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After SNB's franc move, Switzerland is no longer a safe haven

By Dr R Seetharaman

The Swiss National Bank (SNB) shocked financial markets last Thursday by its decision to abandon the minimum rate of 1.20 francs against the euro that it had been defending for more than three years. The SNB cut also key interest rate from −0.25% to -0.75%, raising the amount investors pay to hold Swiss deposits. The Swiss franc soared against major currencies on Thursday after the Swiss central bank ended its policy of capping the value of the currency versus the euro. Following the SNB move, the euro went from buying 1.20 francs to buying just 0.8052, but it later recovered to buy 1.04. It ended last week at 0.99410 francs against the euro. Immediately after the SNB announcement, the Swiss franc surged 20% against the US dollar. However it ended last week at 0.8587 against the dollar. At the end of last week ¥137.07 was equal to a Swiss

franc. Franc had strengthened by 19% after the announcement of SNB action. Swiss capital market index fell by close to 15% till the end of last week after the SNB action.

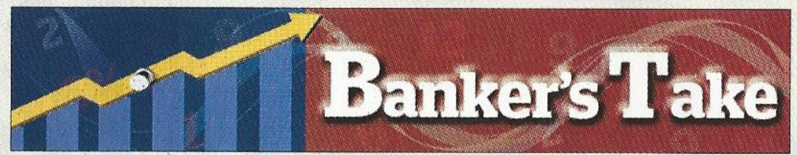
Gold and silver had the longest rally in more than six months as Switzerland's decision to decouple its currency from the euro, boosted demand for previous metals as a safe haven. Gold ended last week at $1280.45/ounce and Silver end last week at $17.78/ounce.

Earlier when the SNB imposed its peg at 1.20 franc against €1 in September 2011, gold was above $1900/ounce on account of easing measures of US Fed. However, it had come down since then as US fed wound up the easing mechanisms. Signs of cooling expansion in Europe boosted speculation that policy makers will add to stimulus, increasing demand for a store of value. Muted inflation and stagnant foreign economies may prompt the US Federal Reserve to delay increases in interest rates and can give some comfort to precious metals.

Swiss 10-year bond yields entered negative territory last Friday and closed by end of last week at -0.03%. US 10-year yields had fallen earlier to 1.695% last Friday as investors sought shelter in haven bonds amid the continued fallout in global markets from the stunning policy shift from Swiss National bank. However it closed at 1.83% as a report showed US consumer confidence in the economy soared to the highest level since 2004.

Japanese government bond prices rose on Friday and yields fell as demand for its bond arose after SNB action. On Friday the 10-year JGB yield fell to as low as 0.225% and recovered to 0.24% by end of last week. The 20-year yield dipped 0.5 basis point to 0.905% and recovered to 1.09% by end of last week.

Switzerland has long been seen as a safe haven, a good place to keep money during fearful times. The SNB managed to keep up the policy for years, but in recent months, the pressure driving up the franc became too great, as Europe's economic prospects took a turn for the worse and investors fled to the safety of the Swiss. It



is especially attractive to Russian investors looking for a safe place to park their money in a world of a cratering rouble. Russian money played a major role, as wealthy Russians rushed to convert their devalued roubles into as many francs as they could get their hands on.

Rapidly mounting uncertainty on the financial markets has substantially increased demand for safe investments. The worsening of the crisis in Russia was a major contributory factor in this development.

The SNB stated the cap had been scrapped because it was unsustainable. As it removed the upper limit on the currency, the SNB sought to discourage new flows into Swiss francs by pushing down its interest rate on some cash deposits held at the central bank by commercial banks and other financial institutions.

Forty percent of Swiss exports are to the eurozone and hence firms across Switzerland will have an impact on their profits, with the luxury and tourism industries most exposed. The SNB's shift marks an attempt to reinforce defences of the Swiss economy before government bond purchases by the European Central Bank that could crumple the franc cap.

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