Switzerland

The latest consumer price data from the USA has also brought a degree of calm to the Swiss interest rate markets. Despite the higher inflation data from Switzerland in April, the SNB will almost certainly make a second key interest rate cut in June.

The surprising rise in the inflation rate in April from 1.04% to 1.37% is reflected in almost all sub-indices, which rose year-on-year but remained below the upper target value of 2.00% (Figure 1). A further, albeit moderate, rise in inflation has been expected by the SNB for some time and now appears to be confirmed (Figure 2).

However, there is no cause for concern: domestic inflation shows no significant increase on a monthly basis and the monthly inflation rate of 0.32% is mainly due to import inflation. This has increased since the beginning of the year due to the weakening of the Swiss franc. In addition, other indicators such as the development of producer prices do not point to any imminent inflation, which is why the rise in inflation is likely to be short-lived.

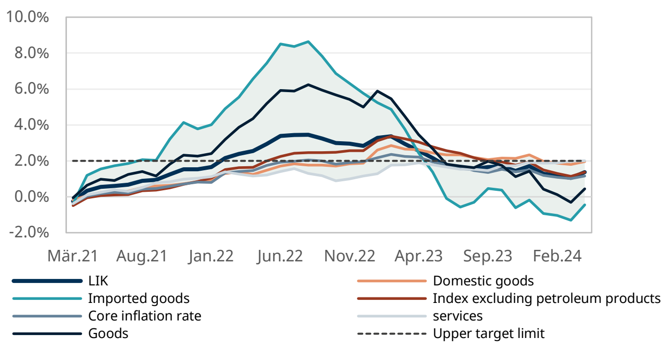
The SNB's path of monetary policy cuts depends, among other things, on the speed and extent to which the ECB and the Fed lower their interest rates. Wednesday's US inflation data therefore not only caused euphoria on the US stock markets, but also a slight sigh of relief on the Swiss interest rate markets (Figure 3). The interest rate swap rates are back at a lower level along the entire curve and imply an almost full interest rate cut for the June meeting (Figure 4).

Compared to the previous month, a lower probability of a third interest rate cut by the end of the year is currently being priced in. This assessment is probably best explained by the weaker franc and the expected stubbornness of inflation. In our view, however, a third cut this year will be unavoidable at the latest as soon as the ECB and ultimately the Fed start easing and the franc appreciates again in real terms despite currency purchases.

Our expectation

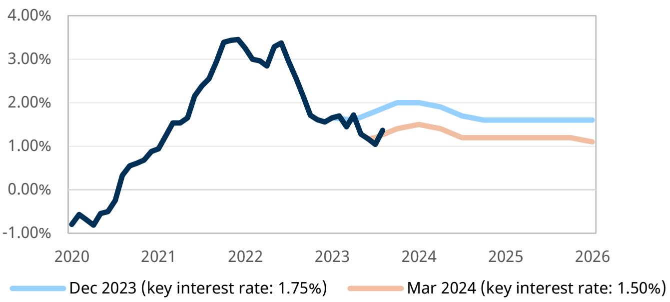
We continue to expect the SNB to cut the key interest rate again by 25 bps in June. We consider a key interest rate of 1.00% to be realistic by the end of the year.

Figure 1: The national consumer price index (CPI)



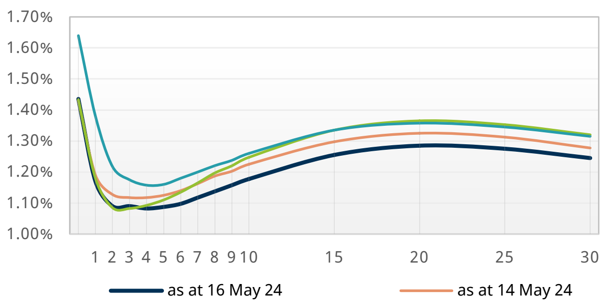
Note: Contributions to the previous year's change in consumer prices in Switzerland with the exclusion of petroleum products.
Source: Data from BfS, as at 16/05/2024

Figure 2: SNB inflation forecast vs. actual inflation



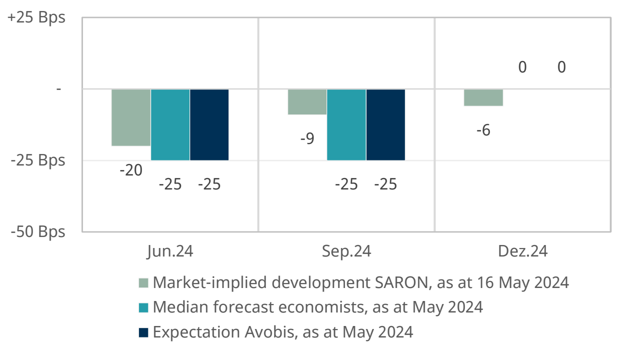
Note: The chart shows the current development of inflation and at the same time depicts the SNB's inflation forecasts as they were made at the time of the last monetary policy assessment. These forecasts are based, among other things, on the assumption that the key interest rate will remain unchanged over the entire forecast period of three years.
Source: Data from SNB, BfS, 16/05/2024

Figure 3: Interest rate swap curve



Note: The swap curves serve as a graphical representation of the underlying interest rate structure on the Swiss swap market. The respective swap rates as at the reporting date for the different maturities (in years) together form the swap curve.
Source: Data from Refinitiv Eikon, 16/05/2024

Figure 4: Market expectations & forecasts for the SARON rate and SNB key interest rate



Note: The market-implied forecast for the SARON rate is derived from the interest rate swaps. The economists' forecast is based on regular surveys by Bloomberg.
Source: Data from Bloomberg, Refinitiv Eikon, Avobis, as at 16/05/2024

International

Expected figures are good figures - this is how the US bond and equity markets reacted to the latest inflation data, which finally ended the four-month phase in which inflation was always higher than forecast. This did not necessarily make interest rate cuts any more likely, but discussions about potential rate hikes are likely to become less important. Meanwhile, the ECB is preparing for a possible interest rate cut.

The inflation trend remains stubborn, but without accelerating unexpectedly. The main driver of persistent inflation is housing costs (Figure 5), which contribute around 40% to current inflation and are only changing slowly. These rising housing costs are an increasing burden on US households and are also a politically explosive issue, with no immediate solution in sight. As a result, inflation due to the housing situation remains stable for the time being.

The rise in producer prices in April is a cause for concern, as it suggests that passing on inflation to consumers could continue to push up the inflation trend. Some relief could come from the continuing slowdown in the labour market, which is characterised by a slow increase in the unemployment rate, a decline in job vacancies and a fall in wage growth rates. However, it will also take time for the situation to cool down sufficiently and return to pre-crisis levels.

Current inflation is running along similar lines to the 1970s (see Figure 6). However, economists expect that this almost perfect correlation will soon no longer apply. Only time will tell whether they are right. However, it is clear that interest rates and inflation will only move downwards very slowly as long as there is no significant economic slump - the keyword here is "hard landing". However, the warning signs continue to increase and it is questionable to what extent the robust economic growth in the USA can survive.

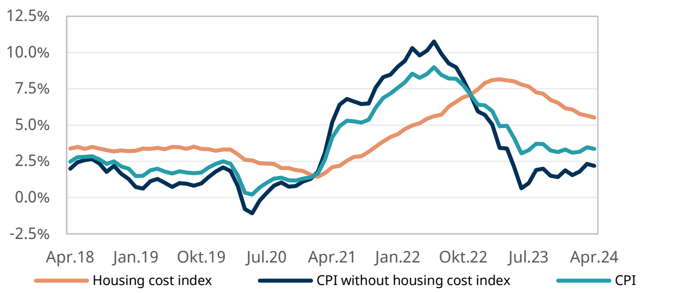
The economic recovery in the European Union remains weak and an easing of monetary policy is essential. The official wage data to be published next week will be crucial for the monetary policy stance, with unofficial data already pointing to a positive trend (Figure 7). However, ECB officials have clearly signalled that even if wage data is not convincing, June is the right time to start cutting rates.

Accordingly, the interest rate market is pricing in almost a complete interest rate cut for the ECB, while the Fed has been given the opportunity to surprise with a cut before the summer break (Figure 8). However, a substantial probability of a rate cut is only being priced in for September.

Our expectations

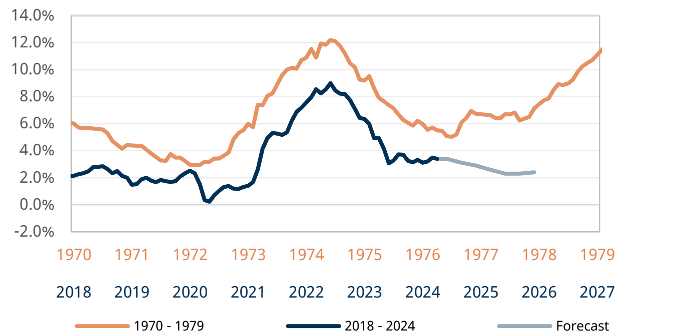
We continue to assume that the ECB will initiate its first interest rate cut of 25 bps in June. We continue to expect that the Fed will very probably refrain from cutting interest rates until the summer break until inflation risks subside.

Figure 5: US consumer price index - housing costs



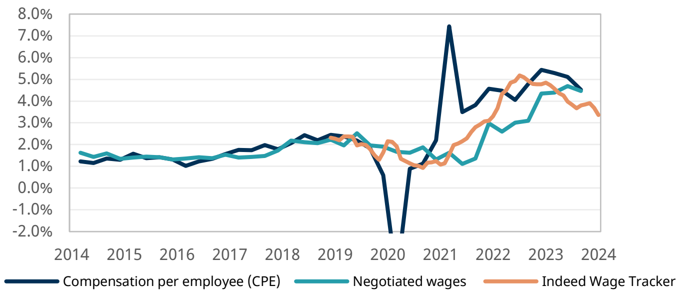
Note: The chart shows the historical development of the annual rates of change in the consumer price index, both including and excluding housing costs, as well as the rates of change in the housing cost index itself.
Source: Data from Fred, as at 16/05/2024

Figure 6: Historical comparison of the current inflation trend in the USA



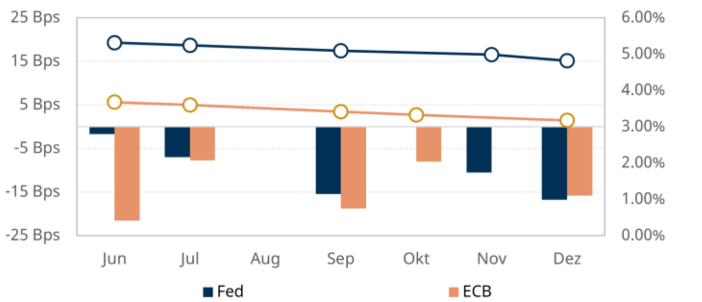
Note: The chart shows the current inflation trend compared to the inflationary environment in the USA in the 1970s. The forecast is based on median values from the Bloomberg surveys in May 2024.
Source: Data from Fred, Bloomberg, as at 16/05/2024

Figure 7: Wage trends in the eurozone



Note: The chart shows the development of various indicators for monitoring wage trends in the eurozone.
Source: Data from ECB Data Portal, GitHub, as at 16/05/2024

Figure 8: Market-implied key interest rate developments Fed and ECB



Note: The chart shows the market-implied development for the key interest rates of the Fed and ECB (right axis). These are derived from Fed Funds futures and overnight index swaps. The left-hand axis shows the implied interest rate adjustments (in basis points) in the respective month in which a monetary policy meeting is scheduled.
Source: Data from Refinitiv Eikon, 16/05/2024

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