

FX Watch

SNB FX Reserves

Key takeaways

- Reserves +CHF15bn @ CHF678bn in Feb. But headline number impacted by valuation adj. FX/Global Agg weaker; equities higher.
- Val adj = lower level of reserves from headline but 2nd consecutive rise versus Jan figures. Implication = SNB intervened
- Real TWI is off lows, but remains historically high - SNB may have more work to do partic if earlier ECB rate cut weakens EUR

07 March 2024

G10 FX Strategy
Global

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Reserves Confirm Intervention

Despite valuation adjustments, the February Reserves data confirms that the SNB were intervening to weaken CHF through Feb. Both the headline and valuation adjusted figures confirm that FX reserves have now stabilised around the CHF670bn region (Exhibit 1). Whilst CHF has traded higher following the release, the evidence points is consistent with the change in FX policy stance adopted by the SNB in December. The weekly sight deposit data hinted at intervention from the SNB but the FX reserves data adds credibility to this view. As a result, CHF remains a high conviction short for us, but we are mindful that the historical evidence implies that price action is likely to be a grind lower rather than a step adjustment. We are therefore recommending put spread structures in CHF to best reflect this view.

Valuation Adjustments in February

Headline February FX reserves rose CHF15bn to CHF678bn. This is the third consecutive monthly increase since November. However, through the month, there were important valuation impacts worthy of note. The three key drivers for those valuation adjustments are: a 4% rise in the MSCI All World Index; 2% fall in CHF TWI; 1% fall in Global Agg bond indices. Adjusting for these changes, our analysis suggests that valuation adjusted reserves rose to approx. CHF674bn – CHF4bn lower than the headline reported figure (Exhibit 2). Comparing this with the January valuation adj. figure, reserves rose by another CHF15bn to bring the cumulative YTD build at nearly CHF45bn. Reserves remain at levels consistent with those seen in 2017.

Will Reserves Continue to Grow?

The simple answer is probably but not at a significant rate. We think the SNB will be mindful of the signaling effect if reserves start to fall again. The key input to the strategy remains inflation and we are attentive to the latest CPI data which were stronger than expected at 1.2% y/y. Any further pick-up in inflation will no doubt pique SNB concerns that the battle on inflation is not yet won. Of equal focus will be the impact, if any, that an ECB rate cut (likely in June) has on EUR/CHF particularly given our view that the SNB is unlikely to move until September.

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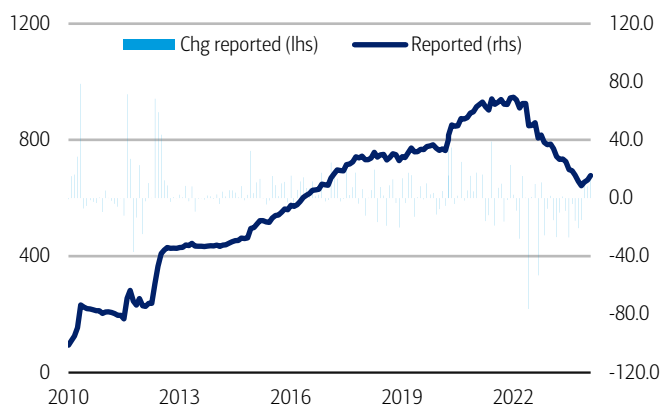
We would add here that the Swiss economy has continued to perform well this year. Indeed, Switzerland is the only other economy except the US to benefit from upward growth revisions. This will also be a factor closely watched by the SNB vis a vis its intervention activities.

CHF Still in Overvalued Territory

While there are a lot of near-term crosscurrents to consider, one long-term consideration remains a constant one. The long-term average of real CHF TWI continues to trade above its long-term averages. Ultimately, this will be the anchor that the SNB will want to use to gauge where it wishes to see CHF stabilise towards. Much of the appreciation trend and overvaluation of CHF has been out of the hands of the SNB – CHF strength has been the by-product of events out of its control since 2010. The current level in the CHF is therefore still elevated despite those events well behind us. So far, the SNB has refrained from characterizing CHF as “significantly overvalued” but that will change once the Swiss economy downshifts and inflation falls. All of this implies that through all the noise, the SNB remains committed to correcting CHF overvaluation.

Exhibit 1: SNB FX Reserves (CHF bn)

Reserves have stabilized at roughly CHF670bn

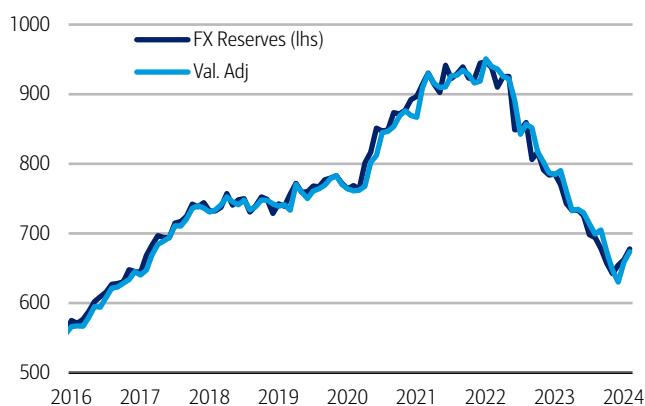


Source: BofA Global Research, Bloomberg

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Exhibit 2: SNB FX reserves – reported vs valuation adjusted (CHF bn)

Valuation adj. shows slower reserve build than headline number



Source: BofA Global Research, Bloomberg

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