FX Watch

What's going on in EUR/CHF?

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G10 FX Strategy
Global

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Key takeaways

- EUR/CHF has retraced 38.2% of YTD rally - losses have been concentrated in run-up to ECB. Position squeeze explains move
- CHF reverting back to its traditional anchors - rates have become important but nuance remains SNB selling FX reserves
- S/t trend signals CHF supportive, but carry still a big headwind. Base case view for higher EUR/CHF over m/t remains intact.

Heads have been scratched.

There has been a great deal of head-scratching in recent trading sessions on the cause of the reversal in EUR/CHF appreciation. Most of the 38.2% retracement has been concentrated this week in the run-up to the ECB. We think Exhibit 1 and Exhibit 2 are the best visualisation of what we think has happened this week. Short CHF has been a popular trade since the start of the year and inevitably there has been a position build particularly vs GBP, EUR, USD & CAD. Whilst the ECB has not been assigned a significant amount of vol premium, we think investors have taken the opportunity to lighten positioning – YTD winners have been squeezed and as a result, the CHF has recovered some of this year's losses. We do not see this as a turning point, quite the opposite as we discuss below.

Back to basics for CHF

Before that, we would make some observations on how CHF has traded relative to some of its traditional anchors. We have placed great store in the observation that CHF had deviated from its traditional drivers through much of the last two years against the backdrop of sizeable CHF buying from the SNB which caused this wedge. However, our analysis suggests that CHF has been slowly reverting to its traditional anchors. Of most significance has been the correlation versus rates as we show in Exhibit 3. Investors have been keen to short CHF for some time based on the view that CHF would make the perfect funding currency versus higher yielders. We think this recalibration now gives that trade a better opportunity. With the lowest policy rates in G10 and the SNB increasingly concerned about the strength of CHF, we think the central bank is unlikely to allow rate differentials to move significantly in favour of CHF and at the minimum, the CHF to benefit from rate spreads moving in its favour.

Timestamp: 26 January 2024 05:10AM EST

Vol sensitivity has also been a strong driver for CHF, but once again, SNB buying has made the CHF inelastic to moves in market volatility. Exhibit 4 shows how FX volatility has become to play a more important role in CHF price action since the end of the year. Our broader macro views look for a benign environment for risk in combination with managed slowdown of the global economy. This should be the perfect backdrop for CHF underperformance on a multi-period basis. In both charts we would observe that November has been the crucial inflexion point in the recalibration to anchors.

FX does not do straight lines.

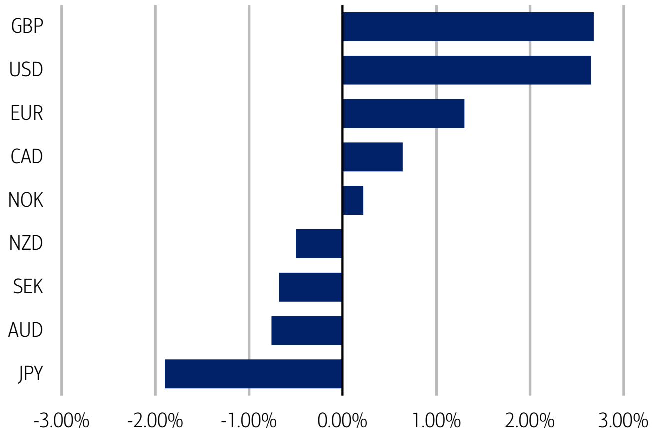
Our guiding principles on further CHF weakness centres around increasing concerns that the SNB has expressed about the rise of the REER (Real Effective Exchange Rate) to record highs and the impact that this is having on Swiss corporates profitability. Whilst the SNB has stopped short of characterising CHF as "significantly overvalued", readers will recall that Swiss corporate concerns were a key driver for SNB interventions in recent years. This may well be the incremental step towards characterising CHF as "significantly overvalued" once again but the direction of travel is clear to us: the SNB wants a weaker CHF in the absence of renewed inflationary impulses. On the latter, we are cognisant of the rising tensions in the Red Sea which is a risk to our medium-term bearish views on CHF.

There has been obvious frustration in the latest reversal in EUR/CHF after a promising start to the year. Our repost is simple: FX markets do not move in straight lines and markets do periodically succumb to bouts of profit taking and position adjustment. Here, our FX factor signals provides an elegant framework of quant signals to compliment our macro views. Exhibit 5 provides a snapshot of our FX Factor Signals. The key takeaway here is that the bulk of those signals suggest scope for further CHF downside based on carry and valuation (CHF remains the most overvalued currency in the G10 space).

Consistent with our view that crowded positioning has been a dominant theme recently, Exhibit 6, shows that our shorter-term trend signals are consistent with the recent pullback in EUR/CHF. The Moving Average Aggregation (MAA) signal is particularly strong (further CHF upside) vs JPY, AUD & NZD. In EUR/CHF, the signal is consistent with the recent pullback but the strength of the MAA does not suggest that the recent pullback is likely to be a deep correction. Overlaying with Up/Down Volatility to generate the composite short-term signal and this points to further attrition in EUR/CHF longs.

Though EUR/CHF risk reversals have moved towards the top of their recent range (less bias for CHF calls) they remain negative and well within longer-term ranges. This has effectively neutralised the impact of U/D vol on the MAA signal. For now it is all about the trend rather than a fundamental change in market views on medium-term CHF weakness. The carry signal remains resolutely bearish for CHF across the G10 space and with the change in focus from the SNB, valuation may once again begin to take a more prominent role. Technically, the failure to break above the 50dma has provided the opportunity to lighten positioning. We are confident that renewed CHF weakness is only a matter of time, and continues to have a bias to express such views via options structures such ratio call spreads.

Exhibit 1: YTD G10 FX performance vs CHF
CHF has been a popular short vs GBP, USD and EUR since start of year



Source: BofA Global Research, Bloomberg

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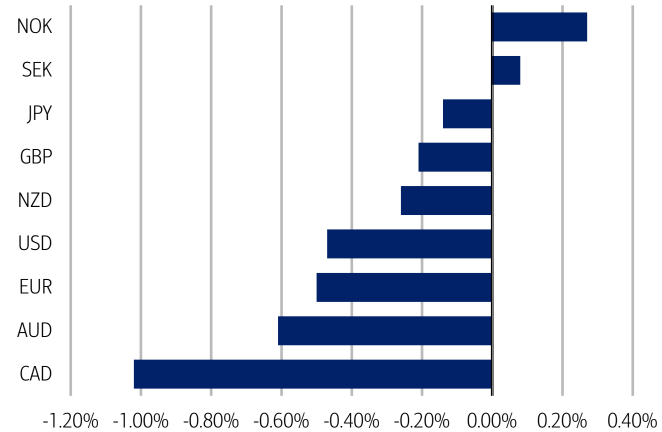
Exhibit 2: G10 FX performance vs CHF since 22-Jan
But there has been a squeeze in popular trades since 22nd January



Source: BofA Global Research, Bloomberg

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Exhibit 3: CHF TWI vs Swiss rates spreads vs weighted G10
CHF correlation with rates has begun to improve

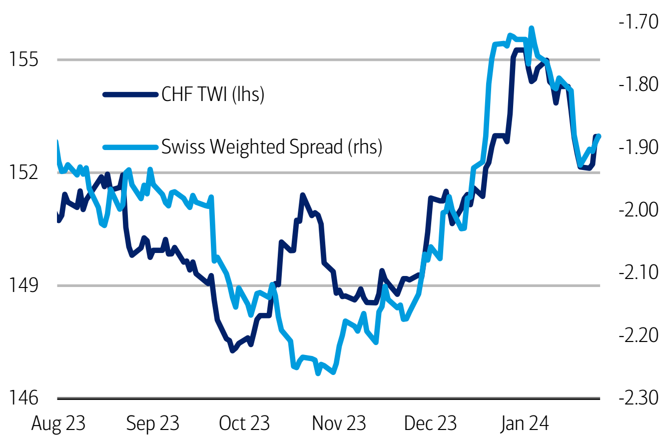

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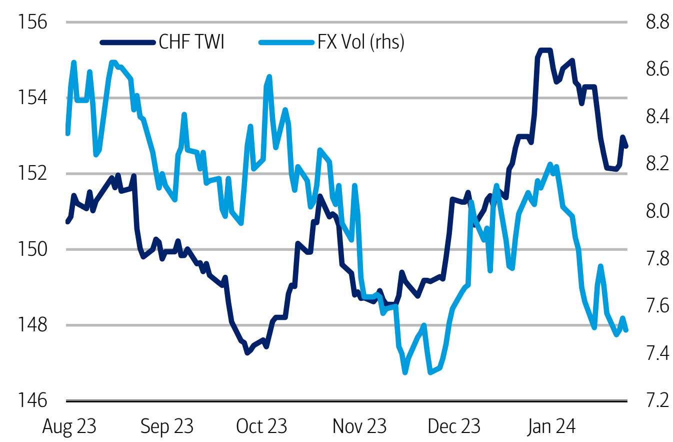
Exhibit 4: CHF TWI vs FX Vol
November has been a crucial inflexion point for resumption of correlation



Source: BofA Global Research, Bloomberg

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Exhibit 5: Factor Signals

Both value and carry signals suggest further CHF downside

Spot (CHF/XXX)		Trend	Carry 3m	Carry 6m	Carry 12m	Vol Adj Carry 3m	Vol Adj Carry 6m	Vol Adj Carry 12m	Consensus 3m	Consensus 6m	Consensus 12m	Value
USD	1.16	↑↑	↓↓↓	↓↓↓	↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓
EUR	1.06	↑↑	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓
GBP	0.91	↑	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓
JPY	171.10	↑↑↑	↑↑↑	↑↑↑	↑↑↑	↑↑↑	↑↑↑	↑↑↑	↓↓↓	↓↓↓	↓↓↓	↓↓↓
AUD	1.76	↑↑	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓
NZD	1.89	↑↑	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓
CAD	1.57	↑↑	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓
NOK	12.11	↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓	↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓
SEK	12.07	↑↑	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓	↓↓↓

Note: Trend signal is given by the Moving Average Aggregation (MAA)signal, attenuated by the Up/Down volatility signal. MAA is rescaled between +100 and -100; MAA>20: uptrend; MAA>60 strong uptrend; MAA<-20: downtrend; MAA<-60: strong downtrend; if MAA>60 and U/D>80 -> high risk of reversal; if MAA<-60 and U/D<20 -> high risk of reversal; The strength of both carry and vol-adjusted carry signals is given by adding a z-score overlay to the pure carry signal. A positive carry signal would be strengthened by a positive z-score and weakened (though never reversed) by a negative z-score. A small - less than abs(0.5) – does not affect the carry signal. Consensus signals are measured relative to forwards, and the value signal, which is contrarian (overvalued currency leads to negative signal) is overlaid with the 5-year z-score in the same way as carry. Factor heatmap first introduced in the report Factor Signals for FX Hedgers in February 2020

Source: BofA Global Research, Bloomberg

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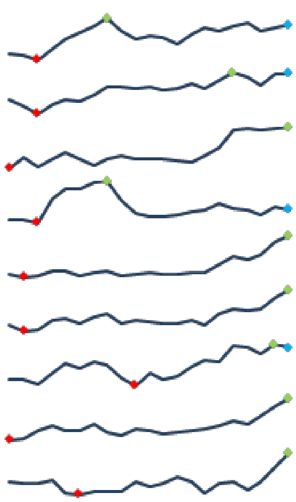
Exhibit 6: Short-term trends (CHF/XXX)

Our short-term trend signals point to near-term CHF upside particularly versus CHF

	Spot level	1y range	Trend (MAA) level	Trend (MAA) signal	1w Δ	1m Δ	UD vol	Signal S/T
USD	1.16		43	↑↑	↑↑	↓↓↓	52	↑↑
EUR	1.06		50	↑↑	↔	↓↓	85	↑↑
GBP	0.91		14	↑	↓↓	↓↓↓	25	↑
JPY	171.10		93	↑↑↑	↑↑	↑↑↑	59	↑↑↑
AUD	1.76		86	↑↑↑	↑↑	↑↑↑	85	↑↑
NZD	1.89		93	↑↑↑	↑↑	↑↑↑	1	↑↑
CAD	1.57		50	↑↑	↔	↓↓	47	↑↑
NOK	12.11		-7	↓	↓↓	↑↑	78	↓
SEK	12.07		50	↑↑	↑↑	↑↑↑	64	↑↑



Note: S/T Trend signal is given by the Moving Average Aggregation (MAA) signal, attenuated by the Up/Down volatility signal but only at extremes. When risk of reversal is high the MAA signal is 'weakened' by the U/D vol measure. MAA is re-scaled between +100 and -100; Up/Down vol looks at the volatility of up vs down moves and is a number between 0 and 100. MAA>20: uptrend; MAA>60 strong uptrend; MAA<-20: downtrend; MAA<-60: strong downtrend; if MAA>60 and U/D>80 -> high risk of reversal; if MAA<-60 and U/D<20 -> high risk of reversal;

Short-term trends introduced in the report Factor Signals for FX Hedgers in February 2020

Source: BofA Global Research, Bloomberg

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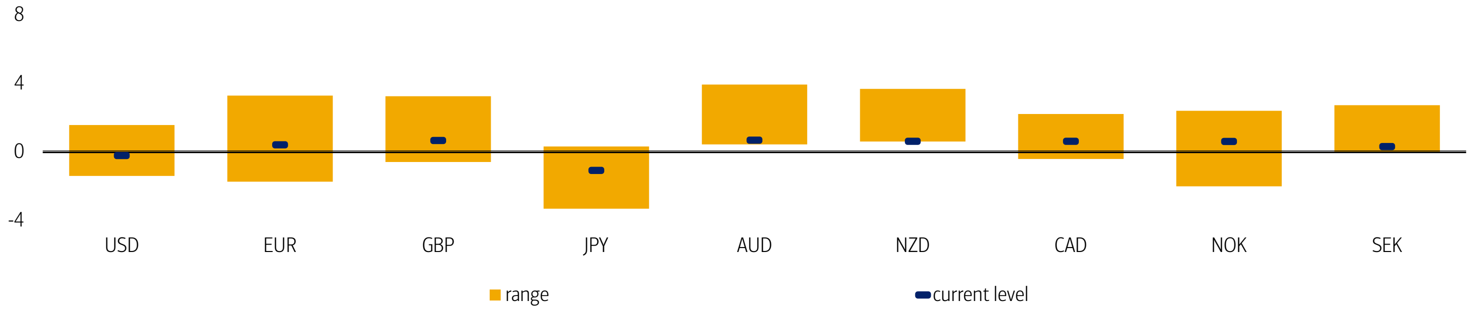
Exhibit 7: 3m risk reversal relative to range for CHF/XXX

Options skew suggests lack of appetite for topside CHF structures even against high beta G10 FX



Note: Range shows the 2% to 98% range of the risk reversal over a 15-year look back. 25 delta risk reversals show the difference in volatility between 25d calls and puts. Positive (negative) values indicate that calls (puts) are more expensive. In other words, a positive (negative) value suggests upside (downside) protection is relatively more expensive.

Source: BofA Global Research, Bloomberg

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