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The cyclical outlook for the Swiss economy is still favourable. However, the risks have increased as a result of the ongoing deep crisis in East Asia, the uncertain economic and political situation in Russia and the turbulence in the international financial markets. The SNB expects moderate economic growth in the second half of the year, resulting in a rise of real GDP over the year as a whole of about 2%. Given the only moderate pace of the recovery, the economy will not run into inflationary capacity constraints in the foreseeable future. The still remaining level of unemployment and considerable productivity growth will prevent inflationary wage pressure. Analysis of the monetary aggregates leads to the same conclusion. Taking these circumstances as well as future prospects into account the SNB regards the current course of its monetary policy as appropriate, supporting the economic recovery without endangering price stability. The turmoil in the international financial markets has again led to fears about an appreciation of the Swiss franc. The SNB will continue to closely observe the development of exchange rates and if necessary it will take countermeasures.

2. Economic and monetary developments
Monetary developments in Switzerland in the second quarter were characterised by a significant expansion of the seasonally-adjusted monetary base, with a continued slow rise in the money stock M3. Even though the Swiss National Bank supplied the money market generously with liquidity, interest rates moved up until mid-July. At the same time, the Swiss franc depreciated against the major currencies. From mid-July onwards, the Swiss franc strengthened amid turbulence in the international financial markets, while interest rates declined once more.

The economic recovery continued in the second quarter. As already in the first quarter, however, the economy grew at a slower pace than in 1997. Real gross domestic product accordingly exceeded the corresponding previous year's level by 2.2%. The further levelling off of growth compared with the previous period is due mainly to the general loss of dynamism in the export sector. While demand from the United States and Europe remained strong, exports to the Asian countries diminished markedly. Private consumption and equipment investment thus replaced exports as the chief pillar of the economy. No stimuli emanated from building investments, following a slight increase in the preceding quarters. The situation on the labour market continued to improve. Employment levels and the number of vacancies rose, and the unemployment rate fell perceptibly. Consumer prices again remained stable from April to August.

3. The repo - a new monetary policy instrument
In April 1998, a market for repos (repurchase agreements) was established in Switzerland. The Swiss National Bank immediately began using repos as a monetary policy instrument. This article explains the SNB's motivation and shows how to enter into a repo agreement with the SNB, what securities it accepts as collateral and how its holdings of repos has developed. Then follows a description of electronic repo trading and of the services offered by SEGA (Swiss Securities Clearing Corporation - depository and securities clearing organisation of the Swiss banks), which include the automatic selection of securities, processing and risk management during the term of the repo. Furthermore, the contractual principles and

the amendments to Swiss legislation, which were necessary for establishing a Swiss repo market, are described.

4. Chronicle of monetary events

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1. Conclusions for monetary policy at the end of September 1998

After a strong acceleration in the second half of 1997, economic growth in Switzerland slowed in the first half of 1998. The dampening was mainly due to a slower expansion of exports as a result of the crisis in East Asia. Domestic demand, however, developed fairly well, but without gaining further strength. The most important impulses came from private consumption and investment in machinery and equipment. Although construction investment did not support the cyclical recovery, it no longer acted as a drag.

The rise in employment continued in the second quarter; it was accompanied by an unexpectedly sharp fall in the number of unemployed. The reduction of registered unemployment is, however, exaggerated on account of government job-creation programmes. Still, rising job vacancies and business optimism about increasing employment provide general confirmation that the demand for labour is rising.

Consumer prices continued to remain stable from April to August. Minimal price increases of domestic goods were offset by lower prices of imported goods. In the communications sector prices continued to drop, but charges for other services rose slightly while demand recovered.

As announced, the Swiss National Bank (SNB) continued its expansionary monetary policy and generously provided liquidity to the money market. Seasonally-adjusted central bank money rose significantly from April to August, overshooting the SNB's forecast for the second quarter and widening the gap to the medium-term target. However, this contrasted with the still very weak expansion of the monetary aggregate M3, which was probably due to the persistently slow growth of domestic credit.

Despite the more abundant provision of liquidity, interest rates in the second quarter rose slightly. This sign of tighter conditions, however, was more than offset by the simultaneous weakening of the Swiss franc against the major currencies. Overall, monetary conditions were somewhat more expansionary than in the first quarter and about the same as in 1997. From mid-July, interest rates eased again while the Swiss franc firmed significantly against most other currencies. Monetary conditions thus remained unchanged.

The cyclical outlook for the Swiss economy is still favourable. However, the risks have increased as a result of the ongoing deep crisis in East Asia, the uncertain economic and political situation in Russia and the turbulences in the international financial markets. Given the deterioration in the international environment, a further slowdown in Swiss exports must be expected. However, domestic demand is likely to remain robust and thus to underpin the rate of activity. The SNB expects moderate economic growth in the second half of the year, resulting in a rise of real GDP over the year as a whole of about 2%.

Given the only moderate pace of the recovery, the economy will not run into inflationary capacity constraints in the foreseeable future. The still remaining level of unemployment and considerable productivity growth will prevent inflationary wage pressure. Analysis of the monetary aggregates leads to the same conclusion. The SNB does not expect any significant acceleration of growth in M3 up to the end of the year. Its fourth-quarter forecast for seasonally-adjusted central bank money shows no change from the third quarter figure of CHF 33.7 billion. This implies a rise of 2.9% from the previous year.

Taking these circumstances as well as future prospects into account the SNB regards the current course of its monetary policy as appropriate, supporting the economic recovery without endangering price stability. The turmoil in the international financial markets has again led to fears about an appreciation of the Swiss franc. The SNB will continue to closely observe the development of exchange rates, and if necessary it will take countermeasures.

4. Chronicle of monetary events

Activation of General Arrangements to Borrow in favour of Russia

On 16 July 1998, the Swiss National Bank, after consultation with the Swiss Federal Department of Finance, agreed to activate the General Arrangements to Borrow (GAB) in favour of Russia. By this, it provided the International Monetary Fund (IMF) with a loan totalling 378 million SDRs (special drawing rights) within the framework of the Group of Ten. This is equivalent to about 750 million Swiss francs. The entire loan of the Group of Ten comes to 6.3 billion SDRs (or about 12.6 billion Swiss francs). Three-quarters of the programme of the IMF in favour of Russia was financed with this sum. Russia is the first country outside the Group of Ten to benefit from the GAB. The GAB allow the IMF to take loans of up to 17 billion SDRs from the countries of the Group of Ten, according to an agreed quota, in exceptional situations and if funds are scarce. Switzerland has been an associate member country since 1964 and a full member of the GAB since 1984. The participation of the Swiss National Bank in the GAB requires the approval of the two houses of parliamentary chambers every five years; in June 1998 they agreed to prolong the membership.