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Economics

Monetary Policy Challenges

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The SNB and its Watchers Conference

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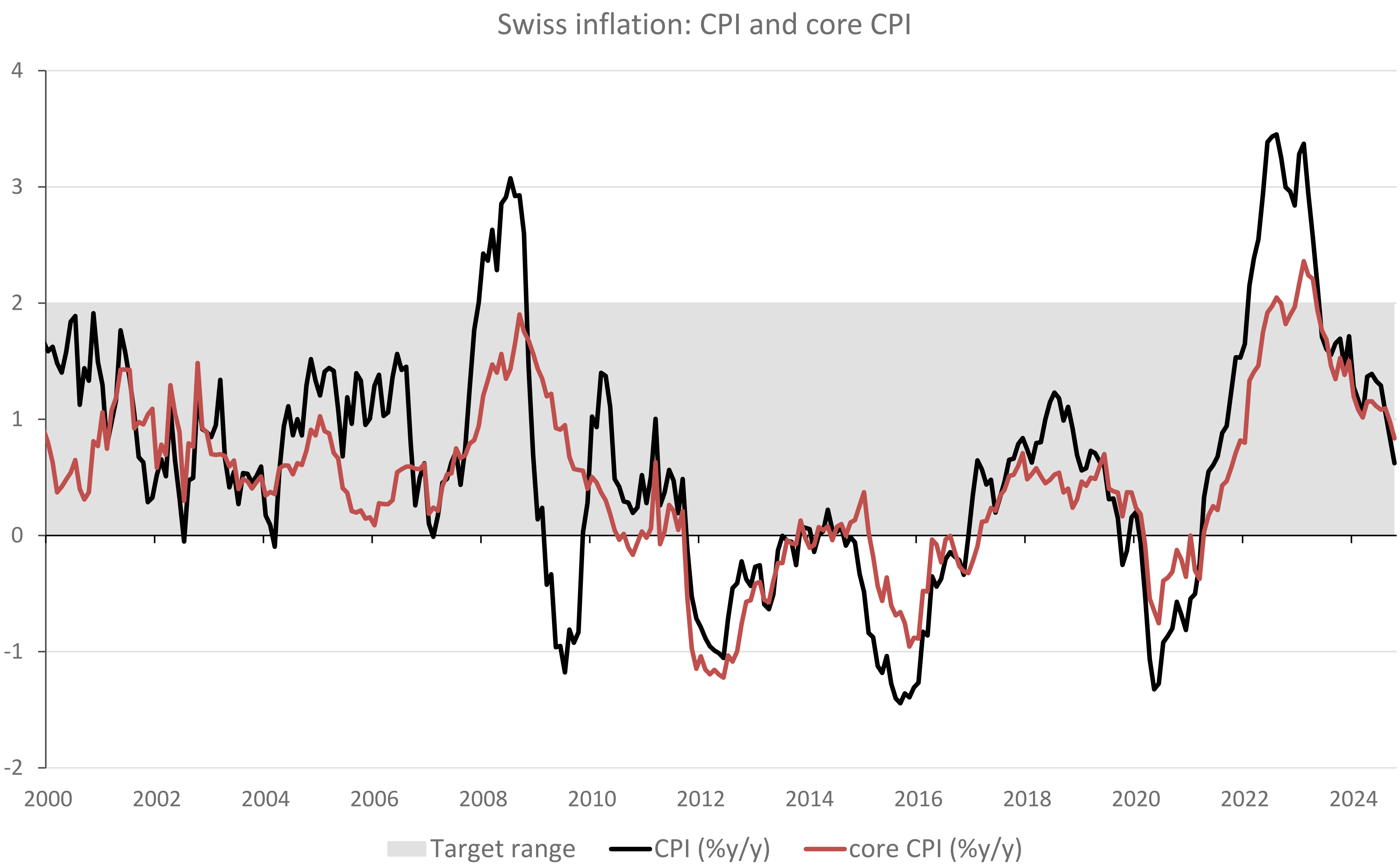
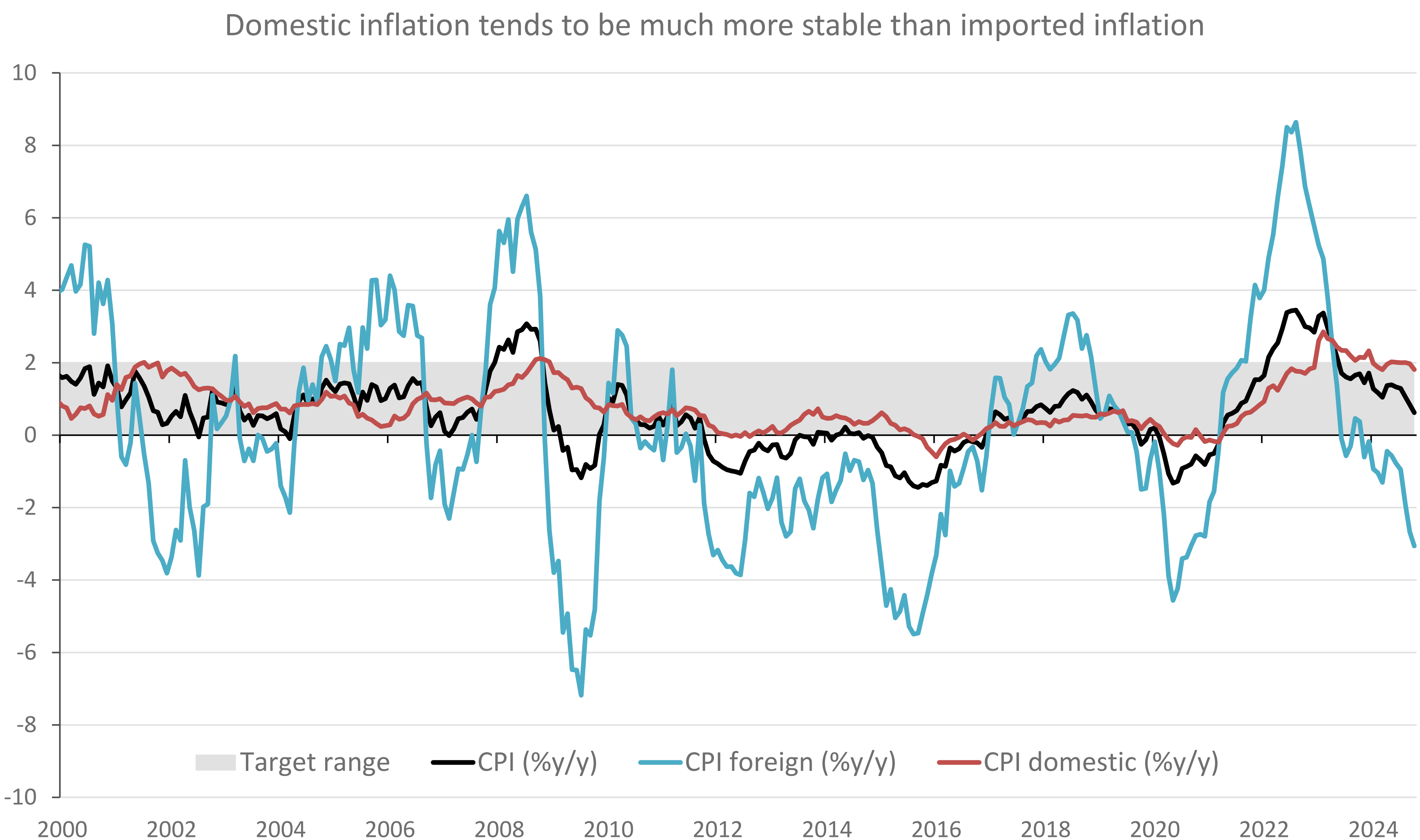
SNB has been successful at maintaining low inflation



Source: Swiss National Bank

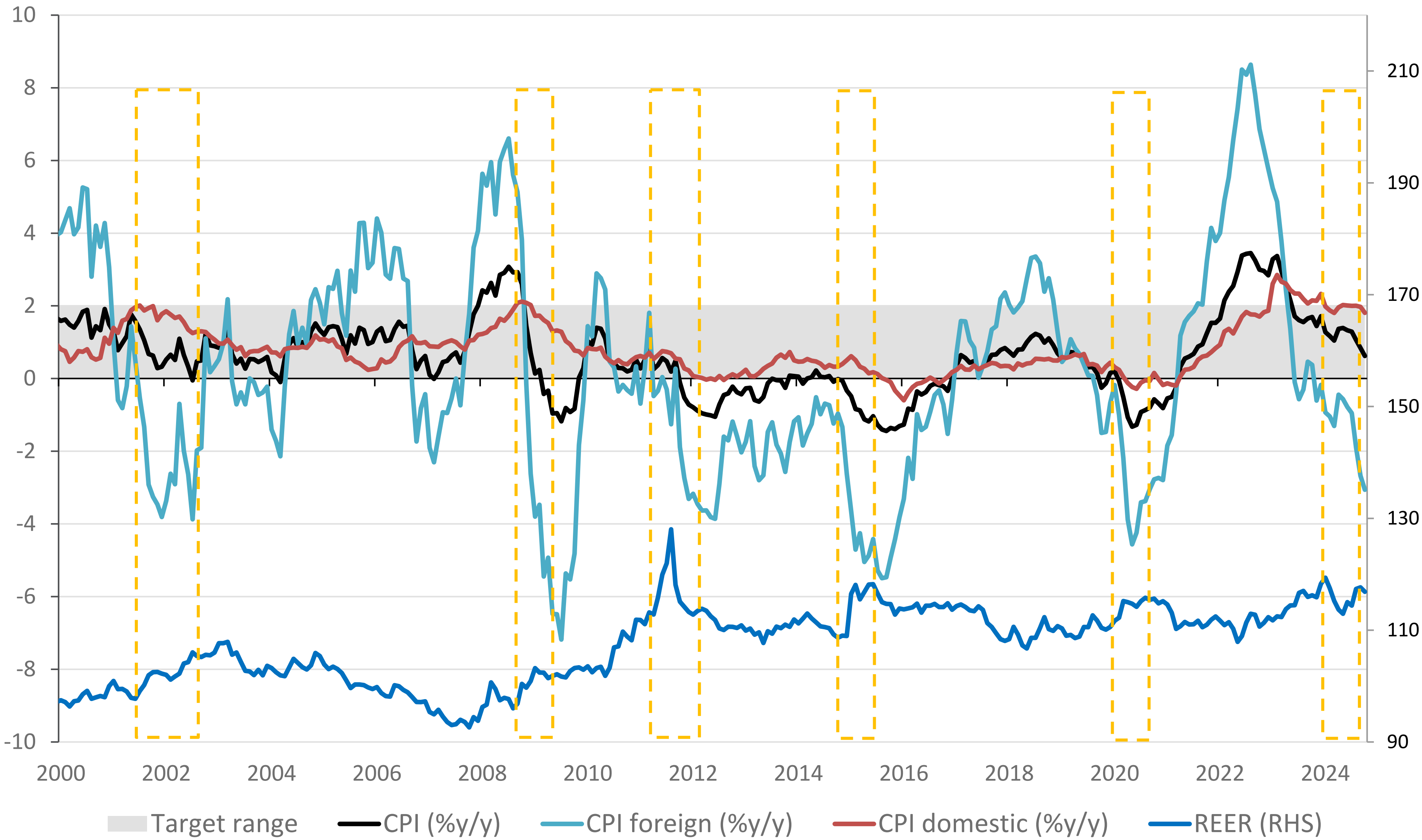
Deviations from target range mostly due to imported inflation...



Source: Swiss National Bank

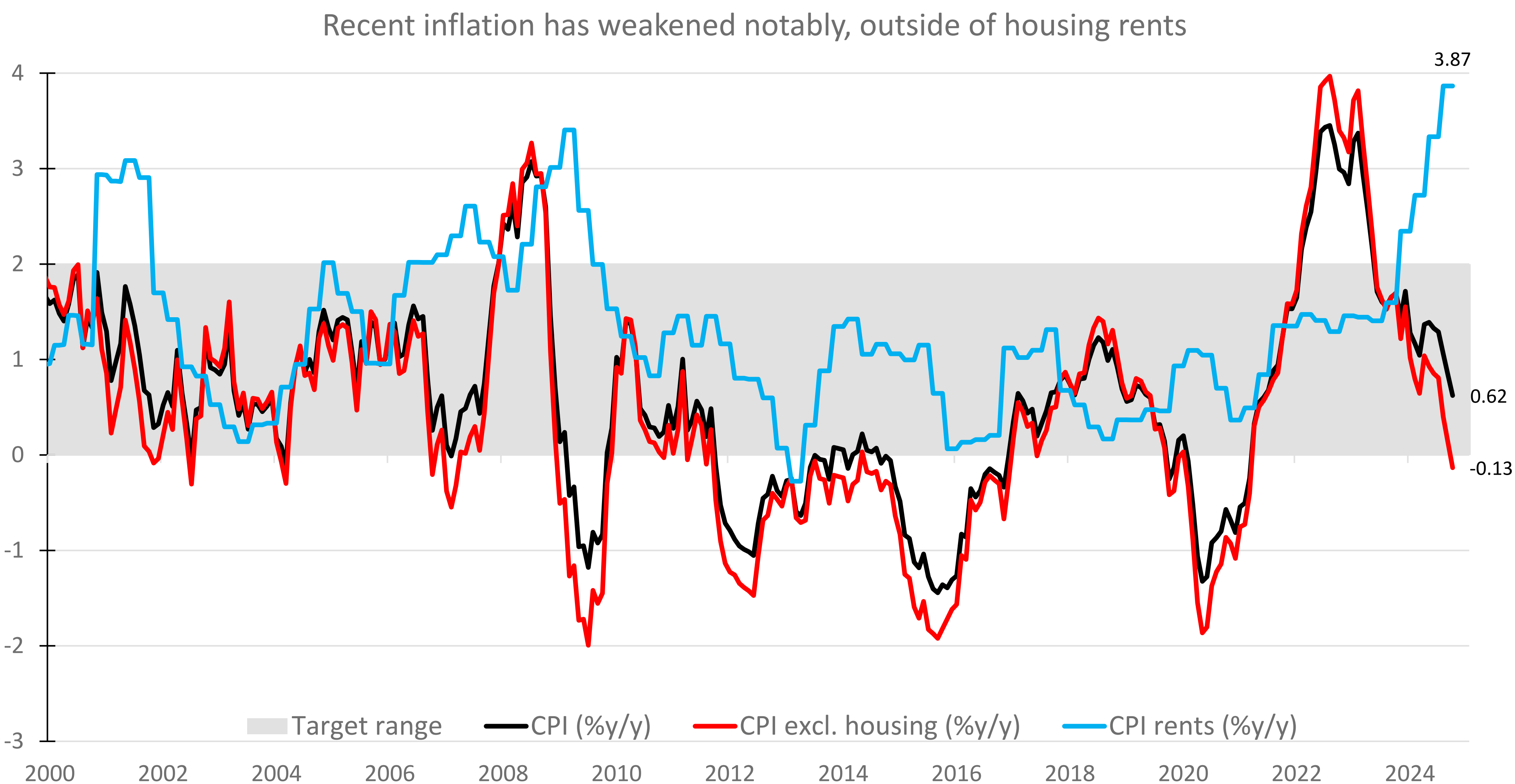
… and RER appreciation

Imported inflation tends to fall sharply after significant real exchange appreciation



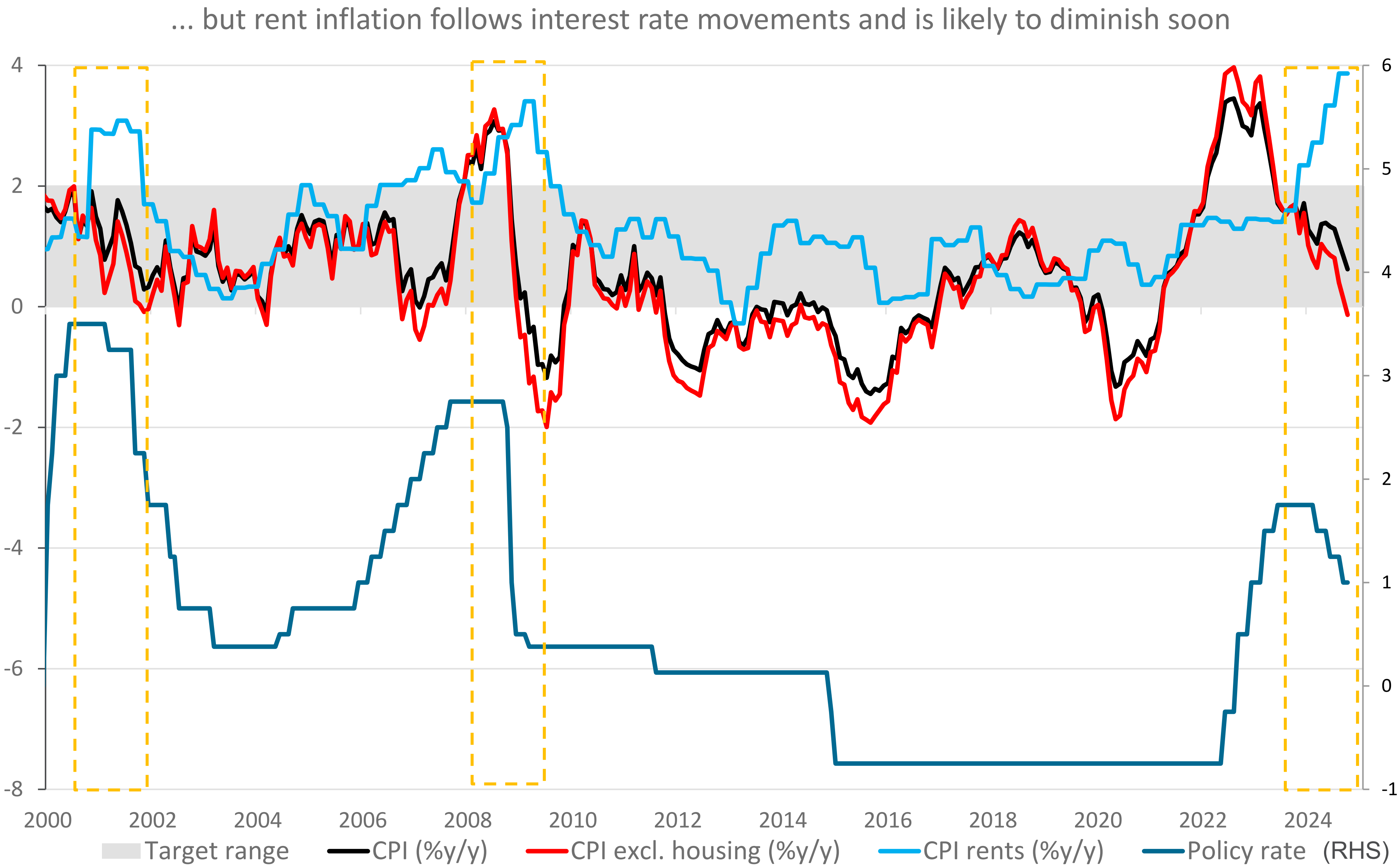
Source: Swiss National Bank

Is inflation about to undershoot target again?



Source: Swiss National Bank

SNB has eased policy this year

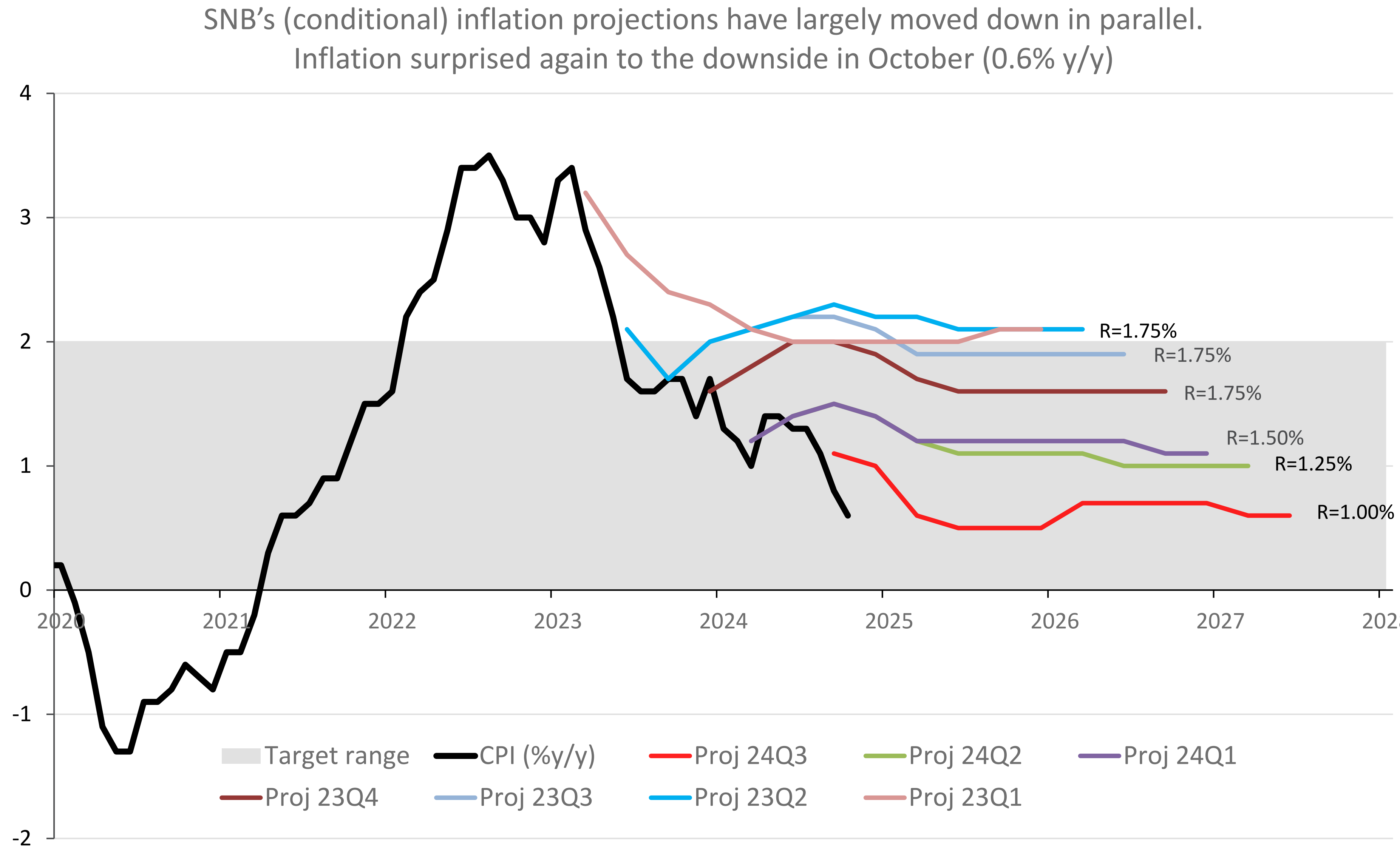


Source: Swiss National Bank

Concern: inflation returns persistently below target range

- Swiss inflation is weakening:
  - CPI excl. housing in deflation (y/y)
    - Inflation momentum (3m/3m SAAR) has continued to move lower across various components (domestic/services inflation; goods/imported inflation)
  - Rent inflation still elevated due to recent increases in mortgage rates
    - But with policy rates heading down and mortgage rates likely following, rent inflation may weaken soon
- Global economic environment:
  - **ECB** will likely proceed with multiple rate cuts through 2025
    - Our FX strategy team expects the CHF to remain strong against the EUR (0.92–0.94) → imported inflation should continue to exert a drag in the near term
  - Sluggish growth in **China**
  - For the **US**, we expect 2025 inflation to stall near 3% for core CPI (2.7% for core PCE inflation), with import tariffs and tighter immigration restrictions
    - We thus don't expect the FOMC to cut rates more than twice 25bp in 2025
    - Our FX team expects only slight CHF depreciation (~2%) → should contribute only marginally to higher imported inflation

SNB has eased policy as it revised inflation projections down



Source: Swiss National Bank

Is SNB sufficiently accommodative?

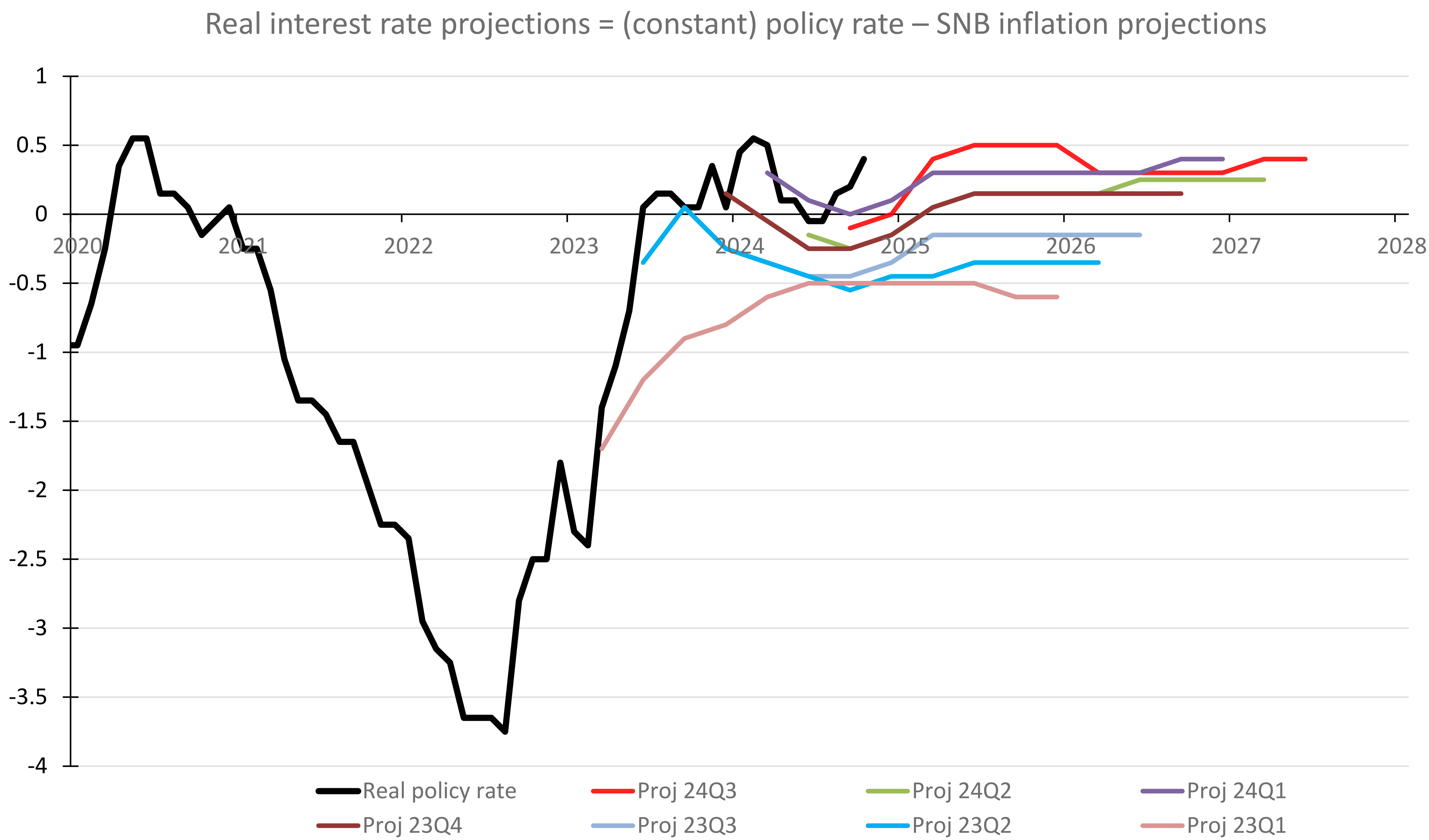
- SNB has repeatedly revised down inflation forecasts since early 2023

  - Inflation forecast was revised down in short and longer term by similar amounts: *Peculiar!*
    - If inflation expectations are well-anchored and inflation surprises reflect non-permanent factors, inflation should be projected to revert toward the anchor
    - Barclays Rates Strategy: *Another inflation miss*

  - Are inflation expectations not well-anchored?
    - Possibly: SNB doesn't have a point target, but a range. As long as inflation fluctuates within the range, the SNB should not be expected to react
    - But measures of inflation expectations seem quite stable

  - Alternative view: Inflation expectations are well-anchored but policy that keeps rates at current levels (conditional forecast) is not stimulative enough
    - Indeed, *real* interest rates implied by conditional forecasts do not show policy easing
    - Hence, we should expect policy rate to be lowered further as inflation weakens

Real interest rate projections do no show policy easing



Source: Swiss National Bank, Barclays Research

More policy easing? Forward guidance could help

- SNB has provided some guidance that policy rate might be lowered further:
  - *"Further cuts in the SNB policy rate may become necessary in the coming quarters to ensure price stability over the medium term."* (SNB decision, Sep 26, 2024)
  - "*We currently see the downside risks to inflation as greater than the upside risks*." (Schlegel, Sep 26, 2024)
  - "*We can't rule out any measures,…we can't rule out negative rates either.*" (Schlegel, Oct 1, 2024)

- If inflation is indeed projected to remain persistently negative, the SNB may need to provide more stimulus:

  1. Lower policy rate (despite limited room)
  2. Targeted FX interventions (to depreciate the CHF and raise imported inflation)
  3. **Explicit forward guidance to lower real interest rates**
     - Affirm preference for bringing inflation to center of target range (1%)
     - Tie low rates (targeted FX interventions) to sustained progress on inflation (eg, inflation projected to clearly return toward center of the range)

- If the SNB is **expected** to lower the policy rate enough, for long enough, this should help raise inflation expectations, lower real rates, stimulate activity, and raise inflation

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