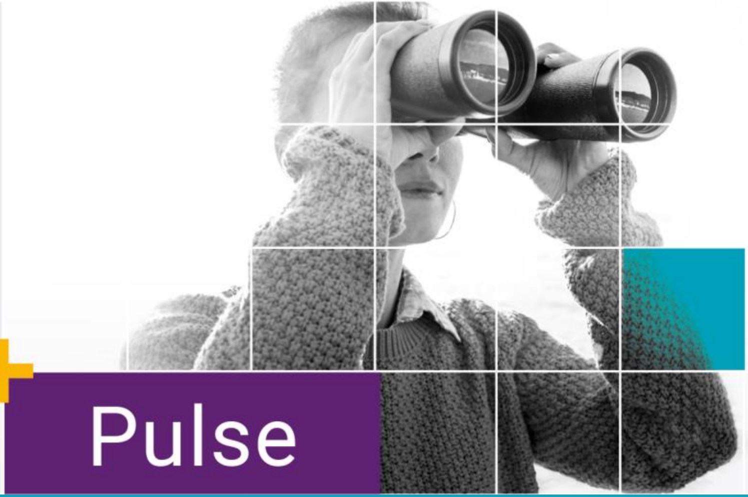
Marketing Communication



Global Market Strategy, NIM Solutions

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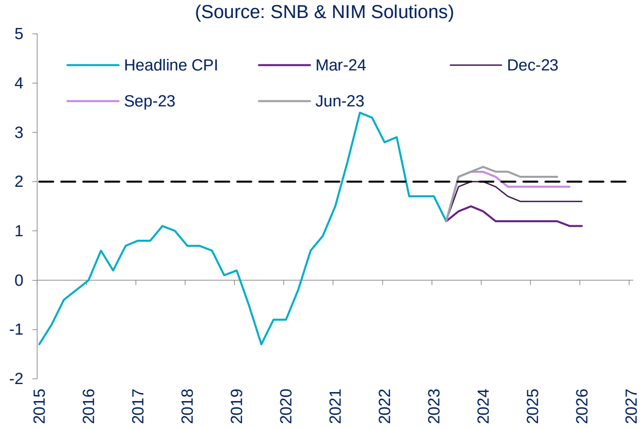
With the SNB being first out of the gates, what is next for the CHF?

While the Swiss National Bank (SNB) has a history of surprising investors with sudden actions, such as the 2015 removal of the CHF cap and the unexpected 50 basis points rate hike in 2022, it caught almost everyone off guard by cutting its key interest rate at its March meeting. The central bank reduced its key rate by 25 basis points to 1.5%, marking the first rate cut among G10 economies. This adjustment seems to come in anticipation of rate cuts in other DM economies and to guard against the potential CHF appreciation. Noteworthy is that the SNB only holds quarterly meetings, with the next one occurring in June but only after those of the Federal Reserve and the European Central Bank.

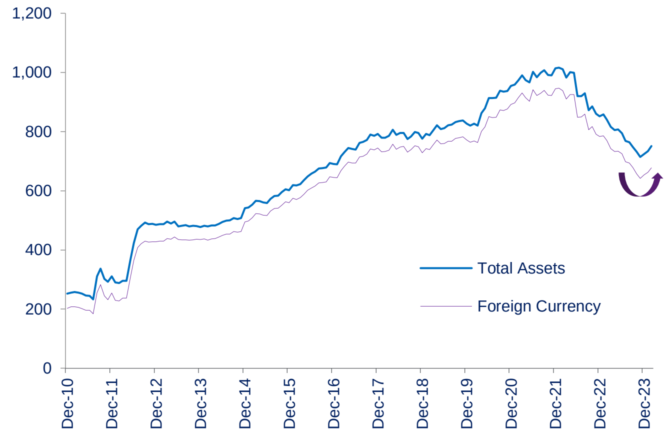
While we had been wondering for some time why the SNB was keeping a hawkish stance with inflation below the 2% ceiling since mid-2023, the market had not expected any rate adjustment until later this year. During the press conference, the SNB President Thomas Jordan stated that the decision to had been made possible due to three factors: the effective fight against inflation over the past 2,5 years, CHF strength in real terms and the prospects for disappointing economic growth performance. On the inflation front, the SNB has revised downwards its consumer price inflation projection and now expects it to average 1.4% this year, 1.2% in 2025, and 1.1% in 2026 (see Figure 1).

Fig. 1: Switzerland Headline CPI & SNB Inflation Projections - YoY
(Source: SNB & NIM Solutions)



Beyond interest rate decisions, SNB's decision indicates that the policy of selling foreign currency reserves to lift the CHF in nominal terms and fight inflation has come to end. The strong CHF has reportedly started to be a source of concern for the central bank. That is because a too high CHF may unleash deflationary forces that central bank had to contend in 2009 and 2015. Nevertheless, alternative measures of the currency valuation as the real effective exchange rate shows an 8.5% rise in the Swiss franc since mid-2022, which is likely to have dampened external competitiveness and inflation. In this regard, the SNB has fought against CHF strength selling foreign exchange reserves to generate a depreciation in the CHF. If we exclude 2022 and the first half of 2023, the latest SNB data show that foreign currency reserves have been increasing and we would not be surprised to see them continuing to do so going forward (see Figure 2). The purpose is crystal clear: support the depreciation of the CHF.

Fig. 2: SNB Balance Sheet Total Assets – Billion CHF
(Source: SNB & NIM Solutions)



Going Forward

Overall, we believe that the SNB will look to prevent a CHF appreciation and hence will continue to monitor economic activity in the Eurozone, making additional rate cuts should the situation in the region deteriorate. It is true that Swiss rents and wages may argued for less rate hikes, but we think that the SNB's cut reflects a broader confidence that the inflation risk has passed and is now focused in protecting growth and its external competitiveness.

As the SNB gradually adopts a more dovish stance, with measures on both the policy rate and foreign exchange reserves, we see the EURCHF with potential to strengthen towards parity within the next 6 months. However, a sustainable rise of the EUR above parity would need a significant rebound in overall economic activity in the Eurozone, which is not our base case for 2024, as we expect the region's economy to stabilize, at most a slight uptick.

As a conclusion, and over the next 12 months, the CHF should gradually converge to the parity as the SNB will continue to prove its determination to put an end to this structural appreciation of the currency against euro and the US dollar. Therefore, the CHF should increase against the major currencies by 3.0% or 4.0% over the medium term. Therefore, Swiss investors should reconsider the relative attractiveness of investing in European money market funds to make up for the likely depreciation of the Helvetic currency.

Sources: Bloomberg & NIM Solutions. Data as of March 29, 2024.