Trade Idea – Foreign Exchange
Swiss National Bank forced to act
3rd December 2015

USD/CHF at five-year highs

- The USD/CHF currency pair hit a five year high last week as investors continue to price in a divergent rate outlook between the US and Switzerland. In the US, lower unemployment and signs of strong manufacturing activity have increased the likelihood of a December interest rate hike, while in Switzerland 0% growth and deflation appear set to keep monetary conditions loose. In addition, the probable expansion/extension of the European Central Bank’s (ECB) asset purchase programme has stoked speculation that the Swiss National Bank (SNB) will be forced to cut benchmark interest rates further into negative territory (currently at -0.75%). We believe that expectations of monetary policy divergence with the US Federal Reserve (Fed) is currently reflected in short term nominal yields and will keep the USD/CHF rising over the next month, presenting a good tactical opportunity to build long exposure to the currency pair.

ECB action could drive looser monetary policy

- After months of rhetoric, it is likely that the ECB will finally expand/extend its quantitative easing (QE) programme at its December monetary policy meeting on Thursday. For the SNB, the concern is that additional QE will place upward pressure on the CHF, harming its key export market in the EU, which is worth approximately 33% of the country’s GDP (Source: Eurostat, European Commission). The country is already reeling from the decision to remove the currency peg in January, which led to a strong appreciation in the CHF against the Euro early in 2015. We expect that any decision to increase stimulus by the ECB will force the SNB to act with the aim of limiting any appreciation of the CHF (against the Euro) from what it already considers to be “significantly overvalued” levels. Additional intervention in currency markets is likely to be the first ‘go-to’ tool for the SNB ahead of its policy meeting in mid-December.

Further CHF weakness to come

- At the time of writing, 10-year Swiss government bond yields have reached record lows. Growing expectations of a SNB rate cut in December are driving government bond yields lower. Since August, the USD/CHF currency pair has been closely

**Figure 1: Rate outlook drives USDCHF**

Nominal Yield Differential = (US 2Y Yield - Swiss 2Y Yield), %
Source: Bloomberg, ETF Securities

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tracking the short term nominal interest rate differential between the US and Switzerland (see Figure 1). The spread suggests that further CHF weakness against the US Dollar is to come, which should be reinforced by both Fed hiking rates at a time when the SNB remains cautious about the economic environment. We therefore anticipate the USD/CHF to continue on its current trajectory and climb higher in coming weeks.

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