Swiss National Bank: More flexibility for more monetary easing

The Swiss National Bank has not changed its key rate, still at -0.75%, but it has changed its tiering system to allow more flexibility in monetary policy in the future

Unchanged rate

As expected, the SNB decided to keep its main policy rate unchanged at -0.75%. The European Central Bank's decision to reduce its deposit rate to -0.5% had no influence on the SNB rate, even though SNB officials have previously emphasised the importance of the interest rate differential between Switzerland and the eurozone. The SNB's interest rate differential with the ECB's deposit facility rate is now 25 basis points, which seems sufficient for the SNB at present, especially because the spread on the three-month horizon has not changed much so far. The SNB has also stated that it's always ready to intervene in the foreign exchange market when it is deemed necessary. Even with the recent appreciation in trade-weighted terms, the Swiss franc is still considered 'highly valued' by the SNB rather than 'overvalued'.

Revising forecasts downward

The SNB revised its inflation forecasts (conditional on an unchanged policy rate) sharply downward. The forecast for the current year has fallen slightly to 0.4% from 0.6% in June. For 2020, the SNB now expects an inflation rate of 0.2%, compared to 0.7% previously. For 2021, projected inflation now stands at 0.6% from 1.1% before. This is very low and can be seen as a sign that the SNB does not expect a return to normal monetary policy over the forecast horizon. This is a very clear message: don't expect a positive policy rate in the coming years.

New monetary policy tool

The big surprise of the day came from the SNB's revision of its tiering system for sight deposits subject to negative rates. Since the introduction of negative interest rates in 2015, the SNB has exempted a portion of deposits from negative interest rates. Until today, the exemption threshold for resident banks was set at 20 times the minimum reserve requirements. This system has been revised. From November 1, the exemption threshold can vary every month and will depend on the evolution of banks' balance sheets over time. For the first period, which will begin on 1 November, the SNB decided to set the exempted amount at 25 times the minimum reserve requirements.

The SNB writes "the adjustment raises the exemption threshold for the banking system and reduces negative interest income for the SNB". According to our calculations, under the old system, about 50% of excess liquidity was exempted from negative rates. During the first period of the new system, about 64% of excess liquidity would be exempted (based on June data). This amounts to about CHF 60 billion more sight deposits exempted from negative rates, which means a gain of about CHF 445 million for resident banks.

This decision is justified by the fact that the low interest rate environment will probably continue for a longer period than previously anticipated. This probably means that the SNB expects this low interest rate period to be very long, and that it must therefore find ways to reduce the unwanted effects of negative interest rates on the domestic banking system. In this "lower for longer" context, the SNB wanted to give itself more flexibility by modifying the tiering system. This new system is now itself a monetary policy instrument, just like interventions in the foreign exchange market and policy rate.

What's next?

After today's rather dovish decisions, we expect rates to remain at their current low level for a long time. We do not expect a rate hike in the next few years.

For the time being, we do not expect a rate cut either, unless a negative shock should occur. We believe that the SNB will continue to intervene in the foreign exchange market when it is deemed necessary. It will also use the exemption threshold, now subject to possible revision every month, as a monetary policy tool to influence money market conditions.

Author

Charlotte de Montpellier
Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com