

# End-of-year Media News Conference, Zurich, 10 December 1999

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

### Monetary policy

The Swiss National Bank, in agreement with the Federal Government, plans to tighten monetary policy somewhat in the coming year 2000. Already this past autumn it permitted money market rates to rise after having pursued a generous monetary policy for an extended period. The National Bank continues to support the economic upswing with its policy, without jeopardising price stability in the long term.

At the start of the year 2000, the National Bank will adapt its monetary concept in various respects. It will no longer fix growth targets for the money supply. Monetary policy decisions will, in future, be based mainly on an inflation forecast, which will take all relevant indicators into account. The money stock M3, will continue to play an important role as a monetary indicator. As in the past, the National Bank will primarily orient its monetary policy to the preservation of price stability. Price stability is considered to have been achieved with an inflation rate, measured by the national consumer price index, of less than 2% per annum. Finally, an innovation will be introduced in the field of money market steering by the fixing of a target range for the three-month Swiss franc money market rate. For the time being, the National Bank will aim at keeping the three-month rate within a range of 1.25% - 2.25%.

It is generally known that in the past years the seasonally-adjusted monetary base was used as a target variable for monetary policy. Originally, annual growth targets were set. Since the beginning of the nineties, we have been applying medium-term growth targets in order to enable us to take better account of the fact that the development of the money supply influences the course of inflation notably in the medium term. The medium-term orientation of monetary policy created the necessary leeway for also taking into account other indicators in decision-making processes, such as real economic development, the situation on the labour market and the exchange rate. The deviations from the target path make it clear that the medium-term target was always considered to be a guideline only. In recent years, this has particularly been the case as the monetary base increasingly forfeited its informative value. For this reason, we have decided no longer to announce a growth target for the monetary base in future. The broad foundation on which our policy rests and which takes all significant indicators into account must become even clearer.

In future, we shall provide a forecast at year-end for the development of inflation in the three ensuing years. The period of three years takes account of the time required for the transmission of monetary stimuli. It is, of course, not easy to predict inflation for such a long period. Our prognosis will therefore be fraught with uncertainties. By publishing a forecast for the following three years, however, we wish to emphasise the need to adopt a forward-looking stance and to react at an early stage to any threats to price stability.

In general and in the longer term, inflation depends largely on the development of the money supply. Notably the money stock M3 thus remains a useful indicator. In the shorter term, however, other indicators of inflationary development must be considered. The main focus is on general economic development, the

situation on the labour market, and exchange rates. The National Bank will comment the development of the indicators on which the inflation forecast is based on a quarterly basis.

By ensuring price stability, monetary policy makes the best contribution to a balanced macroeconomic development. Price stability is considered to be an inflation rate of less than 2%. This takes account, among other things, of the fact that inflation cannot ever be measured with complete accuracy. Measuring problems may, for example, arise from qualitative changes in goods and services. Once more, it must be emphasised that price stability is not an end in itself. Stable prices are conducive to sustained economic growth and prevent socially undesirable developments.

The National Bank must expect frequent price movements in the short term, which it can only influence to a limited extent. As a rule, these result from unexpected strong fluctuations in the oil price and other import prices and from exchange rate changes. Persistent inflationary and also deflationary developments must, however, be firmly countered.

If the inflation forecast deviates from price stability as defined by us, this has implications for monetary policy. Should inflation exceed its forecast, the monetary reins must be tightened, and vice versa.

For the purpose of implementing its monetary policy intentions, the National Bank will, in future, fix a target range for the three-month Swiss franc money market rate. At the same time, we shall provide information on the area we aim at within this target range. The target range will be reviewed periodically and be adjusted, if necessary. In this way, the implementation of monetary policy will become transparent. In return, the discount rate can be abolished. In his remarks, Mr Gehrig will deal in some detail with the ways and means of implementing monetary policy.

Against this background, what then are our concrete intentions for the coming year?

Generally speaking, a sustained upswing is to be expected. Following an expansion of just under 1.5% in 1999, real gross domestic product is likely to increase by 1.8% next year. Inflation, which amounted to approximately 1% in the current year, should rise to 1.5%. Employment will probably grow somewhat.

This development is due to three main causes: the efforts undertaken by the Swiss economy itself, the improved international economic situation and the favourable monetary conditions.

The price development forecast for the coming year will not depend significantly on our future monetary policy. This policy will only have an influence on price developments in the succeeding years. As is generally known, we already adjusted our generous monetary policy moderately last autumn. In order to guarantee price stability in the medium term, we will probably again have to tighten the monetary reins slightly in the coming year. In this case, inflation up to the year 2002 is likely to develop as shown in the graph. Given Switzerland's favourable economic performance, inflation will probably lie in the upper part of the range we equate with price stability. We shall continue to respond flexibly to extraordinary developments such as in the field of exchange rates.

In the year 2000 notably the sustained economic upswing is likely to exert a certain upward pressure on consumer prices. The upward price movement should, however, be dampened by continuing intense competition and falling prices in telecommunications and in the agricultural sector.

The predicted course of inflation is in conformity with the expected development of the monetary indicators watched by us. During the recession of the nineties, the growth of M3 had accelerated considerably in the wake of the National Bank's increasingly expansionary monetary policy. In spring 1997, it began to level off again as the National Bank further relaxed its monetary policy, but to a limited extent only. In October 1999, growth in M3 was at a comparatively low level of 1.0%. No inflationary stimuli of note are therefore likely to emanate from the expansionary monetary policy which the National Bank conducted until recently.

We shall closely observe the development of the principal indicators and review the analyses which form the basis of the inflation forecast every three months. We shall also continue to publish the results of our monetary policy assessment in our Quarterly Bulletin.

### Inflation Forecast

