Forex Focus: Time For SNB To Retire From The Field?

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LONDON (Dow Jones)--The Swiss National Bank should start giving up its intervention battle.

The cost, in terms of increased money supply, will soon become more onerous and the need for a weaker Swiss franc will soon become less imperative.

All the Same, the SNB will no doubt be reluctant to retire from the battlefield while the risks of another sharp collapse in the euro remain so high.

In hindsight, this week could well prove to have been a turning point.

The Swiss central bank succeeded in pushing the euro three big figures higher to CHF1.43 from CHF1.40 Wednesday, helped not only by a fears of coordinated market intervention to prop up the euro but by reduced liquidity in global markets.

Since then, the euro has managed to gain a little more but remains vulnerable to another sharp decline amid highly volatile global financial market sentiment.

See the euro's latest moves against the franc:

http://www.dowjoneswebservices.com/chart/view/4010

Although the SNB has never confirmed its recent market intervention, the bank's foreign exchange reserve data shows a huge CHF29 billion increase in April, indicating the high level of activity.

Nevertheless, the euro is still expected to slide again.

Underlying market concerns about a euro zone debt default haven't really changed. Also, hopes earlier this week of some coordinated central bank exercise to stop the euro's decline have largely faded.

If for no other reason, the European Central Bank is hardly likely to participate in such a high-risk manoeuvre that could damage its own credibility.

Mitul Kotecha, head of global foreign exchange strategy at Credit Agricole in London, summed up a general feeling among analysts: "We believe that intervention is highly unlikely and see little reason for panic about the drop in the euro. Once markets realise that there is indeed little risk of intervention the euro will resume its downtrend".

However, the SNB might be less gung-ho about intervening now.

As the Swiss economy recovers, inflation pressures will grow and the central bank will need to be more careful about recent money supply growth.

The bank is certainly well aware of the problem. After their policy meeting in March, bank officials pointed to the high level of money supply growth and the risk this poses to inflation.

The problem for the SNB is that any rate hike to curb money supply now will only push the franc even higher against the euro, given that the ECB itself is not about to contemplate any rate increases of its own just now.

Thus, the main form of any monetary tightening is likely to be franc strength rather than actual hikes in short-term rates, giving the SNB less reason to intervene as the euro starts falling again.

So this week could well signal the start of a more prolonged decline in the euro towards CHF1.37, as Credit Suisse suggests, as the SNB starts to retire from the market and its forays to stop the franc's advance become less predictable.

Early Friday in Europe, the euro was up at CHF1.4426 at 0645 GMT from CHF1.4369 late Thursday in New York as a combination of factors--a warning about yen strength by the Japanese Finance Minister Naoto Kan and news that U.S. Treasury Secretary Timothy Geithner will be visiting the U.K. and Germany next week to discuss financial stability--helped inject some calm and reversed the rush into safe havens.

"Markets in principle should determine foreign exchange rate issues, but I think we must closely watch them and ensure that there won't be any excessive yen rises", Kan said.

This hint of intervention by the Japanese pushed the yen back down a little from recent highs. The currency previously benefited from the latest wave of investor nerves that sent stock markets tumbling and commodity prices lower.

The dollar is up at Y90.24 from Y89.52 and the euro is up at Y113.23 from Y111.75 while the euro has risen to $1.2538 from $1.2480.

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Reuters   USD/DJ

Thomson   P/1066 or P/1074

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