

Economic Research  
**WEEKLY ANALYSIS**



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## Swiss GDP expected to accelerate to +1.8%

**Manufacturing sector boom. Exports and consumption likely to recover. The Swiss franc will continue to be weak. More than 25 billion in profit for the SNB in 2017.**

### Key points

- GDP rose +0.6% in the 3<sup>rd</sup> quarter, and +1.2% yoy
- Strong prospects for the last quarter
- GDP growth for 2017 estimated at +1.5%
- Favourable forecasts for 2018- GDP growth could even exceed +1.8%
- Leading indicators suggest that the economic bright spell will become even brighter
- The manufacturing sector is absolutely booming again
- Consumers are still cautiously optimistic
- The SNB is on the cusp of celebrating the success of its exchange rate management policy
- More than 25 billion in profit for the SNB in 2017
- The weakness of the Swiss franc is not over
- The rate curve is steepening
- Renewed risk for equities and real estate

**Swiss GDP is expected to have picked up the pace in the second half of the year and should continue to do so in 2018**

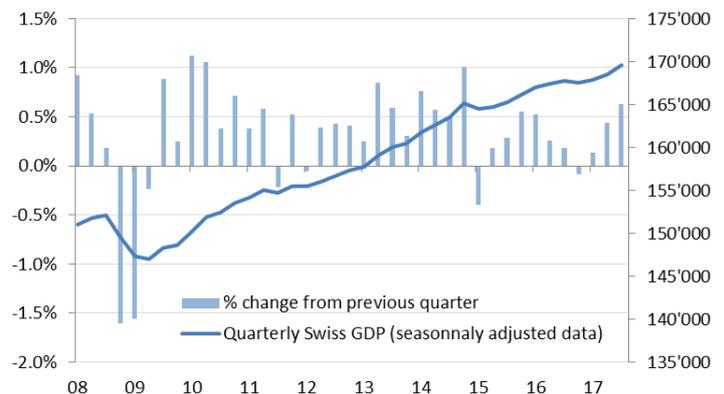
Last Thursday, the State Secretariat of Economic Affairs (SECO) published the latest growth figures for Switzerland. Swiss GDP slightly picked up the pace in the 3<sup>rd</sup> quarter (+0.6%) as compared to the previous quarter, the results of which had been revised upwards from +0.3% to +0.4%. As such, the Swiss economy has posted its best growth rate since the 4<sup>th</sup> quarter 2014, before the SNB (Swiss National Bank) changed its monetary policy on 15<sup>th</sup> January 2015. In the end, growth could come in at +1.5% for 2017, after another robust 4<sup>th</sup> quarter. This result is particularly encouraging for 2018. Swiss GDP has recovered to a growth rate greater than +0.5% per quarter, and also seems to be benefiting from the positive trend over the past few quarters in Europe and in most industrialised countries.

In fact, since 2012, quarterly growth has only come in higher than that of the previous quarter three times, which shows just how positive the current trend is.

The Swiss economy is therefore significantly picking up the pace of its quarterly growth, giving a glimpse of better prospects for 2018, particularly if the global economy continues to improve as expected and exchange rate conditions remain favourable.

Having been a bit behind the European and global trend in the 2<sup>nd</sup> quarter, the 3<sup>rd</sup> quarter results seems better in line with Swiss economy's growth capacity within a more robust international context over the summer. The disappointment that came with the publication of 2<sup>nd</sup> quarter figures can now give way to satisfaction grounded in results which came in better than most forecasters' expectations.

### Performance of the Swiss Economy (GDP in millions of CHF)



Sources: SECO, BBGI Group SA

Year on year growth (+1.2%) has pushed past the +1% threshold, which is a very clear improvement compared to June's result (barely +0.3%), and well above the average analyst forecast of +0.8%. This rise was propped up by domestic sectors (consumption, investment, etc.) as well as international sectors (exports).

**The manufacturing sector was the largest contributor, likely buoyed up by the weakness of the Swiss franc, which fell nearly -8% against the Euro in a period of a few weeks.**

The +2.2% growth is particularly significant in light of other sectors whose contributions to growth were lesser. Trade (+0.6%) and healthcare (+0.5%) posted positive developments, whilst finance and construction each slid -0.6%. Domestic demand was still the mainstay of growth, thanks to a very positive combination of private spending (+0.4%) and public spending (+0.6%). However, the performance of these two sectors is not exceptional, and is not in the same league as average historic contributions. One must turn to capital goods for higher-than-average performance. With +0.9% growth, this segment contributed considerably to the quarterly GDP result, thanks in particular to positive developments in the machinery sector. The trade balance for goods and services is enjoying a particularly favourable situation, as demonstrated by a rise in exports (+2.1%) and a fall in imports (-1.6%).

The quarter was particularly important for the Swiss economy in terms of currency, due to the Swiss franc weakening against the Euro, in the end rather considerably. The exchange rate correction, which we had predicted in the immediate aftermath of the Euro floor being dropped, is now materialising, propping up growth. We believe that the revaluation of the Euro from 1.06 to 1.174 (on 5/12/2017) has significantly helped to improve economic conditions and the perception of risks and opportunities. After having stood strong in the face of the Swiss franc's appreciation, the Swiss economy is now benefiting from exchange rate normalisation. We believe that this situation should continue in 2018, bringing a little more stability to the external value of the Swiss franc.

### Very favourable forecasts for 2018

The current economic trend should continue, enabling the Swiss economy to make sure it is sticking even more firmly with the front peloton of the main European economies, who are set to close 2017 with +2.5% growth.

**As such, we are expecting an approximately +1.5% rise in GDP in 2017, thanks to the positive trend of the last few months continuing into the 4<sup>th</sup> quarter. This will certainly precede a further acceleration to +1.8% in 2018.**

The 1<sup>st</sup> half of the year was rather disappointing due to the unexpected slump in spending in the 2<sup>nd</sup> quarter.

However, we had thought it likely we would see a recovery in the second half of the year, as well as an improvement in exports, which would contribute to the overall acceleration seen in the 3<sup>rd</sup> quarter. The end of the year should still favour the Swiss economy due to the stronger trend in the Eurozone and a robust export recovery, both propped up by the fall in the Swiss franc against the Euro, as well as revived private spending.

### Leading indicators also suggest that things are looking bright for 2018

The latest leading indicators are pointing to economic activity picking up the pace. The KOF index came in at 110.3 for November, which is up 4.3 points compared to the end of September, and at its highest level since 2010. The hesitancy of summer is gone; leading indicators are clearly positive and suggest that 2018 is looking bright.

#### PMI - KOF



Sources: Bloomberg, BBGI Group S.A

The manufacturing PMI index literally leapt, from 55.5 in May to 65.1 in November. This is absolutely extraordinary, as it demonstrates the sector's recovery, which was already clearly visible in the 3<sup>rd</sup> quarter GDP figures. Two years after the shock of dropping the Euro exchange rate floor, the Swiss manufacturing sector seems to be finding its place again, as is suggested by the manufacturing index hitting a ten-year high. The purchasing managers index is showing enthusiasm such as has rarely been seen. Order books are full, which bodes well for a robust trend in 2018, particularly if the exchange rate stabilises at around 1.20 Swiss francs to the Euro, and above 1.05 to the US dollar. Moreover, the consumption climate is improving, as can be inferred from SECO and UBS measures, as well as the considerably increased investor confidence.

**After wavering for a brief period, at the end of the year leading indicators are pointing to the economic trend in Switzerland intensifying.**

## Cautious optimism for consumption

The latest drop in the unemployment rate to 3.1% still leaves it far from the record low of 2.5% in 2008, but the jobs market is showing enough vim and vigour for consumption to gradually increase. Household confidence has been gradually increasing since 2015, though without hitting levels seen in 2014. The improvement in growth prospects and the rise in the Euro should have a greater and more positive influence on the economic climate in Switzerland over the coming months. Private spending should therefore continue to prop up GDP. Public administrations' consumption spending will remain volatile in 2018, but the national and cantonal accounts are in rather good health, and the debt-to-GDP ratio (34%) remains low when compared internationally. We see no reason to predict a fall in public spending in 2017, and reckon on it making a positive contribution.

## Recovery expected for foreign trade

Despite the rise in the Euro over the summer, the trade balance has yet to benefit from the increased competitiveness of Swiss exports to the Eurozone. Although it still has a clear surplus, the trade balance has seen no further positive developments like those seen in January 2017. In fact, the monthly foreign trade balance has stabilised at between 2 and 3 billion Swiss francs. However, we believe that the improvement in international conditions and the weakness of the Swiss franc should finally combine to support an export recovery. The watchmaking recovery has got back on track, posting a +9.3% increase in sales year on year at the end of October. With the exception of the United States (2<sup>nd</sup> largest market), which was down slightly, growth to Hong Kong (largest market) stood at +5.4%, and came in at +17.3% for China (3<sup>rd</sup> largest market).

## The SNB has the champagne on ice

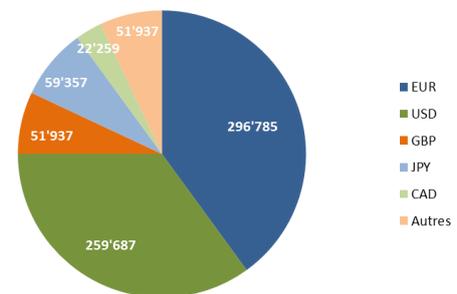
Since January 2015, we have regularly maintained in strategy analyses that the SNB's monetary policy would be a success. We have frequently mentioned that the EUR/CHF exchange rate would return to the 1.20 level it was at when the Euro floor was in place. Introducing negative rates quickly stabilised the exchange rate, though it remained inflated, and only gradually adjusted. We had to await a clear improvement in the European economic situation in 2017 and the prospect of the end of ECB liquidity injections in 2018 for normalisation to begin and then speed up. Today, the exchange rate has hit 1.175 and is barely 2% away from the Euro floor rate in place in January 2015.

The SNB can therefore be pleased with its policy over the last few years, which is increasingly proving to be a major success in terms of monetary strategy. Let us hope that they can pop the cork on the champagne on the 15<sup>th</sup> January 2018 with a 1.20 exchange rate exactly 24 months after their intervention, which in 2015 was mistakenly viewed as them abandoning the Swiss franc.

## 25 billion in profit for the SNB in 2017?

The SNB currency reserves accumulated over the last few years have brought the total assets held in foreign currencies to 741 billion Swiss francs.

### Distribution of SNB Currency Reserves (in millions)



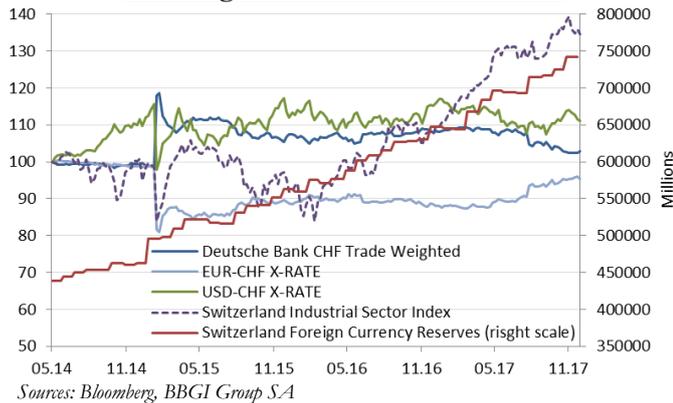
Sources: Bloomberg, BBGI Group S.A

The success of its policy will certainly have a significant impact on its financial results and its ability to make a positive contribution to the national and cantonal budgets when it distributes its profits, which will undoubtedly be higher than in 2017, linked to the 24 billion in profit for the 2016 tax year. Although the SNB has mainly provided support for the EUR/CHF exchange rate, it ensures it keeps a balanced distribution in its currency reserves between the US dollar (35%), Euro (40%), pound sterling (7%), yen (8%), Canadian dollar (3%), and other currencies, including the yuan, at 7%. We believe that the SNB will make around 25 billion Swiss francs in profit directly linked to capital gains on currencies in 2017.

## The weakness of the Swiss franc is not over

The Euro is rising well again after the +20% change in the exchange rate. Stronger growth in the Eurozone and a widening of the interest rate differential will support the Euro in rising to a 1.20 exchange rate with the Swiss franc. In the United States, too, the trend is picking up the pace, and the interest rate curve is increasingly working in the US dollar's favour. In this context, if the US dollar recovers some momentum, it could rise above 1.05.

### Exchange Rates and SNB Reserves



Swiss inflation has now headed north of 0.7%, and should be bolstered by the weakening of the Swiss franc in 2018. As such, it will prop up upcoming rate normalisation in 2018. The bond bubble should therefore start to deflate, with no immediate signs of panic, before picking up again.

### Renewed risks for equities and real estate

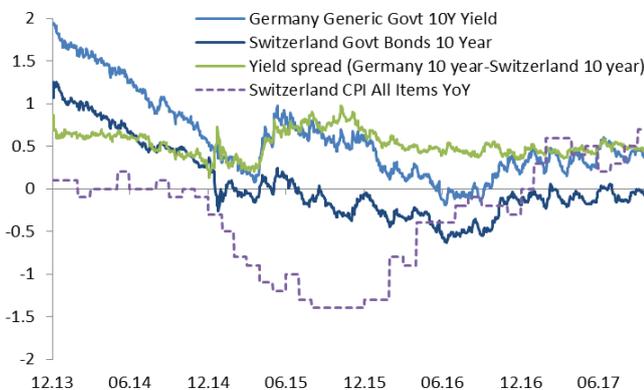
Equity markets and Swiss real estate investments have benefited from this favourable economic and financial context, but with roughly +15% growth in equities, valuations already seem high enough to spark some profit-taking. The same holds true for investment funds (+6.5%) and real estate companies (+12%), which have already seen some adjustments, making yield, which is now once again close to 3%, seem more appealing once again.

### The rate curve is steepening

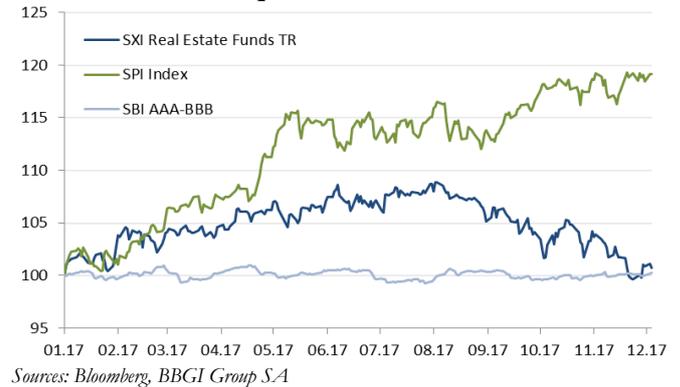
Long-term rates in Switzerland started to normalise in summer 2016 in the wake of the change of trend in the United States. 10-year Swiss rates have bounced back since their -0.6% levels at the start of July, stabilising at just below zero. In this context, the long-term rate differential between the German Bund and Swiss bonds is stable at 0.5%, which is certainly still not enough to push the Euro to rise beyond 1.20.

We are maintaining our positive forecasts for these two asset classes in 2018, but it seems increasingly likely that we will see a temporary price consolidation.

### 10-Year EUR-CHF Interest Rates



### Swiss Bonds, Equities and Real Estate in 2017



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