SNB and the CHF

- Swiss bonds rising in tandem with the CHF
- The SNB has remained on the sidelines
- Is this strategy or resignation?

Early last week, we suggested that the Swiss National Bank (SNB) would be most unlikely to stand idly by were the CHF to remain on its recent trajectory. That supposition may soon be tested.

As we noted yesterday, a sudden deterioration in global economic prospects has preempted a further suppression of interest rates across the globe in anticipation of the collective deployment of central bank "puts".

This has contributed to an already unprecedented and extraordinary pile of negative-yielding debt which now stands $12trn high; and in view of its long-held status as a safe haven, this has had particularly "positive" repercussions for Switzerland.

Indeed, such has been the move into Swiss debt that yields on Bunds now look positively attractive in comparison! The yield on the two-year Swiss sovereign bond – negative since early 2015 – has been fairly stable for much of the past year around -0.7 to -0.8%.

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But since the start of May, the yield has fallen by around 20bps to come within 5bps of the -1.0% marker – a level that has not been seen since the deflation years of 2015/2016.

Yet unlike in 2015 and 2016 (at least following the initial reaction to the removal of the EUR floor), the pressure on the CHF has been unrelentingly higher.

We note that there has been a 90% correlation over the past three months between the performance of the EUR against the CHF and the declines seen in Swiss yields.

The latter has therefore not only accompanied a 3% fall in EUR/CHF, but the CHF 1.12 level - widely regarded as something of a line in the sand at the SNB since 2015 - has long since disappeared in the rear view mirror.

Indeed, SNB data show that total sight deposits held with the Bank have been fairly stable for some time. This broadly confirms that the SNB has yet to be drawn into the FX market in order to alleviate pressure on the CHF.

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Certainly, the zeitgeist in the market could certainly be staying the SNB’s hand. The Bank could feel that it must choose its moments carefully if it is to minimize the subsidy for those looking to get long of the franc and minimize the expansion of a balance sheet that is 50% larger than it was in 2014.

And as we noted last week, such is the conviction behind recent trends that the market has declined to take any note of the ongoing spat between the Swiss government and the EU – something that could yet have profoundly negative
implications for the latter.

Yet at the same time, the SNB has hardly let up with its repeated missives about its “readiness to intervene in the foreign exchange markets. As such, having stood aside as CHF 1.12 fell, the potential for a bear-trap should not be dismissed as the next big figure looms at CHF 1.10.

The upside to the CHF is clear; but as ever, discretion could be the better part of valor.

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