USD: Return of the king or just a breather from a crowded short trade

The sharp 2% bounceback in the broad US dollar index has raised some eyebrows and led to questions whether this is a new trend. But FX positioning data shows this has all the hallmarks of being another short USD squeeze - which has historically been short-lived

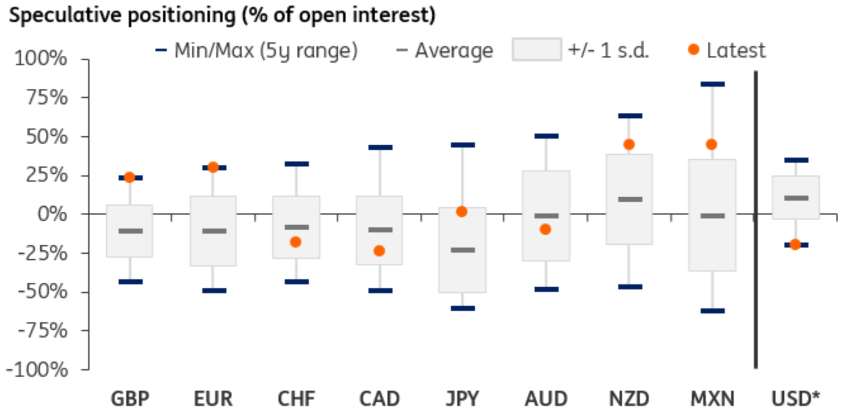
Key messages: Crowded FX positions unwind

- The sharp 2% bounceback in the broad USD (BBDXY) index over the past week has raised questions over whether this is the end of the dollar bear trend - or whether this is merely a pause as investors take stock of what the next big narrative in global markets will be. We believe it's a classic case of the latter - not least given that we've had a strange week or so of low Trumpian noise, while the extremely crowded positioning in G10 FX markets also lends itself to a bit of a breather in the medium-term USD downtrend.
- When looking at G10 FX price action, we note that there is a clear link between positioning and year-to-date performance (yes it's not rocket science!). As the second graphic below shows, those currencies that have had the largest bullish positioning adjustments in 2018 (Sterling, New Zealand dollar, Japanese yen, Euro

and Mexican peso) have also been the clear outperformers this year. Equally, the currencies with the biggest net long positions as of mid-April (MXN, NZD and GBP) have also been the ones that have sold-off the most against the USD over the past week. The clear link between FX positioning & performance means that the 2% USD rally has the hallmarks of being nothing more than a short squeeze - fuelled by (1) local factors (weak data for GBP and NZD; presidential election risks for MXN) and (2) a lack of impetus in the recent drivers for USD weakness.

- The EUR is a slight anomaly here in that its weakness this week hasn't been as pronounced as its long positioning would suggest - though we chalk this down to (1) some focus on this week's ECB meeting and (2) the fact that EUR long positioning has been a function of growing bullish sentiment amongst real money investors - who are happy to play the 'long game'. For more see our April ECB Meeting Crib Sheet.
- A sharp squeeze in short USD positions is not surprising given the lack of further impetus in the array of weak USD drivers - namely US political uncertainty (stemming from either trade or geopolitical risks), a sell-off in relatively expensive US assets or a strong Rest of the World growth story. Equally, it seems that initial dawning of more structural forces like the rising US twin deficit - and the administration's implicit weak USD policy - has already taken place. These structural narratives may require something (maybe a policy announcement or tweet) to once again become active - though we do believe that they will continue to exert downward pressure on an overvalued US dollar over the coming quarters.
- Looking at previous occasions when we've seen a similar sharp squeeze in short USD positioning, we note that the follow-through into USD spot price action has been fairly short-lived. On average the BBDXY index has been 1.1% higher after two weeks - after which there is no clear pattern to which direction the USD will take. If we take the most recent episode - October 2017 - as a precedent, then we could see the USD remain at these elevated levels for around three-four weeks - before the next wave of weakness kicks in. But given the high degree of uncertainty around US trade and foreign policy, we're aware that we may be only one tweet away from this coming much sooner.

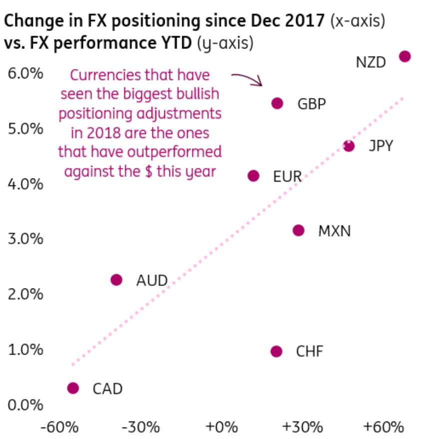
ING FX Positioning Dashboard | Taking a breather from crowded positions

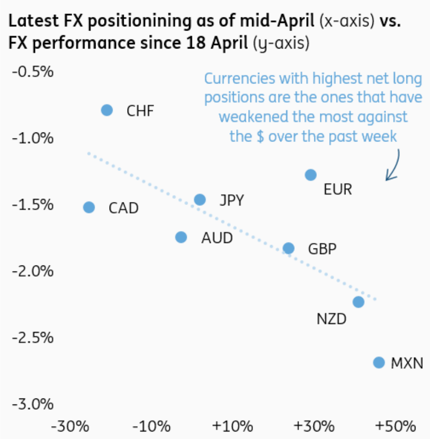


Currency (USD base)	Week Change	Latest net positioning	YTD Change	Weekly Signal	Monthly Sentiment
NZD	+4%	+45%	+68%	Bullish	Bullish
CHF	+3%	-18%	+20%	Bullish	Bearish
CAD	+2%	-24%	-55%	Neutral	Bearish
EUR	+1%	+30%	+12%	Neutral	Bullish
USD	+0%	-19%	-12%	Bullish	Bearish
JPY	-0%	+2%	+47%	Neutral	Bullish
GBP	-0%	+23%	+21%	Neutral	Bullish
AUD	-8%	-10%	-39%	Neutral	Bearish

*Note: Aggregate USD positioning. Source: CFTC, Bloomberg, ING as of 17 Apr 2017 (data reported with a lag)

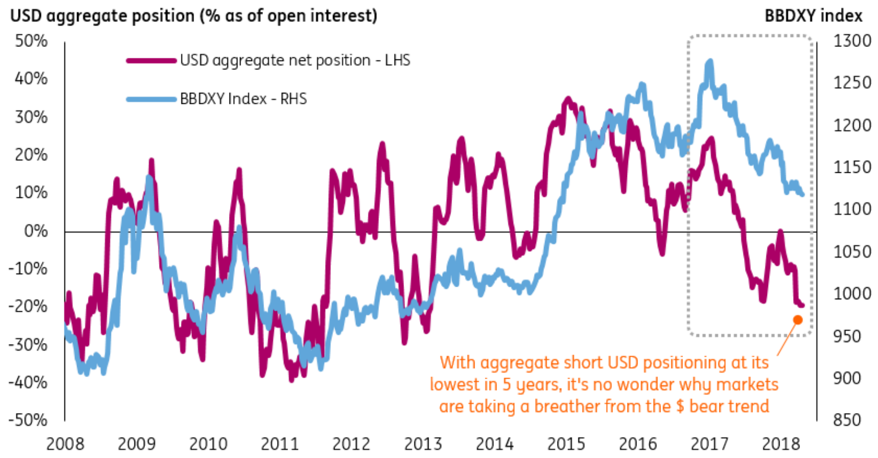
USD rebound screams of positioning adjustment more than anything else...



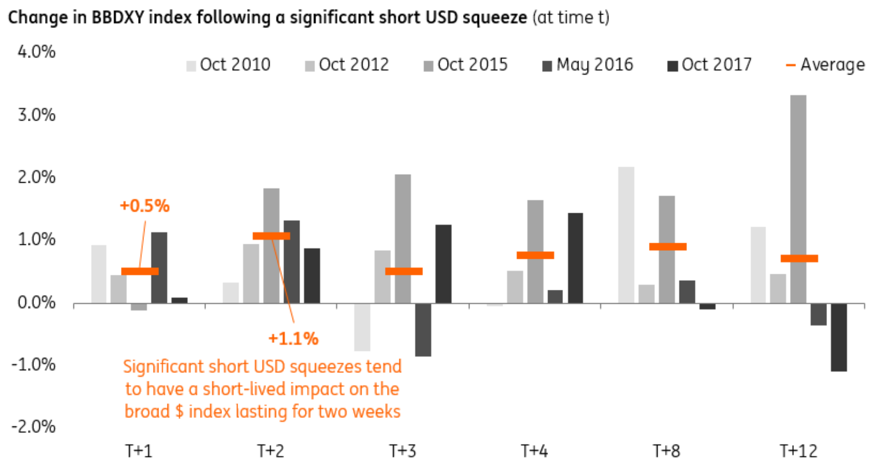


Source: CFTC, Bloomberg, ING estimates

USD bear trend since 2017 coincides with a sharp positioning adjustment



USD rebounds during past short squeezes have been short-lived and shallow



Source: ING estimates, Bloomberg, CFTC. Note: Time period (t) is weekly

Author

Viraj Patel
Foreign Exchange Strategist
+44 20 7767 6405
viraj.patel@ing.com