

USD strength delayed, not derailed

Commonwealth Bank · 2026-09-09 · English original

Key points

- USD strength has been delayed by softer US data and intervention to support the yen.
- CommBank expects the Federal Reserve to raise rates more than markets have priced.
- AUD is still expected to weaken as US rates rise and metal prices fall.

The US dollar traded in a modest 4% range in recent months. Bouts of USD strength have been driven by market participants pricing several 25 basis point interest rate increases by the Federal Reserve.

But the recent string of soft US economic data and particularly the Japanese yen intervention weighed on the dollar.

We still expect the USD to increase solidly over the next two to three quarters because we expect the Federal Reserve to increase the funds rate by more than is priced by market participants.

Intervention gives the yen a boost

After months of jawboning, the US authorities joined their Japanese counterparts to support the yen in late July.

The impact on the yen was large and the USD selling spilled over to other currencies.

The joint intervention was the first since 2011, when several governments intervened to weaken the yen in the wake of the Great East Japan earthquake.

While the Japanese authorities sold US dollars to buy yen, the US authorities sold euros to buy yen.

Further JPY intervention involving sales of euros poses a modest headwind for the euro/USD crossrate.

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US seeks to limit Treasury selling

The US authorities are concerned the Japanese authorities may sell part of their large Treasury portfolio, raising US market interest rates, to buy yen.

To head off that scenario, US Treasury Secretary Bessent championed the Fed's Foreign and International Monetary Authorities (FIMA) Repo Facility as an alternative to selling Treasuries.

The FIMA facility allows foreign central banks to pledge their US Treasury holdings as collateral to access USD.

The facility has rarely been used since its creation during the pandemic in March 2020.

AUD still expected to weaken

The Australian dollar has benefited from the yen intervention. But the AUD has not traded up to its year-to-date high reached in May.

We still consider the next big move in AUD is down.

The main weights on Australia's currency will be higher US interest rates, lower Australian interest rates and lower metal prices.

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