SWITZERLAND

THE SWISS FRANC: AN UNWAVERING SHIELD AGAINST INFLATION

Switzerland differs from other European countries in that it has significantly lower inflationary pressures, protected as it is by its strong currency and by resilient business activity which should continue to grow for the rest of 2022 and during 2023. Although the Swiss National Bank (SNB) is likely to argue that 3.5% inflation year-on-year in August is a reason to raise its key rate by 75 bps on 22 September, and so exit from its policy of negative interest rates, it is unlikely that this monetary tightening will last over the longer term, as inflation is already showing signs of slowing down.

Apart from a period of stagnation in the 1st quarter of 2021, Swiss GDP has continued to grow since the start of the post-Covid recovery. It has even returned to its pre-Covid growth path. In the 2nd quarter of 2022 GDP showed an increase of +0.3% q/q, buoyed by the momentum in private consumption (+1.4% q/q) which itself has been supported by the upturn in activity in the hotel/catering sector (+12.4% q/q). However, the catch-up is not yet complete in this sector since activity is still 10% below its pre-crisis level, as is the case in the leisure sector (-17%). Investment is the only dark cloud in terms of domestic demand, since it is still running at a lower level than at the end of 2019, exacerbated by investment in construction which is 6.4% below its pre-crisis level.

Switzerland is unlikely to be spared the global economic slowdown in the 2nd half of 2022, but the country should avoid recession. According to the OECD, growth should be around 2.5% this year, before slowing to 1.3% in 2023. Leading indicators are giving contrasting signals, but overall activity should continue to grow. The sector-based indicators of the latest KOF economic barometer show that growth in the services sector is likely to remain positive, but it may slow down in the industrial sector. The manufacturing PMI is more positive because, despite a slight slowdown in recent months, it is still clearly in expansion mode (56.4 in August). For the first time since 2007, the Swiss National Bank (SNB) tightened its monetary policy on 16 June by raising its main key rate by 50 bps (from -0.75% to -0.25%). And it is likely to turn the screw again with another 75 bps rise at its next meeting on 22 September. The later actions of the SNB, compared to those of the FED and the BoE, can be explained by the fact that the inflationary shock has been less severe in Switzerland. The SNB also wants to avoid stifling this dynamic too quickly, emerging from 20 years of a fight against deflation (since 2000, Switzerland has experienced 81 months of negative inflation, i.e. 42% of the time). Swiss inflation only exceeded the SNB's target[1] in the early part of 2022, while this phenomenon appeared in the rest of Europe around the end of 2021. Furthermore, price rises have been modest, since inflation was only 3.5% in August year-on-year compared with 9.1% in the Eurozone. As a yearly average inflation should be 2.8% in 2022, before tailing off to 1.9% in 2023, according to OECD forecasts.

The main reason for the lower inflation in Switzerland is the strength of the Swiss franc, which so far has been able to substantially contain the rise in import prices. A second determining element is the fact that the domestic market is a very low inflation environment (with companies controlling their costs, including their payrolls), as evidenced by production prices which barely exceed the rise in consumer prices (+4.1% in July over one year) and which are already showing signs of easing as they have fallen for the 3rd consecutive month. It therefore seems unlikely that the SNB will engage in a process of monetary tightening to the same extent as the FED or the ECB, because inflation is showing signs of slowing down and an increase in interest rates would lead to a further strengthening of the franc, which would harm exports and adversely impact the economic situation.

GROWTH & INFLATION

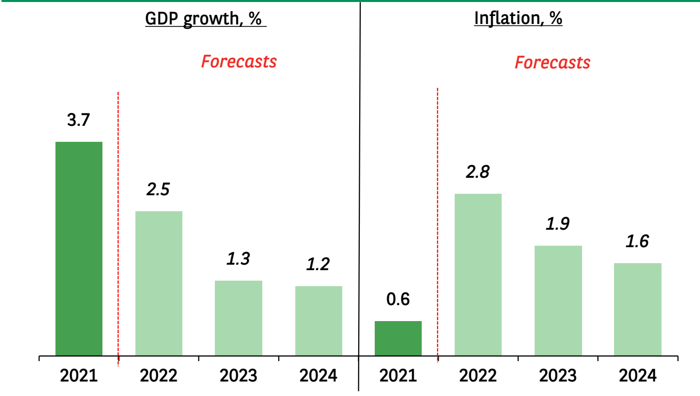

CHART 1

SOURCE: OECD, BNP PARIBAS

SWITZERLAND: INFLATION, PRODUCER PRICE AND POLICY RATE

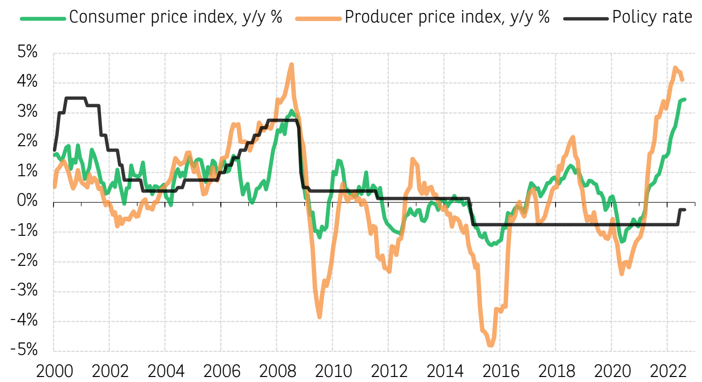

CHART 2

SOURCE: MACROBOND, SNB, BNP PARIBAS

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1 the Swiss National Bank (SNB) : The SNB "equates price stability with a rise in consumer prices of less than 2% per annum. Deflation - i.e. a sustained decrease in the price level - also breaches the objective of price stability. "