Swiss National Bank cuts key rate to 0%

Negative inflation and extremely low inflation forecasts have prompted the Swiss National Bank to lower its key rate to 0%. A return to negative territory is likely

Swiss National Bank Chairman of the Governing Board Martin Schlegel

As anticipated, the SNB cut its key rate by 25 basis points to 0% today. This decision follows the release of Swiss inflation figures for May, which showed a return to deflation. The consumer price index (CPI) fell by 0.1% year-on-year, deviating from the SNB's inflation target of between 0% and 2%. Since peaking at 3.5% in August 2022, inflation has steadily declined, reaching 0% in April and now moving into negative territory. The latest decline is largely attributed to external factors. Global energy prices plummeted in May, causing energy inflation to drop by 8.3%. Additionally, the strength of the Swiss franc, which reached its highest level ever in effective terms, significantly reduced the cost of imported goods, which fell by 2.4% year-on-year in May. Given that imports account for 23% of the CPI basket, this has a substantial impact on overall inflation in Switzerland.

Considering the troubled trade and geopolitical environment, it is unlikely that the Swiss franc will weaken significantly in the coming months, although the SNB hopes that the increase in the interest rate differential between Switzerland and other central banks will help to limit this appreciation. Its 'safe haven' characteristic, which attracts capital flows during high-risk periods, should keep it strong.

Meanwhile, domestic inflation remains more dynamic. Services inflation was still at 1.1% year-on-year in May, and core inflation at 0.5%, both within the SNB's comfort zone.

This situation of negative inflation is not unprecedented. Switzerland has experienced several periods of deflation in recent years. Since 2009, Swiss inflation has been negative for around a third of the time (75 months out of 197). Consequently, the SNB's interest rates were negative between 2015 and 2022.

Even lower inflation forecasts

What is notable about today's decision is that the SNB has once again lowered its conditional inflation forecasts. If the key interest rate remains unchanged at 0%, inflation is now expected to average 0.2% in 2025, 0.5% in 2026 and 0.7% in 2027 (compared with expectations at the last meeting of 0.4%, 0.8% and 0.8%, respectively). In our view, the new downward revision to the inflation forecasts for 2025 and 2026 signals that the SNB has probably not finished cutting rates. Unless the situation changes drastically between now and September, for example as a result of a sharp weakening of the Swiss franc or a very sharp rise in the price of oil products in Swiss francs, today's decision paves the way, in our view, for a further rate cut in September and a return to negative interest rates. Although the SNB acknowledged the adverse effects of negative interest rates at the press conference, it seems increasingly likely that it will have no choice but to move in this direction at its next meeting.

Intervention in the foreign exchange market?

Today's press release also states that 'the SNB remains ready to be active on the foreign exchange market if necessary', but does not say much more on the subject. The SNB no longer defines the value of the Swiss franc as 'significantly overvalued' or 'highly valued', as it did during recent periods of negative inflation. This is despite the fact that the Swiss franc reached its highest level ever in the second quarter (in effective terms). In our view, this suggests that foreign exchange intervention is not currently seen as the most important monetary policy tool by the SNB, in contrast to the 2015-2021 period, and that it does not wish to rely heavily on it at present. We believe the SNB is unlikely to engage in systematic intervention to weaken the Swiss franc in the next months. The fear of being perceived as a currency manipulator by the US administration likely influences this decision.

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