Forex Focus: Swiss Franc's Upside Is Limited Now

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LONDON (Dow Jones)--Calling time on the Swiss franc rally.

At the moment, there is still plenty of reason for bulls to continue buying the Swiss currency. The Swiss economy continues to outperform its neighbors and uncertainty over the global recovery makes the franc attractive as a safe haven.

Look at the other major safe haven, the yen.

The Japanese currency managed to hit a new 15-year high against the dollar as soon as Japanese Prime Minister Naoto Kan was confirmed prime minister after leadership elections in the ruling party this week.

The yen is expected to remain strong, even though the Bank of Japan has now stepped in to stop its advance with the first direct market intervention in six and a half years.

The franc itself hit a record high against the euro only a week ago--at CHF1.2765--and rallied back over parity against the dollar for the first time in nearly 10 months on Tuesday.

See how the euro has fallen against the Swiss franc:

http://www.dowjoneswebservices.com/chart/view/4596

But this could well prove to be the last of the franc's rally.

Not only is the currency's safe-haven role likely to become less urgent, once the global recovery regains its traction, but the Swiss authorities are likely to become less tolerant of a strong currency as the Swiss economy itself shows signs of slowing.

First, the safe haven bit.

For much of this year, as the global recovery stalled and the risks of a sovereign default rose, the franc and other safe havens were very much the currencies of choice.

There are still fears in the global investment community of a double-dip recession in the U.S. and of a payment crisis in one of the euro zone's peripheral debtors.

However, the worst appears to be over. Global economic data have started to look more perky again and the Federal Reserve appears ready to ease monetary policy again if needed. The dollar has been falling on a report from Goldman Sachs that the Fed could move as early as November.

As far as sovereign debt is concerned, a successful bill auction by Greece Tuesday and the launch of a roadshow later this week to boost investor confidence in the country indicate just how far markets have moved since the Greek crisis erupted earlier this year.

The shifting outlook for the Swiss economy will also make the franc less attractive.

Sure, Switzerland is likely to perform much better than its euro-zone neighbors. As the Swiss National Bank is likely to confirm when it meets Thursday, gross domestic product growth for 2010 will probably still be forecast at 2%.

However, by 2011 the story should change as the slowdown in the euro zone takes its toll and Switzerland finds that its growth risks are now on the downside.

Recent data show that inflation pressures are already proving less aggressive than expected and could fall below the SNB's own forecasts in coming months.

This means that the SNB will be less concerned about hiking interest rates, despite forecasts from the Swiss bank UBS that it will do exactly that this Thursday.

But it also means that the central bank will be more concerned about the strength of the franc.

Instead of sitting idly by as it has since June, the SNB could well return to the fray, intervening to stop the franc from rising too far and stifling the country's recovery.

In other words, the Bank of Japan may soon not be the only central bank out there battling to stop its currency from rising too far.

Early Wednesday, the dollar edged back up to CHF1.0017 from CHF0.9953 late Tuesday in New York, according to EBS.

The dollar was also up at Y85.02 from Y83.04, hovering just below its post-intervention high at Y85.14.

The euro was down at $1.2979 from $1.3020, but was up at Y110.38 from Y108.12. The single currency was also up at CHF1.3016 from CHF1.2959.

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