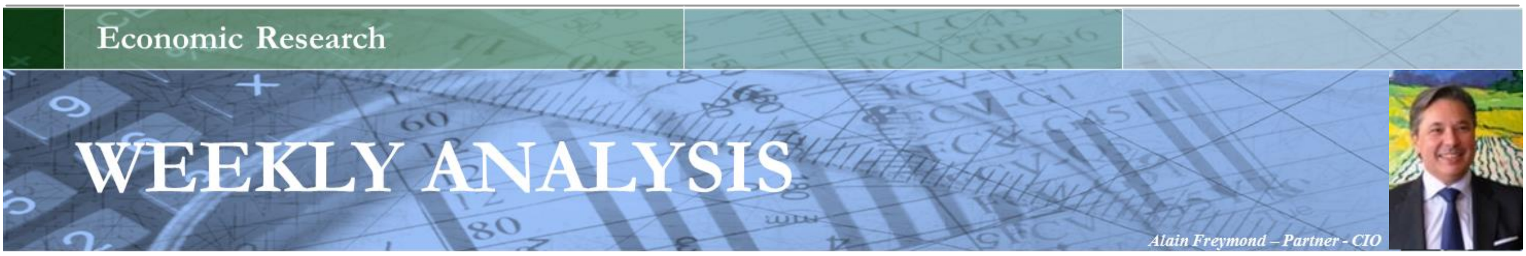



*5th March 2018*

# Swiss GDP forecasts revised: +2.2% in 2018

**The Swiss franc's weak spell is not over. The bond bubble is deflating. Tensions on the interest rate curve. Corrections to risky assets could represent an opportunity.**

## Key Points

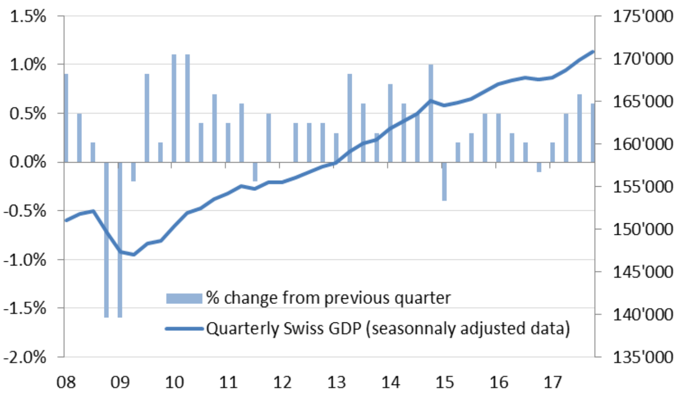
- The forecast acceleration of Swiss GDP in the second half of the year will continue in 2018
- +2.2% GDP growth in 2018
- Leading indicators are looking good
- Consumption will continue to be a key factor
- Boost expected for foreign trade
- The SNB should be pleased with its policy
- Historic CHF 54.4 billion profits for the SNB
- The Swiss franc's weak spell is not over
- Tensions on the interest rate curve in Switzerland
- The bond bubble is deflating
- Reactions are stronger on long maturities
- The correction on risky assets could represent an opportunity

## The forecast acceleration of Swiss GDP in the second half of the year will continue in 2018

**The State Secretariat for Economic Affairs (SECO) published the latest Swiss growth figures last Thursday. Swiss GDP is still showing excellent growth in the 4th quarter (+0.6%) compared to the unrevised results for the previous quarter. As such, the Swiss economy has backed up its good Q3 results of +0.7% after revision, giving it an excellent second half of 2017, and meaning it closed the year with a very pleasing +1.9% rise compared to the same quarter 2016. This figure was 0.2% higher than economists' forecasts, pointing to a positive 2018.**

As such, Swiss GDP has climbed back up to a growth rate of more than +0.5% per quarter, and fits into the more favourable trend seen in Europe and most other industrialised countries over the past few quarters. Real terms GDP growth, as measured by the SECO, should hit +1% for 2017. Despite having picked up the pace significantly in the second half of the year and the recovery broadening to encompass most sectors, the tentative start to the year is holding back annual performance. The Swiss economy has therefore considerably improved its quarterly growth rate, giving glimmers of better prospects for 2018, especially in light of the expected ongoing improvement in the global economy, as well as positive exchange rate conditions. Switzerland is finally enjoying the improvement in the international trend, which we believe to be more in step with the Swiss economy's development capacity within a more robust global context in 2018.

**Swiss Economy Performance (GDP in Millions CHF)**




*Sources: SECO, BBGI Group SA*

This faster pace has been propped up by the very stark recovery of the industrial sector, services and construction. Consumption continues to be a strong driving force, whilst, surprisingly, foreign trade trod water in a context in which currency conditions were nonetheless favourable due to the rise in the Euro. The manufacturing sector made a considerable contribution, given that it is still boosted by the Swiss franc's weakness against the Euro. The manufacturing sector's +1.2% growth is certainly lower than the previous quarter (+2.2%), but its performance remains high. However, it came in lower than construction, which posted an excellent, above average performance of +1.4%. Most economic branches of the services segments posted growth, with the financial sector standing out with a +2.3% leap. Hospitality and catering seem to be benefiting from the "weak" Swiss franc (+1.6%), whilst health has maintained its +0.4% growth rate. Domestic demand still formed the cornerstone of growth, thanks to a positive combination of private spending, which is losing momentum (+0.2%), public spending (+0.5%), and construction investment (+1.1%). Investment in capital goods dipped after a robust Q3. Trade in goods and services did not make a positive contribution (-1.4%), following on from a very strong quarter beforehand (+2.1%). From a currency point of view, the quarter was especially important for the Swiss economy due to the forecast ongoing weakening of the Swiss franc against the Euro. The exchange rate correction, which we had been forecasting as soon as the Swiss franc-Euro floor was lifted, is now materialising, and is propping up growth. The movement revaluing the Euro from 1.06 to 1.18 Swiss francs contributed considerably to improving economic conditions. After having stood strong in the face of the Swiss franc's appreciation, the Swiss economy is now benefiting from normalisation of the exchange rate. This situation should continue in 2018.

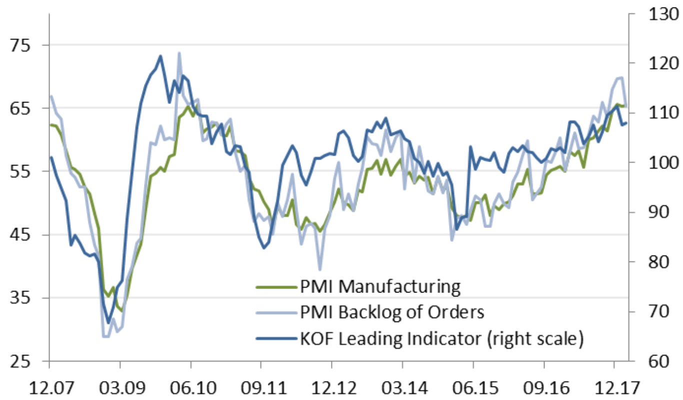
## +2.2% GDP growth in 2018

The economic trend and the adjustment of the Swiss franc's value are set to continue, which should enable the Swiss economy to further catch up with the lead peloton of the main European economies, perhaps exceeding +2% growth in 2018. In 2018, the Swiss economy will benefit from the general improvement in the economic climate and consumer confidence to an even greater degree than in the second half of 2017. The increasingly robust economic situation that should be seen in Switzerland's major economic partners in 2018 will act as a springboard for this trend. The Swiss franc's weakness against most currencies will make Swiss-made products more attractive. We have revised our Swiss economic growth forecasts upwards from +1.8% to +2.2% for 2018.

## Leading indicators are looking good

The latest leading indicators were perhaps temporarily influenced by renewed uncertainty on financial markets in February, but they are still pointing to very strong economic activity for the coming months. In February, the KOF index was down (108) compared to November (110.3), which had marked the highest levels of optimism since 2010. However, the indicator is still on the right track to suggest that the current sunny spell will continue.

**PMI - KOF**




*Sources: Bloomberg, BBGI Group SA*

The manufacturing PMI indicator is also showing signs that the robust trend already underscored in 4th quarter GDP results will continue. It is now at its highest level (65.5) since July 2010 (65.6). Three years after the Swiss franc-Euro floor was dropped, the Swiss manufacturing sector seems to be back on its feet again, as suggested by the index, which has hit a ten-year high. The purchasing managers index is showing levels of enthusiasm rarely seen either for the manufacturing or the services sectors (62.9 compared to 62.8 in January). The expected order book evolution indicator has retreated slightly (65.4 compared to 69.8 in January), but the employment indicator has continued to rise. The spending climate remains good, despite the dip in the UBS consumer confidence indicator in December. The SECO yardstick has risen considerably, and has hit its highest level since 2011. Leading indicators are still suggesting that the Swiss economic trend will strengthen.

## Consumption will continue to be a key factor

The latest drop in unemployment to 3.1% leaves it far from the +2.5% record in 2008, but the labour market is showing enough vim and vigour to enable consumption to gradually increase. Household confidence has been gradually improving since 2015, though without reaching levels seen in 2014. The improvement in growth prospects and the rise in the Euro should also influence the Swiss economic climate to a greater degree over the coming months. As such, private spending should remain a positive factor, propping up GDP. Public administrations' consumer spending will remain volatile in 2018, but national- and cantonal-level accounts are in good shape, and the debt to GDP ratio (34%) remains low when compared internationally. This provides grounds for the lack of change in the situation regarding public spending.

## Boost expected for foreign trade

Although still clearly in surplus, the trade balance has been eaten away at since its peak in January 2017. The monthly foreign trade balance has in fact stabilised at between 2 and 3 billion Swiss francs. However, we believe that the improvement in international economic conditions and the weakness of the Swiss franc should finally join in supporting an export recovery. In January, the recovery of the watch-making sector was confirmed with a +12.6% year on year rise in exports. Machinery exports should also make a positive contribution given the context.

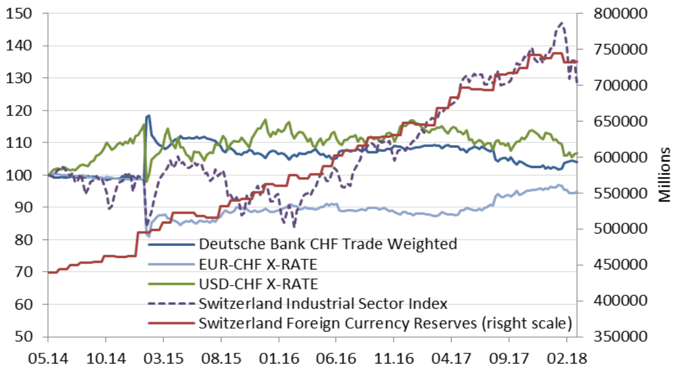
## The SNB should be pleased with its policy

Since January 2015, we have regularly stated in our strategy analyses that the SNB's monetary policy would be a success, frequently mentioning the return of the EUR/CHF exchange rate to the 1.20 floor rate. We had to wait for the European economy to improve significantly in 2017 alongside the prospect of an end to ECB liquidity injections in 2018 for normalisation to get underway and then speed up. Today, the exchange rate has hit 1.18, and is hovering barely 2% away from the floor rate from January 2015. As such, the SNB should be pleased with its policy over the last few years, which is increasingly proving to be a major monetary strategy success, as shown by the historic CHF 54.5 billion in profit for 2017, nearly doubling the previous year's profits. The SNB's currency reserves gathered over the past few years hit a 744 billion Swiss franc peak at the end of the year. However, at the end of February they posted their first contraction, although small, since 2015, falling to CHF 732.7 billion. Market effects over the past few weeks certainly explain the drop in currency reserves, so there is as yet no need to read into it a change in SNB policy.

## The Swiss franc's weak spell is not over

The rise in the Euro is already well underway following a +20% change in the exchange rate. Increased Eurozone growth and a widening of the interest rate differential will help the Euro to continue to grow to 1.20. In the United States, the trend is also picking up the pace, and the interest rate curve increasingly favours the US dollar. In this context, a recovery of momentum could take the US dollar above 1.05.

**Exchange Rates and SNB Reserves**



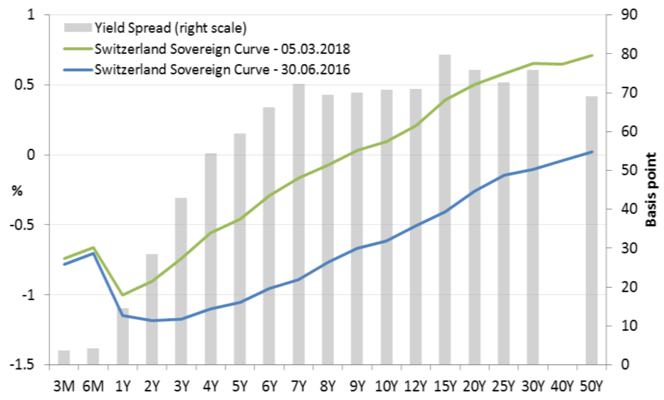

*Sources: Bloomberg, BBGI Group SA*

## Tensions on the interest rate curve in Switzerland

Long rate normalisation in Switzerland got away to a tentative start in summer 2016 in the wake of the change in trend in the United States. Swiss ten-year rates in particular bounced back from their historic low of -0.6% to oscillate between -0.2% and 0% throughout 2017. Last year was therefore mostly a year of horizontal consolidation during which Swiss bond markets did not post a performance, but neither did the speculative bubble burst, as had been so often predicted for several years. This situation will certainly not last in 2018.

We have already been seeing a first significant shift in long rates for a few weeks now, which has finally brought Swiss long rates above the 0% threshold. In just a few weeks, long rates have leapt 40 basis points, and now clearly seem to be on a lasting upward trend. The rise of Swiss long rates at the start of this year heralds a faster pace of interest rate normalisation in Switzerland. This upward movement on ten-year rates is not isolated, of course, and is reproduced across the whole rate curve. This change only started to happen in the 4th quarter 2016 with a first rise of 40 basis points, and is now continuing in the 1st quarter 2018, and to a greater degree, on long-term maturities. The SNB's monetary policy of negative key rates is still influencing the very short part of the Swiss rate curve and is preventing any increase in yield on the very end of the curve. Ever since the start of this first shift (30/06/2016) short-term maturities have naturally had a muted reaction, whereas longer-term maturities have risen by 70 basis points for between 7 and 12 years. Further, the yield correction stood at 80 basis points for 15-year maturities. The rate curve is now steepening, as we mentioned in previous analyses, and should do so to a greater degree in 2018.

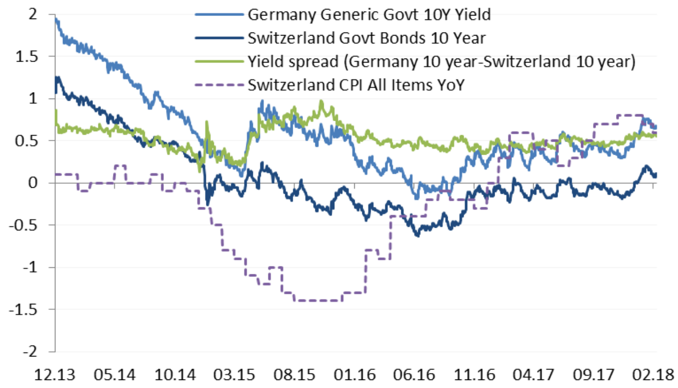
**Swiss Interest Rate Curve**




*Sources: Bloomberg, BBGI Group SA*

In this context, the long rate differential for the German Bund and Swiss bonds has not really changed, although it is a little higher (0.56%) than on 30th June 2016 (0.4%). This trend should continue in 2018, especially given the improvement in the European trend and the plan to end the ECB's bond purchases. Yield for ten-year Swiss bonds stood at 0.18% when it was announced that the 1.20 Euro-Swiss franc floor would be dropped. It hit 0.2% on 15th February 2018, shortly after the Euro/CHF exchange rate had hit 1.18. Equally, Swiss inflation posted one of its strongest months of growth since 2012 in February (+0.4%), and now sits at +0.6% year on year. This trend should be bolstered by the weakening of the Swiss franc. It should therefore prop up the next phase of interest rate normalisation in 2018. We have already stated that the bond bubble should start to deflate, though with no immediate signs of panic, before picking up the pace. We believe that this new faster-paced phase has already begun.

**EUR-CHF 10-Year Interest Rates**




*Sources: Bloomberg, BBGI Group SA*

## The correction to risky assets could represent an opportunity

In 2017, equity markets benefited from a favourable economic and financial context, but at the end of the year we were already concerned by an increased risk of a price correction in 2018. At the end of January, fresh fears of inflation increases in the United States surfaced, and key rates sparked an adjustment to long rates and to equity market valuations. This was obviously not limited to assets in US dollars. The correction to Swiss equities in February has already considerably reduced valuation levels, as seen in the price/profit ratio of Swiss indices, for example. We had stated that it was very likely we would see a short-term fall in prices at the start of the year; in the end, this drop hit -10%, and has therefore pulled valuations down from 17x to 15x. As such, the SPI is now trading at around 10,000 points, after having corrected 1,000 points from its peak in January (11,000) to bring it back down to levels seen at the end of April 2017.

**This correction to Swiss equities as a whole is now already offering a purchase opportunity for investors with an eye to the long-term. However, the possibility of the volatility seen over the last few weeks continuing and offering even better opportunities still cannot be excluded for a while.**



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