

Investing Opportunities in Switzerland

October 2011

- Short-term interest rates will begin rising if the currency depreciates
- Bond yields are unsustainably low and are likely to rise
- The franc will continue to fall and may fall sharply if risk aversion abates

Economic activity expanded briskly from the middle of 2009 until early 2011 with very accommodative macroeconomic policy supporting a private sector that was well positioned to expand. Economic growth was close to 3% last year but was already slowing in the first half of 2011 prior to the substantial tightening of monetary conditions arising from the franc's appreciation. If financial market turbulence abates and the franc continues its decline of recent weeks, growth should be moderate in the coming couple of years. Inflation will be moderated by competitive pressures even if the currency falls (see table of key forecasts). Conversely, if the dampening influence of the high currency were to continue for an extended period, both growth and inflation could be very low in 2012.

The Swiss National Bank lowered short-term interest rates down towards 0% during the 2008/2009 recession. Through 2010, the central bank wanted monetary conditions to tighten and this was delivered through the appreciation of the franc. In 2011, the rise of the franc tightened monetary conditions too rapidly and forced the SNB to offset this by lowering interest rates. Current 90 day futures suggest that short-term interest rates are expected to move below zero and not move back above the SNB's current target band before 2014 (see top chart). The risks are skewed towards an earlier rise, particularly if the franc reverses its appreciation of 2011.

10 year bond yields have fallen sharply during recent months in line with yields in other countries. The current financial market turbulence has contributed to bond yields moving to multi-decade lows (see middle chart). Yields are likely to remain "low" if the economic environment unfolds in line with our expectations but the current level is unsustainable. Swiss bond yields are likely to rebound in line with those of other countries.

The franc appreciated very sharply in the middle months of the year partly due to investors' rising risk aversion. This appreciation prompted a policy response from the SNB which included sizeable foreign exchange intervention. The franc has declined very sharply in recent weeks but it is still substantially above its previous highest point of recent decades (see bottom chart). The substantial loss of competitiveness by Swiss firms and the extremely low level of interest rates are likely to combine to ensure that the franc does not sustain its current elevated levels.

Swiss equities have been one of the worst performing developed markets during the past year, with the loss of firms' competitiveness probably having had a negative influence. If the franc remains high, Swiss corporates will remain under pressure. Conversely, if the franc were to continue its recent fall, the corporate sector would be in solid shape and there are few obvious reasons why Swiss equities would continue to underperform.

Key Forecasts			
	Dec-11	Dec-12	Dec-13
GDP	2	2	2
CPI	1	2	2
Repo	0.25	2.00	3.25
10 year	2.00	3.75	4.00
EUR/CHF	1.30	1.55	1.55
USD/CHF	0.93	1.24	1.32

