

## Research

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## Rate hikes on the horizon?

- **Zurich, we have inflation<sup>1</sup>.** While deflation dominated the economic discourse in Switzerland as little as over three months ago, the conflict in Iran has completely upended that narrative. With inflation, a little heat is exactly what the Swiss National Bank was dreaming of, but the line between a comfortable warmth and getting burned is razor-thin;
- **For now, the Swiss National Bank is in no rush to react.** Inflationary pressure remains comfortable, with both headline and core readings tracking toward the lower end of the central bank's acceptable target range. Because this is primarily an energy-driven supply shock, the SNB has the necessary leeway to look past immediate headline inflationary pressures;
- **Nevertheless, this window of patience is bound to close.** Given that the effects of the blockade in the Strait of Hormuz will take months to untangle – even under a swift resolution – core inflationary pressures are poised to accelerate. Still, our base case is that the SNB will hold rates at zero throughout 2026;
- **Recent data does hint at economic momentum building up but characterizing this as strength is misleading.** Although a conversation can be had about a March 2027 hike – the end of our forecast horizon – the data and historical precedent do not convince me that the SNB will hike. While the winds are starting to shift towards a hike, it remains beyond the horizon;
- **Switzerland's headline inflation rate has increased roughly sixfold since the war in Iran erupted in March.** While that might sound a bit overdramatic, figure 1 shows that we moved from 0.1 percent to 0.6 percent inflation. That leaves headline inflation comfortably within the lower half of the SNB's 0–2 percent target range. The uptick is almost entirely attributable to surging fuel prices – specifically petrol, diesel and heating oil;

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<sup>1</sup> Yes, the Swiss National Bank has a head office in Bern too. Zurich just has a nicer ring to it.

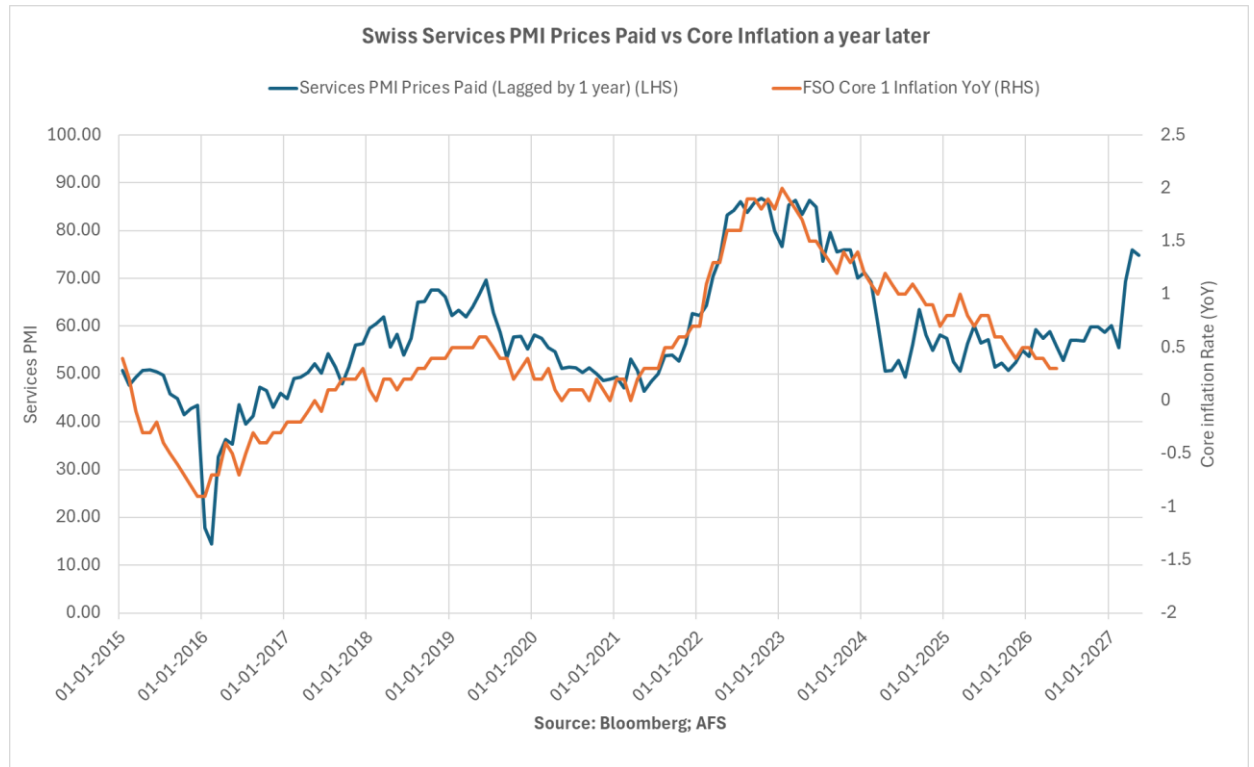
Figure 1: Swiss inflation

Month	Headline inflation YoY %	Core inflation YoY %	Energy & fuels inflation YoY %
31-01-2025	0.40	0.78	-5.20
28-02-2025	0.32	0.84	-6.36
31-03-2025	0.34	0.98	-7.14
30-04-2025	0.03	0.79	-7.84
31-05-2025	-0.10	0.73	-8.35
30-06-2025	0.08	0.81	-8.42
31-07-2025	0.22	0.79	-8.07
31-08-2025	0.15	0.59	-7.72
30-09-2025	0.22	0.56	-6.18
31-10-2025	0.10	0.51	-5.21
30-11-2025	0.02	0.41	-4.79
31-12-2025	0.06	0.48	-5.32
31-01-2026	0.06	0.46	-4.31
28-02-2026	0.13	0.38	-4.38
31-03-2026	0.31	0.36	0.54
30-04-2026	0.60	0.28	5.43
31-05-2026	0.62	0.25	5.99

- **The SNB can look through the direct effects of the external commodity shock.** Instead, the SNB will train its eyes on second-round effects – where companies pass on rising input costs by raising selling prices. Currently such secondary effects can be seen in rising prices for airfares and international package holidays – which are sensitive to the price of kerosene;
- **Outside of airfares tangible secondary effects remain largely elusive.** Core inflation – which strips out volatile energy and seasonal prices – sits at a remarkably benign 0.3 percent. The metric has retreated to levels last seen before and during COVID-19, back when interest rates were deeply negative. A modest lift in core inflationary pressure is not a bad thing for the Swiss economy right now. Therefore, even if the SNB begins to expect early second-round effects they will likely hold off reacting – unless those pressures threaten to spiral out of control. The crucial question is where core inflation goes from here: will it remain a mild lift, or will it become more than policymakers bargained for and force the SNB to act?
- **The latest PMI surveys show that firms across industries are already facing, or at least anticipating, the squeeze of higher input prices.** Historically, this metric has served as a reliable leading indicator for core inflation. Specifically, lagging the PMI Purchase Prices index for services – the bulk of the Swiss economy – by one year reveals a strong correlation with Swiss core inflation;

- As shown in Figure 2, core inflation has closely tracked the path of the services PMI Purchase Prices index since the inception of the metric in 2014. Based on this historical correlation, I expect core inflation to accelerate around the start of 2027. The size of the recent spike in the PMI is associated with a rise in Swiss core inflation to roughly 1.2 percent;

**Figure 2: Swiss PMI vs core inflation**



- **Of course, the Iran war remains a key uncertainty.** My baseline assumption is that military escalation between the US and Iran will be avoided – though it will take time for the knot in oil markets to unwind. Brent crude should remain elevated above \$80 per barrel through 2026 – but a faster decline in oil prices would still allow core inflation to remain contained;
- **A Taylor rule analysis provides insight into how the SNB might react if core inflation reaches 1.2 percent.** Crucially, incorporating the over/undervaluation of the Swiss franc provides a better empirical fit for Switzerland than a standard formula. Figure 3 shows that the modified Taylor rule suggests the expected core inflationary uptick would justify a 25bps hike. The door for a move in March 2027 is ajar. Note that model adds extra weight (inertia) to the current policy rate, assumes the labor market remains steady at current levels and the franc that remains slightly overvalued<sup>2</sup>;

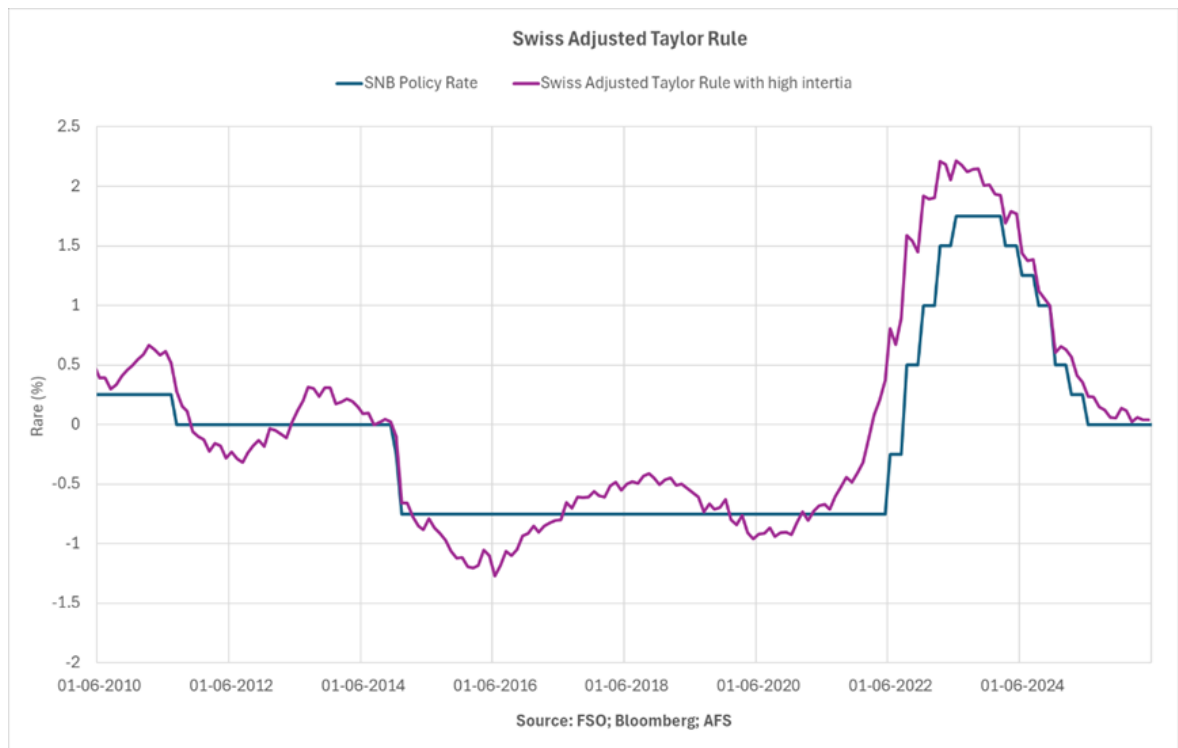
<sup>2</sup> The modelled EURCHF rate is based on Bloomberg EURCHF behavioral equilibrium exchange rate data.

Figure 3: Swiss Adjusted Taylor

Future modelled rate	
Neutral rate	0.5
Actual - natural unemployment rate	0.2
Target CPI	1.0
Core CPI	1.2
Prior SNB rate	0.0
Actual - modelled EURCHF rate	-0.01
Unadjusted Taylor Rule estimate	1.08
With 0.75 inertia	0.27

- Historically, the SNB has been slow to act on modified Taylor rule signals.** As Figure 4 shows, the SNB regularly lags or over/under-delivers relative to the model’s prescriptions. Rather than serving as a strict policy guide, the rule simply offers a directional read on where policy winds are blowing: towards a hike. This lag of the SNB may reflect that during the 2010s rates were at the effective at lower bound – when a premature tightening risked forcing sharper cuts soon after;

Figure 4: Swiss Adjusted Taylor Rule Time Series



- **The SNB has especially favored a cautious stance when dealing with commodity shocks.** The SNB skipped rate hikes during the commodity price spikes of 2008 and 2011: choosing to hold its ground in 2008 as global growth forecasts deteriorated and remaining patient in 2011 as underlying inflation remained well-contained;
- **The approach to the 2022 inflationary shock stands in sharp contrast to those earlier episodes this millennium.** Driven by a combination of robust post-COVID growth and a commodity price surge, inflation was propelled completely out of the target corridor. This forced the SNB to abandon its defensive posture and hike aggressively out of negative territory in rapid 50bps and even 75bps strides;
- **Even with that aggressive pivot, the SNB Governing Board demonstrated a high threshold for reacting.** Headline inflation had already crossed the 2.0 percent mark and core inflation had broken above 1.5 percent before the SNB pulled the trigger – though that move was a 50bps hike. The SNB held its policy rate at a deeply negative –0.75 percent until its conditional forecast proved inflation would remain outside the target corridor for a prolonged period – only then unleashing its opening salvo;
- **The SNB does have extra reason to lift rates from zero to rebuild policy space for future setbacks – especially with Washington scrutinizing its FX interventions.** Last year's tense tariff negotiations soured President Trump's image of the Swiss, so large-scale currency interventions could trigger a fresh round of tariffs. While that won't stop the SNB from currency interventions, having the option to cut interest rates – without diving rates deep into negative territory – would be preferable. However, truly creating policy space would require a 50bps hike – a move the current inflationary outlook does not justify;
- **A rise in core inflation to 1.2 percent doesn't guarantee a hike, but the Taylor rule suggests one is on the table.** The final decision hinges on whether the economy and the franc provide the necessary space to hike. Unlike its initial 2022 post-Ukraine trajectory the franc remains strong against both the US dollar and euro. This persistent strength tempers imported inflation it remains a drag on the export sector – making a hike unneeded. However, this pressure on the franc would lift amid tightening cycles by the ECB and FOMC – coupled with a comprehensive peace deal in Iran reducing safe-haven demand;
- **Headline-grabbing economic data does point to surprising momentum in the Swiss economy that could also provide the space to hike rates.** If growth continues despite the strength of the franc, concerns about currency-related headwinds become less pressing. Figure 5 shows that headline manufacturing and services PMIs have surged to their highest levels since 2022 – defying headwinds from the Iran war. Business activity in both sectors has hit a nearly four-year high, a trajectory that could further fuel core inflationary pressure;

Figure 5: Swiss Headline PMI

Month	Headline manufacturing PMI	Production manufacturing PMI	Headline services PMI	Business activity services PMI
31-01-2025	47.4	48.5	53.7	54.8
28-02-2025	49.4	49.3	54.9	57.0
31-03-2025	48.8	48.8	51.4	51.4
30-04-2025	46.5	49.8	51.9	56.2
31-05-2025	42.4	43.3	55.3	61.0
30-06-2025	48.7	49.7	48.9	52.1
31-07-2025	49.5	50.2	45.0	48.9
31-08-2025	48.2	52.3	45.1	46.9
30-09-2025	46.1	48.9	51.4	54.8
31-10-2025	48.1	48.7	48.3	51.3
30-11-2025	49.6	48.2	46.1	49.4
31-12-2025	46.4	47.2	51.4	54.2
31-01-2026	48.8	50.8	53.8	57.3
28-02-2026	47.4	47.0	54.2	60.8
31-03-2026	53.3	50.6	57.2	59.0
30-04-2026	54.5	52.3	54.8	58.4
31-05-2026	57.3	57.3	56.0	63.5

- **Nevertheless, PMI subcomponents reveal that the headline 'strength' is misleading.** Figure 6 shows the strongest subcomponents across both services and manufacturing are input prices, prolonged delivery times and sales prices – all heavily impacted by the war in Iran. Another development is the sharp rise in stocks of purchases. Scarred by the inflation shock of 2022, Swiss firms seem eager to rebuild inventories and avoid being caught out by renewed price/supply disruptions. However, stockpiling only provides a temporary boost to economic momentum – one that will reverse;

Figure 6: Swiss PMI Subcomponents

Month	Prices paid manufacturing PMI	Delivery times manufacturing PMI	Stocks of purchases manufacturing PMI	Prices paid services PMI	Sales prices services PMI
31-01-2025	49.5	51.0	45.0	53.7	55.5
28-02-2025	52.2	51.8	46.1	59.3	52.1
31-03-2025	51.1	52.6	44.2	57.5	49.4
30-04-2025	49.1	47.8	42.6	58.9	47.3
31-05-2025	48.9	52.5	42.9	55.8	49.1
30-06-2025	47.9	55.4	41.6	52.8	48.7
31-07-2025	50.5	58.9	45.0	57.0	48.7
31-08-2025	53.2	50.8	44.8	57.0	49.7
30-09-2025	51.8	55.5	44.8	56.9	49.7
31-10-2025	52.9	52.6	45.0	59.8	51.1
30-11-2025	54.5	55.9	48.1	59.9	53.7
31-12-2025	52.8	56.4	42.7	58.7	52.8
31-01-2026	51.5	53.9	43.1	60.2	55.0
28-02-2026	55.8	53.4	38.6	55.5	49.5
31-03-2026	71.3	63.6	53.5	69.4	58.0
30-04-2026	82.8	64.1	53.4	76.0	64.3
31-05-2026	82.7	65.7	53.3	74.9	65.6

- **A closer look at the first-quarter real GDP growth – 0.4 percent QoQ on a sport-adjusted basis<sup>3</sup> – reveals that the moderate economic expansion that quarter was almost entirely a result of government spending alongside a slight growth in services exports.** Private consumption flatlined this quarter while goods exports and investment shrank. We aren't seeing the momentum from headline PMI data in economic data yet;
- **There are also economic headwinds looming on the horizon — namely that dreaded T-word.** In Q3 2026, US tariffs on pharmaceuticals are scheduled to take effect. While President Trump repeatedly threatened such measures throughout 2025, this marks the first time the tariffs are actually set to be implemented;
- **That is bad news for Switzerland, where pharmaceuticals account for just over half of all exports to the US, its largest trading partner.** Although Swiss drugmakers face a tariff rate capped at 15 percent – rather than the 100 percent Trump flexes with – the policy remains a blow to the economy. Note that the Swiss could also see a renewed wave of tariff front-running in the coming months. Much like in early 2025, that behavior can distort economic data;
- **Ultimately, the Swiss National Bank remains well-positioned to maintain its policy pause for the coming twelve months.** With inflation still sitting at the lower end of its target range the SNB is under little pressure to react even when the second-round inflationary effects from the Iran war begin to filter through. The economic momentum that could justify a rate hike by March 2027 just doesn't seem to be there – leaving the SNB's policy rate firmly anchored at zero.

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<sup>3</sup> Switzerland hosts major sports organizations like the IOC and FIFA which can cause major swings in GDP without contributing to the economy.

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