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Zurich, 11 March 2010

Monetary policy assessment of 11 March 2010

Swiss National Bank maintains its expansionary monetary policy

The Swiss National Bank (SNB) is maintaining its expansionary monetary policy. Consequently, it is leaving the target range for the three-month Libor unchanged at 0.00–0.75% and intending to keep the Libor within the lower part of the target range at around 0.25%. It will act decisively to prevent an excessive appreciation of the Swiss franc against the euro.

The signs of an economic recovery are becoming more tangible. The improvement is beginning to assist the Swiss export sector, while the domestic sector is performing well. For 2010, the SNB is now expecting real GDP growth of about 1.5%. However, the revival remains fragile and is associated with uncertainties.

Since December, the SNB's conditional inflation forecast has remained almost unchanged at an average of 0.7% for 2010 and 0.9% for 2011. This forecast shows that short-term price stability is not threatened. Although the global economy is continuing to recover, it remains fragile. Should more external shocks occur, the danger of deflation cannot be entirely ruled out. However, the inflation forecast shows that the current expansionary monetary policy cannot be maintained throughout the entire forecast horizon without compromising medium and long-term price stability. The forecast is still associated with considerable uncertainties.

Press release

Global economic outlook

Developments in the global economy are largely as expected. In the emerging economies, particularly in Asia, growth momentum has been strong since the last monetary policy assessment. The economy is also reviving in the US and Europe. However, although the growth in the US in the past few months has been surprisingly positive, economic performance has been disappointing in Europe. The SNB anticipates the continuation of a moderate upward trend. Nevertheless, there are still significant risks for the development of the global economy. It is likely that final demand will still be curbed, in particular, by the high levels of unemployment and the bleak outlook for public finances.

Swiss economic outlook

Economic recovery is also underway in Switzerland. In the fourth quarter of 2009, real GDP was up by 0.7% compared to the previous quarter. This growth was driven by both domestic demand and exports. Particularly strong advances were recorded by retail and wholesale trade, the financial industry and construction. Signs of recovery were increasingly evident in the manufacturing sector – which had been hardest hit by the recession – and were recorded in a considerable number of these industries. The improvement in the economic situation began to be felt in terms of the demand for labour. In the final months of 2009, short-time work declined slightly, and unemployment did not rise any further. The recovery in the economy should continue. However, because of various after-effects of the crisis on the global economy, it is likely to remain fragile. Consequently, companies do not expect a rapid reduction in their excessive production capacities – neither in the manufacturing industry nor in the services sector. In the construction industry, capacity utilisation is likely to remain at the current satisfactory level.

The SNB now expects real GDP to increase by approximately 1.5% in 2010 as a whole.

Monetary and financial conditions

Monetary conditions reflect the SNB’s expansionary monetary policy.

The Libor is at the desired level of 25 basis points. By historical standards, yields on Confederation bonds are very low. This level reflects both the healthy state of public finances and long-term inflation expectations, which are consistent with price stability. Risk premia are now minimal; indeed, on occasion they have fallen even further. Consequently, corporate bond conditions on the capital markets have become attractive.

The trade-weighted external value of the Swiss franc has increased further, mainly as a result of the recent weakness of the euro. Since the SNB no longer has any room for manoeuvre, the SNB has been intervening in the foreign exchange market. In doing so, it is aiming to act decisively to counter an excessive appreciation of the Swiss franc against the euro, since an appreciation of this kind would result in an undesired tightening of monetary conditions.

Although the monetary base has declined, it is still very high. It needs to be reduced in good time to ensure that excessive money creation by the banking sector can be prevented. Due to the substantial growth in the monetary aggregates since autumn 2008, private households and companies now have access to high levels of liquidity. For some months now the situation has been stabilising and the growth of the monetary aggregates has slowed. In January, the annual growth rate of M2 attained 16.5% or half the rate recorded just three months ago. In the same month, the growth rate of M3 was 6.1% as compared to 7.9% in November. Despite these changes, liquidity held by private households and companies remains high. The SNB is keeping a close watch on movements of money aggregates.

Low interest rates are leading to an acceleration in mortgage lending. In January, the growth rate attained 5.3%. Generally, in times of slow economic activity, a decline is recorded in loans not secured by mortgages. This phenomenon can be observed at present, with Swiss franc loans in this category falling by 4.1% in January. However, the level of loans not secured by mortgages is considerably higher than in comparable phases of past economic cycles.

The SNB is keeping a careful watch on the loan market. Its quarterly survey of banks shows that the phase in which lending conditions are tightened is coming to an end. For the second consecutive quarter, banks have reported no more discernable tightening in conditions.

The SNB is warning banks and borrowers to be extremely cautious, in view of the growth in mortgage loans and the continuing increase in residential real estate prices. It is reminding them that in assessing the viability of carrying the debt burden the fact that interest rates are exceptionally low by historical standards must be taken into account. Great caution is needed when setting the loan-to-value ratio.

The SNB is currently conducting an in-depth survey of banks, the purpose of which is to provide more information on banks' practices when granting mortgages for residential real estate. On the basis of the insights obtained, the SNB will work closely with the bank supervisory authority to assess whether there is any need for action.

Monetary policy decision

The inflation forecast has remained almost unchanged as compared to the monetary policy assessment of December 2009. It shows that short-term price stability is not threatened. However, it confirms that the current expansionary monetary policy cannot be maintained throughout the entire forecast horizon without compromising medium and long-term price stability. The recovery of the global economy is continuing, but remains fragile. Should more external shocks occur, the danger of deflation cannot be entirely ruled out. The SNB is leaving the target range for the three-month Libor unchanged at 0.00–0.75%. In doing so, it still aims to keep the Libor within the lower part of the target range at around

0.25%. It will act decisively to prevent an excessive appreciation of the Swiss franc against the euro.

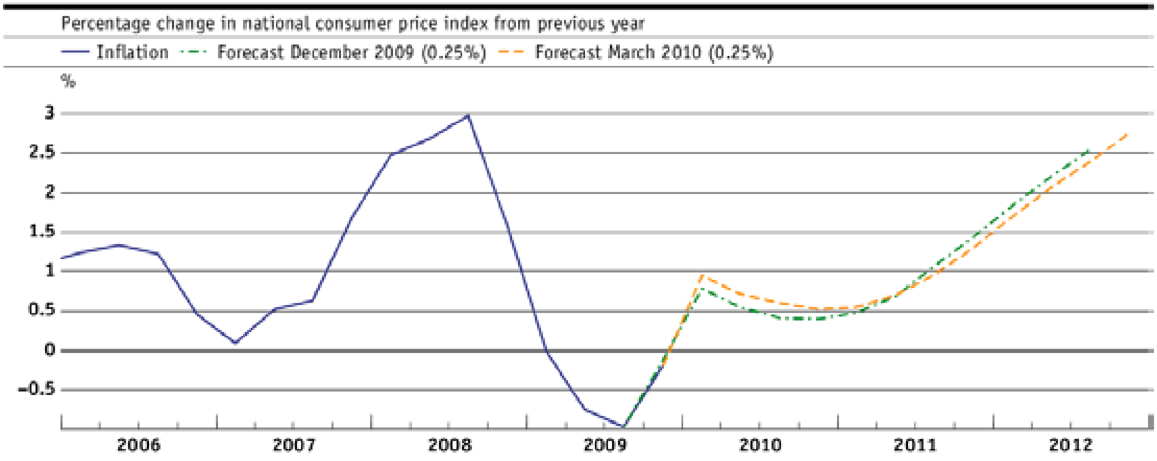
The forecast remains associated with considerable risks with regard to the global economic recovery. The economy is still benefiting strongly from government support measures. Not until these have been phased out will it become clear whether the stabilisation or recovery evident in certain markets is sustainable.

Inflation forecast chart

The new inflation forecast (dashed red line) extends from the first quarter of 2010 to the fourth quarter of 2012. Like the December forecast (dash-dotted green line), it is based on the assumption of the three-month Libor remaining constant at 0.25%. Consequently, it is a conditional forecast.

In the first quarter of 2010, the new inflation forecast temporarily reaches a peak because of a base effect attributable to oil prices. It then sinks slowly throughout the year due to a gradual weakening in the oil-price related base effect and the fact that GDP remains below its potential, which curbs price rises. However, economic activity is more robust than was expected in December. Consequently, the path of the new forecast initially lies above that of the December forecast. The trade-weighted external value of the Swiss franc has risen further, and this has resulted in a tightening of monetary conditions since the last monetary policy assessment. This will offset the tendency for prices to rise because of the more favourable economic situation. The new forecast is therefore slightly below that of December from 2011 onwards. Nevertheless, in the fourth quarter of 2012, inflation attains 2.75%. Consequently, the inflation forecast shows that the current expansionary monetary policy cannot be maintained throughout the entire forecast horizon without compromising medium and long-term price stability.

Inflation forecast of December 2009 with Libor at 0.25% and of March 2010 with Libor at 0.25%



Observed inflation March 2010

	2006				2007				2008				2009				2006	2007	2008	2009
	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	2.47	2.68	2.97	1.58	-0.02	-0.75	-0.97	-0.20	1.1	0.7	2.4	-0.5

Inflation forecast of December 2009 with Libor at 0.25% and of March 2010 with Libor at 0.25%

	2009				2010				2011				2012				2010	2011	2012
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Forecast December 2009, Libor at 0.25%				-0.13	0.79	0.54	0.41	0.40	0.48	0.69	1.07	1.45	1.84	2.20	2.55		0.5	0.9	
Forecast March 2010, Libor at 0.25%					0.95	0.71	0.60	0.52	0.55	0.70	0.96	1.30	1.70	2.07	2.39	2.75	0.7	0.9	2.2

Press release