

## The dollar rally's still going strong

Long positioning is probably the biggest challenge to a further dollar rally from current levels. Yet the juxtaposition of a very hawkish Fed against crumbling growth expectations in Europe and Asia looks set to see the dollar maintaining these lofty levels for the rest of the year



The US dollar is expected to stay strong for the rest of the year

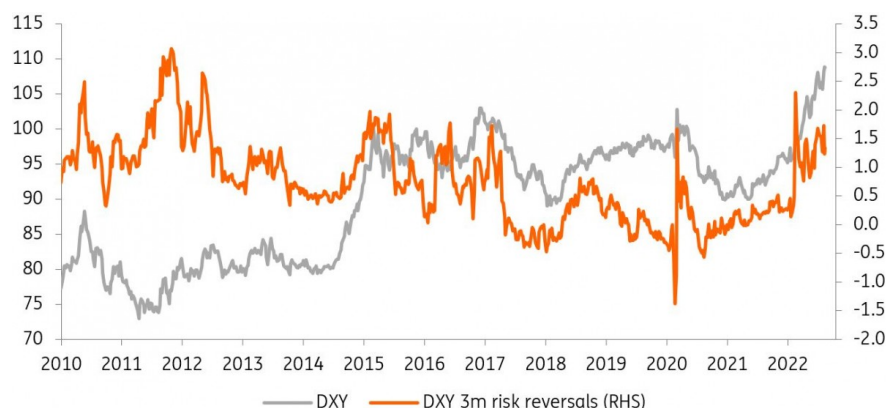
### Long positions in the dollar are seen as the most crowded trade

Surveys this summer have seen fund managers reply 'long dollars' when asked what the most crowded trade in global financial markets currently is. Perhaps this should not come as a surprise given the trade-weighted dollar's near 14% rise this year – with only limited corrections.

True measures of dollar positioning remain hard to come by. Traditional gauges, such as net speculative positioning in FX futures markets, do not show extreme readings right now. However, scepticism is growing that this decades-old analytical tool accurately reflects the ever-changing list of participants in the FX market, including the growth of retail.

An alternative to positioning data is to gauge sentiment in the FX options market. Here the 'skew' towards dollar call options (the right to buy dollars) remains quite stretched. But far from calling a turn in the dollar's trend, in our opinion, this extreme bullish sentiment is well justified.

## The 'risk reversal' or 'skew' for dollar call options remains quite stretched



Source: Refinitiv, ING

DXY Risk Reversal is DXY-weighted of 3m risk reversal for relevant \$ FX pairs

## Macro factors continue to swing in the dollar's favour

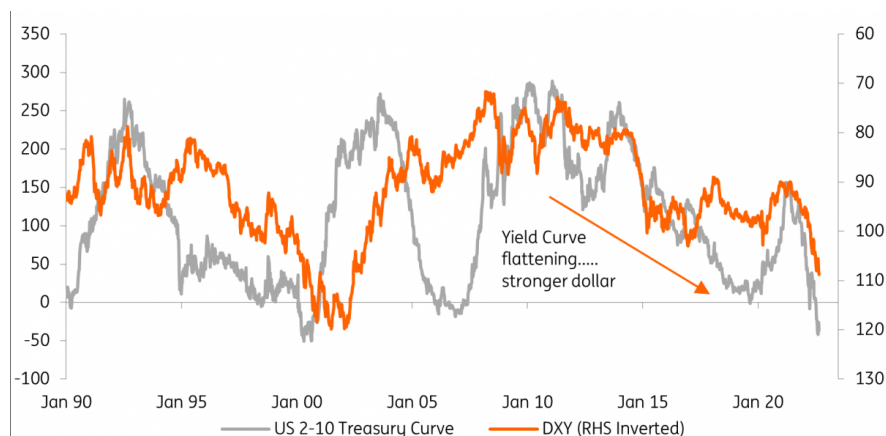
The macro factors that have driven the dollar to these levels are well-documented and remain firmly in place. The Fed is happy to remain very hawkish and drive rates deeper into restrictive territory. The Fed understands and indeed intends that US demand should slow to bring inflationary pressures into balance. Inverted yield curves and equity underperformance are typical of this late-cycle economy; it's an environment that typically sees the dollar outperform. These trends look set to dominate for the rest of 2022 and we do not see a dollar turn until the first quarter of next year if that.

Equally the challenges posed by the energy crisis have taken their toll on the importers in Europe and Asia. We have documented how this has [damaged the euro's fair value](#). And the loss of trade surpluses in Europe and Japan now undermines the status of the euro and the yen as safe haven currencies now that the natural demand from their trade accounts has dwindled.

Additionally, our team still feels that the ECB tightening cycle, rather than the Fed cycle, is more prone to being repriced lower. We look for the recent narrowing in yield differentials to reverse course. This should see EUR/USD remaining under pressure for most of the year, where the 0.95 level may well be tested.

# Inverted US yield curve typically occurs late in the economic cycle and is associated with a stronger dollar

US 2-10 year yield curve versus DXY (RHS Inverted)



Source: Refinitiv, ING

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