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FX Daily: 50/50 Fed call keeps risk assets in demand

Some surprisingly dovish remarks from the Fed s Christopher Waller yesterday sent US yields and the dollar lower, while at the same time sending equities higher. Neither the prospect of a Fed hike nor the surge in the yen has been enough to dent demand for high-yielding FX. That environment looks unlikely to change today, regardless of the US jobs data

Recent dovish remarks from the Fed's Christopher Waller have weighed on the dollar and helped risk assets

USD: Probably more downside risks to the dollar today

Yesterday's speech from the Federal Reserve's Chris Waller was a little more dovish than most were expecting. Rather than reinforcing Chair Kevin Warsh's hawkish speech from a week ago, Waller's remarks shifted the burden of proof towards the need for a hot August inflation print to justify a rate hike – otherwise he would vote for a hold. Short-dated US yields came off 5bp and USD/JPY fell close to 155. Market pricing for a Fed rate hike in September now stands at exactly a 50% probability. Feeding into the story a little will be today's August non-farm payrolls data. We say 'a little' because the Fed seems to be reasonably comfortable with the labour market right now and is squarely focusing on the price side of its dual mandate.

On payrolls, consensus expects a softish +55k number, with the 'whisper' number lower at +30k. The unemployment rate is expected to remain low at 4.1%, which the Fed sees as close to full employment. True, another negative jobs number today would make the optics of the Fed hiking rates later this month a little harder – but the lasting impact for financial markets should come from inflation rather than labour market data.

High yield and procyclical FX remain in demand for the time being. Given the hot debate over whether the Fed raises rates at all, it looks like investors are concluding that any Fed tightening cycle will be very modest and not enough to derail a relatively benign investment backdrop. That presents a mildly negative backdrop for the dollar in the short term. And barring a very strong NFP number today, which would firm up a September rate hike, we could see the dollar drifting a little lower.

99.15/20 could cap DXY intraday strength, with risk to 98.60 on soft payrolls. On a more multi-day view and given our new house call for a 25bp Fed hike, we tend to see the dollar as relatively stable into year-end now.

Chris Turner

EUR: Unwinding the Warsh sell-off

EUR/USD is drifting higher as markets unwind the moves made on the back of Warsh's speech a week ago. EUR/USD had been trading around 1.1650 before that speech and looks to be grinding back in that direction now. The generally offered dollar environment against EMFX and pro-growth currencies in the G10 space is creating a supportive environment for EUR/USD – even if the Fed story is uncertain. One left-field risk for the euro is the upcoming local elections in Germany. Major success for the AfD in Sunday's Saxony-Anhalt elections may raise more questions over the stability of Friedrich Merz's government.

Elsewhere, EUR/GBP is consolidating after breaking above 0.86 yesterday. No doubt the gilt sell-off, and what it means for strained UK public finances, played a role there. On that subject, the new UK Chancellor, John Healey, is expected to make his first major political speech early next week, which will no doubt emphasise fiscal responsibility. For today, monetary policy is in focus. We receive the latest update on the Bank of England's Decision Maker Panel survey and also have a speech from BoE Governor Andrew Bailey at 10:50am CET. It seems too early to get the all-clear on inflation, meaning that up to 60bp of BoE tightening can sit in UK money markets for a while longer. That probably means EUR/GBP can trade 0.8550-0.8600 before breaking higher to 0.87 in the fourth quarter.

Chris Turner

JPY: May have come far enough for the time being

USD/JPY has had another wild week, but yen gains may have come far enough for the time being. Market pricing of the Bank of Japan policy trajectory now has 45bp of hikes priced in by year-end and the policy rate priced close to the fabled neutral 2% rate in about a year's time. Sure, if the Bank of Japan were shifting to its most hawkish setting, a little more could be priced. There is very low risk of a 50bp hike this month and back-to-back hikes in October and December taking the policy rate to 2.00% by year-end. But Japanese consumption remains weak, and government influence remains heavy, suggesting 100bp of tightening by year-end looks highly unlikely.

Helping the yen has also been speculation that the $2tr Government Pension Investment Fund (GPIF) could increase its weighting towards domestic Japanese assets. We'll have to see whether any announcements are made – potentially in late October.

But a lot of these positives are now priced into the yen. 155 is a big support in USD/JPY, and we favour some consolidation here rather than an immediate extension to the 150/152 area. Another factor here is that the speculative market is not as short yen as it was in 2024.

Chris Turner

CZK: Dovish data temper hawkish bets

Czech second-quarter wage growth surprised to the downside yesterday, matching our estimate but falling below market and Czech National Bank forecasts. The strong upside surprise in the first quarter was also revised down sharply. Wage growth averaged 6.3% in the first half of the year. The data eased some of the market's aggressive hawkish pricing, but is not a game changer: wage growth remains uncomfortably high for the CNB, while next year's draft budget points to further wage pressures.

Today's August inflation release should show headline CPI rising from 1.7% to 1.9%, in line with the CNB forecast, mainly due to higher fuel prices. The key focus, however, will be core inflation, which we expect to ease from 3.0% to 2.8% and further temper excessive hawkish pricing. We expect no rate change or major surprise at the September meeting. Attention should instead shift to November, when the CNB will publish a new forecast incorporating next year's state budget, including higher public-sector pay and the minimum wage. Our baseline remains no change in rates, but the risk of another rate hike is increasing despite dovish data this week. Following yesterday's relief on wages, we now see EUR/CZK as fairly valued and are moderating our bullish bias on the koruna.

Frantisek Taborsky

Author

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com

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