18/01/2015

The surprise move by the SNB on 15th of January to remove the EUR/CHF 1.20 cap and the rate change to -0.75% did not only cause a turmoil in markets, but also opened up to new opportunities.

The cap removal:

The cap removal initiated the Franc to appreciate against the Euro, but particularly against all other currencies as well. This makes sense argueing that the SNB was depreciating the CHF by buying Euro government bonds. Once the SNB discontinues this devaluation, the Franc should appreciate across the currency board. However, is the strength of the appreciation really justified? In particular the USD depreciated from USDCHF 1.02 in the early morning of 15th January to USDCHF 85.87 as of 16th of January (Graph 1). In other words, the move against the USD is equal to the move against the EUR (Graph 2 & 3).

The parallel moves of EUR and CHF against USD made absolutely sense when the EURCHF cap was in place. This explains Graph 4. However, with a free floating Franc and rates that diverge substantially from the US, the appreciation of the Franc against USD should not make sense following this arguement, as the Euro continued its depreciation against the USD after the cap removal (Graph 5).

Negative interest rates:

In addition to the cap removal, negative interests on CHF should move wealthy savers in Switzerland to hold USD. On 22nd of January, Swiss banks will announce their savings deposit rates, which will most likely turn negative. With the market expecting the Federal Reserve to hike rates first among all major central banks, it would be a good choice to select USD as a saving currency. Currently, there is a 50bps difference in the upper Libor target between CHF (-0.25%) and USD (0.25%) with potential of further diversion in this year.

Swiss Franc as a funding currency:

The Swiss Franc has been an attractive funding currency with the EURCHF cap in place. Many brokers and hedge funds came under turmoil with the cap removal, as their funding currency became much more expensive overnight to pay back. This shock might have led to USDCHF staying at all time highs after the cap removal, as borrowers were afraid about further uncertainty in the Franc as a funding currency. However, this fear should gradually remove and the Swiss Franc actually offers excellent funding opportunities at current levels.

Credibility loss:

The surprise move by the SNB caused questions about its credibility. Whereas on the day of the cap removal many traders spoke about a credibility loss, few days later some reports underline the SNB´s independence in its decision and not a credibility loss. Nonetheless, independence and credibility can be linked closely together. Market participants might also review their perspective on comments of the FED on rate hikes and other central banks. Forward guidance, a term the FED began to emphasize after the Lehman Crisis, might even loose its current importance. Anyhow, the SNB´s credibility did suffer through the surprising cap removal. A lower credibility usually means less demand for that currency. There is doubt, however, that the safe haven symbol will be affected by the loss of its central bank credibility, meaning the credibility loss is rather limited.

Long-term implications:

The Swiss economy is certainly expected to suffer from the cap removal. UBS, for instance, revised its 2015 GDP forecast down from 1.8% to 0.5%. Especially the export sector and tourism are expected to undergo difficulties at current exchange rates. The SMI index reflects this fear and lost 15% in the two days after the cap removal (Graph 6). These long term indications should put downside pressure on the Franc.

Further long-term implications might be the fight against tax evasion, which should put more downside pressure on the Franc. On the other hand, political instability in Europe with regards to the Charlie Hebdo attacks and the instability of the Eurozone could cause Swiss Franc inflows.

The Swiss purchasing power parity (PPP), would indeed grow under the Franc´s strength. When comparing both, the World Bank and the IMF GDP per Capita PPP Current Dollar, it would indicate Switzerland would outpace the US by far - meaning a 15% increase in Swiss PPP. Graph 7 and 8 compare Switzerland with the US (Graph 8 IMF also includes forecasts up until 2019 before the cap removal)

Outlook:

In the short-term safe haven status could keep the Swiss Franc at current levels. Greek elections on 25th January and other Eurozone problems are the main reasons for justification of current CHF levels. The USD might become a better choice in the future though, as negative rates make the Franc less attractive. Other currencies, such as Australian Dollar also look comparatively cheap to the Franc. USD traded oil could represent another buying opportunity to benefit from the currently strong Swiss Franc against the USD and the low oil price. USD should appreciate against the CHF in the coming weeks and months back to similar or slightly lower levels where it was before.

Graph 1.)

Graph 2.)

Graph 3.)

Graph 4.)


EURUSD 1.1567 As of 16 Jan Source BGN
EURUSD BGN Curncy
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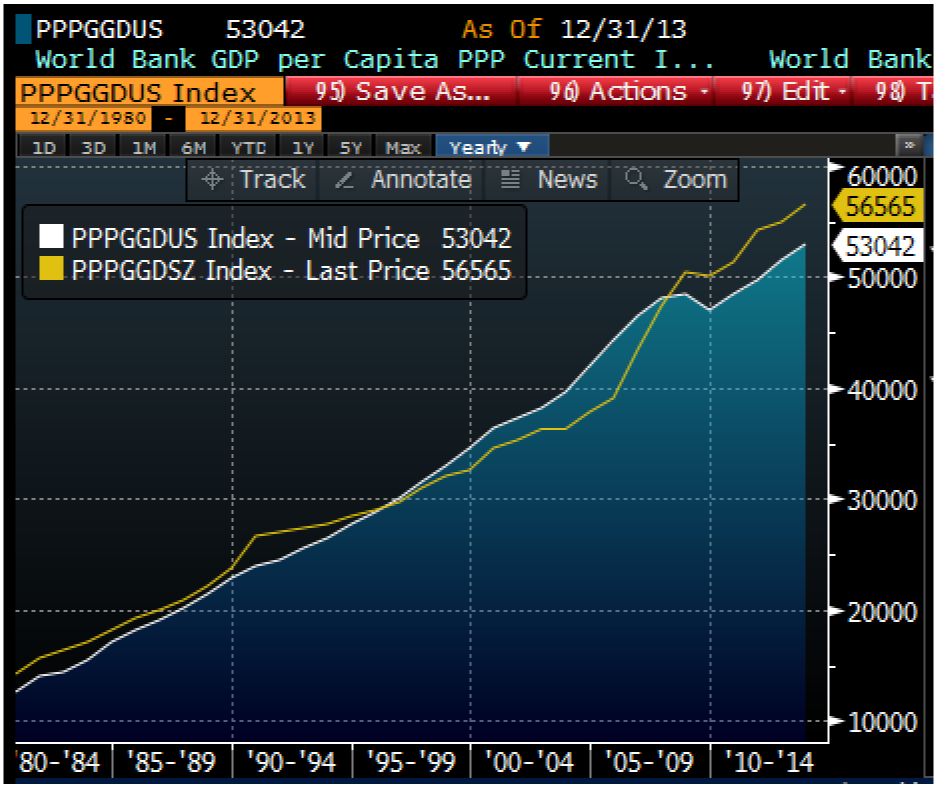
97) Edit
01/20/2014 - 01/18/2015
1D 3D 1M 6M YTD 1Y 5Y Max Daily
Track Annotate News Zoom
Reset
1.4000
1.3500
1.3000
1.2500
1.2000
1.1793
1.1500
1.1000
1.0500
1.0000
0.9821
0.9500
Last Price
EURUSD BGN Curncy 1.1567
CHFUSD BGN Curncy 1.1647
Mar
Jun
Sep
Dec
2014

Graph 5.)

Graph 6.)

Graph 7.)


PPPGGDUS 53042 As Of 12/31/13
World Bank GDP per Capita PPP Current I... World Bank
PPPGGDUS Index
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12/31/1980 - 12/31/2013
1D 3D 1M 6M YTD 1Y 5Y Max Yearly
Track
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News
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PPPGGDUS Index - Mid Price 53042
PPPGGDSZ Index - Last Price 56565
60000
56565
53042
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'80-'84
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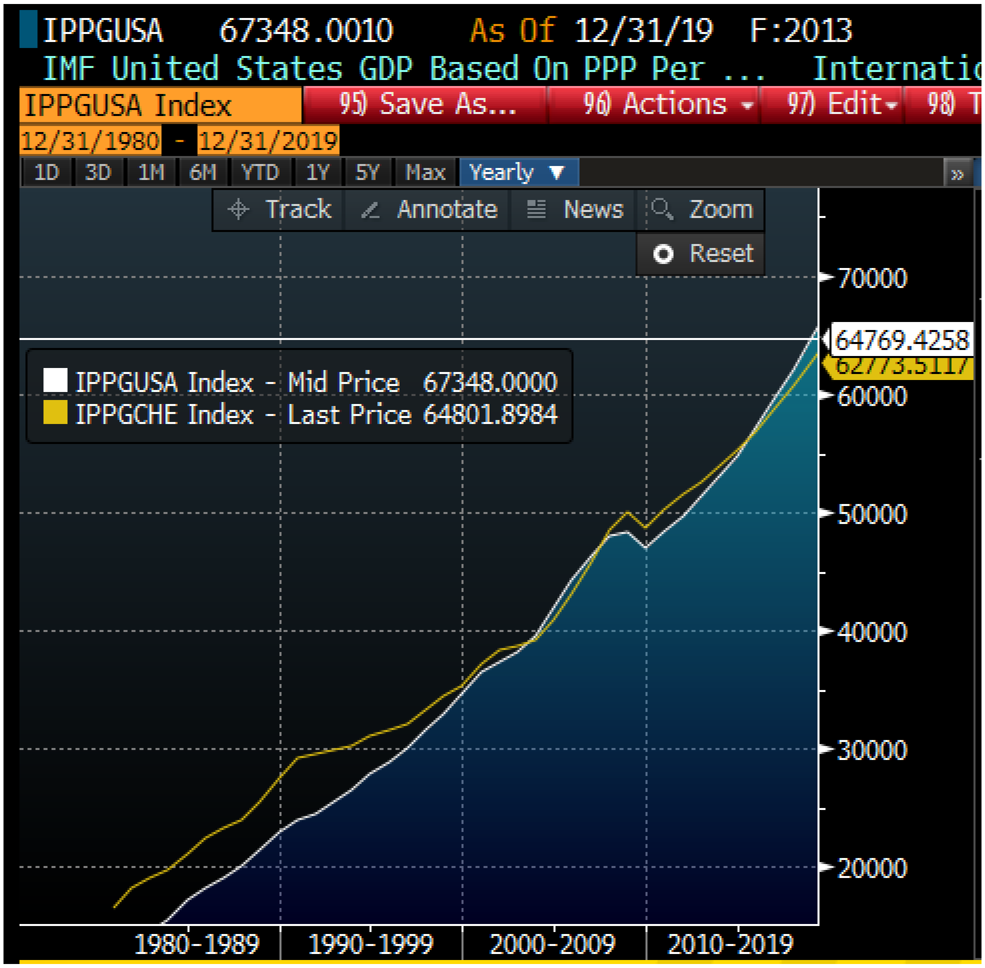
'95-'99
'00-'04
'05-'09
'10-'14

Graph 8.)


IPPGUSA 67348.0010 As Of 12/31/19 F:2013
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12/31/1980 - 12/31/2019
1D 3D 1M 6M YTD 1Y 5Y Max Yearly
Track Annotate News Zoom
Reset
IPPGUSA Index - Mid Price 67348.0000
IPPGCHE Index - Last Price 64801.8984
64769.4258
62773.5117
70000
60000
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30000
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1980-1989
1990-1999
2000-2009
2010-2019