Central Bank Liquidity Action Fails to Stop the Rot
Monday, 16 March 2020 12:30

Leading central banks from across the globe, among them the Swiss National Bank, on Sunday promised to inject additional liquidity. But despite their concerted effort, the massive slide on the stock markets continued today.

When the Swiss National Bank (SNB) releases an important message on a Sunday night, the world is no longer in its usual order. Together with their colleagues from the U.S., the Eurozone, Japan, Canada and England, the Swiss central bankers announced a «coordinated action to enhance the provision of liquidity via the standing U.S. dollar liquidity swap line arrangements».

The aim of the action is to mitigate the effects of the strains in global funding markets on the supply of credit to households and businesses, both domestically and abroad.

The coordinated measures followed a massive rate cut by the Federal Reserve, also on Sunday – the second cut within a short period of time.

The Stock Market Crash Continues

The measures announced last night didn’t calm the nerves on the markets though. The Swiss Market Index on Monday morning dropped about 7 percent, with all stocks deeply in the red – even those of companies such as drugmaker Roche, which usually acts as a safe haven and which produces vital drugs and testing equipment needed to combat the virus.

The fear that the onset of a global recession will lead to payment defaults became evident through sharp declines of the stocks of banks.

Drop in Demand

Central can’t make up for the drop in demand which was prompted by the sharp measures taken by governments in key countries around the world to contain the coronavirus pandemic. The expectation is that the injection of liquidity may alleviate the effects of the sharp drop in economic activity on the financial system.

European banks, which have long procrastinated shaping up following the 2008/09 crisis, are especially vulnerable to this.

Major U.S. banks including J.P. Morgan said they would suspend share buybacks – a method preferred by banks to return capital to shareholders because it typically boosts stock prices.
All Eyes on the SNB

Credit Suisse has previously expected to buy back as much as 1 billion Swiss francs ($1.1 billion) in its own stock by year-end, but this is subject to economic conditions which have now changed dramatically. UBS is in the middle of a 2 billion franc, three-year buyback.

In this situation of uncertainty, all eyes will be on the SNB and its monetary policy assessment due on Thursday.

Last Thursday, the Swiss central bankers presumably were relieved to hear that the European Central Bank (ECB) had refrained from cutting rates further. As the Swiss francs has recently come under sustained upwards pressure, the SNB will probably have to consider action to prevent further damage for the Swiss export-oriented economy.

Currency Interventions Remain in Focus

The slowdown of economic growth in key export markets (Europe, U.S.) will combine with the strong franc to affect Swiss companies. Observers agree that the SNB has been active in currency markets in recent months – and yet, the franc is at trading at the highest level in five years.

Given that events have unfolded very rapidly in recent days and given the signs of panic on the markets, the SNB may well opt to release a statement before Thursday.