29 June
Article

FX Positioning: Shorting North America

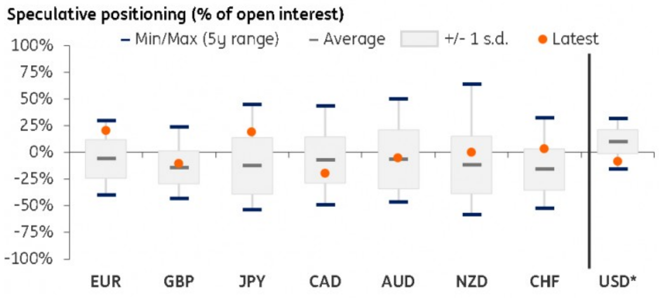
North American currencies remain centre stage in the latest CFTC report, as CAD stays in deep oversold territory and USD net positioning is nearing its five-year lower bound. A look at DXY positioning, however, suggests the build-up in USD shorts may not be losing steam just yet. Meanwhile, GBP positioning is left without support as risk appetite stalls

Source: Shutterstock

Content

CFTC data ending 23 June points to a broad stabilisation in G10 FX positioning after the large swings recorded in the previous week (which we discussed in "FX Positioning: Great escape from the dollar"). As shown in Fig. 1, the biggest moves in the week 17-23 June were again seen by the New Zealand and Australian dollars, which are now well into neutral territory. In the rest of G10, the moves were quite mixed, with the Japanese yen advancing again and the Swiss franc losing ground, while euro and Canadian dollar positioning remained flat.

Fig. 1 - FX Positioning overview



Currency (USD base)	Week Change	Latest net positioning	YTD Change
EUR	-0.1%	+20%	+34%
GBP	-1.3%	-11%	-17%
JPY	+1.6%	+19%	+33%
CAD	+0.5%	-20%	-27%
AUD	+2.1%	-5%	+18%
NZD	+7.0%	-0%	+10%
CHF	-1.1%	+3%	+14%

*Note: Aggregate USD positioning versus G10 FX. As of 23 Jun 2020 (data reported with a lag).

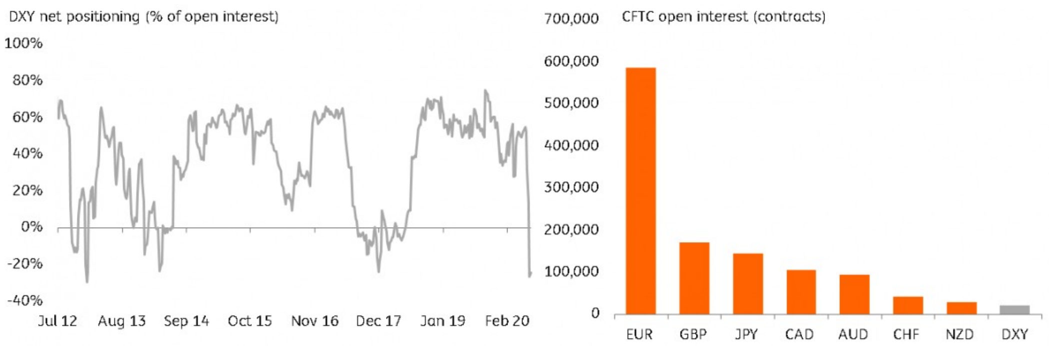
Source: CFTC, Bloomberg, ING

More room to build USD shorts?

The dollar aggregate net positioning (weighted vs the rest of reported G10 currencies) inched lower from -8% to -9% of open interest in the week under analysis. The chart in Fig. 1 shows how this measure of USD positioning is starting to approach the bottom of its five-year range and is now outside of its 1-standard deviation band.

While this could be read as an indication that more downside to the dollar's speculative positioning is limited, a look at DXY (the ICE US dollar index) net positioning could suggest the opposite. The gauge recently dropped sharply into oversold territory and is below its five-year lower bound, actually being at a level that was last seen in 2012 (Fig. 2). The dollar positioning and DXY gauges show very similar weights (with EUR accounting for around half of the total, Fig. 3).

Fig. 2 & 3 - DXY positioning and open interest



Source: CFTC, Bloomberg, ING

A few points must be clarified. The DXY positioning is an alternative way of looking at speculative sentiment on the dollar, but we hardly ever include it in our analysis as the number of contracts on the DXY (as reported to CFTC) is even lower than the least liquid of the other G10 currencies (NZD, Fig. 3) and in turn the DXY positioning gauge shows some excessive volatility. Deriving USD positioning from the other reported G10 currencies ensures, in our view, greater accuracy.

However, as the dollar positioning has shown some dislocation with market dynamics in the past few months – which dented its informative power – using alternative measures to gauge the real market positioning is likely warranted. For example, we looked at retail investor sentiment in this article.

With this in mind, the DXY's fall below its five-year minimum may suggest that there is additional room for USD net shorts to build.

$-bloc: CAD still left behind

In our commentary last week on FX positioning, we highlighted how the big jump in AUD and NZD net positioning was mostly the result of a sharp increase in long positions rather than a fully-fledged short-squeeze. This appeared to be particularly true for NZD, which had actually seen its shorts increase in the week. In the latest CFTC report, NZD net positioning increased again but this time shorts dropped from 60% to 55% of open interest, at pre-pandemic levels. NZD is now showing a perfect balance of shorts and longs.

The Canadian dollar, instead, remains the biggest short in G10 (-20% of open interest) according to CFTC data. What's surprising is the divergence with the antipodeans. Indeed, AUD and NZD have been sheltered from the crash in oil prices and have benefited from resilience in Chinese demand. They have also benefitted from the success of Australia and New Zealand in countering the spread of the virus, although new clusters have recently emerged in Melbourne. In the case of AUD, the surge in iron ore prices also played a role. These factors have contributed to the AUD and NZD recovery, which has been more marked than that seen in CAD.

At the same time, the Canadian dollar has seen some improvement in its fundamentals. In addition to the recovery and stabilisation of oil prices, the economic outlook looks better following employment data which signals a V-shaped recovery.

In turn, we would not be surprised to see CAD positioning recover in the coming weeks, a delayed response to the spot dynamics which was also seen in AUD and NZD. At the same time, the divergence within the dollar-bloc likely points to the fact that CAD net-shorts are likely stickier than most of the other G10 currencies, which could suggest some upside potential for the loonie from short-squeezing. We expect USD/CAD to move below 1.30 before the end of the year.

GBP: If sentiment stalls, Brexit takes over

The recovery in GBP net positioning over the past few weeks was, in our view, mostly a function of the better risk environment (and broad USD weakness) finally being mirrored in CFTC data. The dynamics in the last reported week likely endorse this view: as risk sentiment started to stall, GBP net shorts are back on the rise.

The reason is, once again, tied to uncertainty over the UK-EU trade negotiations. In this sense, we continue to see room for more stress on GBP to build in the coming weeks as trade talks intensify (a new round of meetings is set to start this week). Accordingly, further increases in net shorts may be on the cards.

Although the UK government is taking steps to reopen the economy and reportedly working on an infrastructure boost, lingering short positioning is telling us that Brexit uncertainty will continue to drive the large majority of GBP moves.

Francesco Pesole
FX Strategist
+44 207 767 6405
francesco.pesole@ing.com

Disclaimer