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SNB PREVIEW

HOW MUCH DOVISH COULD THE SNB BE?

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SUMMARY

- At its policy meeting next week, the Swiss National Bank (SNB) will face an uncertain inflation and growth outlook.
- The SNB is likely to stick with its accommodative monetary policy, centred around a negative interest rate (currently at 0.75%) and a willingness to intervene in the FX market if needed.
- Given our view of the ECB's next policy moves, we expect **the SNB to stay on hold until the end of 2020.**
- Yet the question remains: how would the SNB react to further easing by other central banks?
- A further question arises: where does the SNB sit in the growing debate regarding changes in monetary policy frameworks?

SNB meeting – all eyes on inflation forecasts

In its meeting on 13 June, the Swiss National Bank (SNB) will face an uncertain growth and inflation outlook. Economic data have been mixed and, more importantly, external risks (intensification of trade disputes, Brexit, Italian budget disagreements…) have increased. Since the last SNB meeting in March, the CHF has appreciated by 1.5% against the EUR and by 1.3% against the USD.

In this context, we believe **the bank's policy statement will remain broadly unchanged**. The interest on sight deposits at the SNB will remain at 0.75% and the central bank will reiterate its willingness to intervene in the FX market if needed. Furthermore, the central bank's currency assessment is likely to remain unchanged, with the Swiss franc still considered "highly valued" and the situation on the foreign exchange markets "fragile".

The SNB's annual GDP growth forecast of "around 1.5%" in 2019 is likely to remain unchanged. **But its forecast for inflation will be key to watch.** An upward revision in its 2019 conditional forecast is possible (to 0.4% from 0.3%) given the better-than-expected Q2 inflation prints (April-May). But there is a risk that forecasts for 2020 and 2021 are reduced partly due to markets' reduced expectations for the Fed and ECB policy normalisation.

How would the SNB react to further stimulus by the ECB?

We believe it is unlikely that the SNB will hike rates before the ECB. Members of the SNB's governing board have many times referred to the importance of the interest rate differential for the exchange rate. A policy rate increase before the ECB would likely lead to an appreciation of the franc, which would weigh on the inflation outlook. The only way we see the SNB hiking rates before the ECB is if there is a surge in Swiss inflation, which we believe is improbable at this stage. As a result, given our view on ECB's next policy moves, we expect **the SNB to stay on hold until the end of 2020** (see *Chart 1*).

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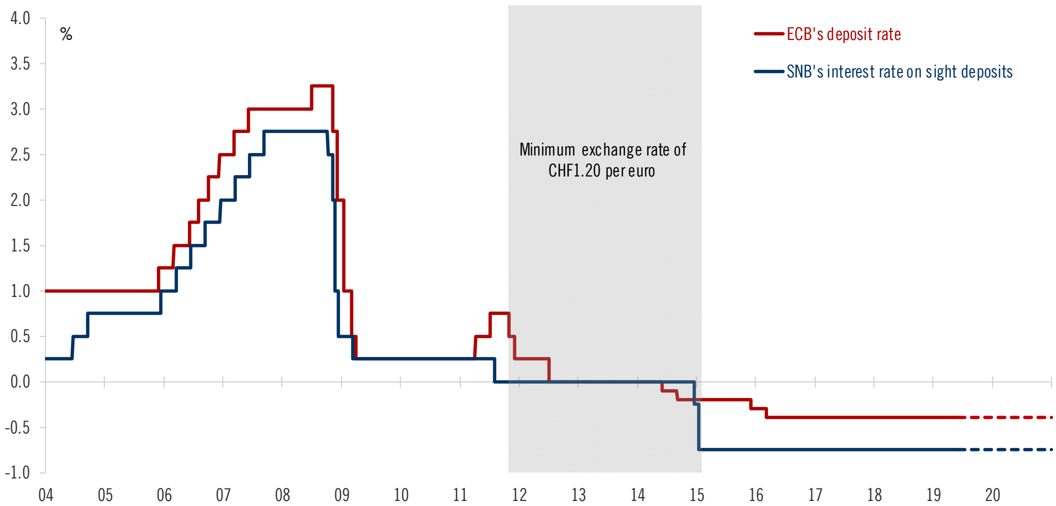
CHART 1: ECB'S DEPOSIT RATE AND SNB'S INTEREST RATE ON SIGHT DEPOSITS



Source: PWM - AA&MR, ECB, SNB

Now the question is how will the SNB react if other central banks actually ease policy? The SNB's policy response will, of course, depend on the instruments (quantitative easing, rate cuts…) used by other central banks, notably the ECB and the Fed. Currently, the SNB's monetary policy is based on two key elements: the negative interest rate and interventions in the FX market as needed. This approach has remained unchanged since January 2015.

Members of the SNB's governing board have said many times that there is still some room to cut rates further should the need arise. While we do not know exactly what the "lower bound" might be, negative rates are certainly weighing on the banking sector.

For the SNB, **the first line of defence to curb any unwarranted appreciation of the CHF will be FX market intervention**. Should the SNB need to loosen monetary policy further by cutting its policy rate, it could increase the exemption threshold from the negative interest applied to sight deposits in order to lower the burden on banks. However, this would not solve the side effects linked to negative interest rates on the mortgage sector.

Time to rethink the SNB's policy framework?

There has been a growing debate around the world on the need to change central banks' policy framework. In the late 1990s, the SNB changed its monetary policy concept and abandoned monetary targeting in favour of an approach based on inflation forecasts (*see Table*). Since 2000, the SNB has considered price stability to be a "rise in the national consumer price index (CPI) of less than 2% per year". In practice, this is often referred to as a 0% to 2% target band. In its June 2002 National Bank Act message (see here), the Swiss federal government deemed that price stability was achieved when annual inflation is "1% per year".

Any discussion of the SNB's policy framework will start by looking at its inflation record. Inflation has been outside this definition of price stability for about one-third of the time since January 1999. Recent years have been particularly challenging. Switzerland is not the only country that had to deal with a series structural factors that are putting

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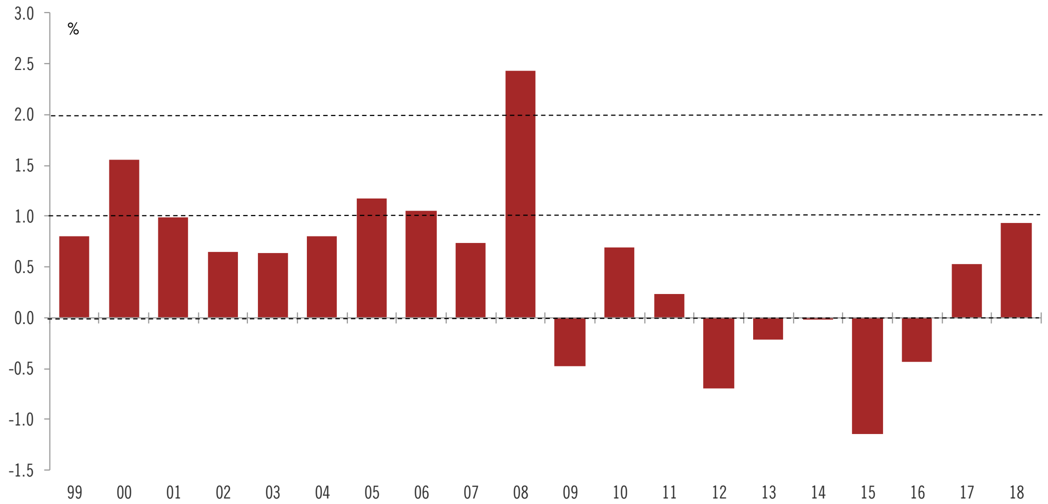
downward pressure on inflation. While currency fluctuations have a particularly significant impact on the inflation outlook for small and open economies like Switzerland's, questions are being increasingly asked about whether the current definition of price stability is the suitable one and whether, for example, other measures of inflation might not be more appropriate. There is no sign the SNB has started such discussion. In any case, unlike the US, discussions about a possible change in policy regime are conducted behind closed doors.

CHART 2: SWISS ANNUAL INFLATION



Source: PWM - AA&MR, FSO

TABLE: SNB'S MONETARY POLICY FRAMEWORK

Date	Monetary policy framework
End of 1974	Annual target for the growth in money stock M1
October 1978	Monetary target replaced it by a target for the Swiss franc/Deutsche mark exchange rate *(i.e a level below 80 Swiss francs to 100 German marks)*
End of 1979	Annual target for the growth in money stock M0
1990	Looser form of monetary trageting by fixing an objective for monetary base covering a five year period
1999	Monetary targeting abandonned. Target range for CHF 3-month Libor as operational target
March 2009	Commitment to purchase foreign currency in order to prevent a further appreciation of the Swiss franc against the euro; Domestic QE programme
December 2009	Domestic QE programme stopped
September 2011	Introduction of a minimum exchange rate of CHF 1.20 against the euro; commitment to buy foreign currency in "unlimited quantities"
December 2014	Introduction of negative interest rates on sight deposits (-0.25%) and intervention in FX market if needed
January 2015	Miniumum exchange rate discontinued. Record low negative interest rate on sight deposits (-0.75%)

Source: PWM - AA&MR, SNB

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