Switzerland

The expectation that the SNB will lower the key interest rate to 0.50% by the middle of next year is gaining ground among economists and on the interest rate market. Above all, disinflation and the weak global economy support this assumption.

Despite having already made three interest rate cuts this year, the SNB is lagging behind the interest rate market (Figure 1). Three further interest rate cuts (75 bps) are currently priced in for the next four meetings, which could lower the key interest rate to 0.25% after the June meeting. This would put us back in a low interest rate environment and only a stone's throw away from negative interest rates. At present, the medium-term segment of the yield curve in particular reflects a scenario with lower interest rates, while the long-term end remains fairly unchanged compared to the previous month (Figure 2).

The current course of the yield curve shows an increasingly marked convexity in the middle segment. For example, the two-year swap rate is already pricing in a key interest rate below 0.25%, while long-term interest rates and overnight interest rates remain high. The reasons for this structure remain open to interpretation, but open up interesting trading options: Whether for experienced traders who are betting on a possible "negative butterfly" - i.e. a scenario in which interest rates fall more sharply at the short and long ends or rise less sharply than in the middle segment - or for debt financing who want to make their target duration more cost-effective by positioning themselves more strongly in the middle of the curve.

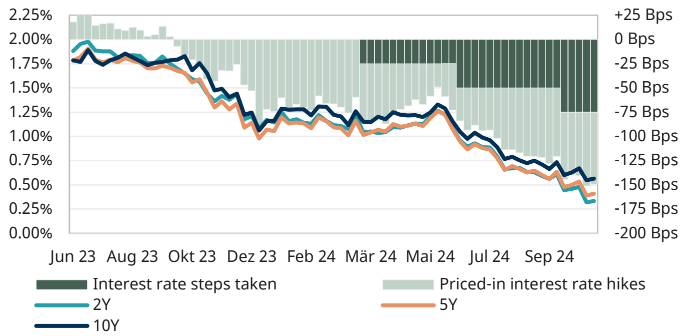
Whether the key interest rate will actually fall to 0.50% and later to 0.25% remains to be seen and depends crucially on price stability, the strength of the Swiss franc and the overall economic situation. The disinflation process is continuing and key price segments have fallen from their highs (Figure 3). Import prices in particular are falling significantly - a development that is largely due to the strong franc, which continues to act as a safe haven in the current environment. If the weakening of prices continues, negative inflation rates are even possible in the coming year, which would prompt the SNB to cut interest rates further.

As an open economy, Switzerland is heavily dependent on the global economy and in particular on the development of its neighbours. Europe is facing structural challenges that - if left unresolved - could weaken its competitiveness in the long term. The German economy in particular is showing signs of stagnation or even decline in 2024. Swiss economic policymakers have therefore been working for some time, and increasingly so since the pandemic, to reduce dependence on individual markets and to broaden the trade portfolio through new markets (Figure 4). Although Switzerland is unlikely to remain completely unaffected by the European weakness, the impact could be cushioned thanks to reduced dependency, a robust domestic economy and stable domestic conditions. An easing of monetary policy based on this argument would be economically favourable, but not absolutely necessary.

Our expectation

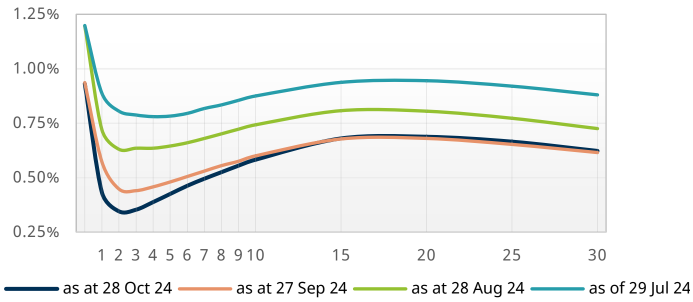
We see two further rate cuts of 25 bps each in December and March as our base scenario and do not rule out further rate cuts thereafter.

Figure 1: Long-term market interest rates and priced-in interest rate hikes for the next four meetings



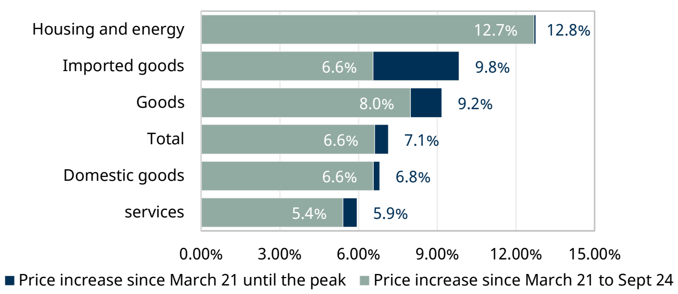
Note: The chart shows the historical development of swap interest rates for maturities of 2, 5 and 10 years as well as the interest rate moves that have already taken place and those priced in for the next four meetings from the monetary policy assessment of 22 June 2023, when the SNB policy rate was last raised from 1.50% to 1.75%.
Source: Data from Refinitiv Eikon, 30.10.2024

Figure 2: Swap curves vs. SARON



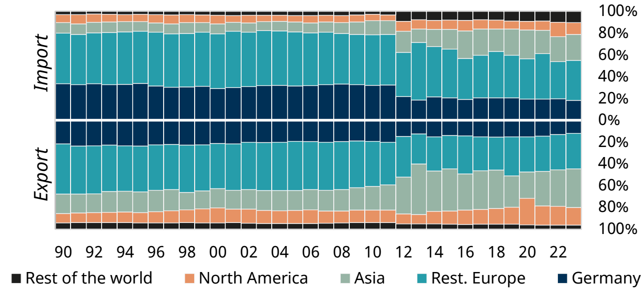
Note: The swap curves serve as a graphical representation of the underlying interest rate structure on the Swiss swap market. The respective swap rates as at the reporting date for the different maturities (in years) together form the swap curve.
Source: Data from Refinitiv Eikon, 30.10.2024

Figure 3: Consumer price trends



Note: The chart shows the price development of the individual segments of the national consumer price index since their respective peak during the rise in inflation as well as the current price levels compared to March 2021.
Source: Data from BfS, as at 30.10.2024

Figure 4: Swiss foreign trade



Note: The figure shows exports and imports in foreign trade by geographical breakdown.
Source: Data from BfS, as at 30.10.2024

International

The end-of-year monetary policy spurt is approaching and the Fed will meet next week for its second-last meeting of the year. The market expects a continuation of the interest rate cut path with a further reduction of 25 bps. A larger reduction of 50 bps is being discussed for the ECB in December.

Since the Fed meeting in September, when the key interest rate was cut by 50 bps, market interest rates have risen surprisingly along the yield curve. The rise in the yield on the 10-year US government bond by over 50 bps is particularly striking (Figure 5). An analysis shows that both real yields and inflation expectations have contributed to the rise.

The US labour market data, which previously signalled a slowdown, is currently showing unexpected robustness (Figure 6). The expected rapid rise in the unemployment rate has so far failed to materialise and the number of job vacancies per jobseeker, a metric closely monitored by the Fed, has stagnated. Since the pandemic, the US economy has recovered strongly (Figure 8), supported by solid employment growth, which is slowing slightly but remains close to average (Figure 7). Economic growth of an annualised 3% is expected for the third quarter. If the labour market remains stable or even grows, this could support growth and possibly cause inflation to rise again - a scenario that argues against further interest rate cuts.

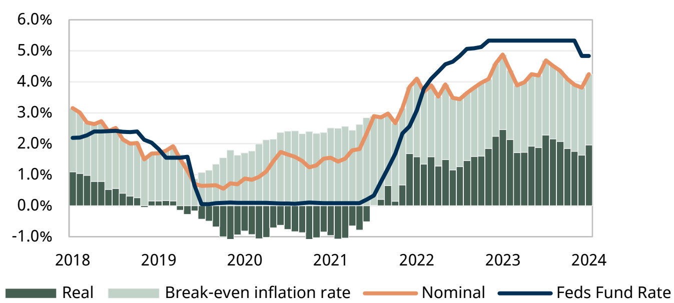
By contrast, the European economy is facing structural problems, including a shrinking workforce, stagnating productivity, insufficient commercialisation of innovations and inefficient regulation. This is reflected in the economic performance of the largest member states, which have lagged behind countries such as Switzerland and the USA since the pandemic (Figure 8). The German economy is even stagnating at pre-crisis levels. Parallel to the weakening economy, inflation has fallen significantly - from 2.2% in August to 1.7% in September - fuelling speculation that the ECB will cut rates by 50 bps in December.

Although further monetary easing could provide positive impetus in the short term, it will not solve the structural problems. A more aggressive approach also harbours the risk of sending undesirable signals, which could indicate a possible panic on the part of the ECB and lead to unwanted volatility on the markets. It is therefore likely that the ECB will maintain its current pace and cut interest rates by 25 bps at each meeting until the desired monetary conditions are achieved. A slide below the neutral interest rate range (estimated between 2.0% and 2.5%) into an expansionary monetary policy seems economically realistic and could become more of a focus in the course of 2025.

Our expectation

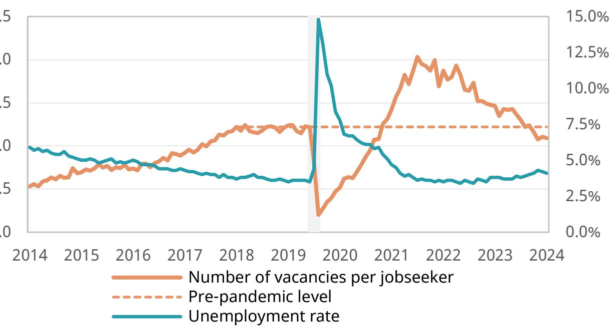
We expect the Fed to cut the key interest rate by 25 bps at its November meeting and believe a further cut is possible in December, but do not rule out a pause in interest rates. We expect the ECB to cut rates by 25 bps at its December meeting, followed by at least three further cuts of the same amount at subsequent meetings.

Figure 5: 10-year US government bond yield



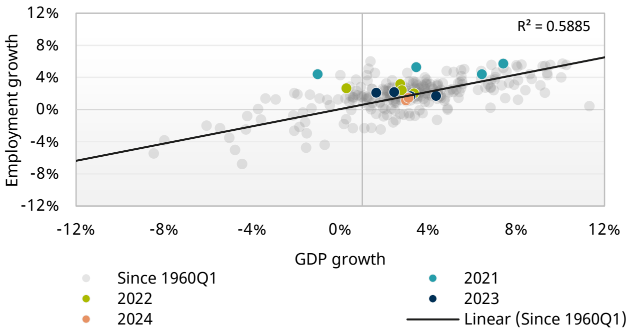
Note: The chart shows the effective federal funds rate and the nominal yield on 10-year US government bonds, broken down into the real interest rate and the break-even inflation rate, which can be interpreted as a market-implied long-term inflation expectation.
Source: Data from Fred, as at 30.10.2024

Figure 6: US labour market (1/2)



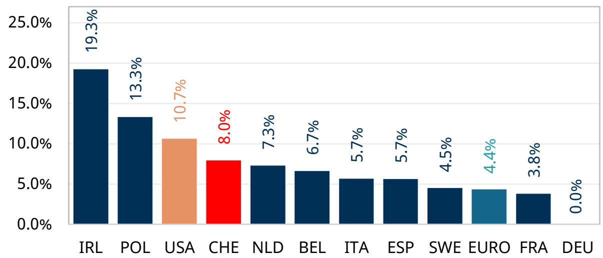
Note: The chart illustrates the development of the US labour market. The shaded area marks the recession phase during the pandemic.
Source: Data from Fred, as at 30.10.2024

Figure 7: US labour market (2/2)



Note: The chart shows the quarterly annualised growth rates of employment compared to the annualised growth of real GDP.
Source: Data from Fred, as at 30.10.2024

Figure 8: GDP growth 2024Q2 vs. 2019Q4



Note: The chart shows the real GDP growth of the ten largest European member states, Switzerland and the USA since Q4 2019.
Source: Data from Eurostat, Fred, as at 30 October 2024

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