SWISS GDP GROWTH IS ON TRACK TO REACH +3.5% IN 2021 AND +3% IN 2022

The Swiss economy is in top form. Growth figures leading to trend reversal in bond markets. The SNB is still not afraid of inflation. Significant correction underway in equity markets.

Key Points

- Swiss GDP grows +1.8% in Q2 2021 and +7.7% year-on-year
- Strong comeback of domestic demand
- Leading indicators support a solid growth outlook
- Manufacturing sector is doing well and diversifying its supply chain
- Inflationary risks rising in Switzerland too
- The SNB is not worried about inflation and is staying the course towards a weakening of the Swiss franc
- The bond bubble is close to bursting
- Biggest decline in Swiss equities since October 2020

Swiss GDP grows +1.8% in Q2 2021 and +7.7% year-on-year

The State Secretariat for Economic Affairs (SECO) has published the Q2 2021 growth figures for our country (+1.8%), which show a very convincing economic comeback after a difficult first quarter (-0.4%) due to the reimposition of health measures in our country as well.

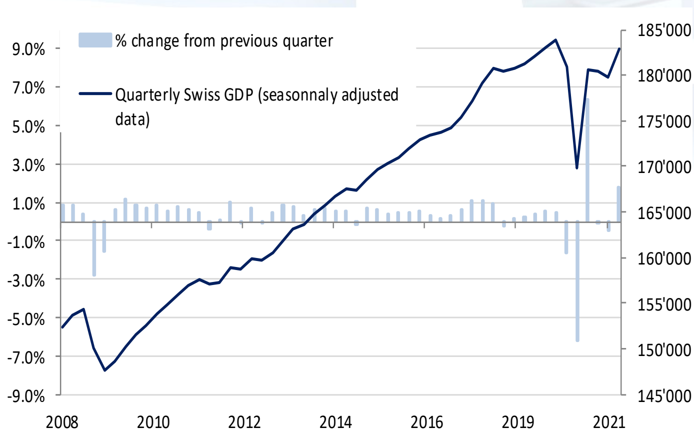
Overall, at CHF 186 billion, Q2 2021 seasonally adjusted nominal GDP is already slightly higher than the Q4 2019 pre-crisis GDP of CHF 185 billion. In a year-on-year comparison, the rebound in Swiss GDP looks quite extraordinary. The year-on-year growth rate of +7.7% is historic, although it results entirely from the base effect, as Q2 2020 marked the pandemic-induced low point in the economic cycle.

The Swiss economy has thus returned to a quarterly GDP level higher than that of Q4 2019, before the health crisis. Our economy has thus recovered rather well from the second stoppage linked to the resurgence of Covid-19 variants after a logical dip at the beginning of the year.

The Swiss economy seems well positioned to grow by a further +1.6% in the current period before slowing slightly to +0.8% in the last quarter of 2021. Overall GDP growth for the year as a whole is thus expected to be +3.5%, followed by +3% in 2022 and +1.6% in 2023.

This series of annual GDP growth rates is high by historical comparison for our country, which has only experienced two periods of strong growth in the last thirty years (1997-1999 and 2005-2007).

Performance of the Swiss economy (GDP) in million CHF



Sources: Bearbull Global Investments Group

Strong comeback of domestic demand

It is not surprising that the easing of measures imposed in Q2 allowed our economy to recover during the spring with a strong uptick in growth in the services sector. The easing and lifting of health restrictions has indeed supported the recovery of consumption and service activity in our country. The most affected sectors, such as the restaurant and hotel industries, were able to benefit from renewed activity and saw their turnover jump by almost 50%, as did leisure and entertainment consumption. It should be noted, however, that this upturn is still insufficient, with added value still less than half that which prevailed before the health crisis. Renewed consumer mobility has also led to growth in the communication and transport sectors (+1.9%), but most significantly it has supported a revival in overall consumption and retail sales. Trade grew by 4.8% and private consumption by 4.1%.

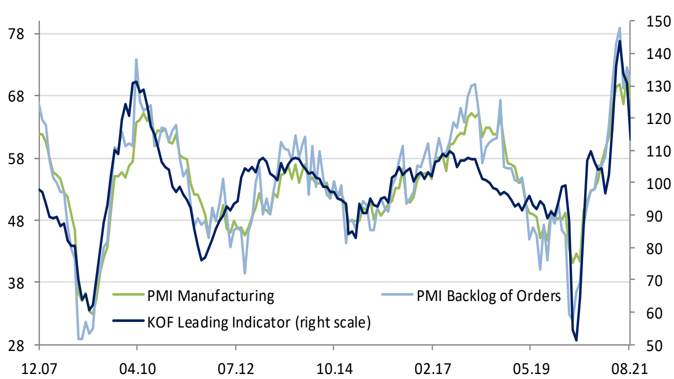
Services exports also benefited from the easing of health measures abroad and contributed positively to the overall increase in GDP with a rise of +3.2%.

Investment in construction remained relatively stable this quarter (+0.1%) in a negative context for the construction sector (-0.3%). Spending on capital goods remains volatile and is up by +1.6% after declining in the previous quarter. Growth in public spending was very solid (+5.5%) and logical in the context of the extraordinary support provided to offset the disastrous economic effects of the pandemic. The Swiss manufacturing industry maintained its momentum of the last few months and managed to grow by +0.9%. Industrial production is now +4.7% above its pre-pandemic level. Exports of goods, however, did not show any significant increase (+0.3%).

Leading indicators support a solid growth outlook

With regards to leading indicators, sentiment measures still seem generally optimistic at the end of the summer. The August manufacturing PMI (67.7) is, however, slightly down from the peak reached in July (71.1).

PMI and KOF indicators



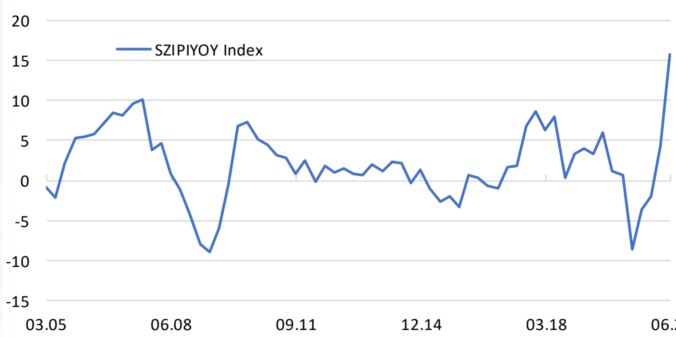
Sources: Bearbull Global Investments Group

The KOF leading indicator remains at its highest levels in the last ten years and still points to very strong economic conditions for Swiss industry. However, it dropped from 130.9 in July to 113.5 in August, which is also a logical reflection of the perception of a temporary downturn in the international economy. Nevertheless, the historically high level of this indicator also suggests that value added in Switzerland is continuing to grow at a sustained pace.

Manufacturing sector is doing well and diversifying its supply chain

Swiss industrial production rebounded in H2, increasing by +15.7% year-on-year, benefiting from a considerable base effect due to a low Q2 in 2020.

Industrial production



Sources: Bearbull Global Investments Group

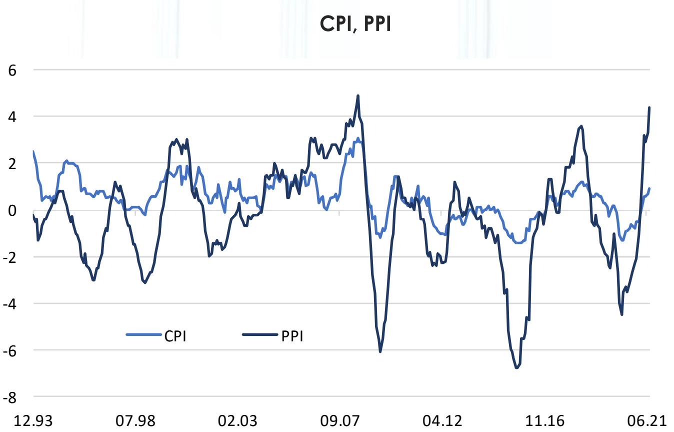
In recent months, Swiss companies have made significant changes to the structure of their production chains. Since the pandemic, the trend has been towards diversification of supply sources. Swiss manufacturers are now seeking greater proximity to Swiss and European producers. According to a recent survey, 50% of the companies questioned emphasised that they had changed their supply channels.

The recovery in the US, Europe and Asia is benefiting Swiss exporters and is already putting pressure on transport costs and raw material prices.

Swiss watch exports reached CHF 1.519 billion in August according to the Swiss watch industry federation. They are back to August 2019 levels. China is leading demand with a +55% increase in imports to over CHF 226 million , ahead of the US (212 million) and Hong Kong (122 million). Despite this positive factor, Swiss exports declined slightly overall (-0.4%), and imports advanced by +0.2%.

Inflationary risks rising in Switzerland too

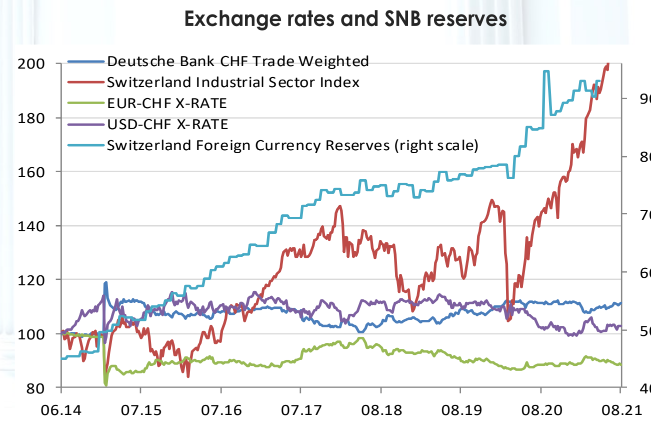
Pressure on the prices of imported products is also beginning to materialise in Switzerland, although at a lower rate than in the US. The +0.7% rise in producer and import prices now stands at +4.4% overall over one year, i.e. +7.6% for import prices and +2.9% for production. Inflation is already clearly visible in our country upstream in the production and distribution chain. On the consumer price side, EU harmonised price indices are not yet much affected, showing only more moderate increases of +0.2% in August and +0.8% over a year, while the CPI measures excluding food and energy are slightly lower (+0.2% and +0.4%). Over a year, the exchange rate has not been a determining factor in these developments, since the USD/CHF exchange rate remained volatile but relatively unchanged at the end of the period. A weakening of the Swiss franc could, however, further support the rise in import prices. On the domestic front, the rapid correction in 2021 of the unemployment rate to 2.7% in August, after having jumped from 2.55% in February 2020 to 3.6% in January 2021, could soon continue and cause wage tensions in our country as well. The adjustments made by Swiss companies to reduce their dependence on Asia in particular will have lasting repercussions on production prices and company margins unless they manage to pass on these increases to their consumers.



Sources: Bearbull Global Investments Group

The SNB is not worried about inflation and is staying the course

The Swiss National Bank does not see any reason to fear inflationary pressures for the time being and is not particularly concerned about the current rise in import prices. Like the Federal Reserve, it likely believes that the current trend will not last. For the time being, it considers that the Swiss economic recovery is consolidating and that it is taking hold without any real effects on price levels. In its latest comments, it therefore reiterated that it will be maintaining its accommodative monetary policy unchanged by keeping its key rate at -0.75% and continuing its strategy of intervention on the foreign exchange market to stabilise the franc against the euro. The SNB's inflation outlook remains below 1% for 2021, 2022 and 2023. Chairman Jordan nevertheless expressed a clear opinion on the high valuation of the franc, pointing out that, if the franc had not been overvalued, inflation in our country would have been higher. Therefore, should we not expect a weakening of the franc as desired by the SNB, which would then have inflationary effects proportional to its degree of weakening? Against the dollar, the franc has appreciated by about 6% since February 2020, while it has depreciated by barely -1% against the euro. Total sight deposits in Switzerland have remained stable at around CHF 710 billion over the past year. However, the SNB's currency reserves have increased further and now stand at CHF 930 billion. The SNB still seems to have to intervene in the foreign exchange market to reinforce the trend, a sign that interest in the Swiss franc and Swiss franc assets is waning. Unlike the other major central banks, which have been active in supporting their respective countries' economies in recent years by stepping up their government debt purchase programmes, particularly during the pandemic, the Swiss central bank has limited its action to an exchange rate stabilisation target that remains valid for 2021.



Sources: Bearbull Global Investments Group

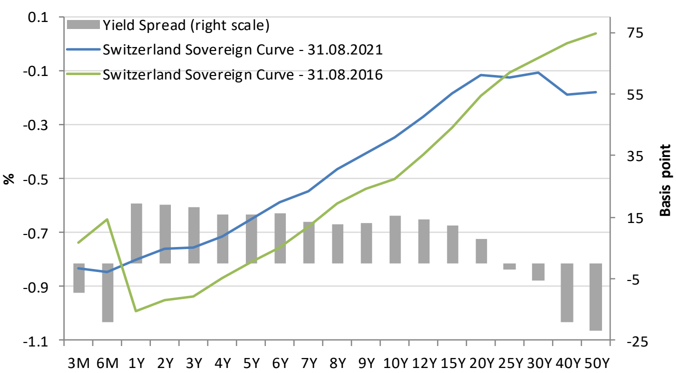
Towards a weakening of the Swiss franc

The Swiss franc had rather benefited from the anxiety-inducing stock market climate of 2020 at the start of the pandemic by initially appreciating against most currencies. The prospects for a global economic recovery are expected to reduce the franc's appeal as a safe haven. Since mid-August, the weakness of the franc seems to be solidifying. The SNB still considers the franc to be overvalued, and the Bank's tolerance for an appreciation of the franc remains low. Our currency is expected to weaken in 2021 and 2022 against most major currencies. In purchasing power parity (PPP) terms, the franc is still overvalued by 10-15% against the euro. A rise in the euro above 1.15 is therefore possible in 2021.

The bond bubble is close to bursting

International bond markets were affected during the summer by the appearance of new Covid-19 variants, raising fears regarding the global economic situation. Uncertainty permeated bond markets, which became convinced that the central banks would continue their asset purchase operations and keep long-term rates low. The emergence of inflation and its persistence in monthly statistics through August did not alter the optimism of investors convinced that central banks would control the entire yield curve. Ten-year government yields thus declined again by around 50 basis points in the US and 30 basis points in Switzerland. However, despite the precautions taken by the Federal Reserve when it communicated its monetary policy on 22 September, it is becoming clear that the quality of the recovery no longer justifies the monetary injections made. The risk of an upward shift in yield curves is therefore becoming clearer. In a totally different context in our country, Swiss government yields have already risen by nearly 30 basis points since the beginning of August to -0.15% and are again close to their highest level in the recent period (25 points in the US at 1.45%).

Swiss government rate curve



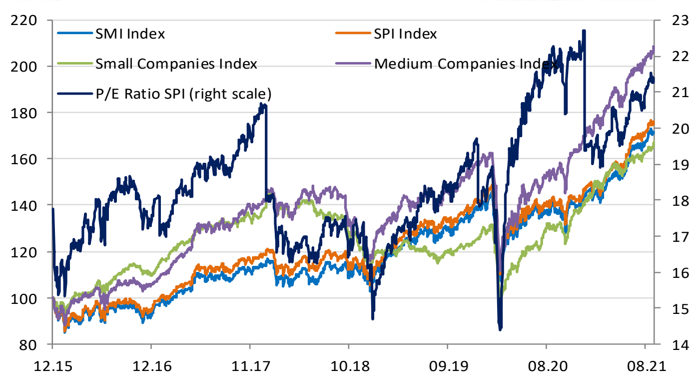
Sources: Bearbull Global Investments Group

The expected trend reversal regarding interest rates thus materialised in the investment grade market, which now has a slightly positive overall yield. However, there is still too small a risk premium between BBB bonds and ten-year government bonds. Yield pick-up strategies are riskier than ever. We recommend a sharp reduction in durations and a reallocation of credit risk to investment grade debt.

Biggest decline in Swiss equities since October 20

The Swiss equity market has seen some profit taking since the end of August, as interest rates in Switzerland have risen significantly. A continuation of this trend could well erase, in September, the gains made since the end of July. It is thus moving against the tide of other markets for the time being. The SNB's lack of asset purchase programme is no longer reassuring investors, who are worried about yields adjusting to the new economic outlook. The rise in interest rates and consequently in the discount factor for corporate profits is therefore already having a visible impact on investor confidence in Switzerland. Stock market euphoria thus seems to be much less prevalent in our market, and hesitation thus seems more rational. It occurs every time 12-month PE valuation levels soar. After a consolidation of -5% over a few weeks, the SMI's average PE is still 19x 2021 and 18x 2022. In the short term, we still believe that the risks of price weakness and consolidation are high. We suggest a reasonable exposure to Swiss equities before we can count on a further continuation of the upward trend in equity markets.

Swiss equity indices



Sources: Bearbull Global Investments Group

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