BearBull
Global Investments Group

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Swiss GDP growth could reach +3.2% in 2021

Switzerland is emerging from the crisis in a position of strength. GDP is already benefiting from Asia's recovery. Swiss franc depreciation is gaining momentum. SNB to post extraordinary profits in 2021. The bond market is gone. Caution on equities.

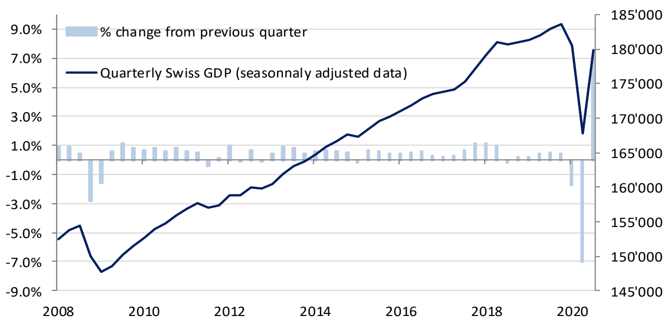
Key points

- Swiss GDP growth of +0.3% in Q4 2020 is higher than expected
- Domestic demand logically collapsed with the return of health restrictions
- Switzerland went through the Covid-19 crisis without any major impact on its GDP in 2020
- Hesitant start to the year but still very favourable outlook for the whole of 2021
- SNB earned 23 billion in 2020, stays the course
- Swiss franc weakens as global economy recovers
- The horizon is getting a little darker for Swiss franc bond markets
- Swiss equities still waffling

Swiss GDP growth of +0.3% in Q4 2020 is higher than expected

The State Secretariat for Economic Affairs (SECO) has published the Q4 2020 growth figures for our country, which show that the economy continued to recover through the end of the year. Although the Q4 growth rate (+0.3%) was much lower than that of the previous quarter (+7.2%), which fully benefited from the end of the health measures, it still proved higher than forecasters' expectations. The latter were in factexpecting GDP to stagnate at the end of the year due to the reinstatement of health restrictions during the quarter. Swiss GDP thus ultimately contractedby -1.6% over the whole of 2020, a satisfactory result overall given the particularly difficult context of the global pandemic during this period. Adjusted for inflation, however, the trend in GDP growth was more negative, declining by -2.9% over the year as a whole. At the end of the year, the Swiss economy surprised most forecasters with its unexpected strength even as the reintroduction of health restrictions was expected to weigh on economic momentum. The negative effects of the slowdown in consumption caused by the pandemic control measures were essentially offset by stronger external demand and higher public spending. The second wave of Covid-19 was thus clearly less damaging to the economy than the first in the spring.

Performance of the Swiss economy (GDP) in mil. (CH)



Sources: Bloomberg, BearBull

Domestic demand logically collapsed with the return of health restrictions

The new government measures taken to combat the second wave of Covid-19 clearly caused a shock in Q4. The sectors already heavily impacted by the first wave in the spring were again affected and logically saw their sales figures contract significantly. The service sector suffered particularly from restrictive measures imposed by the authorities, as did the hotel and restaurant sector, whose activity fell by -20.8%.

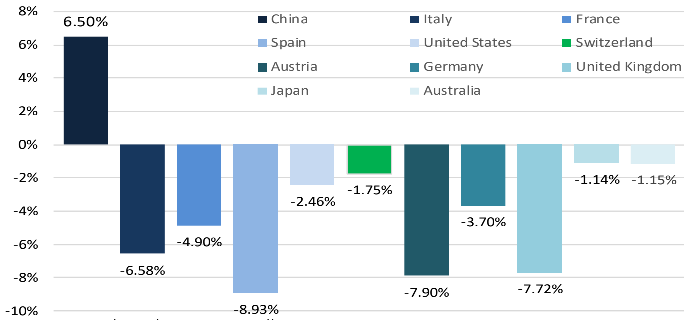
After the short summer upturn, tourism, leisure and entertainment also suffered significant declines. On the private consumption side, spending also contracted by -1.5%, so it is surprising to note an increase in trade (+1.5%) and business services (+0.5%). Overall, thanks to the good performance of financial services (+0.7%), the services sector withstood the situation relatively well. Construction investment remained relatively unchanged (+0.1%), but capital goods spending showed a pleasing increase of +1.9%.

This suggests companies now have better visibility and have decided to start investing again. The +2.3% growth in public spending associated with the authorities' efforts to offset the disastrous economic effects of the pandemic was expected and is logically predicted to continue. Sectors that are sensitive to international economic conditions have rather benefited from the positive momentum of Asian economies. International supply chains were obviously not affected in the same way as in Q1 when China's economy was at a standstill. The Swiss manufacturing industry was therefore able to take advantage of Asian growth and external demand, recording growth of +1.4%, which benefited the machinery, precision instruments and watchmaking sectors. Exports of goods were temporarily affected by the decline in transit trade, while exports of services registered a small increase of +0.4%.

Switzerland went through the Covid-19 crisis without any major impact on its GDP in 2020

The overall impact of Covid-19 on our economy is now known, with GDP recording a -1.6% decrease in 2020. Switzerland's economy, although very sensitive to international economic conditions, has in fact proved to be particularly resilient during these uncertain and troubled times. As a result, Switzerland's economy is experiencing the smallest economic contraction in Europe. The country has thus weathered the health crisis better than its main economic partners such as the United States (-2.46%), Germany (-3.7%), France (-4.9%), Italy (-6.58%), the United Kingdom (-7.72%) or Spain (-8.93%). The management of the health crisis in our country therefore seems to have been rather effective, at least from an economic point of view, in view of this result, which is similar to Japan's (-1.14%) or Australia's (-1.15%), two countries that were altogether less affected than others by the Covid-19 pandemic.

International comparison of Q4 GDP



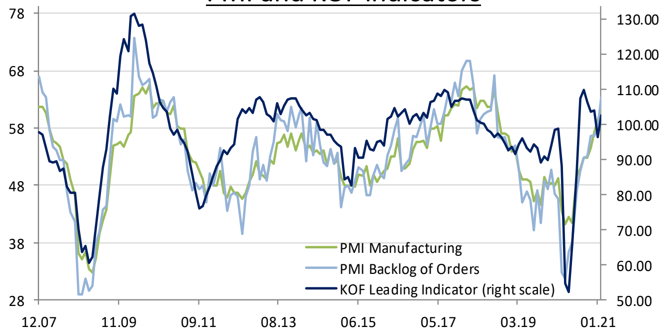
Sources: Bloomberg, BearBull

Hesitant start to the year but still very favourable outlook for the whole of 2021

Q1 2021 is likely to continue to be influenced by the restrictive health measures that were tightened in January and are still in effect today. The same trends are therefore likely to continue, with consumption still anaemic, as retail sales recorded a year-on-year fall of -0.5% in January. This weakness in consumption could be offset by rising public spending. The economic slowdown in Europe is expected to weigh on external demand, which however could still be supported by the strengthening economic momentum in Asia. Exports rose by +5.7% over one month in January, but the figures for the watch industry are still down by -11% over a year despite the +58.2% increase in exports to China. On the leading indicators side, sentiment measures seem more generally optimistic.

February's manufacturing PMI index improved again for the 7th consecutive month and now stands at 61.3, its highest level since August 2018. The manufacturing sector clearly seems to be following a new, more solid trend, which makes it possible to envisage a gradual and sustainable recovery in activity. Asia's recovery is benefiting Swiss exporters and is already causing increased pressure on transport costs and raw material prices.

PMI and KOF indicators



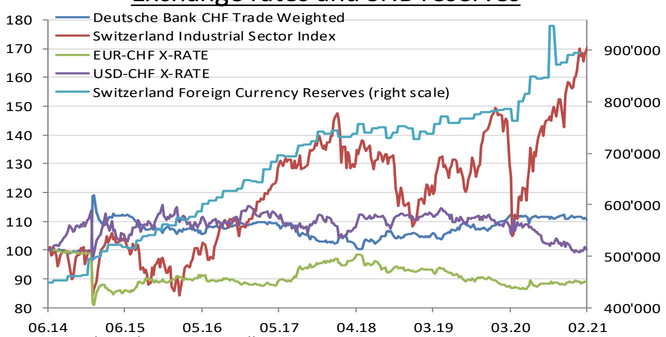
Sources: Bloomberg, BearBull

Purchase prices are therefore on the rise. As far as services are concerned, the trend has been more stable in recent months and is still influenced to a greater extent by less dynamic domestic factors. The KOF leading indicator, which had slipped in Q4, strengthened again in February (102.7) and returned above 100, reaching its highest level since February 2018. Consumer confidence remains sluggish despite this increasingly positive context and has been stagnating at -14.6 for several months. Investor confidence continues its meteoric rise from its March lows (-45) and now exceeds its previous peak in December 2017, recording its highest level ever (55.5). Swiss GDP is thus likely to grow by +3.2% in 2021, benefiting from domestic and international recovery.

SNB earned 23 billion in 2020 and stays the course

The Swiss central bank confirmed that it had recorded a profit of USD 23 billion in 2020 due to developments in currencies and gold prices. This result, which is significant in absolute terms, will undoubtedly attract a great deal of attention, and the SNB will distribute part of it, i.e. around CHF 6 billion, to the Swiss Confederation and the Swiss cantons, in accordance with applicable rules. However, in view of the size of the SNB's balance sheet, these profits are not exceptional. The SNB's gains resulting from its strategy to combat the strength of the Swiss franc will not affect its monetary policy in 2021, which will remain unchanged. Contrary to the other main central banks, which have been active in supporting the economies of their respective countries in recent years by reinforcing their government debt purchase programmes, particularly during the pandemic, the Swiss central bank has limited its action to an exchange rate stabilisation objective, which remains in force for 2021. Foreign exchange reserves have increased slightly over the last few weeks and now stand at nearly USD 1 trillion (CHF 896 billion).

Exchange rates and SNB reserves



Sources: Bloomberg, BearBull

On the key interest rate front, the SNB is pursuing its strategy of keeping negative rates unchanged in order to ensure a sufficient yield differential with euro-denominated rates to allow the Swiss franc to weaken. These rates are expected to remain unchanged in 2021 and to contribute to the weakness of the Swiss franc, which seems likely to depreciate once again in the current global economic recovery.

Global economic recovery will support Swiss franc depreciation

The Swiss franc took advantage of the anxious stock market climate of 2020 at the start of the pandemic by first appreciating against most currencies. A few months later, as early as June, the prospects of a global economic recovery had already begun to reduce the franc's attractiveness as a safe haven. In recent weeks, the weakness of the franc seems to have intensified with the growing hopes for a global economic recovery. The month of February was marked in particular by a generalised and expected depreciation of the franc against the euro and other currencies such as the US, Canadian and Australian dollars and the pound sterling.

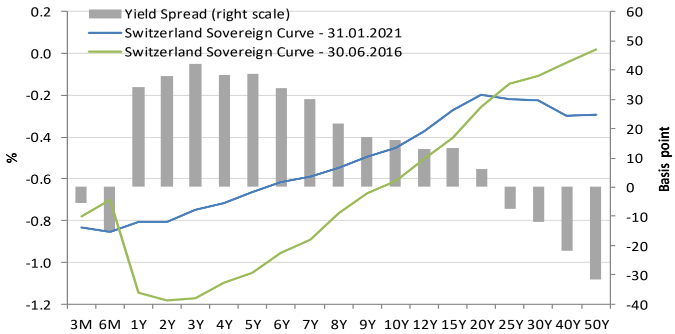
The rise in long-term rates in the US to 1.5% probably marks a change in investors' perceptions, who now clearly see yield spreads widening in favour of other currencies. Expectations of a resumption of inflation are supporting long-term yield increases and flows of funds away from the franc, contrary to what happened in the spring of 2020. Swiss investors are expected to continue to invest in foreign currencies, thereby enabling the SNB to reduce its interventions on the foreign exchange markets.

The SNB has been patient and consistent in its actions and is likely to be even more amply rewarded in 2021 for its policy of stabilising the franc. We still believe that a return to global growth in 2021 is likely to have a negative impact on the demand for Swiss francs. Overall, investors' appetite for risk 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 an appreciation of the franc remains low. Our currency is expected to weaken in 2021 against most major currencies. In terms of purchasing power parity (PPP), the franc is still overvalued by 10% to 15% against the euro. A rise of the euro beyond 1.15 is therefore possible in 2021.

The horizon is getting a little darker for Swiss franc bond markets

International bond markets remained highly correlated at the beginning of the year and followed the same trend as in the US. While 10-year US Treasury yields jumped from 1% to 1.5% in a few weeks, Swiss franc interest rates did not remain insensitive to changes in inflation expectations and underwent similar adjustments. Despite a totally different context in our country, characterised by inflation of barely 0.2% in February and -0.5% over one year, the Confederation's yields nevertheless rose by 40 basis points between January and February, pushing them to their highest levels in the last 24 months. As a result, the Swiss government yield curve has tightened significantly in a generalised move to adjust rates in line with new expectations of accelerating economic growth. Let us note that the SNB estimates real GDP growth in 2021 at +3.2% with inflation of only 0.1%.

Confederation yield curve



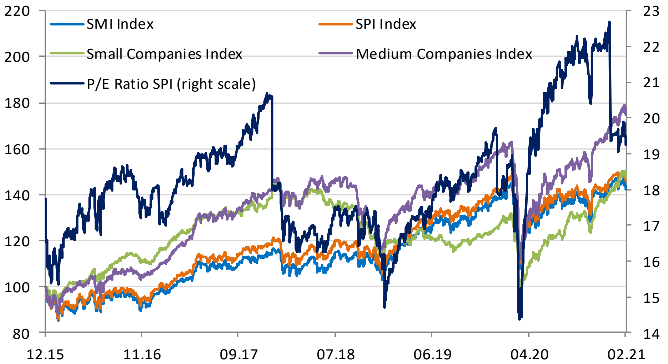
Sources: Bloomberg, BearBull

The expected change in interest rate trends has thus materialised in the investment grade market, but the risk premium between BBB bonds and ten-year Swiss government bonds during the same period still decreased. These are now at an all-time low of 0.45%, which suggests a clear loss of attractiveness for the increasingly risky yield pick-up strategies. We recommend a sharp reduction in durations and areallocation of credit risk to investment grade securities.

Swiss equities still waffling

The Swiss equity market ended February on a very limited consolidation of -1.45% after two marginal declines. However, it is moving against the trend in other markets, which are showing moderate increases. The nature of the companies listed in our country and the defensive nature of the Swiss market do not lend themselves to the same forms of speculation as those observed in the US in particular. Technology stocks are rare in the Swiss market, which therefore attracts little speculation. As a result, the euphoria on the stock market seems to be much less pronounced in our market in Q1 2021. However, hesitation seems to increase every time 12-month PE valuation levels soar, both for SMI stocks when they reach 19x expected earnings for 2021, and for SPI stocks (20x). The recent slide as stocks approached these valuations brought SMI levels back to 10,500 points, which they had already reached in July 2020 when the health measures were lifted. The main SMI blue chips still seem to offer attractive growth prospects, and the stability of their business model could also benefit them in a context that is once again more uncertain for risky assets due to the upward trend in interest rates. In the short term, we still consider the risks of price consolidation to be high and suggest a reasonable exposure to Swiss equities before we can expect the upward trend in equity markets to resume at a later date.

Swiss equity indices



Sources: Bloomberg, BearBull

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