

Article | 19 May 2022 FX | Switzerland

EUR/CHF: Sea change in Swiss National Bank's FX attitude

For a central bank that acquired close to half a trillion Swiss francs worth of FX reserves in fighting a strong Swiss franc, the Swiss National Bank (SNB) seemingly now welcoming Swiss franc strength has come as quite a shock. Given the SNB's focus on a stable real exchange rate, low inflation in Switzerland points to EUR/CHF trading 4% cheaper next year



Inflation in Switzerland is running around 4% lower than its main trading partner, the eurozone

Keeping it real

The Swiss franc (CHF) has been the strongest G10 currency over the last five days. Its low and negative correlation with global equity markets has certainly helped in the current risk-averse global environment.

But CHF's strength over the last 24 hours has been helped by comments from SNB president Thomas Jordan. Yesterday he was quoted saying: "The SNB is ready to act if inflation risks materialise". These comments un-nerved a market thinking that the SNB would prefer to delay rate hikes and allow an ECB tightening cycle to lift EUR/CHF off the floor. After all, the SNB has accumulated CHF500bn of FX reserves in fighting CHF strength over the last decade, so surely it

Article | 19 May 2022

would prefer a stronger EUR/CHF?

Apparently not. In an important speech made on 29 April, entitled 'What are the consequences of the war in Ukraine for the SNB's monetary policy? Jordan made the revelatory point that a weaker real Swiss franc exchange rate would be inappropriate given the inflation threat in Switzerland.

The implication here is that the SNB wants at least a stable real exchange rate. Given that inflation in Switzerland is running around 4% lower than its main trading partner, the eurozone, one could roughly argue that EUR/CHF needs to be 4% lower in nominal terms over the next year to keep the real CHF stable. That would point to EUR/CHF trading under parity this time next year. Or at least the point we have been making over recent weeks is that parity should not be seen as any kind of floor.

Stable real CHF + inflation differential = lower EUR/CHF



What about SNB rate hikes?

Inflation in Switzerland has risen significantly in recent months, in line with other countries, reaching 2.5% in April. This is above the SNB's target, but still well below what is observed elsewhere, thanks to a favourable energy mix and the relative strength of the Swiss franc, which lowers imported inflation. We expect inflation to remain above 2% for the remainder of the year, averaging 2.3% in 2022, before falling sharply back to 1% in 2023.

Against this background, and also taking into account the fact that the SNB is willing to accept a stronger Swiss franc in nominal terms to avoid a real depreciation, the SNB is likely to seize the opportunity of the ECB rate hike to also embark on a series of rate hikes to normalise its monetary policy. If the ECB starts raising rates in July, then in September and again around the turn of the year as we expect, the SNB should follow suit.

We expect a first SNB rate hike of 25 basis points at the September meeting, a second in December and a final one in March 2023. At the same time, the SNB is likely to continue to express its readiness to intervene in the foreign exchange markets when it deems it necessary, although it will effectively accept a more expensive Swiss franc in nominal terms as the inflation differential is expected to remain high, at just over 4% for the whole of 2022.

Article | 19 May 2022

Where the CNB goes, will the SNB follow?

Over the last decade, there have been some similarities between the Czech National Bank (CNB) and the SNB when it comes to foreign exchange policy. Both employed FX floors when the zero bound constraint was hit. And both seemingly now want stable or firmer currencies in the support of monetary policy goals. In fact, the CNB intervened to sell EUR/CZK last week after the koruna sold off on the announcement that the next CNB governor would be the more dovish Alex Michl.

Clearly with policy rates at 5.75% in the Czech Republic and -0.75% in Switzerland there are substantial differences in monetary policy. But just as there had been discussions in the Czech Republic over whether massive FX reserves would be formally used to drive EUR/CZK lower, could the same story come to the SNB and EUR/CHF?

The prospect of the SNB outright selling EUR/CHF does seem fanciful right now. But the policy choice of a stronger nominal CHF from the SNB is starting to make the case that EUR/CHF will struggle to sustain any moves above 1.05 over the next 12 months and that our baseline EUR/CHF forecast profile must now be revised lower.

Authors

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE chris.turner@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland charlotte.de.montpellier@ing.com

Disclaimer

This publication has been prepared by the Economic and Financial Analysis Division of ING Bank N.V. ("ING") solely for information purposes without regard to any particular user's investment objectives, financial situation, or means. ING forms part of ING Group (being for this purpose ING Group N.V. and its subsidiary and affiliated companies). The information in the publication is not an investment recommendation and it is not investment, legal or tax advice or an offer or solicitation to purchase or sell any financial instrument. Reasonable care has been taken to ensure that this publication is not untrue or misleading when published, but ING does not represent that it is accurate or complete. ING does not accept any liability for any direct, indirect or consequential loss arising from any use of this publication. Unless otherwise stated, any views, forecasts, or estimates are solely those of the author(s), as of the date of the publication and are subject to change without notice.

The distribution of this publication may be restricted by law or regulation in different jurisdictions and persons into whose possession this publication comes should inform themselves about, and observe, such restrictions.

Copyright and database rights protection exists in this report and it may not be reproduced, distributed or published by any person for any purpose without the prior express consent of ING. All rights are reserved. ING Bank N.V. is authorised by the Dutch Central Bank and supervised by the European Central Bank (ECB), the Dutch Central Bank (DNB) and the Dutch Authority for the Financial Markets (AFM). ING Bank N.V. is incorporated in the Netherlands (Trade Register no. 33031431 Amsterdam). In the United Kingdom this information is approved and/or communicated by ING Bank N.V., London Branch. ING Bank N.V., London Branch is authorised by the Prudential Regulation Authority and is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. ING Bank N.V., London branch is registered in England (Registration number BR000341) at 8-10 Moorgate, London EC2 6DA. For US Investors: Any person wishing to discuss this report or effect transactions in any security discussed herein should contact ING Financial Markets LLC, which is a member of the NYSE, FINRA and SIPC and part of ING, and which has accepted responsibility for the distribution of this report in the United States under applicable requirements.

Additional information is available on request. For more information about ING Group, please visit http://www.ing.com.

Article | 19 May 2022