Dollar weak as cracks in US labour market spur rate cut bets

By Ankur Banerjee, Reuters, September 3, 2025

The U.S. dollar softened on Thursday in a volatile week as investors contended with bond market jitters while weighing data that showed a weakening labour market, which reinforced expectations the Federal Reserve will cut rates this month. With the Fed focused on the labour market, Friday's crucial jobs report will set the tone for the near-term rate outlook after data on Wednesday showed job openings fell to a 10-month low in July, although layoffs remained relatively low. Traders are pricing in about 97% chance of the Fed cutting interest rates later this month, up from 89% a week earlier, CME FedWatch showed. They are also pricing in 139 basis points of easing by the end of next year. The softer-than-expected job openings data weighed on the dollar. The euro held onto its overnight gains and last bought $1.165775. After a bruising week, sterling was steady at $1.3442 in early Asian hours. The Japanese yen last fetched 148.12 per dollar after eking out a small gain in the previous session. The dollar index, which measures the U.S. currency against six other units, stood at 98.178 after easing 0.17% on Wednesday.

Several Federal Reserve officials who spoke on Wednesday said labour market worries continue to underpin their view that rate cuts still lie ahead for the central bank. James Knightley, ING's chief international economist, said the Fed is very likely to cut rates meaningfully in the months ahead with little inflation pressure coming from the jobs market. "We expect them to cut 25 bp at the September, October and December FOMC meetings." Much of the focus this week has been on the bond market where yields on long-end notes across the globe have risen as investors become increasingly anxious about the fiscal health of major economies from Japan to Britain and the United States. But the dovish comments from policymakers along with soft labour data spurred a rally in Treasuries, pushing yields lower. U.S. 30-year bond yields were at 4.891% after hitting 5%, the highest in about 1-1/2 months on Wednesday.

Investor focus will also be on an auction of 30-year Japanese government bonds later in the day, a litmus test for investors' appetite for super-long fixed income. Japan's 30-year government bond yield was at 3.27%, just below the record high of 3.285% touched in the previous session. Uday Patnaik, head of Asia fixed income and global emerging market debt in the asset management division of L&G, said the rise in yields reflects poor fiscal conditions in some of the largest advanced economies, where the debt-to-GDP ratio is heading above 100%. "The problem here is not one of these countries are running a primary surplus, which means revenues cannot even cover non-interest spending," he said. "To fix this will necessitate significant cuts in spending or additional revenues, at a time when social and political pressures are running high." In other currencies, the Australian dollar was steady at $0.6545, while the New Zealand dollar last bought $0.5881.

China uses yuan as olive branch in US trade talks

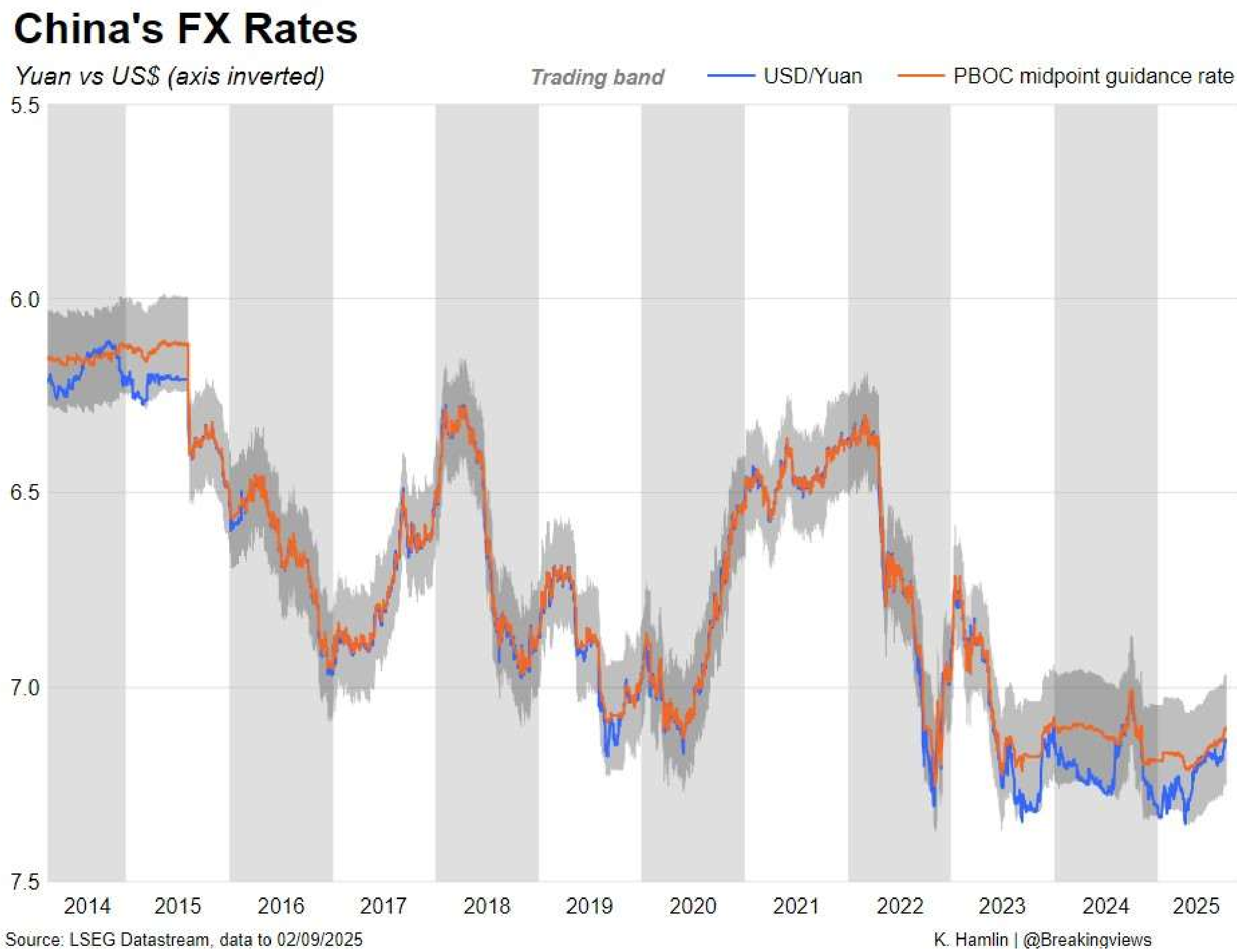
Jamie McGeever, Reuters, September 3, 2025

ORLANDO, Florida - A notable trend this year has been the often-counterintuitive market reactions to U.S. President Donald Trump's efforts to upend many long-held economic norms. One of the biggest surprises has been the appreciation of China's yuan. The consensus opinion at the start of the year was that Beijing would counter Washington's punitive tariffs on Chinese imports by depreciating the yuan against the dollar. This would keep Chinese goods competitive, enabling the country's exporters to compensate for any loss of U.S. business. On top of that, a weaker exchange rate would, in theory, help to reflate China's economy, pulling it out of the deflationary funk it has been in since its property bubble began to burst in 2021. And, finally, a weaker yuan would be a poke in the eye to Washington. A key pillar of the Trump administration's economic agenda, articulated most artfully by adviser Stephen Miran and Treasury Secretary Scott Bessent, is a weaker dollar.

But Beijing surprised everyone. The yuan did slide to an 18-year low around 7.350 per dollar during the chaos of Trump's April 2 'Liberation Day' tariffs. And combined with low domestic inflation and even deflation in recent years, the yuan's broad 'real' effective exchange rate (REER) is the weakest in over a decade. But since April, it has reversed course rapidly against the dollar, trading last week at a 2025 high of 7.1260 per dollar. Indeed, measured by the People's Bank of China's official daily fixings or offshore market trading, the yuan just posted its biggest monthly gain against the greenback in almost a year. These big moves can partly be explained by strong capital inflows. The Shanghai Composite equity index is at a 10-year high, boosted by record net inflows from hedge funds in August. And even though China's trade surplus with the U.S. may be shrinking, its global surplus in the first seven months of the year hit a new record. That's a recipe for a stronger exchange rate.

GOOD FAITH

But with a currency as tightly controlled as the yuan, market dynamics are not the whole story. The appreciation appears to be a deliberate policy choice by Beijing, potentially hinting at its broader strategy in combating Trump's tariffs. On a basic level, this doesn't make sense. Given the deflationary pressures still weighing on the Chinese economy, why do authorities appear to be actively pursuing a stronger exchange rate? But when viewed as a negotiating tactic, the logic starts to become clear. The Trump administration has explicitly stated that it wants a weaker dollar – not a 'weak dollar', mind you – but a currency level that would make U.S. exports more attractive. And Beijing can help deliver this, especially given that China's currency acts as an anchor for other regional exchange rates. Thus, the yuan's appreciation against the dollar indicates that – despite China's show of force this week – Beijing is still willing to negotiate with Washington.



'ANTI-INVOLUTION'

China may also want a firmer exchange rate to help ease some domestic concerns, namely sluggish consumption. The economic data coming out of China will do little to support consumer sentiment or domestic demand: the latest headline manufacturing PMI data was soft, new orders are declining, and construction has contracted at its fastest rate since the pandemic. President Xi Jinping is clearly taking this seriously. He has pledged to take steps to boost domestic consumption and technological innovation, while supporting small firms. And he has also spoken about breaking the cycle of "involution", a term now widely used for excess competition and overcapacity. An appreciating yuan should help these efforts because, as all else being equal, a stronger currency should boost domestic demand. The yuan's recent rise against the dollar is thus "a policy push, not a market pull," as Goldman Sachs analysts neatly put it. And given the foreign and domestic concerns China currently faces, investors should not be surprised if Beijing keeps pushing the currency higher, at least until the latest U.S.-Sino tariff truce expires in November. A stronger yuan may be one olive branch Beijing is still willing to offer.