

Thomas Jordan: The Swiss National Bank's monetary policy decision and assessment of the economic situation

Introductory remarks by Mr Thomas Jordan, Chairman of the Governing Board of the Swiss National Bank, at the Media News Conference of the Swiss National Bank, Zurich, 19 March 2015.

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Ladies and gentlemen

It gives me great pleasure to welcome you to this news conference. Following the discontinuation of the minimum exchange rate, we have decided to hold an extraordinary news conference at our quarterly assessment in March, in addition to the traditional six-monthly news conferences which will take place in June and December. In my presentation, I will explain the Governing Board's monetary policy decision and outline our assessment of the economic situation. Afterwards, my colleagues and I will be at your disposal to answer questions.

Monetary policy decision

I will begin with our monetary policy decision.

The SNB has decided to leave the target range for the three-month Libor unchanged at between -1.25% and -0.25% . Interest on sight deposits at the SNB remains at -0.75% and the exemption thresholds remain unchanged. Negative interest helps to make it less attractive to hold investments in Swiss francs. Overall, the Swiss franc is significantly overvalued and should continue to weaken over time. The SNB will continue to take account of the exchange rate situation, and its impact on inflation and economic developments, in formulating its monetary policy. It will therefore remain active in the foreign exchange market, as necessary, in order to influence monetary conditions.

Since the last monetary policy assessment, the exchange rate and interest rate conditions have changed substantially. This has considerable repercussions for the inflation and growth outlook in Switzerland.

Global economic outlook

I will now present our assessment of the global economy. The international economic environment is developing largely in line with our previous expectations. The global economic recovery is continuing.

In the fourth quarter of 2014, growth in the US remained above potential. The favourable momentum of the economy there is also reflected in the sound growth in employment. The economy picked up somewhat in the euro area. This was primarily due to strong quarterly growth in Germany. In Japan, too, demand increased. By contrast, economic developments in the major emerging economies were mixed. Consumer price inflation edged down worldwide due to lower oil prices. In many advanced economies, inflation moved into negative territory at the beginning of 2015.

During the course of the year, the growth of the global economy is likely to firm gradually. Several factors are supporting this growth. First, the significant decline in oil prices is helping to increase demand. Second, monetary policy in the advanced economies remains very expansionary. The euro area, in particular, is likely to benefit from the further decline in interest rates as well as the marked depreciation of the euro. Recently, an easing in European banks' lending conditions, which were very restrictive, has also been observed.

Despite these favourable developments, the outlook for the global economy is still uncertain. Overall, substantial risks remain, with the focus on issues relating to the economic outlook for Greece and the Ukraine conflict.

Assessment of the exchange rate situation

I would now like to look at the exchange rate situation. In recent quarters, this was mainly driven by diverging developments in the US and the euro area. The direction of monetary policy in the major currency areas is drifting ever further apart. While in the US a start to monetary policy normalisation is in sight, the European Central Bank (ECB) has now launched a further substantial easing of its monetary policy – its quantitative easing programme.

Since the first indications of quantitative easing by the ECB in spring last year, the euro has depreciated sharply against the US dollar. In May 2014, a euro still cost almost USD 1.40. At our monetary policy assessment in December, the EUR/USD exchange rate was at 1.25. When we discontinued the minimum exchange rate on 15 January, the euro had already fallen to USD 1.18; now, in March, it is trading at USD 1.05. In other words, in the short period since our monetary policy assessment in December, the euro has lost around 15% against the US dollar; and since May 2014, as much as 25%. Given this situation, it is clear that a minimum exchange rate of CHF 1.20 against the euro was no longer sustainable. In the weeks before 15 January, the level of intervention needed to maintain the EUR/CHF minimum exchange rate on the foreign exchange markets was already high and climbing rapidly.

The further depreciation of the euro against the dollar after 15 January, and following the ECB's decision on quantitative easing shortly afterwards, is an impressive illustration of how enormous the additional pressure would have been to maintain the minimum exchange rate. Had we delayed the discontinuation of the minimum exchange rate, this would only have been at the expense of an uncontrollable expansion of the SNB balance sheet – by hundreds of billions of Swiss francs, and potentially several times Swiss GDP. Such an expansion would have severely impaired the SNB's future ability to conduct monetary policy and substantially jeopardised the fulfilment of its mandate in the long term. Moreover, given the fact that the minimum exchange rate was no longer sustainable, further intervention would have been pointless, and the magnitude of the associated losses could not have been justified.

Following the discontinuation of the minimum exchange rate, the Swiss franc initially appreciated sharply against all currencies, before weakening again somewhat in recent weeks. Overall, the Swiss franc is still significantly overvalued. We expect that this will be corrected with time.

We are aware that the new situation presents the Swiss economy with great challenges. Nevertheless, it cannot be compared with conditions before the introduction of the minimum exchange rate. At that time, the global economy was still dealing with the immediate effects of the financial crisis, and the Swiss franc was significantly overvalued against all currencies. The international economic environment is now much more positive.

Inflation and economic outlook for Switzerland

The change in the exchange rate situation also alters our assessment of the inflation and economic outlook for Switzerland, which I will outline for you now.

As a result of the discontinuation of the minimum exchange rate, the inflation outlook has again declined significantly. For the current year, we have reduced our inflation forecast from -0.1% to -1.1% . Together with the sharp fall in oil prices, the appreciation of the Swiss franc since the discontinuation of the minimum exchange rate temporarily moves inflation further into negative territory. Inflation reaches its low point in the third quarter of 2015, at -1.2% .

Thereafter, forecast inflation rises more rapidly than in the December forecast, due to the interest rate reductions since the last monetary policy assessment. Nevertheless, in 2016, inflation will amount to -0.5% , which is 0.8 percentage points lower than in the December forecast. Not until 2017 will inflation move into positive territory again, at 0.4% . The conditional forecast assumes that the three-month Libor remains at -0.75% over the entire forecast horizon, and that the Swiss franc weakens.

The inflation forecast shows that the period of negative inflation is temporary. Sustained negative inflation, or even a deflationary spiral, is not to be expected. This is in line with surveys on inflation expectations. Although survey respondents now anticipate that inflation will be significantly lower, their expectations remain in positive territory for the medium term.

With the new exchange rate situation, conditions for the Swiss economy have become more difficult. In the past, entrepreneurs and employees have always found ways to deal with a strong Swiss franc, thereby demonstrating, time and again, their great flexibility. Nevertheless, every appreciation represents a fresh challenge with an uncertain outcome. Therefore we have great respect for the difficult tasks which the economy now faces.

In this regard, I would like to say a few words about the economic situation in Switzerland.

In the fourth quarter, the Swiss economy again grew faster than expected. On the output side, growth was relatively broad-based, with manufacturing being the main driver. Value added also rose significantly in the banking industry and the public sector. On the demand side, both consumption and equipment investment recorded favourable developments. By contrast, exports of goods and services stagnated.

In December, the SNB expected annual growth of some 2% for 2015. With the appreciation of the Swiss franc since mid-January, this forecast has had to be revised. A noticeable weakening in the economy may be expected, particularly in the first half of the year. For the year as a whole, the SNB now only expects real GDP to increase by just under 1% . Given this weakening, appreciable underutilisation of production capacity may be expected in the short term. Unemployment is likely to increase moderately. The anticipated strengthening in the global recovery will have a supportive effect.

Negative interest rates

I would now like to turn to negative interest rates.

Following the interest rate reductions since the last monetary policy assessment, the reference interest rate is now negative for the first time in the history of the SNB. This situation is new, and has therefore been discussed in detail in the public arena. I would like to emphasise that lowering the interest on sight deposits at the SNB into negative territory is a necessary monetary policy measure. Negative interest makes holding investments in Swiss francs less attractive for Swiss and foreign investors. This creates incentives to reduce inflows to the franc, and reinvest Switzerland's traditional current account surplus abroad. Negative interest thus contributes to a weakening of the Swiss franc.

The interest rate reductions had a rapid effect. As expected, the negative interest rate imposed on banks by the SNB was transmitted to the entire spectrum of money and capital market interest rates. However, low or negative interest rates are not limited to Switzerland. Low interest rates are a global phenomenon and some other countries, especially in the euro area, also have negative rates. Switzerland cannot disassociate itself from such developments. With the interest rate reduction in Switzerland, the interest rate differential to the major currency areas, which had declined to virtually zero in recent years, has now increased again. Clearly, given that the Swiss franc is significantly overvalued, the earnings outlook for Swiss franc investments compared to those in other currencies is considerably reduced.

There is widespread discussion on negative interest rates, in part because institutional investors, and pension funds in particular, could now incur costs for holding liquidity. However, in the current environment, there are no real alternatives to our measure. Negative interest helps to reduce the overvaluation of the Swiss franc. If the Swiss franc were even stronger, this would have a direct or indirect effect on everyone in the economy: companies, households and the public sector.

With all the concern about negative interest it is important to remember that when inflation is negative, real interest rates are higher than nominal interest rates. In the past, the inflation rate was often higher than the nominal rate of interest. In other words, in terms of real returns, there have been times when saving was less worthwhile than it is now, indeed, times when savings balances actually lost value in real terms. Moreover, in the current situation, efforts to circumvent negative interest rates by obtaining exemptions or shifting to cash are not in Switzerland's general interest, since they undermine monetary policy intentions. It should be remembered, in this respect, that holding cash also entails substantial costs and is subject to a high level of risk. We will retain the current interest rate level for the time being. It will continue to support the weakening of the Swiss franc.

Concluding remarks

In closing, I would like to return to our decision of 15 January. Discontinuing the minimum exchange rate and reducing interest rates further are monetary policy measures for which there are no better alternatives.

As I outlined previously, since the introduction of the minimum exchange rate in September 2011, the international currency relationships have changed fundamentally. In view of this development, a minimum exchange rate of CHF 1.20 per euro was no longer sustainable. Over the long term, adhering to the minimum exchange rate would have jeopardised the SNB's ability to conduct monetary policy and fulfil its mandate in future. This would have saddled the Swiss economy with longer-term costs that would have been out of all proportion to the benefits of continuing to enforce the minimum exchange rate of CHF 1.20 per euro.

With the international low interest rate environment, monetary policy faces big challenges. Overall, the Swiss franc is significantly overvalued. Negative interest helps to make investments in Swiss francs less attractive and thereby correct this overvaluation over time. The SNB will continue to take account of the exchange rate situation, and its impact on inflation and economic developments, in formulating its monetary policy. It will therefore remain active in the foreign exchange market, as necessary, in order to influence monetary conditions.

Ladies and gentlemen, thank you for your attention.