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Liquid Insight

FX flows in '24 – half a step back

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Rates and Currencies Research
Global

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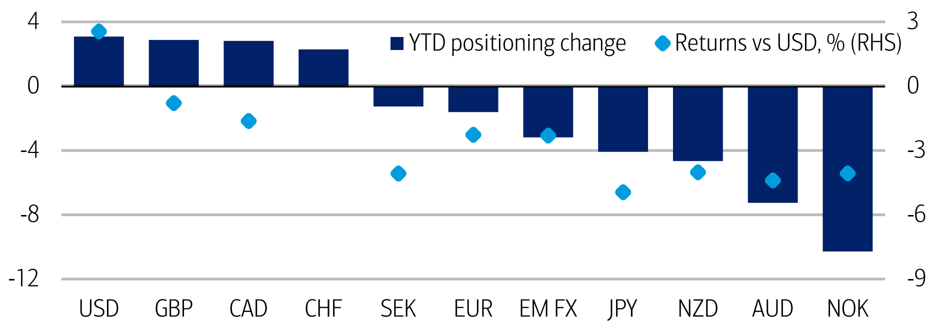
Key takeaways

- Investors took half a step back at the start of '24, buying USD largely across the board, a partial reversal of end-23 action
- The price action seems driven by Hedge Funds, and is more strongly correlated with our Asia investor flows
- In the options space, recent activity has been along similar lines, with the demand for USD calls picking up

By Michalis Rousakis, Athanasios Vamvakidis, Vadim Iaralov, and Howard Du

Chart of the day: Change in BofA aggregate FX positioning YTD vs. price action
FX positioning changes have been well in line with the price action



Source: BofA Securities, Bloomberg. Note: Data are for the period Dec 29-Feb 2. +50 (-50) is max long (short) positioning level vs history. Currencies ranked on their YTD positioning change. We use DXY for USD and the JPMorgan Emerging Market Currency Index for EM FX.
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A partial reversal of the end-'23 FX flows marked the start of '24. Toward the end of '23, investors sold USD, largely across the board and especially vs. EM FX, amid the improved US inflation outlook and the dovish December FOMC meeting. But the resilient US activity data forced a partial rethink among investors at the start of '24, already ahead of the relatively hawkish January FOMC meeting and the solid payrolls report, according to our proprietary FX flows. The recent activity in the FX options space has been along similar lines, with the demand for USD calls picking up.

This year's FX price action seems to be Hedge Fund-driven, and correlates well with Asia-based investor flows. Near-term USD upside would likely require stronger Real Money participation, but we would watch the Hedge Funds' space for a USD sell-off. Overall, FX positioning remains light in most cases, and the recent investor positioning changes suggest somewhat reduced positioning risks to most of our trade recommendations.

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Partial pullback at start of '24

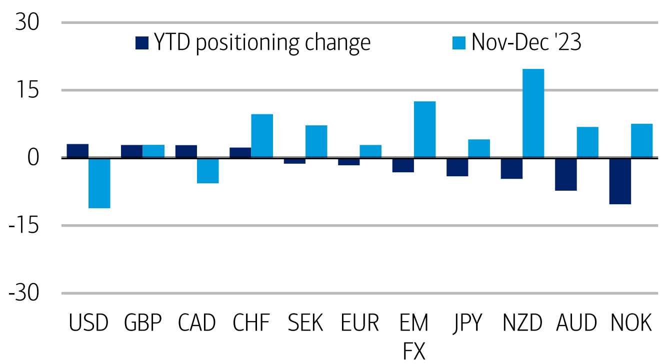
A partial reversal of the end-2023 FX flows marked the start of 2024 (Exhibit 1).

Toward end-'23, investors sold USD – largely across the board and especially vs. EM FX – amid the improved US inflation outlook and the dovish December FOMC meeting, largely in line with the price action (see also FX flows & positioning in 2023 19 Jan 24).

But the resilient US activity data forced a *partial* rethink among investors at the start of 2024. This *preceded* the relatively hawkish January FOMC meeting and the solid payrolls report: already in early January, our FX & Rates Sentiment Survey (with cut-off on Jan 10) suggested the USD selling had stopped (FXRS 12 Jan 24), which soon gave way to some USD buying (LCBF 22 Jan 24).

Overall, in the first five weeks of '24, we have seen a partial reversal of the year-end USD selling largely across the board, with changes in our aggregate FX positioning measure well in line with the price action (see Chart of the Day).

Exhibit 1: Change in FX aggregate positioning YTD vs. Nov-Dec 2023
A partial reversal of the end-2023 FX flows marked the start of 2024



Source: BofA Securities, Bloomberg. We show changes in aggregate positioning. Aggregate positioning is the equally-weighted average of five inputs (BofA Hedge Funds, BofA Real Money, a signal from our monthly FX & Rates sentiment survey, TFF Leveraged Funds, TFF Asset Managers). Each signal is scaled to +50 and -50. Where fewer than five inputs are available (Scandies, CHF, EM FX), aggregate positioning assigns equal weights to all available inputs. .For details, please see LCBF: Primer 26 May 2021

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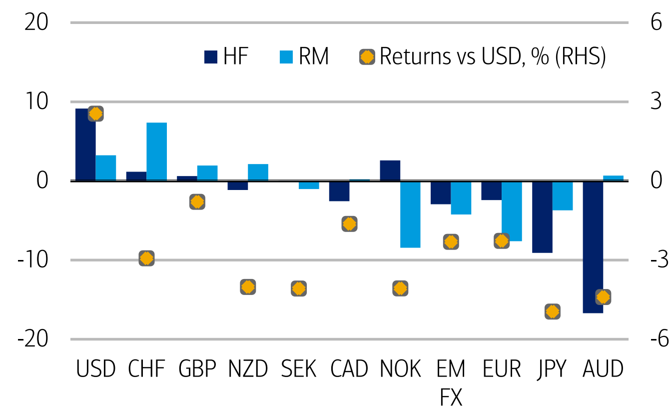
Exhibit 2: Change in BofA investor FX positioning YTD vs. price action
Price action year-to-date seems Hedge Fund-driven



Source: BofA Securities, Bloomberg. Note: Data are for the period Dec 29-Feb 2. +50 (-50) represents max long (short) positioning level vs history. Currencies ranked on the equally-weighted average positioning change across Hedge Funds and Real Money year-to-date. We use DXY for USD and the JPMorgan Emerging Market Currency Index for EM FX.

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Investor flows Hedge Fund-driven

Both Hedge Funds (HF) and Real Money (RM) have bought the USD year-to-date but, overall, the price action seems driven by Hedge Funds (Exhibit 2). Main highlights are:

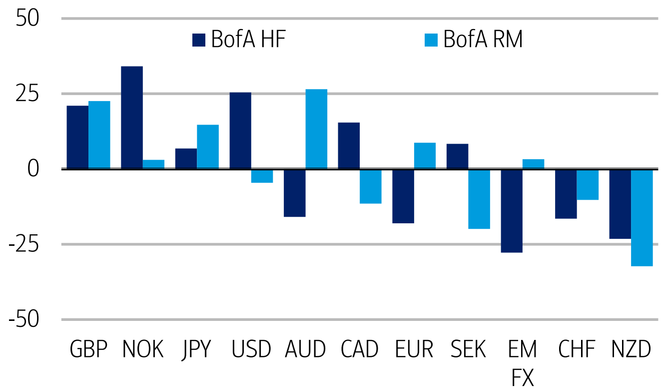
- Real Money have slightly pared back their USD shorts but, notably, Hedge Funds added to their longs – USD is now the second longest HF position in G10 (Exhibit 3).
- Real Money clients have led the pressure on EUR and EM FX so far this year but remain slightly long in both, while Hedge Funds have slightly added to their shorts.
- Despite Hedge Funds and Real Money having had similar (slightly long) JPY positions at the start of the year, the JPY supply this year has been Hedge Fund-led.
- Real Money have partly pared back their CHF shorts but Hedge Funds remain more skeptical on CHF.
- GBP flows have been neutral to slightly positive year-to-date from long levels at the start of the year.
- AUD pressure this year has been led by Hedge Funds. Meanwhile, the Real Money NOK longs reduction that started in Q4 has continued – they are now neutral NOK.

Light positioning overall

The latest FX positioning is overall light, taking into account signals from our proprietary investor flows, the CFTC (Commodity Futures Trading Commission) data, and our FX & Rates Sentiment survey. We find the market roughly neutral USD, EM FX and EUR, long NOK, and short NZD (Exhibit 4).

Not all our investor positions in G10 FX are light, but none seems heavy either (again Exhibit 3). Of note is Hedge Funds' long USD position vs the Real Money's largely neutral position. Given our diverging near-term and medium/longer-term FX views (see also 3 FX questions after a big macro week 7 Feb 24), this suggests near-term USD strength amid continued US data resilience would likely require stronger Real Money participation. But for the USD to (eventually) sell off, we would watch the Hedge Funds' space.

Exhibit 3: Latest BofA investor FX positioning levels
Hedge Funds long USD but Real Money now almost back to neutral



Source: BofA Securities. Note: +50 (-50) represents a max long (short) positioning relative to history. Currencies ranked on the equally-weighted average across Hedge Funds and Real Money.
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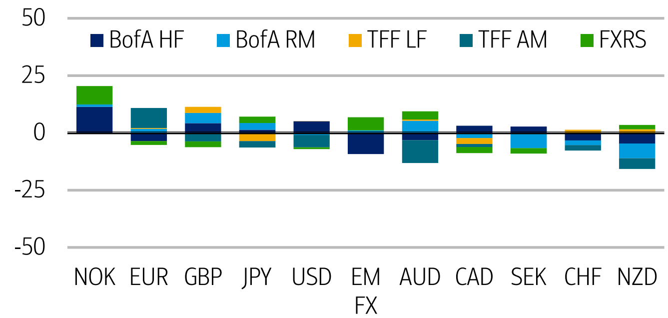
Exhibit 4: Latest aggregate G10 FX positioning level decomposition
Aggregate FX positioning largely neutral in most cases, long NOK, short NZD



Source: BofA Securities, Bloomberg. Aggregate positioning is the equally-weighted average of five inputs (BofA Hedge Funds, BofA Real Money, a signal from our monthly FX & Rates sentiment survey, TFF Leveraged Funds, TFF Asset Managers). Each signal is scaled to +50 and -50. Where fewer than five inputs are available (Scandies, CHF, EM FX), aggregate positioning assigns equal weights to all available inputs. .For details, please see LCBF: Primer 26 May 2021
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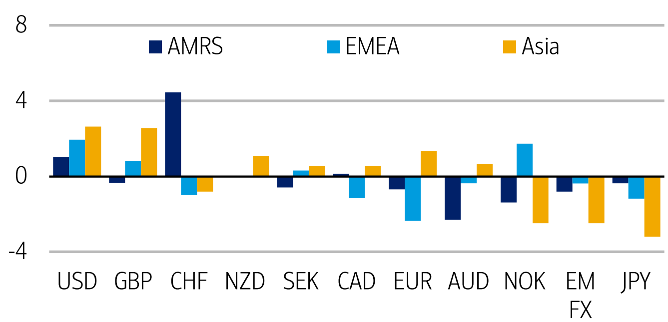
Asia investors refuse to sell the USD

The USD has been supported in all regions but more so by Asia-based investors (particularly vs. EM FX and JPY), whose flows year-to-date have been correlated meaningfully with the price action (Exhibit 5).

- Notably, Asia and EMEA investors were reluctant to sell USD in Nov-Dec '23, with the year-end USD sell-off seemingly led by AMRS investors (Exhibit 6).
- Of note to us have also been the persistent EUR selling by EMEA investors in the past three months and the JPY selling by both EMEA and Asia investors.

Exhibit 5: FX flows by region year-to-date
USD has been supported in all regions but more so by Asia-based investors



Source: BofA Securities. We sum the weekly flows' (2-year) z-scores, attaching equal weights to flows by Hedge Funds and Real Money. Currencies ranked on their sum of z-scores across regions
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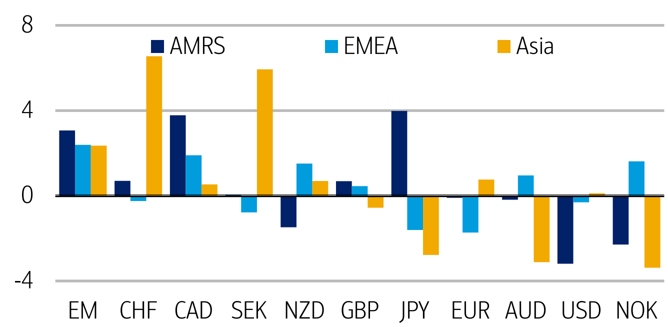
Exhibit 6: FX flows by region in Nov-Dec 2023
EUR under persistent pressure by EMEA investors, JPY by Asia investors



Source: BofA Securities. We sum the weekly flows' (2-year) z-scores, attaching equal weights to flows by Hedge Funds and Real Money. Currencies ranked on their sum of z-scores across regions
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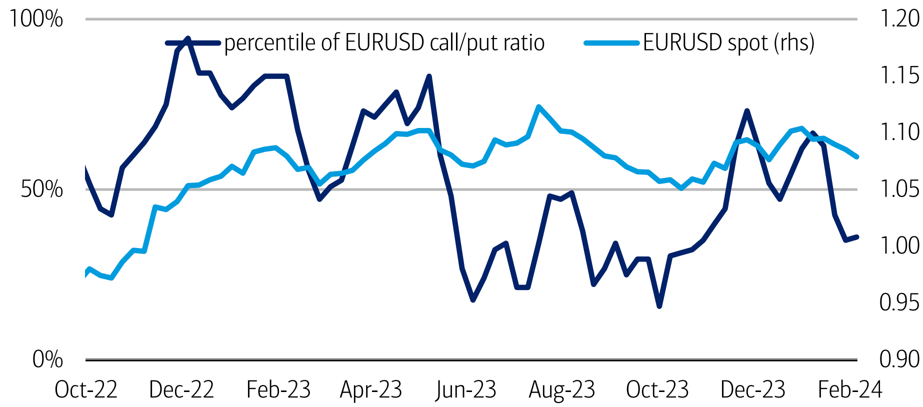
Demand for USD calls picked up year-to-date

In the first half of 2023, the options market consistently showed demand for EUR calls vs the USD. Demand for EUR calls became more subdued in Q3 '23 on the back of the 10-week USD rally through Oct '23 and picked back up again in the last two months of the year as a result of the Q4 '23 USD selloff. Year-to-date, option investors have been buying more EURUSD puts than calls, bringing the latest call/put ratio for the last four weeks to below 50th percentile (Exhibit 7). As it currently stands, option investors are more bearish than bullish on EURUSD, with more room for the bearish option positioning to grow.

Exhibit 7: Demand for EURUSD put picked up as spot grinded lower in 2024
EURUSD weekly spot vs call/put ratio



Source: BofA Global Research, Bloomberg, DTCC. EURUSD call/put ratio has been normalized into a 4-week rolling average of 6m rolling percentile. A higher percentile corresponds to more demand for EURUSD calls; lower percentile corresponds to more demand for EURUSD put. Charts the evolution of weekly EURUSD call/put flows for options under 3m tenors.

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Positioning changes vs. our trade recommendations

Overall, the G10 FX positioning remains light, and this year's investor positioning changes suggest somewhat reduced risks to our recent trade recommendations:

- Tactically buy GBPCHF (current spot: 1.1028; see FX Alpha: Tactical Trade: Buy GBP/CHF 5 Feb 24). Risks to the trade are heightened geopolitical tensions or a fiscally damaging UK Budget (6th March).
- Tactically sell EURJPY (current spot: 160.17; see FX Alpha: Buy 3m EUR/JPY put spread 26 Jan 24). Risks to this trade are markets pricing a more dovish BoJ stance or a more hawkish ECB stance.
- Buy NOKSEK (current spot: 0.9895; see FX Alpha: Buy NOK/SEK 1 Feb 24). Risks to this trade are lower oil prices and softer than expected Norway data.

Our investor positioning changes year-to-date may suggest slightly increased risks to our tactical long USDSEK recommendation (current spot: 10.46; see FX Alpha: Buy USD/SEK 5 Feb 24), but we find these clearly lower relative to early Q4. Risks to this trade are US data softening more and faster than we expect, leading markets to price a higher chance of Fed rate cuts before June, and upside inflation surprises in Sweden.

Beyond the near term, we think there is room for USD to sell off once markets have onboarded the US data resilience and recalibrated a little further the Fed stance – our year-end EURUSD forecast remains at 1.15, but we have kept it at 1.07 at end-Q1 (see also Global FX Weekly 2 Feb 24 and USD Year Ahead 25 Jan 24).

Notable Rates and FX Research

- **Global Macro Year Ahead 2024 -** Hope for the best, prepare for the worst, 19 Nov 2023
- **Global Rates Year Ahead 2024 –** Cloudy with a chance of landing, 19 Nov 2023
- **G10 FX Year Ahead -** The year of the landing, 20 Nov 2023
- Into month-end and the Fed, **Liquid Cross Border Flows**, 29 Jan 2024

Rates, FX & EM trades for 2024

For a complete list of our open trade recommendations, as well as our trade recommendations closed over the past 12 months, see the reports below:

Global FX Weekly: Despacito 02 February 2024

Global Rates Weekly: Confidence text 02 February 2024

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