A surprise pause by the Swiss National Bank, which could last for some time

The Swiss National Bank (SNB) surprised today by deciding to take a break from its cycle of rate hikes, keeping its key rate at 1.75%. Inflation expectations have been revised downward and the outlook for growth is weaker. That means this pause could last

Swiss National Bank (SNB) Chairman Thomas Jordan

A surprise pause

The SNB surprised today by deciding to keep its key rate at 1.75%, whereas the consensus was for it to rise by 25bp to 2%. In justifying its decision, the SNB said that "the significant tightening of monetary policy in recent quarters is countering remaining inflationary pressure". However, it did not close the door on future rate hikes, saying: "It cannot be ruled out that a further tightening of monetary policy may become necessary to ensure price stability over the medium term".

As always, the SNB says it is ready to intervene in the foreign exchange market. In the current context, this means selling foreign currency to strengthen the franc and limit imported inflation.

Like the US Federal Reserve, the SNB wanted to present today's decision as a pause, allowing it to wait for new data to get a clearer picture of the economic and inflation situation before the next meeting, which is scheduled for December 2023.

Inflation expectations revised downward

This decision comes against a backdrop in which inflation has moderated markedly in Switzerland, while the economic outlook has deteriorated. Over the past three months, consumer price inflation has been below 2%, and fell to 1.6% in August, thanks in particular to the appreciation of the Swiss franc, which is moderating imported inflation.

While the SNB still expects inflation to pick up again in the coming months, rising back above 2% at the end of 2023 and in 2024, it has revised down its inflation forecasts for the second half of 2024, 2025 and 2026. It now expects inflation to average 2.2% in 2023 and 2024, and 1.9% in 2025 and the first half of 2026, compared with 2.1% previously. The downward revision of inflation forecasts to below 2% in the medium term is clearly a rather dovish signal, suggesting that the pause in rate hikes today could be extended at future meetings.

Weakening economic outlook increasingly worrying

In addition, following the stagnation of GDP in the second quarter, the SNB seems to be much more concerned about the economic outlook. The SNB believes that the economic outlook is weakening, particularly as a result of the global economic slowdown, and indicated that this should help to moderate inflationary pressures.

At the press conference, the SNB insisted that "the increases in our key rate and the appreciation of the Swiss franc are only having their full effect on economic activity and inflation with a certain time lag", which seems to indicate that it believes that monetary tightening will continue to moderate the economic and inflation outlook in the coming months.

A pause that could last

Ultimately, despite the SNB's insistence at the press conference on keeping the door open to future rate hikes, the overall message is rather dovish. If, as we expect, the economic outlook continues to deteriorate over the next few months, it is likely that today's pause will extend into December and 2024. A further rate hike in December cannot be ruled out, but at this stage the most likely outcome is that the rate hike cycle effectively ended in June and that the rate will be maintained at 1.75% for the next few years.

Foreign currency purchases and sales and exchange rate management will probably once again be the sole monetary policy instrument for the next few quarters.

Temporary setback for the Swiss franc

The Swiss franc has understandably weakened after the surprise hold in the policy rate today. However, the SNB has said that it will still be using the exchange rate to "provide appropriate monetary conditions" and to do this will likely continue to sell FX.

In the past, the SNB has said that it has been pursuing a policy of keeping the real exchange rate stable. In fact, the real exchange rate has actually appreciated around 3% over the last year and the nominal exchange rate is up 7% year-on-year. Pressure for this kind of appreciation looks set to slow as the SNB seemingly turns more dovish and inflation rates among trading partners edge closer to the low levels seen in Switzerland.

However, we presume that the focus on keeping the real exchange rate stable will continue –

hence the reference to the ongoing sales of FX. For reference, the SNB sold CHF27bn and CHF32bn of FX reserves in 4Q22 and 1Q23 respectively in order to keep the real CHF stable.

Looking ahead, the strong dollar environment – keeping USD/CHF bid – means that the SNB will have to manage EUR/CHF lower to get the nominal CHF appreciation it needs. That is why we suspect that any near-term spike in EUR/CHF is not sustained and that as long as the SNB is leaning hawkish, levels near 0.9500 and possibly a little below are likely later this year.

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