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Swiss Economic

OUTLOOK

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Swiss Economic Outlook: Striving for a Neutral Stance

Introduction

Switzerland, known for its picturesque landscapes and robust economy, continues to maintain a position of neutrality not only in politics but also in its economic stance. As the global economic environment faces volatility and uncertainty, Switzerland's economic outlook remains cautiously optimistic, anchored by its strong fundamentals and adaptive policies.

Economic Fundamentals

Switzerland's economy is characterized by high per capita income, low unemployment, and a diversified industrial base. The country excels in sectors such as finance, pharmaceuticals, and manufacturing. Despite global economic challenges, Switzerland's GDP growth has been steady, driven by innovation and a strong export sector.

Key Sectors

1. **Finance and Banking:** Switzerland's financial sector is renowned for its stability and innovation. Swiss banks, with their global reach and expertise in wealth management, continue to attract international clients.
2. **Pharmaceuticals and Biotechnology:** Home to leading pharmaceutical companies like Novartis and Roche, Switzerland is a global hub for biotech research and development.
3. **Manufacturing and Precision Engineering:** Swiss manufacturers are known for high-quality products, particularly in precision engineering, watchmaking, and machinery.

Economic Policies

Switzerland's economic policies emphasize stability, innovation, and competitiveness. The government actively supports research and development, ensuring the country remains at the forefront of technological advancements. Additionally, Switzerland's commitment to free trade and open markets has bolstered its economic resilience.

Monetary Policy

The Swiss National Bank (SNB) plays a crucial role in maintaining economic stability. With an inflation target range of 0-2%, the SNB uses monetary policy tools to navigate economic challenges. In recent years, the SNB has adopted a negative interest rate policy to combat deflationary pressures and support economic growth.

Fiscal Policy

Switzerland's fiscal policy is marked by prudence and sustainability. The government maintains a balanced budget and low public debt levels. Fiscal policies are designed to support economic stability and long-term growth, with a focus on infrastructure investment, education, and social welfare.

Challenges and Opportunities

While Switzerland's economic outlook is positive, several challenges loom on the horizon. Global economic uncertainty, geopolitical tensions, and potential disruptions from technological advancements pose risks. However, these challenges also present opportunities for Switzerland to leverage its strengths in innovation and adaptability.

Digital Transformation

Embracing digital transformation is crucial for Switzerland's future growth. The government and private sector are investing heavily in digital infrastructure and skills development. Initiatives to foster digital innovation are underway, aiming to position Switzerland as a leader in the digital economy.

Sustainability and Green Economy

Switzerland is committed to sustainable development and transitioning to a green economy. Efforts to reduce carbon emissions, promote renewable energy, and enhance environmental conservation are integral to the country's economic strategy. Sustainable practices are not only environmentally beneficial but also create new economic opportunities.

Conclusion

Switzerland's economic outlook remains stable and resilient, supported by strong fundamentals and prudent policies. The country's neutral stance in global politics extends to its economic strategy, emphasizing stability and adaptability. As Switzerland navigates global challenges, its commitment to innovation, sustainability, and economic resilience will ensure continued prosperity.

The Swiss National Bank (SNB) is aiming for a neutral monetary policy that prevents the CHF from strengthening and lowers inflation. But what does this mean for investors? We take a closer look at Switzerland and their journey towards a neutral policy.

Key take-aways

- A revised inflation forecast and appreciation pressures on the currency put another rate cut on the agenda for the next SNB meeting in September.
- At 1.4%, Swiss inflation is well within the 0% – 2% target range.
- Swiss equities have been catching up with other developed markets over the past two

months. We recommend increasing exposure to the mid-cap segment given its higher cyclicality.

SNB outlook: open for more easing

The SNB is aiming for a neutral monetary policy that prevents the CHF from strengthening. A downwardly revised inflation forecast and appreciation pressures on the currency put another rate cut on the agenda for the next meeting in September.

Together with currency interventions, this has strengthened confidence in our forecast of a weaker CHF in the coming months.

The SNB has cut its key interest rate for the second time in a row and expects inflation to settle at 1%. We think that further easing is on the agenda. Following the SNB's decision last week to cut the policy rate to 1.25%, we have brought forward our forecast for a further rate cut to the next meeting in September of this year. The SNB seems to be aiming for a neutral stance and sees the current policy stance as not expansionary.

The best estimate of a neutral stance is currently a policy rate of 1%, consisting of 1% inflation and 0% real interest. This estimate for a neutral or natural real rate was put forward by SNB President Jordan. The resulting nominal neutral rate is in line with financial market expectations.

Key Points

At 1.4%, Swiss inflation is well within the 0% – 2% target range, and the updated inflation forecast under current policy conditions points to a further decline from here to 1% in 2026. This is slightly lower than the previous projection. More importantly, the SNB has emphasised its willingness to intervene in foreign exchange markets against a strengthening CHF.

The CHF has recently strengthened on the back of heightened political uncertainty in France and the eurozone and has the potential to push Swiss inflation even lower than the SNB projects. Another cut in the policy rate at the next policy meeting would make foreign exchange interventions against the CHF more efficient, helping to prevent Swiss inflation from moving too low. A further rate cut by the SNB at the next meeting and the willingness to intervene in foreign exchange markets increase our confidence in our forecast of a weaker CHF in the coming months.

Swiss equities: Catching up

Swiss equities have been catching up with other developed markets over the past two months. Within the Swiss equity market, we recommend increasing exposure to the mid-cap segment given its higher cyclicality.

The Swiss equity market had a rough time in the first months of 2024, underperforming most of its peers. Both the high exposure to defensive segments, which have lagged so far this year, and the low exposure to beneficiaries of artificial intelligence were to blame. Moreover, idiosyncratic issues at two of the three largest companies within the Swiss Market Index also did not help. However, since the start of Q2, Swiss equities have seen a catch-up rally, outperforming both

US and European equities on a currency-adjusted basis.

Going forward, we stick to our view that Swiss equities deserve a strategic allocation in an equity portfolio. The equity market scores highest in terms of quality balance sheet characteristics and stability of earnings growth, which have historically resulted in superior returns for shareholders. In addition, our economists expect the Swiss franc to weaken against the euro and the US dollar, which should give a further boost to Swiss equities given that the majority of revenue share is generated outside of Switzerland.

What does this mean for investors?

Within the Swiss equity market, we recommend increasing exposure to the mid-cap segment, which should benefit from the expected upturn in global growth momentum from H2 2024 onwards given its high degree of cyclicality. Compared to their peers in Europe and the US, Swiss mid-caps tend to have more solid balance sheets characteristics and they have delivered higher earnings growth rates over the past ten years. Ultimately, Switzerland’s high level of innovation provides a fertile ground for high-quality businesses to emerge and grow, leading to solid and sustainable returns for shareholders.

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