Forex Focus: Swiss Franc Is Even More Of A Problem Now

By Nicholas Hastings

A DOW JONES NEWSWIRES COLUMN

LONDON (Dow Jones)--The Swiss National Bank is slipping firmly between a rock and a very hard place.

As the global recovery falters and concerns over the euro zone's debt funding problems return, the Swiss franc is once again on the rise.

With the economy now weaker than it was a few months ago, a strong franc is the last thing Switzerland needs.

But, as the SNB found out earlier this year as it fought to prevent the euro from falling under CHF1.50, intervention doesn't really work.

The problem is, the need to intervene appears even more imperative than it was before.

The SNB always claimed that its previous intervention was designed to prevent deflation. Only a few weeks ago, one of the central bank's board members Jean-Pierre Danthine was crowing that "deflationary trends have practically disappeared today."

But here we are three weeks later with a Swiss economy showing distinct signs of a slowdown and with spare capacity showing little signs of shrinking.

To make matters worse, the latest set of consumer price figures show that deflation still remains a threat with the core inflation rate hovering just above zero at 0.1% on the year.

The data should ensure that any vestigial talk of interest rates hikes when the SNB next meets on September 16 is dropped fast as the Swiss central bank, like those of most other major economies, contemplates what may be needed to prevent their economies facing a double dip recession.

However, unlike most other central banks, which are faced with weaker currencies that will essentially ease monetary policy and make exports more competitive, the SNB is burdened with a rising franc that will inflict even more damage on a beleaguered Swiss economy.

The problem for the SNB now is how to respond.

Despite its repeated intervention, selling the franc against the dollar and the yen, not only did the euro still manage to fall from over CHF1.50 all the way down to CHF1.30 by the end of June but the central bank itself ran up a bill of CHF4 billion in exchange rate losses in the first half of the year.

Since then, the euro may have managed to bounce back to about CHF1.40 but as its strength erodes the single currency has already fallen back to under CHF1.35, posing an even more serious dilemma for the SNB this time around.

See how the euro has fared against the franc in recent months:

http://www.dowjoneswebservices.com/chart/view/4424

With risk appetite remaining poor early Monday in Europe, the Swiss franc was being pushed higher - with the euro falling to CHF1.3381 by 0645 GMT from CHF1.3415 late on Friday in New York, according to EBS.

The dollar was down at CHF1.0436 from CHF1.0516.

The dollar also fell to Y85.88 from Y86.28 as weaker than expected Japanese GDP growth in the second quarter sent investors scurrying for safe havens.

However, after early losses, the euro was staging a rebound in early dealing, rising to $1.2822 from $1.2757. It was also back up at Y110.19, nearly unchanged from Y110.21.

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