Danske Bank

Foreign Exchange

8 September 2026

Reading the Markets USD

Fed preview: hawkish hold

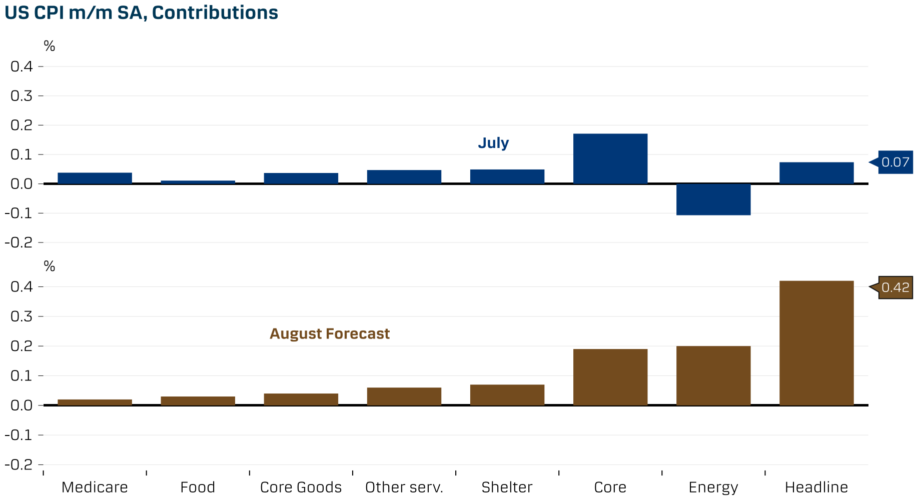
We still expect the Fed to keep rates unchanged next week even after the August Jobs Report. We do not believe the data received since the July meeting has been sufficiently hot to tilt the FOMC majority towards a hike. We still expect the Fed to hike rates twice later, in December and March.

Last week's Jobs report signalled stronger growth, but not necessarily tighter labour market conditions. Payrolls grew by 162,000 and previous months were revised up by 55,000. Even so, unemployment rose by 115,000, as the labour force unexpectedly rebounded by 683,000. We believe that tighter labour conditions will eventually lift wage growth towards 2027, but compared to late July, the outlook has not changed materially.

Even if we do not believe there will be a hike next week, we still think the current pricing (with close to even odds between a hike and hold) is well justified. **The decision will likely come down to just a handful of votes.**

We think all three participants who voted for a hike in July (Hammack, Logan and Kashkari) will do the same in September and while it would be historically unprecedented for the Chair to dissent from the majority, we cannot rule it out after Warsh's remarks at Jackson Hole and the *sources story published by the FT* soon after the July meeting. John Williams and Christopher Waller made the strongest cases for waiting beyond September in their remarks last week, barring a hot CPI surprise on Friday. We also believe Paulson and Jefferson are likely to remain in the wait-and-see camp.

Chart 1. Our forecast for the key August CPI release this Friday. Headline inflation is driven higher primarily by energy prices



Source: Macrobond, U. S. Bureau of Labor Statistics, Danske Bank

Key views

- **Macro.** Cyclical outlook remains healthy, even if stagnant labour supply growth weighs on real growth. GDP +2.1% in 2026 in line with consensus.
- **The Fed.** 25bp hikes in December and March. Rates held at 4.00-4.25% for the rest of 2027 (below market pricing).
- **EUR/USD.** Relative macro and monetary policy outlook push EUR/USD lower towards 1.12 on a 12M horizon. Below consensus (1.19) and forward (1.18).
- **10Y UST.** 5.00% in 12M (near forward at 4.97%).

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Bowman and Powell made few or no public remarks over summer. Barr and Cook suggested they remain open to the idea of hiking, but only if warranted by upside inflation surprises. This means that there at least four unclear votes that could tip the balance either way. **However, as a base case, we expect a split vote with 3-4 votes in favour of a hike.**

Note that a FOMC vote has never ended in a tie, and FOMC's rules of procedures do not specify the outcome in case of a tied vote. Our base assumption is that policy change requires a majority of at least seven votes, and that in case of a tie, rates would remain unchanged.

Additionally, we still expect the FOMC to publish its updated 'dots', even if Warsh opts out from submitting his personal views again. In the June SEP, six participants predicted at least two hikes for this year, and whether that remains the case would be key for the October-December outlook. Warsh has also been reported to push for reducing the number of annual monetary policy meetings. Even if the decision was made next week, the change might only take effect from 2028 onwards, as 2027 meetings dates have already been announced. The 2028 dates will be set next summer.

Important CPI release Friday

This leaves Friday's August CPI print with potentially large market implications. We forecast headline inflation at 0.4% m/m SA, or 3.4% y/y, up from 3.3%, as higher oil prices lifted retail gasoline prices.

The Fed will focus more on whether underlying inflation continues to trend lower. We expect core inflation at 0.2% m/m SA, or 2.4% y/y, down from 2.5% and in line with consensus. Our forecast includes a small uptick in 'supercore' services inflation momentum, which has remained near its pre-pandemic average over recent months. However, for the Fed, an upside surprise in broader services inflation beyond our forecast would be difficult to disregard as just a one-off. Also watch Thursday's August PPI, which is unusually released before CP, and could therefore carry more market weight than usual.

The vote-split matters

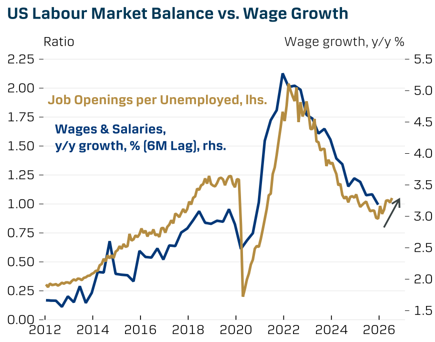
The Fed remaining on hold next week would mark a short-term upside risk to our bearish EUR/USD view, **but the exact vote split will matter a lot for the market reaction**. If Warsh again votes for a hold despite his hawkish remarks at Jackson Hole, markets could reconsider their confidence in his communication. The outcome would likely mirror the repricing seen after the July meeting, with higher long-end inflation expectations driving curve steepening and broadly weaker USD FX (chart 3).

However, if he votes for a hike, and simply fails to get the committee majority on board, we would expect markets to maintain pricing for hikes in the later meetings. At the end of the day, we think the macro case for tightening policy at a later stage is still very much alive.

In the latter scenario, we would consider any temporary USD sell-off as a good opportunity to re-enter USD longs. One attractive alternative would be a long USD/SEK position, which would benefit from a scenario in which the Fed is eventually expected to tighten policy and the global manufacturing cycle begins to see fading momentum.

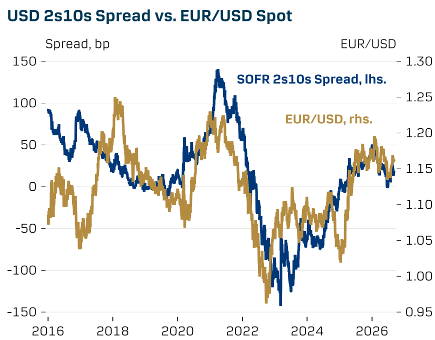
A decision to hike rates already now would naturally push EUR/USD lower, and as the implied probability of the hike has risen, the EUR/USD options market has again begun to demand a premium for EUR/USD puts over calls. For

Chart 2. Further tightening of the labour market could turn into an inflation problem, but we are not there yet



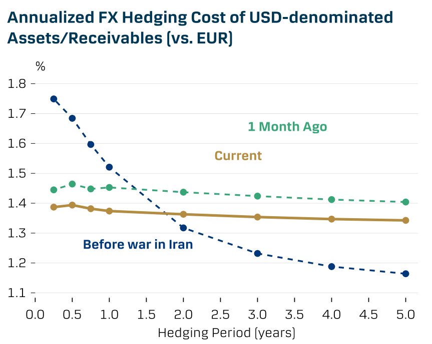
Source: Macrobond, U. S. BLS, Danske Bank

Chart 3. Hawkish Fed and curve flattening would push EUR/USD lower (and vice versa)



Note: Past performance is not a reliable indicator of current or future results.
Source: Macrobond, Bloomberg, Danske Bank

Chart 4. EUR/USD FX forward curve remains flat at a historically low level



Note: Past performance is not a reliable indicator of current or future results.
Source: Macrobond, Bloomberg, Danske Bank

clients hedging USD assets or income, we recommend considering risk reversals over forwards to take advantage of the favourable skew and to maintain profit potential from the spot rate moving lower over coming 3-12M.

EUR/USD FX forward curve remains essentially flat several years into the future (chart 4). Our Fed call (2x25bp hikes in December and March) is still broadly aligned with current pricing, but our ECB call (final hike this week) is clearly on the dovish side of market pricing. If the ECB halts its hiking cycle already after this week, the EUR/USD FX forward curve should begin to steepen. Hence, extending maturing USD hedges into 2027 and beyond could lock in the carry at historically attractive levels.

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