

Switzerland: macro scenario update

CHF's strength puts pressure on the SNB

12 FEBRUARY 2024, CIO OFFICE & MACRO RESEARCH

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FLASH NOTE

SUMMARY

- Our views regarding growth and inflation in Switzerland have not changed. We expect economic activity to remain sluggish in early 2024 amid euro area weakness, with a gradual recovery from Q2 onwards. Stripping out the impact of major sporting events, we project annual GDP growth of 0.9% in 2024, down from an estimated 1.2% in 2023.
- Meanwhile, while increases in electricity prices, VATs and rents will fuel inflation in Q1, we expect it to average 1.7% in 2024, down from 2.1% in 2023.
- However, the sharp appreciation of the Swiss currency in both nominal and real terms since December has led us to change our call on monetary policy. We now expect the Swiss National Bank to cut its policy rate by 25bp in June and again in September, bringing the policy rate down to 1.25%.

SNB LIKELY TO EASE MONETARY POLICY IN 2024

The Swiss National Bank (SNB) has played a key role in keeping inflation under control by letting the Swiss franc appreciate in order to reduce imported price pressure. Between June 2022 and June 2023, the SNB raised its policy rate by 250 basis points to their current level of 1.75%. It also intervened to keep the franc strong, selling more than CHF110 bn in foreign currency reserves in the first nine months of 2023 alone.

However, at its latest policy meeting in December, the SNB dropped the tightening bias in its press statement. It also changed the language around FX interventions, mentioning that its focus was no longer on selling foreign currencies. This was hardly surprising since inflation is now mostly domestically driven, reducing the need to strengthen the Swiss currency to reduce imported price pressures.

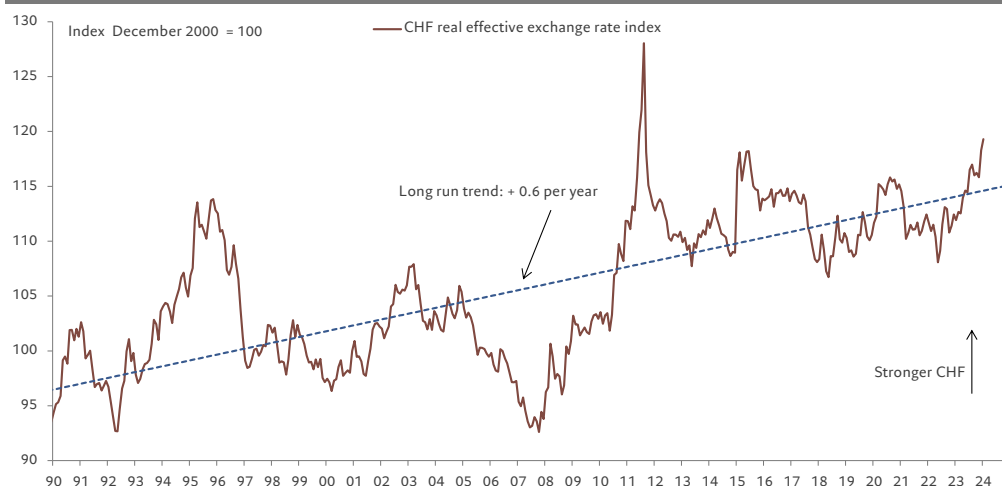
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The SNB is now in a relatively comfortable position as inflation is within its target range. Our view on Swiss inflation has not change since we published our 2024 Swiss macro-outlook in November 2023. We continue to predict that headline inflation will hover around 2%, averaging 1.7% in 2024 compared with 2.1% in 2023. Before the pandemic, the long-term annual average for Swiss consumer inflation was 1%.

However, we are changing our call on central bank rate policy. We previously expected the SNB to stay on hold in 2024, with risks tilted to some easing in H2 2024, and to reduce or even stop its interventions to strengthen the Swiss franc given that inflation was expected to be domestically driven.

For two reasons, we now expect the SNB to loosen rates by 25 bps twice this year (in June and again in September) to bring its main policy rate down to 1.25%. First, the appreciation of the Swiss franc in real terms is altering the growth and inflation outlook. Second, the SNB's recent change of tone indicates it may be worried by the recent renewed strengthening of the Swiss currency.

Chart 1: CHF real effective exchange rate index



Source: Pictet Wealth Management, Swiss National Bank, as of 09.02.2024

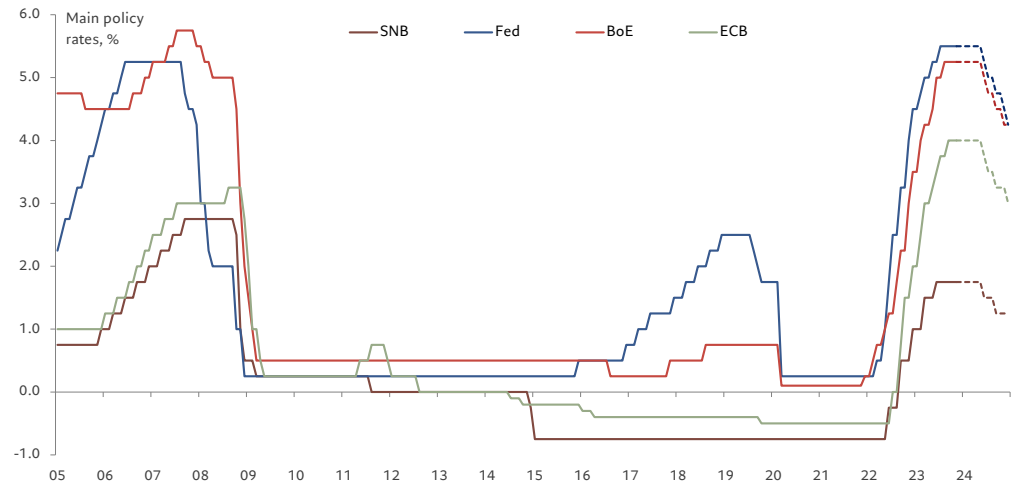
It is always difficult to say how strong the CHF has to become to trigger SNB intervention. But while the SNB could restart its FX purchases to counter any unwarranted appreciation of the CHF, we nevertheless think verbal communication and adjusting the policy rate will remain its policy tools of choice.

We believe the next SNB meeting on March 21 will be too early for it to start cutting rates as increases in electricity prices, VAT rate hikes and rents will seep into inflation figures Q1—to what extent is difficult to gauge (especially for rents), but our view is that the SNB will want to wait to monitor potential second-round effects. Thus, a June rate cut seems more likely in our view.

Our base case that other central banks such as the US Federal Reserve and the European Central Bank will also start easing their monetary policies in June should enable the SNB to do likewise.

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Chart 2: Main policy rates of SNB, US Federal Reserve (Fed), Bank of England (BoE) and European Central Bank (ECB)



Source: Pictet Wealth management, SNB, Fed, BoE, ECB, as of 09.02.2024

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