



13 September 2019

## General uncertainty also impacting Swiss economy in Q2

**Low GDP growth in Q2 (+0.3%). Scaled down prospects for 2019.  
Decrease in rates will not last. High equity valuations. Extreme real estate premiums.**

### Key points

- Logical slowdown in GDP growth in Q2 in a very uncertain context (+0.3%)
- Consumption is the main GDP growth driver (+0.3%)
- Things finally looking up for leading indicators
- Growth prospects scaled down for 2019 from +1.5% to +1.3%
- Swiss franc relatively stable
- US dollar likely to rise moderately
- Irrational situation with regard to long-term rates
- Beware the adjustment of long-term rates and its effects on all asset classes
- Rate cut boosts equity markets
- Beware securitised real estate premiums

### Logical slowdown in GDP growth in Q2 in a very uncertain context

After a downward revision of Swiss growth in Q1 from +0.6% to a mere +0.4%, Q2 dampened the optimism of forecasters a little more. Indeed, the State Secretariat for Economic Affairs (SECO) published Swiss Q2 growth figures, which show a significant decline in demand. Switzerland's economy posted a +0.3% increase in GDP despite a difficult European context due to the -0.1% contraction of Germany's GDP. Nevertheless, our economy's performance is rather satisfactory in this context, even if risks of a more pronounced slowdown in the coming months persist.

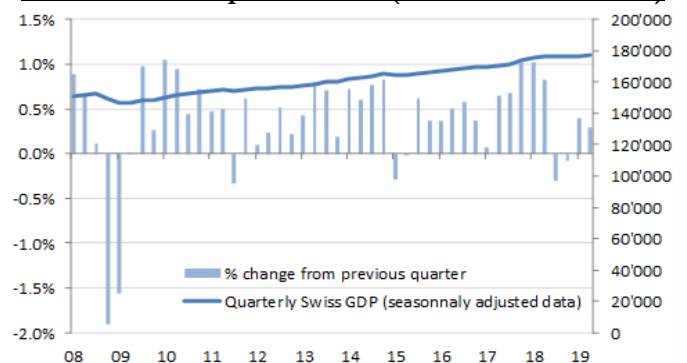
The +0.3% increase of real GDP in Q2 is not worrisome, however, and is in line with the more uncertain economic trends observed in other countries. Domestic demand in Switzerland has thus logically weakened alongside international demand.

Switzerland's nominal GDP in Q2 thus increased from CHF 173.8 billion to 174.5 billion. Year-on-year, Switzerland's GDP has thus reached approximately CHF 695 billion.

Switzerland's real GDP on a seasonally unadjusted annual basis grew by only +0.2% after increasing by +1.7% over twelve months in the previous quarter.

Switzerland's economy cannot go it alone in the uncertain context of Q2 and is thus unsurprisingly running out of steam.

### Swiss economic performance (GDP in CHF million)



Sources: SECO, BearBull

The economic forecasts of the Swiss government experts' committee had already been scaled down in the more uncertain context of the beginning of 2019.

However, the recent situation will undoubtedly involve another downward revision of their growth estimates below their previous forecast, which had already been lowered from +1.5% to +1.1% due to fears relating to a slowdown in international economic activity and its effects on Swiss exports. The global economic downturn is now also affecting our economy, which has had to reckon with a slightly stronger Swiss franc for the past few months again. Our country's economic vitality in Q1 is thus threatened by factors that are essentially external. Switzerland is starting to feel the effects of the uncertainty surrounding Brexit and the conflictual situation between China and the US, which has impacted global demand. The situation in Germany has also somewhat affected our industrial sector of course, and Germany's slowdown is likely to have an impact on our exports.

**In this context, we have revised our own GDP growth estimates for 2019 from +1.5% to +1.3%.**

### **Consumption is the main stability factor for GDP growth**

Among the long-term causes for satisfaction in our economy, let us mention the resilience of private consumption, which once again this quarter has been one of our economy's main drivers. The latter's +0.3% increase still stands slightly above average quarterly growth thanks to the specific contributions of the health, housing and energy sectors. Compared with the previous quarter, government consumption is well below the +0.5% rise observed in Q1 with a small +0.1% increase. Investments in equipment and construction have slowed down markedly, falling by -1% and -0.1% respectively after a very good period in Q1. Value added in the construction sector adds stability (+0.1%) after a very positive result of +1.9% in the previous quarter. The same goes for equipment expenditures, which have fallen by -1% after rising by +1.5% in March.

Global uncertainty is hindering investment. Surprisingly, Switzerland's manufacturing sector has not suffered as much as one might have feared from the decrease in global demand and the rise of the Swiss franc. Our country's industry has performed well, unlike other European countries, by contributing positively to GDP growth. The manufacturing sector has increased by +1.3% in a very uncertain and difficult context for companies, even though business leaders have noted that margins are unfortunately under pressure.

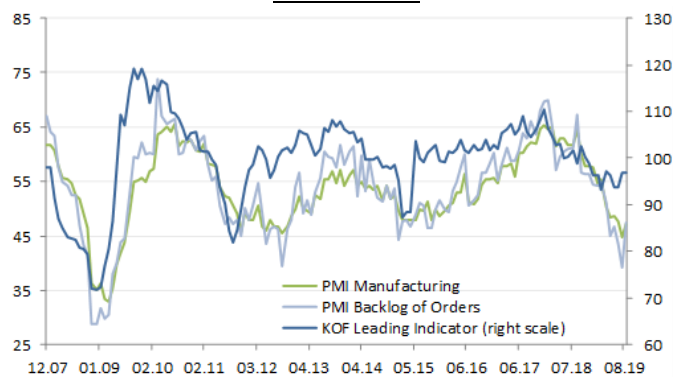
The pharmaceutical sector still supports this encouraging trend. Declining merchandise exports (-0.8%) adjusted faster than merchandise imports and services, which have fallen by -0.6%.

**The economy is thus following the trend set in the previous quarters with no genuine obstacles.**

### **Things finally looking up for leading indicators**

The manufacturing PMI index has continued the decline that began in 2018 to reach the level of 44.7 in July, i.e. the worst result in almost ten years. De facto, the rebound to 47.2 in August is good news and might herald a more positive change of trend for our industrial sector. The fall in the KOF leading indicators was marginally less worrisome until June (93.8), but the stabilisation and the slight recovery observed since (97) have once again renewed hopes of a global upturn in Q2. Let us mention however that the decline in leading indicators, which has lasted for more than twenty-one months now, was not followed by a marked weakening of Swiss GDP. For the moment, the economy has withstood leading indicators' negative forecasts. The excellent performance of retail sales, still on the rise by +0.4% in July, has continued and is close to reaching its best results in the last five years, while the unemployment rate remains at its lowest level (2.1%). Regarding exports, sales of Swiss watches clearly rebounded (+4.3%) in July after a -10.7% contraction in June.

**PMI – KOF**



Sources: Bloomberg, BearBull

Industrial production also recovered and posted a +3.6% increase in June.

**Although they have not turned truly positive, leading indicators have stabilised and shown some more positive signs for a recovery in H2.**

## Growth prospects scaled down for 2019

In light of the latest events, the uncertainty surrounding the China-US trade negotiations does not look like it will be resolved just yet. Weeks and months have passed without any noticeable progress. Although it appears obvious that both parties had better find some common ground, the objectives and political agenda of the two main protagonists are so different that it is increasingly difficult to assess the real chances of success of the negotiations, their content and the timing of a highly-anticipated agreement.

Our economy is not immune to the effects of the considerable uncertainty that is threatening investment, trade and growth because of the raging trade war. The fact that Germany is particularly affected by the uncertainty that has affected its automotive sector is not a reassuring factor for Switzerland either of course. However, the stabilisation of the leading indicators and the resilience of our economy as the Swiss franc has temporarily strengthened in the last few months are encouraging elements. They will likely strengthen domestic consumption momentum, which thankfully remained robust in Q2. Although the current context is not particularly favourable to the Swiss franc, which is not very likely to appreciate against the US dollar, the relative stability of exchange rates is unlikely to hamper Switzerland's foreign trade. Beyond exports, domestic demand is likely to remain positive, consumption is likely to strengthen somewhat in 2019, and growth is expected to be a little more dynamic.

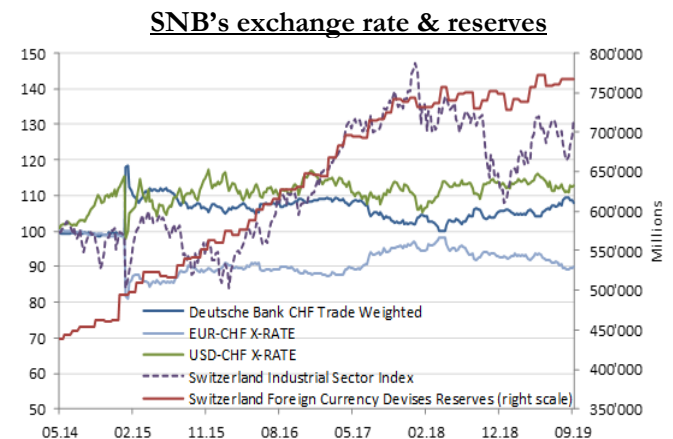
**We expect prospects for Q2 2019 to improve and drive the demand for Swiss products and services. In this context, we have reduced our GDP growth forecast to +1.3% for 2019.**

## Swiss franc relatively stable

Since the SNB's decision to introduce negative rates, the Swiss franc has remained relatively stable against the US dollar, despite the numerous economic and political upheavals that have happened in the last five years. The exchange rate has remained centred on a value close to parity, falling at times for a few weeks below 0.95 to the dollar or temporarily exceeding 1.03. Thus, interest rate and GDP growth differentials that strongly favour the dollar have not triggered any substantial appreciation of the US currency, which is likely to remain within the mentioned fluctuation range in the medium term. We believe that the next few months will likely be characterised by a new phase of widening yield spreads on long-term rates in particular, which will likely increase the attractiveness of the dollar and push the exchange rate above parity.

With regards to the euro, the problem is different, especially since the yield gap between rates in euros and in Swiss francs is not that significant and the trend of the last few months does not point to the same type of trend we expect for the US dollar. The yield gap that the SNB had hoped to create and maintain to weaken the Swiss franc is increasingly under attack by the necessary and anticipated decline of the ECB's rates.

The gap had stabilised at about 60 basis points in early 2018 during the rise in the exchange rate to 1.20, but it then steadily dropped to fall beneath 22 basis points in the last few weeks. Due to the euro area's sluggish economy and accommodative monetary policies, it is difficult to imagine a rise of the euro against the Swiss franc in the short term. For such an appreciation to happen, a serious and lasting European economic recovery will have to occur or at the very least be anticipated with enough credibility.



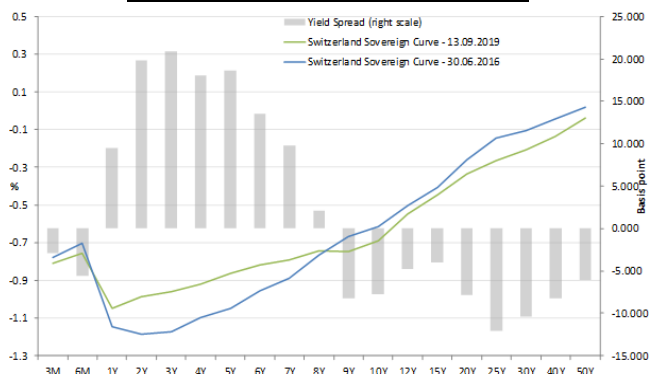
Sources: Bloomberg, BearBull

It remains our view that a future phase of weakness of the Swiss franc will also depend on the relative economic performance and the interest rate differential between the Swiss franc and the euro. We still believe that the SNB will not raise its key rates as fast as the ECB, which today seems very unlikely in the near future. The surprise may however come from a decision to further reduce the SNB's discount rate by 25 basis points, which we do not believe is necessary in the current context of relative stability of foreign reserves in the last twenty-four months (767.1 billion). The euro/Swiss franc exchange rate is looking to stabilise after losing about -5% in the last four months, which were marked by somewhat irrational expectations in our mind of a recession in the US and of a marked global economic slump. A return to 'reason' is likely to have quick, positive effects on exchange rates and to take a little pressure off the Swiss franc.

## Irrational situation with regard to long-term rates

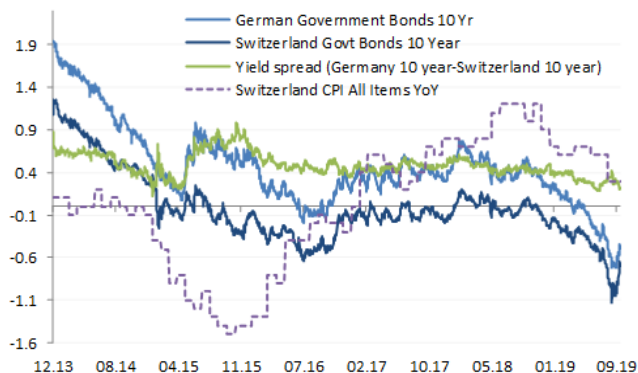
Interest rates markets are clearly not convinced that the global economy is not heading towards recession. The overall drop in yields, which accelerated in August, has also affected Swiss capital markets. The Confederation's ten-year rates have thus reached a new historical low at -1.12%, completely erasing the normalisation process of long-term rates that was initiated in the summer of 2016. This drop in yields is irrational and is likely to be followed by a very significant rebound as soon as risks of a recession are finally assessed rationally.

**Swiss Confederation's rate curve**



Sources: Bloomberg, BearBull

**EUR-CHF ten-year interest rates**

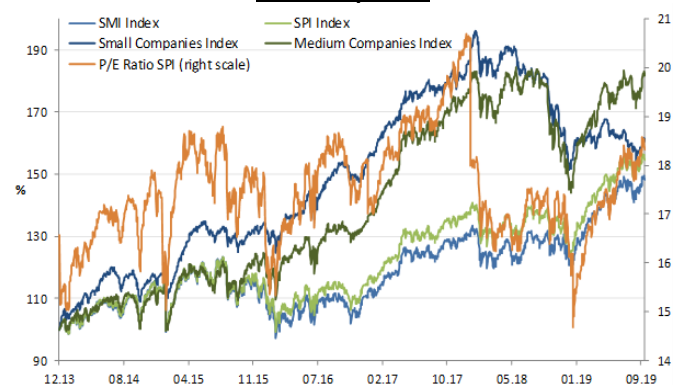


Sources: Bloomberg, BearBull

## Rate cut boosts equity markets

As expected, the marked adjustment of Swiss shares at the end of 2018 provided an investment opportunity for 2019. Nevertheless, after impressive rises in the first two quarters, the valuation of Swiss equities and especially blue chips has reached levels which we consider excessive already. Increasingly negative yields in Swiss franc interest rate markets have contributed in a substantial if not abrupt way to this enthusiasm for equities, pushing valuation ratios up excessively in the short term. We recommend a more defensive strategy given the current stabilisation of prices at high levels, which have been going on since June.

**Swiss equities**



Sources: Bloomberg, BearBull

## Beware high securitised real estate premiums

Securitised real estate remains a choice alternative to fixed-income investments in Swiss francs, but the recent momentum is nevertheless likely to run out of steam in the short term. Indeed, the increase in prices has triggered an expansion of premiums in both investment funds and real estate companies in excess of 30%. We believe such valuations are excessive and essentially linked to the irrational behaviour of interest rates. We recommend a temporary reduction of the Swiss securitised real estate allocation.

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