Switzerland

In his last meeting, Thomas Jordan decided in favour of a rate cut of just 25 bps before handing over the reins to his successor. In our view, a move of 50 bps would have been preferable. We explain our arguments in favour below.

The key interest rate primarily influences the short end of the yield curve, while its influence on medium and long maturities is significantly lower. These areas are dominated by monetary policy expectations, inflation expectations and the economic outlook. As the market doubts that the SNB will keep the key interest rate restrictive in the long term, future interest rate cuts after the interest rate pause in September 2023 are already heavily priced in. This is reflected in the decline in term spreads, which have reached almost -70 bps by today's decision, even for longer maturities (Figure 1). As a result, interest rates in the medium and long range have already fallen sharply and have no longer been considered restrictive for some time, while the key interest rate has kept short-term interest rates artificially high (Figure 2). A rate cut of 50 bps would have aligned SARON with long-term interest rates.

Despite the SNB's early monetary policy measures, the Swiss franc has appreciated significantly in nominal terms against the major currencies since the first quarter of this year (Figure 3). In addition to the solid fundamentals of the Swiss economy, the franc is increasingly acting as a safe haven in the current macroeconomic situation. This is reflected in the positive correlation between the franc and gold. Investors who bet on the franc in times of increased market volatility also benefit from the money market rates kept high by the key interest rate. However, today's interest rate cut is unlikely to diminish the appeal of the franc as a safe haven, and a further appreciation cannot be ruled out until the next meeting.

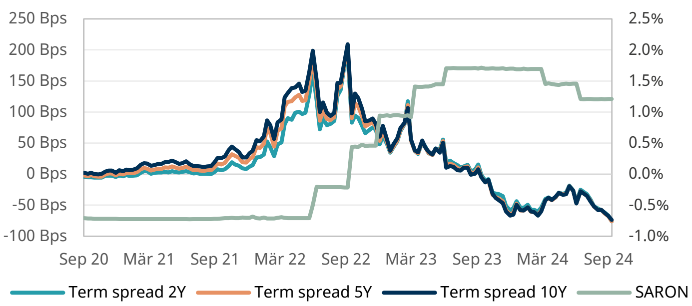
The risk of increased disinflation in Switzerland is growing, as the SNB's new inflation forecast shows (Figure 4). Import prices are falling by 1.9% almost every year, which is due to falling commodity prices and the stronger Swiss franc. The current inflation rate of 1.06% is largely influenced by the rental price index. With the expected reduction in the mortgage reference interest rate by March 2025 at the latest, further disinflationary effects are likely to materialise in this area. A return to low inflation and a strong franc, similar to before the pandemic, is therefore becoming increasingly likely. As there are currently no signs of extensive intervention on the foreign exchange market to counter a strong franc and such measures generally only have the greatest effect when interest rates are close to the lower limit, we believe it would have been optimal to utilise the available scope for a rate cut of 50 bps in this decision.

Nevertheless, we rate the overall assessment of the situation as positive, as the SNB appears to be taking a cautious approach and does not want to make any hasty decisions, particularly in view of the current economic and geopolitical uncertainties.

Our expectation

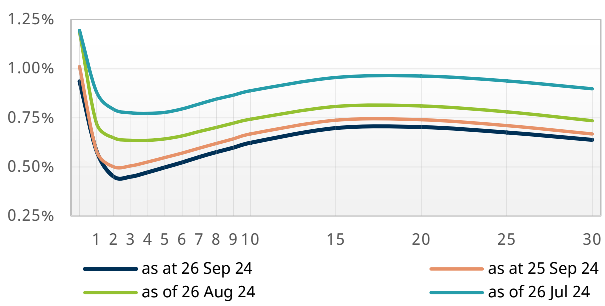
We see two further interest rate cuts of 25 bps each in December and March as our base scenario.

Figure 1: Term spread (swap rates vs. SARON)



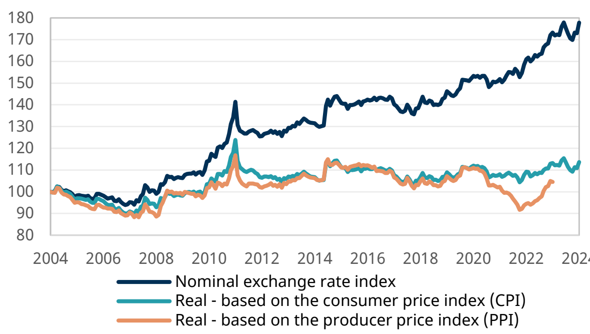
Note: The term spreads of the swap rates are calculated as the difference between the swap rate for the respective term and the SARON.
Source: Data from Refinitiv Eikon, 26/09/2024

Figure 2: Swap curves vs. SARON



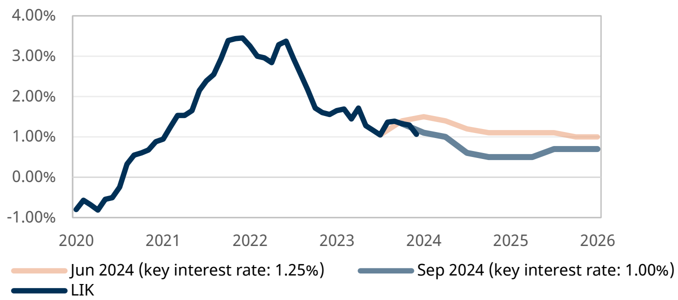
Note: The swap curves serve as a graphical representation of the underlying interest rate structure on the Swiss swap market. The respective swap rates as at the reporting date for the different maturities (in years) together form the swap curve.
Source: Data from Refinitiv Eikon, 26/09/2024

Figure 3: Effective exchange rate indices



Note: The chart shows the nominal and real effective exchange rate index of the Swiss franc. While the nominal index measures the exchange rate development against the most important trading partners, the real index also takes into account the price development in Switzerland and abroad.
Source: Data from SNB, as at 26/09/2024

Figure 4: New SNB inflation forecast



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, as at 26/09/2024

International

Last Wednesday, Jerome Powell surprised everyone with a significant rate cut of 50 bps - the first since the start of the pandemic. The Fed's statement was unexpected, as the markets were divided until shortly before the decision: The probability of a 50 bps cut was only 55%, while a 25 bps cut was still trading at 45%. This uncertainty kept the tension high until the final announcement.

With this decision, the Fed is following up its announcements with action and clearly demonstrating that it will not accept a weakening of the labour market. The slowdown continues, but is less severe than feared: The number of job vacancies is falling, leading to a decline in vacancies per jobseeker. The unemployment rate, on the other hand, remained unchanged in August (Figure 5). The combination of a continuing robust labour market, easing inflation and the start of interest rate cuts is causing many market participants to breathe a sigh of relief and increasing the chances of a soft landing. Accordingly, the stock markets reached new all-time highs after the interest rate decision.

Inflation momentum in the US has slowed noticeably and various indices are slowly moving in the desired direction. Nevertheless, market expectations for medium and long-term inflation remain outside the Fed's target range (Figure 6). A comparison with the German break-even inflation rates with the same duration reveals a discrepancy. This is due to the fact that the US economy continues to grow strongly in contrast to the European economy, which means there is a risk that an easing of monetary policy could fuel inflation again.

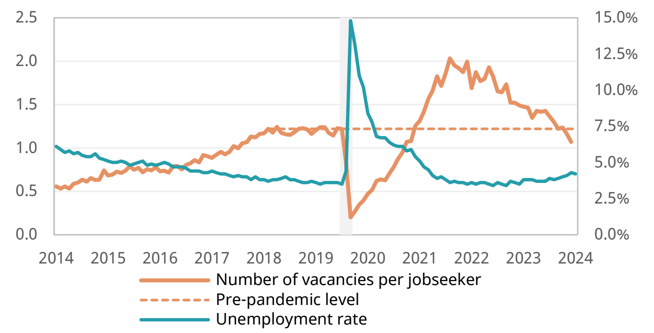
The European economy is facing a number of challenges: In addition to declining competitiveness, labour shortages and stagnating productivity, there is also a lack of sufficient investment in forward-looking technologies. There are increasing signs of a slowdown, particularly in the manufacturing industry (Figure 7). A further easing of monetary policy may be welcome and, to a certain extent, necessary, but it will not solve the fundamental structural problems.

Both central banks still have two meetings to go before the end of the year. The Fed is expected to cut interest rates by a total of 75 bps, while the ECB is expected to cut rates by around 50 bps (Figure 8). The pace of the Fed's rate cuts will depend crucially on the new labour market data. If the labour market proves to be more robust than expected, there is little reason for the Fed to continue at the same pace, especially as inflation risks remain. However, if the data points to a stronger slowdown, the Fed could react with a further reduction of 50 bps. The ECB's pace is likely to be influenced by the Fed's decisions, meaning that if the Fed takes a more aggressive approach, a cut of 25 bps in October and 50 bps in December could be on the cards.

Our expectation

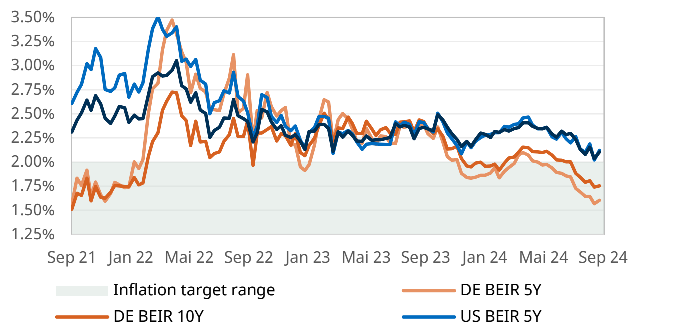
We expect the ECB to cut interest rates by a further 25 bps at its October meeting. In the base scenario, we expect the Fed to cut rates by 50 bps at the November meeting. If the labour market data is positive, we expect a moderate reduction of 25 bps.

Figure 5: US labour market



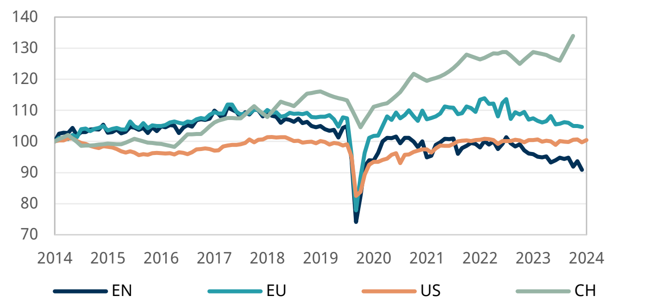
Note: The chart illustrates the development of the US labour market. The shaded area marks the recession phase during the pandemic.
Source: Data from Fred, as at 26/09/2024

Figure 6: Market-implied inflation expectations



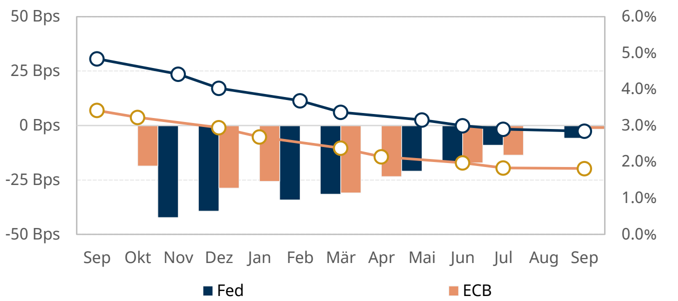
Note: The chart includes the historical development of the break-even inflation rate (BEIR) for the USA and Germany. The BEIR is defined as the yield differential between government bonds and inflation-linked bonds (ILB) with the same maturities. The BEIR can be interpreted as a market-implied inflation expectation.
Source: Data from Refinitiv Eikon, as at 26/09/2024

Figure 7: Industrial production index



Note: The chart shows the industrial production indices for various countries / economic areas.
Source: Data from Refinitiv Eikon, as at 26/09/2024

Figure 8: 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 26/09/2024

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