G10 Forex

Forex

CHF – Swiss Franc

The franc remains "highly valued" mostly due to the presence of global risks and uncertainty. The SNB has therefore reasserted the need to keep monetary policy accommodative and, most of all, that it is ready to act on the currency market if necessary. Weakening expected beyond the near term, but risks are skewed upwards.

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Research Department

Macroeconomic and Fixed Income Research

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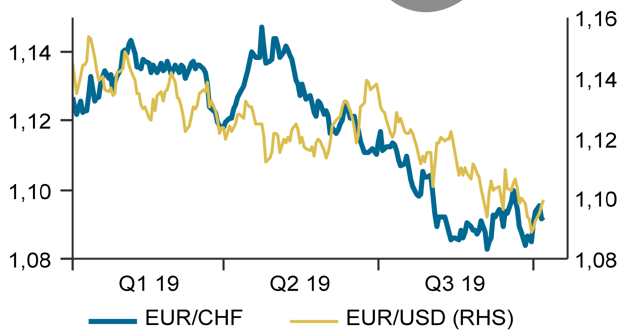
The Swiss franc has progressively appreciated against the euro in the course of 2019, displaying a particularly strong trend between April and September, when it rose from lows in the EUR/CHF 1.14 area to highs in the EUR/CHF 1.08 area (Fig. 1). The underlying trend of the EUR/CHF exchange rate remains essentially aligned with that of the EUR/USD, which has also weakened in the course of the year, although the positive correlation between the EUR/CHF and the EUR/USD has slackened somewhat compared to the average for the past few years, proving more sensitive to global developments. Specifically, the strengthening of the franc is tied to the **deterioration of the international scenario,** where the widespread slowdown of activity growth is made worse by the risks stemming from US-China trade tensions and geopolitical uncertainty, in relation to Brexit in particular. The scope and persistence of these risks have helped enhance the franc's role as a "safe haven" currency, resulting in its appreciation also in terms of the effective exchange rate (Fig. 2).

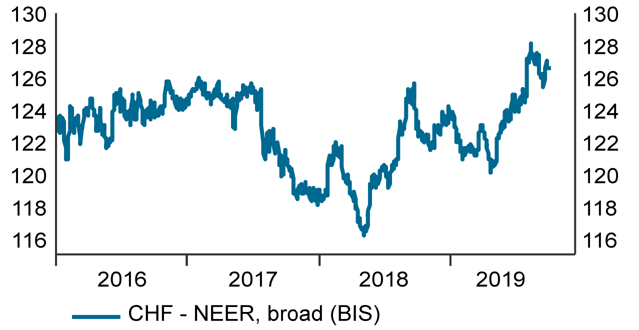
The deterioration of the global picture is having negative repercussions on the Swiss economy as well, as also pointed out by the central bank at its latest monetary policy meeting, held on 19 September. On that occasion **the Swiss National Bank revised down both its growth forecasts** for this year, to 0.5%-1.0% from an estimate of around 1.5% dating back to the previous meeting in June **and, more importantly, its inflation forecasts,** to 0.4% from 0.6% for this year, to 0.2% from 0.7% for 2020, and to 0.6% from 1.1% for 2021. The SNB explained that the change in growth forecast was in part due to the downward revision of the series in 2H 2018 and in 1Q 2019. For what concerns the inflation forecasts, on the other hand, the SNB said that the revision was prompted by the weakening growth and inflation outlook at the international level and by the strengthening of the exchange rate.

Fig. 1 – Franc strengthening as the euro weakens



Source: Thomson Reuters-Datastream

Fig. 2 – Franc strengthening in terms of the effective exchange rate as well



Source: Thomson Reuters-Datastream

More in detail, **the SNB continues to consider the franc as "highly valued"** and the situation on the currency market fragile. As a result, in light of recent developments on the international front and of the domestic inflation scenario, the central bank confirmed that **monetary policy needs**

to remain accommodative, leaving **unchanged at -0.75% the intervention rate**[1] and reasserting its **determination to act on the currency market if needed,** with the aim of containing unwelcome upward pressures on the exchange rate. The policy strategy remains unchanged: keeping interest rates in negative territory and confirming the determination to act on the exchange rate remain crucial in easing upward pressures on the franc and therefore stabilising the trend of inflation, while offering support to growth at the same time.

The only operational change introduced on occasion of the September meeting was the announcement of the **adjustment of the calculation basis for the negative interest rate applied to sight deposits held by banks with the central bank.** The banks will continue to pay negative interest on the share of deposits in excess of a certain exemption threshold. The adjustment will concern this threshold, which starting on 1st November will be updated monthly based on the evolution over time of bank balance sheets, and will be effectively raised in order to reduce the costs for the banking system resulting from the presence of negative interest rates[2]. This move may even be a prelude to a potential rate cut, as in September the SNB left rates unchanged, whereas both the ECB and the Fed, respectively one week and one day beforehand, cut them, creating a gap in policy action which fuelled a strengthening of the franc against both the euro and the dollar on the wake of the SNB meeting.

The SNB's next monetary policy meeting will be held on 12 December. If in the meantime the international scenario should deteriorate further, leading the ECB and/or the Fed to implement additional accommodation, and/or economic data in Switzerland weaken further, the SNB could also decide to align and proceed with a rate cut. The key **data releases to monitor** at the domestic level will be: 3Q GDP growth, due out on 28 November, important in terms of the distance from the SNB's growth forecast for this year; inflation, due out on 1 November and 3 December, and the KOF leading indicator, due out on 30 October and 29 November. The central bank will also take into account the evolution of the exchange rate, in making its policy decisions: a significant further appreciation would prompt an easing, which in any case would also have to be considered in light of developments on the other fronts mentioned. Any speeches by SNB central bankers should also be monitored closely. In an address delivered on 2 October, Maechler stressed that monetary policy must remain accommodative to counter global uncertainty, making explicit reference to the key role played on this front by developments in the trade dispute between the US and China, and concerning Brexit. Maechler also explained that recourse to negative interest rates will be temporary, but that the difficulty lies in determining how long this "temporary" phase should last. Lastly, he affirmed the SNB's determination to act on the currency markets if deemed necessary.

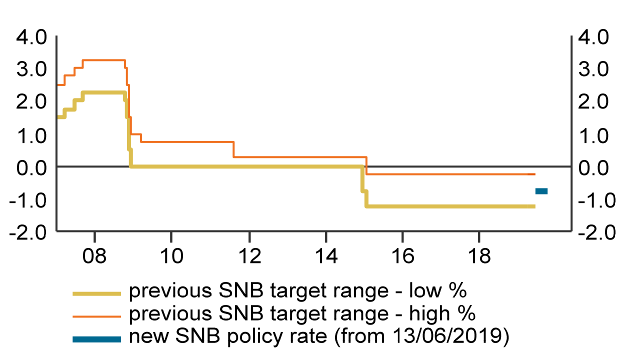
In light of the scenario of global uncertainty, which is unlikely to be resolved any time soon, we continue to expect the franc to **generally stabilise in the near term** against the euro, at its strong recent levels of EUR/CHF 1.08-1.10 on a 1m-3m horizon. **Subsequently,** on the other hand, **the franc should weaken back** towards EUR/CHF 1.12-1.13-1.15 on a 6m-12m-24m horizon, given the prospect of the SNB keeping monetary policy markedly accommodative for an extended period of time, at least equal to the ECB's timeline, to prevent a narrowing of rate/yield differentials to the advantage of Switzerland prompting an undesired appreciation of the Swiss currency. **The**

[1] The SNB introduced a single policy rate on occasion of the meeting held on 13 June 2019. The new intervention rate replaces the target range previously used for the 3m Libor, which until June was of between -1.25% and -0.25%, and corresponds to the rate on the sight deposits of banks held with the central bank, of -0,75% in June. This way, continuity of the parameters and of the monetary policy stance were maintained. The decision to introduce a new policy rate was dictated by the "lack of guarantees on the future of the Libor", as the British banking supervision authority will suspend contribution to this rate after the end of 2021, and the SNB drafts its conditioned inflation forecasts assuming unchanged interest rates along the entire forecasting horizon, which is three years long and would therefore extend to beyond 2021 (the details are explained by the SNB in the "Press Release – Monetary policy assessment of 13 June 2019": https://www.snb.ch/it/mmr/reference/pre_20190613/source/pre_20190613.it.pdf).

[2] The details are explained by the SNB in the "Press Release – Monetary policy assessment of 19 September 2019": https://www.snb.ch/it/mmr/reference/pre_20190919/source/pre_20190919.en.pdf).

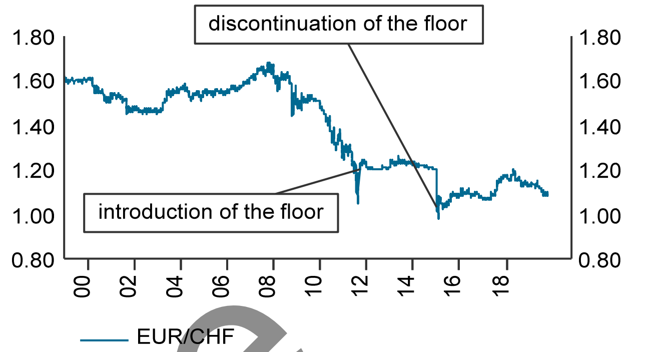
expected weakening, however, is modest, as the tendency towards a policy alignment between the SNB and the ECB should keep rate/yield differentials relatively stable. **Risks to the forecast outlook are skewed to the upside,** therefore the franc could prove stronger than expected (within EUR/CHF 1.06-1.05 in the near term), as the uncertainties currently weighing on the global context could prove more persistent or produce tail-end effects beyond the near term.

SNB: Previous target range and new policy rate



Source: Thomson Reuters-Datastream

The "floor": from September 2011 to January 2015



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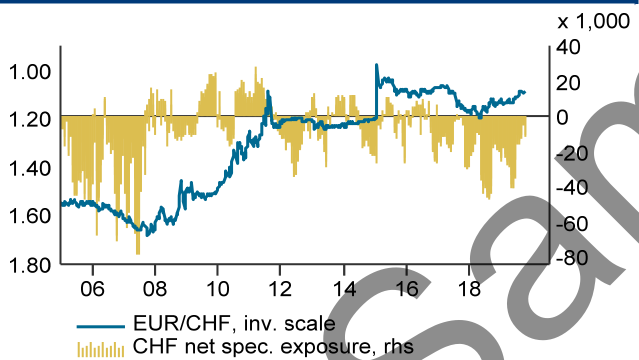
CHF: speculative positions (CME)



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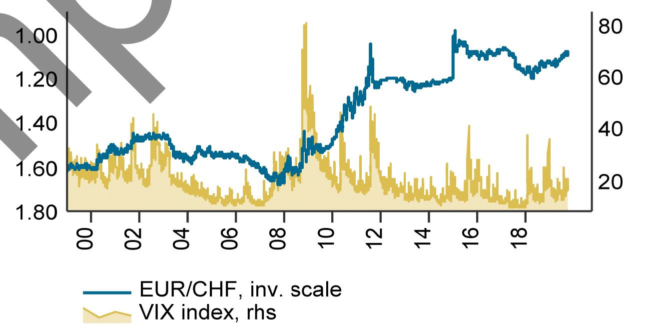
Swiss franc and risk aversion



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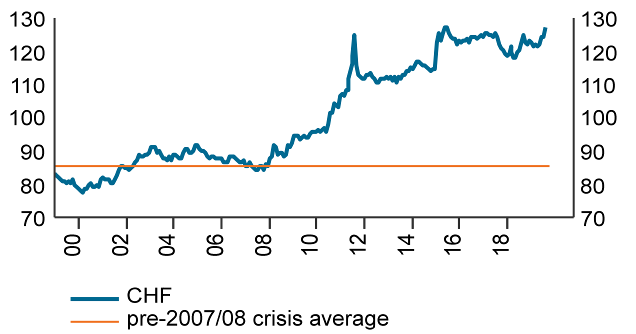
Swiss franc (nominal effective exchange rate, BIS)



Source: Thomson Reuters-Datastream

Euro (nominal effective exchange rate, BIS)

Source: Thomson Reuters-Datastream

Central banks (calendar)

Date (time)	Country	Monetary policy meetings
24 October		
09:30	SEK	**Riksbank**: interest rate announcement (current repo rate = -0.25%)
10:00	NOK	**Norges Bank**: interest rate announcement (current depo rate = 1.50%)
13:45	EUR	**ECB**: interest rate announcement (current main refi rate = 0.00% and current deposit facility rate = -0.50%)
30 October		
15:00	CAD	**Bank of Canada**: interest rate announcement (current BoC overnight lending rate = 1.75%)
19:00	USD	**Fed**: interest rate announcement (current Fed Funds target range = 1.75-2.00%)
31 October		
-	JPY	**BoJ**: policy announcement (current short-term policy rate = -0.10%, current long-term policy rate = 0.00%)
5 November		
04.30	AUD	**Reserve Bank of Australia**: interest rate announcement (current cash rate target = 0.75%)
7 November		
13:00	GBP	**BoE**: interest rate announcement (current bank rate = 0.75%) and publication of the Inflation Report
13 November		
02:00	NZD	**Reserve Bank of New Zealand**: interest rate announcement (current official cash rate = 1.00%)
3 December		
04.30	AUD	**Reserve Bank of Australia**: interest rate announcement
4 December		
16:00	CAD	**Bank of Canada**: interest rate announcement
11 December		
20:00	USD	**Fed**: interest rate announcement
12 December		
09:30	CHF	**SNB**: interest rate announcement (current policy rate = -0.75%)
13:45	EUR	**ECB:** interest rate announcement
19 December		
-	JPY	**BoJ**: interest rate announcement
09:30	SEK	**Riksbank**: interest rate announcement
10:00	NOK	**Norges Bank**: interest rate announcement
13:00	GBP	**BoE**: interest rate announcement

Source: Research Department - Intesa Sanpaolo S.p.A.

	Past Values				Exchange Rates				Forecast	
[BLANK0]	-24m	-12m	-6m	-3m	-1m	09-10-19	+1m	+3m	+6m	+12m	+24m
EUR/USD	1.17	1.15	1.13	1.12	1.10	1.0981	1.10	1.12	1.15	1.17	1.20
USD/JPY	113	113	111	109	107	107.31	105	108	110	112	114
GBP/USD	1.31	1.31	1.31	1.25	1.23	1.2223	1.22	1.25	1.28	1.32	1.35
EUR/CHF	1.15	1.14	1.13	1.11	1.10	1.0905	1.08	1.10	1.12	1.13	1.15
EUR/SEK	9.54	10.46	10.43	10.62	10.67	10.9189	10.80	10.60	10.50	10.40	10.00
EUR/NOK	9.37	9.50	9.64	9.70	9.86	10.0590	10.05	9.90	9.70	9.50	9.30
EUR/DKK	7.44	7.46	7.47	7.46	7.46	7.4687	7.46	7.46	7.46	7.46	7.46
USD/CAD	1.25	1.29	1.33	1.31	1.32	1.3299	1.34	1.32	1.30	1.28	1.26
AUD/USD	0.78	0.71	0.71	0.69	0.69	0.6743	0.66	0.68	0.70	0.72	0.74
NZD/USD	0.71	0.65	0.67	0.66	0.64	0.6315	0.62	0.64	0.66	0.68	0.70
EUR/JPY	132	130	125	122	118	117.88	116	121	126	131	136
EUR/GBP	0.89	0.87	0.86	0.90	0.89	0.8984	0.90	0.89	0.89	0.88	0.88
EUR/CAD	1.47	1.49	1.50	1.47	1.45	1.4606	1.47	1.48	1.49	1.50	1.51
EUR/AUD	1.51	1.62	1.58	1.62	1.61	1.6285	1.67	1.65	1.64	1.63	1.61
EUR/NZD	1.66	1.77	1.67	1.70	1.72	1.7384	1.77	1.75	1.73	1.72	1.71

Source: Thomson Reuters and Intesa Sanpaolo elaborations

Appendix

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