

The bridge to dollar weakness



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“The analogy of a bridge connecting to a destination: in this instance, the ‘destination’ is medium-term dollar weakness.”

Key takeaways

- The case for a bearish USD trade has returned, with a soft patch in the labour market (leading to looser monetary policy going forward), combined with an eroded ‘risk premium’ for negative structural factors (such as Fed independence).
- This creates an asymmetric opportunity to be short the dollar, with cyclical factors in place to provide a bridge to medium-term dollar weakness.

When reflecting on our dollar view this year, we have referenced the analogy of a bridge connecting to a destination: in this instance, the ‘destination’ is medium-term dollar weakness, driven by structural factors such as concerns around the Fed’s independence, uncertainty around U.S. policymaking, and hedging of the large foreign ownership stock of U.S. assets. The ‘bridge’ is the path to the destination – shorter-term cyclical drivers of the dollar, such as the labour market and rate differentials. Market positioning, meanwhile, represents the tailwind or headwind on the journey.

Evolving landscape for the dollar

Going into Liberation Day, the weaker dollar trade was very compelling and key factors aligned: medium-term drivers were in place, as concerns around the currency were elevated, apprehension around U.S. policy making and foreign hedging of U.S. exposure. The bridge was also in place (with major concerns around the adverse impact of tariffs on US growth and front-end rates rallying). This produced a perfect path to dollar weakness, with positioning as a tailwind, given the market was heavily long the dollar coming into the year.

By June, the landscape looked completely different. Many of the medium-term concerns were dissipating – there was no Mar-a-Lago accord for dollar weakness nor a Section 899 tax on foreign capital inflows, and tariff-related policy uncertainty was diminishing. Similarly, the bridge was no longer in place – U.S. data was rebounding, recession odds were being priced out, and rate differentials moved in favour of the dollar. Finally, positioning was a headwind, with the speculative community heavily short the dollar. As such, we turned neutral the dollar in early June.

The stars are re-aligning

Today, however, factors are re-aligning for a bearish dollar trade, in our view. Concerns around the Fed's independence have risen markedly, with the firing of Governor Cook, and speculation regarding a potential plan for the administration to gain increased influence over the central bank via the district president confirmation process in February 2026. This brings a renewed focus to the medium-term dollar weakness thematic.

The bridge is also back in place, with the labour market in a clear soft patch. Whilst this does not necessarily suggest a major U.S. slowdown or imminent recession, the Fed's apparent readiness to respond provides a compelling cyclical driver for dollar weakness.

At the same time, positioning is moving from being a headwind to more lacklustre, with certain metrics showing that dollar short positioning has at least halved from its peak in June.

Weak spots in recent labour data

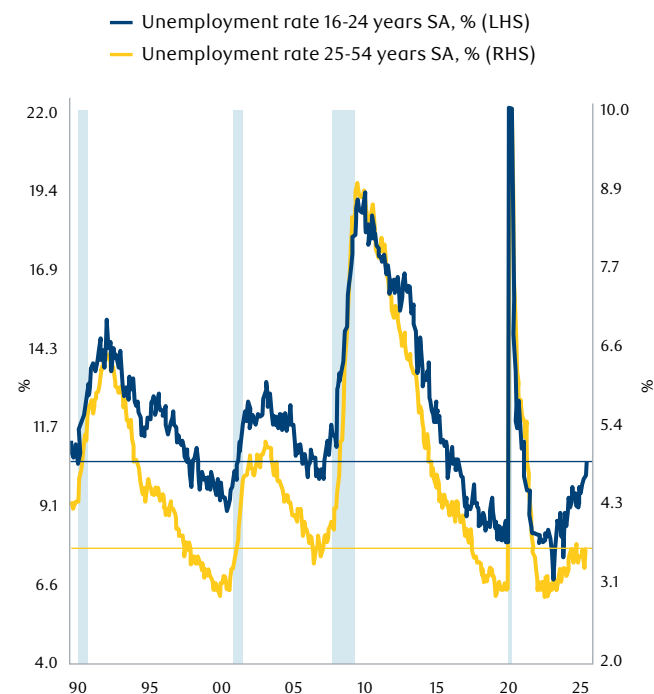
Digging deeper into the most recent labour data, and bearing in mind the caveats around reduced supply of labour due to immigration crackdowns, numerous signs point to weakness; this should lead to looser monetary policy in the coming period. Headline Non-farm payrolls (NFP), JOLTS, and ADP were all weaker; NFP in particular provided a 2.7 standard deviation downside surprise¹, which was quite large, with most cyclical sectors printing negative job growth. Challenger job cuts for August were the worst for the month since 2020 and, before that, 2008². Finally, the unemployed-to-job vacancy ratio has risen above 1 for the first time since 2021, and the rise in youth unemployment looks particularly worrying (Chart 1).

An asymmetric opportunity to be short USD

With the dollar having gone sideways in the last few months despite rate differentials moving against it, the 'risk premium' for negative structural factors (such as Fed independence) has completely eroded. As Chart 2 shows, the risk premium the factors listed above, we believe this creates an asymmetric opportunity to be short the dollar.

Indeed, the cyclical factors are in place to provide a bridge to the medium-term destination, and the winds are quite calm.

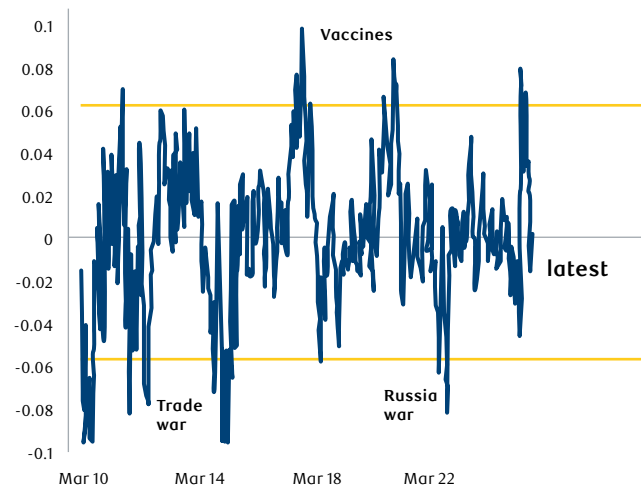
Chart 1: Youth unemployment is rising



Source: Goldman Sachs, 2025.

Chart 2: Zero risk premium priced into the USD

EUR/USD deviation from value implied by real and nominal rate differentials, rolling 1 year regression



Source: Deutsche Bank, Bloomberg, as at September 2025.

¹ All Employees, Total Nonfarm (PAYEMS) | FRED | St. Louis Fed.

² Challenger-Report-August-2025.pdf



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