

Research

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Franc-ly, my dear, I don't give a d*mn

- **The deceptive geopolitical tranquility of late 2025 has gone with the wind.** The Swiss franc acting as the global storm cellar, much to the chagrin of the Swiss National Bank. Yet, the SNB remains poised to weather the storm. We expect the bank to maintain a 0 percent policy rate throughout 2026 believing that domestic economic resilience will eventually overcome price stagnation, even in the face of a punishingly strong currency.
- **The US–Iran conflict has nonetheless pushed the SNB into an even greater predicament.** On Monday, the bank effectively drew a line in the sand as EURCHF sank towards 0.90. Breaking with its typically understated communication style, the SNB issued a statement stressing its increased readiness to intervene in FX markets. The verbal intervention worked: Friday's franc gains were reversed, a reminder that speculators cannot assume a one-way trade.
- **Yet by Tuesday the narrative had shifted. Focus moved from the franc's strength to surging energy prices, and rate-cut expectations quickly evaporated as SARON forwards flattened.** Ironically, higher imported inflation may provide the SNB with temporary breathing room against persistent franc strength. A rate hike this year, however, remains a distant prospect unless inflation sustainably breaches the 2 percent ceiling – an unlikely scenario given still-moderate growth and the possibility that the conflict subsides in the coming weeks.
- **For now, Chairman Martin Schlegel has signaled tolerance for mild, temporary deflation should it reappear in coming months.** Further safe-haven surges of the franc would first be met with FX intervention. But given political sensitivities – the scrutiny from Washington – the scope for sustained intervention is limited. If consistent deflation takes hold and growth were to stall, a cut deeper into negative rates would be the SNB's weapon of choice.

- Our base case remains: a 0.00 percent policy rate throughout 2026.** While the Swiss franc's recent surge is grabbing headlines, it hasn't yet affected headline inflation. In fact, February's headline rate hit its highest level since September. At 0.1 percent, it's also within the zero to two percent target range, albeit barely so. Doing something about such low inflation would entail deeper negative rates, an unenticing prospect to say the least. More importantly, core inflation (consumer prices stripped of volatile energy and perishable food prices) ebbed only slightly to 0.4 percent. It's hardly something to write home about, but it's more than enough to keep the lights on. Furthermore, underlying inflation remained positive even though the primary driver, housing rents, decelerated while imported deflation was the strongest since the summer of 2025. In table 1 below you can see the developments in Swiss inflation components since January 2025. Core inflation has slowed down to just under half a percent in the last months.

Table 1: Swiss inflation data since January 2025

Month	Headline inflation YoY %	Core inflation YoY %	Imported inflation YoY %	Domestic inflation ex. rents YoY%
31-01-2025	0.40	0.78	-1.48	0.29
28-02-2025	0.32	0.84	-1.52	0.22
31-03-2025	0.34	0.98	-1.71	0.33
30-04-2025	0.03	0.79	-2.48	0.13
31-05-2025	-0.10	0.73	-2.40	0.02
30-06-2025	0.08	0.81	-1.88	0.11
31-07-2025	0.22	0.79	-1.41	0.15
31-08-2025	0.15	0.59	-1.33	0.23
30-09-2025	0.22	0.56	-0.93	0.18
31-10-2025	0.10	0.51	-1.26	0.08
30-11-2025	0.02	0.41	-1.27	0.03
31-12-2025	0.06	0.48	-1.56	0.22
31-01-2026	0.06	0.46	-1.52	0.15
28-02-2026	0.13	0.38	-1.61	0.38

- The key takeaway here is that when we strip out rents, domestic inflation is actually picking up.** From 0.15 percent YoY in January to 0.38 percent last month, the biggest rise in more than a year. So, rather than reaching for the interest rate lever, the SNB is likely to play the waiting game, hoping the latest bout of imported deflation shall pass too. Should market panic trigger a flood of safe-haven flows, expect them to fight off speculators with FX interventions first.

- **Despite the franc's climb, the inflation outlook certainly isn't a one-way street to even weaker levels.** Surging global energy prices are currently serving as a natural hedge against franc-driven disinflation. With Brent crude climbing roughly \$15 over the last month, the deflationary anchor of 2025 is being cut loose. Suddenly, the talk of the town has shifted to spiking inflation and the specter of rate hikes – such talk is clearly premature.
- **There are clear parallels with the 2022 energy price shock.** Still today's macro backdrop is notably different. Back then, Switzerland was riding a post-Covid boom with rising underlying price pressure – spillover from excessively easy fiscal and monetary policy in both the US and the Eurozone. Today, inflation remains subdued in Switzerland and only modestly elevated abroad, while monetary policy abroad is restrained and at least partially offsetting easy fiscal stances.
- **Even in the event of a large energy spike, Switzerland's structural advantage lies in its energy mix.** The country is less reliant on natural gas – prices of which have surged even more aggressively than Brent crude oil – than many of its European peers. Natural gas makes up 10% of the Swiss energy mix, compared to the European average of 24%. This positions Switzerland to better absorb an inflationary pulse without hikes, which could potentially squash domestic economic momentum.
- **Bottom line: before the Iran war became the over-arching narrative, the SNB was already able to hold rates as domestic inflation remained strong enough to offset imported deflation.** February's data confirmed this resilience, with domestic inflation hitting its highest level since July. As domestic price pressures slowly accelerate, it effectively removes any immediate pressure for the SNB to ease.
- **The SNB can continue to lean on strengthening domestic inflation with some confidence.** The Swiss economy entered 2026 with surprisingly strong momentum. Although 2025 GDP growth was modest at 1.4 percent (sports-adjusted) – trailing the historical trend of 1.8 percent – it nonetheless represented the economy's fastest expansion since 2022.
- **Growth isn't just a backward-looking success story; leading indicators suggest the SNB can comfortably maintain its wait and see approach.** The KOF Leading index – which is a strong indicator for the economic situation six months in advance – has been in expansionary territory for the past five months, reaching an 18-month high in February. With the lights on green there is another reason for the SNB to hold rates. Table 2 below shows the Swiss economic indicators since January 2025. The KOF index is now back in expansionary territory after the US tariff policy announced in April 2025 dragged into contractionary territory.

Table 2: Swiss economic indicators since January 2025

Month	KOF Leading Index	Unemployment rate (seasonally adjusted)	Notified vacancies YoY%	Services PMI	Manufacturing PMI
31-01-2025	102.8	2.6	-0.1	57.2	47.4
28-02-2025	102.9	2.7	2.4	56.8	49.4
31-03-2025	100.8	2.7	0.3	50.6	48.8
30-04-2025	95.3	2.8	-1.6	52.4	46.5
31-05-2025	97.7	2.8	-4.9	55.3	42.4
30-06-2025	95.4	2.9	0.4	48.9	48.7
31-07-2025	100.8	2.9	8.5	45	49.5
31-08-2025	97.3	2.9	4.5	45.1	48.2
30-09-2025	97.9	3.0	-2.5	51.4	46.1
31-10-2025	101.3	3.0	1.5	48.3	48.1
30-11-2025	101.5	3.0	-0.7	46.1	49.6
31-12-2025	103.7	3.0	18.1	51.4	46.4
31-01-2026	103.3	2.9	16.3	53.8	48.8
28-02-2026	104.2			54.2	47.4

- The Swiss National Bank will welcome tentative signs of labor market stabilization which strengthen its case for policy patience.** The seasonally adjusted unemployment rate fell to 2.9 percent in January from 3.0 percent, marking the first monthly decline since early 2023. This resilience is supported by a surge in notified vacancies, which posted their strongest year-on-year increases since 2022 across December and January.
- Not all is well though as output growth relies on the larger services sector.** In contrast, the manufacturing sector remains stuck in a contraction that has been ongoing for almost three years.
- Ultimately, the Swiss National Bank is prepared to tolerate industrial weakness if the services sector continues to provide a sufficient buffer.** With services-led growth, the SNB can maintain its outlook that sustained deflation will be avoided, and that there thus will be no need for rate cuts.

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