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MACRO MORNING BRIEFING

March 13, 2024

Jordan Prepares To Land Last SNB Flight

SNB to keep policy unchanged; current rate-cut pricing excessive

- Franc remains strong but not yet disinflationary
- SNB to confirm inflation target met through forecast horizon
- Jordan's September departure marks end of an era

Policy bias to reflect price stability being met

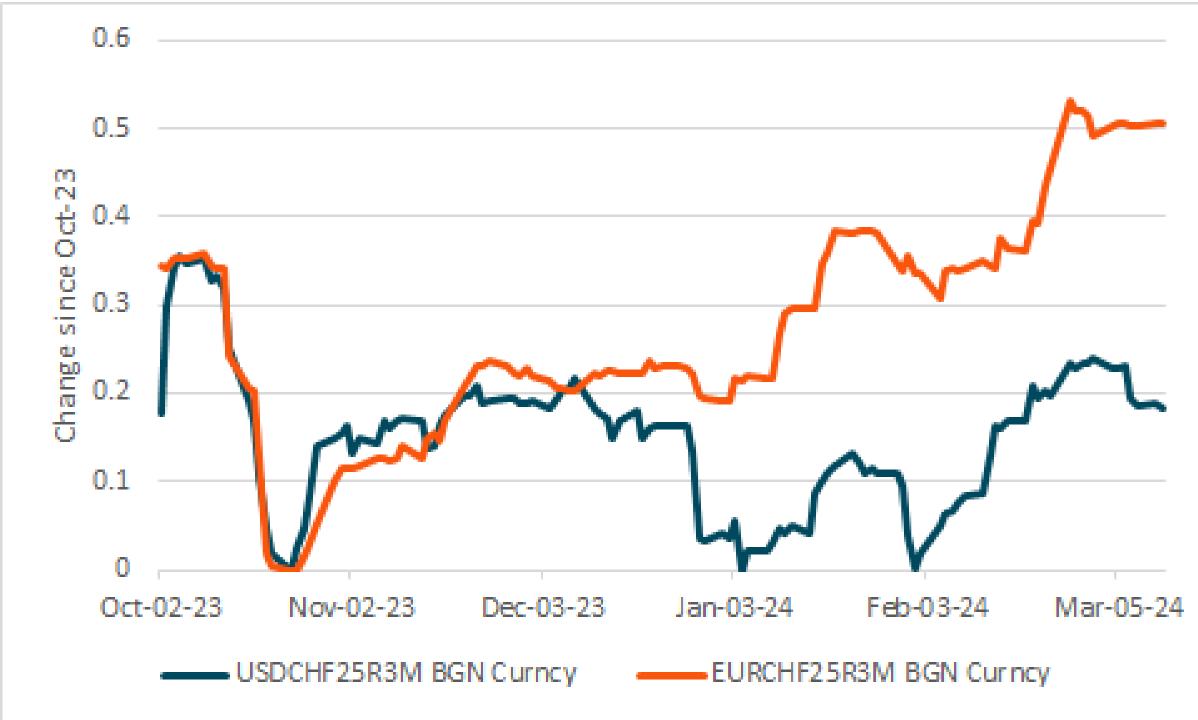
What was expected to be a relatively staid run-up to the Swiss National Bank's Monetary Policy Assessment this month was punctuated by a press release on Feb. 29 revealing that current Chairman Jordan would step down at the end of September. His career at the SNB spanned 27 years, 12 of those at the helm. His term as Chairman was to run to end-2027, so his decision marks, by our count, the fourth consecutive SNB Chairman to depart early.

Jordan's remarks at the press conference announcing his decision may not have been intended to provide any form of monetary policy guidance, but there were some hints regarding the status quo. He commented that "monetary stability has been reached" and “Swiss price developments shows we did well”. Assuming there were no translation issues, his use of the past tense here means that price stability in Switzerland has been achieved and inflation is expected to meet the operational target of “less than 2% per annum” through the forecast horizon. Given the SNB's December forecast round and CPI peaking at 2.0% in Q2 and Q3 of this year, below the 1.75% conditional forecast, Jordan's comments were valid. And considering that global price pressures and expectations were showing tentative signs of rebounding in early March, when he made the comments, it's also a sign that he and the SNB were not overly concerned about spillovers into Switzerland.

The challenge we see, therefore, is whether price stability under the SNB’s definition can be maintained to the downside as well. For most of Jordan’s tenure, it was disinflation and deflation that were challenges before the pandemic radically shifted expectations. The sharp appreciation of the franc towards the end of the 2023 and uncertain global outlook over the medium terms means a shift in bias is likely necessary. The SNB was not ready to send such a signal in December but, with the latest ECB guidance and current Fed pricing, Switzerland faces very little prospect of imported inflation, and policymakers will now need to be mindful of domestic growth pressures arising from adverse external conditions.

Those concerns could explain FX and rates markets starting to change expectations on the franc's trajectory. Exhibit 1 shows changes in 3-month 25-delta USDCHF and EURCHF risk reversals since October. Since February, pricing has begun to shift in favour of a weaker CHF on crosses, even when two-months earlier these pairs were falling aggressively. Even after its recent pullback, the franc remains stronger on an annualised basis.

Exhibit #1: Change In CHF Risk-Reversal Pricing



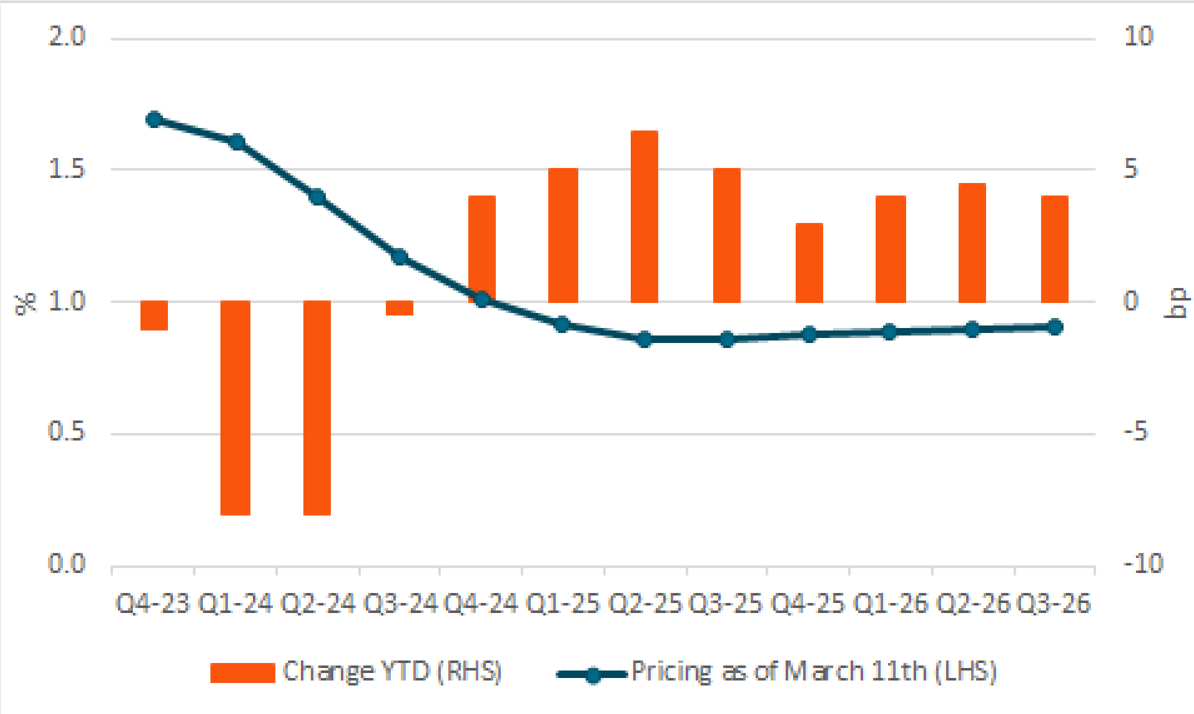
Source: Bloomberg, BNY Mellon

Being well-versed in the SNB's prior reaction function regarding excessive franc strength over the years, the market likely sees SNB intervention to sell the franc quite early on. This suggests that pricing-in strong downside in EURCHF and USDCHF offers unfavourable risk:reward when there is unlimited capacity on the other side. Even on an absolute basis, volatility will likely be capped due to the dampening effect of extreme balance-sheet easing.

However, as we highlighted in our review of the SNB's prior actions, the bar for using the balance sheet is very high – we doubt it will be deployed as a primary policy tool for the balance of Jordan's tenure. The policy rate will likely need to be cut to zero beforehand, and at the SNB's pace of choice. If warranted, easing outside of the regular quarterly schedule is also possible. However, as exhibit 2 indicates, the market is not expecting policy rates to move to the zero lower bound through 2026, so re-engaging on the currency beyond smoothing operations appears out of the question.

There has, however, been a change in the shape of the SARON futures curve since the beginning of the year, whereby a higher chance of easing has been assigned for H1 2024 but future cuts priced out. The timing of the change can also explain the recent move in favour of downside risk for the franc in EURCHF and USDCHF (exhibit 1). Like in other G10 economies, on a cumulative basis the SNB is not expected to move as much, but the 'front-loading' of easing is incongruent with broader pricing of global inflation dynamics. This is most likely in response to near-term franc strength rather than domestic inflation. It appears overdone relative to fundamentals, in our view.

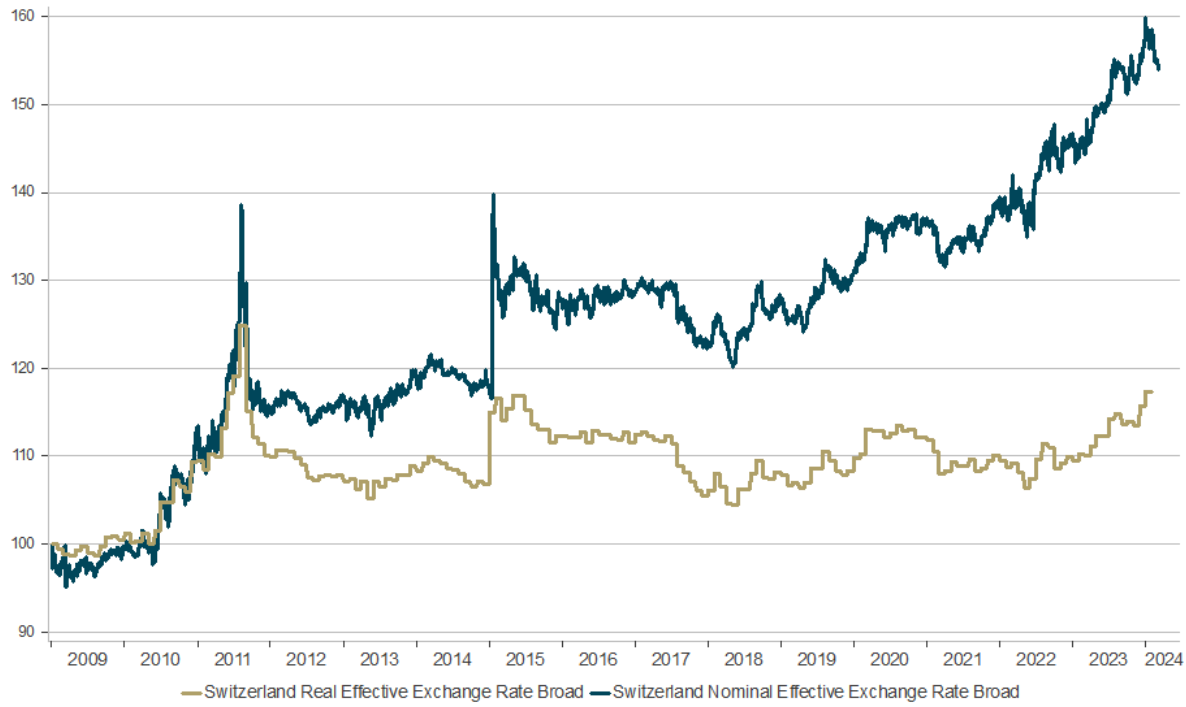
Exhibit #2: Current SNB Expectations



Source: Bloomberg, BNY Mellon

Exhibit 3 shows that the CHF Nominal Effective Exchange rate (NEER) has softened slightly in recent weeks but remains at historical highs. The CHF's Real Effective Exchange Rate (REER) has also continued to move higher, though the pace is being dampened by inflation differentials and levels remain below the extremes seen over a decade ago. While we do expect the SNB to react if needed were the franc to become disinflationary, the pace of the moves matter as much as the levels. By this criteria, even the NEER gain is not exceptional compared to the waves in 2010 and 2011.

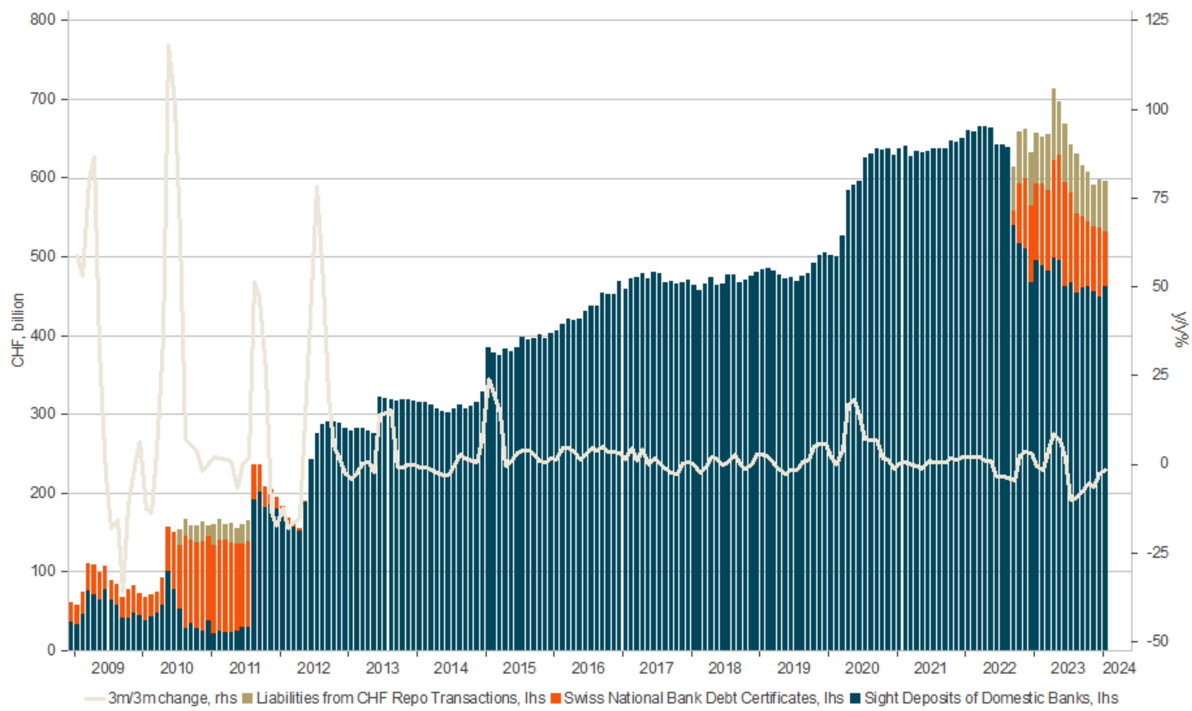
Exhibit #3: CHF Nominal & Real Effective Exchange Rates



Source: Macrobond, BNY Mellon

The pace of contraction of the SNB's balance sheet (exhibit 4) has started to slow and Sight Deposits have picked up gently, which normally would have been viewed as a sign of intervention. We stress that given the current ample level of SNB Bills and repurchase agreements which can revert to Sight Deposits upon maturity or open-market operations, there seems no urgency to use the exchange rate as a tool outright.

Exhibit #4: Composition And Change In SNB Balance Sheet



Source: Macrobond, BNY Mellon

Jordan's departure marks the end of an era. His tenure is already the longest since Gottlieb Bachmann, who presided as Chairman between July 1925 and March 1939. On the SNB's own governance, Jordan offered no opinion on whether it would be right to bring in an external successor, as opposed to an appointment from within the SNB, which was his route and that of immediate predecessors. Nonetheless, an external candidate would not break precedent, as Edwin Stopper was appointed as SNB Chairman in 1966 after a career in the Federal Government. We take no view on the future chairman, but an external appointment could resurrect the notion that the SNB needs to retain what Jordan calls an "intelligent, but narrow" mandate under its next leader. Lessons are still being learned from developments last year, which briefly had Switzerland at the centre of global financial stability risk.

To quote Jordan's parting speech one final time, "the global growth environment is not easy and the geopolitical environment is challenging". All things considered, perhaps the future requires widening of that "narrow" mandate.

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