

# Ending the Swiss franc ceiling

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## The Swiss franc spikes as ceiling is abandoned

The end of the Swiss franc ceiling had a dramatic impact on the currency market. On 15 January the Swiss National Bank surprised markets by abandoning its ceiling against the euro. This was put into place in 2011 to prevent overvaluation of the Swiss franc due to speculative flows away from the then troubled euro. Following the news, the franc rose as much as 39% against the euro on the day of the news, but ended the day 15% higher. That latter figure showed some stability: on January 19<sup>th</sup> the Swiss franc traded 1.02 against the euro, compared to the 1.20 ceiling.

At the same time the central bank has lowered its benchmark interest rate further to -0.75% to prevent the inflow of new funds into the country. Switzerland is still regarded as a 'safe haven' by international investors. The exceptionally low interest rate may reduce the upward pressure on the franc as the return in investment in the country falls.

## Impact on Swiss companies

Many large Swiss companies are directly affected by the measure. The Swiss stock market fell immediately as the news broke. Most Swiss companies that rely on export are adversely affected. They see their domestic production costs rise relative to their export prices, which squeezes

profit levels. Tourism may also be adversely affected as prices of holiday's rise for foreign tourists. Switzerland relies heavily on exports which account for 70% of GDP.

A stronger franc may also raise the chance of prolonged deflation, i.e. falling prices. As the value of the franc rises, import prices fall pushing down overall inflation. Swiss inflation was already negative in December last year falling by 0.3% compared to the same period the year before. Entrenched deflation could lead consumers to postpone consumption and companies to delay investment. This would undermine overall economic growth.

Rally of the Swiss franc

(Swiss franc per euro)



Source: IHS

## Impact on foreign companies and households

At the same time, a number of foreign firms have immediately run into problems, with the first bankruptcies already reported. In particular, financial institutions such as investment banks, hedge funds and currency traders that relied on the fixed exchange rate have faced steep losses.

Just as important is the impact on foreign companies and households that have borrowed in the Swiss currency. This was popular as rates on these loans were generally low. The rising value of the Swiss franc however also raises the

value of the debt. Households and companies with debt denominated in Swiss francs are seeing their debt levels and debt service costs rise substantially.

This is especially a problem in Eastern Europe. In Poland for example about 14.6% of outstanding loans and 37% of household debt is in Swiss francs. But other countries such as Hungary and Croatia have actively pursued measures over the past years to bring down the number and value of loans denominated in Swiss francs. That should limit the impact of the rising value of the Swiss franc.

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