Sallfort Privatbank AG

Quarterly Letter January 2019

"Economics: the only subject in which the same questions yield different responses every year." (Danny Kaye)

Dear Clients, Partners and Interested Parties,

In 2019, questions will be answered on some topics that originated in 2018 or earlier, so they come with no surprise. In this quarterly letter, we will take a closer look at a few of the most important questions and topics.

Will the US trade dispute with China be settled? Beijing has already signalled its willingness to negotiate by suspending punitive tariffs on cars.

Will the oil price remain stable? Inflation will be slowed worldwide by the drop back after an initial strong rise.

Can private consumption and domestic demand in certain countries outweigh the decline in exports? The latest positive developments on the labour markets give cause for optimism for the time being.

Brexit is probably a major problem child. It seems that every possible outcome is associated with disadvantages for all involved - wait and see?

Perhaps one of the major current issues for Switzerland is the state of negotiations on the expansion of the bilateral path with the EU. For a very long time it seemed that the outcome was a formality. For too long, people had probably relied on the fact that everything could continue as before. But the EU apparently sees itself called upon to signal to the British that it is taking a clear line and keeping to it - much to Switzerland's regret. Exchange equivalence will certainly continue, suppliers in the electricity market will compromise and research programmes will be continued. the question is at what price.

Looking back ten years, all these uncertainties are comparatively easily resolvable challenges. They are visible, assessable and predictable. The American president is an opponent of predictability, but he too has had to conclude that the world order follows certain rules.

The most important thing about challenges is to face up to them, reflect on your own strengths and enter alliances with the right partners. Sallfort Privatbank has found a similar partner in Banque Heritage and will be even better equipped to meet these challenges in the course of the merger. In keeping with our motto for the merger: Taking tradition to the future.

I look forward to following this path with you and believe in our joint success.

Kind regards,

Johannes T. Barth

CEO

Current topics for the first quarter

Global economy

According to the latest estimates, the global economy achieved solid growth of 3.0% in 2018 as a whole (2017: +3.0%). However, international economic headlines have recently been predominantly negative, and in some industrialised countries (e.g. Germany, Switzerland and Japan) economic output fell in the third quarter of 2018. The smouldering trade conflict between the US and China and the uncertain outcome of the Brexit negotiations in particular are causing uncertainty among companies. The increased uncertainty clouds the outlook for 2019. We therefore expect a somewhat weaker global expansion rate of 2.8% in the new year.

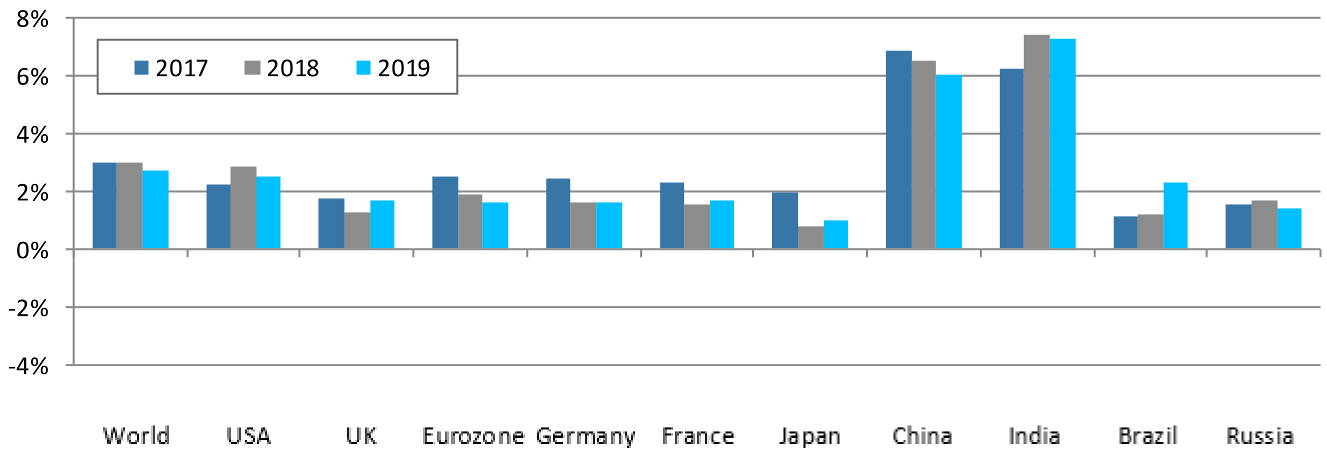
Euro zone loses momentum

Growth momentum in the euro zone weakened further in the second half of 2018. Foreign trade and industrial production in particular lost momentum, while domestic demand remained robust. Overall, the euro zone economy is expected to have grown by 1.9% in 2018. A slightly lower GDP growth of 1.6% is forecast for 2019. The slower growth of the global economy will slow the export sector in the euro zone. By contrast, private consumption should gain momentum, as the upward trend on the labour market continues unabated and the recent sharp drop in oil prices will curb inflation. One risk factor for 2019, however, is the uncertain outcome of the Brexit negotiations.

Good economic situation in the USA

The US economy should have achieved strong growth of 2.9% in 2018. The expansive fiscal policy has above all boosted corporate investment. In addition, private consumption benefited from the sustained positive development on the labour market and the tax cuts. The pace of growth is expected to slow slightly in 2019, as the economic cycle is well advanced and the tailwind from the expansive fiscal policy is gradually weakening. In addition, the trade conflict with China is clouding the outlook for the US export sector. Nonetheless, the US economy should be able to continue its growth in 2019 by as much as 2.5%. In view of the good situation on the labour market and rising wage growth, private consumption in particular should remain a growth engine.

Figure 1-1 Economic growth in selected countries



GDP growth (%)
Source: BAK Economics, Oxford Economics

Restrained outlook for many emerging markets

Economic growth in China slowed only slightly in 2018. In the coming months, however, the negative consequences of the trade conflict with the USA are likely to become increasingly apparent. However, the more expansive fiscal and monetary policy should helpt to ensure that Chinese growth only declines moderately to 6.1% in 2019 (2018: +6.6%).

In many other emerging markets, however, the growth outlook is subdued. The interest rate turnaround in the US has led to capital outflows and currency devaluations in many emerging markets (e.g. Turkey). The resulting deterioration in the financial environment calls for a more restrictive monetary policy in some countries.

Swiss economy

Abrupt slowdown in the third quarter of 2018, but no danger of recession

The increasing headwind from the global economic environment has also left its mark on Switzerland. The boom in the Swiss economy was abruptly interrupted in the third quarter and GDP fell by 0.2 percent compared with the previous quarter. The development was subdued in all important usage-side components. Exports and investments in equipment fell sharply, while private and government consumption as well as construction investments stagnated practically.

However, there is no threat of a recession: even though uncertainties have recently increased, Swiss companies continue to assess their business situation and prospects as positive. This is evidenced by the Purchasing Managers' Index, which at 57.7 points (industry) and 53.7 points (services) respectively points to solid growth in the coming months. Following the decline in the third quarter, goods exports also picked up again in October, and the upward trend on the labour market is also intact. The Swiss economy should therefore return to a growth path in the final quarter of 2018. For 2018 as a whole, BAK forecasts GDP growth of 2.6 percent (previously +3.0%).

Slower growth momentum in 2019

According to our estimates, Switzerland will grow noticeably more slowly in the new year than in the previous year. The increased uncertainty in the international environment is clouding the outlook for the Swiss export sector and dampening the investment activity of domestic companies. In addition, a slight decline in construction investments is

Tab. 1-1 Historic forecasts for Swiss GDP and individual components

	09	10	11	12	13	14	15	16	17	18	19
GDP CH	-2.2	3.0	1.7	1.0	1.9	2.4	1.3	1.6	1.6	2.6	1.2
GDP per cap.	-3.3	1.9	0.6	-0.1	0.6	1.2	0.2	0.5	0.9	0.3	0.3
Priv. Spending	1.3	1.7	0.7	2.3	2.6	1.3	1.7	1.5	1.1	1.0	1.5
Pub. Spending	3.0	1.1	1.7	1.5	2.3	2.2	1.1	1.2	0.9	1.0	0.7
Inv. Constr.	3.0	3.5	2.5	2.9	3.1	3.2	1.6	0.5	1.4	1.1	-0.4
Inv. Equipm.	-12.3	4.9	5.6	3.5	-1.0	2.9	2.7	5.4	4.5	3.2	1.8
Exports	-7.2	7.9	3.5	3.0	-0.1	5.2	2.6	7.0	3.6	1.8	2.4
Goods	-11.3	9.8	6.5	1.7	-1.0	4.1	0.7	6.6	6.0	4.1	3.5
Trans. Trade	18.0	25.6	4.0	-4.3	-11.6	20.1	17.1	6.9	-2.0	-3.8	1.3
Services	-4.2	1.2	-2.2	7.5	4.5	4.0	2.4	7.6	0.7	-0.9	0.8
Imports	-4.8	9.5	4.7	4.4	1.4	3.3	3.0	4.7	4.1	1.9	1.9
Goods	-8.3	10.9	3.1	2.3	0.7	1.7	0.0	4.4	5.5	5.4	1.5
Services	4.8	6.4	8.6	9.3	3.0	6.8	8.8	5.3	1.6	-4.7	2.6

Component growth on use side (real, % p.a.) lower than corresponding trend 08-17 higher
Source: BFS, SECO, BAK Economics

likely. The main reason for this is that residential construction is losing momentum. Immigration is clearly below its old record levels, which limits the rise in demand. This is already reflected in the increased vacancy rates. In contrast, private consumption remains a pillar of growth: the upturn on the labour market continues to provide tailwind, and the significantly lower oil price will slow inflation in 2019.

Overall, real Swiss economic growth of 1.2 percent is forecast for 2019 (2018: +2.6%). However, this slowdown in growth from 2018 to 2019 is oversubscribed by a special effect. In 2019, last year's license revenues from the Olympics and the FIFA World Cup will disappear, which will reduce Swiss GDP growth by around 0.3 percentage points.

Without this special effect, the growth forecast for 2019 would only be slightly below potential growth.

Prices, foreign exchange and capital markets

Ascent and descent of oil prices

The oil price experienced a roller coaster ride in 2018. By the beginning of October, the oil price had climbed to USD 85 per barrel, with the US sanctions against Iran and the turbulence in Venezuela leading to rising prices. Since then, however, the price of oil has fallen to USD 58 per barrel. This was mainly due to very strong oil production in the USA and concerns about a slowdown in the global economy. In 2019, the oil price should stabilize at just over USD 60 per barrel. Despite the recently decided OPEC production cuts, supply bottlenecks are unlikely due to the expected further increase in US production.

Monetary policy in Europe and Switzerland to be tightened only slowly

The decline in oil prices should slow inflation in 2019. The easing inflationary pressure allows the ECB to continue its expansionary policy. We do not expect an initial interest rate hike in the euro zone until the final quarter of 2019. In Switzerland, the SNB will most likely wait for this first interest rate hike by the ECB before starting its own rate hikes. However, long-term interest rates in both the euro zone and Switzerland are expected to gradually rise over the course of 2019 in anticipation of the turnaround in monetary policy.

In the USA, on the other hand, the turnaround in monetary policy is already well advanced. In view of the increasing bottlenecks on the labour market, we expect two further key interest rate steps in 2019. Interest rates on 10-year government bonds in the USA should also soon climb back above the 3 percent mark.

Appreciation of the US dollar and the Swiss franc in 2018

The US dollar gained significantly in value in 2018. The strong economy in the USA and the tightening of US monetary policy contributed to this. For 2019, however, we expect the US dollar to lose some ground against the euro. In particular, the growing twin deficit in the USA should weaken the US dollar in the course of 2019.

The franc also appreciated against the euro in 2018. The increase in uncertainty in the second half of 2018 led to the Swiss franc once again assuming its role as a safe haven. In the first half of 2019, the Swiss franc should remain at its current level of around 1.13 EUR/CHF. In the second half of the year, we expect a slight depreciation as soon as the role of a safe haven recedes into the background.

Risks & Chances 2019

Increasing risks with EU framework agreements and BREXIT

The reorientation of partnerships between the EU and the rest of the continent is proving to be an increasingly important risk factor. In the international context, fears of a disorderly BREXIT and the resulting negative effects on the real economy have continued to grow. In the British Parliament there are no majorities in sight for the resignation deal. The compromise lines between the United Kingdom and the EU are becoming increasingly thin.

The negotiations on the further development of the bilateral path between Switzerland and the EU are similarly deadlocked. The negotiation process, which is believed to have progressed a long way, has been called into question by the domestic political resistance and the subsequent new consultation phase. Although this does not immediately pose a danger to Switzerland similar to that which arose after the adoption of the mass immigration initiative, it does not mean that Switzerland will have to face up to the new challenges. However, a renewed deterioration in relations with the EU and occasional pinpricks could have a painful short-term impact on the local economy. This applies in particular to stock exchange transactions, the electricity market and participation in EU research programmes.

In addition, the generally increased uncertainty regarding the future design of access to the EU internal market represents a risk that should not be underestimated for the attractiveness of the location and investment activity here. The same is true of the continuing uncertainties regarding TRAF (formerly tax proposal 2017). A renewed failure of the reform would cause a loss of confidence among domestic and foreign investors, which could hardly be repaired.

A pronounced downturn in the global economy would hit local exporters hard

Overall, the global demand environment remains very turbulent. Apart from the factors already mentioned, the Swiss economic outlook is also exposed to a variety of sources of danger. The spectrum ranges from an expansion of the trade conflict between the USA and China, persistent problems in the emerging markets, which are heavily indebted in dollars, Italy's unstable creditworthiness, the protests in France to the numerous geopolitical trouble spots. Irrespective of these risks, it should also be borne in mind that the global upswing has now matured considerably. A marked slowdown, which goes well beyond the expected level, cannot therefore be ruled out for purely cyclical reasons alone.

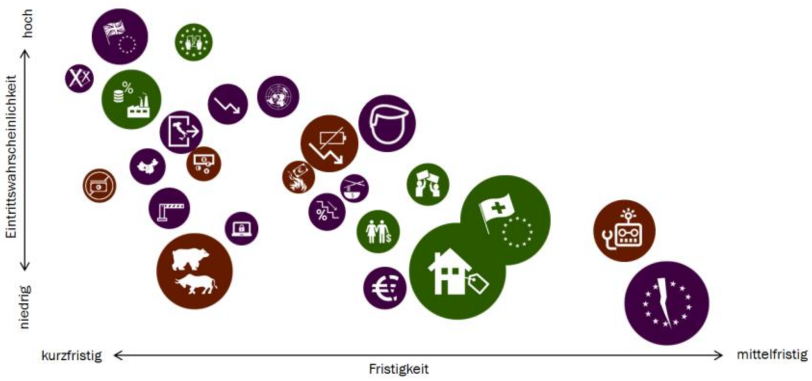
In contrast to "normal" times, a weakness in the global economy, however triggered, could quickly lead to recessionary developments. In the global context, neither monetary nor fiscal policy currently have any significant leeway to counter demand shortfalls with compensatory measures. The lack of confidence on the part of economic players in the ability of fiscal and monetary policy to act could prove to be a strong accelerant of a cyclical downturn.

Deescalation of the trade dispute as an opportunity

The trade conflict between the US and China is currently one of the biggest risk factors for the global economy. However, there is a good chance that the conflict will ease sooner than expected and that tariffs between the world's two largest economies will be lowered. Recently there have been some positive signs in this respect, for example the

Chinese suspended retaliatory tariffs on US car imports for three months at the beginning of December. A possible de-escalation of the trade conflict would boost world trade and boost global corporate investment due to declining uncertainty. A decline in global insecurity would also probably lead to a devaluation of the Swiss franc, as the role of a safe haven would recede into the background.

Fig. 1-2 BAK Risk Monitor – What is important for Switzerland and what is becoming more important?



For the interactive graph click in the picture above or enter the following URL:

https://consult.bak-economics.com/en/current-topics/bak-risk-monitor/

In the print version you can scan the QR-code next to the graph.
(An app from a third party may be required. Interactivity may be restricted depending on the device.)

Disclaimer:

This publication is a non-binding statement of market conditions and is provided by Sallfort Privatbank AG in a confidential manner and for informational purposes only. The opinions expressed therein are not necessarily the opinion of Sallfort Privatbank AG, its shareholders or its employees. This information is provided to the best of our knowledge and belief and is believed to be correct.

The published information on investment forms of any kind does not constitute an offer, nor a solicitation or recommendation to buy or sell.

No liability shall be accepted for any loss or damage caused by any decision made by you based on this information. The sources of the information have been carefully selected, but no guarantee can be given, and no liability will be assumed that they are current, correct and complete.

Due to legal restrictions in individual countries, this information is not intended for persons with the nationality or place of residence of a country in which the authorization and distribution of publications of this type is restricted.

-This publication has been translated from German.