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Monetary policy assessment of 17 March 2011

Swiss National Bank maintains its expansionary monetary policy

The Swiss National Bank (SNB) is maintaining its expansionary monetary policy. It is leaving the target range for the three-month Libor rate unchanged at 0.0–0.75%, and intends to keep the Libor within the lower part of the target range at around 0.25%.

Global economic developments, especially in the US and Asia, have been somewhat more dynamic than the SNB had expected in December. Despite the continued strength of the Swiss franc, the Swiss economy also grew more vigorously in the fourth quarter of 2010 than anticipated. Positive business expectations suggest favourable developments in the economy in the coming months, even though stagnating goods exports indicate that growth will slow during the course of the year. For 2011, the SNB expects Swiss GDP to advance by approximately 2%.

With the strengthening of the global economic recovery, the prospects for Switzerland's economy have improved since the last quarter. However, continuing debt problems in Europe and the possible dampening effects of high oil prices on economic activity pose considerable downside risks. In addition, the consequences of the earthquake catastrophe in Japan are, at this stage, difficult to assess. At the same time, geopolitical tensions and rising commodity and food prices lead to upside risks to inflation across the globe. Survey data show however that inflation expectations in Switzerland remain stable.

The SNB's conditional inflation forecast shows slightly higher inflation for 2011. This is due to higher oil prices, more dynamic domestic growth and the more positive assumptions for the global economy. From mid-2012 onwards, the impact of the recent Swiss franc appreciation has a moderating influence on the forecast. After this point, the new conditional inflation forecast is therefore identical with the December forecast. Assuming an unchanged three-month Libor of 0.25% during the forecast horizon, average inflation is expected to amount to 0.8% for 2011, to 1.1% for 2012 and to 2.0% for 2013. The conditional inflation forecast shows that there is no threat to price stability in the short term. However, the rising path in 2012 and 2013 shows that the current expansionary monetary policy cannot be maintained over the entire forecast horizon

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without compromising price stability in the longer term. The conditional inflation forecast is associated with a very high level of uncertainty.

Global economic outlook

The expansion in the global economy is progressing somewhat faster than expected in December. After a brief slowdown, growth in the emerging economies picked up again in the fourth quarter, particularly in Asia. In the advanced economies, the pace of the recovery still varies significantly from one country to another. In the US, growth became more broad based. As the labour market continued to recover, consumer spending picked up. In Europe, the recovery has remained modest overall and dependent on foreign demand. However, Germany's economic upturn stands out considerably from the European average.

The global economic outlook is encouraging. The latest indicators point to robust growth in industrial output and trade in the first quarter. The export industry in the advanced economies is likely to benefit further from the vigorous demand coming from the emerging economies. In the US, the fiscal measures decided in December boosted domestic demand. As a result of the stronger growth momentum in the US and the emerging economies, the SNB revised its global growth assumptions upwards for 2011. Furthermore, inflationary pressure is rising, owing to commodity and food prices as well as the increasing capacity utilisation.

Although uncertainty about the future outlook for the global economy has abated, it still remains considerable. Since worries about the stability in the euro area and geopolitical concerns could lead to renewed tensions, downside risks continue to dominate. Uncertainty about developments in Japan has introduced a new element of risk.

Swiss economic outlook

In spite of the marked appreciation of the Swiss franc, the economic recovery in Switzerland recently proved to be more dynamic than anticipated. GDP growth again exceeded potential growth and was broad based. Technical capacity utilisation continued to increase. In manufacturing and in the service sector, it is at a satisfactory level, while in the construction industry it is high. At the same time, demand for labour has firmed, resulting in a renewed drop in unemployment and short-time work. Despite the noticeable dampening effect of the Swiss franc appreciation, the continued positive business expectations suggest favourable developments in the coming months.

During the course of 2011, the SNB continues to anticipate weakening growth. It now expects real GDP to expand by roughly 2% for the year as a whole. First, surveys point to increased competitive pressure and narrow margins for many Swiss export firms. Second, with the continued strength of the Swiss franc, goods exports have lost considerable momentum since the spring of 2010, and spending on tourism services has even declined.

Monetary and financial conditions

The effect of the expansionary monetary policy continues to be reflected in monetary and financial conditions in Switzerland. Since December, the three-month Libor has remained virtually unchanged within the lower part of the target range. Long-term interest rates have risen since August, but remain low.

After the Swiss franc appreciated sharply between June and December 2010, its value remained essentially unchanged compared to the December assessment. At the same time, its performance was characterised by considerable fluctuations. Overall, the real trade-weighted external value of the Swiss franc remains at a historically high level.

The vigorous growth of the broader monetary aggregates has continued since the last monetary policy assessment. The rise in long-term interest rates can be expected to stabilise money growth to a certain degree.

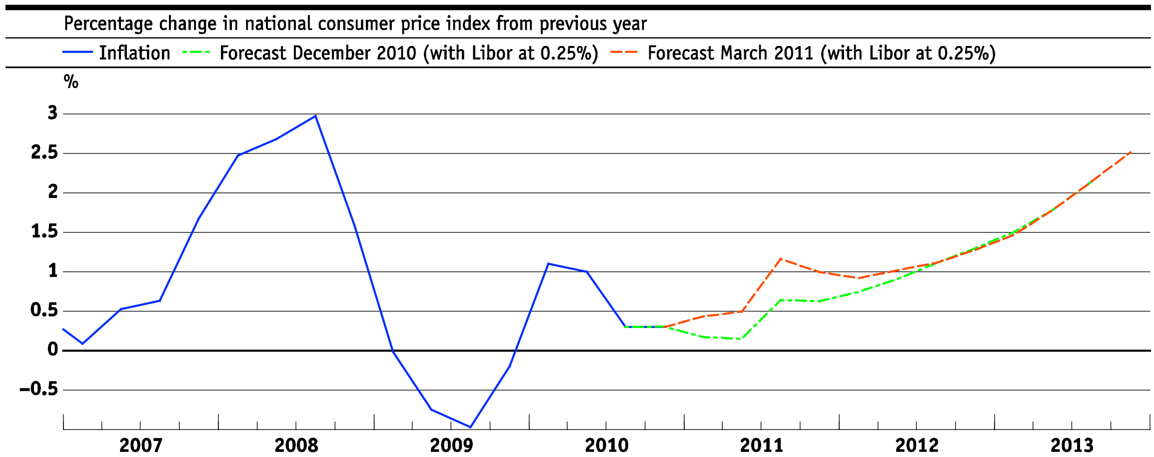
Lending activity remained brisk in the fourth quarter of 2010. According to the SNB survey on bank lending, there were virtually no changes in corporate lending. Banks reported the same lending standards and no change in the demand for loans. Growth in mortgage lending decelerated marginally, but remains at a high level. The situation on the mortgage and real estate markets still requires the full attention of the SNB.

Chart of conditional inflation forecast

The (dashed) red curve on the chart represents the new conditional inflation forecast. It shows the future path of inflation, assuming that the three-month Libor remains constant at 0.25% over the entire forecast horizon, and it covers the period from the first quarter of 2011 to the fourth quarter of 2013. For purposes of comparison, the (dash-dotted) green curve shows the conditional inflation forecast published in December, which was also based on the assumption of a three-month Libor of 0.25%.

The new conditional inflation forecast shows a slight rise in inflation for 2011. This is due to a renewed sharp increase in oil prices, more dynamic domestic growth and more positive assumptions for the global economy. The peak in inflation in the third quarter of 2011 is due to a base effect, because inflation in the third quarter of 2010 was comparatively low. From mid-2012 onwards, the new conditional inflation forecast follows that of December. This is a reflection of the fact that the assessment of the inflation outlook has not changed significantly compared to the previous quarter. Towards the end of the forecast horizon, inflation rises briskly and exceeds the upper bound of 2%, assuming that the three-month Libor remains at the current level. This shows that the current expansionary monetary policy cannot be maintained over the entire forecast horizon without compromising price stability in the longer term. Due to the risks mentioned previously, this conditional inflation forecast is associated with a very high level of uncertainty.

Conditional inflation forecast of December 2010 and of March 2011



Observed inflation March 2011

	2007 Q1	Q2	Q3	Q4	2008 Q1	Q2	Q3	Q4	2009 Q1	Q2	Q3	Q4	2010 Q1	Q2	Q3	Q4	2007	2008	2009	2010
Inflation	0.1	0.5	0.6	1.7	2.5	2.7	3.0	1.6	0.0	-0.7	-1.0	-0.2	1.1	1.0	0.3	0.3	0.7	2.4	-0.5	0.7

Conditional inflation forecast of December 2010 with Libor at 0.25% and of March 2011 with Libor at 0.25%

	2010 Q1	Q2	Q3	Q4	2011 Q1	Q2	Q3	Q4	2012 Q1	Q2	Q3	Q4	2013 Q1	Q2	Q3	Q4	2011	2012	2013
Forecast December 2010, Libor at 0.25%				0.3	0.2	0.2	0.6	0.6	0.7	0.9	1.1	1.3	1.5	1.8	2.1		0.4	1.0	
Forecast March 2011, Libor at 0.25%					0.4	0.5	1.2	1.0	0.9	1.0	1.1	1.3	1.5	1.8	2.1	2.5	0.8	1.1	2.0

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