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Swiss Deflation Confirms Likely June Policy Rate Cut

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Summary

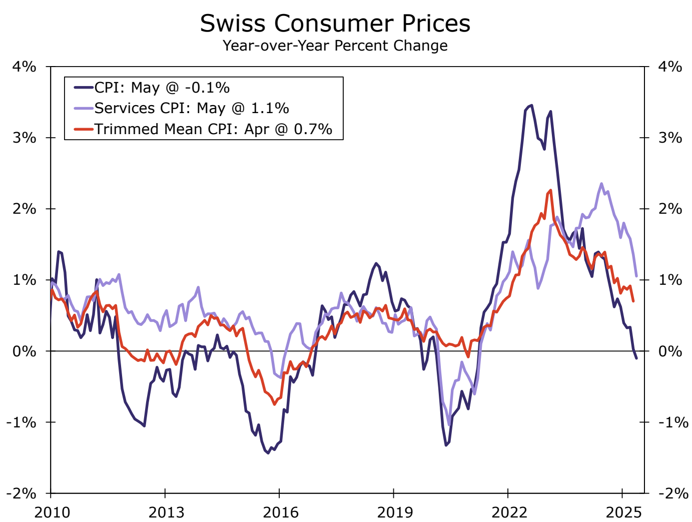
- The release of Switzerland's CPI report for May should be enough, in our view, for the Swiss National Bank (SNB) to cut rates at its upcoming June 19 meeting. The headline CPI fell 0.1%, the first foray into deflationary territory since early 2021, while a continued disinflationary trend was evident for underlying price measures.
- Taking into account recent Swiss inflation data, widespread expectations among market participants for further SNB easing and an increasing possibility of a more-dovish European Central Bank going forward, we have adjusted SNB policy outlook. We now see one more 25 bps SNB rate cut, to a policy rate of 0.00%, at the June 19 meeting.
- Beyond the June meeting, we see a less persuasive case for further easing, as the Swiss economy has shown a degree of resilience. In our view, further rate cuts after June would likely only materialize if there was a significant deceleration in economic activity and if we saw deflation become evident in underlying price measures as well. At this time, we believe that 0.00% will be the low for this monetary easing cycle.

Swiss Deflation Confirms Likely June Policy Rate Cut

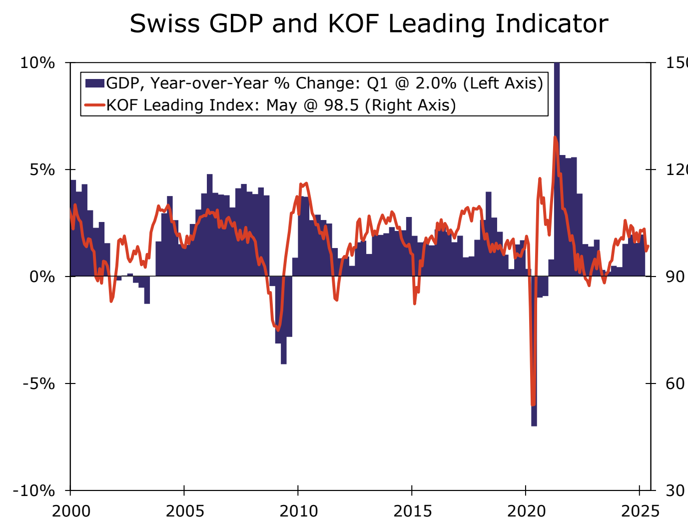
Today's release of Switzerland's May CPI was the key remaining data point ahead of the Swiss National Bank's (SNB) monetary policy announcement on June 19 and will, we think, be enough for the central bank to deliver on widespread expectations for a further rate cut. The May headline CPI dipped 0.1% year-over-year, which matched the consensus forecast but was still the first foray into deflationary territory since March 2021. Meanwhile, the details of today's report point to a disinflationary trend in underlying price metrics, but not yet one of outright deflation. In May, for example, core inflation eased to 0.5%, domestic inflation slowed to 0.6%, and services inflation slowed to 1.1%. Trimmed mean inflation, which is released with a slight lag, rose 0.7% in April. Overall, we view recent Swiss inflation trends as providing reasonable rationale for further monetary easing, though not necessarily an "open and shut" case for rate cuts.

Recent activity and sentiment data, meanwhile, are consistent with some resilience in the Swiss economy, at least through the early part of 2025. Swiss Q1 GDP rose 0.5% quarter-over-quarter, while adjusted for sport events, GDP growth was even firmer at 0.8%. Within the details, household consumption rose a moderate 0.2% while gross fixed capital formation was somewhat firmer, rising 0.5%. Swiss exports jumped 10.5% ahead of higher U.S. tariffs, although the impact on overall GDP growth was somewhat muted and offset by a jump in imports, which also rose 13.1%. Finally, for the overall economy, with growth revised higher for prior quarters, the Q2 GDP increase of 2.0% year-over-year was also stronger than the consensus forecast.

While recent sentiment survey results are a bit mixed, they are still consistent with some resilience in the economy. The May KOF leading indicator rose broadly as forecast to 98.5 in May, a level historically consistent with Swiss GDP growth of around 1.5% year-over-year. The details of the KOF report showed firmness in manufacturing but subdued foreign demand and private consumption. Meanwhile, the Swiss May PMI indices were mixed, as the manufacturing PMI fell to 42.1 but, importantly, the services PMI rose to 56.3. Assessing recent activity and sentiment data, we see potential for the Swiss economy to continue growing near a 1.5% pace, though we acknowledge that the potential for higher U.S. tariffs poses some downside risk to that outlook.



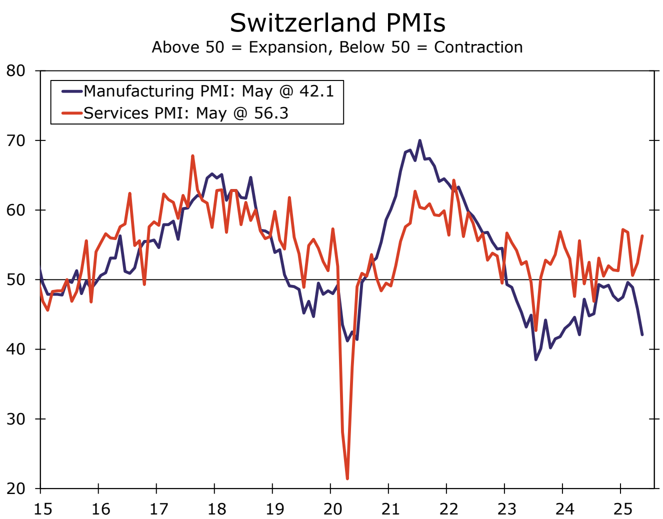
Source: Datastream and Wells Fargo Economics



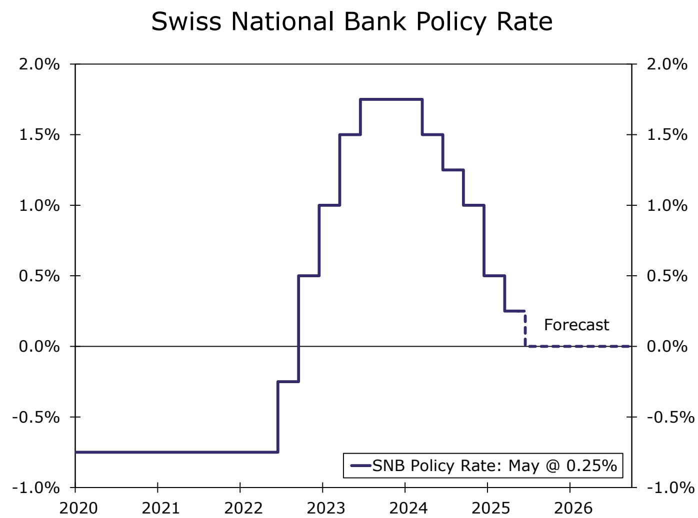
Source: Datastream and Wells Fargo Economics

In our assessment, we think Swiss growth and inflation data provide a reasonable, but not decisive, case for further SNB monetary policy easing. Comments from the Swiss National Bank have also highlighted the possibility of further easing from the central bank, without being definitive. In recent weeks, SNB President Schlegel has said the central bank has not ruled out cutting the policy rate to zero, or ruled out negative interest rates, while also indicating that while the central bank expects negative inflation in some months, its does not necessarily see a need to react to every single inflation print.

Although the SNB's guidance has not been definitive, we see a few factors that point toward another rate cut this month. First, the overall ebbing of inflation pressures is enough to put monetary policy easing back on the table. Second, the expectations for further SNB easing are very widespread, with market participants pricing in more than a 100% chance of a 25 bps rate cut for June, and cumulative rate cuts of more than 50 bps over the rest of this year. Finally, the noticeably soft Eurozone inflation figures for May—which saw both core and services inflation slow significantly—also increase the chances of a more dovish approach from the European Central Bank going forward. In our view, a subdued Eurozone economy and dovish European Central Bank are relevant factors for Swiss National Bank policymakers, even if they are not the primary drivers of their monetary policy decisions. Given this backdrop, **we expect the Swiss National Bank to lower its policy rate by 25 bps to 0.00% at its June monetary policy announcement.** We would be surprised, but not completely shocked, if the central bank held its policy rate steady at the current 0.25% level. **We are less persuaded by the case for further rate cuts beyond June and, at this time, do not expect the SNB to take its policy rate into negative territory.** We think a more significant deceleration in Switzerland's economic performance is needed to warrant a return to negative interest rates. That is, we think underlying inflation measures—in addition to headline inflation—would also need to drop into deflationary territory, and Swiss GDP growth would need to slow to only a marginally positive pace in the range of 0% to 0.5% annually, for the Swiss National Bank to lower interest rates further beyond its June meeting. Accordingly, we are not convinced the second rate cut that is priced in by market participants for later this year will be delivered by the Swiss National Bank.



Source: Bloomberg Finance L.P. and Wells Fargo Economics



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