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Monetary policy assessment of 17 September 2009

Swiss National Bank maintains its expansionary monetary policy

The Swiss National Bank is maintaining the expansionary monetary policy which it initiated last March. Despite the recent increase in the number of encouraging economic signs, uncertainty as to future developments remains considerable. In these circumstances, the SNB is opting for caution and retaining its monetary policy unchanged.

Consequently, the SNB is holding the Libor target range at 0–0.75%. It is still aiming to keep the Libor within the lower end of this range, i.e. at approximately 0.25%. It will continue to provide the economy with a generous supply of liquidity and, if necessary, to purchase Swiss franc bonds with a view to reducing risk premia on long-term debt instruments issued by private sector borrowers. In addition, it will continue to act decisively to prevent any appreciation of the Swiss franc against the euro.

The global economy has improved over the past few months and the downturn in the Swiss economy has proved to be considerably less substantial than had been forecast in the second quarter. The SNB has therefore revised its GDP growth forecast for the current year. It now expects real GDP to fall by between 1.5% and 2%. Growth is likely to pick up again gradually during the months ahead.

The inflation forecast is almost unchanged for 2009 but is slightly higher for the subsequent years. This is mainly due to the fact that developments in both the Swiss and the global economies are less negative than had been expected. Average annual inflation for 2009 will be negative, amounting to around –0.5%, and the SNB expects prices to increase by 0.6% in 2010 and 0.9% in 2011. This inflation forecast is associated with major risks. The recovery anticipated in the global economy may fail to materialise. Moreover, although the financial industry is well into the process of recovery, another deterioration cannot be entirely ruled out. A risk of deflation therefore remains. Consequently, an immediate tightening of monetary conditions is not necessary. However, the inflation forecast shows that the expansionary monetary policy cannot be maintained indefinitely without compromising medium and long-term price stability.

Press release

In view of the uncertainties, the SNB is adopting a cautious approach and pursuing the expansionary monetary policy outlined last March. By continuing to use an inflation forecast as its guide, the SNB can ensure that the exceptional measures currently in force do not compromise medium and long-term price stability.

Global economic outlook

The global economy has a strong impact on the Swiss economic outlook. Consequently, the SNB bases its inflation forecast on the most likely assumptions with respect to future developments in the global economy. Its current assumptions are based on growth rates that are slightly higher than those foreseen in June. Positive growth rates are expected before the end of the year, both in the US and in Europe. However, there are still major risks to global economic developments.

Swiss economic outlook

The economic situation in Switzerland remains difficult. GDP contracted again in the second quarter. The rate of capacity utilisation continued to fall, particularly in manufacturing. Unemployment and short-time working shot up, while consumer confidence persisted at a low level.

However, goods exports are likely to pick up in the next few months as the global economy recovers. The upturn in activity will affect the various export sectors in different ways. The demand for capital goods and consumer durables, in particular, is likely to remain modest. In the area of domestic demand, the combined softness in both private consumption and investment should result in a sluggish GDP.

For 2009 as a whole, the SNB now expects GDP to fall less substantially (–1.5% to –2%, compared with –2.5% to –3% in June). There are two reasons for this revision: global economic growth has resumed more quickly than expected and, as early as the second quarter, the fall in Swiss GDP was less deep than anticipated. Nevertheless, the SNB still holds the view that the return to full capacity utilisation will be slower and more uncertain overall than is usually the case at the end of a recession.

Changes in monetary and financial conditions

Monetary conditions remain extremely relaxed. The Libor has declined, in line with the SNB’s stated intention, which is to bring the Libor down gradually to the lower end of the target range. Yields on Swiss Confederation bonds have also fallen. For a ten-year term, the yield is around 2.2%. Risk premia on the capital market have dropped.

The Swiss franc is stable in trade-weighted terms. It is also stable against the euro, which shows that the monetary policy measures taken last March were effective. However, the situation will remain tenuous as long as the level of financial uncertainty at the international level remains high. Consequently, the SNB will continue to act decisively to prevent any strengthening in the Swiss franc against the euro.

Developments in lending and money aggregates provide confirmation of the major relaxation in monetary conditions. In July, mortgage loans – which constitute 80% of all loans – increased by 4.6%. This rate had previously been falling, but began rising again after the SNB substantially lowered its Libor target range in November 2008. Most mortgage loans are construction loans. Loans other than mortgage loans, referred to as 'other loans', declined by 1.6% in July. This category of loans is reacting as it has in the past to a contraction in economic activity. The information obtained from the statistics is corroborated by the quarterly survey on lending conditions conducted by the SNB since the beginning of 2008 with the 20 most important banks in Switzerland. The survey shows that 40% of the banks questioned have slightly tightened their lending conditions.

No credit crunch of any kind has been observed in the lending statistics, neither in the household lending figures nor in the data on lending to small and large companies. With the decline in the quality of certain borrowers during a recession and the contraction in economic activity, it is inevitable that a cyclical tightening of lending conditions, or even a fall in the amount outstanding, will occur. This kind of development cannot be likened to a rationing effect, since it is not due to an autonomous fall in supply. In the current circumstances, the SNB considers that it would not be appropriate for the public authorities to introduce new support measures in the credit market.

The volume of central bank money has more than doubled since the beginning of the financial crisis, but has already fallen considerably in past months. This reflects the efforts of the SNB to provide the interbank market with sufficient liquidity as a response to the increased demand for liquidity which, for its part, was due to a climate in which financial sector agents had lost trust in one another.

The amount of liquidity is significant, not just in the banking and financial industry but also in the household and corporate sectors. This is reflected in the increasingly rapid growth of the monetary aggregates since the beginning of the year. The M3 aggregate, which was still increasing at a moderate rate at our last assessment in June, has begun to advance more rapidly. The SNB is keeping a close watch on movements in the monetary aggregates.

Inflation and the risk of inflation

For six months, inflation has been negative and core inflation is still declining. Given the economic outlook in March and June, the forecast was for a rate of inflation close to zero for 2010 and 2011. It was associated with a deflationary risk. The inflation forecast has now been revised slightly upwards and, as a result, the risk of deflation has somewhat abated. Nevertheless, two scenarios could provoke a resurgence of deflation if they were to materialise.

First, the recent signs with regard to the development of the global economy have yet to be confirmed. The current improvement is being supported by certain factors whose impact is of limited duration, such as fiscal stimulus programmes and inventory depletion.

In addition, the US has acted as a locomotive driving global economic growth because of its strong demand for imported goods. However, should US consumers step up the process of debt reduction, the country might no longer be in a position to maintain this role, particularly since there is no other source of domestic demand that could fill it.

Second, the financial industry is in the midst of a period of recuperation. Central banks are still providing financial markets with a generous supply of liquidity. It is difficult to assess how the banking industry will be affected by the expected deterioration in the financial position of households and companies.

Monetary policy decision

The long-term inflation outlook has changed since the June assessment. The outlook now shows that the expansionary monetary policy cannot be maintained for the next three years because price stability would be compromised in the long term.

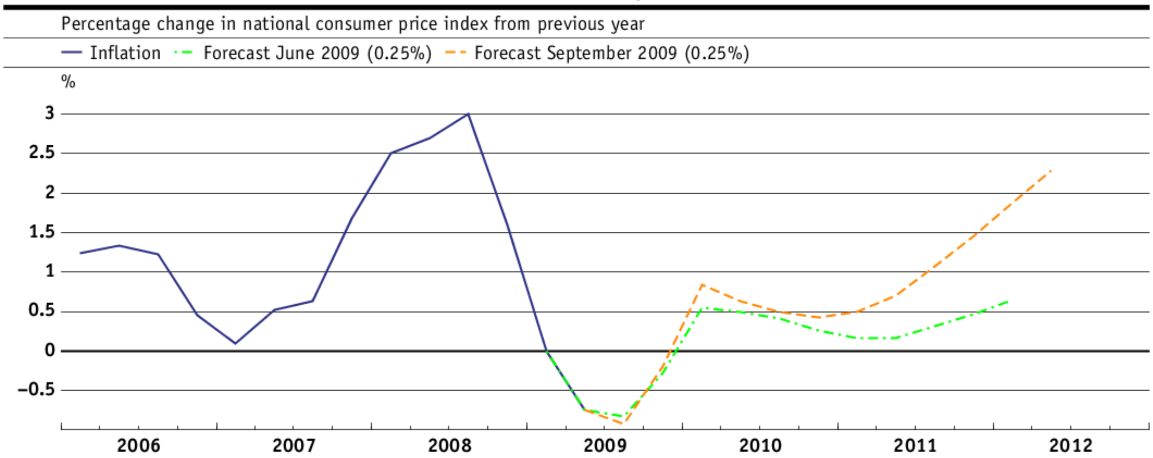
However, an immediate correction in monetary policy would be precipitate since the inflation outlook is associated with major downside risks. If these risks materialised, the threat of deflation could re-emerge. The uncertainties relate to the global economy and to the level of recovery within the financial industry. These factors have persuaded the SNB to opt for a cautious approach, and to adhere to its present monetary policy course for the time being.

Inflation forecast chart

The new inflation forecast (dashed red curve on the chart) covers the period from the third quarter of 2009 to the second quarter of 2012. Like the previous forecast (dash-dotted green curve), it is based on the assumption that the three-month Libor remains unchanged at 0.25%.

The new inflation forecast is almost unchanged for 2009 and 2010. The explanation for both the negative inflation in 2009 and the increase in prices at the beginning of 2010 is to be found in a base effect attributable to changes in energy prices. Until the end of 2009, oil prices are likely to be lower than those recorded one year previously. From the beginning of next year, this pattern should once again be reversed. In 2010, inflation will remain weak since production capacity will be under-utilised. The new forecast is based on the assumption that the gap between actual and potential output will close more rapidly than the SNB had been expecting as recently as June. As a result, inflation will be higher in 2011 and, particularly, in 2012, if the current expansionary monetary policy is maintained indefinitely. Consequently, inflation will exceed the 2% mark from the end of the forecasting period.

Inflation forecast of June 2009 with Libor at 0.25% and of September 2009 with Libor at 0.25%



Observed inflation September 2009

	2006				2007				2008				2009				2006	2007	2008
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Inflation	1.23	1.33	1.22	0.46	0.09	0.52	0.63	1.68	2.50	2.70	3.00	1.60	0.00	-0.75			1.1	0.7	2.5

Inflation forecast of June 2009 with Libor at 0.25% and of September 2009 with Libor at 0.25%

	2009				2010				2011				2012				2009	2010	2011
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Forecast June 2009, Libor at 0.25%		-0.74	-0.83	-0.28	0.55	0.50	0.40	0.26	0.16	0.17	0.31	0.46	0.65				-0.5	0.4	0.3
Forecast September 2009, Libor at 0.25%			-0.92	-0.20	0.84	0.63	0.50	0.43	0.49	0.70	1.07	1.46	1.87	2.28			-0.5	0.6	0.9

Press release