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ECONOMIC RESEARCH – February 2025

INVESTMENT INSIGHT SWITZERLAND

- ✓ Swiss exports slide at the start of year
- ✓ Leading indicators for services still very positive
- ✓ Inflation falls further in January to +0.4% year-on-year
- ✓ SNB to cut rates by a further 0.25% in March

ATTRACTIVE OUTLOOK FOR SWISS SMALL CAPS

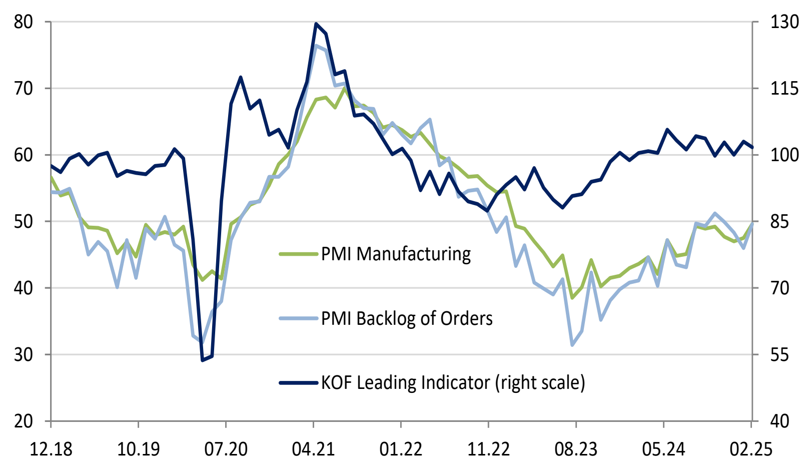
A mixed start to the year

Swiss exports experienced a decline in January, falling by -3.9% in real terms, despite a sharp rise in December. This slide highlights the ongoing struggle against weak global demand and the uncertainties associated with potential new trade tariffs from the US, which could indirectly impact Swiss trade. While the depreciation of the franc against the dollar failed to offset these external pressures, a positive note came from the Swiss watchmaking industry, which saw exports rise by +4.1%. A -1.9% drop in imports suggests a narrowing of the trade surplus, indicating that foreign trade will likely not be a significant contributor to GDP growth at the start of the year.

Services vs. manufacturing

Leading economic indicators paint a clear picture of a two-speed economy. The manufacturing sector continues to struggle, with the Purchasing Managers' Index (PMI) remaining below 50, at 47.5, indicating contraction. Conversely, the services sector shows remarkable resilience, with its PMI soaring to 57.2 in January—the highest level since June 2022. This robust performance in services, supported by a gradual improvement in consumer confidence since the SNB's interest rate cut, is a key driver of domestic economic growth. However, the KOF indicator's "flirting" with the 100 mark for six months suggests that this momentum remains fragile.

PMI– KOF Indicators



Sources : Bloomberg, BBGI Group

A deflationary trajectory

Swiss inflation is on a clear and steady downward path, reaching just +0.4% year-on-year in January, with a monthly decline of -0.1%. This places it at the very bottom of the SNB's target range and below the current key rate of 0.5%. This trend confirms previous forecasts of a steady deceleration since the CPI peaked in June 2022. Core inflation, while slightly more resilient at +0.9%, follows a similar trajectory. Furthermore, imported and producer prices are in outright deflation, a positive sign for corporate margins and an indication that the franc's weakness against the dollar has not yet translated into price increases.

SNB's prudent approach

The Swiss National Bank (SNB) has successfully kept inflation under control without severely impacting the economy. The latest inflation data provides a strong validation of its accommodative policy. The SNB's prior interest rate cut is already contributing to improved consumer confidence and is expected to continue supporting domestic consumption. The central bank is now faced with heightened international uncertainty, particularly concerning US trade policy, which could trigger a flight to safety and a renewed demand for the Swiss franc. The SNB will need to act to counter this potential appreciation.

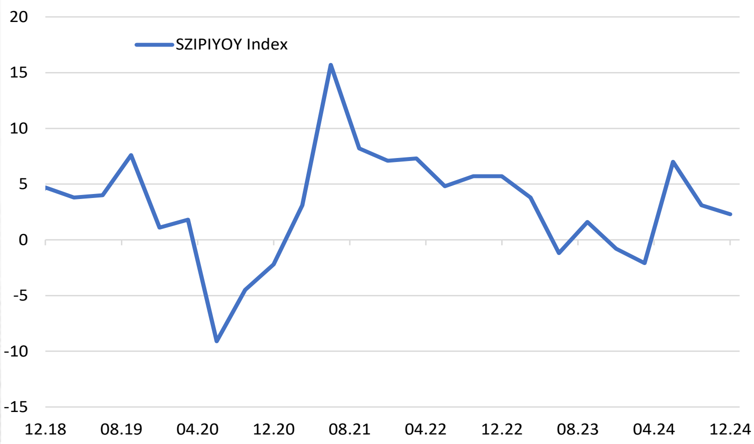
Anticipating a March rate cut

Given the sustained decline in inflation, the SNB has a clear mandate and ample room to implement another rate cut. The ongoing risks of a slowdown, exacerbated by external factors, and the need to boost domestic confidence and influence the franc's value against other currencies, make a further reduction a strong possibility. We anticipate that the SNB will lower its key rate by another 0.25% in March, bringing it to 0.25%. This move would also address other factors poised to lower prices further, such as expected drops in electricity prices and a reduction in the reference rate for rents.

A return to negative rates?

The current volatile international environment could lead to a significant reallocation of assets towards less risky investments, driving demand for the Swiss franc. To counteract this, the SNB might be forced to consider more drastic measures. In an environment of growing uncertainty and a continued deflationary trend, it is not out of the question to imagine that key interest rates could once again turn negative. The SNB's goal is to maintain price stability and support the economy, and its next actions will be crucial in navigating the complex interplay of domestic resilience and external headwinds.

Industrial production



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