SNB Threatening Negative Rate Awaits Draghi’s Next Move

By Catherine Bosley and Andre Tartar - Dec 9, 2014

Swiss National Bank officials have their eyes on one man: Mario Draghi.

The prospect of the European Central Bank intensifying stimulus by purchasing government bonds has weakened the euro, pushing the franc to within 0.2 percent of the SNB’s upper limit of 1.20 versus the single currency. More than 60 percent of economists in a Bloomberg News survey say SNB President Thomas Jordan will have to use negative interest rates to buttress the ceiling if ECB quantitative easing threatens the threshold.

Policy makers at the Swiss central bank have pledged numerous times to “immediately” supplement their three-year-old cap if needed, with options including a charge on sight deposits. While no change is forecast at their policy meeting in Bern this week, their willingness to follow through may be tested early in 2015.

“The SNB are in a trade-off here,” said Jordan Rochester, an economist at Nomura International Plc in London. It’s “between a proactive decision of cutting rates before ECB action, or kicking the can further down the road and saving ammunition in case they need to relieve pressure on the floor if the ECB does commence quantitative easing.”

ECB Stimulus

Last week, ECB President Draghi postponed another barrage of stimulus until at least January, saying he’ll “reassess” the situation then. Further policy easing in the euro area could cause a depreciation of the common currency against the franc.

The euro has already fallen about 2 percent against the Swiss currency this year. The franc was partly boosted in the buildup to a referendum last month on the SNB’s gold holdings. If it had passed, it would have forced the central bank to boost gold reserves, impeding its ability to intervene in foreign-exchange markets.

The franc traded little changed against the euro at 1.2021 at 8:52 a.m. in Zurich. Against the dollar it stood at 97.48 centimes.

All but one of the 27 economists surveyed forecast the SNB will step up interventions should pressure on the cap intensify, according to the poll conducted Dec. 4-8. Seventeen see it...
introducing a negative deposit rate, following the ECB’s June move to charge banks for overnight deposits. With permanent excess liquidity in the Swiss financial system exceeding 300 billion francs ($307 billion), negative rates would have a bigger impact in Switzerland than they did in the euro area, according to SNB Board Member Fritz Zurbruegg.

‘Line of Defense’

“We expect currency interventions to remain the first line of defense,” said Thomas Bloomfield, an economist at 4Cast Ltd. in London. “However, in the event of broad-based QE by the ECB, we do not think the SNB will hesitate to introduce a negative deposit rate.”

The SNB’s foreign-exchange holdings have ballooned due to currency interventions to defend the cap and now total 462.4 billion francs -- about three quarters of Switzerland’s annual economic output.

Sight deposits -- cash-like holdings commercial banks keep with the SNB -- rose in the week ending Nov. 21, a sign the central bank may have intervened to defend its currency cap after a two-year hiatus. The SNB declined to comment and sight deposits have since declined.

The SNB is expected to keep the target range for its benchmark interest rate at zero to 0.25 percent and the cap unchanged at 1.20 at its meeting on Dec. 11, according to a separate survey.

‘Panic Mode’

The rate announcement at 9:30 a.m. local time will be followed by a press conference 30 minutes later, at which policy makers may say whether or not they resumed currency interventions after halting them in September 2012. Either way, 70 percent of economists see the SNB lifting the cap no earlier than 2017, up from 56 percent in last month’s survey.

The SNB will also issue new growth and inflation forecasts this week, including a first projection for 2015 gross domestic product. GDP climbed the most in more than a year in the July-September period, increasing a quarterly 0.6 percent thanks to domestic consumption. The central bank currently predicts growth of “just below” 1.5 percent for 2014. It sees inflation for this year at 0.1 percent, accelerating to 0.2 percent in 2015 and 0.5 percent in 2016.

A recent slide globally in the price of crude oil could lead to the SNB sticking with its currency cap, which it set in September 2011 citing the risk of deflation and a recession. While cheaper energy boosts the spending power of households and businesses, it also undercuts inflation and risks becoming embedded in inflation expectations both in Switzerland and in the euro area.

“Government bond purchases by the ECB are not in themselves a sufficient condition to trigger the SNB enacting a negative deposit rate,” Timo Klein, senior economist at IHS Global Insight in New York. “It depends very much on the volumes involved and whether financial markets are at risk of...
slipping into panic mode or not."

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