BCGE

Interest rates

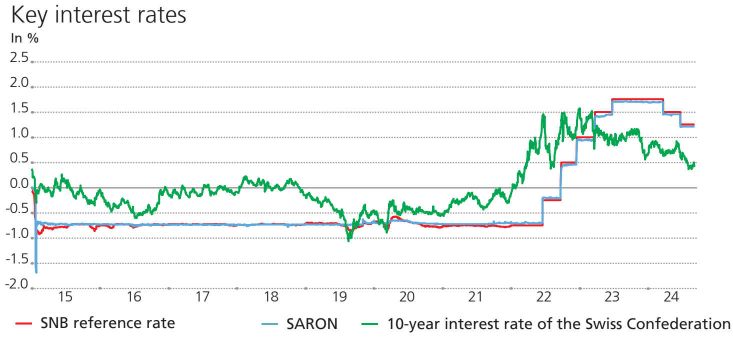
October 2024

Evolution & Outlook

Fluctuation limits

In the third quarter, interest rates – particularly US 2-year rates, which were the target of expectations concerning changes in the Fed's key interest rates – fell across the board. However, these movements were interrupted after the Fed's 50 basis point cut to 5%. Indeed, US rates quickly recovered, driven by rising inflation expectations. In Europe, the ECB continued to lower its key rates, reducing the main refinancing rate to 3.25% in mid-October. In Switzerland, in response to expectations of easing, the SNB also lowered its key rate by another 25 basis points, bringing it down to 1%, close to the equilibrium rate. However, the other bond maturities of the Confederation and the swap market are at levels below the key rate. Is this due to excessive expectations or a reflection of a lack of liquidity and abundant demand, particularly from private individuals keen to rebuild their bond portfolios that provide protection and a source of income again? In view of sticky domestic inflation and the sensitivity of inflation to external pressures and structural issues, further rate cuts in line with market expectations seem excessive. Rates should stabilise but at a higher range, justifying upward forecasts.

Key interest rates



Source: LSEG Datastream

After its appreciation against the US dollar and the euro in July, the Swiss franc stopped being a safe haven just as investors began to show a degree of nervousness about the delicate geopolitical context, over-interpreting the economic data published. Over the quarter, this caused the value of the Swiss franc against the US dollar and the euro to return close to the levels seen at the start of the year. Confronted with carry trades by speculators using the Swiss franc and Japanese yen to finance their transactions, the Swiss currency was also subject to foreign currency sales by the SNB. These liquidity management transactions were carried out against the backdrop of an existing Swiss trade surplus, which was boosted by pharmaceutical exports to the United States. The systematic appreciation of the Swiss franc against its main partner currencies is therefore mitigated by more temporary liquidity transactions.

Foreign exchange transactions and key interest rates are now part of the common monetary policy instruments. While the forex transactions are used to control pressure on imported prices, particularly for basic resources, the interest rates must ensure that domestic inflation remains anchored. Domestic inflation proves sticky, however, with wages and service prices continuing to increase at an annual rate of almost 2%. In a context where inflation expectations are confirmed at around 1% and where the persistence of a tight employment market does not leave room for an easing of wage conditions, it is difficult to integrate a key rate below core inflation. A risk that the SNB is not willing to take in a context of increased sensitivity of inflation to any potential shock.

Despite other central banks continuing their easing cycle, the SNB might pause to assess the effect of its comparatively early rate cut policy. Long-term yields, on which fixed mortgage rates are based, could oscillate at higher levels, allowing the yield curve to normalise and offer a return on investments higher than the financing costs incurred.

The Swiss franc, increasingly influenced by the SNB's interventions either to manage its balance sheet or to limit potential pressures from imported prices, will probably remain strong but its systematic annual appreciation, already more moderate against the euro and the US dollar since 2022, is likely to simply reflect the relative cost structure between regions, with a maximum annual appreciation of 1 to 2%. The normalisation of inflation rates in the various regions and the modified structure of the external accounts can justify the more moderate appreciation of the Swiss franc against its two main partner currencies.

In fact, the examination of Switzerland's external position reveals a change in the structure of the current account. The surplus, long fuelled by trade in goods, services and surplus income, has been transformed since 2020. The United States has overtaken Germany as the main market for Swiss exports, with more than 30% of pharmaceutical goods going to the US. Furthermore, trade in services and in income from shareholdings in companies no longer generates a surplus. This change conceals an industrial structure weakened by Switzerland's exit from major European research and development programmes such as ITER (nuclear fusion) and QuantERA (quantum technology). These changes are not without consequences for the strength of the Swiss franc and its competitiveness.

3-month interest rates	15.10.2024	3 months	12 months
Switzerland	0.94	1.00	1.00
Eurozone	3.22	3.00	2.75
USA	4.85	4.75	4.00
10-year interest rates			
Switzerland	0.43	0.60	0.90
Eurozone	2.23	2.30	2.50
USA	4.03	4.20	4.50

Source: Refinitiv Datastream & BCGE outlook

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