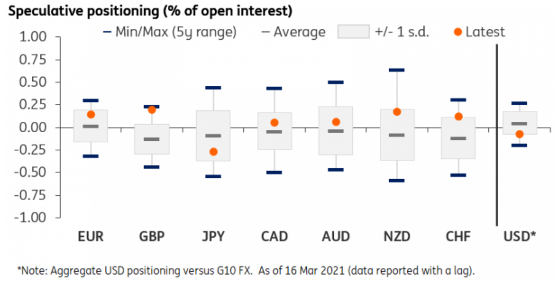
FX Positioning: Historic drop in JPY positioning

CFTC reported the biggest weekly drop in JPY positioning in a decade, worth 30% of open interest. The yen's net positioning is now below its five-year average, in oversold territory. CHF and NZD net positioning also fell significantly. Meanwhile, USD appears to have a more balanced positioning, and therefore less protection in the event of a new downtrend

Speculators bet heavily on JPY weakness

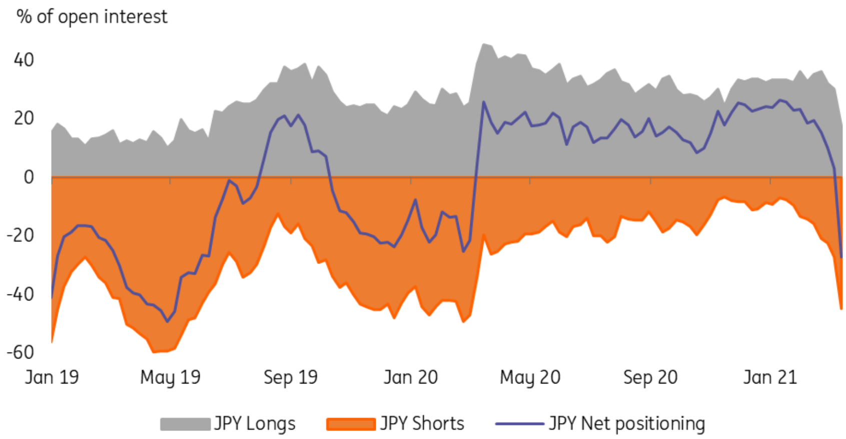
CFTC positioning data for the week ending 16 March showed the biggest weekly drop in net yen positions since 2011. The rise in US yields combined with some resilience in global risk sentiment has created a hostile environment for the yen in 2021, as is evidenced by the steady drop in net positioning on the currency over the past few weeks.



Currency (USD base)	Week Change	Latest net positioning	YTD Change
EUR	+0.0%	+14%	-7%
GBP	+0.6%	+19%	+16%
JPY	-30.1%	-27%	-51%
CAD	-0.8%	+6%	-4%
AUD	+0.6%	+6%	+11%
NZD	-15.9%	+18%	-9%
CHF	-12.8%	+12%	-10%

Source: CFTC, Macrobond, ING

We had previously highlighted how the marked JPY underperformance in the spot market in 1Q21 suggested that market positioning had likely moved into net short territory. In the week ending 16 March, JPY shorts rose sharply and the remaining long contracts were nearly halved (as shown in the chart below). The result was a drop in net positioning worth 30% of open interest: JPY net positioning is now in deep oversold territory, at -27% of open interest, a one-year low.



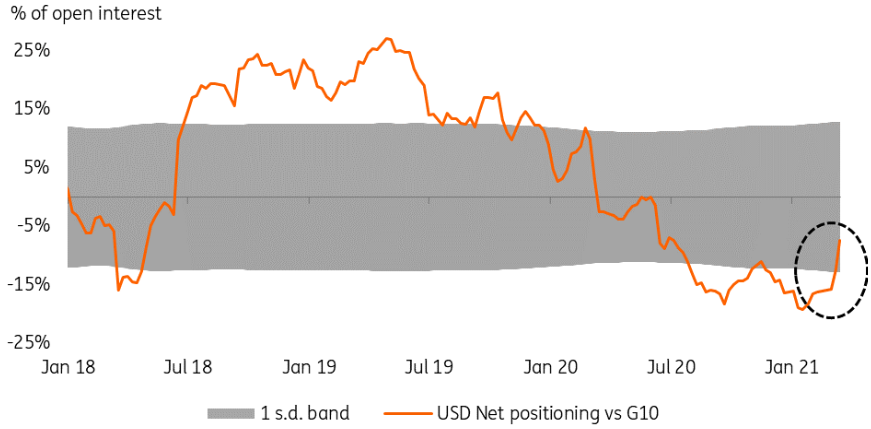
Source: CFTC, Macrobond, ING

After yet another week of marked underperformance of US bonds, the near-term outlook for the yen remains strictly tied to the dynamics of US yields. However, the overstretched net short positioning would normally imply more contained downside risk for the currency.

Dollar less and less oversold

We remain of the view that the rise in US yields should continue in a more controlled fashion in 2Q21 as markets may start to feel at ease with yield levels that match inflation expectations. With the Federal Reserve expected to remain dovish despite inflation spikes and the reflationary narrative supporting risk sentiment, we think the dollar will have plenty of room to resume its bear trend.

The dollar’s aggregate positioning vs reported G10 currencies (i.e. G9 excluding Sweden's krona and Norway's krone) has continued to move towards neutral levels, dropping from 12.5% to 8.5% (in terms of net shorts) in the week ending 16 March. It is now back inside its one-standard-deviation band (as shown in the chart below) which normally contains values that are not considered to be “extreme”.



Source: CFTC, Macrobond, ING

Considering what we've said above about our base-case scenario for the dollar in 2Q and onwards, the fact that the dollar appears to have already reaped most of the benefits of a position-squaring effect suggests there should be more limited resistance to a fresh dollar decline – at least from a positioning perspective.

CHF and NZD see major long-squeeze

The euro – despite having been hit lately by the temporary suspension of AstraZeneca vaccines in EU countries – saw no changes in its positioning. Indeed, EUR/USD net long positioning had already faced a material downsizing in the past few weeks, and like the case of the aggregate dollar positioning, it is back into "normal" values (i.e. within its one-standard-deviation band).

Another low yielder – the Swiss franc - however, saw a big long squeeze effect in the week ending 16 March. According to CFTC data, net long speculative positions on the franc dropped by 12% of open interest to +13%. While the extreme volatility in JPY positioning was very surprising, the same can not be said about CHF, which had more than once displayed sharp changes in its positioning even without any corresponding move in spot over the past year. This time, however, the curtailment of net longs appears very much in line with what has been recorded in the spot and futures markets, with CHF having been the worst G10 performer in the past month, dropping around 3.5% vs USD. There is indeed a possibility that we could see more sharp drops in CHF positioning soon, and a move into neutral or net short territory may well be on the cards.

While sterling, and the Australian and Canadian dollars saw their positioning broadly unchanged, the New Zealand dollar experienced a fierce long squeeze. The fact that the market was excessively long the Kiwi dollar has been evident as the currency has tended to underperform its closest peer AUD lately despite having a more solid set of fundamentals. CFTC data confirmed that the NZD's inability to fully cash in on good weeks for risk sentiment was largely due to a position squaring impact. With a more balanced positioning, the room for NZD upside in the crosses (especially against AUD) is, in our view, fairly wide.

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