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MONETARY POLICY OUTLOOK

November 2024

Switzerland

On 12 December, the SNB's decision-makers will meet for their last monetary policy assessment of the year and a fourth interest rate hike of 25 bps is largely considered a foregone conclusion. At the same time, conditions along the yield curve have eased further, bringing the level of low interest rates before the pandemic within reach.

The disinflationary trend is continuing and inflation is once again below the SNB's conditional inflation forecast from the September meeting. Consumer prices fell to 0.62% in October compared to the previous year and recorded the fourth monthly decline in a row with a fall of -0.13% compared to the previous month. Excluding the component of residential rents, inflation on an annualised basis is even negative for the first time (Figure 1).

The disinflationary trend is likely to continue in the coming year, which makes negative inflation rates for the entire basket of goods probable. Apart from the US dollar, the Swiss franc will remain strong against most currencies, which will continue to favour low import prices. The expected reduction in the mortgage reference interest rate, which is likely to take place by March at the latest, will probably also lead to a fall in inflation for existing rents. Further interest rate cuts may be necessary to ensure a positive inflation rate again in the medium term. SNB Chairman Martin Schlegel has also signalled that the reintroduction of negative interest rates could even be considered if necessary.

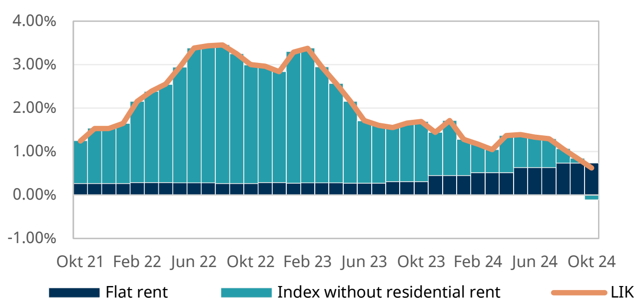
The market has revised its expectations for the key interest rate level significantly downwards since the summer (Figure 2). While the interest rate swap curve previously implied three-month forward swap rates of just under 1.00% for the end of 2025, the current swap rates for the second half of 2025 point to a SARON rate of around 0.10%. In principle, forward rates are distorted as a prediction of future interest rate trends and therefore do not necessarily materialise. Nevertheless, these adjustments reflect the increased expectation of a more expansive monetary policy.

Compared to the previous month, the interest rate swap curve has not only shifted downwards in the short and medium term due to the expectation of lower interest rates, but has also fallen significantly at the long end (Figure 3). At the same time, the premiums of swap rates over government bond yields have fallen and are now close to 0% (Figure 4). Overall, this indicates a noticeable easing along the entire yield curve.

Our expectation

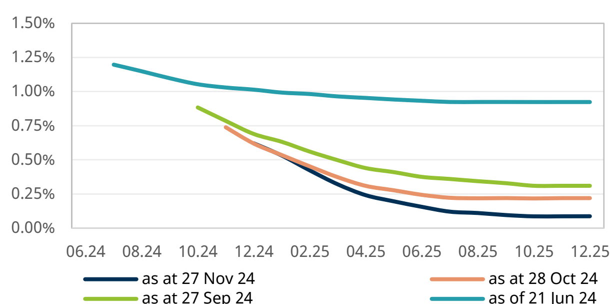
We see two further rate cuts of 25 bps each in December and March as our base scenario and do not rule out further rate cuts thereafter.

Figure 1: The national consumer price index (CPI)



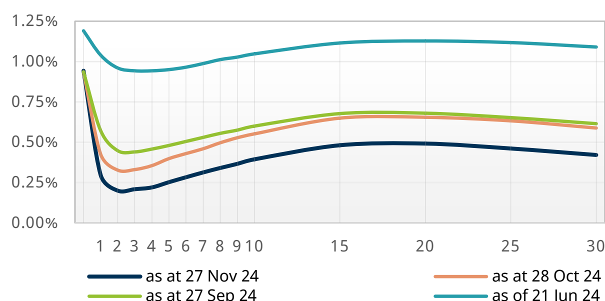
Note: Contributions to the previous year's change in consumer prices in Switzerland broken down by index excluding residential rents and residential rents.
Source: Data from SNB, BfS, 27.11.2024

Figure 2: Three-month forward swap rates until the end of 2025



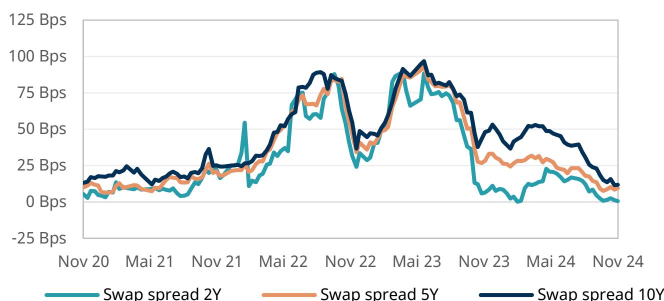
Note: The chart shows the forward swap rates with a term of three months to the end of 2025 as at the respective reporting date.
Source: Data from Bloomberg, as at 27 November 2024

Figure 3: Swap curves vs. SARON



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, 27.11.2024

Figure 4: Swap spread (swap rates vs. bond yields)



Note: The swap spread is calculated as the difference between the swap rate and the bond yield for German government bonds for the same term.
Source: Data from Refinitiv Eikon, as at 27 November 2024

International

The Fed and the ECB will also face their final monetary policy assessment of the year next month. While the ECB is likely to decide on a fourth rate cut and maintain this pace in the coming year, the Fed could slow its pace in view of solid economic growth and stubborn inflation and pause interest rates in December.

The rise in consumer prices in the US accelerated in October, indicating that the inflation-dampening trend of the last two years is coming to a halt. Worryingly, inflation could flare up again, similar to the 1980s, as current developments so far show striking parallels (Figure 1). While the forthcoming tax cuts and tariff increases under Donald Trump's presidency are more likely to lead to one-off inflation spikes, the increasing fiscal debt and the continued robust economy could promote structurally higher inflation rates.

Consumer spending in the US is showing robust growth rates and is contributing around 70% to economic growth. At the same time, the savings rate has recovered, which indicates a solid consumer base (Figure 6). Labour market indicators show a largely unchanged picture in the previous month, which also points to the stability of the labour market.

Overall, the current environment suggests that the Fed will take a more cautious approach to further interest rate cuts, which makes a further slowdown in the pace likely. Accordingly, the market's expectations for interest rate cuts in 2025 have been significantly reduced (Figure 7). The futures market is currently signalling an approximately 30% probability of an interest rate pause at the meeting on 18 December. The economic data published by then will be decisive for this.

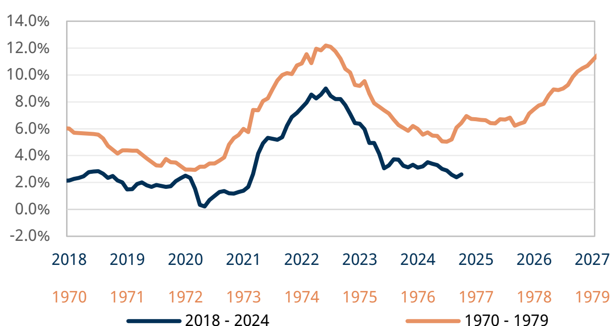
Negotiated wages, a key indicator for the ECB, rose by 54% in the third quarter compared to the previous year (Figure 8). Although most ECB representatives are in favour of further interest rate cuts in view of the weak economic momentum, the pace and scope of these cuts are the subject of increasingly controversial debate. Caution is being urged above all because of the continuing price pressure in the service sector, where wage growth remains strong.

Nevertheless, the rise in negotiated wages is unlikely to deter the ECB from cutting interest rates again in December. Monetary policy makers are now increasingly focussing on forward-looking indicators for wage growth and the overarching inflation outlook appears less worrying. The market is pricing in further interest rate cuts for the coming year (Figure 7).

Our expectation

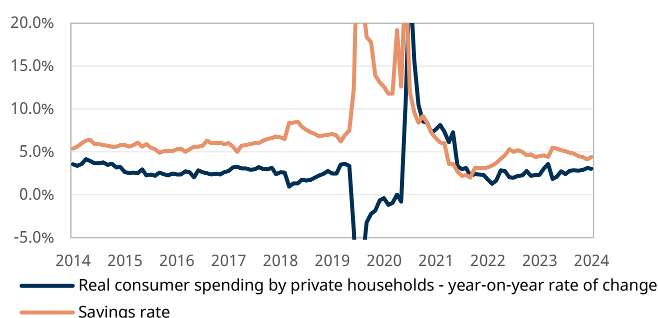
Although a rate cut by the Fed cannot be ruled out, a more cautious approach seems more sensible, which is why we believe a pause in interest rates is more likely. We expect the ECB to make at least two further interest rate cuts of 25 bps each after the December meeting.

Figure 5: Historical comparison of the current inflation trend in the USA



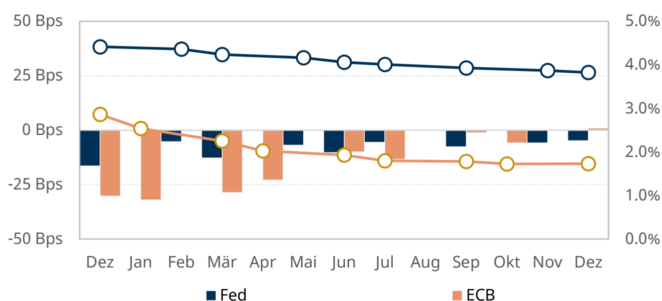
Note: The chart shows the current inflation trend compared with the inflationary environment in the USA in the 1970s.
Source: Data from Fred, as at 27 November 2024

Figure 6: US consumer spending



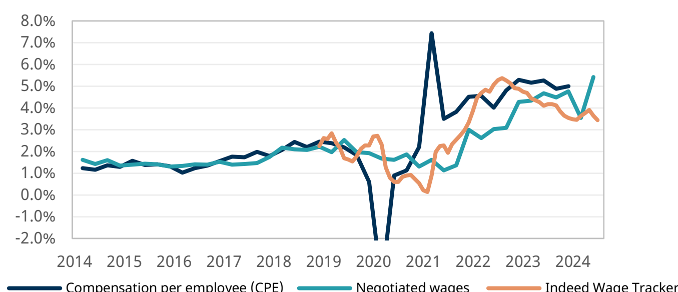
Note: The chart shows the monthly rates of change in real consumer spending by private households compared with the same month of the previous year and the savings rate in the USA.
Source: Data from Fred, as at 27 November 2024

Figure 7: Market-implied key interest rate developments



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 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, as at 27.11.2024

Figure 8: 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 27 November 2024

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