

## Swiss National Bank raises rates by 50bp and hints at further hikes ahead

The Swiss National Bank (SNB) raised its key rate by 50bp as expected, bringing the total monetary tightening to 175bp. The upward revision of medium-term inflation forecasts signals a further rate hike in March



### A 50bp hike

As widely expected, the SNB decided to raise its key rate by 50bp to 1% – following the 75bp increase in September and the 50bp increase in June – to combat the spread of inflationary pressures. The total monetary tightening in Switzerland will therefore have been 175bp in 2022, compared with probably 250bp in the eurozone and 425bp in the United States over the same period.

The SNB also indicated that it is prepared to continue to be active in the foreign exchange market. In recent months, the SNB has sold foreign currencies, which has helped to strengthen the appreciation of the Swiss franc and limit imported inflation.

### Inflation expectations are above the medium-term target

After years of fighting deflation with a very accommodating monetary policy, the SNB remains

very uncomfortable with the current level of inflation, despite the stabilisation at 3%, down from the peak of 3.5% reached in August. It believes that "inflation remains well above the range that the SNB equates with price stability", which is between 0% and 2%, and that "while developments are pleasing, it is too early to let our guard down". Thanks to a more favourable energy mix, a lower share of energy in consumption, and above all the appreciation of the Swiss franc, which limits imported inflation, inflation in Switzerland is nevertheless much lower than in neighbouring countries. That said, the SNB considers that the risk of second-round effects is still present, which is why "it cannot be ruled out that further rate hikes will be necessary to ensure price stability in the medium term".

The SNB's inflation forecast shows inflation at 2.1% at the end of its forecast horizon, the third quarter of 2025. It believes that "increased inflationary pressure from abroad and the spread of price increases to the various categories of goods and services in the consumer price index will push this forecast higher in the medium term". The SNB now expects inflation to average 2.9% in 2022, 2.4% in 2023 and 1.8% in 2024.

These above-target inflation forecasts for the end of the forecast horizon signal that the SNB is not done with monetary tightening. We believe that a further 50bp rate hike could take place at the next meeting in March 2023, taking the rate to 1.5%. Rates will then remain stable for an extended period. Indeed, we expect price growth to decelerate gradually but slowly over the year. This will make it more comfortable for the SNB to intervene in the foreign exchange market afterwards, without changing the interest rate further.

## **FX: SNB confirms it has been selling FX reserves recently**

In today's communication, SNB President Thomas Jordan confirmed that the SNB had been intervening in FX markets to sell FX over recent months. This has got nothing to do with the SNB wanting to downsize its FX reserves for financial stability reasons, but everything to do with monetary policy. Here Jordan confirmed that a stronger Swiss franc has helped ensure that less inflation has been imported from abroad.

This is all in keeping with this year's policy of wanting to keep the real Swiss franc stable. To achieve that – and given that Swiss inflation is substantially lower than that overseas – the SNB requires nominal Swiss franc appreciation. The SNB confirmed the nominal franc has appreciated 4% this year.

On the assumption that inflation differentials between Switzerland and its trading partners do not immediately narrow, we assume that the SNB will want further nominal appreciation in 2023. The big question is through which channels this occurs. The recent sharp fall in USD/CHF has taken the pressure off the EUR/CHF axis to make the adjustment. But if we are right with our call for the dollar to strengthen into the first quarter of 2023, then EUR/CHF will have to come lower – helped in part by SNB intervention. Our call is that EUR/CHF continues to struggle to hold any gains over 0.99 and heads back to the 0.95 area into next spring.

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