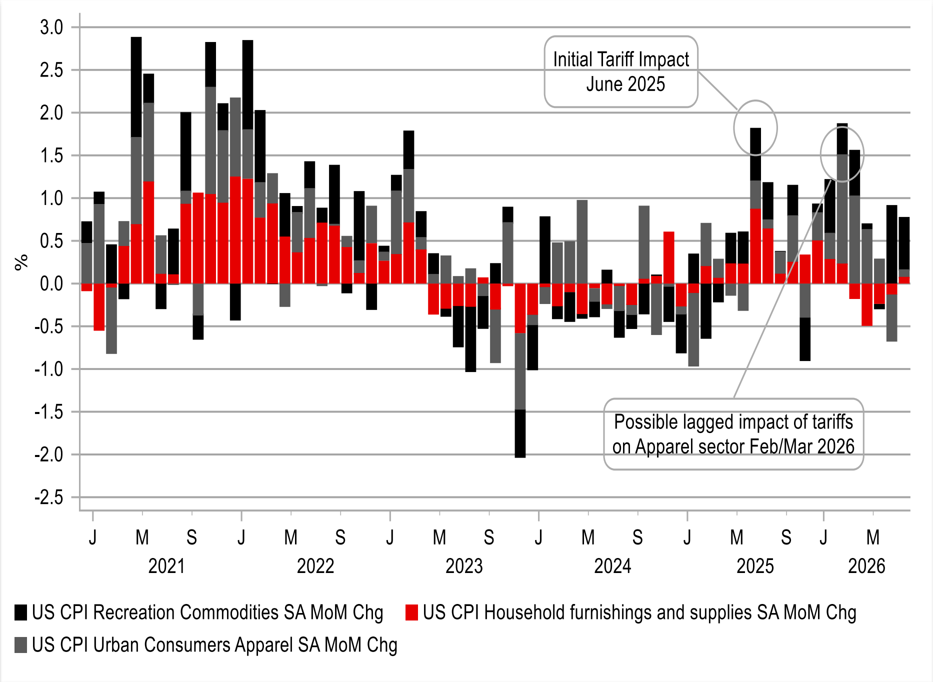


Source: Bloomberg, Macrobond MUFG GMR

US disinflation | Factors that can lower annual CPI ahead

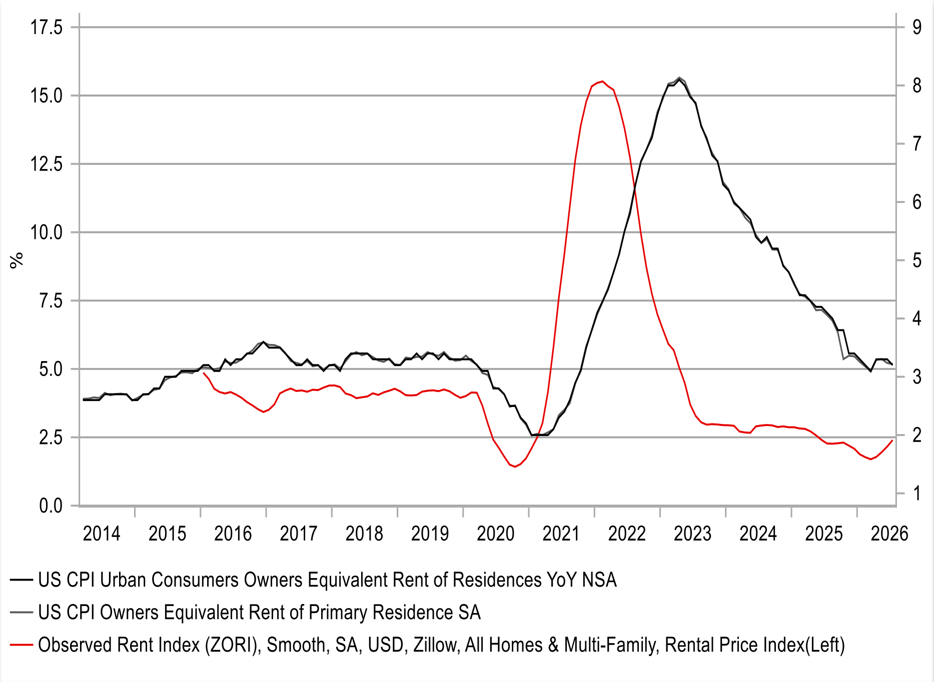
Tariff base-effect should start to unwind in June 2026 but apparel impact may have had a longer lag & will take longer to unwind

MoM change in CPI tariff-exposed sub-sectors; h/hold furnishings, recreation goods, apparel



Actual rents slowed in 2024-25 and this year hit lowest level since covid. Pass-through to CPI could shave 0.2-0.3ppt off YoY CPI

Zillow Observed Rent Index (ZORI) versus CPI Rents & OER YoY



Source: Bloomberg, Macrobond MUFG GMR

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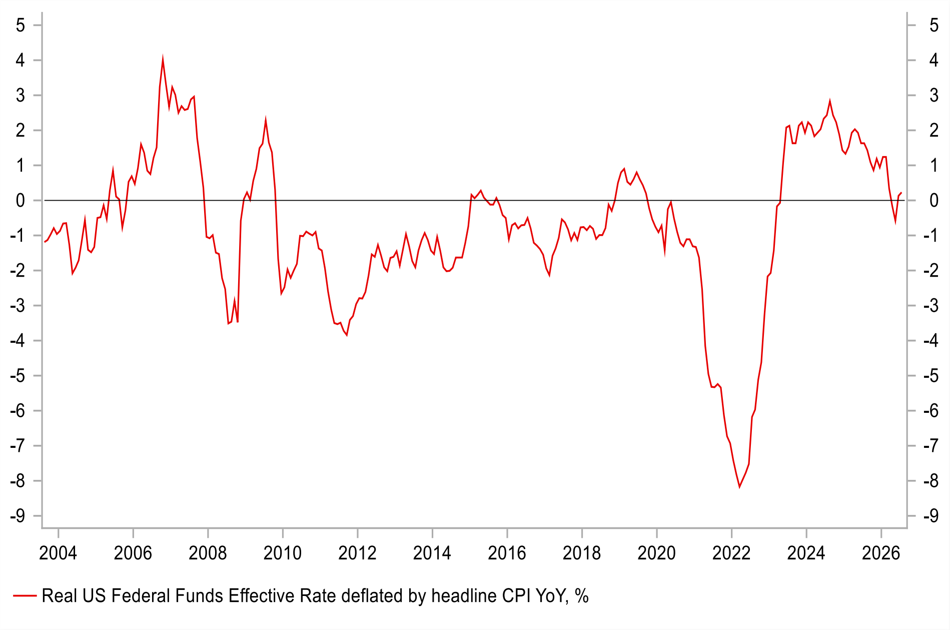
Fed policy | Debasement risk low if 2027 projections are realised

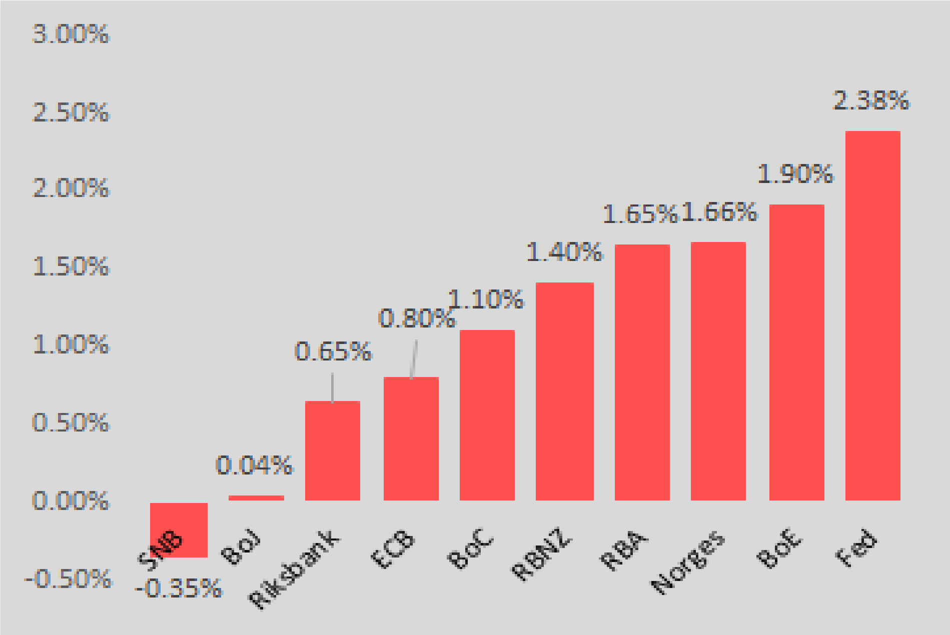
The period post-Middle East conflict has accelerated the drop in Fed real policy rate to a level that is deemed to be accommodative

.....but projecting forward to mid-2027, forward OIS rate for the Fed and the consensus for headline CPI will take Fed policy back to peak restrictive stance

Fed real policy rate



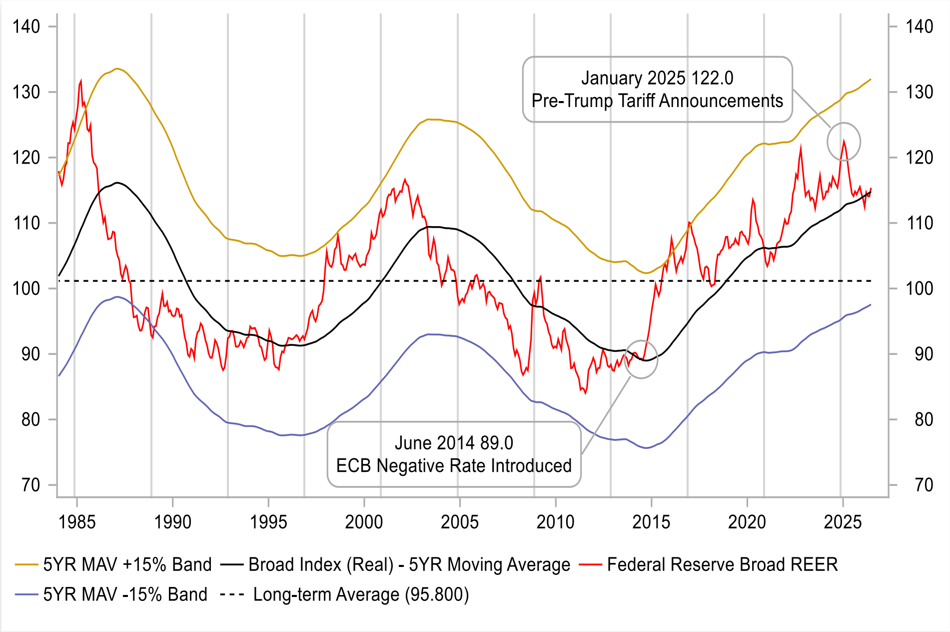
Market priced projections of G10 real policy rates



Valuation | US dollar remains over-valued

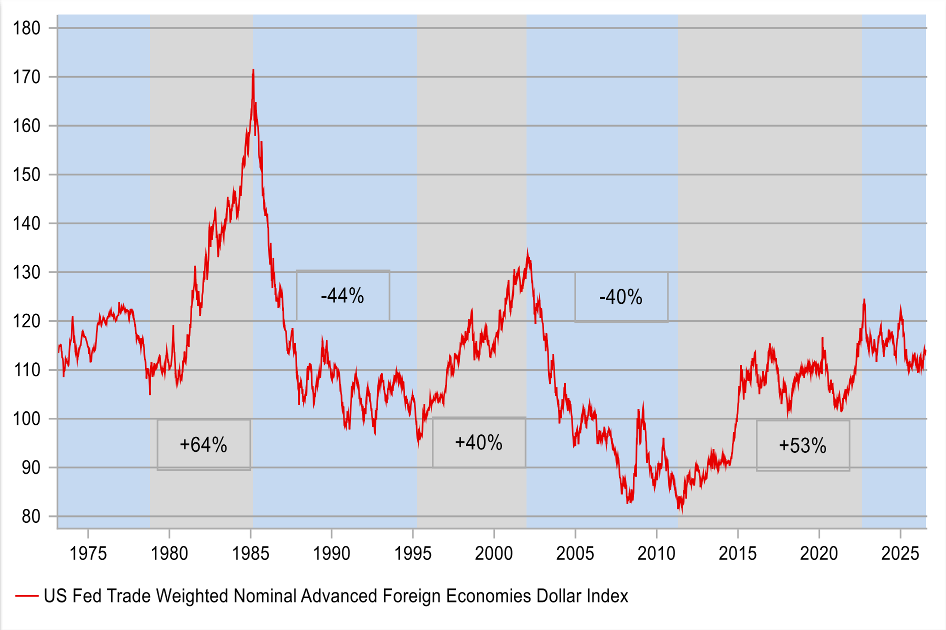
37% advance in REER over 10.5yrs to Jan 2025 has dropped just 6.4% and a further 13% fall would see the long-term average REER level reached

Fed's USD REER Index & 5yr MAV and LT Avg



Long-term USD trends go in cycles and we see the most recent peak (in 2022) as a turning point to period of USD depreciation

Fed's USD Advanced Foreign Economies Index against historical USD bull-bear cycles

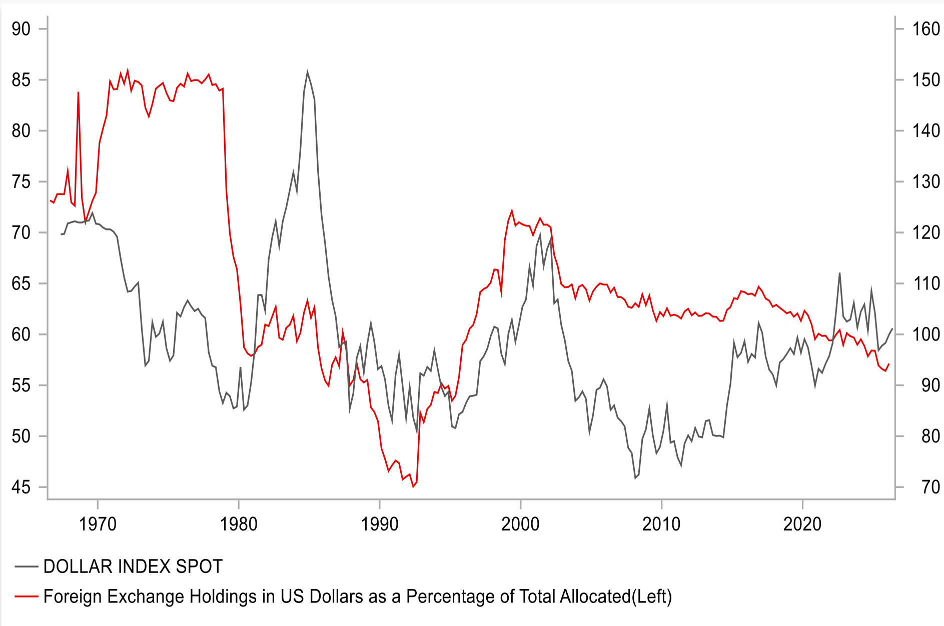


Source: MUFG GMR; Bloomberg; Macrobond

De-dollarisation | Can EUR finally take advantage?

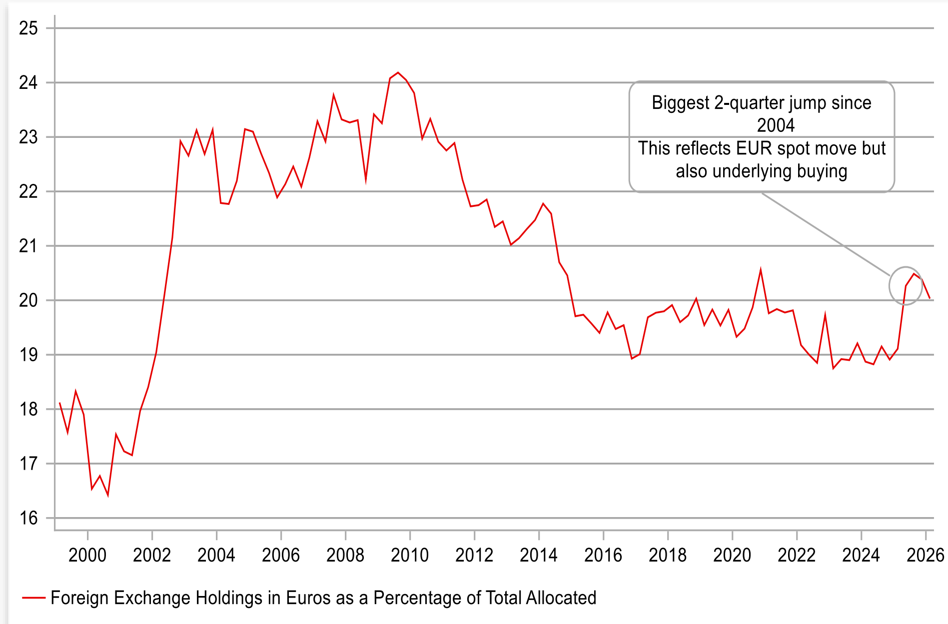
Global reserve managers have been reducing USD holdings for years and are now at lowest composition since 1995

USD composition in global reserves % USD DXY Index



EUR composition has jumped reflecting in part the surge in EUR/USD last year but also due to underlying increased buying

EUR composition in global reserves



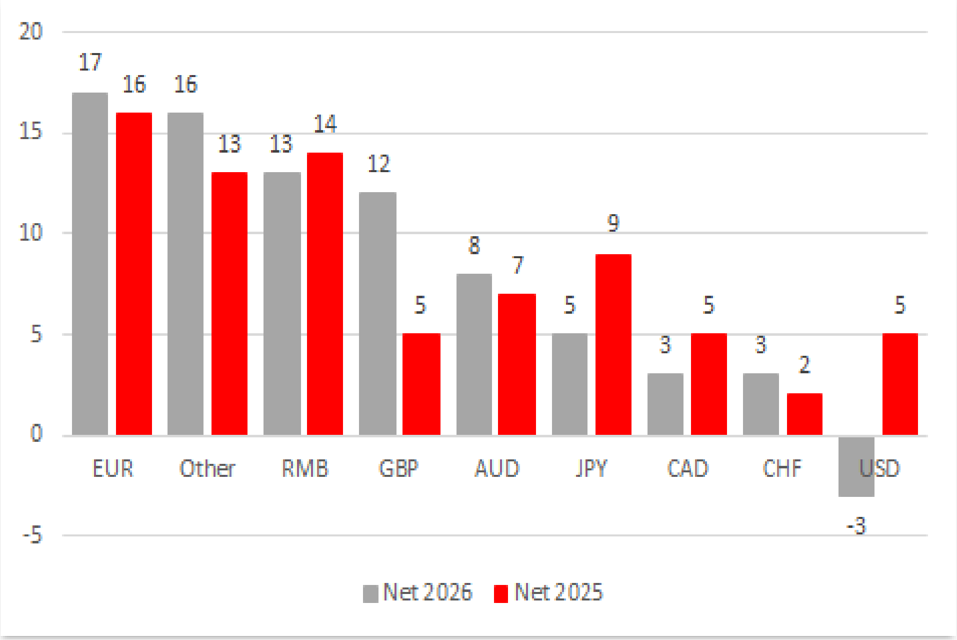
Source: MUFG GMR; Macrobond & Bloomberg

De-dollarisation | Reserve managers to continue move away from USD

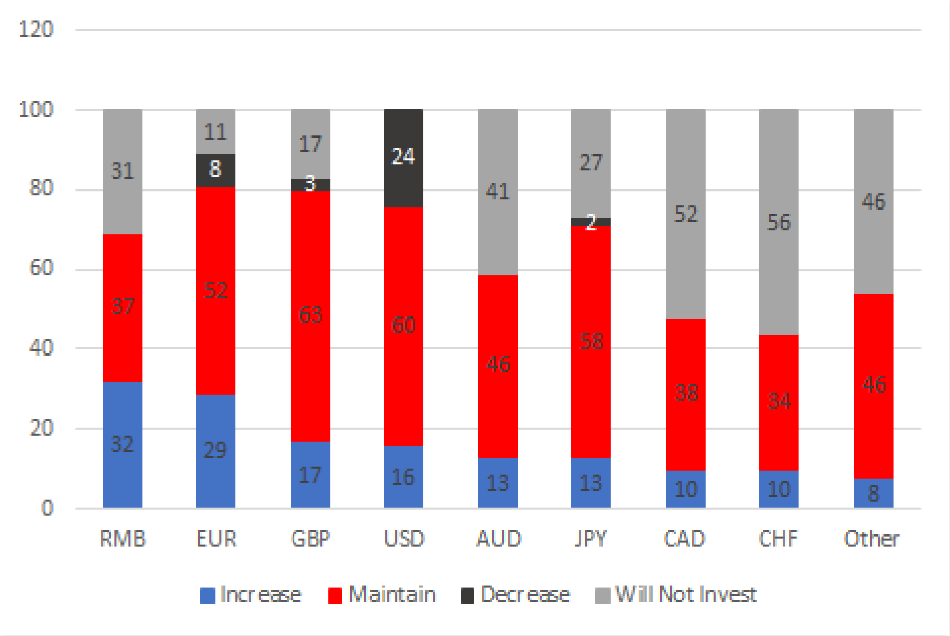
Global reserve managers favour EUR and RMB when asked for FX reserve changes planned over the next 12-24mths & first ever reported plan to sell USD

Longer-term plans for currencies amongst reserve managers with $10trn of reserves showed 24% plan to reduce exposure to the US dollar

12-24mth planned FX reserve changes



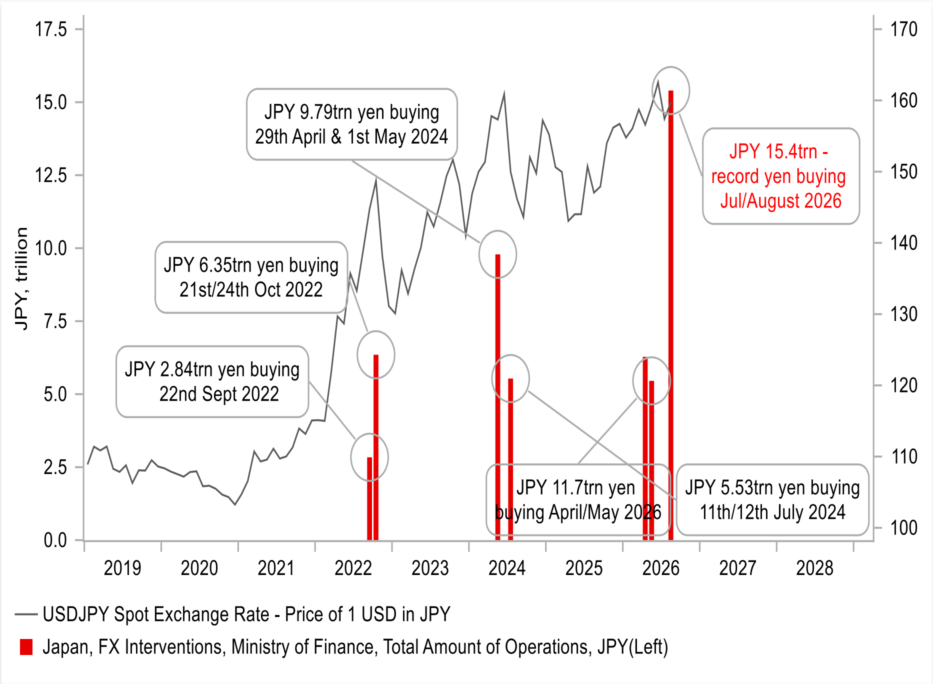
Long-term (10yrs) planned FX reserve changes



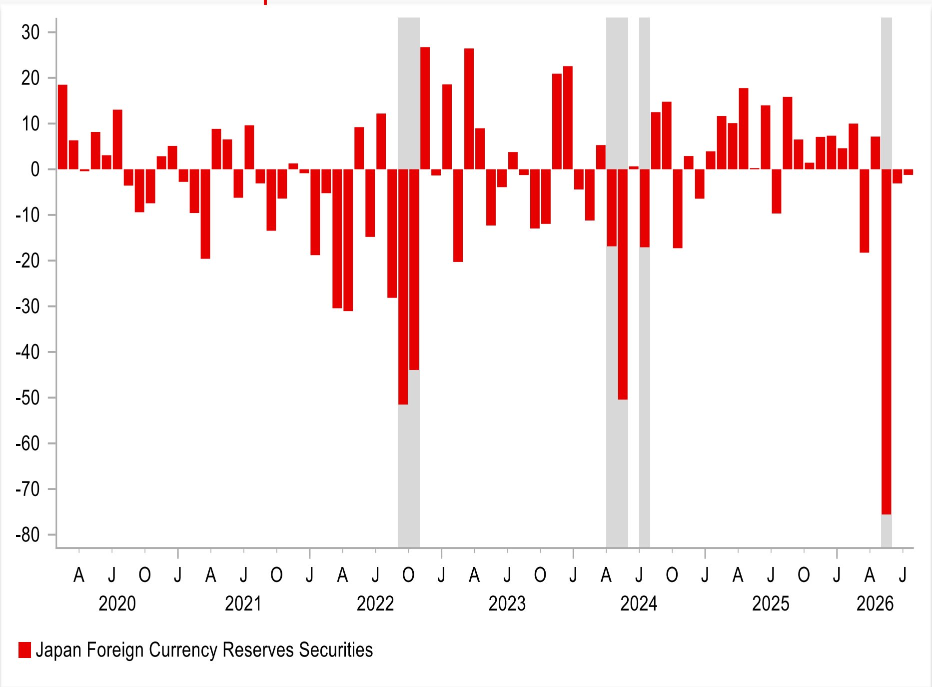
Japan FX policy | "Joint" intervention adds to USD debasement fears

Intervention at the end of July was the 6th episode of yen buying intervention since 2022 as the MoF fights yen weakness. While the US did not actually sell US dollars the wish to portray the action as "joint" indicates Washington's wish for a weaker US dollar

USD/JPY & episodes of intervention



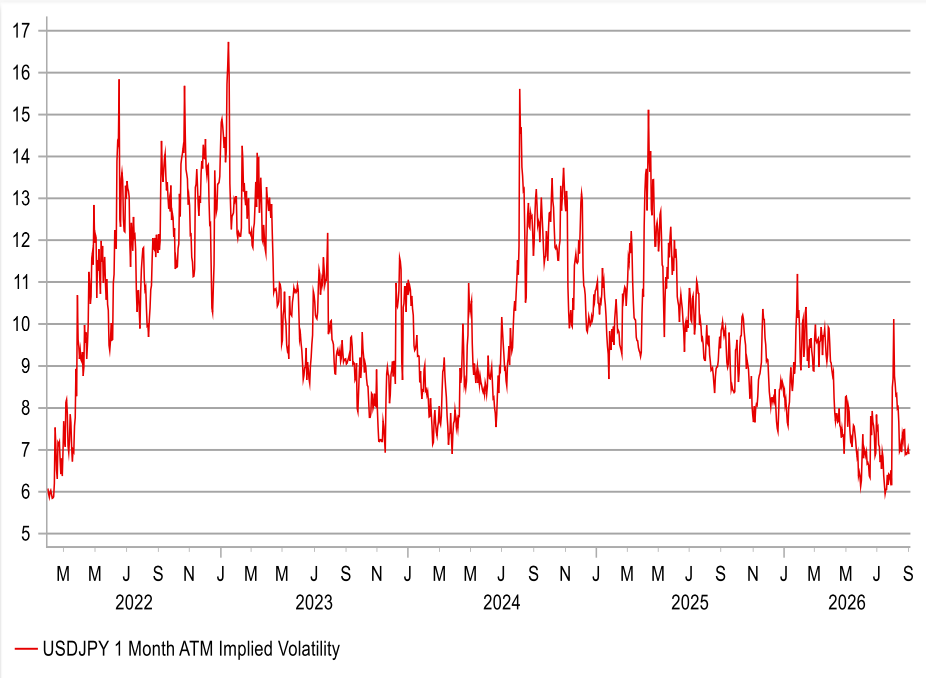
MoF FX reserves – changes in securities held & episodes of FX intervention



Joint intervention | but why now?

Volatile or disorderly FX market conditions were cited as a reason but this was not the case – 1mth implied volatility in USD/JPY had just hit the lowest level since Jan 2022

USD/JPY 1mth implied volatility



A possible US-Japan Agreement was reached

The Trump administration is becoming increasing concerned with rising UST bond yields that could destabilise risk assets ahead of the mid-term elections. Sole intervention was increasingly resulting in UST bond sales by Japan lifting US yields while JGB market instability adds further upward pressure on US yields.

The Solutions :

1. Japan agrees to making greater use of FIMA – the repo window where Japan can swap UST bond holdings for cash rather than sell. Scott Bessent has also called on the Fed to expand FIMA in size from the current $60bn per day limit.

2. The Japan government agrees to behind-the-scenes encouragement of the BoJ to increase the pace of monetary tightening to reach more quickly a neutral policy stance that helps to stabilise the yen & JGBs.

Vice Finance Minister Atsushi Mimura (4th Aug) :
"We will respond to FX coordination with monetary policy….I have shared the understanding with the BoJ"

UST Secretary Scott Bessent (4th Aug) :
"I'm highly confident Japan will follow up with a policy response… BoJ Gov Ueda will do what is needed"

Source: Bloomberg, Macrobond & MUFG GMR

US intervention scope | US FX holdings are relatively small

The Fed's SOMA & the Treasury's ESF hold a relatively small amount of sellable FX. USD & SDRs are also held. Bessent described US intervention as "reserve reallocation" (EUR to JPY)

Breakdown of SOMA & ESF foreign currency holdings available for sale

Millions of U.S. Dollars

		Changes in Balances by Source				
	Carrying Value, December 31, 2025[a]	Net Purchases and Sales[b]	Investment Earnings[c]	Realized Gains / Losses on Sales[d]	Unrealized Gains/Losses on Foreign Currency Revaluation[e]	Carrying Value, March 31, 2026[a]
Federal Reserve System Open Market Account (SOMA)						
Euro	13,336	0	64	0	(248)	13,152
Japanese yen	5,995	0	11	0	(86)	5,919
Total	19,331	0	75	0	(334)	19,071

		Changes in Balances by Source				
	Carrying Value, December 31, 2025[a]	Net Purchases and Sales[b]	Investment Earnings[c]	Realized Gains / Losses on Sales[d]	Unrealized Gains/Losses on Foreign Currency Revaluation[e]	Carrying Value, March 31, 2026[a]
U.S. Treasury Exchange Stabilization Fund (ESF)						
Euro	13,315	0	64	0	(248)	13,131
Japanese yen	5,995	0	11	0	(86)	5,919
Total	19,310	0	75	0	(334)	19,050

ESF Statement as of end-June also shows holdings of USD 25.5bn of cash & securities and USD 172bn of SDRs

Source: New York Federal Reserve; Treasury & Federal Reserve Operation Jan-Mar 2026 & ESF Statement June 2026

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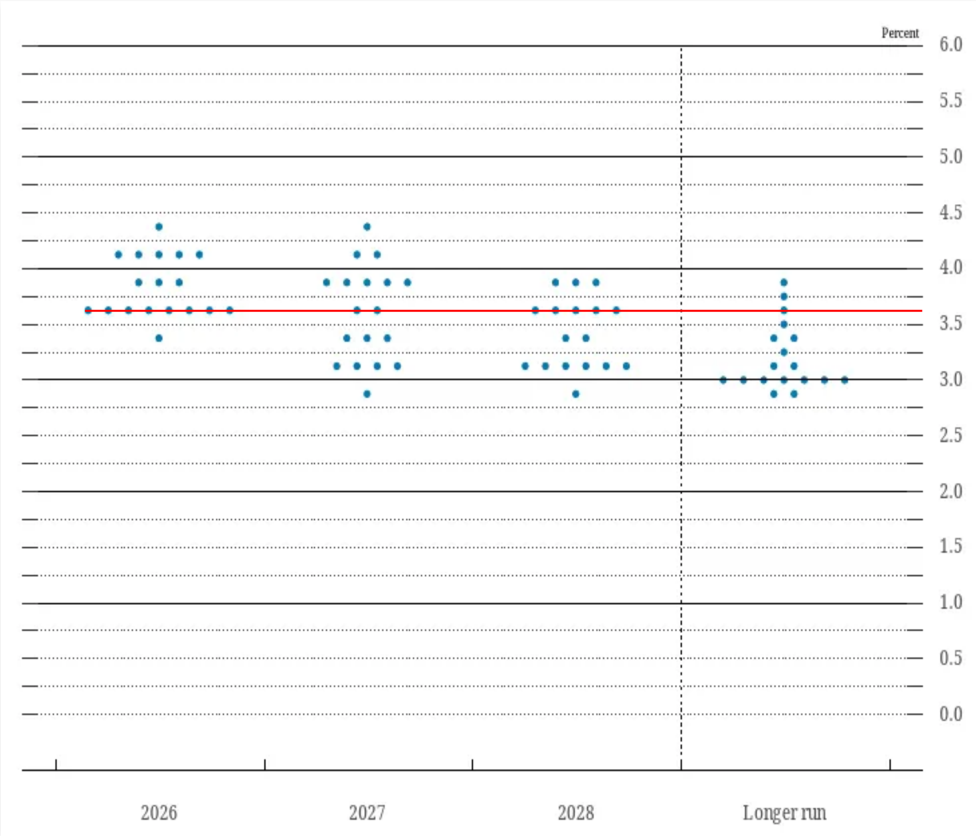
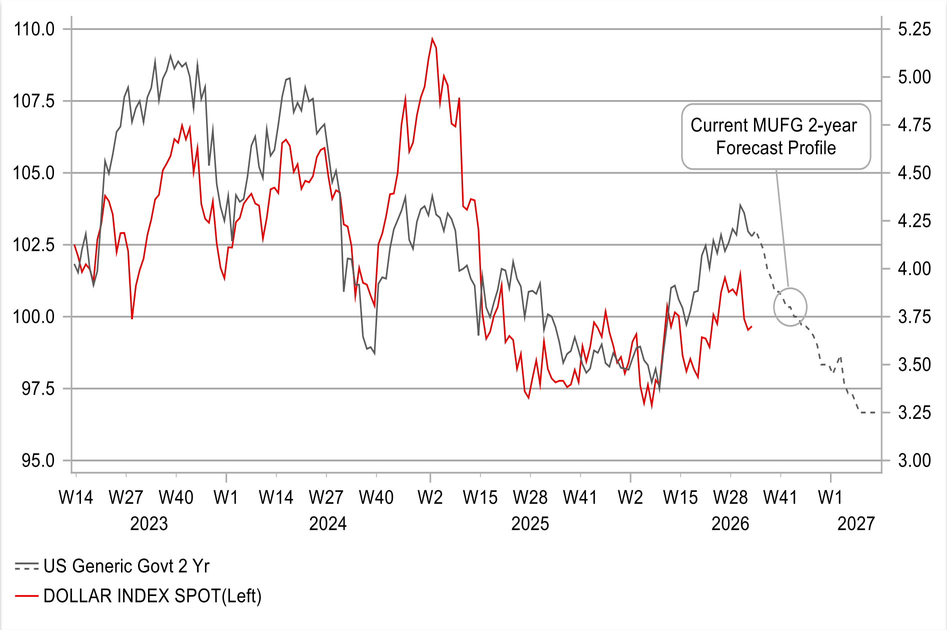
Fed division | Peak FOMC hawkishness before inflation subsides

In the remainder of 2026, the June SEPs Dots showed that **eight FOMC members want to keep rates unchanged; one wants one 25bp rate cut; three want one 25bp rate hike; five want two 25bp hikes; and one wants three 25bp hikes**. The swing from cuts to hikes from just one SEP to the next SEP was the largest ever. We would argue that under the assumption of a ceasefire holding these dots already look dated

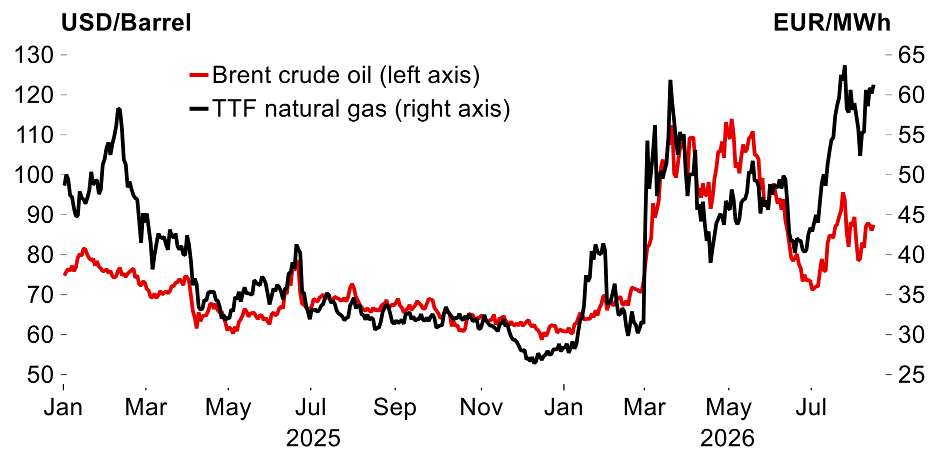
FOMC Dots profile is likely to be scrapped



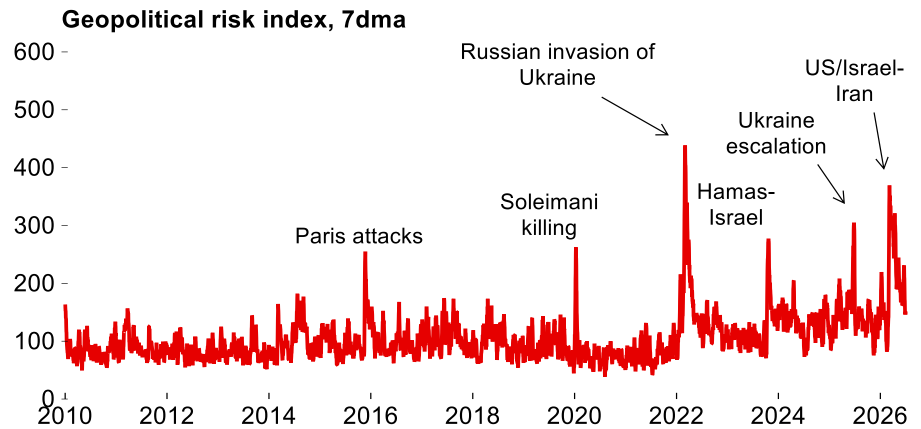
2-year yield to move from rate hike pricing to rate cuts dragging USD lower



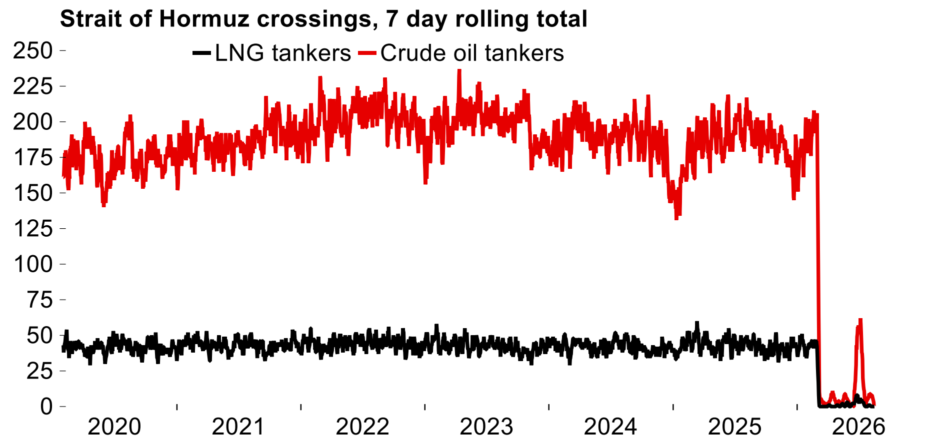
Geopolitical volatility | Continued gridlock a growing risk for Europe



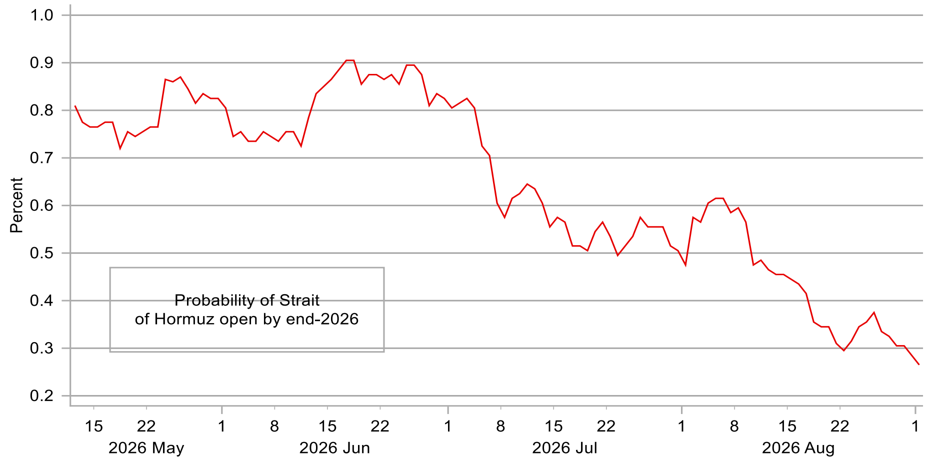
Source: Macrobond, MUFG GMR



Note: Index measures "adverse geopolitical events and associated risks based on a tally of newspaper articles covering geopolitical tensions". Source: Caldara, Dario and Matteo Iacoviello (2022), Macrobond, MUFG GMR



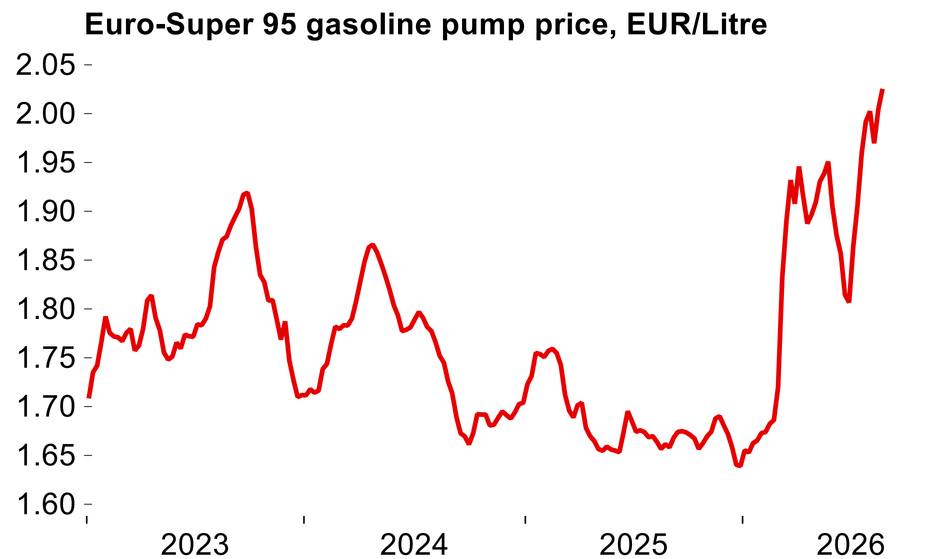
Source: Bloomberg, Macrobond, MUFG GMR



Energy | Attention is increasingly turning to the gas storage deficit

Oil developments swiftly translate into higher pump prices, weighing on household incomes and discretionary spend

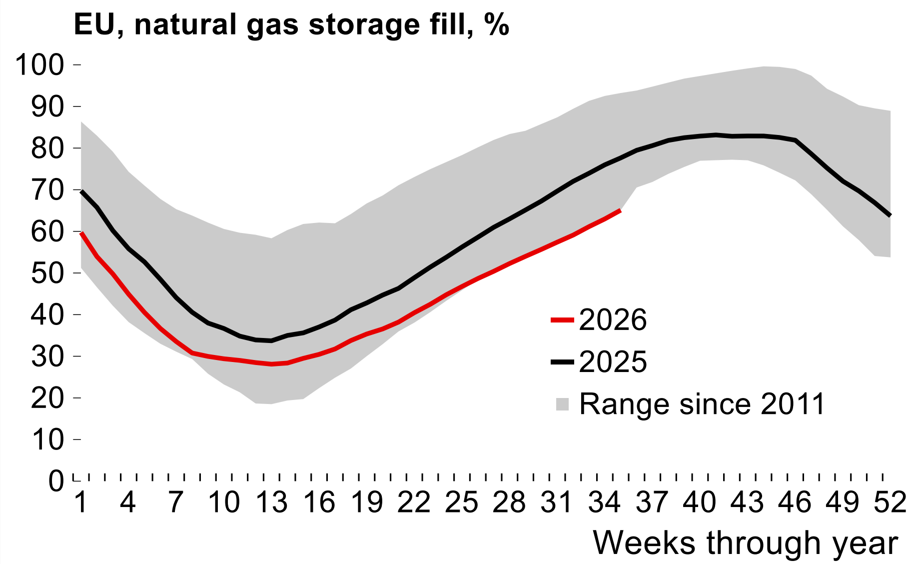
Euro area pump prices are up around 20% Y/Y following Middle East re-escalation



Source: European Commission (DG ENERGY), Macrobond, MUFG GMR

A low starting point, damage to LNG facilities and global competition leaves Europe vulnerable to systemic gas price risks

European gas storage is relatively low heading into the 2026-27 heating season



Source: GIE, Macrobond, MUFG GMR

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