

Swiss National Bank terminates negative interest rates

The Swiss National Bank raised interest rates by 75 basis points to 0.5% as planned, bringing the rate into positive territory for the first time since 2015. A reverse tiering system and a reduction in liquidity were also announced. EUR/CHF suffered a short squeeze on the news, but should come lower again



Despite an encouraging decline, the SNB continues to see inflation as a persistent problem

75bp increase

As expected, the SNB has just announced an increase of 75bp in its key interest rate, bringing it to 0.5%. The rate in Switzerland is therefore back in positive territory for the first time since January 2015 and is no longer the lowest in the world. It is the end of an era. This rate hike is intended to combat inflation in Switzerland, which reached 3.5% in August, and is therefore higher than the SNB's objective of having inflation between 0 and 2%. Thanks to a more favourable energy mix, a lower share of energy in consumption, and the strength of the Swiss franc, which limits imported inflation, inflation in Switzerland is nevertheless still much lower than in neighbouring countries. The SNB believes that the risk of second-round effects is significant. The SNB now expects inflation to reach 3.0% in 2022, 2.4% in 2023 and 1.7% in 2024. Against this background, it says it "does not rule out further rate hikes in the coming months".

Reverse tiering and liquidity reductions

Interestingly, the SNB also took two other important decisions. First, it will introduce a two-tier system for the remuneration of sight deposits held by banks and other financial market participants. From now on, they will be remunerated at the SNB's key interest rate (0.5%) up to a threshold, and the part above this threshold will be remunerated at a rate of 0%. The threshold is currently set at 28 times the reserve requirement. It is therefore a reverse tiering system. The aim of this system is, according to the SNB, to encourage money market operations, even in a situation of excess liquidity. At first sight, this may seem surprising, as it could push money market rates to remain below the SNB rate. However, this system goes hand in hand with the desire to reduce liquidity in the market, which in practice should severely limit the proportion of holdings bearing 0% interest. To reduce liquidity, the SNB will conduct open market operations (repo and T-bills). According to the SNB, the aim of this is to ensure that money rates reach the SNB's key interest rate as quickly as possible.

Further rate hikes to come in December

Given the inflation forecasts, there is little doubt that the SNB will continue to raise rates in the future. Unlike other central banks, the SNB only meets quarterly, so the next meeting will be in December. By then, the European Central Bank and the Federal Reserve will probably have raised rates by another 75 basis points in October and November and will raise rates again in December. The SNB could follow suit, probably raising its rate by 75bp in December as well. This is likely to be the last rate hike and we do not expect anything more in 2023. Indeed, the deteriorating economic outlook and the expected decline in inflation in 2023 should be enough to leave the SNB comfortable with a rate of 1.25% for the year as a whole.

EUR/CHF: Short squeeze should not last

EUR/CHF rallied around 1.5% following the 75bp hike and comments from SNB Chairman Thomas Jordan that it would intervene against excessive moves. The squeeze probably owed to some positioning for a 100bp rate hike today, following the Swedish Riksbank's 100bp hike earlier in the week. Like the Riksbank, the SNB now only has one further rate meeting this year.

However, we do not think this EUR/CHF rally will last. We think the SNB is happy to [guide EUR/CHF lower as a means to keep its real exchange rate stable](#) - given trading partner inflation is some 5% higher than in Switzerland. At the start of the year, few would have believed the SNB would be comfortable with EUR/CHF at today's level of 0.95/0.96. Equally, we think the case is growing for EUR/CHF to be trading 0.93 by the end of the year and conceivably 0.90 by next summer. Developments to the East only add to the case to hold the Swiss franc now.

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