The Swiss economy decelerates

Swiss growth has been slowing down and we believe the economy will continue to decelerate in the coming months, suggesting another rate cut could be on the menu again

Source: Shutterstock

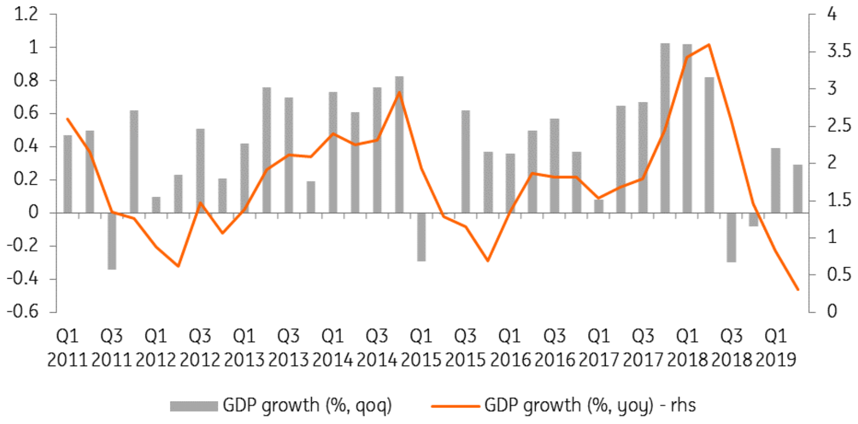
Lower growth

Swiss GDP increased by only 0.3% quarter on quarter in 2Q19, down from 0.4% in the first quarter, which was revised down further from 0.6%. On an annual basis and adjusted for the effects of sporting events, growth was 0.9%, down from previous quarters.

Domestic demand and foreign demand for services were weak in the second quarter. Trade tensions and the downturn in Germany, Switzerland's main trading partner, are clearly weighing on the outlook. Investment in capital goods fell by 1% qoq - a sign of dark clouds in the Swiss economic climate.

Surprisingly, unlike its European neighbours, the Swiss manufacturing sector is doing rather well. The value-added of the manufacturing industry increased by 1.3% in Q2. But, as usual, the devil is in the detail. This good performance is only due to the chemical and pharmaceutical industries, while other industries, such as machinery and metals, have been suffering significantly from weak global trade and problems in the automotive industry. In total, Swiss merchandise exports fell by 0.8% in 2Q.

Growth decelerates



Source: Thomson Reuters Datastream, ING Economic Research

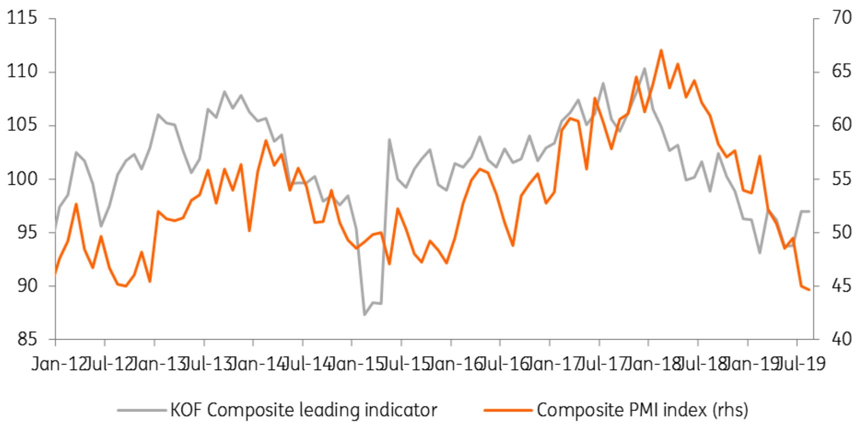
An uncertain future

The leading indicators are clearly not very well oriented - a sign of a probable slowdown. The composite PMI indicator reached 44.6 in August, its lowest level since 2009. The KOF leading indicator rose slightly in July and August but remains below its long-term trend.

The decline in exports is expected to continue. Indeed, the global uncertainty, linked to the trade war and Brexit, has strengthened the value of the Swiss franc since the summer. EUR/CHF has reached 1.08 recently, its highest level in two years, which will further dampen exports, half of which are to the euro area.

We expect GDP growth for the whole of 2019 to be below 1%, down from the 2.8% seen in 2018.

Leading indicators not well oriented



Source: Thomson Reuters Datastream, ING Economic Research

What does this mean for the Swiss central bank?

Since August, there is evidence that the Swiss central bank intervenes regularly in the foreign exchange market. In fact, this is the first thing the SNB does when the CHF appreciates too much. If the franc strengthens further due to a more accommodative monetary policy by the ECB and a rise in global uncertainty, the SNB may need to implement other measures, including a rate cut.

> *If a rate cut by the ECB is accompanied by a strong appreciation of the CHF, the Swiss national bank could be forced to lower its main policy rate probably by 25bp to -1%*

We believe the SNB would rather avoid further easing and wait for the ECB's decision, but if the ECB cuts its rate by 20bp in September, the SNB could be forced to intervene.

In the past, SNB officials have emphasised the importance of interest rate differentials between Switzerland and the eurozone. The SNB's policy interest rate differential with the ECB's deposit facility rate is currently 35 basis points. If the ECB reduces its rates by 20bp, the differential could be reduced to 15bp - the lowest amount since 2015. As a consequence, if the rate cut by the ECB was to be accompanied by a strong appreciation of the CHF, the Swiss national bank could be forced to lower its main policy rate probably by 25bp to -1%.

Author

Charlotte de Montpellier
Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com