Switzerland's solid recovery is set to weaken significantly

Swiss GDP continued to recover in the fourth quarter of 2021, concluding a very strong year. The fundamentals for growth were strong in early 2022, but the war in Ukraine is clouding the outlook. The Swiss National Bank will probably wait to change its monetary policy

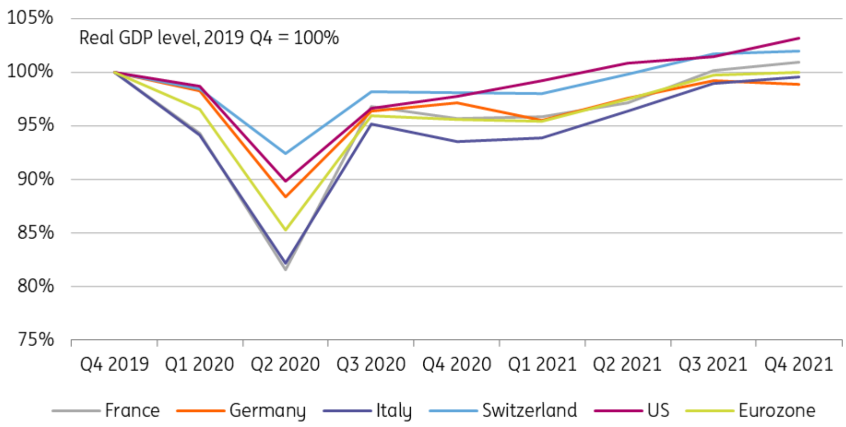
Zurich city centre

2021, a good economic year for Switzerland with a booming industry

In the fourth quarter of 2021, Swiss GDP grew by 0.3%, after 1.9% in the third quarter. As expected, the recovery continues in Switzerland, although it slowed in the fourth quarter due to health restrictions. As a result, GDP increased by 3.7% in 2021, following a 2.4% decline in 2020. At the end of the fourth quarter of 2021, GDP was 2% above its pre-crisis level, a better performance than its European neighbours.

Over the year, Swiss manufacturing has done very well, with activity increasing by 11.2% after a 3% decline in 2020. This situation contrasts sharply with the rest of Europe where disruptions in supply chains have severely hampered industrial production. One reason for this difference is the importance of the chemical and pharmaceutical sector in Switzerland, which accounts for more than 43% of Swiss manufacturing output and has been much less affected by supply problems. At the end of 2021, production in the chemical and pharmaceutical sector was 20% higher than its pre-crisis level, while the rest of industrial production was 4.4% higher than its level at the end of 2019. On the demand side, the strength of industry allowed Swiss exports to perform very well in 2021, increasing by 13.3% over the year (for exports of goods without valuables and transit trade). Despite several periods of health restrictions during the year, household consumption also picked up in 2021 to end the year 0.9% above its pre-crisis level. The very strong labour market, with an unemployment rate of 2.4% at the end of 2021, provides significant support for consumption.

Swiss GDP performed better than its European neighbours



Source: Refinitiv Datastream, ING Economic Research

Strong fundamentals at the start of 2022, but the war clouds the outlook

The year 2022 started well for the Swiss economy, with the economy still expanding even as the pace of growth normalised. The KOF leading indicator stood at 105 in February, well above its long-term average of 100, although down slightly from 107 in December. The composite PMI was still at a very high level of 62, signalling a strong expansion. Unfortunately, these indicators do not take into account the latest geopolitical developments, which will have a significant impact on the Swiss economy: growth will be lower and inflation higher. As a result, we have revised our growth forecast downwards from 2.9% to 2.5% for 2022. For the time being, we do not foresee a recession. Driven by energy prices, inflation will increase more than expected and should average 1.7% for 2022, compared to the previous forecast of 1.2%. Compared to neighbouring countries, inflation in Switzerland is expected to remain more moderate (although up sharply from 0.6% in 2021), due to the strengthening of the Swiss franc, which dampens imported inflation.

The SNB on hold

It is in this difficult context that the SNB will have to decide on the next steps in its monetary policy. On the one hand, continued growth (albeit less dynamic than previously expected), a very strong labour market and rising inflation, in line with its target, should push the SNB towards a normalisation of its policy. But on the other hand, the very strong appreciation of the Swiss franc since the beginning of the war in Ukraine due to its safe-haven character will encourage the SNB to be very cautious. Given the current low risk of deflation, the appreciation of the Swiss franc is probably considered by the SNB to be less problematic than in the past. Nevertheless, it is unlikely that the SNB will reinforce appreciation trends by raising interest rates in such an environment. As a result, we believe that the SNB will maintain its 'wait-and-see' attitude at its March meeting and will not change monetary policy until the impact of the Ukrainian conflict on the economy and the markets is clearer. It will therefore maintain its key rate at -0.75 and continue to intervene in the foreign exchange market when it deems it necessary. Going forward, we continue to expect the SNB to raise rates before the end of the year, probably in December 2022.

Author

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

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