Forex Focus: All Eyes On Swiss National Bank

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By Katie Martin
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LONDON (Dow Jones)--The clock is ticking towards the week's biggest event for the currency markets.

Never mind the Greek downgrade, U.K. inflation data and the biggest drop in German economic sentiment since Lehman Brothers collapsed. No, all eyes this week are on the quarterly meeting of the Swiss National Bank.

These meetings are always important for the Swiss franc, of course. But the next one, the results of which will be known early Thursday, is a big deal across the markets.

The reason, of course, is that the SNB has been on a euro feeding frenzy for months, gobbling up the single currency on an unprecedented scale in an effort to stop the franc from rocketing higher.

It has worked, to some extent; the franc is nowhere near as strong now as it would have been if the SNB had stood aside and let it climb. Indeed, the euro has now edged far enough back from the precipice against the franc that a squeeze higher is now possible.

But the safe-haven currency has still hit its strongest levels on record against the wobbly euro of late, and the bill at the SNB for preventing a further climb has been enormous.

Last month, the SNB's reserves swelled by an eye-watering CHF78.8 billion, or 15% of the country's entire economic output, as it battled to hold the franc down. That's EUR56.5 billion, or close to EUR3 billion a day. Every day. That's a lot of euros. It's currency management on a Chinese scale. Indeed, the SNB is probably the biggest euro buyer in town.

Without it, most analysts agree that the euro would be an awful lot lower against a whole range of other major currencies right now, not just against the franc. In particular, it would almost certainly be weaker against the dollar too. So, this quarterly meeting could be unusually influential.

The central bank is likely to leave interest rates where they are. But the markets don't really care about that. All eyes and ears are on what it says about the currency.

"OK lads. The game's up. Buy all the swissies you like," is an unlikely response. It's not likely to give up at this point. But it may shift its wording. It may step away from its policy of seeking to prevent "excessive" gains in the franc and move towards smoothing overly volatile moves. All things being equal, that would probably mean euro buying on a more moderate scale.

The central bank doesn't like to see the franc climbing too fast, which usually happens when panic strikes and safe-haven flows kick in. But Swiss growth and inflation data clearly suggest that the economy is recovering nicely.

Perhaps the central bank will acknowledge more clearly that other forces, aside from safe-haven demand, are at play. "If the SNB becomes more confident that Swiss franc strength is down to a strong economy, they might be more comfortable with it," said Daragh Maher, a senior currencies analyst at Credit Agricole in London.

Easing back on euro purchases is a difficult balancing act for the SNB. It is unlikely to want to help the euro to collapse, as that would leave a lot of euro-denominated assets worth less than it paid for them. The Swiss could usefully ask the Chinese for advice on how to deal with that conundrum. It certainly needs to be handled carefully.

The SNB is one of the most respected central banks in the world. It knows what it's doing and is trusted not to make a hash of it. Nonetheless, it could inject a fresh jolt of volatility into the market Thursday morning.

In early European trading Wednesday, the euro was continuing to enjoy support at $1.2337 against the dollar, down a shade from $1.2348 late in New York Tuesday, according to trading system EBS. The dollar was at Y91.62 from Y91.40 against the yen, which was under pressure as safe-haven demand waned in generally buoyant conditions. The euro was flat at Y112.89. The pound was also flat at $1.4810.

The ICE Dollar Index, which tracks the dollar against a basket of other major currencies, was little changed at 85.999 from 85.934.

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