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MONETARY POLICY OUTLOOK

March 2024

Switzerland

As we expected: The SNB has once again demonstrated its monetary policy independence by lowering the key interest rate by 25 bps to 1.50% at its monetary policy assessment on 21 March 2024 - a clear step away from the policies of the Fed and the ECB. While many observers considered a rate cut in March to be premature, this decision did not come as a surprise to us. However, the interest rate markets reacted to this decision with surprising restraint.

The momentum of inflation in Switzerland is slowing faster than initially assumed. Since the December meeting, a series of extraordinarily positive inflation data has accumulated, prompting the SNB to adjust its forecasts at its March meeting (Figure 1). Despite the reduction in the key interest rate to 1.50%, the SNB expects inflation to be lower than originally expected. This development confirms that price stability can be guaranteed and allows monetary policy to be eased accordingly.

The fears observed in other countries that rising real wages could lead to a renewed surge in inflation have no basis in Switzerland. The moderate increases in real wages expected in this country will probably only be sufficient to compensate for the loss of purchasing power over the last three years without creating new inflation risks (Figure 2). The results of the wage negotiations for 2024 underpin this assessment and were also included in the SNB's decision-making process.

Without the deliberate strengthening of the Swiss franc, inflation dynamics would have developed much more aggressively and would have followed a similar pattern as abroad, which would indeed have made a rate cut appear premature at this point. Currently, the real exchange rate of the Swiss franc is at a level that corresponds to that after the discontinuation of the minimum exchange rate - a situation that gives cause for concern (Figure 3). This could become a challenge for the SNB in the near future, particularly as it has had to resort to negative interest rates in the past in an environment of a strong franc and deflation.

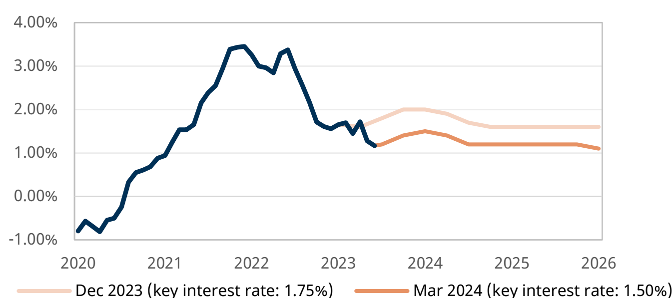
In a scenario in which inflation in both Europe and the US remains stubbornly above the target value of 2.0% over the next few years, while inflation in Switzerland remains close to zero, the SNB could come under increasing pressure. In addition to foreign currency purchases, it could become necessary to establish a greater interest rate differential to other currencies by lowering the key interest rate in order to counteract an appreciation of the Swiss franc.

The reaction in the medium and longer segments of the yield curve remained largely unimpressed and was only slightly lower than a week ago (Figure 4). This indicates that there is still some uncertainty and risk assessment in the longer-term perspective, which has not been completely dispelled by the first rate cut.

Our expectation

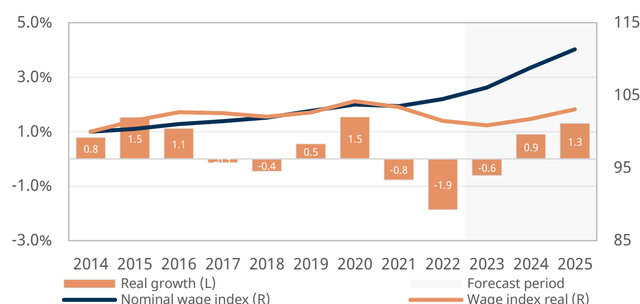
We expect the SNB to cut the key interest rate again by 25 bps in June. Depending on inflation trends and the real development of the Swiss franc, a cut of 50 bps cannot be ruled out.

Figure 1: New inflation forecast



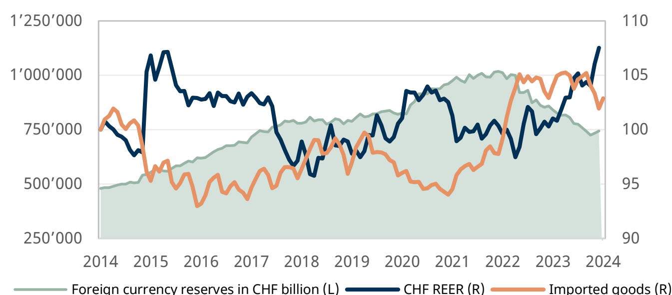
Note: The chart shows the current development of inflation and at the same time depicts the SNB's inflation forecasts as they were made at the time of the last monetary policy assessment. These forecasts are based, among other things, on the assumption that the key interest rate will remain unchanged over the entire forecast period of three years.
Source: Data from SNB, BfS, as at 22 March 2024

Figure 2: Wage price development



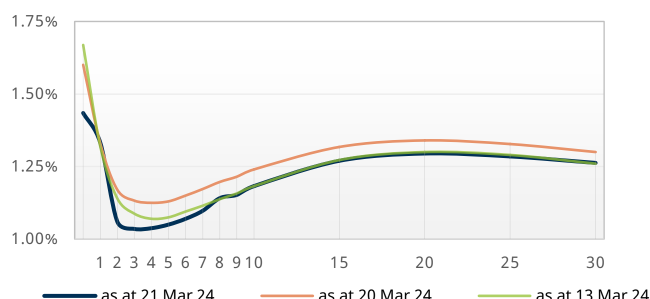
Note: The chart shows the historical development of the Swiss wage index in both nominal and real terms and also presents KOF forecasts.
Source: Data from BfS, KOF, as at 22 March 2024

Figure 3: Strong Swiss franc



Note: The chart shows the SNB's foreign currency reserves in CHF bn (left-hand axis), the Real Effective Exchange Rate (REER) and the inflation index for foreign goods (right-hand axis). The REER is a weighted average of a country's exchange rates against the currencies of its most important trading partners, adjusted for inflation differences. It measures the purchasing power of the Swiss franc relative to the currencies of its trading partners.
Source: Data from SNB, BfS, BIS, as at 22 March 2024

Figure 4: 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, as at 22 March 2024

Abroad

As expected by the market, the ECB and the Fed decided in favour of another interest rate pause at their March meetings. However, it is becoming apparent that both central banks are prepared to cut interest rates in the summer, with the ECB tending to take a more aggressive approach than the Fed.

Communication from both central banks has increasingly taken on a dovish undertone, suggesting that a first interest rate cut is imminent. Inflation trends in both economies continue to move in the desired direction, albeit slowly and stubbornly. It has been clearly signalled that inflation rates do not necessarily need to be close to the upper target of 2.0% for interest rate cuts to be considered. However, clear evidence of a sustained slowdown in inflation is required before a change in interest rate policy can be considered.

The ECB has emphasised the development of wages and salaries as a decisive factor for the possibility of an interest rate cut. In the last quarter of the previous year, growth in negotiated wages slowed slightly (Figure 5). However, this slight change alone does not seem sufficient to justify a cut in interest rates. If the data for the current quarter, which is expected in May, shows a continuation of this slowing trend, a rate cut in June, or July at the latest, could become realistic.

The situation is somewhat more complex for the Fed. Rising wages are also important here, although a longer-term trend of falling growth rates is already recognisable. However, the surprisingly strong consumer spending, which is making a significant contribution to the unexpectedly high economic growth rates, is problematic. Despite some indicators such as stagnating retail sales, which could point to an incipient slowdown, the economy remains robust overall (Figure 6).

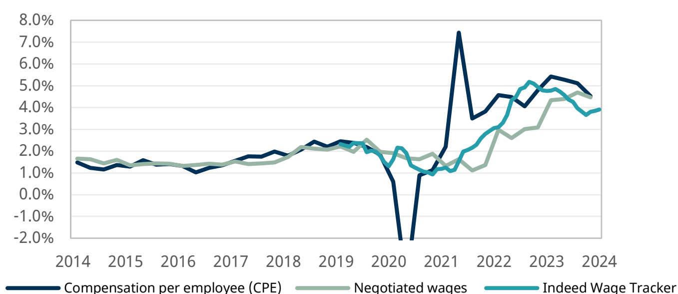
Prices for services are labour-intensive. A premature reduction in interest rates could stimulate consumer demand and thus rekindle the wage-price spiral. This risk is one of the main reasons why the Fed has so far shied away from cutting interest rates. However, there is growing evidence of a slowdown in the labour market, and should a slowdown in consumer behaviour also become apparent, this could give the Fed the leeway to reduce interest rates.

The Federal Open Market Committee (FOMC) has left its median projection for the US key interest rate unchanged, which can be seen as a positive sign, as the decision-makers are signalling their adherence to the expectation of three interest rate cuts in the current year (Figure 7). This assessment appears to be largely in line with current market expectations (Figure 8).

Our expectations

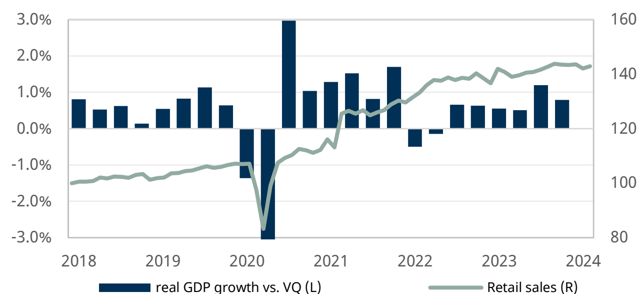
We assume that the data situation will give the ECB sufficient reason to initiate an initial interest rate cut of 25 bps by June. For the Fed, we expect the first rate cut to take place at the last summer meeting in July.

Figure 5: Wage trends in the eurozone



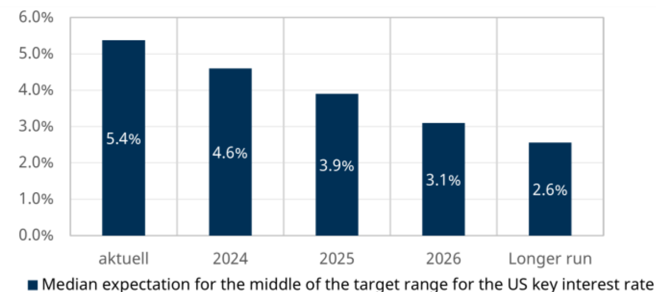
Note: The chart shows the development of various indicators for monitoring wage trends in the eurozone.
Source: Data from ECB Data Portal, GitHub, as at 22/03/2024

Figure 6: US economic growth and retail sales



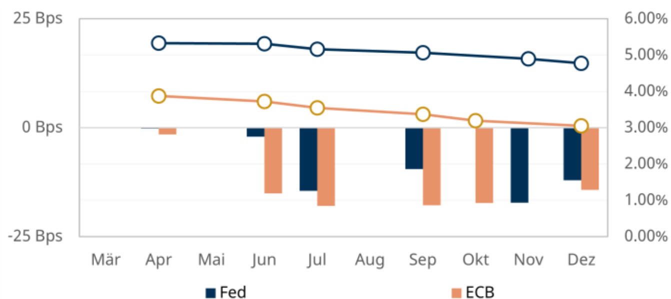
Note: The chart shows the quarterly development of real economic growth in the USA as well as the development of retail sales, which are indexed to 100 as at 1 January 2018.
Source: Data from Fred, as at 22/03/2024

Figure 7: FOMC meeting: expectations for the US key interest rate



Note: The chart shows the median values of the middle target range for the federal funds rate, based on the FOMC participants' assessments of appropriate monetary policy.
Source: Data from FRED, Fed, as at 22 March 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 the 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 22 March 2024

CONTACT

Burak Er, CFA
Head Research

Avobis Group AG
Brandschenkestrasse 38
8001 Zurich

T: +41 58 255 49 09
burak.er@avobis.ch

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