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SNB May 'Punish Speculators' by Returning to Markets to Temper Franc Surge

By *Simone Meier* - Jul 2, 2010



Swiss central bank president Philipp Hildebrand speaks at a press conference in Zurich.
Photographer: Peter Frommenwiler/Bloomberg

Switzerland's central bank may have to consider resuming its battle with currency markets after the franc surged against the euro within two weeks of policy makers ending attempts to counter gains, economists and investors say.

The franc has gained more against the euro since June 17 than any other currency from the Group of 10 nations, which include the U.S., Japan, and Canada. It rose to a record 1.3074 per euro yesterday before weakening in late trading in Zurich. It fell 0.5 percent to \$1.3336 as of 11:29 a.m. today. [Werner Abegg](#), a spokesman for the Swiss National Bank, declined to comment on whether the central bank intervened.

"The franc is already expensive but above 1.30 it will become a serious issue," said [David Kohl](#), deputy chief economist at Julius Baer Holding AG in Frankfurt. "They'll wait for the right moment to punish speculators. It's only a question of time, the appreciation is simply too fast."

Resuming currency interventions to protect Switzerland's export-led recovery would increase the SNB's record [currency holdings](#), leaving it vulnerable to larger losses as the euro weakens. The central bank may nevertheless have to run that risk as the franc climbs against the euro on investor concern that the euro-area debt crisis will worsen.

'Excessive'

SNB policy makers led by President [Philipp Hildebrand](#) on June 17 said deflation risks have "largely disappeared," ending a 15-month policy of countering what they called "excessive" gains of the franc. They also raised their 2010 growth forecast to 2 percent from 1.5 percent.

Officials "can always change their mind, they're watching the situation," said [Richard Benson](#), who oversees \$14 billion of currency funds at Millennium Asset Management in London. "Central banks don't like rapid movements in their currencies."

With exports accounting for more than half of Swiss gross domestic product, the central bank has been under pressure to weaken the franc and protect companies including [Swatch Group AG](#), the world's largest watchmaker. The 16-member euro region buys around two thirds of Swiss exports. The SNB added an unprecedented 85 billion francs (\$80 billion) in foreign currencies to its balance sheet in May to stem franc gains, boosting holdings to 239 billion francs. Its first-quarter profit plunged 69 percent, due largely to a 2.9 billion-franc loss on its euro reserves.

'Hurdle'

The scale of potential currency losses may force the SNB to think twice, said [Dirk Schumacher](#), an economist at Goldman Sachs Group Inc. in Frankfurt.

"The hurdle for interventions seems materially higher now, in light of the financial risk posed by the sheer size of foreign-currency exposure" on the balance sheet, he said. [Thorsten Polleit](#), an economist at Barclays Capital, said the SNB "might give a verbal warning to markets first."

SNB Vice President [Thomas Jordan](#) said June 21 he doesn't "necessarily" expect the franc to appreciate further and the central bank won't need to counter gains as long as they reflect the economy's strength. The Zurich-based central bank would only act to counter an "overshooting" and if the risk of deflation returned, he told Swiss television.

"The SNB is definitely very uncomfortable with its large currency reserves," said [Ursina Kubli](#), a foreign-currency analyst at Bank Sarasin in Zurich. "It could have been considered a capitulation, had they just stopped with interventions. The only way out was to declare the deflation risk as over."

'Detrimental'

[Beat Siegenthaler](#), a foreign-exchange strategist at UBS AG in Zurich, said the SNB may hold off intervening unless the franc reaches 1.25 per euro.

"There will probably be some level where the central bank will reconsider their decision," he said. "The market may have to overshoot to a level that would start to become detrimental" to the Swiss economy.

The economy has so far shown few signs of weakening. [Swiss manufacturing](#) expanded at close to the fastest pace on record in June and [leading economic indicators](#) increased to the highest in almost four years last month. M3 money-supply growth, which serves as a gauge for future inflation, accelerated to 7.1 percent in May from 5.4 percent the previous month.

“The SNB already has a large bulk risk on its balance sheet,” said [David Marmet](#), an economist at Zuercher Kantonalbank in Zurich. “Policy makers may still want to counter any strong franc gains but they know that they won’t be able to do anything against euro weakness.”

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