31 May 2024

FX Viewpoint

Currencies
Global

JPY and CHF: Winds of change?

- The JPY and CHF both gained recently on policy considerations…
- …but the current environment is still unfavourable for low-yielding currencies…
- …until major central banks start to ease, amongst other factors

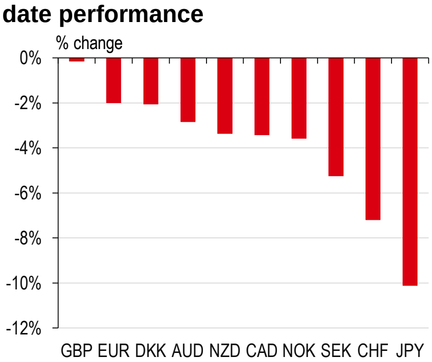
The current environment remains unfavourable for low-yielding currencies

The JPY is the worst performing G10 currency so far this year, with the CHF not far behind (Chart 1). As major central banks are in no rush to cut rates soon, **cross-asset volatility remains low,** which sets the stage for carry trades[1] at the expense of low-yielding currencies, like the JPY and CHF. However, both currencies have seen some brief relief recently on policy considerations.

We still look for a modest JPY recovery later this year

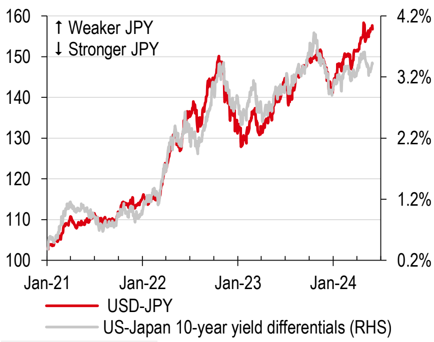
On 29 May, the Bank of Japan (BoJ) board member Seiji Adachi mentioned that **the central bank could raise interest rates if the sharp deterioration in the JPY has a big impact on inflation or inflation expectations**. He also mentioned that the BoJ must avoid rapid rate hikes and increase rates only gradually (*Bloomberg*, 29 May 2024). Following his comments, the JPY briefly moved below 157 against the USD, before paring some of the gains. **The risk of FX intervention when USD-JPY reaches key levels also makes investors wary about extending short JPY positions.** That being said, the mood around USD-JPY is only likely to change when the underlying factors change. For example, the Federal Reserve (Fed) starts to ease and the BoJ tightens further, at least narrowing what would still be a large gap between US and Japanese interest rates (Chart 2).

1. G10 currencies vs USD: Year-to-date performance



Source: Bloomberg, HSBC (Last updated on 30 May 2024 at 19:00 HKT)

2. USD-JPY and its rate differentials



Source: Bloomberg, HSBC

We expect the CHF to strengthen against the EUR over the long term

The CHF gained after the Swiss National Bank (SNB) Governor Thomas Jordan highlighted that **a weaker CHF is now the most likely source of higher Swiss inflation**, and that **the SNB could counter this by selling foreign exchange**. He also added that there were reasons to believe that **the neutral rate has increased somewhat or might rise over the coming years,** which would pose a small upward risk to the inflation forecast (*Bloomberg*, 30 May 2024). We believe the depreciation pressures on the CHF against the EUR will wane over time, and even more so if the SNB's FX stance begins to shift amid sticky domestic inflation; and/or when major central banks, in particular the European Central Bank, start to ease.

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[1] A carry trade typically involves borrowing in a low-interest rate currency (known as "funding currency") and converting the borrowed amount into another currency or financial product with a higher rate of return.

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