PICTET 1805

PICTET WEALTH MANAGEMENT

Switzerland: macro and bonds

An outperformer

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FLASH NOTE

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SUMMARY

- The Swiss economy has shown remarkable resilience since the recent energy shock. We expect Swiss GDP to expand by 1.0% in 2023 and headline inflation to average 2.3%.
- Recent downside surprises in Swiss consumer inflation (now below 2%) may not change the Swiss National Bank's (SNB) assessment of inflation much. We expect a final rate hike of 25bp in September, bringing the policy rate to 2.0%.
- The dip in headline inflation below 2% in June means the SNB is the first major central bank to reach its inflation target. More muted inflationary pressures in Switzerland than elsewhere probably explain the strong performance of the 10-year Swiss government bond year-to-date.
- We expect 10-year Swiss yields to move slightly up (from 0.93% on 30 June to 1.10% by year's end), as the SNB's worries about medium-term inflationary pressures mean it is likely to hike again in September and is unlikely to be the first central bank to cut in 2024 or beyond. As such, we have downgraded our stance on Swiss government bonds from neutral to underweight and rather favour short-term investment-grade corporate bonds in Swiss francs.

AN ISLAND OF RESILIENCE

The Swiss economy started the year on a strong footing. Adjusted for sporting events, Swiss GDP rose by 0.5% q-o-q in Q1, after a flat print in Q4. There was substantial growth in private consumption (+0.6%) in Q1 (unlike in Germany where private consumption contracted by 1.2%). There was a significant increase in consumer spending on services such as travel and tourism. Investment activity also contributed to the solid growth in domestic demand in the first quarter, while government consumption (+0.0%) was a weak spot. Trade was a drag on GDP figures, with imports outpacing exports.

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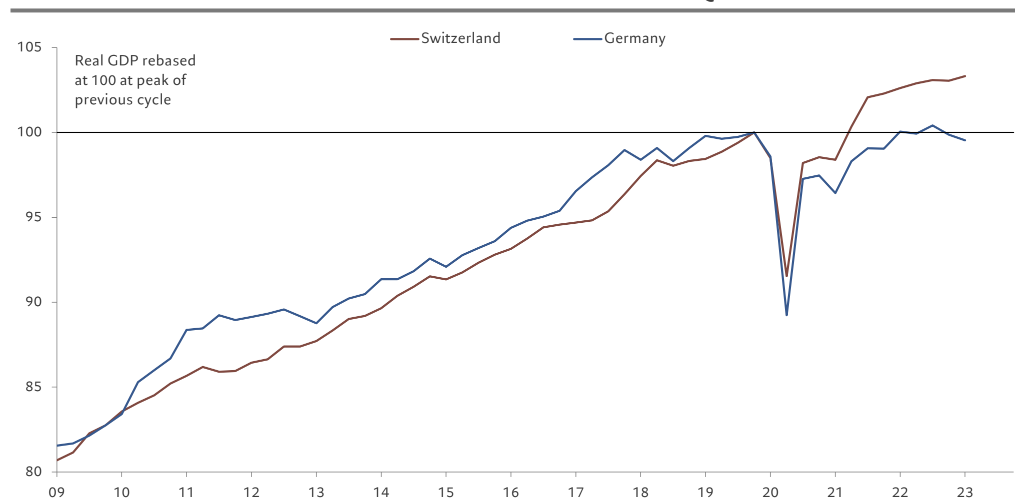
Looking ahead, weakening global demand will be a challenge for some Swiss manufacturers. Indeed, recent business surveys are consistent with a slowdown in economic activity in the coming quarters. Nonetheless, it is worth noting that pharma and chemicals, which account for 50% of total Swiss goods exports, are less sensitive to exchange-rate and global growth fluctuations and should therefore suffer less from lower demand and a strong Swiss franc.

In addition, a robust labour market and rising real wages should continue to support household consumption. Therefore, we expect Swiss GDP to expand by 1.0% in 2023, which is still below potential growth.

Chart 1: Swiss versus German real GDP rebased at 100 in Q4 2019



Source: Pictet Wealth Management, SECO, Destatis, as of 29.06. 2023

MUCH LESS INFLATION PRESSURE

Swiss headline inflation has surprised to the downside in recent months. In June, it eased by 50bp to 1.7% y-o-y, falling below 2% for the first time since January 2022. The core inflation rate fell as well, but to a lesser extent—to 1.8% y-o-y from 1.9% in May. Goods inflation moderated by 90bp to an annual 1.8% in June, while services inflation was stickier, easing by only 10bp to 1.7%.

Inflation is set to reaccelerate in the coming months, mainly driven by domestic price pressure. Several price components will be impacted. Of particular concern will be a larger-than-usual increase in housing rents this autumn as a consequence of indexation to reference rates. Housing rents are an important component of the Swiss consumer price index (CPI), accounting for 18.6% of the total CPI basket. Electricity prices are also set to rise in 2024 by around 12% (according to a recent survey by the Association des entreprises éléctriques suisses), after an increase of 27% in 2023. Public transport prices are also set to rise by 4.3%. VAT rates are also set to increase in January 2024. The impact of the rise in public transport costs and the sales tax is likely to remain limited. In all, we expect CPI inflation to average 2.3% in 2023.

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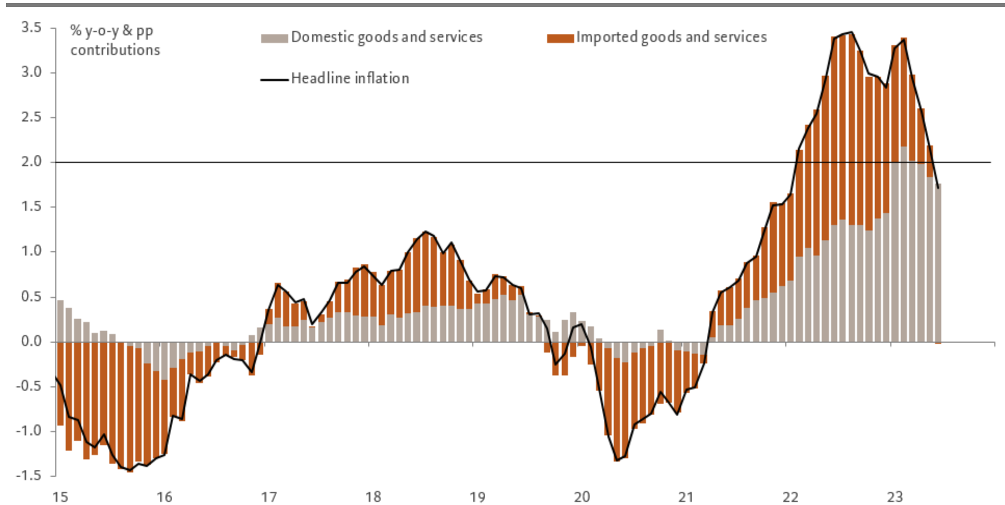
Chart 2: Swiss headline inflation – imported versus domestic goods and services

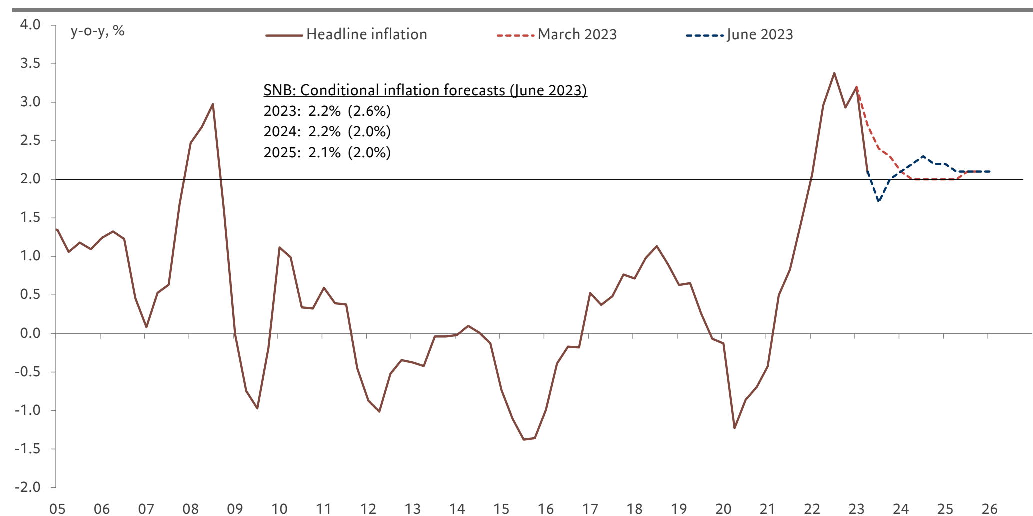


Source: Pictet Wealth Management, Federal Statistics Office (FSO), as of 03.07.2023

SNB: A FINAL HIKE IN SEPTEMBER

The Swiss National Bank (SNB) increased its policy rate by 25bp at its June meeting, bringing it up to 1.75%. Despite downside inflation surprises in recent months, the SNB has sounded rather concerned about the medium-term inflation outlook, revising up its price forecasts for 2024 and 2025. The reasons for this were 'second-round' effects, the upcoming increases in electricity prices and rents and more persistent inflationary pressure from abroad. The SNB now sees average annual (headline) inflation at 2.2% in both 2023 and 2024, and 2.1% in2025. With inflation still expected to be above its definition of price stability in Q1 2026 (the end of its forecast horizon), these numbers suggest that the SNB may consider that more tightening is warranted. We therefore expect a final rate hike of 25bp in September, bringing the policy rate to 2.0%.

Chart 3: Swiss headline CPI and the SNB's 'conditional' inflation forecasts



Source: Pictet Wealth Management, FSO, SNB, as of 03.07.2023

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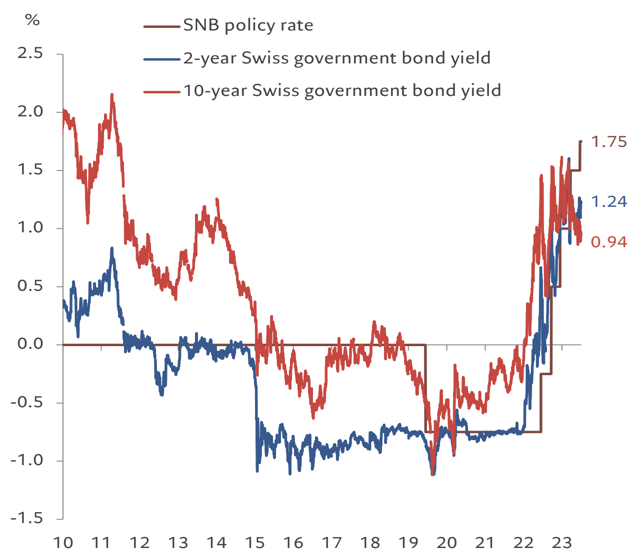
While the policy rate is the SNB's instrument of choice, its balance sheet is also an important policy tool. We expect the SNB to remain active in the FX market even though the increasingly domestic tinge to Swiss inflation makes it more difficult to combat by strengthening the franc.

SWISS GOVERNMENT BONDS STAND OUT

The dip in headline inflation below 2% in June makes the SNB the first major central bank to reach its inflation target. Comparatively muted inflationary pressures probably explain the strong performance of the 10-year Swiss government bond year-to-date. Despite continued hawkish rhetoric coming from the SNB, Swiss 10-year bonds recorded a total return of 6.8% (in CHF) in H1.

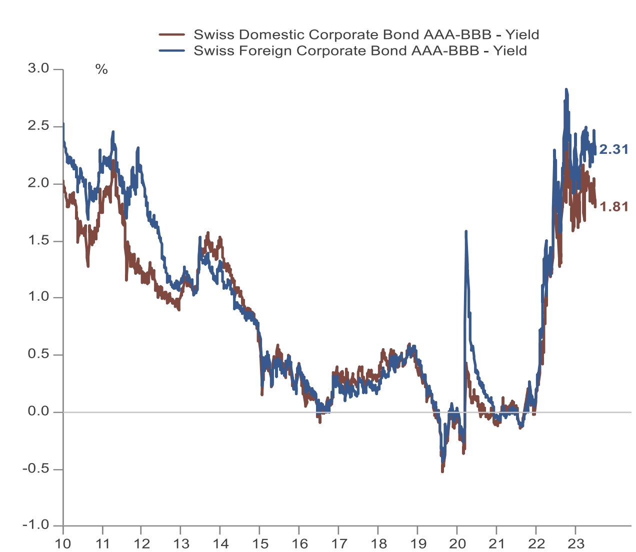
Even though the SNB policy rate moved up to 1.75% in June, both the two-year and 10-year Swiss government bond yields are much lower—at 1.24% and 0.94%, respectively on 30 June (*see chart 4*). The SNB's hawkishness means the Swiss sovereign yield curve has been inverted since late May, in the wake of similar inversion elsewhere, including in Germany and the US.

Chart 4: SNB policy rate and Swiss government bond yields



Source: Pictet Wealth Management, FactSet, as of 30.06.2023

Chart 5: Yields on domestic and foreign corporate bonds in Swiss francs



Source: Pictet Wealth Management, FactSet, as of 03.07.2023

With real rates positive, investment-grade (IG) corporate bonds (in Swiss francs) are finally offering some interesting potential for investors. Although yields on domestic and foreign IG bonds have fallen since the beginning of the year, yields on foreign bonds in CHF remain well above those offered by their domestic Swiss peers (2.31% versus 1.81%, respectively, on 3 July, *see chart 5*).

We expect the 10-year Swiss government bond yield to move slightly up from the current level (0.93% on 30 June) to 1.10% by year's end, as the SNB's worries about medium-term inflation mean it is likely to hike again in September and is unlikely to be the first central bank to cut rates in 2024 or beyond. As such, we have downgraded our stance on Swiss government bonds from neutral to underweight and rather favour short-term investment-grade corporate bonds in Swiss francs.

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