Thomas Jordan: 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, Berne, 18 June 2015.

* * *

Ladies and gentlemen

It is a pleasure for me to welcome you to the Swiss National Bank's (SNB) news conference. As usual, I shall begin by outlining the Governing Board's monetary policy decision and our assessment of the economic situation. This will be followed by Jean-Pierre Danthine's presentation of our annual *Financial Stability Report* and Fritz Zurbrügg's comments on financial market developments. After that, we will be happy to take your questions.

Monetary policy decision

Let me 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% and interest on sight deposits at the SNB is to remain at –0.75%. Negative interest rates in Switzerland make holding investments in Swiss francs less attractive and will help to weaken the Swiss franc over time. Overall, the Swiss franc is significantly overvalued. In formulating our monetary policy, we take account of the exchange rate situation and its impact on inflation and economic developments. We will therefore remain active in the foreign exchange market, as necessary, in order to influence monetary conditions.

Our new conditional inflation forecast does not differ greatly from the one we presented in March. Inflation will reach its low point in the third quarter of 2015, at –1.2%. For the subsequent period, the new inflation forecast is slightly higher than in March due to the rise in oil prices. The short and medium-term forecast is up slightly, by 0.1 percentage points to –1.0% for 2015 and to –0.4% for 2016. The forecast continues to indicate that inflation will move back into positive territory at the beginning of 2017; there will be a slight slowdown in the rate of increase as the year progresses. The inflation forecast for 2017 is down by 0.1 percentage points, to 0.3%. The conditional forecast assumes that the three-month Libor will remain at –0.75% over the entire forecast horizon, and that the Swiss franc will weaken.

Global economic outlook

As our inflation forecast is heavily influenced by economic developments abroad, let me now present our assessment of the global economy.

Global economic growth was weaker than expected in the first quarter of 2015, and this development had a detrimental impact on world trade. In the US, GDP declined slightly, partly due to special factors. Moreover, the strong US dollar weighed on exports. In the euro area, however, the economy continued to pick up, supported by persistent euro weakness and improved lending conditions. In contrast to the previous quarter, all of the large member states contributed to growth. Italy reported GDP growth for the first time since entering a multi-year recession. In Japan, too, the economy gained momentum. In the emerging economies, performance remained uneven, while growth continued to cool in China.

The global economy is expected to gather pace again, reinforced by expansionary monetary policy around the world and ongoing low oil prices. For instance, after a disappointing first quarter, the two large economies, the US and China, are starting to show signs of improvement.

Nonetheless, uncertainty about the future development of the global economy remains high. Various risks – first and foremost the difficult financial situation in Greece and geopolitical tensions – could jeopardise the recovery.

Swiss economic outlook

According to initial estimates, Switzerland's real GDP declined slightly in the first quarter. As expected, goods exports suffered from the strong Swiss franc appreciation, but also from a downturn in global trade. Domestic demand, by contrast, developed robustly. Having said this, the situation varies considerably from one industry to another. Profit margins are under significant pressure in several sectors, and this is forcing companies to take steps to reduce production costs and raise efficiency. Against this backdrop, unemployment has increased slightly on a seasonally adjusted basis.

Over the coming months, the global economic recovery is likely to lead to a gradual upturn in demand for Swiss products; this will cushion the impact of the exchange rate shock somewhat. As the global economy gathers momentum, we expect Switzerland to return to positive growth in the second half of the year. The SNB continues to anticipate growth of just under 1% for 2015 as a whole.

Monetary and financial conditions

Allow me to move on now to monetary and financial conditions.

Since the discontinuation of the minimum exchange rate, inflation has moved well into negative territory. This is chiefly attributable to imported goods prices, which in May were down roughly 5% year-on-year, mainly due to the fall in oil prices. Domestic inflation, meanwhile, remains in positive territory. Our inflation forecast shows that the period of negative inflation will be temporary; it is part of an adjustment process following the sharp appreciation of the Swiss franc. The SNB does not currently expect a sustained price decline or, indeed, a deflationary spiral with the associated harmful effects on economic activity and employment.

Available surveys on inflation expectations of households and companies present a similar picture. Short-term inflation expectations have stabilised, albeit at a very low level. Long-term inflation expectations have remained virtually unchanged over the last half-year.[1] They remain within a range that is consistent with the SNB's definition of price stability.

Low inflation rates translate to low nominal interest rates. On the money market, short-term interest rates are close to the interest on sight deposits at the SNB of –0.75%; interest rates in Switzerland are thus lower than in most other countries. However, due to negative inflation, Switzerland's real interest rates, which ultimately determine investment returns, are higher than its nominal rates. Moreover, they are also higher than real interest rates in other countries, such as the US, Germany and the UK. My colleague, Fritz Zurbrügg, will provide further details on interest rate developments on the money and capital markets.

Despite the low interest rates, mortgage growth has continued to weaken slightly in recent months. Notwithstanding this, imbalances on the mortgage and real estate markets remain high. My colleague, Jean-Pierre Danthine, will discuss this in greater depth in his remarks.

[1] In October 2014, Consensus Economics projected inflation expectations of 1.4% for the period 2020–2024; in April 2015, it put these at 1.5% for the period 2021–2025. Long-term inflation expectations are only surveyed on a half-yearly basis.

In light of the uncertainty regarding the future of Greece, the Swiss franc continues to serve as a safe haven currency. In trade-weighted terms, the Swiss franc is still approximately 12% higher than it was at the beginning of the year. Over time, negative interest rates on the Swiss money and capital markets should help to correct the overvaluation of the Swiss franc. The rise in long-term interest rates abroad has also led to a widening of the interest rate differential with these countries of late. As conditions continue to normalise on international financial markets, investments in other currencies should become more attractive; this, in turn, is likely to help ease the overvaluation of the Swiss franc. The slowdown we are now observing in the economy also suggests that the Swiss franc is very unlikely to remain persistently high.

Monetary policy outlook

I shall now move on to our monetary policy.

Since 15 January, we have repeatedly and thoroughly explained our reasons for discontinuing the minimum exchange rate and introducing negative interest on sight deposits at the SNB. Upholding the minimum exchange rate was no longer sustainable given the changes taking place in the international arena and the sharply diverging monetary policy stances of the world's major currency blocks.

In formulating our monetary policy, we are confronted with an exceptionally complex situation on international financial markets. What is more, the global economy is still grappling with the after-effects of the financial and economic crisis, not least in the form of high levels of uncertainty. These are the realities that the SNB – and the Swiss economy – are facing. Turning a blind eye is not an option.

In this environment, we were aware that the discontinuation of the minimum exchange rate would cause Switzerland's economy to slow. While the data from the first quarter confirm that this slowing process is now underway, the country's economic development since 15 January has been broadly in line with our expectations.

Our monetary policy is geared towards this challenging set of circumstances and is currently guided by our willingness to take an active role in the foreign exchange market and apply negative interest rates. This two-pronged approach is designed to weaken the Swiss franc. The SNB's interventions in the foreign exchange market, which feed more liquidity into the banking system, reinforce the effect of both of these measures. We intend to retain the current interest rate level for now and will monitor its effects closely.

With respect to setting interest rates and supplying the money market with liquidity, the SNB's monetary policy decisions have been very bold by international standards. All things considered, the Swiss franc nevertheless remains significantly overvalued. Were Switzerland not to have negative interest rates, and hence have a narrower interest rate differential with other countries, demand for Swiss francs would be even greater and our currency would be even stronger today.

We are aware that the current exchange rate situation is extremely difficult for exporters, tourism and industries that are particularly exposed to competition from abroad. While we recognise the scale of the challenges facing the affected companies, it is worth remembering that in the current climate there is, regrettably, no easy solution that would absorb all external disruptions. We must accept these challenging economic conditions for the time being. That said, we are convinced that, under the circumstances, the SNB's current choice of monetary policy will best serve Switzerland's overall interests in the long term.

Ladies and gentlemen, thank you for your attention. It is now my pleasure to give the floor to Jean-Pierre Danthine, who will present our *Financial Stability Report*.