Swiss National Bank: On hold in the wake of deflation

No surprises from the SNB, which decided to do nothing new in terms of monetary policy and seems to be waiting for the situation to become less uncertain

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No change in monetary policy

The Swiss National Bank decided to leave its monetary policy unchanged at its June meeting. Interest rates therefore remain at -0.75%, the lowest level in the world. It should be noted, however, that there is a tiering system in Switzerland and that this was increased at the beginning of April. In practice, according to the SNB, this means that only one quarter of the banks' assets at the SNB are subject to negative interest, the rest being exempt and therefore subject to the 0% interest rate. By leaving its rates unchanged at -0.75%, the SNB is therefore seeking to keep market rates low, but with tiering, it is trying not to weigh too heavily on banks' profitability.

The SNB still considers the Swiss franc to be "highly valued" and continues to intervene in the foreign exchange market when it deems it necessary. It indicated in the press release that it was even prepared to intervene more extensively in the foreign exchange market, if necessary. FX intervention therefore remains one of the key elements of the SNB's monetary policy at present.

Deflation forecast

The SNB expects Swiss GDP to decline by 6% in 2020 as a result of the coronavirus, the biggest drop since the oil crisis of the 1970s. In addition, the SNB has also once again revised its conditional inflation forecast downwards (assuming an unchanged key interest rate of -0.75%). It estimates that inflation will be -0.7% in 2020, -0.2% in 2021 and 0.2% in 2022. The central bank is therefore forecasting 18 months of inflation below 0%. Under normal circumstances, this revision could be described as a "dovish" signal for monetary policy in the coming years. Indeed, with deflation expected until the end of 2021, it is clear that the SNB is failing to fulfil its price stability mandate and this should normally lead to an even more accommodative monetary policy. Nevertheless, the current situation is far from normal, as the coronavirus shock is causing a great deal of uncertainty and inflation expectations are largely caused by the sharp decline in growth prospects and lower oil prices. We therefore doubt that the SNB will implement a more accommodative monetary policy in the coming months. We expect that it will continue to intervene in foreign exchange markets when it deems it necessary and that interest rates will remain at their current levels for several years.

Of course, it is possible that the SNB may decide to lower rates even further if the situation were to deteriorate sharply. In fact, the SNB governor has already said several times that rates could be lowered even further. But that's not our base case. We believe that it will try to wait until the crisis passes and the uncertainty dissipates with a broadly unchanged monetary policy.

This is not without challenge of course. Firstly, Switzerland is still on the watchlist of the US authorities for currency manipulation, which could limit the SNB's ability to intervene as much on the foreign exchange markets as it wishes. In addition, there is always the question of the credibility of its action, as it clearly does not allow inflation forecasts to be kept above 0%. For the time being, however, the SNB believes that the current situation is manageable and will therefore continue to rely on its usual instruments.

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