Quarterly Bulletin, 1, March 2002

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Overview

1. Monetary policy assessment

On 21 March 2002, the Swiss National Bank decided to adhere to its current monetary policy. It left the target range for the three-month Libor rate at 1.25%–2.25%. The National Bank considered the risk of a further weakening of economic activity and the associated danger of a deflationary price development to be smaller than three months ago. The National Bank had last lowered the target range for the three-month Libor rate in December 2001 by half a percentage point.

2. Economic and monetary developments

Business activity in the world's three large economies – the Unites States, Europe and Japan – showed uneven development. Whereas the economic situation in the United States stabilised sooner than expected in the fourth quarter, real gross domestic product in the euro area contracted slightly. In Japan, the recessionary trends intensified.

In the first few months of 2002, the US economy continued its broad-based recovery, and signs of a rebound multiplied in Europe as well. In Japan, however, there is still no indication of a turnaround.

The Swiss economy stagnated in the second half of 2001. Real gross domestic product remained at the same level as in the previous period after having contracted slightly in the third quarter for the first time in four years. Private consumption continued to be the main pillar of the economy. The massive decline in equipment investment, the substantial reduction in inventories and, to a lesser degree, falling exports had a negative impact. The industrial sector, in particular, was still hard hit by the cyclical downturn. At the beginning of 2002, however, there were emerging signs of a stabilisation. Companies considered the inventories to be adequate again and were considerably more optimistic in their outlook than in the previous months. The economic slowdown also affected the labour market. Employment fell slightly in the fourth quarter, and the jobless rate increased by 0.5 percentage points to 2.3% from September to February. The annual inflation rate as measured by the national consumer price index climbed by 0.4 percentage points to 0.7% from November to February. While oil prices continued to have a dampening effect on inflation, the prices of domestic goods rose slightly.

The easing of monetary policy in the second half of 2001 was reflected in a marked decline in short-term interest rates. In February, the three-month Libor rate stood at 1.68%, compared with 2.19% in October. Long-term interest rates, measured by the yield on ten-year Confederation bonds, however, rose by 0.6 percentage points to 3.6%.

3. Inflation forecasting with vector auto-regressive models

Inflation forecasts play a key role in the concept of the Swiss National Bank. They form the main basis for monetary policy decisions and are a crucial instrument for communication. The National Bank employs various models for producing its inflation forecasts. The article introduces the vector auto-regressive models (VAR models) used by the National Bank. The estimation and the properties of non-structural and structural VAR models are examined. Moreover, the article explores possible ways in which the different VAR models can be used to generate inflation forecasts and to conduct monetary policy simulations.

4. Chronicle of monetary events

Target range for the three-month Libor rate left unchanged

At its quarterly assessment of the situation on 21 March 2002, the Swiss National Bank decided to leave the target range for the three-month Libor rate at 1.25%–2.25%. It considered the risk of a further weakening of economic activity and the associated danger of deflation to be smaller than in December 2001.

Partial revision of the Banking Law – Text of the message on the guarantee of deposits and comments by the SNB

In its comments submitted in June 2001, the National Bank principally welcomed the revision proposals by the committee of experts on bank reorganisation, bank liquidation and depositor protection (see Chronicle of monetary events, Quarterly Bulletin 2/2001). It delivered its final comment on depositor protection, the most controversial element of the partial revision of the Banking Law, only in January 2002.

Depositor protection consists of two components, namely preference in bankruptcy and a deposit guarantee. While preference in bankruptcy protects the deposits' substance, the deposit guarantee ensures their fast payout. The revised law stipulates that preferential claims in bankruptcy shall be extended to all deposits of up to Sfr 30,000 per depositor (currently: only savings deposits). Furthermore, the deposit guarantee shall become mandatory for all preferential deposits under the Agreement on Depositor Protection of the Swiss Bankers Association. The system-wide upper limit for the deposit guarantee will be retained. There was some controversy, however, regarding the amount of deposits guaranteed (previously Sfr 1 billion) and as to the question whether a supplementary guarantee should be provided for a bank's preferential deposits whose total exceeds the upper limit.

In its comment, the National Bank stressed the importance of depositor protection, and especially of the deposit guarantee, for the stability of the banking system. The protection of preferential deposits in case of bankruptcy shall continue to be organised and ensured by the banks. However, the National Bank proposes some modifications to the existing scheme. First, it recommends that the system-wide upper limit up to which the banks have to provide their own depositor protection be increased from Sfr 1 billion to at least Sfr 3 billion or, preferably, Sfr 5 billion. Second, to cover preferential deposits exceeding this upper limit, the banks should hold sufficient assets of value that are eligible as security. This would enable the National Bank, in its role as lender of last resort, to provide liquidity assistance under improved conditions if it deemed this necessary for systemic reasons.