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USDCHF drop puts SNB in spotlight

Swiss economy

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- On 11 April, the USDCHF fell to as low as 0.8140, levels seen only twice since 2011, amid tariff fears, safe-haven inflows, and a weakening US dollar.
- We think the SNB may consider rate cuts or interventions to manage the franc's strength and excessive volatility.
- We see the USDCHF trading in a range of 0.79-0.88 against this backdrop, while the EURCHF may trade in a 0.91-0.96 range. We recommend considering high-quality dividend stocks in Switzerland that offer around 3% returns.

Source: UBS

What happened?
Over the past 24 hours, the USDCHF has fallen sharply to as low as 0.814, a level seen only twice since 2011. On a broader basis, the Swiss franc has appreciated by around 5% in trade-weighted terms in recent days amid ongoing market turmoil and global economic growth concerns, and as investors weigh the impact of the trade war initiated by the US.

The franc's "safe-haven" status has been amplified by global trade disruptions and a weakening US dollar. Appreciation pressure also likely rose on a squeeze on speculative short positions in the currency.

A significant portion of the franc's recent strength is tied to the US dollar's weakness, driven by tariff-related uncertainties and broader market volatility. The USD index has experienced fluctuations reminiscent of the "Liz Truss moment" in the gilt market in 2022, with the dollar remaining lower compared to pre-tariff announcement levels. In the near term, we believe further dollar weakness is likely on both tariff risks and anticipation of Federal Reserve easing.

In addition, we saw the Swiss franc appreciate against the euro, with the EURCHF trading almost as low as 0.922 as safe-haven demand overrode any euro support from fiscal expansion. As global investors diversify from the USD, the EUR benefits from its liquidity, but the CHF's strength remains evident. The upcoming European Central Bank (ECB) meeting may result in a rate cut, potentially tempering near-term euro strength. However, if volatility and uncertainty fade, the EURCHF should move back toward 0.95 in the second half of this year.

What do we expect?
The Swiss National Bank (SNB) now faces increasing pressure to address the franc's rise, with potential actions influenced by the ECB's forthcoming decisions.

The SNB has a history of managing the franc's strength, particularly during periods of global uncertainty. In 2011, the SNB set a minimum exchange rate of 1.20 CHF per euro to curb the franc's appreciation, a policy that was abruptly abandoned in 2015, leading to significant market volatility. We think these past interventions underscore the SNB's readiness to take decisive action to protect the Swiss economy from excessive currency strength, if warranted.

If market distress persists, the franc is likely to remain strong, prompting the SNB to consider several measures to curb its appreciation:

- **Policy rate cut:** The SNB may opt for a rate cut in June if the franc's strength continues, especially if the ECB signals further easing. A 25-basis-point reduction to 0% could be on the table, particularly if inflation moves into negative territory. Historically, rate cuts have been used to lower borrowing costs and weaken the franc by making Swiss assets less attractive to yield-seeking investors.
- **Foreign exchange interventions:** The SNB could engage in foreign currency purchases to counter temporary appreciation pressures. This approach offers flexibility but risks being perceived as currency manipulation, potentially escalating trade tensions with the US. In the past, such interventions have provided immediate relief to appreciation pressures but have also led to diplomatic challenges.
- **Emergency rate cut:** In a more aggressive move, the SNB might implement an emergency rate cut if it deems the franc's appreciation a significant threat to inflation and economic growth. This would be the most radical option, potentially opening the door to additional easing measures. Historically, emergency rate cuts have signaled serious concerns about economic conditions, leading to further monetary easing and liquidity measures.

The SNB's decisions will be influenced by the ECB's policy moves, as coordinated easing could help manage the franc's strength. ECB actions could provide a framework for SNB measures, aligning regional monetary policy to stabilize currency fluctuations.

Factors such as low yield and improving European GDP growth should eventually lead to a weaker CHF. In the meantime, the SNB's policy decisions will be crucial in managing the franc's near-term trajectory and mitigating any adverse economic impacts.

We expect the Swiss economy to grow by 1% in 2025, supported by consumer demand. However, we do not anticipate foreign demand to contribute to GDP growth this year, given the uncertainty surrounding the tariff dispute. If the Swiss franc continues to appreciate, linked to recession risks in other regions, economic growth could slow to 0.5% or less.

What are our investment views?

EURCHF and USDCHF

Fundamentally, the Swiss franc remains in real terms below its historical highs. In our base scenario of a reduction in tariffs from current levels, the appreciation pressure on the Swiss franc could gradually ease. In this scenario, the euro should be supported by German fiscal expansion. We continue to see the EURCHF exchange rate at 0.95 over a 12-month horizon. However, in the current risk-off environment, downward pressure on the EURCHF could persist. In such a scenario, we expect the SNB to lean against a rapid fall in the pair, making a strong move below the all-time lows unlikely.

Following the tariff announcement, fears of a US recession have increased significantly, and markets have begun pricing in considerably more interest rate cuts by the Fed. As a result, the Swiss franc has appreciated substantially against the USD. If expectations of a slowdown in the US economy are confirmed and the Fed significantly lowers interest rates, the US dollar is likely to depreciate further. With the EURUSD breaking through its 2023 high, a short-term move above 1.15 is possible. As the SNB is likely to keep the EURCHF broadly stable, the USDCHF will depend on EURUSD movements. If the EURUSD moves above 1.15, the USDCHF would likely dip below 0.80. We see the USDCHF at 0.83 in 12 months, but expect a wide range on near-term volatility.

Swiss 10-year yields

Yields on Swiss government bonds have declined significantly since the announcement of US tariffs, likely reflecting lower economic growth expectations and increased uncertainty. We see long-term yields rising slightly once global trade tensions start to ease. Consequently, we keep our 12-month forecast for 10-year Swiss yields unchanged at 0.50%. In a downside scenario, where the SNB lowers its policy rate into negative territory, the 10-year yields would likely fall to 0%. Conversely, in a positive scenario characterized by a rapid easing of global trade tensions, the 10-year yields could rise to their recent highs of between 0.70% and 0.80%.

Swiss high-quality dividend stocks

Investing in Swiss high-quality dividend stocks can be appealing as interest rates decline, providing a defensive approach in uncertain times. With average dividend yields around 3% in our selection, these stocks offer returns that currently exceed Swiss franc bonds. We have selected Swiss companies that generally maintain strong balance sheets and profitability, supporting sustainable market-wide distributions. While yield is important, the growth factor also plays a crucial role; dividends are considered high quality when they are sustainable and growing. Therefore, Swiss dividend-paying equities may offer a steady income stream and potential for capital appreciation, serving as an option for managing market volatility.

Appendix

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