Article | 29 March 2021

FX Positioning: Not much left to squeeze

Dollar shorts were squeezed again in the week ending 23 March, sending the greenback even closer to a neutral positioning. However, speculators surprisingly held on to their euro net longs. Elsewhere, the yen extended its drop in oversold territory, and sterling's positioning saw the biggest correction in 2021, mostly because of the broad USD rebound

Source: Shutterstock

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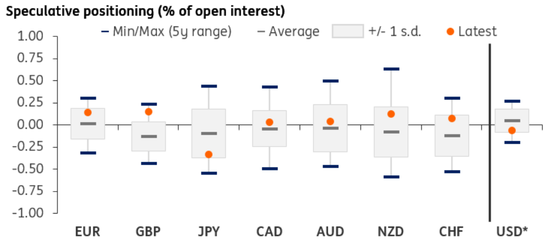
Dollar shorts keep falling...

CFTC FX positioning data as of 23 March shows a continuation of the unwinding in dollar shorts seen over the past few weeks. All G10 currencies saw their net positioning decrease in the week ending 23 March, with the exception of the EUR which saw a marginal increase in net longs.



Currency (USD base)	Week Change	Latest net positioning	YTD Change
EUR	+0.5%	+15%	-7%
GBP	-4.3%	+15%	+12%
JPY	-6.4%	-33%	-58%
CAD	-2.4%	+3%	-7%
AUD	-1.4%	+5%	+9%
NZD	-5.2%	+12%	-14%
CHF	-4.8%	+8%	-15%

*Note: Aggregate USD positioning versus G10 FX. As of 23 Mar 2021 (data reported with a lag).

Source: CFTC, Macrobond, ING

The USD net aggregate positioning versus reported G10 currencies (i.e. G9 excluding Sweden's krona and Norway's krone) improved for a tenth consecutive week, with net shorts now worth only 5.6% of open interest (they were as high as 19% in mid-January). Incidentally, all reported currencies except GBP have positioning levels inside their 1-standard-deviation band, a sharp difference from the beginning of the year when many currencies showed overstretched net long positioning.

This is a testament to how the recent rebound in the dollar has been interconnected with a sizeable position-squaring effect, which ultimately exacerbated the downside correction in some currencies like the G10 low-yielders, which had the biggest net long positioning at the start of the year. Looking at the latest data, it appears that the room for the dollar to benefit from further short-squeezing has shrunk significantly.

... but not against the EUR

The euro was a surprising outlier in the CFTC report, as speculators held on to their EUR net longs (which actually slightly increased) while all the other reported G10 currencies saw their positioning drop. This positioning dynamic was an example of the diversion to the actual market moves, as EUR/USD actually stayed on a downward trend into the week ending 23 March.

With the Covid-19 contagion picture in the EU worsening and the pace of vaccinations still lagging behind the US and the UK, EUR sentiment has remained weak over the past week, and some more short-squeezing has likely played a role. We would expect the EUR net longs to shrink more in the coming CFTC reports.

The two other low-yielders, the Japanese yen and Swiss franc, saw the biggest fall in net positioning in G10 in the week ending 23 March. After a drop worth 30% of open interest in the previous reported week, speculators have continued to build their net short positions on the yen, which now amount to 33% of open interest, close to the bottom of the 1-standard-deviation band.

A rebound in bonds in the past week may have slowed the pace of increase in JPY's shorts, but JPY has most likely retained a big gap to other G10 currencies positioning-wise. Should yields stabilise and possibly inch lower again, the yen's oversold condition may assist a rebound. Should, instead, the bond market show increasing weakness, the yen's net shorts do not appear extreme enough to suggest many limitation to further pressure on the currency just yet.

CHF, instead, remained in net-long territory (+8% of open interest). Considering that the franc has performed just as poorly as the yen in 2021, there is a possibility CFTC data underestimates the amount of shorts on CHF. We could see those shorts emerge with some lag (CHF positioning as reported by CFTC has not been fully reliable in the past year).

GBP positioning experiences biggest contraction this year

Sterling's positioning dropped by 4.3% of open interest in the week ending 23 March, and net longs now amount to 15% of open interest. This was the biggest drop in positioning for GBP this year after a material build-up in GBP longs. That, however, does not appear to be particularly related to GBP-specific factors , but mostly to the broad-based dollar rebound.

Despite this, GBP is the only G10 currency left with a net long positioning that is above its 1-standard-deviation band, which could lead to the conclusion that GBP is materially exposed to position-squaring downside risk. It must be noted, however, that GBP positioning in recent years was heavily characterised by Brexit uncertainty, which caused a skew towards the net-short side. With that factor now removed, the average positioning for GBP should adjust to the upside, and the current 15% of o.i. should not be considered as an excessively high value, in the same way it is not extreme for the EUR (which also has a +15% net positioning).

In the rest of the G10, the New Zealand dollar saw a material short drop in positioning (-5.2% of o.i.) in the reference week. The drop in spot after the announcement of some measures by the New Zealand government to curb housing investments may not be fully shown in the CFTC positioning data and we could see NZD face further short-squeezing in the next positioning report. A more balanced positioning was one of the reasons why we think the NZD is now facing more limited downside risk.

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