SNB preview: 50bp rate hike expected as inflation moves in the right direction

The Swiss National Bank (SNB) meets on 15 December and is expected to decide on a third rate hike, this time probably by 50bp, in the context of a stabilisation of inflation at 3%. A further rate increase could then take place in March 2023, after which rates are likely to remain unchanged. We forecast further nominal CHF appreciation in the first half of 2023

New tightening to come

After years of fighting deflation with a very accommodating monetary policy, including interventions in the foreign exchange market to weaken the Swiss franc and the lowest policy interest rate in the world, the SNB began a normalisation of monetary policy in June 2022 to fight inflation. After a 50bp increase in June and a 75bp increase in September, the Swiss policy rate returned to positive territory at 0.5%. In November, inflation in Switzerland stabilised at 3%, down from the August peak of 3.5%. Inflation is therefore still above the SNB's target of between 0-2%, but well below that of neighbouring countries, thanks to a more favourable energy mix, a lower share of energy in consumption and the strength of the Swiss franc, which limits imported inflation.

At its December meeting, the SNB is expected to acknowledge that Swiss inflation has probably passed its peak and that the deceleration observed since the summer is a good thing. It will provide new inflation forecasts, with a likely downward revision for 2022 (it was expecting 3.0% on average for the year at its September meeting, but 2.8% now seems more likely). At the same time, it will probably also warn against celebrating victory too soon and insist that inflation is still well above its target and that second-round risks remain significant.

As a result, we expect the SNB to raise its policy rate by 50bp at the December meeting, leading to a total rate increase over the year 2022 of 175bp in Switzerland, against probably 250bp in the eurozone and 425bp in the US over the same period. Going forward, we expect price growth to decelerate gradually but slowly, remaining above target for the first half of the year, before falling back below 2% by the end of 2023. We expect the SNB to make a final 50bp hike at its March 2023 meeting, bringing the rate to 1.5% and leaving it there for an extended period.

FX: Does the SNB still want a firmer Swiss franc?

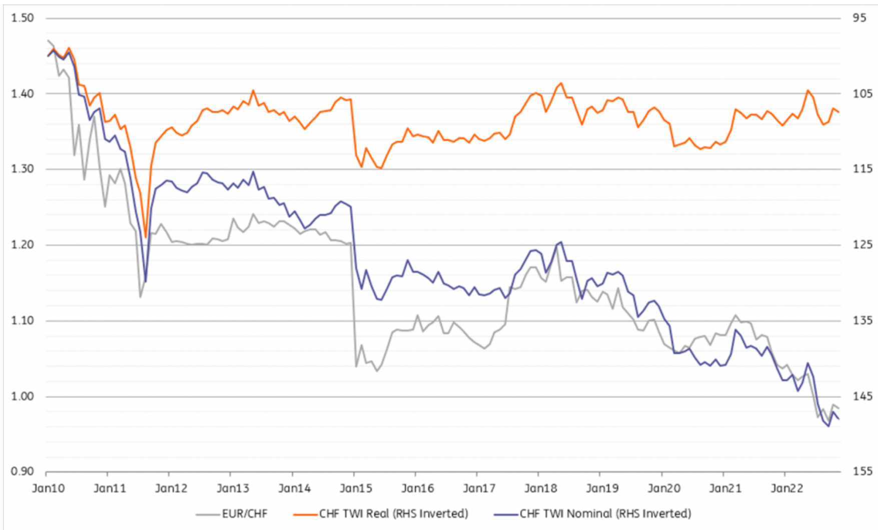
EUR/CHF goes into the December SNB meeting not far from second-half highs at 0.9900/9950. Recent trading ranges have been relatively subdued after the volatility seen throughout the summer. Interestingly the FX options market seems to be taking a keen interest in the upcoming meeting, where traded volatility for the 15 December event risk has picked up. The FX options market now prices 0.75% moves for EUR/CHF and USD/CHF on the day itself.

While the SNB will say that it does not target the exchange rate, earlier this year it had been happy to announce it had backed nominal appreciation in the Swiss franc. And a core piece of communication during this second half has been that the SNB is prepared to intervene on both sides of the market. Historically it had only been happy to sell the Swiss franc as it battled deflation. Its stance on intervention is now more equivocal.

As far as we can understand, the SNB's FX policy now is to keep the real exchange rate stable as it wrestles with above-target inflation. As our chart shows, the real trade-weighted Swiss franc has been relatively stable this year (down 1.5% year-to-date). Given Switzerland's far lower inflation than trading partners, the real CHF has been kept stable by allowing nominal CHF appreciation (+3.6% YTD).

SNB delivers real CHF stability and nominal CHF appreciation

Trade-weighted indices Jan 2010 = 100



Source: SNB, ING

Assuming the SNB stays hawkish and wants to keep the real CHF stable, further nominal CHF appreciation is our call in the first half of 2023. The weaker dollar (a 12% weight in the CHF basket) has contributed to some of the nominal CHF appreciation recently. If we are right with our call for a stronger dollar into the first quarter of 2023, and the SNB still wanting to keep the real CHF stable, then a lower EUR/CHF will be the requirement for early next year. That – and the Swiss franc's defensive properties in a difficult 2023 – are factors behind our forecast for EUR/CHF heading back to the 0.95 area next spring.

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