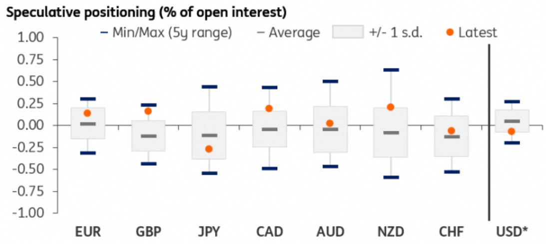
FX Positioning: USD shorts mounted before inflation 'scare'

In the week before the release of April's inflation numbers in the US, speculators added more dollar bearish positions. USD net short positioning was starting to look overstretched again and the post-CPI rally may have been exacerbated by some short squeezing. CAD and GBP showed the largest increase in net longs, CHF fell into net short territory

Source: Shutterstock

Positioning may have played a role in USD rally after US inflation release

CFTC data on G10 FX positioning shows an increase in net short positions on the dollar in the week ending 11 May. The aggregate net short USD positioning vs reported G10 currencies (i.e. G9 excluding Norway's krone and Sweden's krona) increased to 7% of open interest, from 5.7% the week before and is now at the bottom of its 1-standard-deviation band.



Currency (USD base)	Week Change	Latest net positioning	YTD Change
EUR	+0.9%	+13%	-8%
GBP	+3.2%	+16%	+13%
JPY	-0.2%	-27%	-52%
CAD	+6.0%	+19%	+9%
AUD	+0.6%	+2%	+6%
NZD	+1.3%	+21%	-6%
CHF	-6.9%	-7%	-29%

*Note: Aggregate USD positioning versus G10 FX. As of 11 May 2021 (data reported with a lag).

Source: CFTC, Macrobond, ING

As shown in the figure above, most of the increase in USD net shorts was the result of speculative bets on a rise in sterling and Canada's dollar, although net longs on the euro also rose by almost 1% of open interest. All this was broadly in line with moves in the spot market, as the dollar lost ground against all G10 currencies in the week ending 11 May.

The release of the US CPI numbers on 12 May generated a rally in the dollar after headline inflation jumped to 4.2% and likely fuelled doubts about how long the Federal Reserve will be able to retain its ultra-dovish stance. At the same time, there have been multiple indications in recent weeks that the Fed is ready to accept temporary spikes in inflation, so that higher prices would only mean a steadily worsening USD real rate.

Considering how USD net shorts had risen in the week leading up to the release and again reached rather stretched levels, the rally in the dollar may have been exacerbated by a short squeeze, which may emerge in the coming CFTC weekly report.

CAD and GBP saw large increase in net longs

The Canadian dollar saw an increase in net long positioning worth 6% of open interest, reaching a total of 19%. It is not a surprise to see speculative positioning on CAD rise, considering how the loonie has seen a consolidation of its bullish momentum, which started after the Bank of Canada's hawkish shift at the April meeting.

We discuss the outlook for CAD after the recent rally in "CAD: Hard to buck the bullish trend". In short, CAD remains attractive from a carry perspective, and fast vaccination in Canada may offset the worsening data-flow due to recent Covid-19 restrictions. In line with our bearish USD view and our forecast for oil to remain supported in 2H21, we expect USD/CAD to keep moving lower and reach 1.16 at the end of the year. Accordingly, we would not be surprised to see CAD net longs continuing to overshoot in the coming months.

Sterling saw a rise in net longs worth 3% of open interest in the week to 11 May. Some recent moves in GBP positioning have been related to political risk, namely the 'cash for curtains' scandal involving the Prime Minister, and the Scottish elections possibly raising the risk of new Independence Referendum. Both those risks have proven to be considerably less concerning than feared, and this likely explains why sterling has seen a rebound in its net positioning.

JPY and CHF the only two G10 currencies with a net short positioning

The only two currencies that did not score an increase in net speculative positioning in the reference week were the Japanese yen and Swiss franc, which are now also the only two currencies that do not have a net long positioning against the dollar.

While JPY has remained in oversold territory – largely due to the rise (and perceived risk of future rises) in US Treasury yields – CHF only recently started to show signs of net shorts prevailing.

It is not a surprise to see CHF positioning being more in line with JPY and the current net short positioning on CHF is likely a more accurate indication of the effective market positioning on the currency than it was earlier in the year. However, the weekly moves in CHF positioning as reported by CFTC should be taken with caution as the gauge is generally quite volatile on a week-to-week basis, and wide swings rarely indicate a shift in market sentiment on CHF in that specific week.

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