Switzerland

Consequences of Switzerland being labelled "currency manipulator"

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The US Treasury has labelled Switzerland a "currency manipulator." This will trigger negotiations between the two countries to address some of the issues identified by the US authorities. The imposition of immediate sanctions is very unlikely, however.

Although the substantial intervention activity by the Swiss National Bank (SNB) is one of the three reasons for Switzerland being labelled a "currency manipulator," the SNB today reiterated its willingness to "intervene more strongly in the foreign exchange market" if regarded as necessary to achieve its monetary policy goals.

However, the pressure on the SNB to reduce interventions has increased, in our view. That said, given our expectations for a global economic recovery and a strong EUR extensive interventions may in fact not be needed.

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Switzerland labelled "currency manipulator"

On 16 December, the US Treasury released its report on the "Macroeconomic and foreign exchange policies of major trading partners of the United States" (US Treasury report), in which it officially labels Switzerland a "currency manipulator." Being labelled a "currency manipulator" does not automatically lead to economic sanctions. However, the USA will "engage in negotiations" with the Swiss authorities to address some of the issues identified by the US Treasury. The report was long due and we expected Switzerland to attract the attention of the US Treasury, given its large current account surplus, a large bilateral trade surplus with the USA and the extensive foreign exchange interventions conducted by the SNB, in particular during the first half of 2020.

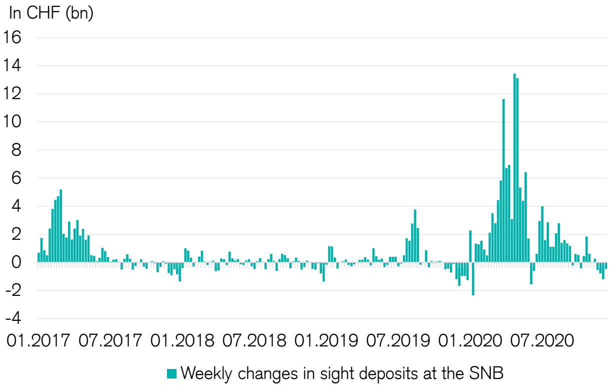
Demands of the US Treasury difficult to satisfy

The main issue raised by the US Treasury is the large current account surplus of Switzerland that the US Treasury assesses as being "excessive." There is no mention of the Swiss franc being undervalued against the US dollar, although the report says that "further franc appreciation would help facilitate gradual adjustment of Switzerland's excessive current account surplus." As the large current account surplus of Switzerland is essentially due to pharmaceutical exports and commodity trading (merchanting), two categories that have proved resilient to the appreciation of the Swiss franc, the surplus is unlikely to fall, even if the Swiss franc were to appreciate further; the large trade surplus of Switzerland with the USA is mainly driven by pharmaceutical and gold exports. While the surge in gold exports is likely temporary, pharmaceutical exports to the USA have been increasing continuously for years. The Swiss external position is therefore unlikely to change any time soon in a direction that would satisfy the US Treasury. More generally, the US external deficit with other countries is in our view driven mainly by the "savings deficit" of the USA versus the savings surpluses of other countries, with the exchange rate playing a lesser role.

Pressure on SNB to limit foreign currency purchases
In our understanding, the sanctions foreseen by the US legislation are mild, if Switzerland were to fail to address the issues raised by the US Treasury. In any case, the Swiss authorities will have some time before a hypothetical escalation between the two countries, given that the USA wants to negotiate first. In addition, a lot will depend on the view of the new US administration on the issue. Nevertheless, if Switzerland wants to ensure that diplomatic tensions with the USA are avoided, the key change needed would be for the SNB to clearly limit its foreign currency interventions.

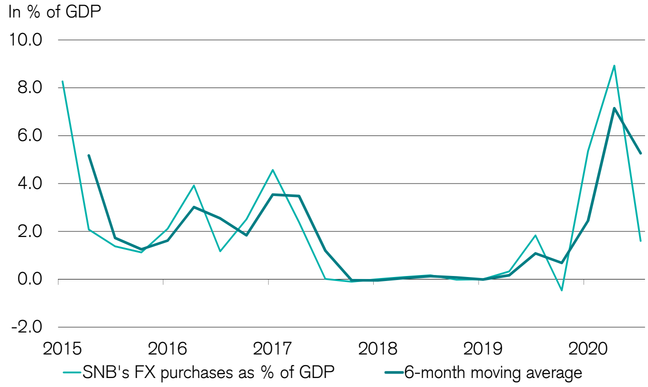
That said, reducing or even halting foreign currency purchases may in fact be quite possible. As Figure 1 shows, the SNB was able to significantly reduce its FX purchases since the summer as the first COVID shock abated, independently from the US Treasury report's demands. Moreover, between mid-2017 and end-2019 (Figure 2), the SNB did also not intervene much, allowing it to "escape" the currency manipulator label. If the global economy continues to recover as we expect, the need for foreign currency purchases will likely diminish quite naturally, because appreciation pressure on the CHF, at least relative to the key currency for Switzerland's sensitive SME sector, i.e. the EUR, should abate. (As regards the USD, the ability of the SNB to halt its depreciation is anyway quite limited unless interventions were coordinated with other major central banks; such coordinated action is, for now, very unlikely.)

Figure 1: Fewer foreign currency purchases recently
Changes in sight deposits at the SNB are a proxy for the foreign currency purchases of the SNB.



Last data point: 11/12/2020. Source: SNB, Credit Suisse

Figure 2: The SNB did not intervene much between mid-2017 and end-2019
The foreign exchange interventions are estimates.



Last data point: Q3 2020. Source: Datastream, Credit Suisse

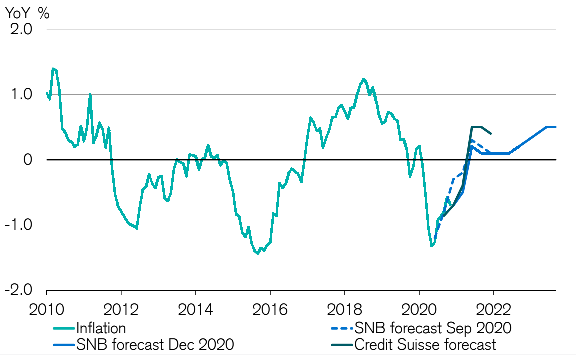
Monetary and fiscal options are limited
Foreign currency purchases have been the most powerful tool of the SNB to ease monetary policy (or at least to prevent monetary conditions from tightening.) Purchases of domestic sovereign and corporate bonds are not really an option for the SNB given the small size of the domestic capital market. Finally, as the policy rate is already at –0.75%, further easing through additional interest rate cuts is also difficult. On the fiscal side, the government has eased its policy during the COVID-19 crisis, but has been reluctant to extend some of the measures recently. In any case, both the government and the parliament are unlikely to substantially increase fiscal expenditures to contribute to the "rebalancing" of the external accounts, as demanded by the US Treasury, not least due to the Swiss balanced budget rule. In sum, we believe that the SNB will still resort to foreign currency purchases in time of crisis. However, under more "normal" economic circumstances, the need for foreign currency purchases should be almost inexistent, even if the Swiss franc were to appreciate, at least against the USD.

SNB keeps policy rate unchanged, reiterates willingness to intervene
Following its regular quarterly monetary policy assessment scheduled the day after the release of the US Treasury report, the SNB has maintained its policy rate unchanged at –0.75%, as expected. The SNB continues to assess the Swiss franc as "highly valued," a statement that the central bank has repeated at each policy rate decision since September 2017 (prior to that the SNB had assessed the Swiss franc as being "significantly overvalued"). In addition, the SNB reiterated its willingness to intervene "more strongly" in the foreign exchange market. Neither the press statement, nor the prepared statements of the SNB Governing Board members for the press conference mentioned the conclusions of the US Treasury report. In our view, this shows that the SNB is not ready to exclude foreign currency purchases from its tool box. Any such statement, or even hint, would most likely trigger a sharp appreciation of the Swiss franc. In that vein, during the press conference that followed the policy rate decision, Thomas Jordan, Chairman of the SNB Governing Board said that the US Treasury report "has no impact on [the SNB's] monetary policy" and that the currency purchases are "the

result of the SNB mandate given by the people of Switzerland and the Swiss parliament." However, Jordan did highlight the constructive dialogue between the US authorities and the SNB.

Inflation forecast almost unchanged

Figure 3: Inflation forecasts



Last data point: 11/2020 (inflation rate). Source: Datastream, SNB, Credit Suisse

The SNB has kept its inflation forecast almost unchanged in comparison to its September forecast (Figure 3), and still does not anticipate inflation to rise even close to 1%. As this forecast is conditional on an unchanged policy rate, it indicates that the SNB intends to keep its policy rate unchanged at least until Q3 2023.

Further downside for USD/CHF

Despite the sizable SNB interventions over the course of 2020, the CHF has performed extraordinarily well against the USD during this period. While we expect the impact of the US Treasury's announcement on the CHF to be only minor, we see more CHF appreciation potential at the margin and, hence, reiterate our negative USD/CHF view. Besides the SNB's policy, the fundamental arguments for CHF strength against the USD remain in place. In the new theme of ultra-low rates across the globe, carry trades have become less attractive, which will continue to be supportive for the CHF. The lack of yield-seeking capital flows makes it even more difficult for Switzerland to recycle its long-time sizable current account surplus. In the absence of private capital outflows, the SNB's currency intervention policy has been the only major force against excessive CHF strength. And without it, the exchange rate would likely adjust accordingly. USD/CHF is trading within its fair value range according to our models. Yet, relative current account and fiscal balances and inflation dynamics favor the CHF over the USD. We maintain our negative USD/CHF stance and remain neutral on EUR/CHF. We also acknowledge the risk stemming from negative USD positioning against the CHF and the economic impact of (unlikely) US sanctions. Our forecasts for USD/CHF are 0.87 and 0.88, and we expect EUR/CHF at 1.08 and 1.10 in 3 and 12 months, respectively. (17/12/2020)