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FX Focus

USD Back on Fundamentals

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- *Fed credibility matters again. Warsh's Jackson Hole speech has reduced USD debasement fears and shifted the focus back to inflation, labour markets and policy rates.*

- *The USD is trading on fundamentals again. Sticky inflation, a labour market that remains near full employment, and a Fed that is still prepared to tighten policy if needed should provide support for the USD into early 2027.*

- *Risks remain if inflation and employment data soften materially. Structural concerns around fiscal sustainability and Treasury interventions remain and could resurface if bond market volatility intensifies.*

We have updated our forecasts to reflect recent market moves (see *Forecast Reset, 1 September 2026*) after the USD weakened amid policy uncertainty sparked by the Treasury's surprise EURJPY intervention and expanded buyback programme. Despite this adjustment, we maintain a modestly bullish USD outlook into early 2027.

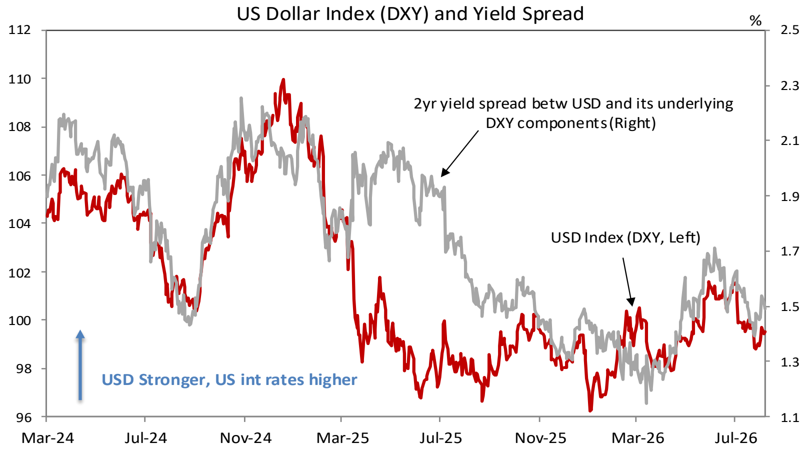
The key shift is that concerns over policy-driven USD debasement have eased significantly following Fed Chair Warsh's Jackson Hole speech. Markets had become increasingly focused on structural USD headwinds, including Treasury intervention, buyback policies and doubts about the Fed's commitment to controlling inflation. Warsh directly addressed these concerns, reiterating that inflation remains the Fed's primary focus and warning that policy still has "work to do" if inflation does not return to target quickly enough.

Importantly, Warsh described the labour market as consistent with full employment and argued that financial conditions are not restrictive. This suggests the Fed sees little urgency to ease policy and remains focused on inflation risks rather than employment concerns.

Market reaction reflected a meaningful improvement in Fed credibility. The USD recovered much of its post-buyback losses, gold gave back gains, the Treasury curve flattened and markets increased pricing for further tightening. More importantly, investors shifted away from questioning the Fed's commitment to price stability and back towards cyclical fundamentals.

A resilient labour market, inflation still above target and the Fed's determination to protect its inflation-fighting credentials should keep policy biased towards tightness and continue to support the USD.

Resilient job market and sticky inflation should keep Fed policy biased toward tightness, providing continued support for the USD

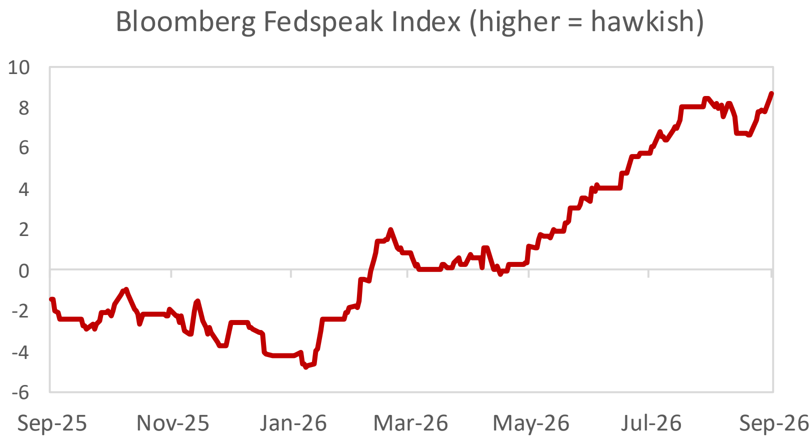


Source: Bloomberg, OCBC Group Research

Signposts to Watch:

- US labour market data (4 September): Payrolls, unemployment and wage growth will determine whether the Fed continues to view the labour market as consistent with full employment. Stronger-than-expected data would reinforce higher-for-longer expectations.
- US inflation data (10-11 September): PPI and CPI will be the key releases ahead of the September FOMC meeting. Upside surprises would increase the likelihood of another policy hike.
- Fed communication: Markets will be watching for hawkish commentary from other FOMC members. A broader alignment around a hawkish message would reinforce cyclical support for the USD.

Markets will be watching for hawkish commentary from other FOMC members



Source: Bloomberg, OCBC Group Research

The main downside risk is that inflation and labour market data weaken enough to unwind recent hawkish pricing. Structural concerns also remain. While fears about Fed credibility have faded, questions surrounding US fiscal sustainability, Treasury market intervention and unconventional policy measures have not disappeared. These issues could re-emerge if the global bond sell-off continues.

Overall, we believe Warsh has successfully restored confidence in the Fed's commitment to price stability. Debasement fears have faded, the credibility discount embedded in the USD has narrowed and markets are once again focused on cyclical fundamentals. Unless inflation falls sharply or labour market conditions deteriorate materially, we continue to expect a modestly firmer USD into early 2027.

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