Trade Idea – Foreign Exchange

SNB prompts feelings of déjà vu

4th February 2016

Swiss Franc continues to weaken

- The Swiss Franc has continued to march lower in 2016. Recent market turmoil and dovish rhetoric from the European Central Bank (ECB) have both failed to attract support for the currency, which has fallen 1.8% year to date on a trade weighted basis (Source: Bloomberg). While prospects for the Swiss economy look more positive this year than the last, the monetary policy outlook remains accommodative and continues to keep the CHF pressured. In the build up to the March meeting of the Swiss National Bank (SNB) on the 17th, we continue to expect the USD/CHF and EUR/CHF to climb higher as domestic growth and inflation metrics remain subdued and the SNB maintains its dovish disposition.

Figure 1

Source: Bloomberg, ETF Securities

SNB message remains consistent

- In a recent speech to the Swiss Press Club in Geneva, Thomas Jordan the SNB chairman re-iterated the Bank’s central message that the CHF remains “significantly overvalued” and that authorities remain poised to intervene in currency markets if necessary. This is the same message that has been delivered over the past 12 months, during which time the trade-dependent economy has witnessed growth stall, falling to 0% in Q3 15 (QoQ basis), and deflation take grip (see Figure 1). Swiss retail sales and exports have also continued to trend lower as the after effects of the SNB’s surprise decision to remove the currency peg still impact the nation’s economic performance. This economic backdrop will ensure the SNB keeps monetary conditions loose for the foreseeable future and should place the CHF under pressure against the Euro and US Dollar in coming weeks.

Interest rate divergence

- Market expectations of multiple US rate hikes this year have declined, causing the US-Swiss nominal interest rate differential to drop (see Figure 2). We expect this trend to reverse in coming months as a healthy US labour market and signs of increasing wages lead to greater domestic inflationary pressure and in turn boost expectations of further tightening by the US Federal Reserve in 2016.
Figure 2

Yield differential declines...

Recent trend to reverse...

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

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