End-of-year press conference, Zurich, 12 December 1997

Introductory Remarks by Hans Meyer, Chairman of the Governing Board of the Swiss National Bank

The Governing Board of the Swiss National Bank, in agreement with the Federal Government, does not plan to tighten monetary policy in 1998. It currently considers the inflation risks in Switzerland to be low. The supply of money will be expanded as required to permit continued economic recovery without threatening price stability. Monetary policy will also duly take the uncertainties emanating from European monetary integration into account. As usual, the Governing Board will retain the option of deviating from its monetary course in the event of disruptions in the financial markets.

The Swiss National Bank's task is to pursue a monetary policy serving the interests of the country as a whole. This task needs to be described in more detail. A monetary policy that ensures an adequate supply of money in relation to the needs of the real economy tends to guarantee price stability in the long term. Price stability is not an end in itself. It helps to create a favourable framework for balanced economic development. More particularly, price stability is an important social concern since the weakest members of society suffer most from inflation.

As the year went by, the prospects for a gradual economic recovery began to improve. The long stagnation, which has taken its sad toll in terms of human suffering and material loss of substance, may well be behind us. Before discussing our monetary policy intentions for the coming year, I should like once more to look back on past developments.

A year ago we planned to continue implementing a generous monetary policy. At that time, we had to take into account the unfavourable economic situation as well as the possible implications of European monetary integration. We expected a gradual economic recovery and at first only a minor danger of inflation. Nevertheless, we drew attention to the strong expansion of the monetary base and emphasised the associated medium-term risks. However, we also pointed out that a change in monetary policy would only enter into consideration once the economy was clearly on an uptrend.

Today we are able to say that economic developments in Switzerland have largely come up to our expectations. Real gross domestic product rose markedly in the second and third quarters of 1997. Its growth rate is expected to be 0.5% on an annual average. With an inflation rate on a similar level, it is possible to speak of price stability.

In the implementation of an adequate monetary course, however, considerable difficulties were encountered in the course of the year. We had already pointed out at the end of 1996 that the demand for base money had exceeded expectations and that this falsified the indicator value of our target aggregate. In 1997 new problems arose. Notably, the demand for one thousand franc banknotes increased excessively. It therefore seemed to us beyond doubt that the vigorous expansion of the monetary base, which is likely to surpass the previous year's level by approximately 3% in the fourth quarter, overstated the degree of monetary expansion (cf. chart).

In view of these imponderables, we set our sights increasingly on other money supply aggregates, notably on M_3. Our investigations show that there is a fairly close correlation between the development of the money supply M_3 and the price level. At the end of 1995, the growth of M_3 accelerated markedly, reflecting our generous monetary policy. The comparatively strong expansion of M_3 by and large continued in the first half of 1997. We were therefore of the opinion that monetary policy would have to be considerably tightened sooner or later.

Until late summer our aim was to supply the money market with abundant liquidity. Given the clear signs of economic revival, we permitted money market rates to rise moderately in October, in line with interest rate developments in other European countries. We found it necessary to tighten monetary policy somewhat in order to contain money supply growth and thus maintain price stability in the long term.

A renewed review of the situation, however, leads to the conclusion that the excess money supply which existed at the beginning of 1997 already seems to have been reduced substantially. The growth in the money supply M_3 amounted to 4% at the end of October. It therefore tends to lie in a range consistent with price stability in the long term. The monetary base shows a similar development if the said shifts in demand are disregarded as far as possible. Without these shifts the monetary base is likely to come close to its medium-term target path.

As stated earlier on, we intend to expand the money supply in 1998 so as to permit the economic recovery to continue without threatening price stability. This implies that we will adjust the supply of money to the increase in demand resulting from the development of the Swiss economy forecast for 1998. We are expecting an increase in the real gross domestic product of 2% and a rise in consumer prices of 1%. Under these circumstances, the growth trend of the money supply M_3 is likely to remain at the present level in 1998. Temporary deviations from the growth trend cannot, however, be ruled out even for M_3. Due to the said distortions and possible future shifts in demand it is difficult to predict how the monetary base will develop. Should no further shifts occur, the monetary base is likely to rise from its present level on a line parallel to the medium-term target path. From this follows that for the time being there is no need for another increase in Swiss interest rates.

As in 1997, we shall not orient our monetary policy solely to the monetary aggregates but will also take the economic and exchange rate situation as well as interest rate developments into account. If real growth should fall considerably short of expectations, then the expansion of the money supply is also likely to decrease markedly. Under these circumstances, interest rates would have to fall. An unexpectedly pronounced economic upswing, on the other hand, would probably put upward pressure on interest rates. The course we are aiming at will in any case support the economic revival from the monetary side.

Next spring the European Union will decide on the beginning of the third stage of the Economic and Monetary Union. The markets are expecting a timely start at the beginning of 1999. This expectation is already reflected in the development of the exchange rates of the Swiss franc vis-à-vis the European currencies. It is nevertheless conceivable that the transition to the third stage will trigger fluctuations of the Swiss franc exchange rate that are both unexpected and undesirable. To end with, I should like to reiterate that we shall certainly use the monetary means at our disposal to counter an exchange rate development that is undesirable from the point of view of the economy as a whole.