Currency Market Commentary

Insights
August 2026

Summary

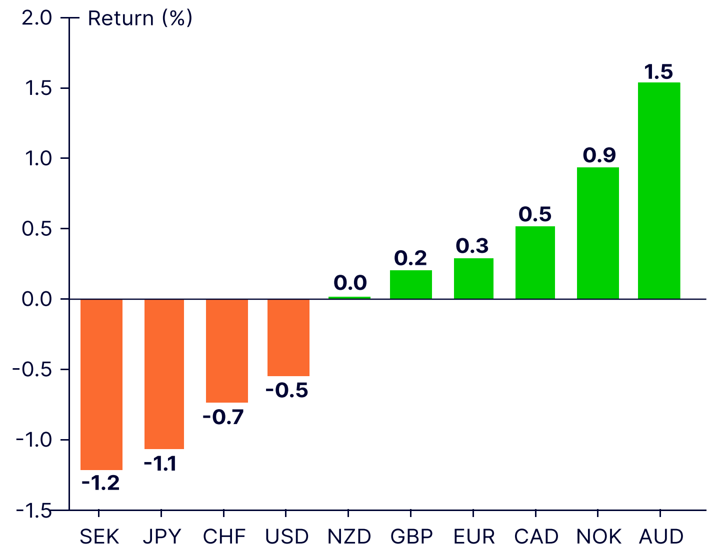
We continue to see offsetting fundamental forces driving range-bound markets into September. Within those ranges, the US dollar is likely to move higher, while the Norwegian krone, Australian dollar, and Japanese yen remain near the top of their ranges and the Swedish krona, euro, Swiss franc, and British pound risk falling toward the lower half. Contrary to this mildly bullish view, our published model ranks the US dollar last, and it may remain under pressure if inflation and growth data continue to surprise to the downside.

However, the rankings may be unstable. Signal strength is narrowly dispersed, so modest changes in economic surprises could quickly alter them, while policy and geopolitical developments remain critical and volatile drivers that the model cannot rapidly capture.

Global growth remains resilient, corporate earnings growth is strong, and financial conditions appear supportive, favoring higher-yielding and commodity-sensitive currencies. Although we are entering a seasonally volatile period for risk assets, robust earnings growth makes this year a plausible candidate for a relatively calm September-October period.

That said, our concern is increasing. Growth outside the US through Q2 and over the summer exceeded depressed expectations despite the energy shock, particularly among net energy importers such as the euro, British pound, Swedish krona, Swiss franc, and Japanese yen. With expectations now higher, further positive surprises will be difficult to achieve, and outright disappointments are becoming increasingly likely.

Figure 1: August 2026 Currency Return vs. G10 Average



Source: Bloomberg and State Street Global Investment Management, as of 30 August 2026. **Past performance is not a reliable indicator of future performance.**

Refined-product prices and European Union (EU) natural gas prices remain well above Q2 averages, implying a larger drag on growth. Reduced energy shipments through the Red Sea and Strait of Hormuz, together with the loss of roughly 2 million barrels per day of Russian product exports, create a risk of another significant energy-price spike over the next one to three months. Multi-decade-high interest rates in many countries, partly reflecting these pressures, pose an additional challenge to growth.

By contrast, the US experienced declining employment, softer-than-expected inflation, and weaker retail sales, lowering expectations as those elsewhere rose. The US therefore appears better positioned to generate positive surprises, as illustrated by the strong employment report released an hour ago, and should be less sensitive to further energy-price spikes. This relative data-surprise skew, combined with the hawkish shift from Fed Chair Warsh, supports our view that the US dollar could approach the top of its range despite the weak model signal. Downside risks are concentrated in lower-yielding energy importers excluding Japan, namely the euro, Swiss franc, and Swedish krona. The British pound is also vulnerable because of its energy dependence and diminishing fiscal flexibility as interest rates rise.

Record highs in refined-energy prices and the spike in interest rates are approaching levels that could trigger a notable increase in risky-asset volatility, moderating our enthusiasm for the Australian dollar and Norwegian krone even if oil prices rise significantly.

The Japanese yen may be the largest beneficiary as the Bank of Japan (BoJ) appears set to accelerate rate hikes, investors consider potential asset repatriation ahead of 2027, and increased risky-asset volatility would likely be supportive. We expect the USD/JPY 155-160 range to hold for now, but the probability of a move toward 150 or slightly below is rising. The Japanese yen appears even better positioned against other lower-yielding currencies.

Figure 2: September 2026 Directional Outlook

	Tactical outlook	Strategic outlook
CAD	↑	—
NOK	↑	↑
JPY	↑	↑
NZD	—	—
AUD	—	—
CHF	—	↓
SEK	↓	↑
EUR	↓	↓
GBP	↓	↓
USD	↓	↓

Note: All individual currency views in the table above are relative to the G-10 average.
Source: State Street Investment Management, as of 30 August 2026.

US Dollar (USD)

The US dollar is the worst-ranked currency in our model dashboard, reflecting a series of weaker employment, retail sales, and inflation readings, as well as equity-market underperformance relative to other G10 economies. This is consistent with the US dollar hovering near its 12-month low. Additional weak data, particularly another soft consumer price index (CPI) reading, could put further downward pressure on the currency over the next one to two months.

However, it is important to note that the magnitude of the model signals remains weak. This means even modest improvements in the news flow could rapidly change the US dollar's ranking. We are already seeing early signs of such improvement. Fed Chair Warsh struck a hawkish tone in his Jackson Hole speech, August employment data came in strong, and refined-energy prices are pushing to new cycle highs. Meanwhile, positive economic surprises outside the US have prompted investors to raise expectations and lower their estimates of growth sensitivity to the conflict with Iran and higher energy prices. As energy prices continue to rise and the conflict persists with few clear signs of resolution, positive economic surprises outside the US are likely to become increasingly difficult to achieve.

On balance, despite the poor model ranking, we believe the balance of risks favors a higher US dollar retracement over the next one to two months, although we expect it to remain within its 12-month range.

We retain our pessimistic long-term view of the US dollar and saw clear examples in August of the forces that could drive such a move. US debt surpassed US$40 trillion, and the US Treasury's decision to implement Operation Twist to flatten the yield curve highlights longer-term debasement risks. Innovative companies and the dynamic, flexible US labor and capital markets continue to make the US an attractive destination for investment capital. Even so, the heavy concentration of foreign investment in artificial intelligence and US equities more broadly, combined with elevated valuations, suggests that any meaningful correction in the artificial-intelligence outlook could trigger a simultaneous bear market in both the US dollar and US equities.

In summary, rising US macroeconomic risks stemming from tariffs and other policy measures, elevated debt and fiscal deficits, and the persistent current-account deficit have damaged the US dollar's long-term attractiveness. Why not hedge some of this pronounced US macroeconomic risk through a higher US dollar hedge ratio while maintaining exposure to attractive, innovative US companies and other compelling investment opportunities?

Canadian Dollar (CAD)

The Canadian dollar is likely to remain range-bound, trading largely between 1.38 and 1.42 versus the US dollar. A pickup in employment trends, improving purchasing managers' index (PMI) data, and stronger-than-expected retail sales support positive gross domestic product (GDP) surprises following the economy's recent soft patch. Sticky inflation that remains above target, combined with improving growth, opens the door to further Bank of Canada policy tightening over the coming quarters.

The challenge remains tariffs. The US imposed an additional 50% tariff on a wide range of goods in August, and Canada responded with retaliatory measures of its own. The back-and-forth trade dispute could worsen before it improves. That uncertainty, combined with a rising likelihood of Federal Reserve rate increases, should limit the potential for near-term Canadian dollar appreciation despite improving economic fundamentals.

We are more constructive on the Canadian dollar over the medium term. Monetary policy remains appropriately accommodative. Real policy rates near 0% are likely below their long-run equilibrium level and should rise as growth improves on a sustained basis. Tariffs remain a headwind, but roughly 80% of trade continues to flow largely tariff-free under the Canada-United States-Mexico Agreement (CUSMA). Looking ahead to 2027 and 2028, lower mortgage rates should also become supportive as mortgages originated near peak interest rates begin to reset.

At the same time, we expect US growth to remain healthy but gradually decelerate alongside inflation later this year and into next year. Overall, we expect conditions to improve gradually, allowing the USD/CAD exchange rate to decline into the mid-1.30s by late 2026 or early 2027. Ultimately, given our long-term US dollar bear-market thesis, we believe the USD/CAD exchange rate could return to 1.20 over the coming years. Even so, the Canadian dollar may continue to underperform the G10 excluding the US, as a weaker US dollar is likely to act as a headwind.

Euro (EUR)

We are negative on the euro relative to the G10 average despite recent improvements in economic data and the high probability of a September European Central Bank (ECB) rate hike. The challenge is that the war with Iran and higher oil prices are likely to persist for some time, weighing on growth prospects. Investors have been impressed by the resilience of EU growth since the onset of the energy shock. However, expectations have now reset higher, and as the effects of the conflict intensify, EU natural gas prices have already risen nearly 60% above their Q2 average. As a result, economic disappointments in the euro area are becoming increasingly likely.

One or two additional ECB rate hikes are unlikely to provide significant support in this environment. While tighter policy may help contain inflation, it will also create further headwinds for growth and still leave the euro short of being one of the highest-yielding currencies in the G10. This mixed cyclical backdrop, combined with structural challenges such as elevated debt levels, intensifying competitive pressures from China, limited exposure to the artificial-intelligence buildout, and slow progress on growth-oriented reforms, creates an unfavorable environment for the euro.

Over the long term, we remain constructive on the euro versus the US dollar, driven primarily by expected US dollar weakness rather than euro strength, for the reasons discussed in the US dollar section above. The case for European investors to reduce their concentrated exposure to US assets, or at least adopt higher average currency hedge ratios, remains compelling as the US becomes a less reliable trade and security partner.

The outlook against other G10 currencies is less favorable. The euro appears expensive relative to the Japanese yen, Norwegian krone, Swedish krona, Canadian dollar, and Australian dollar and is likely to underperform those currencies materially over the coming years.

British Pound (GBP)

We are negative on the British pound relative to the G10. The UK remains exposed to higher energy prices, unemployment is elevated, real wage growth is weak, and higher gilt yields have consumed much of the available fiscal space, constraining the upcoming autumn budget. On the policy front, core inflation at 2.6%, combined with sluggish wage growth, makes it increasingly likely that the Bank of England will fall short of delivering the 2.75 rate hikes currently priced in by the market over the next year. Tightening fiscal constraints are also likely to shorten the honeymoon period for the new government as it confronts significant structural growth challenges with limited fiscal flexibility and an increasingly vigilant bond market.

Over the longer term, however, the outlook is not as fragile, at least against the US dollar and Swiss franc. Over a three- to five-year horizon, we see the British pound/US dollar exchange rate rising above 1.40. We also expect the British pound to outperform the expensive, low-yielding Swiss franc on a total-return basis over the coming years.

Beyond the US dollar and Swiss franc, however, we expect the British pound to struggle against the rest of the G10 over the medium and longer term.

Japanese Yen (JPY)

The Japanese yen gave back some of its late-July intervention gains in August but remains one of our favored currencies, particularly against other lower-yielding currencies. We see a near-100% probability of a BoJ rate hike in September, broadly in line with market expectations. We also believe persistent inflation and pressure from the US, in exchange for support on currency intervention, could pave the way for a faster pace of future rate hikes, bringing the policy rate to 1.75% by mid-2027.

The prospect of capital repatriation is another potential source of support that has entered the discussion, although we believe this is more likely to be a 2027 story. The Government Pension Investment Fund (GPIF) management committee met on 21 August, prompting speculation that it may have discussed raising its allocation to Japanese government bonds (JGBs). This development was followed by reports that Norway's sovereign wealth fund had increased its JGB holdings. With yields rising, capital repatriation becoming increasingly likely, and downside risks for the Japanese yen seemingly capped by intervention, the balance of risks appears skewed to the upside. We also expect the Japanese yen to perform well on safe-haven demand if higher energy prices dampen global growth sufficiently to trigger a meaningful correction in risk assets.

The Japanese yen still faces several near-term challenges that could limit appreciation. A move toward 150 on the USD/JPY exchange rate appears achievable, but a sustained break below 155 may prove difficult if US inflation remains elevated and the Federal Reserve continues to raise rates. In absolute terms, Japanese interest rates remain low relative to the higher-yielding currencies in the G10. Fiscal concerns, which have weighed on the currency periodically, are also likely to re-emerge from time to time, particularly if energy prices spike again.

Because timing remains a challenge, we favor medium-term long positions in the Japanese yen against other lower-yielding currencies, including the Swiss franc, euro, and Swedish krona, while taking a more tactical approach to long Japanese yen positions against higher-yielding currencies.

Over the longer term, we see substantial upside for the Japanese yen against the US dollar, with the USD/JPY exchange rate likely to return to the 120-130 range over the next three to five years, consistent with our long-term US dollar bear-market thesis.

Swiss Franc (CHF)

We are slightly negative on the Swiss franc relative to the G10. The Swiss franc appears less attractive as global real and nominal yields rise relative to Switzerland's 0% nominal policy rate and negative real policy rate. The Swiss National Bank (SNB) has made clear that it stands ready to intervene to prevent excessive Swiss franc strength. With core inflation running at just 0.4% year over year, policymakers have room to keep interest rates at 0%.

This backdrop is unfavorable for the Swiss franc relative to the US dollar, Australian dollar, Norwegian krone, and British pound, all of which offer policy rates above 3.6%. Even the defensive, low-yielding Japanese yen now provides carry above 1% and continues to trend higher. As a result, we prefer the Swiss franc as a funding currency.

Low yields and an expensive valuation argue for more meaningful Swiss franc weakness over time, but we are moderating our expectations for now. Strong Q2 Swiss gross domestic product (GDP) growth, a weaker Swiss franc, and accelerating domestic demand could encourage the SNB to soften its rhetoric around intervention at its September meeting. In addition, if oil prices rise further and equity-market volatility increases, the Swiss franc could find support from safe-haven demand in the near term.

The biggest risk to our near-term view is a resurgence of fiat-currency debasement concerns. The Swiss franc appreciated sharply alongside gold after the US Treasury announced Operation Twist on 19 August, reflecting investor concerns about potential currency debasement. If US policymakers push further in that direction, we would expect additional upside for the Swiss franc.

However, that is not our base case. Without support from the Federal Reserve in the form of quantitative easing (QE), the Treasury's ability to flatten the US yield curve remains limited. Moreover, in the absence of QE, Operation Twist merely shortens the maturity profile of US government debt rather than monetizing that debt, a key condition for sustained currency debasement concerns.

Norwegian Krone (NOK)

We remain constructive on the Norwegian krone, but view it as a higher-risk, higher-volatility investment case. The Norwegian krone tracked the sharp rise in oil prices closely, making it one of the stronger-performing G10 currencies in August. The ongoing energy-market supply deficit and limited signs of progress in the US-Iran standoff increase the likelihood that oil prices remain elevated and potentially move to new highs. This backdrop is supportive of the Norwegian krone, as are its relatively high interest rates, which remain the second highest in the G10 after the Australian dollar. If the US and Iran were to reach a credible agreement, the Norwegian krone could come under pressure as oil prices retreat. While a near-term resolution is not our base case, it is arguably the key risk to long Norwegian krone positions.

Domestic data, however, has diverged from the otherwise supportive oil story. The GDP, core inflation, and retail sales have all surprised to the downside. Although Norwegian interest-rate levels remain high, the increase in Norwegian rates during August lagged that of much of the G10. This negative domestic divergence, combined with oil-price volatility and the Norwegian krone's historical sensitivity to risk assets, tempers our enthusiasm.

The long-term outlook is more constructive. The Norwegian krone remains historically cheap relative to our estimates of fair value and is supported by steady, albeit modest, long-term potential growth, attractive yields, and a strong sovereign balance sheet.

Swedish Krona (SEK)

We retain a negative tactical bias on the Swedish krona, although several encouraging developments warrant close monitoring. For a market likely to remain focused on growth and interest rates, the Swedish krona faces a number of challenges. Most notably, the Riksbank's 1.75% policy rate reflects a backdrop of core inflation running at just 0.6% year over year and trend unemployment of 8.7%, well above its 2023 low of 7.2%. Expected GDP growth of roughly 2% this year compares favorably with many G10 peers but is unlikely to offset the drag from relatively low yields. In addition, Sweden remains dependent on energy imports and demand from the European Union, both of which are vulnerable to disruptions stemming from the US-Iran conflict.

That said, we are monitoring several signs of improvement. Services and manufacturing purchasing managers' indexes (PMIs) point to strengthening economic expansion, and while core inflation remains low at 0.6% year over year, it has risen from 0.0% for the 12 months ended April. Retail sales have improved, and Q2 GDP growth came in at a robust 3.3% year over year. Although Sweden remains exposed to higher energy costs, the economy appears to be absorbing those pressures relatively well. If these trends continue, the Swedish krona could be well positioned for a recovery once a more durable resolution emerges in the Middle East, although that process may take time and conditions could worsen before they improve.

Long-term valuation metrics also support the Swedish krona. The currency remains historically cheap on a real effective exchange-rate basis, while Sweden's debt-to-GDP ratio of approximately 33% compares favorably with many developed-market peers. This should prove advantageous in a world characterized by elevated fiscal burdens.

We also expect Sweden to benefit from gradual portfolio reallocation under our long-term US dollar bear-market thesis. The potential for Swedish and broader European investors to reduce concentrated exposure to US assets, or simply increase US dollar hedge ratios on existing holdings, should provide a meaningful long-term tailwind for the Swedish krona.

Australian Dollar (AUD)

We favor the Australian dollar over the medium to long term but maintain a neutral stance for now. Our view is best characterized as a buy-on-dips approach. The Australian dollar remains inexpensive by historical standards and offers the highest policy rate in the G10. Purchasing managers' indexes (PMIs) have returned to expansion territory, labor-market conditions remain strong, and inflation is running above the Reserve Bank of Australia's (RBA) target range. Recent improvements in economic data have also revived the possibility of additional RBA rate hikes, potentially as soon as this month.

The challenge is the risk of slower global growth and higher equity-market volatility as refined-energy prices reach new cycle highs and the US-Iran standoff persists. Domestically, declining home prices also create the risk that the RBA delays further policy tightening despite strength across other segments of the economy.

Over a multi-year horizon, we are considerably more constructive on the Australian dollar, particularly against the US dollar and Swiss franc. Australian investors appear to maintain substantial unhedged exposure to US dollar-denominated assets.

Consistent with our long-term US dollar bear-market thesis, we believe the Australian dollar is well positioned to benefit from its comparatively high yields and a growing incentive for Australian investors to increase currency hedge ratios or rotate part of their portfolios away from the US toward a more diversified global allocation.

New Zealand Dollar (NZD)

We are neutral on the New Zealand dollar relative to the G10 average. The economy is gradually recovering from its 2024–2025 recession, and both manufacturing PMIs and consumer confidence have shown further signs of improvement in recent months. The Reserve Bank of New Zealand (RBNZ) also raised interest rates by 25 basis points, bringing the policy rate to 2.75%.

Despite these improvements, we remain cautious on the New Zealand dollar. Additional energy-price shocks could undermine the recovery, and the latest retail-sales report has already turned negative. Core inflation remains within the RBNZ's 2%–3% target range, suggesting less urgency for further rate increases than markets currently anticipate.

The RBNZ reinforced this view following its most recent meeting. Without a meaningful upward repricing of policy-rate expectations, current interest-rate levels provide only limited support for the currency. At 2.75%, policy rates sit near the middle of the G10 range, which is not especially compelling for a country running large and persistent current-account deficits.

The New Zealand dollar appears inexpensive, but the case for a full normalization of interest rates and a sustained acceleration in economic growth remains too uncertain to draw us off the sidelines.

Our longer-term outlook is more balanced. Based on our estimates of long-run fair value, the New Zealand dollar appears undervalued relative to the US dollar and Swiss franc, leaving meaningful room for appreciation. However, it appears expensive relative to the Japanese yen and the Scandinavian currencies, suggesting a less favorable outlook against those peers over the longer term.

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