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SWISS NATIONAL BANK

News conference

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Introductory remarks by Jean-Pierre Roth

Ladies and Gentlemen

As we have just announced in our press release, the Swiss National Bank is raising its target range for the three-month Libor by 0.25 percentage points to 0.50–1.50%. This change will take effect immediately. The SNB intends to hold the rate in the middle of the target range for the time being.

Economic recovery is continuing as expected. It has grown stronger and is more broad-based. The SNB has raised its forecast for economic growth in 2005 and now expects the increase in GDP to reach just over 1.5%. For 2006, it projects growth of a little more than 2%. The National Bank anticipates average inflation for 2005 to remain at 1.2%. On the assumption that the three-month Libor remains unchanged at 1.0%, it forecasts annual inflation of 0.8% in 2006 and 1.2% in 2007.

By raising its target range, the Swiss National Bank is adjusting its monetary policy to economic developments, which are proceeding as expected. The SNB thus ensures that the inflation outlook remains favourable. Despite the increase in the interest rate, the monetary policy of the SNB remains expansionary and supports the upswing. As economic recovery progresses, the SNB will continue to gradually adjust its monetary policy. If the Swiss franc were to appreciate rapidly, the National Bank would react appropriately.

Today's increase in the three-month Libor was generally expected. Why did financial markets anticipate this move? The answer is simple. The moderate increase in the interest rate is compatible with our strategy of making gradual corrections to a very expansionary monetary policy, while taking into account economic recovery. Let me clarify this statement.

Economic activity

At our monetary policy assessment in mid-September, we addressed the factors indicating an economic improvement in the second quarter. We expected that this trend would strengthen in the second half of the year. The movements in economic indicators over the last three months confirm this scenario.

According to estimates by the State Secretariat for Economic Affairs (seco), real GDP in the third quarter exceeded the previous quarter by an annualised figure of 4.3%. With respect to the year-back level, it was up by 2.3%. Together with the GDP figures for the

third quarter, seco also presented revised figures for the first two quarters. The new figures are substantially higher than before, even after the considerable increase in the figure for the first quarter that was presented in September. Most observers were surprised by the size of the growth estimate for the third quarter. What is more, the retrospective revisions have considerably modified the perception of the economic situation in the first half of the year. Nevertheless, interpretation of the quarterly estimates is difficult in view of the sizable fluctuations in final demand and the fact that the main factor impacting on GDP momentum are changes in inventories. Other indicators, such as the consumer confidence index, company expectations, labour demand and the continued low level of inflation expectations, appear to indicate a more modest level of economic momentum.

Despite the uncertainty with respect to the GDP estimates, the information currently available to us indicates that economic recovery has accelerated over the past few months. Fourth-quarter indicators point to a continuation in the economic upswing.

Although export growth is slowing, international demand remains robust. This momentum is increasingly shifting into the domestic sector, where it is acting as a stimulus. Gradually, the utilisation of industrial production capacities is improving. Meanwhile, companies expect demand to pick up over the next few months.

There were signs of a recovery in corporate investment in the third quarter. Over the next few quarters, a high utilisation rate of technical capacity in industry and a more favourable sales outlook are likely to provide greater support for investments in equipment and a gradual increase in labour demand. As a result, the disequilibrium in the labour market is likely to diminish.

In the last quarter, private consumption remained strong. Since employment can be expected to increase over the course of 2006, consumer confidence should strengthen. By contrast, the stimulus provided by construction investment is likely to subside next year. In particular, we may expect that, after three years of robust growth, investments in residential construction will stagnate at a high level.

Overall, we project GDP growth of just over 1.5% this year. Previously, we had expected growth to reach about 1%. To a large extent, this correction to our growth forecast is due to seco’s revision of the figures for the first two quarters. For 2006, we forecast economic growth of a little more than 2%. This would take GDP growth to a level above the potential growth path for the Swiss economy. The output gap – i.e. the gap between normal and actual utilisation of resources – will diminish.

Monetary development

Alongside the figures for the real economy, movements in monetary and credit aggregates also indicate that economic recovery is underway. Since adopting a resolutely expansionary monetary policy three years ago, mortgage lending has grown at an annual rate of over 5%. We continue to monitor developments in the real estate market closely. Since September, other loans have also recorded positive rates of growth with respect to

year-back figures. In the past, a development of this kind usually indicated a strengthening in economic recovery.

The economy is well supplied with liquidity as a result of the expansionary monetary policy. Although the growth of the broadly-defined monetary aggregate, M3, had fallen to 1% in October 2004, it has since climbed back to over 6%. However, excess liquidity will be gradually reduced as a result of the interest rate increase announced today. In this way, we aim to ensure that price stability is not endangered in future.

The monetary policy decision

The economic and monetary situation has developed in the way we anticipated. The inflation outlook prior to today's decision was largely in line with the figures presented at the last monetary policy assessment. For 2006, however, we forecast a slightly higher level of inflation to that presented in the last assessment. This is due to revisions made to certain figures that point to a higher rate of utilisation in the economy.

In view of this inflation outlook, what is the justification for our decision to increase the target range for three-month Libor by 25 basis points? While we anticipate falling rates of inflation next year, this decline is not relevant in terms of monetary policy. Recent inflation levels of over 1% are probably largely due to the rise in oil prices which began in the first half of 2004. At the time, we decided not to take this increased inflation into account in our monetary policy decisions, due to the fact that its consequences could not be neutralised through monetary policy measures. It seems logical, therefore, not to take account of a decline in inflation attributable to subsiding oil prices, particularly since this drop also results from a statistical effect. A number of inflation components are likely to persist at a low level, even in 2006. We are working on the assumption that the prices of imported products will continue to fall, due especially to the continued pressure exerted by international competition. This will have a dampening effect on the domestic price level. All of these factors mean that some of the gains in productivity will be passed on to consumers in the form of price reductions.

Since there is a considerable lag between the adoption of monetary policy measures and their impact on prices, monetary policy does not affect price developments in the near term. Consequently, the National Bank is guided by the medium-term inflation outlook rather than the short-term forecast. The inflation forecasts published since 2003 show high rates of inflation at the end of each forecast horizon. This makes it clear that we cannot continue our expansionary monetary policy for an unlimited period of time. The three-month Libor was already lifted in June and September 2004, each time by 25 basis points. Because the economy weakened in the fourth quarter of 2004, there was an improvement in the inflation outlook at the monetary policy assessments of December 2004, and March and June 2005. Consequently, a decision not to undertake further increases in the rate of interest was appropriate. However, the forecast of mid-September 2005 indicated that there would be no further improvement in the inflation outlook. Nevertheless, we decided not to increase interest rates at that time. We determined not to take any action because of the fact that oil prices had attained record heights just before

our monetary policy assessment. It was not possible at the time to fully assess the impact on the economy and on inflation.

If monetary policy had remained the same at this assessment, the medium-term inflation outlook would once again have been unchanged. In the meantime, however, the room for manoeuvre available to monetary policy has declined. Our inevitable concerns with respect to the high price of oil in September have been dissipated by the favourable developments in the economy. As a result, we have decided to increase the target range for the three-month Libor by 0.25 percentage points. Consequently, this decision is in line with the statements we made at the last monetary policy assessment.

Inflation forecast graph

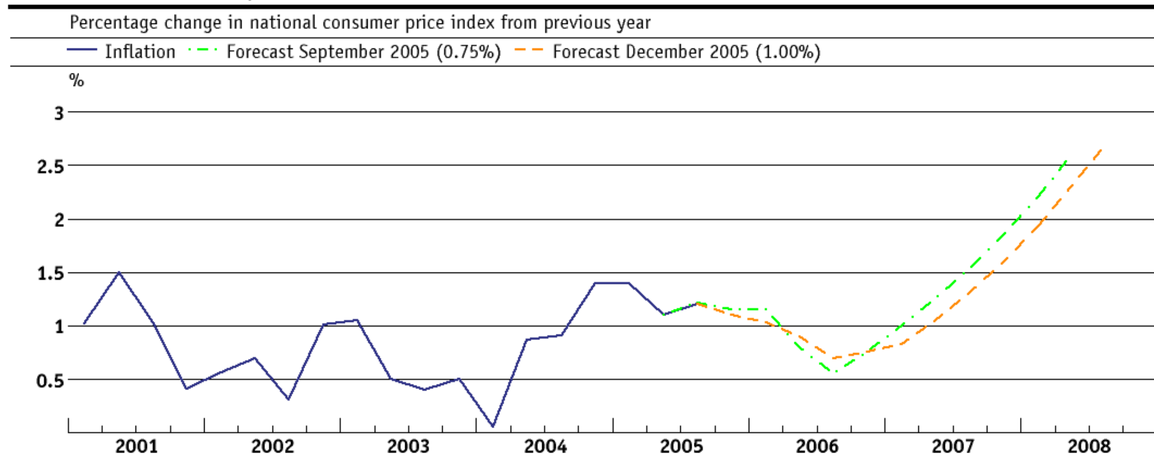
I now turn to the current inflation forecast, which is based on the assumption of a change in the three-month Libor, to 1.0%. The graph depicts the current and the previous forecasts. The dashed red curve represents the new forecast, which covers the period from the fourth quarter of 2005 to the third quarter of 2008. It summarises the inflation outlook, following today's increase in the rate of interest. The dash-dotted green curve shows the inflation forecast at the time of the last monetary policy assessment and is based on a three-month Libor of 0.75%.

The two forecasts are very similar for 2006, and show receding rates of inflation due to the fact that oil prices are not increasing any further. As of 2007, the new inflation forecast lies below the previous one. This reflects the dampening effect of today's interest rate decision on future inflation.

The forecast shows that there is no immediate inflation risk. At 0.8% and 1.2% in the coming two years, the expected rates of inflation remain low. However, it is evident from the inflation dynamics that, even with a three-month Libor of 1.0%, monetary policy has an expansionary effect.

With today's decision to increase the three-month Libor by 25 basis points, we are adhering to our previous monetary policy course. We continue to support the economy, using the leeway available to us. This should guarantee price stability in the longer term. If the Swiss franc appreciates rapidly, the National Bank will respond appropriately, and is keeping all its options open for such an eventuality, as it has in the past.

Inflation forecast of September 2005 with Libor at 0.75% and of December 2005 with Libor at 1.00%



Observed inflation December 2005

	2002				2003				2004				2005			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Inflation	0.56	0.69	0.31	1.01	1.05	0.50	0.40	0.50	0.06	0.87	0.91	1.40	1.40	1.10	1.20	

Inflation forecast of September 2005 with Libor at 0.75% and of December 2005 with Libor at 1.00%

	2005				2006				2007				2008			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Forecast September 2005, Libor at 0.75%			1.21	1.15	1.15	0.80	0.55	0.75	1.00	1.25	1.53	1.85	2.20	2.60		
Forecast December 2005, Libor at 1.00%				1.10	1.03	0.90	0.70	0.75	0.83	1.05	1.30	1.60	1.93	2.30	2.70	