Is the tightening cycle finally over?

The Fed, the ECB and the Bank of England again raised their key rates by 25 basis points at the end of July and beginning of August, while continuing to reduce their balance sheets. To everyone’s surprise, the Bank of Japan (BoJ) relaxed its policy of controlling the yield curve. The markets took this decision as a prelude to a possible exit from ultra-accommodative monetary support.

The guarantors of price stability began their tightening cycle more than a year ago, and the peak now appears to be approaching. Nevertheless, uncertainty remains regarding future decisions. J. Powell and C. Lagarde have both reiterated that each decision is, and will be, taken meeting by meeting, on the basis of all data in possession. Forward guidance is therefore not on the agenda, and decision-making remains data-dependent. Central bankers have their eyes riveted on inflation, of course, but also (and above all) on its components.

The source of increasing prices is no longer external. It is now resolutely domestic, more diffuse, and fuelled by wage hikes and growth in corporate profits. The robustness of the labour market helps employees in their wage negotiations with companies, which are themselves in a position to pass on, at least in part, the rising prices they are facing. As a result, corporate profitability is not in danger of collapsing. Household purchasing power is also holding up, even though wages are rising more slowly than prices.

How has Switzerland, in particular, been faring? Inflation has continued to slow and ended July at 1.6%. In monthly terms, consumer prices fell by 0.1% over the month. Core inflation, which excludes fresh and seasonal products, fell by 0.2%. Central bankers closely watch this measure of inflation because it gives a better indication of potential risks in price drift. Inflation in services, which is closely monitored for its sensitivity to wage growth, is under control. The Swiss National Bank is nevertheless remaining prudent. In June, it raised its key rate by 25 basis points and has not ruled out further hikes. Its medium-term inflation forecast has been revised upwards, while its shorter-term forecast has been lowered due to reduced oil prices and the appreciation of the Swiss franc. The SNB will make its next decision on September 21, most likely following in the footsteps of other central banks. While the state of the economy does not appear to call for a further hike in interest rates, one cannot be ruled out. The SNB has indeed surprised audiences on numerous occasions, both with its decisions and with the firm rhetoric of its Governing Board members. As a result, 30% of market participants surveyed by Reuters expect a further 25-basis-point hike, with the remainder expecting the SNB to keep its policy unchanged.

The SNB has also enlisted the Swiss franc in its battle against inflation. While in recent (deflationary) years the Swiss National Bank feared an appreciation of its currency, it now welcomes upward movements in the franc, which help to limit imported inflation (particularly via energy products). The SNB has been a net seller of currencies (mainly EUR and CHF) since the 2nd quarter of 2022. This strategy has helped to limit inflation, without putting exporters at a disadvantage. The Swiss franc remained stable in 2022 when adjusted for inflation differentials with other currencies; when producer price inflation is taken into account, the appreciation of the Swiss Franc can be considered to have reached almost 9%. Since the beginning of 2023, the Swiss franc has gained 5.5% against the US dollar and 2.9% against the euro. This nominal rise is greater than inflation differentials demanded. In other words, Swiss exports have become less competitive while Swiss companies and households have gained in international purchasing power.

The peak in interest rates seems ever closer, but in their latest communications, central banks have remained vague about their upcoming policy plans. They are trying to avoid any premature easing expectations that would affect financial conditions. Over the coming months, this uncertainty surrounding monetary policy and inflation will continue to fuel volatility. That is why fairly wide fluctuation limits for rates need to be maintained, without altering the trend in Swiss rates. Current mortgage rates should stabilise within our outlook horizon. How the Swiss franc behaves in this respect will not govern rates. In July, the Swiss franc gained further ground against the dollar and the euro.