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MONETARY POLICY OUTLOOK

March 2025

Switzerland

The SNB has lowered the key interest rate for the fifth time in a row - from 0.50% to 0.25%. It attributes the decision to the continuing decline in inflationary pressure and the current predominant economic downside risks. The interest rate move is therefore preventative in nature.

The yield curve structure has normalised again after a long time and shows a positive slope along the curve (Figure 1). While interest rates are lower at the short end as a result of the key interest rate cut, they have risen at the long end - primarily due to the simultaneous rise in yields on German government bonds, triggered by the turnaround in German budgetary policy. With the forthcoming expansionary fiscal policy from Germany and the rest of Europe, the economic outlook is also improving. The Swiss economy should also benefit from this - through higher demand and additional growth potential. This expectation is also reflected in the yield curve.

Despite this potential stimulus, the SNB expects inflationary pressure to ease, which is why the new inflation forecast for March is only marginally higher than that of December despite the cut in the key interest rate (Figure 2). Inflation is likely to fall further in the coming months, as no significant drivers of inflation can currently be identified. Although survey results indicate that prices are likely to remain high in individual sectors such as the hospitality industry, in others - such as retail - the trend is more towards falling prices.

The question of how monetary policy will develop over the remainder of the year and whether a further cut in key interest rates will take place currently depends largely on global developments.

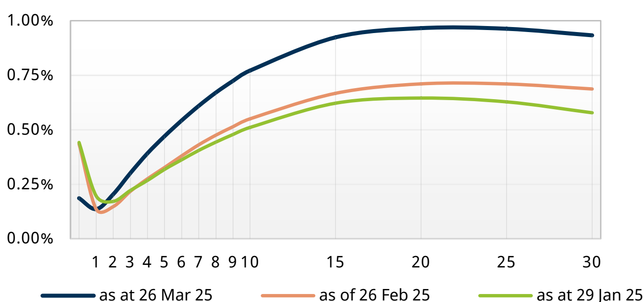
If the situation surrounding tariffs and trade barriers worsens, the Swiss economy is also likely to suffer from weaker demand in its most important sales markets. At the same time, the Swiss franc would come under upward pressure in such an environment, which would put additional pressure on price stability. In such a scenario (Figure 3, negative scenario), the economy would lose significant momentum - and further key interest rate cuts, even into negative territory, would be very likely.

However, if the situation does not deteriorate further and there is no trade war, SECO anticipates slightly lower growth in the base scenario compared to the last forecast and still below-average growth overall. Furthermore, if the expansionary fiscal policy in Germany and Europe is implemented to the desired extent and without major delays, a noticeable growth spurt could begin as early as 2025 - or 2026 at the latest (Figure 3, positive scenario). In such a scenario, the Swiss franc would depreciate against the euro and the risk of deflation in Switzerland would be significantly lower, which is why key interest rate cuts would be very unlikely.

Our expectation

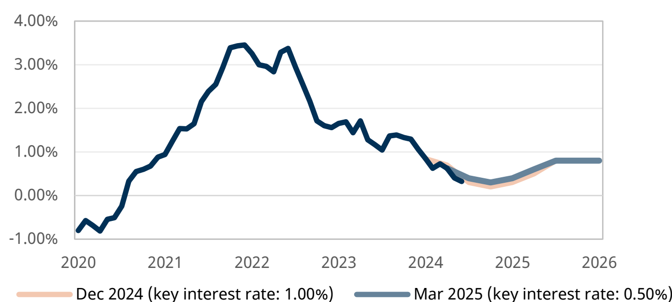
The negative risks currently outweigh the positive ones. Nevertheless, the interest rate market is currently only pricing in a low probability of a further interest rate cut in the current year (Figure 4). In our view, a key interest rate cut in June has become much less likely - but cannot be ruled out. Although long-term interest rates are likely to ease somewhat, they will remain at a high level.

Figure 1: Swap curves vs. SARON



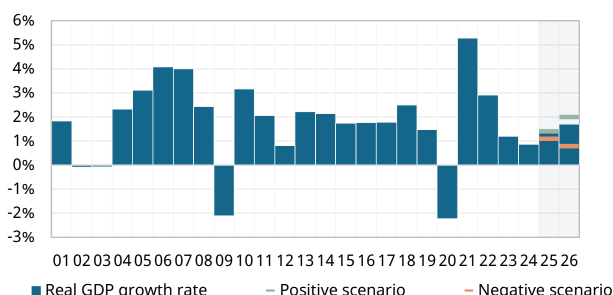
Note: The swap curves serve as a graphical representation of the underlying interest rate structure on the Swiss swap market. The respective swap rates as at the reporting date for the different maturities (in years) together form the swap curve.
Source: Data from Refinitiv Eikon

Figure 2: New SNB inflation forecast



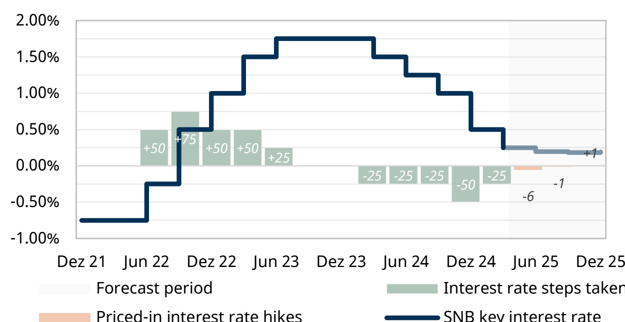
Note: The chart shows the current development of inflation and at the same time depicts the SNB's inflation forecasts as they were made at the time of the last monetary policy assessment. These forecasts are based, among other things, on the assumption that the key interest rate will remain unchanged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

Figure 3: GDP growth scenarios for 2025 and 2026



Note: The figure shows the annual real growth rate of Swiss GDP. The SECO forecasts are shown for 2025 and 2026 - differentiated according to three scenarios: Base scenario (blue bar), Positive scenario and Negative scenario.
Source: Data from the Federal Statistical Office, SECO

Figure 4: Monetary policy market expectations



Note: The chart shows the interest rate hikes expected (priced in) by the market, which were derived from short-term interest rate swaps. Although these expectations relate to the SARON rate, they are applied to the key interest rate in this illustration for the sake of simplicity.
Source: Data from Refinitiv Eikon

Abroad

At its March meeting, the ECB cut its key interest rate by 25 bps for the sixth time in a row. However, it remains to be seen whether there is any further room for manoeuvre in monetary policy in view of the forthcoming expansionary fiscal policy. At the same time, the Fed classifies the inflation-related risks from possible tariffs and tariffs under Trump as temporary, but sees no pressure to act - the March meeting therefore resulted in a pause in interest rates.

Following the suspension of US military aid to Ukraine, the EU presented the "ReArm Europe" plan on 4 March, which aims to massively increase defence spending. It is planned to mobilise up to 800 billion euros via various financing mechanisms, including national debt under suspension of the 3% deficit rule, EU loans or grants as part of joint EU debt. In principle, there is agreement among the member states - the controversy concerns the specific financing. Fiscally conservative countries are against joint borrowing, while southern European states are pushing for grants. The proposals still require the approval of all EU member states, but they have already left their mark on the interest rate markets - with rising long-term yields (Figure 5).

At the same time, Germany has announced that it will relax the national debt brake to allow for higher defence spending and additional investments by the federal states. There are plans to set up a special fund totalling 500 billion euros to strengthen infrastructure and finance strategic future projects. The corresponding plans were passed by the Bundestag and confirmed by the Bundesrat - they mark a clear break with decades of fiscal policy conservatism. On the interest rate market, this change of course is reflected in rising expectations of real yields on German government bonds (Figure 6)

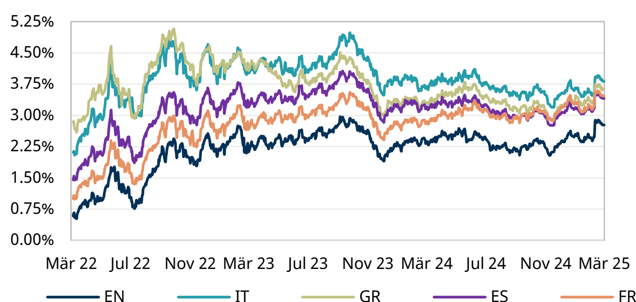
The forthcoming expansionary fiscal policy in Europe could revitalise the currently weak economy, but also harbours inflation risks. In addition, the ECB is likely to find it difficult to ease monetary policy further in view of the higher long-term interest rates. The interest rate market has priced in just under two interest rate cuts by the end of the year, with a 75% probability of a seventh cut in April (Figure 7).

The trade policy announced by Trump with new tariffs and duties is currently fuelling short-term inflation expectations. However, it remains uncertain whether these will translate into higher structural inflation. The Fed continues to assume that the inflationary effects are only of a temporary nature - based on the experience of Trump's first term in office. At the same time, there are increasing signs that the US economy is entering a phase of slowing growth and stubborn inflation. This assessment is also reflected in the Fed's latest economic projections (Figure 8). As the labour market has been stable so far, the Fed is likely to remain cautious for the time being. The interest rate market is currently not pricing in a substantial probability of a first rate cut until June.

Our expectation

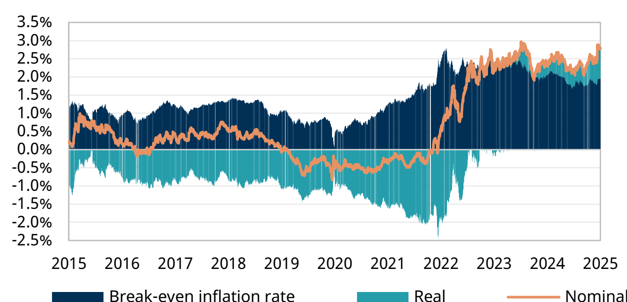
We expect the ECB to cut its key interest rate once again at its April meeting. We expect the Fed to leave its key interest rate unchanged at its next meeting in May.

Figure 5: 10-year bond yields of EU member state bonds



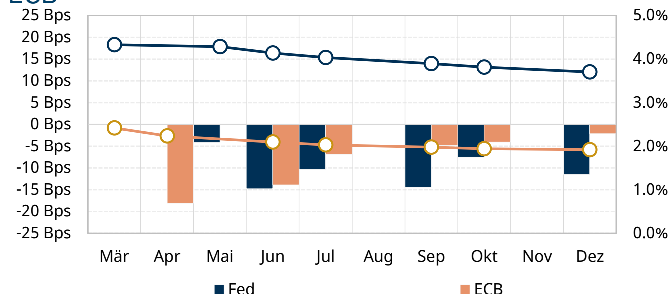
Note: The chart shows the bond yields of 10-year government bonds from certain European member states.
Source: Data from Refinitiv Eikon

Figure 6: Components of German 10-year bond yields



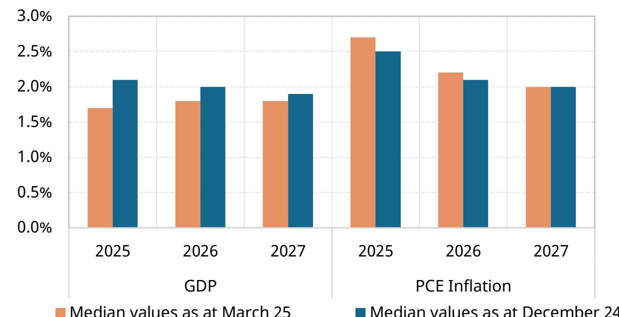
Note: The chart shows the historical development of nominal and real yields as well as the break-even inflation rate (BEIR) for German government bonds with a 10-year term. The BEIR is calculated as the yield difference between nominal government bonds and inflation-linked bonds (ILB) with the same maturity and can be interpreted as a market-implied inflation expectation.
Source: Data from Refinitiv Eikon

Figure 7: Market-implied key interest rate developments Fed & 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 axis shows the implied interest rate adjustments (in basis points) in the respective month in which a monetary policy meeting is scheduled.
Source: Refinitv Eikon

Figure 8: FOMC Summary of Economic Projections



Note: The chart shows the median values of the FOMC members' projections for the future development of real GDP growth and PCE inflation (Personal Consumption Expenditures Price Index).
Source: Federal Reserve Summary of Economic Projections

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