Currencies: Swiss franc

SNB's support to the franc has ended

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FLASH NOTE

SUMMARY

- Following Swiss franc strengthening in December, Thomas Jordan, the chairman of the Swiss National Bank, has started to sound more vocal about the value of the franc and its impact on the Swiss economy, suggesting limited appetite for further FX interventions aimed at strengthening the Swiss currency.
- Recent data on capital flows also point to a less supportive environment for the franc in 2024.
- Should global economic perspectives improve, the search for higher yields may trump the positive impact on the franc of a likely narrowing of interest-rate differentials.
- Our three-month projection for the EUR/CHF rate is CHF0.95, while our 12-month projection stands at CHF0.99.

FRANC'S VOLATILITY HAS PICKED UP IN THE PAST WEEKS

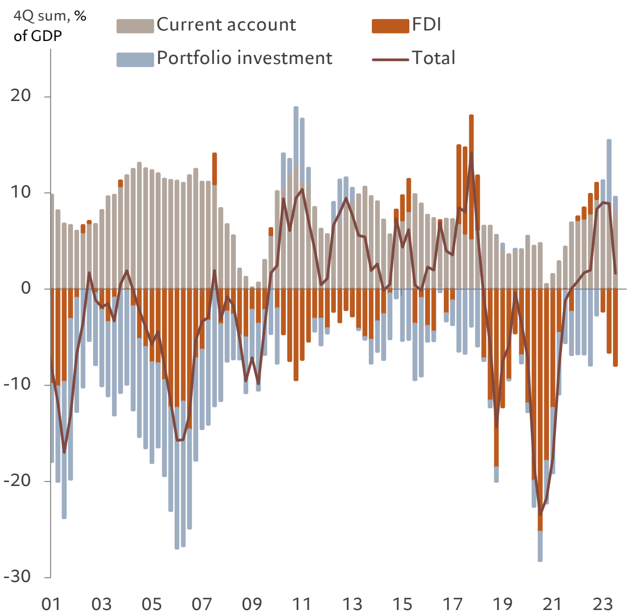
At CHF0.93 per euro on 29 January, the Swiss franc is slightly stronger than when we published our last Flash Note on the currency on 7 December, but with a lot of volatility in the interim. The franc weakened after the Swiss National Bank (SNB) said it was no longer focusing on foreign currency sales at its 14 December meeting, then appreciated significantly in the last days of the year, only to depreciate again for most of January, helped by SNB chairman Thomas Jordan who on 17 January chose to highlight the strength of the franc in real terms. Then, in the final trading days of the month, the franc strengthened again on the back of increasing geopolitical tensions. In particular, the disruptions in supply chains caused by attacks on merchant ships in the Red Sea have led to increasing shipping costs, which could drive inflation higher, especially in the euro area.

CAPITAL FLOWS ARE SHOWING SIGNS OF DETERIORATING

One of our key assumptions in predicting some franc depreciation this year is the prospect of reduced support for the currency from Switzerland's balance of payments. Q3 data tend to back this assumption (*see chart 1*). There were massive net outflows from Swiss debt securities in that quarter (*see chart 2*), reversing the support the franc received from net capital inflows in previous quarters. What's more, the current, high account surplus may find it hard to improve any further, while net foreign direct investment (FDI) has been negative since Q1 2023 (on an annualised basis).

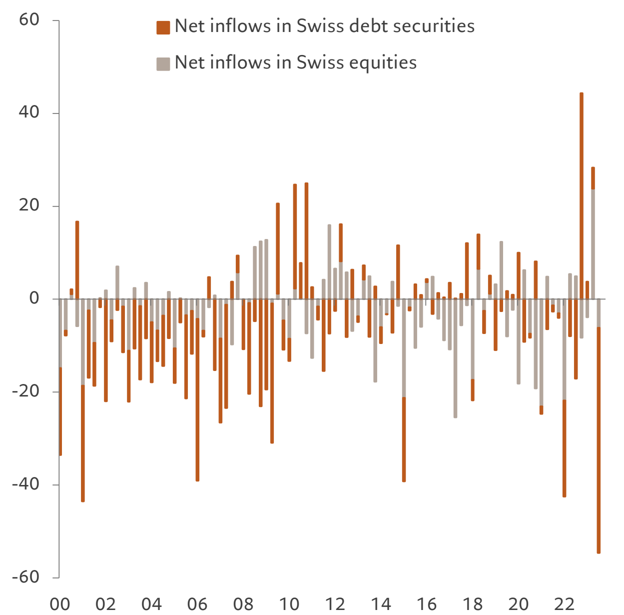
Interestingly, the strengthening of the franc at the end of 2023 coincided with a sharp unwinding of short Swiss franc positions by asset managers in the futures market (*see chart 3*). While the behaviour of such investors has significantly changed since 2018, they have rarely held large net long CHF positions, except in 2020 at the height of the covid pandemic. As in the case of capital flows, the scope for building net long positioning looks limited and the opposite more likely absent a significant external shock.

Chart 1: current account, portfolio inv. & foreign direct inv.



Source: Pictet Wealth Management, LSEG, as of 29.01.2024

Chart 2: Switzerland: portfolio investment flows (as CHFbn)



Source: Pictet Wealth Management, LSEG, as of 29.01.2024

IS THE SNB BECOMING CONCERNED ABOUT THE FRANC'S STRENGTH?

More significant, perhaps, is Thomas Jordan's recognition on 17 January that the franc's recent appreciation in real terms may have a material impact on the inflation outlook. Jordan's comments make it more improbable that the SNB will intervene again to prop up the franc unless the currency depreciates significantly or inflation rebounds too strongly for the central bank's liking.

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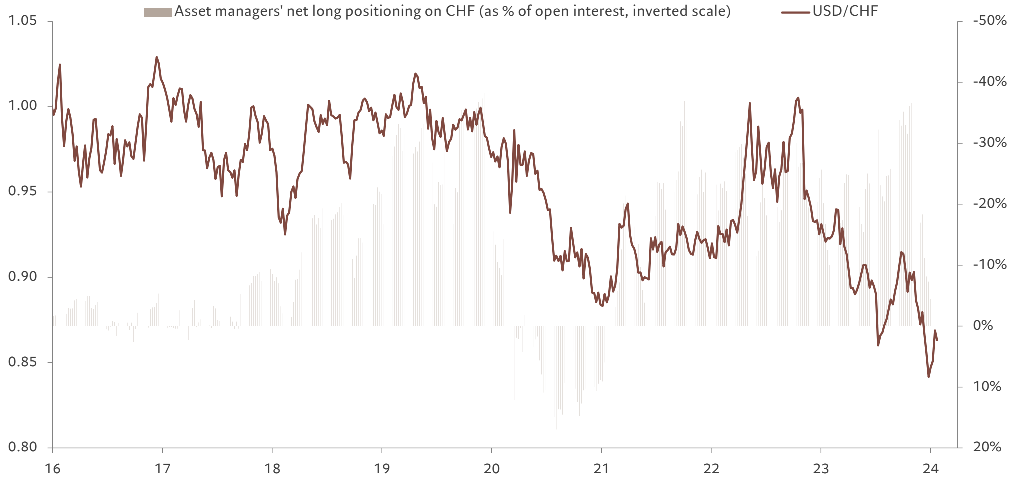
We are not convinced that the SNB will easily revert to its old habit of curbing an overly strong Swiss franc through FX interventions. While monthly inflation dynamics have looked tame of late in Switzerland, the SNB's own inflation forecast does not point to a risk of deflation. This lessens the likelihood that the SNB steps in to purchase foreign currencies to weaken the franc. That said, as highlighted by Thomas Jordan on 17 January, the strengthening of the franc during December "needs to be taken into account" as it "pushes down inflation". Given the relatively subdued economic outlook, Jordan's comments would seem to increase the chances that the SNB follows other major central banks' lead by cutting rates this year.

CHART 3: USD/CHF and CFTC asset manager net long CHF positioning (futures only)



Source: Pictet Wealth Management, LSEG, as of 29.01.2024

STICKING TO OUR FORECAST OF A WEAKER FRANC IN 2024

We acknowledge that the downward pressure on interest rates globally may help the low-yielding Swiss franc through a narrowing of interest-rate differentials. The current geopolitical tensions in the Middle East may also help the franc through safe-haven demand—although it remains to be seen how durable this support lasts. In the longer term, should the global economic outlook improve later this year, as we believe, investors are likely to search for higher returns than those offered by Swiss assets.

A further source of support for the franc could come from resurgent concerns among investors about highly indebted economies in an environment of higher interest rates. While debt dynamics in European countries may not worsen significantly in the next few quarters, concerns may become more acute in the US ahead of the presidential election in November. In such circumstances, Switzerland's low and stable debt-to-GDP ratio may afford the franc some additional support.

Overall, our scenario remains for a weaker franc in 2024 due to a deterioration in capital flows (from very supportive levels) and reduced support from the SNB. In the next three months, the Swiss franc may remain strong relative to the euro in the context of weak economic activity. But the expected deterioration in capital flows into Switzerland should eventually takes its toll on the franc and lead to some

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underperformance later this year. Our three-month projection is at CHF0.95 per euro while our 12-month projection stands at CHF0.99. Based on our EUR/USD forecasts, the implied USD/CHF rate is at CHF0.91 per USD and CHF0.90 on a three-month and 12-month time horizon, respectively.

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