Swiss central bank: More to follow

Rates on hold, a modification of the tiering system and coordination with the government is what the central bank did today. But now more than ever, it is becoming evident that foreign exchange market interventions are the central bank's main monetary policy tool

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Unchanged rate

Today, the Swiss central bank decided to keep its key rate unchanged at -0.75%, as expected.

In addition, it has increased the portion of excess reserves that is exempt from negative interest rates for banks and it is considering easing the counter-cyclical capital buffer for banks. This means that the central banks wants to give banks more leeway so that they can provide financing to the real economy during the current coronavirus crisis.

FX interventions

The central bank has also recognised that the recent appreciation of the Swiss franc has forced it to intervene further on the foreign exchange market to help stabilise the situation.

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The SNB's intervention isn't really a surprise. The fact that it acknowledges increased intervention probably means that it intends to continue to intervene intensively in the coming weeks and months. Now, it seems even more clear that the foreign exchange market interventions are the central bank's main monetary policy tool. The question is how much longer will it be able to base its policy primarily on FX market intervention. At some point, things might get complicated.

Especially given the US Treasury has placed Switzerland on the watch list for "currency manipulators". An excessive increase in the reserves held by the SNB could lead to Switzerland being classified as a currency manipulator and subject to sanctions by the US.

Monetary and fiscal policy

It is interesting to note that the central bank expects "a pronounced decline in activity in Switzerland in the first half of the year" and estimates that GDP will probably be negative for the whole of 2020. We believe this is a warning for the budgetary authorities in Switzerland to take massive action.

The central bank also indicates that it is working closely with the Federal Council to support the Swiss economy. This is an important statement. It underlines that the SNB, probably even more so than all other central banks, has extremely limited room to support the economy and that coordination with the budgetary authorities is of paramount importance.

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We know Switzerland has very low public debt and has plenty of room for expansionary fiscal policies. We believe the SNB is clearly pushing for a massive fiscal plan and is ready to accompany it with monetary measures if necessary.

For the time being, the Swiss Federal Council has already put in place measures to support the economy and affected sectors (compensation for short-time unemployment, financial support for companies in need of liquidity, bank loan guarantees, compensation for losses, etc.) but these measures are relatively small in value (no more than 1.5% of GDP). The Swiss Confederation clearly has room to do more.

In our view, today's decision is likely to be an intermediate decision, and further measures are likely to be announced in the coming weeks.

It is unclear the kind of measures that are forthcoming but they will probably depend heavily on the fiscal measures taken. We cannot rule out a future rate cut, especially if the pressure on the Swiss franc builds. Right now, we're not ruling out other unconventional monetary policy measures too.

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