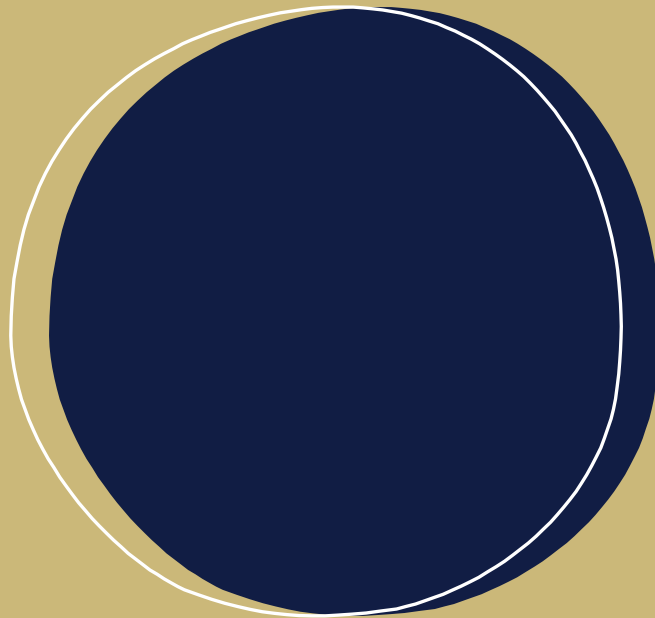


# News from the financial markets

CHF strength or EUR weakness?

January 5, 2010

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## CHF strength or EUR weakness?

Oliver Schlumpf, Investment Strategist

**During the course of 2009, the Swiss National Bank (SNB) intervened in the forex markets repeatedly in effort to prevent the Swiss franc from rising against the euro. In mid-December, however, the cross abruptly exited its sideways channel and fell below the psychologically important EUR/CHF 1.50 level.**

To date, the SNB has not reacted noticeably to the franc's sudden appreciation versus EUR. Although the central bank has never indicated any specific price threshold for its forex market interventions, the current drop below the key 1.50 mark gives cause for a closer look at the situation.

EUR/CHF



Sources: VP Bank, Datastream

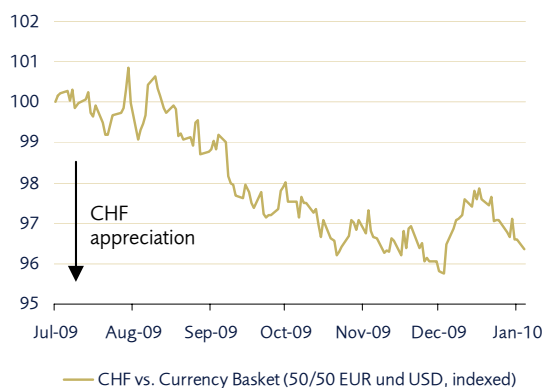
A strong franc burdens the Swiss export industry by making the prices of the country's products less competitive in the global marketplace. Thus the interventions in recent months have been an appropriate means of jump-starting the Swiss economy. The euro zone is the largest consumer of Switzerland's exports; accordingly, the EUR/CHF exchange rate is of considerable importance.

### Complete decontrol of the franc?

We are going on the assumption that the SNB will not let go of its reins on the Swiss franc; we consider the currency to be well supported over the short term at prices around 1.48. In December, the SNB made a slight adjustment to the wording of its monetary policy review: now, it will act to counter an *unreasonable* appreciation of the franc instead of, as previously, an *appreciation...full stop*. Based on purchasing power parity (PPP), CHF at its current level is still slightly undervalued versus the euro. So in this regard, there is nothing to argue against the policy of a controlled CHF appreciation. On the interest rate front, there are also no divergent impulses at present, given that we are not reckoning with any initial synchronized rate moves until the second half of the year at earliest.

The stronger dollar is working to the favor of the SNB's policy. In December, the franc did not appreciate against a currency basket of EUR and USD, and competitive pressures outside the euro zone have receded.

Swiss franc versus currency basket



Sources: VP Bank, Datastream

More than anything else, the discussion surrounding government indebtedness has burdened the euro in recent months. Greece shocked the markets by announcing that it will take on new debt amounting to roughly 13% of its GDP, and this with a total debt ratio that runs at almost 120% of GDP. Other peripheral EU states such as Ireland, Italy and Portugal are also struggling with cumbersome debt loads.

Equally spoken, we also reckon that the SNB will take action to weaken the Swiss franc in the event the currency continues to appreciate significantly against EUR. Thus for the time being, we are sticking by our neutral assessment of the cross. However, for the longer term, we are looking for the franc to strengthen modestly against the euro in reflection of the Confederation's solid standing in terms of public finances.

**The bottom line:**

The SNB will keep the franc's appreciation within bounds, but that is in no way equivalent to a complete decontrol of the foreign exchange rate. The buoyancy in CHF is a reflection of EUR weakness that conceivably could persist in 2010. For the near future, the franc is likely to trade in a volatile sideways pattern around its current level. Longer term, we are going on the assumption that CHF will work its way higher against EUR.

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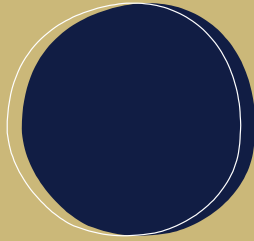
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