SWITZERLAND: ECONOMIC ACTIVITY

SNB - BETWEEN A ROCK AND A HARD PLACE

Author

NADIA GHARBI, CFA
ngharbi@pictet.com

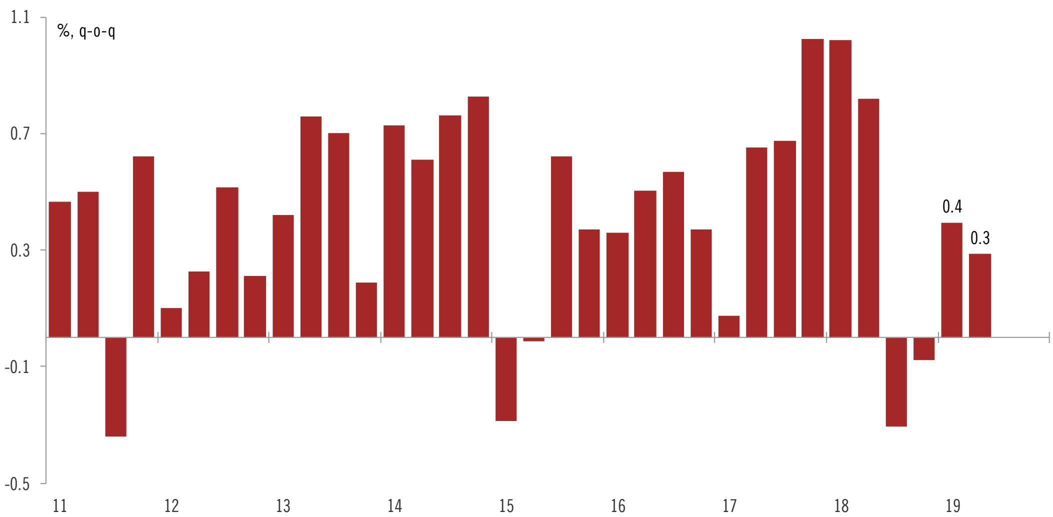
SUMMARY

- Swiss GDP rose by 0.3% q-o-q in Q2. Previous quarters were revised down and now show that Switzerland was in a technical recession in H2 2018. Unlike other European countries, however, manufacturing contributed positively to growth in Q2. But the devil is in the detail. The solid performance of manufacturing was mainly due to one segment—chemicals and pharmaceuticals, which is less sensitive to exchange rate movements and the economic cycle than others. Other industry sectors, specifically machinery and metals, reported declining turnover.
- The escalation of trade tensions led us to revised down our euro area GDP growth forecast this summer. As a small and open economy, Switzerland is particularly affected by weakening global demand and geopolitical uncertainties. Hence, we are lowering our Swiss GDP forecast to 0.8% for 2019 from a previous forecast of 1.3%. The downgrade also reflects the downward revision of GDP growth in prior quarters, which mechanically lowers annual 2019 GDP growth.
- There are high expectations that the SNB will cut rates at its monetary policy assessment on 19 September. But we believe that the SNB will be reluctant to cut rates, especially if the ECB cuts its deposit rate by (only) 10 basis points (bps), as per our baseline scenario.

Uncertainties and global slowdown are weighing on business investment

Swiss GDP rose by 0.3% q-o-q in Q2, compared with a downwardly revised increase of 0.4% in Q1. Previous quarters were revised down and now show that Switzerland was in a technical recession in H2 2018 (see *Chart 1* and Appendix).

CHART 1: SWISS QUARTERLY GDP GROWTH



Source: PWM - AA&MR, SECO

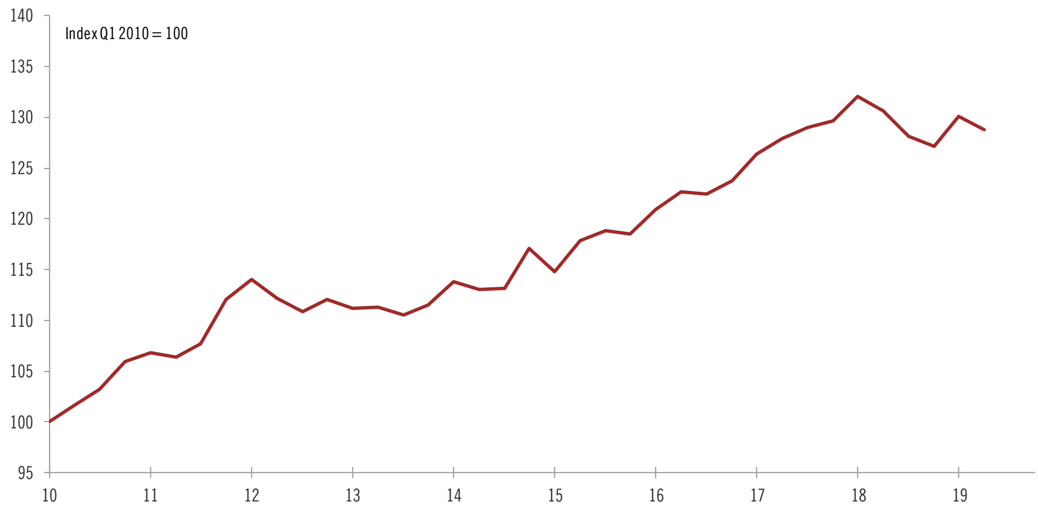
The GDP report revealed that household consumption expanded by 0.3% q-o-q in Q2, mainly due to spending in healthcare, housing and energy. The pace of growth in

SWITZERLAND: ECONOMIC ACTIVITY

SNB - BETWEEN A ROCK AND A HARD PLACE

consumption was a bit softer than the average growth of the last few years. Investment spending in equipment dropped by 1.0% q-o-q in Q2 as companies held up spending in machinery, according to the State Secretariat for Economic Affairs (SECO). Investment spending in equipment has been week since mid-2018 (see *Chart 2*). **Uncertainty and slower growth at the global level are probably weighing on business sentiment**. Investment in construction (-0.1%) was also a drag in Q2.

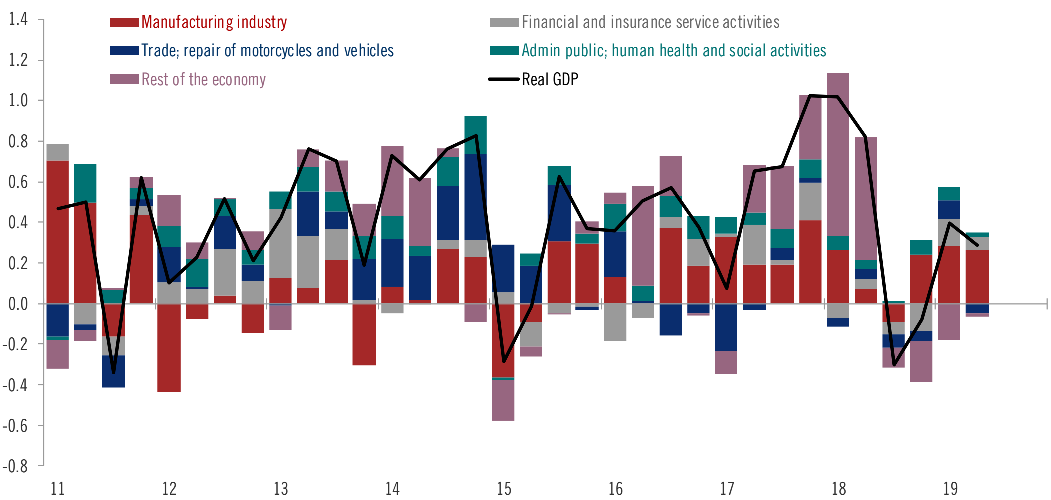
CHART 2: SWISS INVESTMENT SPENDING IN EQUIPMENT AND SOFTWARE



Source: PWM - AA&MR, SECO

A look at the production approach showed that unlike other European countries, **manufacturing contributed positively to growth in Q2. But the devil is in the detail. The solid performance of manufacturing was mainly due to one segment—chemicals and pharmaceuticals,** which is less sensitive to exchange rate movements and the economic cycle. Other industry sectors, specifically machinery and metals, reported declining turnover.

CHART 3: SWISS GDP BREAKDOWN – PRODUCTION APPROACH (% Q-O-Q AND PERCENTAGE POINTS)



Source: PWM - AA&MR, SECO

SWITZERLAND: ECONOMIC ACTIVITY

SNB - BETWEEN A ROCK AND A HARD PLACE

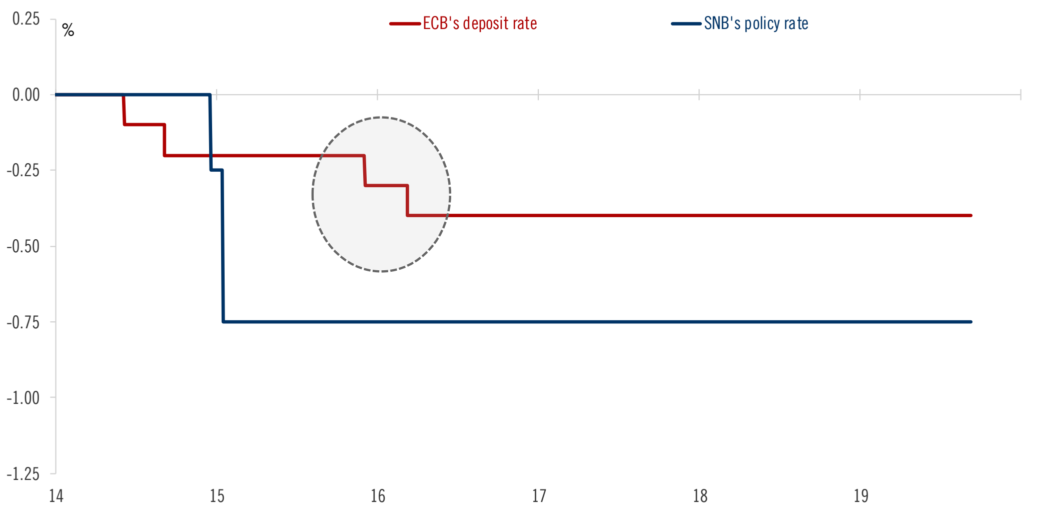
The escalation of international trade tensions led us to revised down our euro area GDP growth forecast in August (see our Flash Note here). As a small and open economy, Switzerland is particularly affected by weaker global demand. **Hence, we are now also lowering our Swiss GDP forecast to 0.8% for 2019 from 1.3%** (unchanged since November last year). The downgrade also reflects the downward revision of GDP growth in prior quarters, which mechanically lowers annual 2019 GDP growth *(see Appendix for further details).*

SNB: interventions in the FX market rather than a policy rate cut

Swiss National Bank (SNB) officials have emphasized the importance of the interest rate differential (mainly versus the euro area) for the exchange rate and thus the policy outlook. The SNB's policy rate differential with the ECB's deposit facility rate now stands at 35bp, below the 50bp it stood at in 2015 when the SNB lowered its interest rates to -0.75%.

However, **we believe that the SNB will be reluctant to cut rates in direct response to ECB easing, especially if the ECB rate cut widely expected this week is only 10 basis points (bps)**, as per our baseline scenario. This would not be the first time that the SNB does not follow the ECB with a policy rate cut of its own since the Swiss introduced negative interest rates in 2015 (see *Chart 4*). Instead, we believe that **the SNB could respond to upward pressures on the CHF through foreign exchange (FX) interventions** rather than through a policy rate cut.

CHART 4: ECB'S DEPOSIT RATE AND SNB'S POLICY RATE



Source: PWM - AA&MR, ECB, SNB

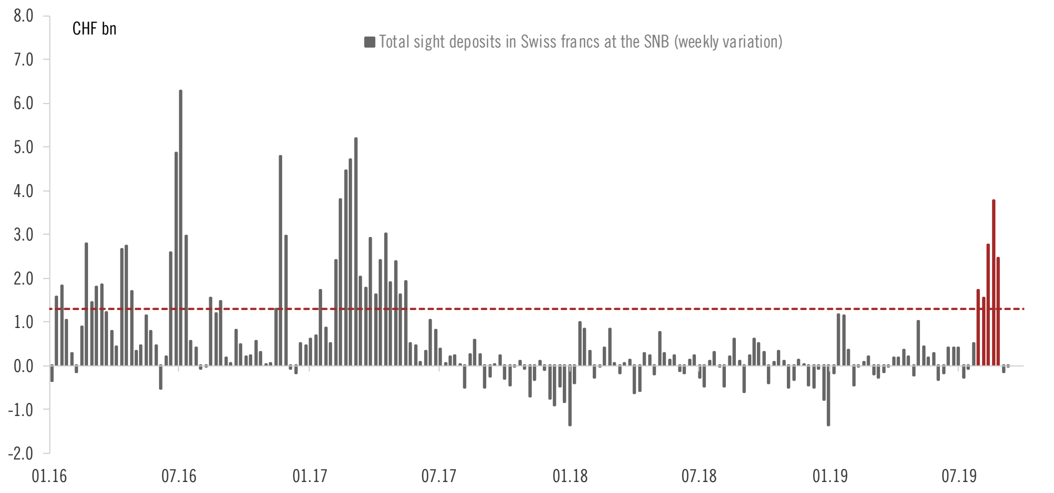
Since mid-July, the CHF's appreciation has prompted the SNB to intervene repeatedly in the foreign exchange market. However, after five weeks of increase, commercial banks' sight deposits at the SNB – a proxy of foreign exchange interventions by the SNB – remained broadly stable in the last week of August and the first week of September. This suggest that the SNB has reduced its foreign exchange interventions or may even have halted them (see *Chart 5*). At margin, **recent developments in total sight deposits reduce the need of a rate cut in our view.**

PICTET 1805

SWITZERLAND: ECONOMIC ACTIVITY

SNB - BETWEEN A ROCK AND A HARD PLACE

CHART 5: TOTAL SIGHT DEPOSITS IN CHF AT THE SNB (WEEKLY VARIATION)



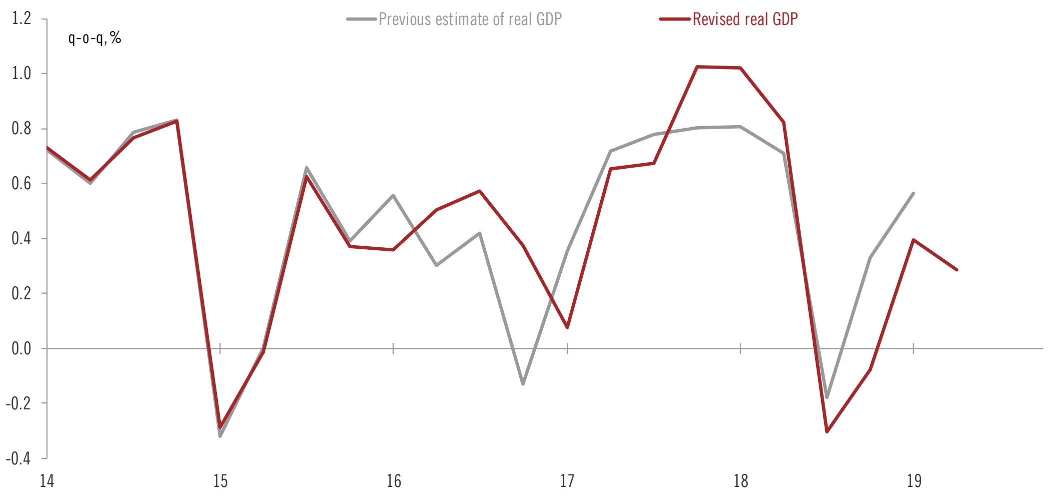
Source: PWM - AA&MR, SNB

The SNB will be facing high expectations of a policy rate cut at its monetary policy assessment meeting on 19 September. While we believe the SNB will stay on hold, our forecast is a close call and a lot will depend on ECB and Fed meetings.

Appendix: GDP revision

The Federal Statistical Office's (FSO) revision of annual GDP data has been followed by quite substantial revisions of the quarterly GDP data by the SECO. The revised data reveal the occurrence of a technical recession in H1 2015 and H2 2018.

CHART 6: SWISS QUARTERLY GDP GROWTH – PRIOR AND AFTER REVISIONS



Source: PWM - AA&MR, SECO

DISCLAIMERS

Distributors: Banque Pictet & Cie SA, Route des Acacias 60, 1211 Geneva 73, Switzerland and Pictet & Cie (Europe) SA, 15A, avenue J. F. Kennedy, L-1855 Luxembourg/B.P. 687 L-2016 Luxembourg.

Banque Pictet & Cie SA is established in Switzerland, exclusively licensed under Swiss Law and therefore subject to the supervision of the Swiss Financial Market Supervisory Authority (FINMA).

Pictet & Cie (Europe) SA is established in Luxembourg, authorized and regulated by the Luxembourg Financial Authority, Commission de Surveillance du Secteur Financier.

This marketing communication is not intended for persons who are citizens of, domiciled or resident in, or entities registered in a country or a jurisdiction in which its distribution, publication, provision or use would violate current laws and regulations.

The information, data and analysis furnished in this document are disclosed for information purposes only. They do not amount to any type of recommendation, either general or tailored to the personal circumstances of any person. Unless specifically stated otherwise, all price information is indicative only. No entity of the Pictet Group may be held liable for them, nor do they constitute an offer or an invitation to buy, sell or subscribe to securities or other financial instruments. The information contained herein is the result neither of financial analysis within the meaning of the Swiss Bankers Association's Directives on the Independence of Financial Research, nor of investment research for the purposes of the relevant EU MiFID provisions. All information and opinions expressed in this document were obtained from sources believed to be reliable and in good faith, but no representation or warranty, express or implied, is made as to its accuracy or completeness.

Except for any obligations that any entity of the Pictet Group might have towards the addressee, the addressee should consider the suitability of the transaction to individual objectives and independently assess, with a professional advisor, the specific financial risks as well as legal, regulatory, credit, tax and accounting consequences.

Furthermore, the information, opinions and estimates in this document reflect an evaluation as of the date of initial publication and may be changed without notice. The Pictet Group is not under any obligation to update or keep current the information contained herein. In case this document refers to the value and income of one or more securities or financial instruments, it is based on rates from the customary sources of financial information that may fluctuate. The market value of financial instruments may vary on the basis of economic, financial or political changes, currency fluctuations, the remaining term, market conditions, the volatility and solvency of the issuer or the benchmark issuer. Some investments may not be readily realizable since the market in the securities can be illiquid. Moreover, exchange rates may have a positive or negative effect on the value, the price or the income of the securities or the related investments mentioned in this document. When investing in emerging countries, please note that the political and economic situation in those countries is significantly less stable than in industrialized countries. They are much more exposed to the risks of rapid political change and economic setbacks.

Past performance must not be considered an indicator or guarantee of future performance, and the addressees of this document are fully responsible for any investments they make. No express or implied warranty is given as to future performance. Moreover, forecasts are not a reliable indicator of future performance. The content of this document can only be read and/or used by its addressee. The Pictet Group is not liable for the use, transmission or exploitation of the content of this document. Therefore, any form of reproduction, copying, disclosure, modification and/or publication of the content is under the sole liability of the addressee of this document, and no liability whatsoever will be incurred by the Pictet Group. The addressee of this document agrees to comply with the applicable laws and regulations in the jurisdictions where they use the information reproduced in this document.

Distributors: Bank Pictet & Cie (Asia) Ltd ("BPCAL") in Singapore, 10 Marina Blvd #22-01 Tower 2, Marina Bay Financial Centre, Singapore 018983 and Pictet & Cie (Europe) S.A., Hong Kong branch ("Pictet HK branch") in Hong Kong. The registered address of Pictet HK branch is 9/F, Chater House, 8 Connaught Road Central, Hong Kong.

The information, tools and material presented in this document are provided for information purposes only and are not to be used or considered as an offer, an invitation to offer or solicitation to buy, sell or subscribe for any securities, commodities, derivatives, (in respect of Singapore only) futures, or other financial instruments (collectively referred to as "Investments") or to enter into any legal relations, nor as advice or recommendation with respect to any Investments. This document is intended for general circulation and it is not directed at any particular person. This document does not have regard to the specific investment objectives, financial situation and/or the particular needs of any recipient of this document. Investors should seek independent financial advice regarding the appropriateness of investing in any Investments or adopting any strategies discussed in this document, taking into account the specific investment objectives, financial situation or particular needs of the investor, before making a commitment to invest.

BPCAL/Pictet HK branch has not taken any steps to ensure that the Investments referred to in this document are suitable for any particular investor, and accepts no fiduciary duties to any investor in this regard. Furthermore, BPCAL/Pictet HK branch makes no representations and gives no advice concerning the appropriate accounting treatment or possible tax consequences of any Investment. Any investor interested in buying or making any Investment should conduct its own investigation and analysis of the Investment and consult with its own professional adviser(s) as to any Investment including the risks involved with transactions on such Investment.

This document is not to be relied upon in substitution for the exercise of independent judgment. The value and income of any Investment mentioned in this document may fall as well rise. The market value may be affected by, amongst other things, changes in economic, financial, political factors, time to maturity, market conditions and volatility, and the credit quality of any issuer or reference issuer. Furthermore, foreign currency rates of exchange may have a positive or adverse effect on the value, price or income of any Investment mentioned in this document. Accordingly, investors must be willing and able to, and effectively assume all risks and may receive back less than originally invested.

Past performance should not be taken as an indication or guarantee of future performance and no representation or warranty, expressed or implied, is made by BPCAL/Pictet HK branch regarding future performance.

This document does not constitute the investment policy of BPCAL/Pictet HK branch, or an investment recommendation, and merely contains the different assumptions, views and analytical methods of the analysts who prepared them. Furthermore, the information, opinions and estimates expressed herein reflect a judgment at its original date of publication and are subject to change without notice and without any obligation on BPCAL/Pictet HK branch to update any of them. BPCAL/Pictet HK branch may have issued or distributed other reports or documents that are inconsistent with, and reach different conclusions from, the information presented in this document.

While the information and opinions presented herein are believed to be from sources believed to be reliable, BPCAL/Pictet HK branch is not able to, and do not make any representation or warranty as to its accuracy or completeness. Accordingly, BPCAL/Pictet HK branch accepts no liability for loss arising from the use of or reliance on this document presented for information purposes only. BPCAL/Pictet HK branch reserves the right to act upon or use any of the information in this document at any time, including before its publication herein.

BPCAL/Pictet HK branch and its affiliates (or employees thereof) may or may not have long or short positions in, and buy or sell, or otherwise have interest in, any of the Investments mentioned herein, and may or may not have relationships with the issuers of or entities connected with Investments mentioned in this document. BPCAL/Pictet HK branch and their affiliates (or employees thereof) may act inconsistently with the information and/or opinions presented in this document.

The information used to prepare this document and/or any part of such information, may have been provided or circulated to employees and/or one or more clients of BPCAL/Pictet HK branch before this document was received by you and such information may have been acted upon by such recipients or by BPCAL/Pictet HK branch.

This document is provided solely for the information of the intended recipient only and should not be reproduced, published, circulated or disclosed in whole or in part to any other person without the prior written consent of BPCAL/Pictet HK branch.

Singapore

This document is not directed to, or intended for distribution, publication to or use by, persons who are not accredited investors, expert investors or institutional investors as defined in section 4A of the Securities and Futures Act (Cap. 289 of Singapore) ("SFA") or any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or would subject BPCAL and any of its affiliates or related corporations to any prospectus or registration requirements.

BPCAL has obtained an exemption from the Monetary Authority of Singapore ("MAS") under section 100(2) of the Financial Advisers Act ("FAA") for the provision of financial advisory services to High Net Worth Individuals (as defined in the MAS Guidelines on Exemption for Specialised Units Serving High Net Worth Individuals FAA-G07) (the "Exemption") and is exempted from the requirements of sections 25, 27, 28 and 36 of the FAA, the MAS Notice on Recommendations on Investment Products (FAA-N16), MAS Notice on Appointment and Use of Introducers by Financial Advisers (FAA-N02), MAS Notice on Information to Clients and Product Information Disclosure (FAA-N03) and MAS Notice on Minimum Entry and Examination Requirements for Representatives of Licensed Financial Advisers and Exempt Financial Advisers (FAA-N13).

Please contact BPCAL in Singapore in respect of any matters arising from, or in connection with this document.

Hong Kong

This document is not directed to, or intended for distribution, publication to or use by, persons who are not "professional investors" within the meaning of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong) and any rules made thereunder (the "SFO") or any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or would subject Pictet HK branch and any of its affiliates or related corporations to any prospectus or registration requirements.

Pictet & Cie (Europe) S.A. is incorporated in Luxembourg with limited liability. It is an authorized institution within the meaning of the Banking Ordinance and a registered institution (CE No.: AQ515) under the SFO carrying on Type 1 (dealing in securities), Type 4 (advising on securities) and Type 9 (asset management) regulated activities.

Warning: The contents of this document have not been reviewed by any regulatory authority in Hong Kong. You are advised to exercise caution in relation to the offer. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice. Please contact Pictet HK branch in Hong Kong in respect of any matters arising from, or in connection with this document.

Distributor: Pictet Bank & Trust Limited, where registered office is located at Building 1, Bayside Executive Park, West Bay Street & Blake Road, Nassau, New Providence, The Bahamas.

The document is not directed to, or intended for distribution or publication to or use by persons who are not Accredited Investors (as defined in the Securities Industry Regulations, 2012) and subject to the conditions set forth in the Securities Industry Regulations, 2012 or to any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, publication, availability or use would be contrary to law or regulation or would subject Pictet Bank & Trust Limited to any prospectus or registration requirements. Pictet Bank & Trust Limited is incorporated in The Bahamas with limited liability. It is a bank and trust company that is licensed in accordance with the Banks and Trust Companies' Regulation Act and is regulated by the Central Bank of The Bahamas. Additionally, Pictet Bank & Trust Limited is registered with the Securities Commission of The Bahamas as a Broker Dealer II and is approved to (i) Deal in Securities 1.(a) & (c); (ii) Arrange Deals in securities; (iii) Manage Securities ; (iv) Advise on Securities.

Warning: The content of this document has not been reviewed by any regulatory authority in The Bahamas. You are, therefore, advised to exercise caution when processing the information contained herein. If you are in any doubt about any of the content of this document, you should obtain independent professional advice.