A Tale of Two Currencies

• US Treasury has stoked already strong CHF demand
• Regional considerations make it a go-to safe haven
• Tolerance of a strong currency may be reaching a limit

While the focus was on China and the CNY, the real impact from release of the US Treasury’s semi-annual currency ‘manipulators’ report on Tuesday fell upon the CHF, which, courtesy of Switzerland’s re-admission to the list, rose to a two-year high against the EUR.

The Swiss government protested, but a current account surplus and significant bilateral trade surplus with the US sealed its fate.

Of course, the US Treasury is not solely responsible for the franc’s current trajectory, as might be inferred from an ongoing, lengthy divergence between the CHF and the JPY.

Whilst declining geopolitical tensions have seen the JPY (and gold) retreat around 1.5 - 1.7% since the turn of the year, the franc remains firmly in demand, as highlighted by the accompanying chart (click to expand).

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1. US and China sign ‘phase one’ trade deal >

2. New Chinese bank loans disappoint but social financing soars in December >

3. Chinese annual home price inflation falls in December >
In fact, the CHF/JPY cross stands 6.5% higher than it did in early October, for which there are a number of possible explanations, but we suspect the divergence pertains largely to geographical market proximities of the safe haven in question.

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Indeed, since the autumn, the CHF has been recovering ground lost to the JPY over a two-year period in which the world has been preoccupied by China’s spat with the US – an underperformance that began as the US imposed $50bn of tariffs on Chinese goods on March 2018.

And as US-Sino relations have improved to the JPY’s detriment, this relative recovery in the CHF might also be seen in the context of a heightening in trade tensions between the US and EU, with President Trump planning to impose 100% tariffs on select French imports following France’s imposition of a ‘digital’ tax.

As ever, perhaps the one thing the market has to worry about is the SNB intervention.

Certainly, sight deposits have fallen marginally since mid-December suggesting a fairly relaxed view on the CHF; but the mitigating circumstances that Switzerland could plead (the SNB still regards the distant EUR/CHF 1.12 rate as "highly over valued") suggests that the US Treasury report will be no barrier to the SNB’s resumed intervention to arrest the franc’s climb.

After all, Swiss inflation is back to hovering above zero, and though the government sees better times ahead, they are not expected until 2021 which means there is ample scope for their presumptions to go awry.
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And right there, another familiar chapter in the protracted story of extraordinary monetary policy in Switzerland might well close. But always bear in mind that this lengthy story needs a definitive ending.

Indeed, there is a distinct sense that politicians, corporates and the public alike are at the end of their tethers with the SNB’s extreme policies. Of course, we immediately recognise the problems in this very suggestion after a protracted status quo and carbon copy predictions of currency-related economic penury.

However, we currently see opposition to SNB policy involving an unusual alliance of left and right-leaning politicians voicing protest at “the expropriation” of savings.

Hence, the SNB is also facing calls for a redistribution of its profits to the public pension system with some pressure for the issue to be put to a public referendum.

None of this is to suggest that we should anticipate any change to what is likely to be a very familiar policy statement from the SNB when it next meets on March 19.

But unless we are to assume that distortions and their by-products are here to stay in perpetuity, then the limits to adaption, adjustment and flexibility will at some point oblige an alternative strategy, irrespective of whether it is currently deemed to reside at the tail end of the probability distribution curve.

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