Forex Focus: Opening The Way For More Franc Strength

By Nicholas Hastings

A DOW JONES NEWSWIRES COLUMN

LONDON (Dow Jones)--The Swiss National Bank may yet regret its recent candour.

Jean-Pierre Danthine's surprise confirmation this week that the central bank won't intervene to halt the Swiss franc's rise again, unless deflation pressures return, opens the door to even more fierce euro/franc losses.

See how far the euro has already fallen against the franc:

http://www.dowjoneswebservices.com/chart/view/4204

For the moment, the strength in the franc isn't hurting Swiss exports or even Swiss growth, as Wednesday's stronger than expected KOF survey will attest.

But there will come a point when it does take its toll on the economy and by then there might be little the SNB can do.

In a recent study, Robin Brooks, a currency strategist with Goldman Sachs in New York, suggested that the immunity of Swiss exports to the franc's strength has much to do with the fact that they consist largely of value-added goods headed for German manufacturers which have low sensitivity to price.

In other words, the Germans will still order regardless of how far the franc rises against the euro.

Even so, Brooks admits, there is still a point at which the Swiss economy is put at risk.

"To be fair, the impact from CHF appreciation on economic growth may be broader than simply through exports," he stated.

Not only does a strong franc inhibit exports, other than those going to Germany, by making them more expensive but it acts as de facto tightening in monetary policy on the economy as a whole.

So while the Swiss economy might be on target to achieve the 2% growth the SNB is looking for at the moment, this could well change if the franc extends its gains as many expect.

No only does the strong Swiss growth, as suggested by recent data including the Kof, increase the chances of the SNB hiking interest rates before the end of the year, there is little sign of the franc falling out of favor for many other reasons.

If anything, the franc's safe haven status has increased in recent weeks as concern over the European debt crisis and the impact on banks in the euro zone appears to have encouraged more savers to pull out of the euro.

Germany's decision to ban short selling also encouraged further inflows from Germany as investors worried about their ability to trade.

As the euro has fallen to new record lows under CHF1.32, pre-crisis borrowers who made loans funded in the franc have come under increased pressure to hedge their positions.

On an even wider level, the recent disappointment over U.S. growth data and fears that China may now be slowing down faster than anticipated have contributed to a fresh distaste for risky assets, ensuring that the franc's position as a safe haven is even more attractive than it was before when Switzerland's growth prospects didn't look so good.

By choosing to define the SNB's intervention policy quite so clearly, rather than leaving its intervention intentions uncertain as most central bankers are advised to do, Danthine has removed the element of doubt.

Even more franc buying is now likely--pushing the franc to new record levels that could well start damaging the economy in other ways.

Early Thursday, the euro slipped a little further to CHF1.3121 by 0645 GMT from CHF1.3183 late on Wednesday in New York, according to EBS.

Moody's downgrade of Spanish debt, a disappointing private sector employment report from the U.S., another decline in China's manufacturing activity and worries that there could still be strong bank demand for the ECB refinancing later in the day all appeared to be weighing on the euro.

However, there was some good news too in the form of a sharply improved Bank of Japan Tankan survey and a rise in German retail sales that helped to lift hopes of better consumer activity.

The euro was still down a little at $1.2210 from $1.2238 and at Y108.00 from Y108.21 but the dollar was more or less flat at Y88.44.

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 Reuters   USD/DJ
   Thomson   P/1066 or P/1074
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