



Source: UBS

The SNB must remain vigilant

14 November 2025, 14:03 UTC, written by Daniel Kalt

The Swiss economy is under pressure: High US tariffs, a weak European industrial sector, and the strong franc are weighing on exports, while private consumption is supporting the economy. The SNB remains challenged but is likely to intervene only in the event of more severe surges in franc appreciation.

The Swiss economy is going through turbulent times. Also, the reduced 15% US's tariff rate poses considerable challenges, especially for small and medium-sized enterprises that generate a high share of the value added of their US exports in Switzerland. However, the manufacturing sector has not only faced difficult conditions since the beginning of August, when high US tariffs were imposed. What is proving even more challenging is that the crucial transmission belt to the world for many Swiss suppliers—the core European industry, especially in Germany—has barely moved for several years. Although leading indicators point to a tentative recovery in European industrial activity, overall it is likely to remain below average and thus provide little impetus for the Swiss industrial sector.

As a result, it is mainly domestic demand, especially private consumption, that is currently keeping the Swiss economy afloat. Solid employment and real wage growth have been an important support for private consumption demand over the past two years. Our recently published wage survey on the results of this autumn's wage settlements shows that nominal wage growth will likely be around one percent, somewhat lower than in previous years. Given that inflation has now fallen to almost zero, this is not surprising and, despite modest nominal wage increases, should result in a slight real increase in purchasing power for consumers on average.

Because inflation in Switzerland quickly subsided after the surge in 2022/2023 and is now just above zero percent—almost too low—the Swiss National Bank (SNB) was able to swiftly lower its policy rate to zero from the beginning of last year. However, SNB President Martin Schlegel has repeatedly emphasized that the hurdles for another rate cut into negative territory are relatively high. The SNB will therefore likely try to avoid negative rates. Whether this will become necessary depends, among other things, on whether the global—and thus the Swiss—economy can avoid a recession in the coming quarters.

In this context, the franc must not appreciate suddenly and sharply, especially against the euro. The euro is particularly important for a significant portion of Swiss suppliers to the already struggling European industrial sector. The purchasing power parity—that is, the exchange rate we would consider “fair”—for EURCHF is around 0.96, which is higher than the current spot rate. Further strengthening of the franc would therefore soon prompt the SNB to act, in our view, potentially through foreign exchange market interventions and, if necessary, further rate cuts to counteract an excessively drastic decline in the euro exchange rate.

For the USDCHF currency pair, purchasing power parity according to our calculations is around 0.77, which is lower than the current spot rate. Given the expected slowdown in the US economy and further rate cuts by the Federal Reserve, we also anticipate a further reduction in the interest rate differential between the franc and the greenback. This should cause the US dollar to trend toward 0.76 over the coming months. We believe hedging USD long positions becomes attractive above 0.81, and selling CHF upside potential can improve returns in a low-volatility environment.

Appendix

Non-traditional asset classes are alternative investments that include hedge funds, private equity, private credit, real estate, and managed futures (collectively, alternative investments). Interests of alternative investment funds are sold only to qualified investors, and only by means of offering documents that include information about the risks, performance and expenses of alternative investment funds, and which clients are urged to read carefully before subscribing and retain. **An investment in an alternative investment fund is speculative and involves significant risks.**

Specifically, these investments (1) are not mutual funds and are not subject to the same regulatory requirements as mutual funds; (2) may have performance that is volatile, and investors may lose all or a substantial amount of their investment; (3) may engage in leverage and other speculative investment practices that may increase the risk of investment loss; (4) are long-term, illiquid investments, there is generally no secondary market for the interests of a fund, and none is expected to develop; (5) interests of alternative investment funds typically will be illiquid and subject to restrictions on transfer; (6) may not be required to provide periodic pricing or valuation information to investors; (7) generally involve complex tax strategies and there may be delays in distributing tax information to investors; (8) are subject to high fees, including management fees and other fees and expenses, all of which will reduce profits.

Interests in alternative investment funds are not deposits or obligations of, or guaranteed or endorsed by, any bank or other insured depository institution, and are not federally insured by the Federal Deposit Insurance Corporation, the Federal Reserve Board, or any other governmental agency. Prospective investors should understand these risks and have the financial ability and willingness to accept them for an extended period of time before making an investment in an alternative investment fund and should consider an alternative investment fund as a supplement to an overall investment program.

In addition to the risks that apply to alternative investments generally, the following are additional risks related to an investment in these strategies:

- **Hedge Fund Risk:** There are risks specifically associated with investing in hedge funds, which may include risks associated with investing in short sales, options, small-cap stocks, "junk bonds," derivatives, distressed securities, non-U.S. securities and illiquid investments.
- **Managed Futures:** There are risks specifically associated with investing in managed futures programs. For example, not all managers focus on all strategies at all times, and managed futures strategies may have material directional elements.
- **Real Estate:** There are risks specifically associated with investing in real estate products and real estate investment trusts. They involve risks associated with debt, adverse changes in general economic or local market conditions, changes in governmental, tax, real estate and zoning laws or regulations, risks associated with capital calls and, for some real estate products, the risks associated with the ability to qualify for favorable treatment under the federal tax laws.
- **Private Equity:** There are risks specifically associated with investing in private equity. Capital calls can be made on short notice, and the failure to meet capital calls can result in significant adverse consequences including, but not limited to, a total loss of investment.
- **Private Credit:** There are risks specifically associated with investing in private credit. This could include losses stemming from defaults on loans, which in significant adverse circumstances could result in a substantial loss of investment.
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