

The SNB magic formula

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SNB and its Watchers 2022

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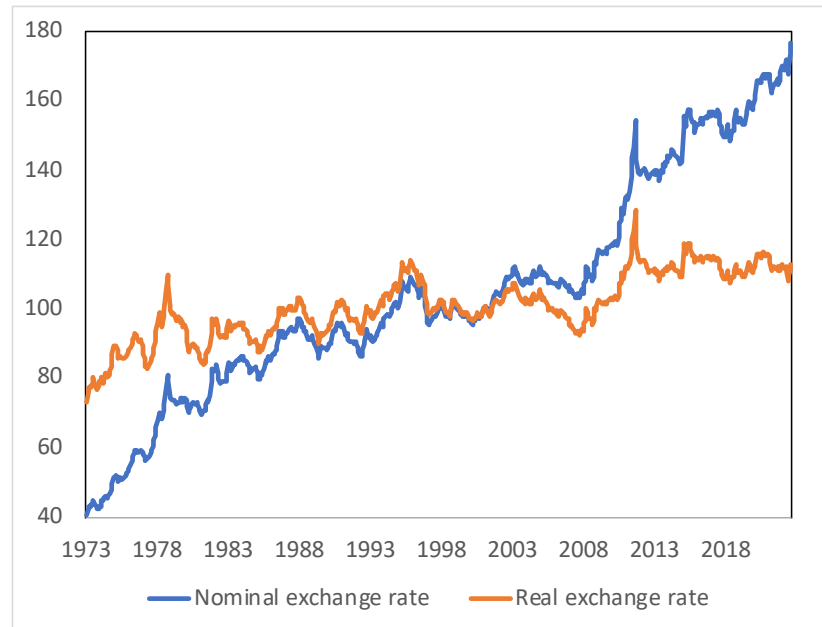
The formula

- Old truth: the exchange rate is central to a small open economy
- The SNB exchange rate strategy:
 - “An independent monetary policy that is geared towards the objective of price stability fundamentally requires flexible exchange rates. Nevertheless, due to the influence of the exchange rate on monetary conditions, the SNB intervenes in the foreign exchange market as necessary.”

The Swiss National Bank in Brief
- Interventions have been one-sided
 - Why?
 - Link with balance sheet

Monetary policy in the long run

- Trend real appreciation



Source: SNB

Average annual:
2.9%

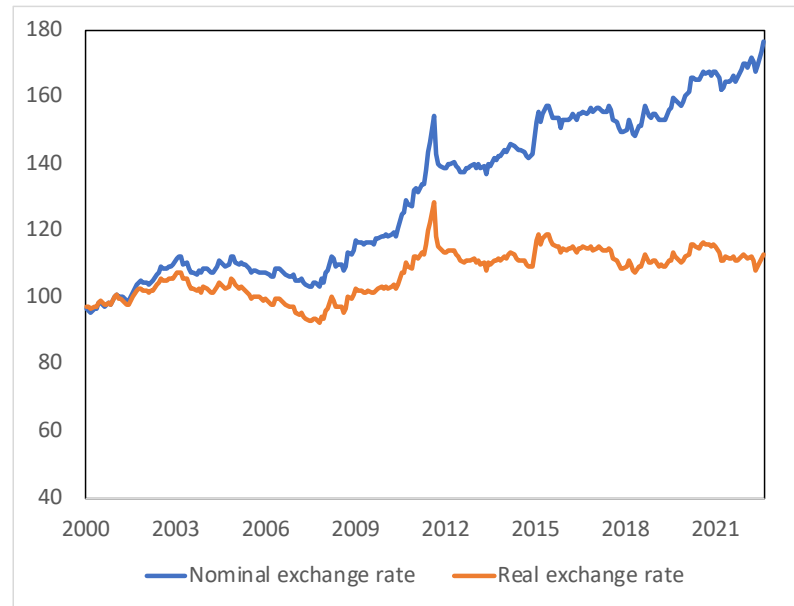
Average annual:
0.8%

- Trend nominal appreciation
 - Trend real - inflation differential

Average annual:
-2.1%

Monetary policy since 2000

- Trend real appreciation



Average annual:
1.2%

Average annual:
0.3%

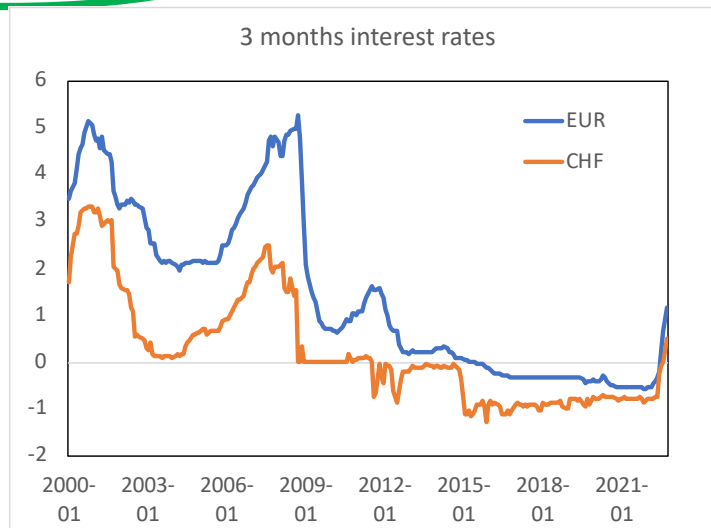
- Trend nominal appreciation
 - Trend real - inflation differential

Just right!

Average annual:
-0.9%

So far, so good, but...

- One-sided interventions
 - Safe haven
 - Too high returns



EUR average annual:
1.43%

CHF average annual:
0.23%

- Average nominal appreciation: 2.24%

Catch 22 strategy

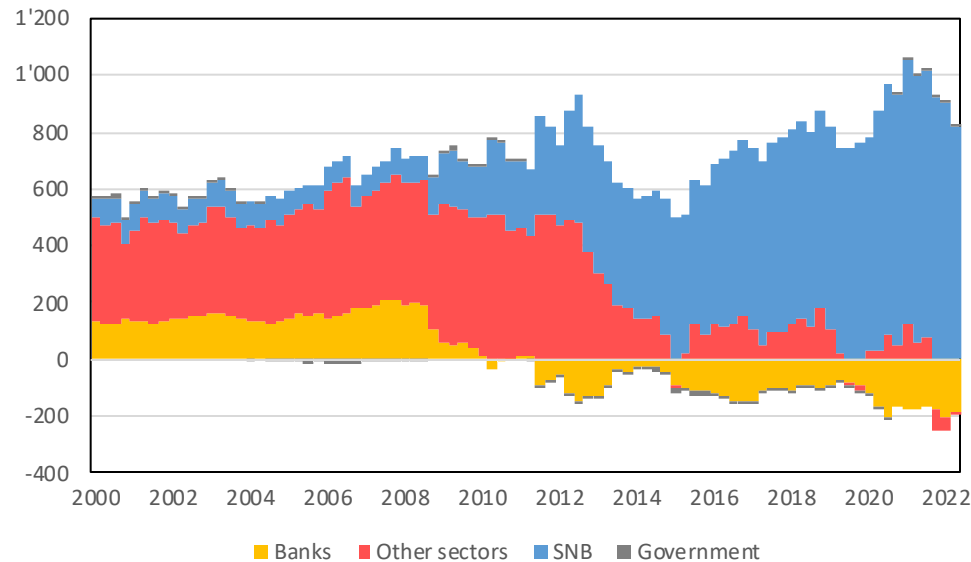
- Interest rate and real exchange rate trend: incompatible
 - Effective lower bound is binding
 - Also the case before
 - Jan 2000 – Dec 2011:

EUR rate	2.95%
CHF rate	1.13%
Appreciation	2.09%
- Foreign exchange market interventions: unavoidable
- Consequence: buildup of SNB foreign asset holdings
 - Currently about 100% of GDP

Asset buildup: Harris Dellas view

- Safe haven → lower interest rate → carry trade is good business for Switzerland & Co.
 - Not what I find
- Public sector can absorb large risks
 - Isn't it what private sector is all about? More later
- Government does not do it
 - Maybe for good reasons, not just returns
- OK for SNB to take over, BUT disconnect profit distribution from asset returns
 - SNB = not for profit according to law
 - Profit distribution: yes please! (SNB Observatory)

Net financial positions



Source: SNB

- Banks and non-banks used to play the game
- Then withdrew
- SNB has taken over, not intentionally
 - Byproduct of foreign exchange market interventions

Conclusion

- Magic formula has worked
 - Use interest rate as instrument, foreign exchange interventions as complement
 - Price stability objective = mission accomplished
- Magic but not free
 - Massive unwanted foreign asset accumulation
 - Risky and a threat to independence
- Needs some refining