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, Berne, 10 December 2015.

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Ladies and gentlemen

It is a pleasure for me to welcome you to the Swiss National Bank's (SNB) news conference. I will begin by explaining our monetary policy decision and presenting our assessment of the economic situation. Fritz Zurbrügg will then speak about current developments in the area of financial stability. After that, Andréa Maechler will review the situation on the financial markets. Finally, we will – as usual – be pleased to take your questions.

Monetary policy decision

Let me begin with the inflation forecast and our monetary policy decision.

Overall, the new conditional inflation forecast differs little from that of September. It indicates slightly higher inflation in the short term, and that inflation had already bottomed out in the third quarter. Owing to a slight deterioration in the outlook for the global economy, medium-term inflation is somewhat lower than predicted in September. For the current year, inflation is forecast at –1.1%, a 0.1 percentage point rise on last quarter. For 2016, we still anticipate an inflation rate of –0.5%, and for 2017, the forecast is now at 0.3% instead of 0.4%. The conditional inflation forecast is based on the assumption that the three-month Libor will remain at –0.75% over the entire forecast horizon.

Despite depreciating somewhat in recent months, the Swiss franc is still significantly overvalued. Furthermore, inflation prospects have largely remained the same. We have therefore decided to maintain our expansionary monetary policy. The target range for the three-month Libor is unchanged at between –1.25% and –0.25%, and interest on sight deposits at the SNB remains at –0.75%. The interest rate differential with other currencies, even following the European Central Bank's (ECB) mild interest rate cut, is thus still markedly higher than at the beginning of the year. The negative interest rate makes the Swiss franc less attractive, and continues to help weaken the currency. The SNB also remains active in the foreign exchange market in order to influence the exchange rate situation, as necessary. The negative interest rate and our willingness to intervene in the foreign exchange market are intended to ease pressure on the Swiss franc. Our monetary policy thus helps to stabilise price developments and support economic activity.

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 third quarter of 2015. This was mainly due to subdued manufacturing activity around the globe and sluggish world trade.

The Chinese economy is currently undergoing structural change, and growth in the country's industrial output has therefore slowed considerably since the beginning of the year. This has curbed manufacturing activity worldwide and weighed on commodity prices. Global investment activity in the third quarter has thus been hesitant. This has especially impacted economies with strong global trade links as well as commodity-exporting countries.

In contrast to manufacturing, the services sector performed well in most countries due to robust domestic demand. Particularly in the US and Europe, private household consumption has regained momentum. Contributing factors were the decline in energy prices and a further improvement in the labour market.

The SNB has revised its short-term growth forecast for the global economy slightly downwards, but the outlook for the medium term remains unchanged. On the whole, the moderate recovery in the advanced economies looks set to continue, on the back of highly expansionary monetary policy and low energy prices. Increases in public spending should also stimulate demand. In this environment, inflation is likely to pick up again.

Our overall assessment of global economic prospects is cautiously optimistic. We nevertheless see significant risks. The structural change underway in China could continue to hold back global manufacturing and investment activity. Equally, structural weaknesses in Europe have yet to be addressed. Current concerns about public safety could also weigh on economic developments.

Swiss economic outlook

The slower pace of global economic growth was also felt in Switzerland, with the first official GDP estimate indicating stagnation in the third quarter. Economic performance thus came in below expectations.

This was mainly due to a slump in value added in trade and the financial sector. Growth in manufacturing was positive, but varied greatly from one sector to another. Aside from the strong Swiss franc, sluggish global manufacturing activity was also undoubtedly a factor. Demand for Swiss intermediate goods and equipment was particularly lacklustre.

On closer examination, however, the economic situation appears somewhat more favourable. There are three reasons for this. First, growth was materially inhibited by an unusually sharp dip in energy output over the summer months, which had nothing to do with the economic cycle. The second reason concerns final demand, namely, that both private and public consumption as well as exports were up on the half of the year. And third, a range of other indicators leads to a somewhat more positive assessment of the economy.

Nevertheless, capacity utilisation remains unsatisfactory, and demand for labour muted, with the seasonally adjusted unemployment rate having edged up from 3.3% to 3.4% since the last monetary policy assessment.

As many companies have had to reduce prices considerably, margins remain a major source of concern. Recent months have seen numerous measures aimed at cutting production costs and increasing efficiency. According to the latest survey conducted by the SNB delegates for regional economic relations, these measures are now beginning to take effect. Furthermore, rallying demand is likely to help ease pressure on margins in the coming months.

We continue to expect a slow improvement of the economy. Our forecast for real growth in 2015 is unchanged at just under 1%. The global economy is likely to gather pace gradually over the course of 2016, and this should strengthen foreign demand for Swiss goods and services. Domestic demand is also likely to remain robust. For 2016 as a whole, we expect growth of approximately 1.5%.

Interest rates, exchange rates and inflation expectations

I will now review changes in monetary conditions and inflation expectations since the beginning of the year.

When we discontinued the minimum exchange rate in January, the monetary policies of the major currency areas were set to diverge, and we were aware that this would have significant consequences for international monetary relations. This is exactly what came to pass, and is clearly reflected in the exchange rate path of the Swiss franc against various currencies. While the Swiss franc/US dollar exchange rate is now virtually the same as it was at the end of 2014, the Swiss franc has appreciated 10% against the euro since the beginning of the year. The export-weighted Swiss franc exchange rate is about 8% higher than it was in January, having gained approximately 20% at times in the interim.

In January, concurrently with the discontinuation of the minimum exchange rate, we lowered the interest rate on sight deposits to –0.75%. The interest rate differential with other currencies, which had narrowed considerably due to declining interest rates abroad, again expanded significantly following this decision. Even after the ECB's mild interest rate cut, the Swiss franc/euro interest rate differential remains significantly wider than at the beginning of the year. This has helped to weaken the Swiss franc, pulling it back from the highs recorded shortly after the discontinuation of the minimum exchange rate.

Short-term inflation expectations declined substantially immediately after the discontinuation of the minimum exchange rate. Since then, they have stabilised. Surveys indicate that companies expect positive inflation rates over a horizon of two years and more. Despite weak inflation in recent years, inflation expectations six to ten years into the future have barely changed. Companies evidently believe that the negative inflation we are currently experiencing will be temporary. As you can see from our inflation forecast, our forecast models confirm this assumption.

Monetary policy outlook

Ladies and gentlemen, let me summarise my key points. The depreciation of the euro against other major currencies confirms that the discontinuation of the minimum exchange rate was a necessary step. Diverging monetary policy stances in the major currency areas present small open economies like Switzerland, in particular, with huge challenges as they typically trigger substantial exchange rate fluctuations and hamper economic growth. Switzerland's economy is thus going through a difficult phase.

Our monetary policy, which is currently geared towards this challenging set of circumstances, consists of two key elements: the negative interest rate and the SNB's willingness to take an active role in the foreign exchange market. Both of these elements are intended to make Swiss franc investments less attractive, thereby supporting economic activity.

Swiss sovereign money initiative (*Vollgeldinitiative*)

In conclusion, let me say a few words about the recently submitted sovereign money initiative. This popular initiative aims to fundamentally remodel Switzerland's monetary policy and banking system. The initiative aims to remove the banks' money creation powers. Instead, all new money would be created by the SNB and distributed directly to the Confederation or the citizens. Under the new system, proponents want any income that the SNB derives from note-issuance to be distributed to the public. Moreover, they claim that such a system would enhance financial stability.

The sovereign money initiative would entail a radical overhaul of Switzerland's financial system, creating a regime that does not exist in any other country today. The introduction of sovereign money would be a risky experiment. We must therefore carefully analyse the impact of the proposed constitutional change on the structure and implementation of monetary policy. Equally, we must take a comprehensive look at its implications for financial stability, the exchange rate and the economic cycle.

We will comment further on the sovereign money initiative in due course.

Ladies and gentlemen, thank you for your attention. It is now my pleasure to give the floor to Fritz Zurbrügg, who will present our financial stability assessment.