4 December 2020

Swiss GDP surprisingly proves most resilient among developed countries

Growth above expectations. Solid domestic demand. Positive outlook for 2021. The franc still seems overvalued. A digital Swiss franc? Consolidation of Swiss equities.

Key points

- Swiss GDP surged by +7.2% in Q3, almost making up for the -8.6% drop at the end of June
- Domestic demand is surprisingly strong
- Switzerland has better been able to withstand the Covid-19 shock
- Positive growth at the end of the year and favourable outlook for 2021
- SNB maintains a different course from that of the major central banks
- SNB assesses the desirability of a digital franc
- Will the special situation for Swiss yields soon come to an end?
- Further consolidation of Swiss equities

Swiss GDP surged by +7.2% in Q3, almost making up for the -8.6% drop at the end of June

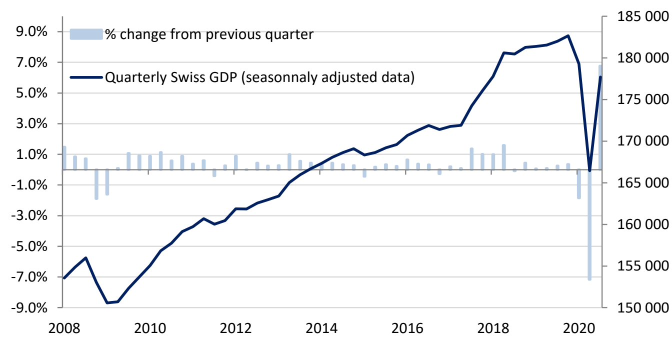
The State Secretariat for Economic Affairs (SECO) published Q3 2020 growth figures for our country, which show that GDP (seasonally adjusted) rebounded by an extremely satisfactory +7.2% after declining by -7% in the previous quarter and by -8.6% cumulatively over the first six months of the year.

The Swiss economy thus erased the contraction of the previous quarter and could well end the year on just the slightest annual decline. To date, the size of the Swiss economy as expressed by seasonally adjusted real GDP is only 2% below its year-end 2019 level.

Domestic demand (+11.9%) clearly bolstered this economic rebound. The Swiss economy was already showing strong resilience to the crisis by international comparison, but this quarter it also proved that it is capable of rebounding strongly when international conditions permit. After recording its sharpest quarterly decline since this statistic was first published in 1980, it achieved its best result ever this quarter.

By international comparison, Switzerland thus appears to have been much more resilient to the crisis and the generalised recession caused by the protective measures taken by governments and health authorities.

Performance of the Swiss economy (GDP in CHF million)



Sources: Bloomberg, BearBull Global Investments Group Limited

Domestic demand is surprisingly strong

During the quarter, most of the components of GDP posted positive contributions with the exception of the finance and insurance component, which fell very slightly by -0.1%. The measures to lift the lockdown and normalise activity logically benefited sensitive sectors such as accommodation and catering, as well as sectors linked to recreational activities, which rebounded by +72.9% and +61.9% respectively during the summer period.

However, these encouraging upswings are not enough to reassure because, compared to the same quarter in 2019, the drop in activity is still of -24.8% and -7.9%, respectively. Despite the easing of health measures, tourism in Switzerland has remained severely affected by the pandemic and travel difficulties.

Domestic demand thus progressed mainly thanks to the renewed dynamism of private consumption, which rose by 11.9% and was thus much stronger, to the point of erasing the -8.1% fall of the previous quarter and the -4.1% fall in the first three months of the year. Compared with the same period in 2019, it is still slightly lower by -1.1%. Investments in capital goods (+8.8%) and construction (+5.1%) were able to resume and led to a joint increase of +11.9% in imports of goods.

The sectors sensitive to international economic conditions are still struggling to recover from weak external demand, but the recovery in exports of goods (+6.9%) is encouraging and also helps support production and the manufacturing industry, up by +8.6%. Merchandise exports had declined by -7.9% in Q2, so the recent recovery is appreciable, since Swiss exports are up slightly by +1.8% yoy. The situation is more difficult for service exports, which rose slightly by +1.4% after a fall of -15.4% at the end of March. The sector thus remains significantly down (-19.3%) yoy.

Switzerland has better been able to withstand the Covid-19 shock

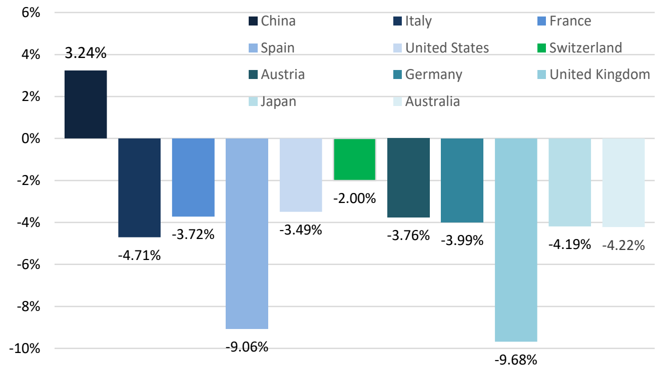
By international comparison, the 7.2% rebound in Q3 in Switzerland (-7.0% in Q2) seems more modest than in other countries such as Germany, whose +8.5% rebound follows a -10.1% decline in Q2.

However, over nine months, Swiss GDP is much closer to its year-end 2019 level than the vast majority of developed countries. China is an exception with GDP growth of +3.24% since the beginning of the year, but Switzerland has also achieved an excellent result, ranking first among industrialised countries.

With an impact for the moment limited to -2%,the Swiss economy is showing exceptional resilience and is almost twice as strong as that of the US (-3.49%), Germany (-3.99%), France (-3.72%), Italy (-4.71%), Spain (-9.06%), Japan (-4.19%) and the UK (-9.68%).

Growth prospects in Switzerland for the last quarter seem a little better, which could further increase the differentials observed at the end of September.

International comparison of Q3 GDPs



Sources: Bloomberg, BearBull Global Investments Group Limited

Positive growth at the end of the year and favourable outlook for 2021

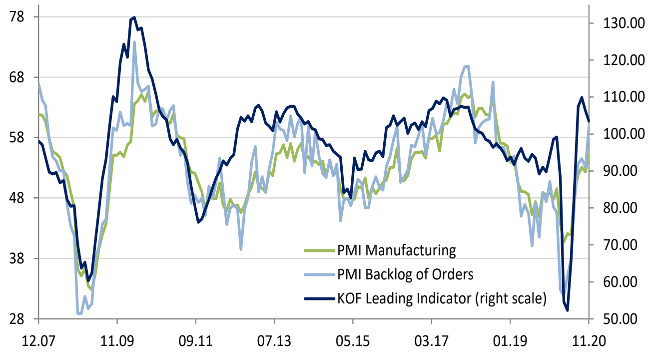
The GDP figures published for Q3 surprised observers favourably by clearly exceeding the consensus forecasts. A continuation of this positive trend in Q4 could even allow FY2020 GDP to balance out. Most leading indicators have strengthened and still suggest a favourable trend for our economy over the winter. GDP could approach +1.5% in Q4 and exceed +2.5% in 2021.

The manufacturing PMI index for November (55.2) strengthened quite significantly above the theoretical growth threshold (50), while the services PMI logically suffered the negative impact of the new health restriction measures and slipped from 50.4 to 48. The manufacturing sector now seems to be on a new and probably more solid trend, supported by the order book component, which is proving to be even stronger (59.7), thus boosting the outlook for a gradual and sustainable recovery in activity.

As for the KOF leading indicator, which had collapsed from 101.7 in February to 49.5 in May, it has since stabilised above 100, weakening slightly in November from 106.3 to 103.5 but remaining positive all the same.

Consumer confidence is relatively stable at -12.8, close to its pre-Covid level. It is supported by a still low unemployment rate (3.2%), a reassuring economic recovery and better health prospects due to the forthcoming availability of vaccines.

PMI – KOF

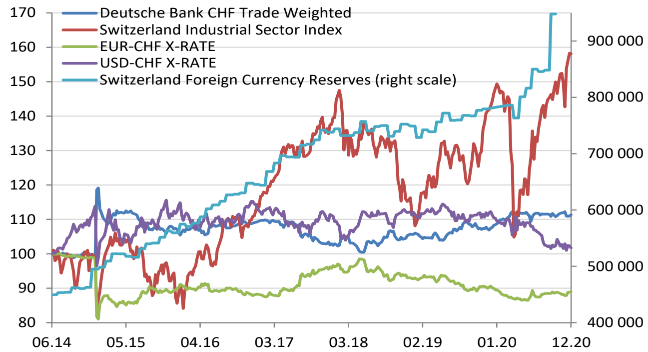


Sources: Bloomberg, BearBull Global Investments Group Limited

SNB maintains a different course from that of the major central banks

The SNB has not changed its monetary policy, unlike the other major central banks, which have been more active in supporting the economy of their respective countries by strengthening their government debt purchase programmes in particular.

Exchange rates and SNB reserves



Sources: Bloomberg, BearBull Global Investments Group Limited

Foreign exchange reserves have risen slightly by around CHF 20 billion and now exceed the threshold of CHF 870 billion, significantly more than annual GDP. Renewed investor interest in the Swiss franc in October drove the franc up by around +1.06%, which was quickly countered by a rise of +1.5% in November.

Key interest rates remained unchanged in Switzerland, and the SNB is staying the course by curbing any appreciation of the franc against the euro.

The end of the crisis is approaching and is likely to be conducive to continued depreciation of the franc, which started in mid-May already against the European currency when the exchange rate reached 1.05 francs to the euro.

The Swiss franc did rather well in the uncertain international economic environment during the pandemic, but we believe that a return to normality in 2021 is likely to have a different impact on the demand for Swiss francs.

An improvement in the situation in Europe, particularly in terms of taxation, is likely to allow the euro to appreciate against our currency in the longer term. Overall, investors' risk appetite will increase in 2021 and will be unfavourable to the Swiss franc, whose short-term yield is still the lowest in the world.

The SNB still considers the Swiss franc to be overvalued, and its tolerance for any appreciation of the franc remains low. It has mostly acted to counter such a rise against the euro, but it could also ultimately decide to act to limit its appreciation against the US dollar if such appreciation were to become more likely.

Switzerland's economy at the end of the health crisis clearly seems better positioned than that of many of its economic partners. Switzerland's recovery in 2021 could benefit greatly from that of Germany and Asia in particular.

However, we do not consider this to be a decisive factor in the near-term for the Swiss franc, which is expected to weaken in 2021 against most major currencies. In terms of purchasing power parity (PPP), the franc is probably still overvalued by 10% to 15% against the euro. A rise of the euro beyond 1.15 is therefore possible in 2021.

SNB assesses the desirability of a digital franc

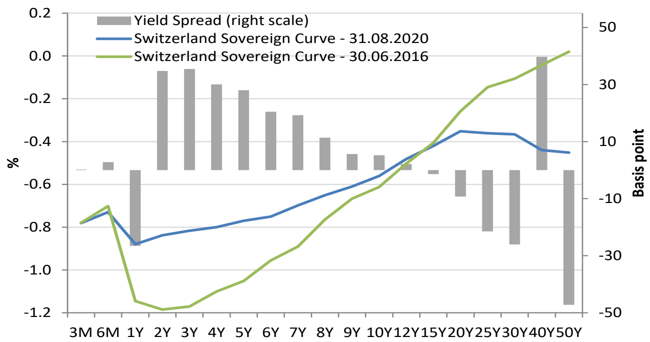
The Swiss National Bank recently announced that it had conducted an experiment to test the effects of introducing a digital Swiss franc into the Swiss financial system. This experiment, conducted in conjunction with the Bank for International Settlements and the financial infrastructure operator SIX, was to test the link with the interbank payment system.

A test of the introduction of digital money on a blockchain platform was also carried out to provide oversight. The SNB is not alone in testing the use of digital currencies around the world. At this stage of the experiment, the SNB noted that major obstacles in terms of policy and governance need to be investigated.

Will the special situation for Swiss yields soon come to an end?

Interest rates in Swiss francs did not remain insensitive to changes in international risk parameters. The correlation between the Swiss market and other developed capital markets remained positive, but while in the US and the euro zone in particular central banks were particularly active in steering the yield curve, in Switzerland the SNB remained comparatively inactive.

Swiss sovereign yield curve



Sources: Bloomberg, BearBull Global Investments Group Limited

While central bank action in the US and the euro area clearly maintained and reinforced the downward pressure on yields, the lack of SNB intervention in Switzerland left market forces free to find an equilibrium. De facto, the Confederation's 10-year yields remained rather stable at around -0.45%, with the exception of the short period of volatility observed in Q1.

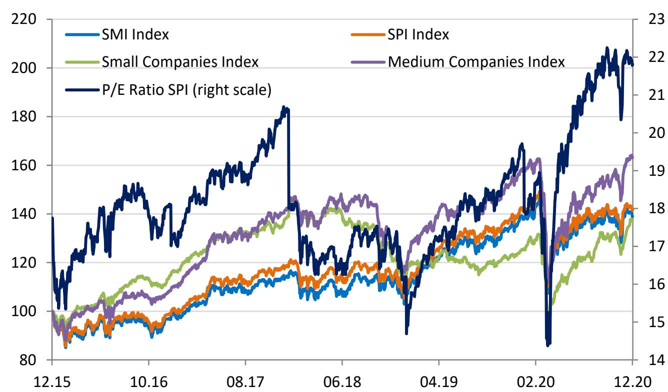
The risk premium between BBB and 10-year Swiss Confederation bonds has steadily declined from 2.46% to only 0.99% and is perhaps already close to its absolute low point. The growth prospects for Swiss GDP in 2021 would justify a significantly higher yield for Swiss franc bonds.

However, interest rates in Switzerland will probably only start to increase significantly once it becomes clear to investors that central banks' steering of artificially low long-term interest rates is nearing its end. The immediate risks of a rise in interest rates are relatively small in Switzerland, but so are the opportunities.

Further consolidation of Swiss equities

While at the end of March, the extreme pessimism of the investment climate seemed to us to offer an opportunity for repositioning at reasonable valuation levels, the current level of the Swiss stock market, on the contrary, obliges us to suggest renewed caution. The rebound in the Swiss market had been rapid, but for the past six months the levels of the SMI and SPI indices have been similar to those prevailing in January. Earnings expectations for 2021 are around +10%, bringing 2021 PE valuation levels to 20x. These SPI valuation levels are historically rather generous, but in a context of abundant global liquidity it is not inconceivable that current trends will continue. However, we believe that some temporary weakness is more likely before a resumption of the upward trend in 2021.

Swiss equities



Sources: Bloomberg, BearBull Global Investments Group Limited

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