Global Rates & FX Watch

CHF: SNB spices up the remuneration party

30 October 2023

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Key takeaways

- The SNB announced two changes to its remuneration policy effective from December 2023
- Bias to fade the immediate CHF FX-Sofr widening, min reserves remuneration changes may save c. CHF 300m in annual costs
- Asymmetric price action to limit CHF weakness as traditional correlations breakdown. Optimal level of b/s yet to revealed.

Two remuneration changes coming up in December

On 30 October 2023, the Swiss National Bank (SNB) announced two changes that will be effective from 1 December 2023: 1) the threshold factor applied to the tiered remuneration structure will be reduced from 28 to 25; 2) it will no longer remunerate sight deposits held by banks to meet their minimum reserve requirements. The decision was made to ensure that monetary policy implementation remains effective and will reduce interest costs for the SNB.

We are biased to fade the immediate FX-Sofr reaction

Based on current rate and deposit levels, we calculate the remuneration change on minimum reserves will reduce SNB costs by c. CHF 300m per annum. This is small when compared to the CHF 132bn loss the central bank incurred last year, although that loss was driven by exceptionally strong market movements impacting its foreign currency positions. We do not believe the threshold factor change will prompt a significant search for yield by Swiss banks and are biased to fade the immediate widening in CHF FX-secured overnight financing rate (Sofr) basis following today's announcement.

Thoughts on CHF

Year-to-date, CHF has been the best performing currency versus USD and whilst the geopolitical outlook has deteriorated, it would be remiss of us to explain CHF strength as safe-haven buying. What strikes us is how CHF has decoupled from some its traditional anchors. This suggests that there is some asymmetry in CHF price action. As much as investors were hesitant to push CHF higher when the SNB imposed a floor under EUR/CHF, FX has become an increasingly important tool via balance sheet adjust. The SNB continues to sell foreign assets and for as long as they continue to do this, we expect CHF to remain well supported. The SNB is in effect acting as a deterrent to sell the CHF. Until they guide markets otherwise, a move back towards EUR/CHF parity seems unlikely.

Nonetheless, one cannot ignore recent developments outside of Switzerland and specifically, we are paying close attention to the dynamics in Euro Area peripheral spreads which have returned as a factor driving CHF price action.

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Timestamp: 30 October 2023 09:36AM EDT

Two changes for December

The SNB announced on 30 October 2023 that, from 1 December 2023, two changes will come into effect:

> First, it is lowering the threshold factor applied in the tiered remuneration of sight deposits. Second, sight deposits which are held to meet minimum reserve requirements will no longer be remunerated. These adjustments will ensure that monetary policy implementation remains effective and will reduce interest costs for the SNB. The changes have no impact on the current monetary policy stance.

Rates: Fade the FX-Sofr basis widening

At the system level, we estimate no sight deposits were subject to the lower remuneration rate of the SNB policy rate minus 50bp since the SNB exited negative rates (Exhibit 1). This reflects the decline in sight deposits due to 1) a reduction in the SNB's balance sheet, and 2) net issuance of SNB bills (Exhibit 2).

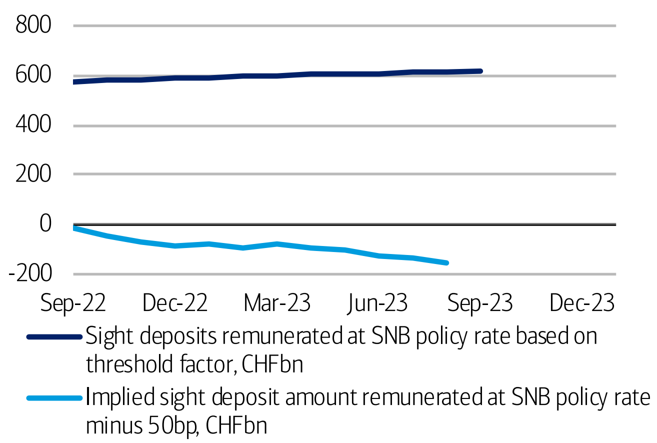
Our calculations indicate no sight deposits, again at the system level, will be subject to the lower remuneration rate even after the lower threshold factor of 25 comes into effect in December 2023. This would imply search for yield by Swiss banks because of this change could be limited. We therefore believe the impact on Swiss Average Rate Overnight (Saron) fixings may be limited and are biased to fade the immediate widening in the CHF FX-Sofr basis shortly after the announcement (Exhibit 3).

But the market impact from such changes may be meaningful if there were a strong increase in sight deposits, subjecting sight deposits to the lower remuneration rate. Such an increase could come from an increase in balance sheet or shift between the central bank's liabilities for example a reduction in SNB bills.

The change in remuneration of minimum reserves, as the SNB stated, is aimed at reducing the central bank's interest costs. In 2022, the SNB made losses of CHF 132bn, primarily from its foreign currency positions. That accounted for most of the decline in its provision and equity capital that year. Based on current rate and sight deposit levels, we estimate the change to minimum reserve remuneration will reduce the SNB's costs by c. CHF 300m in annual costs.

Exhibit 1: Implied sight deposit amount remunerated at lower rate

Our calculations suggest no sight deposits are remunerated at lower rate



Source: BofA Global Research, SNB

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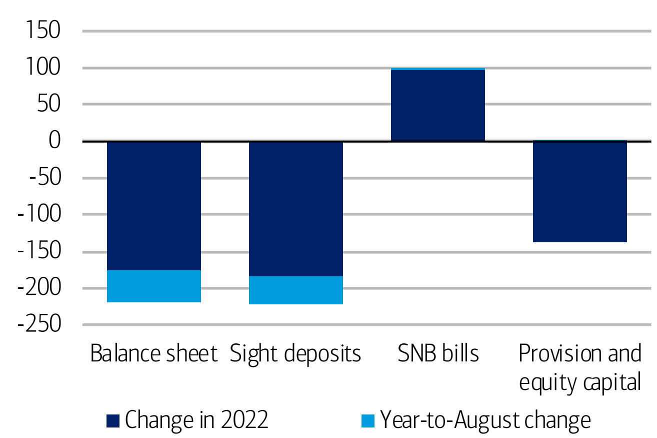
Exhibit 2: Change in SNB balance sheet and liabilities

Fall in sight deposits reflected balance sheet reduction and more SNB bills



Source: BofA Global Research, SNB

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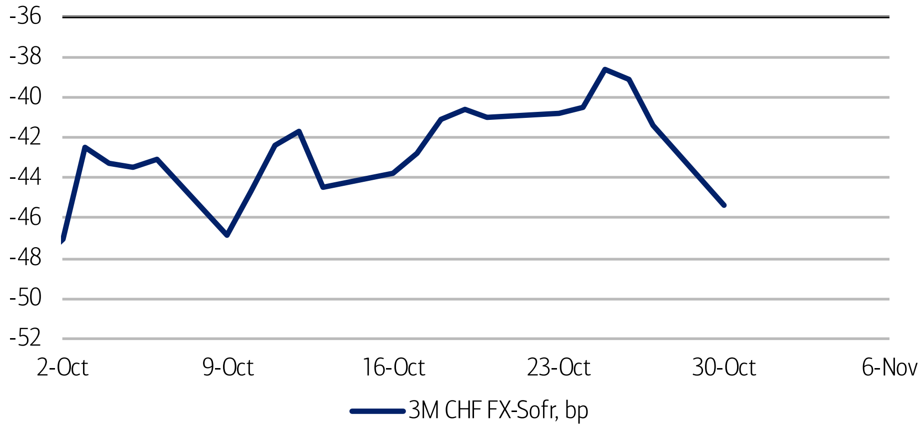
Exhibit 3: 3M CHF FX-Sofr basis

We are biased to fade immediate widening on basis following the SNB's announcement



Source: BofA Global Research

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FX: SNB limits CHF downside

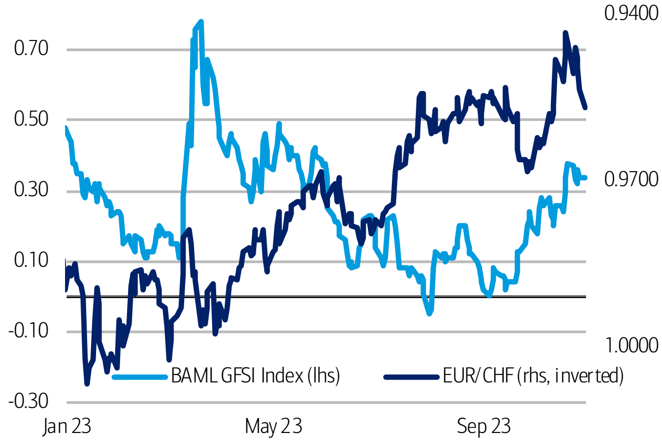
The Swiss Franc has been the strongest performing G10 currency since the start of the year. Though the geopolitical climate has deteriorated, it would be remiss of us to conclude that CHF strength has been driven by safe-haven buying. Broad measures of volatility such as the BofA GFSI™ have fluctuated through this year whilst CHF TWI has remained in a broad uptrend (Exhibit 4). We can replicate this analysis for narrower measures of volatility such as the MOVE or VIX. Exhibit 5 shows how the correlation between CHF and traditional measures of safe haven – gold and JPY – have broken down.

The breakdown in some of the traditional drivers of CHF reflects an asymmetry in price action. As much as the EUR/CHF floor provided a deterrent to buying CHF for fear of SNB intervention, the ongoing tapering of the SNB balance sheet (which is now ~100% GDP, Exhibit 7) is acting as a headwind for markets to sell CHF. To recall, the SNB has increasingly used FX as the primary tool for policy, helping it to limit the amount of rate hikes which have lagged the rest of the G10. Today's sight deposit change confirms that the SNB has pushed levels back towards 2015, before the ECB started QE. The question is whether the SNB has an optimal level for the level of reserves. Until we have guidance from the SNB, we assume that this process continues and will provide support to CHF. We think the upside in EUR/CHF will remain capped.

Recent SNB commentary suggests that the bias is for further rate hikes and makes this week's CPI data and important release. Not only does a stronger reading validate hawkish SNB rhetoric but is also incentivises the SNB to continue to use the balance sheet as a shield against inflation. One measure of (localised) risks that bears further observation is the recent widening in Euro Area periphery spreads (Exhibit 6). Spread moves in the periphery have historically been very important for CHF. Any further dislocation here continues to exert upward pressure on CHF.

Exhibit 4: EUR/CHF vs BofA GFSI

Broader Risk has played little part in CHF moves this year



Source: BofA Global Research, Bloomberg

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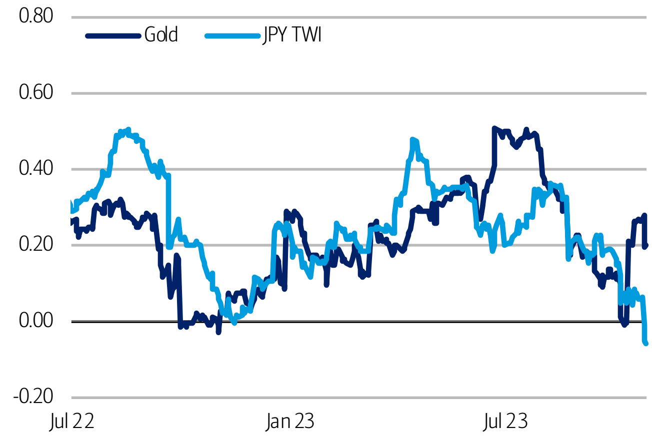
Exhibit 5: 6mth rolling correlation CHF vs JPY & Gold

Traditional safe haven correlations have broken down.



Source: BofA Global Research, Bloomberg

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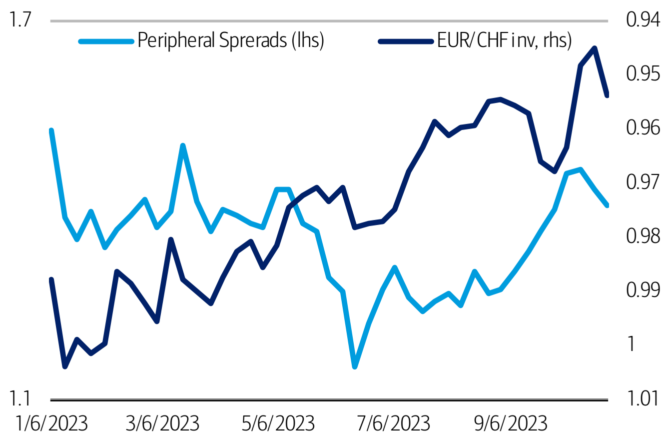
Exhibit 6: EUR/CHF vs Peripheral Spreads

Widening Peripheral Spreads is Weighing on EUR/CHF.



Source: BofA Global Research, Bloomberg

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Exhibit 7: SNB Balance Sheet

SNB continues to wind down balance sheet.. but to where?

Source: BofA Global Research, Bloomberg

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