Swiss National Bank
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Sectional breakdown of bulletin Q3/2009

Monetary policy report (p. 6)

Following the sharp downward trend of the past few quarters, the global economic situation brightened in the second quarter of 2009. Signs of recovery were most apparent in the emerging economies of Asia and in Japan, where the economic downturn had been particularly pronounced up to that point.

Since the last monetary policy assessment, the SNB has revised its short-term global growth estimates upwards. In the medium term, however, the SNB is not expecting a sustained recovery as would normally be the case after a deep world recession. Accordingly, global economic growth looks set to weaken again in 2010 after just a temporary acceleration.

In Switzerland, GDP continued to decline, albeit at a slower pace, and fell by 1.0% in the second quarter. As a result, the degree of underutilisation of production capacity increased even further. This was particularly pronounced in manufacturing, where both technical capacity utilisation and the demand for labour fell markedly. There is also under-utilisation in the services segment, although to a lesser extent than in manufacturing. Capacity utilisation in the construction industry, by contrast, remains relatively high. Against this background, unemployment rose rapidly, as did the number of firms using short-time working.

For 2009, the SNB now expects a contraction in GDP of between 1.5% and 2%, following its forecast in June, when it was still anticipating a decline of 2.5% to 3%. This adjustment is essentially based on two factors: first, according to SECO estimates, GDP figures have, on the whole, clearly exceeded expectations; second, the more positive assumptions about the global economy are having a favourable impact on the second half of the year.

At the September quarterly assessment, the SNB decided to maintain the expansionary monetary policy initiated in March, to leave the three-month Libor target range unchanged at 0–0.75% and to adhere to its objective of keeping the Libor within the lower end of this range at approximately 0.25%. It will continue to provide the economy with a generous supply of liquidity and, if necessary, continue purchasing Swiss franc bonds with a view to reducing risk premia on long-term debt instruments issued by private sector borrowers. It will take firm action to prevent an appreciation of the Swiss franc against the euro.

The economic situation from the vantage point of the delegates for regional economic relations (p. 44)

In the talks held by the SNB delegates for regional economic relations in July and August, most of the 160 or so representatives of various economic sectors and industries said the pace of economic decline was easing. This was most obvious in industries that hold an early position in the economic cycle. Assessment of the outlook also improved, although in many cases respondents conceded that the situation remained vulnerable. Outstanding orders and production, they said, were still below the year-back level, and quite substantially so in some areas.

The discussions showed that export-based companies were still more severely affected by the crisis than those focused on the domestic market. However, there was an increase in the number of respondents who spoke of a firming up in foreign demand and positive signals emanating, in particular, from Asia. By contrast, the domestic economy – which had held up well for a long time – has been increasingly affected by the crisis. Construction appears relatively robust. Confidence has improved in the banking industry.

Complaints about bank financing conditions and the exchange rate remain rare. However, a number of respondents expressed concern that interest rates might increase next year and the Swiss franc could strengthen again.

SNB Working Papers (p. 48)

Abstract of a paper: Paul Söderlind, 'Inflation risk premia and survey evidence on macroeconomic uncertainty', *SNB Working Paper* 2009-4.

Monetary policy report

Report for the attention of the Governing Board of the Swiss National Bank
for its quarterly assessment of September 2009

This report is based primarily on the data and information available
as at mid-September 2009.

Monetary policy report
Contents

About this report

The Swiss National Bank (SNB) has a statutory mandate to pursue a monetary policy serving the interests of the country as a whole. It ensures price stability while taking due account of economic developments.

It is a particular concern of the SNB that its monetary policy be understood by a wider public. However, it is also obliged by law to inform the public regularly of its policy and to make its intentions known. This monetary policy report performs both of these tasks. It describes economic and monetary developments in Switzerland and explains the inflation forecast. It shows how the SNB views the economic situation and what conclusions it draws from this assessment.

Sections 1–3 of the present report were drawn up for the Governing Board's assessment of September 2009. The sections headed 'Monetary policy decision' and 'SNB inflation forecast' take due account of the Governing Board's monetary policy decision of mid-September 2009.

Unless otherwise stated, all rates of change from the previous period are based on seasonally adjusted data and are annualised.

Monetary policy decision

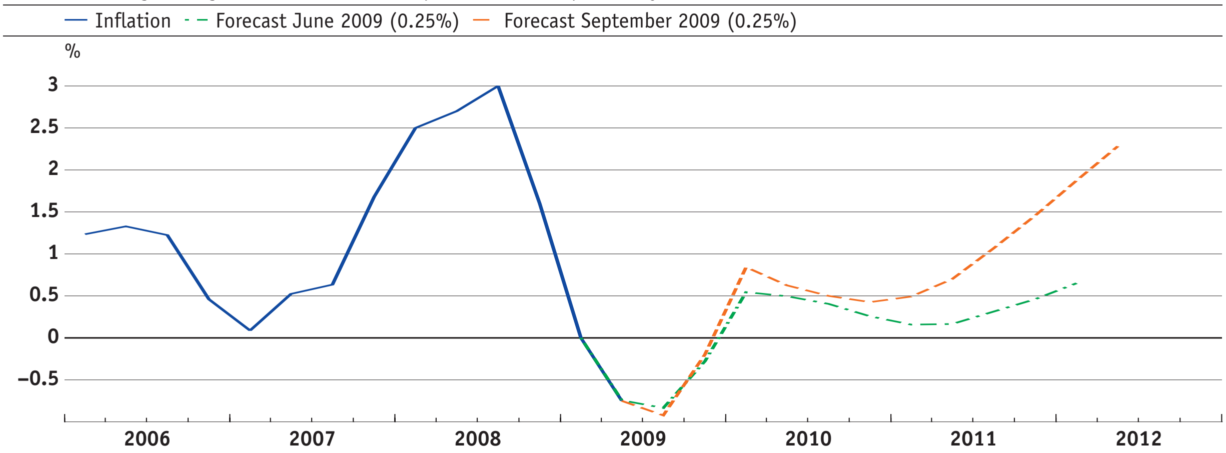
At its quarterly assessment on 17 September 2009, the Swiss National Bank (SNB) announced that it would maintain the expansionary monetary policy which it initiated last March. Despite the fact that the global economy has improved over the past few months and the downturn in the Swiss economy has proved to be considerably less substantial than had been forecast in the second quarter, uncertainty as to future developments remains considerable. In these circumstances, the SNB decided to retain its expansionary monetary policy unchanged.

The SNB therefore held the Libor target range at 0–0.75%. It will still aim to keep the Libor within the lower end of this range, i.e. at approximately 0.25%. It will continue to provide the economy with a generous supply of liquidity and, if necessary, continue purchasing Swiss franc bonds with a view to reducing risk premia on long-term debt instruments issued by private sector borrowers. In addition, it will continue to act decisively to prevent any appreciation of the Swiss franc against the euro.

Consequently, an immediate tightening of monetary conditions is not necessary. However, the inflation forecast shows that the expansionary monetary policy cannot be maintained indefinitely without compromising medium and long-term price stability. By continuing to use an inflation forecast as its guide, the SNB can ensure that the exceptional measures currently in force do not compromise medium and long-term price stability.

Inflation forecast of June 2009 with Libor at 0.25% and of September 2009 with Libor at 0.25%

Percentage change in national consumer price index from previous year



Source: SNB

Inflation forecast of June and September 2009
Average annual inflation in percent

	2009	2010	2011
Forecast June 2009, Libor at 0.25%	−0.5	0.4	0.3
Forecast September 2009, Libor at 0.25%	−0.5	0.6	0.9

Source: SNB

1 Developments in the global economy

Following the sharp downward trend of the past few quarters, the global economic situation brightened in the second quarter of 2009. Signs of recovery were most apparent in the emerging economies of Asia and in Japan, where the economic downturn had been particularly pronounced up to that point. Germany and France, too, recorded positive growth which exceeded expectations. This was likely due to two main factors. First, foreign trade strengthened after having declined sharply in the wake of the massive upheaval in short-term financing markets last winter. Second, demand was supported by large-scale fiscal policy measures, with both private consumption and investment activity (the latter particularly in China) reaping the benefits.

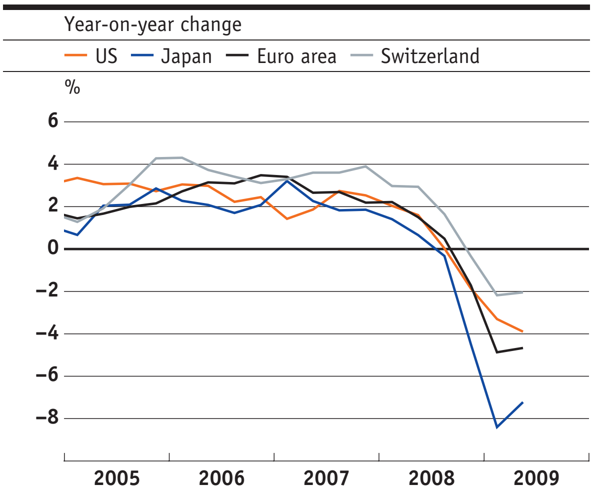
The situation in the financial and money markets continued to improve. Risk premia for all maturities declined further and the issue volume in the bond markets picked up. The rally in equity markets, which began in March, continued into September.

Business confidence has improved noticeably, suggesting a strong rise in aggregate output in the second half of the year. The turnaround in the inventory cycle is likely to make a significant contribution to growth. In the last few quarters, companies had drastically reduced their inventories, and production had plummeted, particularly in the area of consumer durables (e.g. automotive industry). Owing to inventory effects and the aforementioned fiscal measures, the SNB has, since the last quarterly assessment, made upward adjustments to its global growth forecasts for the short run.

In the medium term, however, the SNB is not expecting a sustained recovery as would normally be the case after a deep global recession. In view of the severe financial losses, the restricted access to bank loans and the difficult situation in the labour market, household spending is likely to grow only hesitantly. In addition, owing to the fact that the current excess supply of property in some countries will first have to be reduced, there will be no cyclical impulse coming from the real estate market as is traditionally the case. The rise in government indebtedness is also likely to hold back consumption. Accordingly, global economic growth looks set to weaken again in 2010 after just a temporary acceleration. The forecasts are still subject to a substantial degree of uncertainty, albeit less towards the downside than before given that tensions in the financial markets have eased considerably.

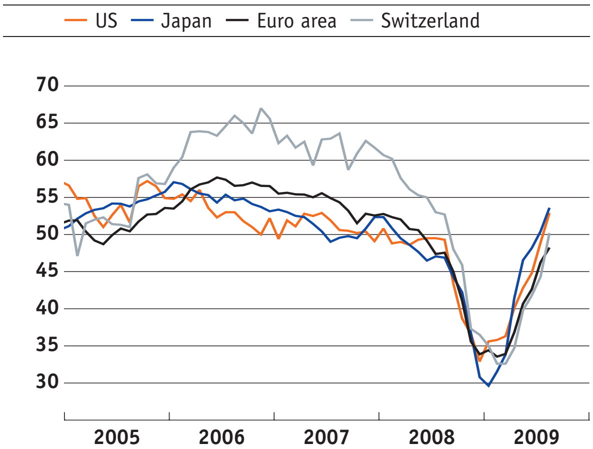
Although commodity prices have been on the increase again since March, the high level of unemployment and the low utilisation of production capacity will probably keep inflation in check in the medium term.

Chart 1.1
Real GDP



Sources: State Secretariat for Economic Affairs (SECO), Thomson Financial Datastream

Chart 1.2
Purchasing managers' indices (manufacturing)



Source: Thomson Financial Datastream; © and database rights: Markit Economics Ltd 2009; all rights reserved

Economic recovery in Japan ...

One of the countries to show distinct signs of recovery in the second quarter is Japan, with its economic performance picking up for the first time in a year. GDP grew by 2.3% after having previously contracted at double-digit rates. At 7.2%, it nevertheless remained below the year-earlier level. Private consumption and exports recovered in particular, while equipment and construction investment continued to fall. Private consumption is likely to have been bolstered by the state cash payments made to households in the amount of 0.4% of GDP, while exports displayed a certain catch-up effect after the extraordinary slump.

Recent developments indicate that GDP will expand further in the second half of the year. The manufacturing industry, in particular, has picked up pace of late. Industrial production, which had fallen to the level of the early 1980s at the beginning of the year, rose between March and June by over 16%. According to surveys, companies are planning to increase output further in the next few months. The recovery has already taken firm hold in the electronics industry and is now spreading increasingly to other industries. In the second half-year, state incentives are likely to breathe new life into the battered automotive industry in particular. Exports have picked up substantially since March and will probably continue to benefit from the upswing in the manufacturing industry. Private investment, meanwhile, is not expected to contribute to growth in the near term, owing to the low level of capacity utilisation and weak corporate earnings, with the result that further cost savings are on the cards. The effects of fiscal stimulus, which will peter out over the course of the next year, will likely be offset by a gradual recovery in global demand.

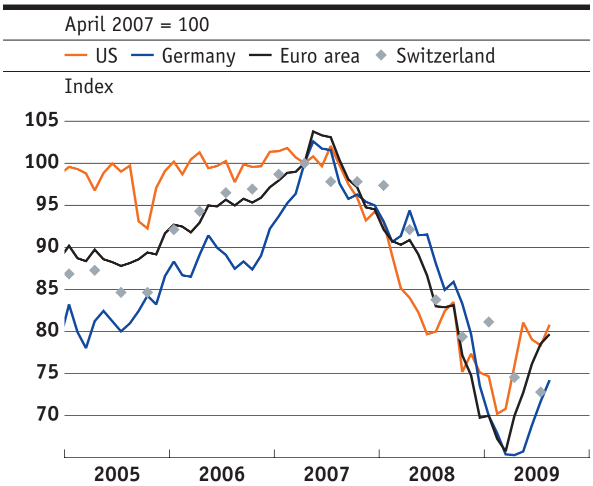
The SNB has revised its growth estimate for the Japanese economy upwards for 2009. It now expects a decline in GDP of 4.9%, as compared to a fall of 6.8% in its June estimate.

... and in the emerging economies of Asia

In China, the impact of the massive economic stimulus package, implemented for this year and next, is becoming increasingly evident. In the second quarter, GDP growth increased further, to 7.9% year-on-year. Investment activity grew strongly, and private consumption also reacted positively to the state incentives. Meanwhile, with imports rising and exports stagnating, the foreign trade contribution had a dampening effect on growth.

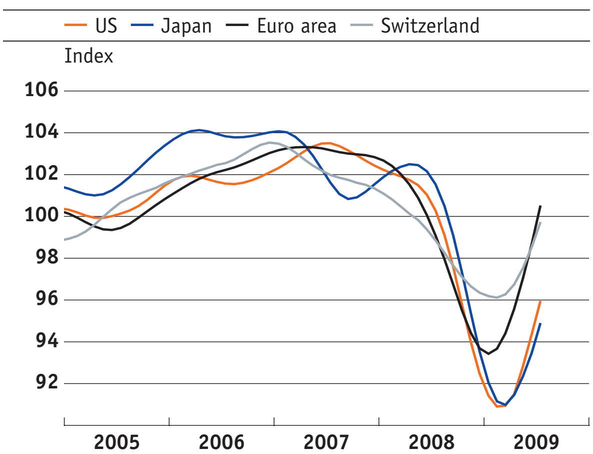
Various indicators in the manufacturing industry are painting a positive picture for the remainder of the year. Exports picked up for the first time by mid-year. At the same time, imports increased further, driven by the extraordinarily high demand for commodities. The latter reflects the increase in government spending on infrastructure, the rise in spending on residential property and the need to build up inventories again. In addition, household

Chart 1.3
Consumer confidence index



Sources: SECO, Thomson Financial Datastream

Chart 1.4
OECD composite leading indicators



Source: OECD

spending was noticeably revived by the incentives introduced mid-year to boost consumption of consumer durables and by the recovery of the Chinese equity market. It thus seems likely that growth in the second half of the year will also be fuelled by domestic demand.

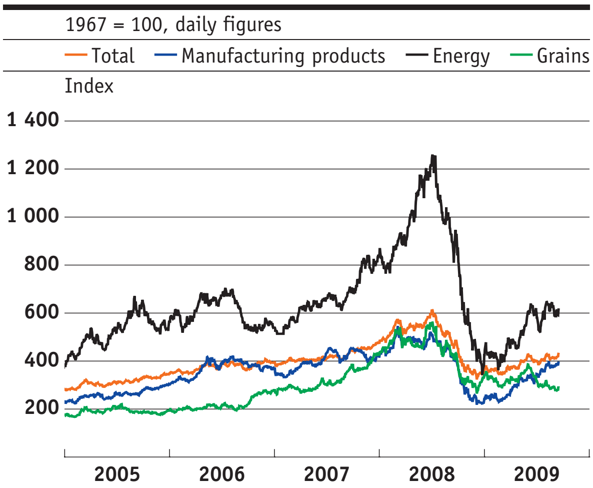
The upswing also took hold in the East Asian tiger economies of Korea, Taiwan, Hong Kong and Singapore, where GDP picked up considerably. Unlike in China, however, exports were the main growth drivers. In an effort to meet the unexpectedly high demand, industrial production increased sharply and inventories were reduced. In some countries, industrial production almost returned to the pre-crisis level; indeed in the case of the electronics sector, this level was surpassed. The economy as a whole still has some catching up to do, however. A positive inventory cycle and rising orders in the export sector should make a significant contribution to growth in the second half of the year, while the expansionary monetary policy and generous fiscal stimulus packages will continue to underpin domestic demand.

Return to growth in the US

The recession that has held the United States in its grip since the end of 2007 weakened significantly in the second quarter of 2009. The fall-off in the rate of growth came to 1.0%, as compared with a slump of roughly 6% in the two previous quarters. Foreign trade and government spending made positive contributions to growth. Meanwhile, a continued decline in spending on residential property and a record reduction in inventories held down GDP growth in the second quarter. Private consumption also fell, having had a supportive effect in the previous quarter. The situation in the labour market was no better, with the number of people in employment falling between May and August by one million and the rate of unemployment rising to 9.7%.

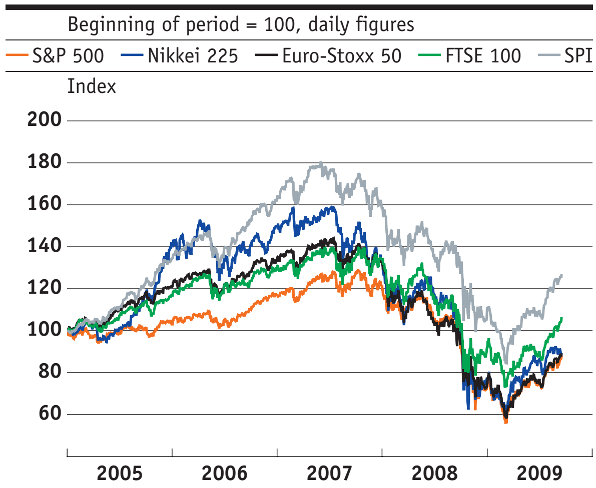
The worst recession in the post-war period is expected to come to a close in the third quarter. The turnaround in the inventory cycle and the fiscal stimulus package should support growth in the second half of the year. Government schemes, such as home loans for first-time buyers or the 'cash for clunkers' scrappage programme to encourage people to trade in their cars for more fuel-efficient vehicles, will contribute to growth in the short term. A marked increase in the number of house sales and building permits suggests that the housing market is beginning to stabilise. Owing to the high number of houses for sale, however, residential construction is unlikely to be a major growth driver in the medium term. The situation in manufacturing has improved. Production picked up again in July, with both business surveys and new orders also looking good for the coming months. However, at the current low level of capacity utilisation, a strong rise in business investment is unlikely. Furthermore, with the financial losses in recent quarters and the high level of unemployment weighing on households, it is likely that private consumption will rise only slightly, despite the tax rebates.

Chart 1.5
Commodity indices



Sources: Reuters, Thomson Financial Datastream

Chart 1.6
Share prices



Sources: Bloomberg, Thomson Financial Datastream

In view of the improved outlook for the second half of 2009, the SNB is now expecting a decline in US GDP of 2.4%, as compared to a drop of 2.8% in its June estimate. Growth for 2010 is expected to remain moderate.

Euro area on the road to recovery

As in the United States, the downward momentum in the euro area also slowed noticeably. After having dropped in the first quarter by 9.5%, GDP fell only by a moderate 0.5%. Indeed in Germany and France, it even rose. Meanwhile, in the medium-sized economies such as Spain and the Netherlands, GDP fell quite considerably yet again. Government incentives for the purchase of consumer durables (especially cars) buoyed private consumption and contributed to a general improvement in consumer confidence. Given that the decline in exports was lower than that of imports, the contribution of foreign trade to growth was positive for the first time in three quarters. Sales to Asia picked up again slightly. At the same time, companies continued to reduce their inventories. Investment spending by companies was still under pressure as industrial capacity utilisation remained at a low level.

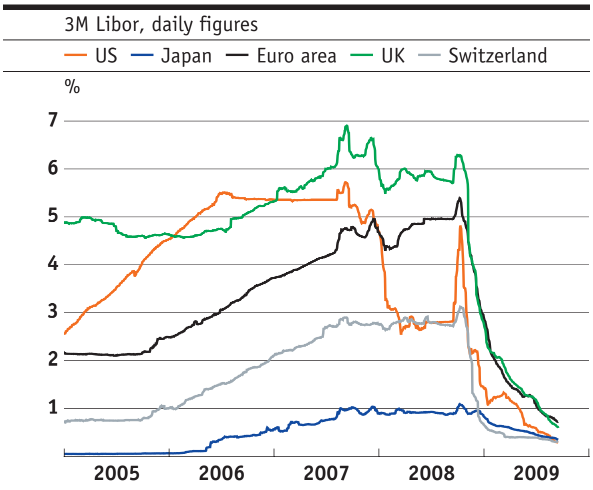
The renewed rise in most business climate indices suggests that economic recovery is set to continue. Owing to the more positive assessment of new orders, the European purchasing managers' indices in manufacturing rose further. The inventory cycle is likely to have bottomed out in the second quarter and should make a positive contribution to growth in the second half of the year. Following a slump in investment of over 10% in the last four quarters, slight pent-up demand can be expected. In the financial markets, the credit spreads declined considerably, thus easing financing conditions. Economic stimulus packages should increasingly take effect and underpin construction activity. However, more restrictive bank lending could curb this activity in the medium term. In addition, the situation in the labour market is likely to deteriorate further. The SNB has revised its 2009 growth estimate for the euro area upwards to –3.6%, as compared to –4.6% in June. For 2010, it also expects higher growth than forecast in June.

Decline in consumer price inflation persists

Measured in terms of consumer prices, annual inflation continued its downward trend between April and July, largely as a result of negative base effects for energy prices and a smaller rise in food prices. Core inflation, which excludes energy and food prices, receded only very slightly. The negative base effects for energy prices will decline in the second half of the year. A surge in inflation is not expected, however, owing to low industrial capacity utilisation and the high level of unemployment.

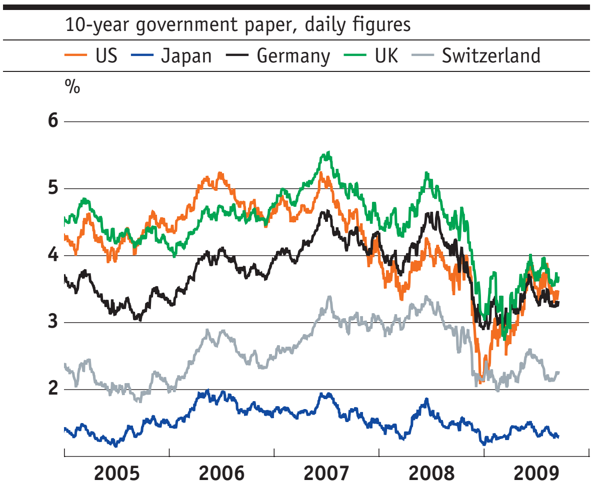
Annual inflation in the US dropped from –0.7% in April to –2.1% in July. Core inflation fell in the same period from 1.9% to 1.5%. In the euro area, annual inflation receded from 0.6% to –0.2% in August, while core inflation remained at a higher

Chart 1.7
International short-term interest rates



Source: Thomson Financial Datastream

Chart 1.8
International long-term interest rates



Sources: SNB, Thomson Financial Datastream level (1.3% in July). Annual inflation in Japan retreated by more than 2 percentage points to –2.2%; its core inflation fell to –0.9%. The Asian tiger economies also saw annual inflation slip into the negative zone, to an average of –0.2%. China recorded a further decline in annual inflation, to –1.8%.

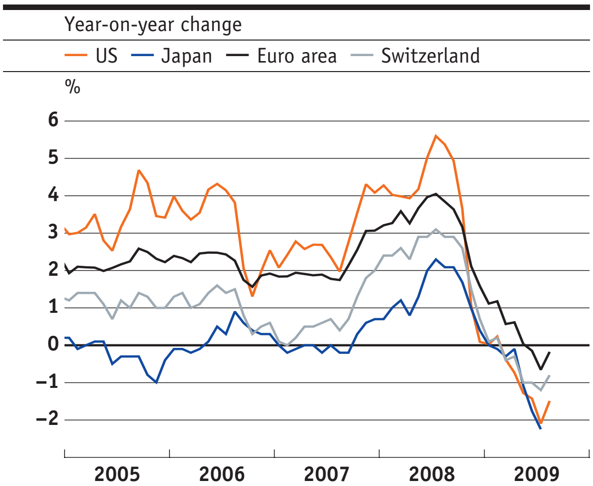
Monetary policy to remain expansionary

The central banks of most industrialised countries adhered to their expansionary monetary policy. Since March of this year, the US Federal Reserve left the target range for the federal funds rate unchanged at 0.0–0.25% and refrained from expanding its purchases of securities beyond the ceiling planned. In order to allow a gradual withdrawal, it was announced that the purchase of Treasury bonds worth USD 300 billion would be concluded by October 2009. Meanwhile, the Fed extended the Term Asset-Backed Securities Loan Facility (TALF) by a further six months, through to mid-2010. This credit programme aims to strengthen the commercial real estate market. Prices for money market futures suggest that the interest rate policy will begin to normalise in the first half of 2010.

The European Central Bank (ECB) retained its relaxed monetary policy conditions and left its main refinancing rate at 1%. Furthermore, the purchase of euro-denominated covered bonds amounting to over EUR 12 billion to date has helped to stabilise the liquidity situation of the banking system. The ECB intends to use the full amount of EUR 60 billion announced in May by mid-2010. In addition, the first of three planned twelve-month refinancing operations succeeded in lowering the money market interest rates at the end of June. Two further operations are scheduled for the end of September and mid-December.

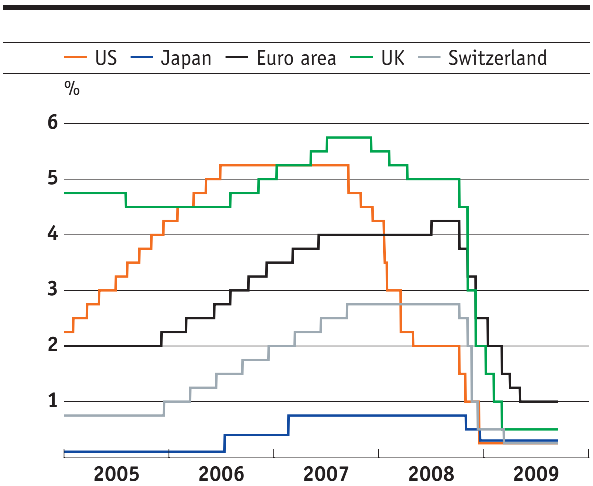
The Japanese central bank left its call money rate at 0.1% and extended its unconventional measures aimed at making short-term liquidity easier to obtain. This move particularly helped smaller enterprises, which were still suffering from the effects of tight credit conditions. Owing to the fact that there is still considerable uncertainty with regard to the sustainability of the current economic recovery, the central banks of many Asian countries are maintaining their wait-and-see stance.

Chart 1.9
Consumer prices



Sources: Swiss Federal Statistical Office (SFSO), Thomson Financial Datastream

Chart 1.10
Official interest rates



Sources: SNB, Thomson Financial Datastream

2 Developments in the Swiss economy

In Switzerland, GDP continued to decline, albeit at a slower pace, and fell by 1.0% in the second quarter. As a result, the degree of underutilisation of production capacity increased even further. This was particularly pronounced in manufacturing, where both technical capacity utilisation and the demand for labour fell markedly. The machinery, metals and watchmaking industries were particularly hard hit. There is also under-utilisation in the services segment, although to a lesser extent than in manufacturing. Capacity utilisation in the construction industry, by contrast, remains relatively high.

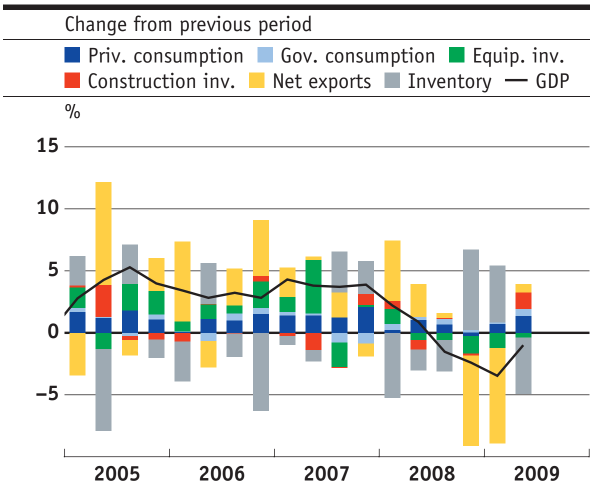
Against this background, unemployment rose rapidly, as did the number of firms using short-time working. In the medium term, this will also affect consumer confidence. Although private consumer spending increased in the second quarter, it is expected to grow at a slower pace in the near future.

Expectations among export-oriented manufacturing companies continued to improve, from a very low level. A gradual pick-up in export activity during the third quarter is thus anticipated. The first signs of a recovery in exports of commodities and semi-manufactured goods were already observed in July.

In the talks held by the SNB delegates for regional economic relations in July and August, most of the 160 or so representatives of various economic sectors and industries also said that the pace of economic decline was easing. This was most obvious in industries that hold an early position in the economic cycle. The assessment of the outlook also improved, although many respondents conceded that the situation remained vulnerable.

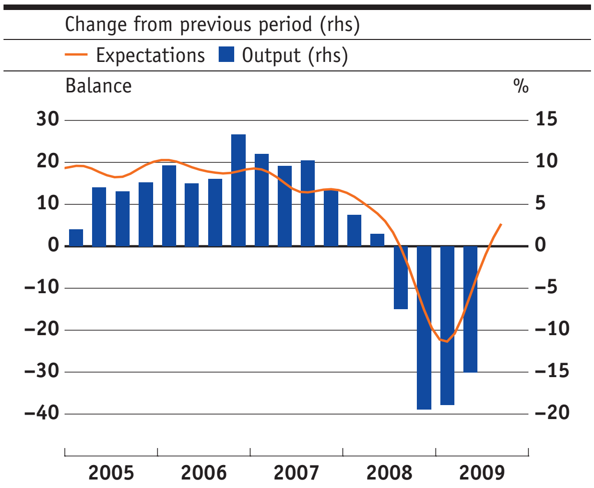
In addition, the discussions revealed that differences between export and domestically oriented companies have become less pronounced over the past few months. Export-based companies continue to be more strongly affected by the crisis than domestically oriented companies. However, an increasing number of respondents are mentioning firmer foreign demand and favourable indications, particularly from Asia. By contrast, the domestic economy – which had held up well for a long time – has been increasingly affected by the crisis. Reports from the construction industry continue to be relatively favourable.

Chart 2.1
Factors contributing to growth



Source: SECO

Chart 2.2
Manufacturing output



Sources: KOF Swiss Economic Institute, SFSO

2.1 GDP growth

According to preliminary estimates by the State Secretariat for Economic Affairs (SECO), the annualised decline in Swiss GDP was 1.0% in the second quarter, following a fall of 3.5% in the first. In year-on-year terms, the decline was 2.0%. This was a considerably smaller decline than either the SNB or most observers had expected.

On the demand side, movements in GDP were mainly driven by a negative contribution from inventories. Equipment investment also decreased. By contrast, private consumption and construction investment posted positive growth. Exports continued to decline markedly, but since there was an even greater decline in imports, the contribution of foreign trade to GDP growth was positive overall.

On the supply side, value creation was hampered, above all, by the negative growth in manufacturing and in company-related services. Domestic trade and the hospitality industry also registered a decrease. On the other hand, the banking industry recorded positive growth for the first time since 2007, as a result of the recovery in financial markets. The construction industry and the public sector also made positive contributions.

Real GDP and components Table 2.1
Growth rates on previous period, annualised

	2005	2006	2007	2008	2007		2008				2009	
					Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Private consumption	1.7	1.6	2.4	1.7	2.1	3.6	0.4	1.8	1.2	–0.4	1.2	2.3
Government consumption	1.2	0.3	0.5	–0.1	–6.9	–7.8	4.7	2.4	4.2	2.1	0.9	5.1
Investment in fixed assets	3.8	4.7	5.2	0.4	–9.7	4.9	8.7	–6.1	–2.5	–7.7	–5.9	4.4
Construction	3.5	–1.4	–2.3	0.9	–1.0	10.2	7.4	–8.1	0.6	–1.6	–0.1	14.7
Equipment	4.0	10.1	11.1	0.1	–15.2	1.4	9.7	–4.7	–4.7	–11.9	–10.3	–3.2
Domestic final demand	**2.1**	**2.1**	**2.8**	**1.1**	**–2.0**	**2.5**	**2.9**	**–0.1**	**0.6**	**–1.9**	**–0.5**	**3.1**
Domestic demand	**1.8**	**1.4**	**1.3**	**0.4**	**1.0**	**8.7**	**–4.9**	**–0.5**	**–4.8**	**7.5**	**9.3**	**–4.3**
Total exports	7.8	10.3	9.5	2.9	5.2	1.2	3.7	16.1	0.7	–27.5	–23.4	–10.4
Goods	5.8	11.1	8.4	2.6	3.7	3.2	7.9	14.9	–1.4	–34.1	–24.4	–7.2
Excluding valuables[1]	6.5	11.2	8.3	2.1	3.9	6.6	2.8	18.9	–7.7	–31.2	–22.2	–7.7
Services	13.2	8.4	12.5	3.4	8.9	–3.6	–6.1	19.1	5.9	–9.6	–20.7	–17.2
Aggregate demand	**3.8**	**4.5**	**4.3**	**1.4**	**2.6**	**5.8**	**–1.7**	**5.7**	**–2.7**	**–7.8**	**–3.9**	**–6.5**
Total imports	6.6	6.5	6.0	0.4	0.2	10.1	–9.7	17.1	–5.2	–18.6	–4.9	–18.2
Goods	5.6	7.8	5.1	–0.5	–2.1	9.5	–10.2	21.5	–7.3	–28.0	–2.0	–23.2
Excluding valuables[1]	5.3	7.4	6.7	–1.0	0.1	5.5	–11.7	22.4	–8.2	–24.8	–7.1	–19.8
Services	11.3	0.6	10.3	4.8	11.4	12.5	–7.4	–1.5	5.6	38.5	–15.1	6.2
GDP	**2.6**	**3.6**	**3.6**	**1.8**	**3.7**	**3.9**	**2.2**	**0.9**	**–1.5**	**–2.4**	**–3.5**	**–1.0**

1 Valuables: precious metals, precious stones and gems as well as objets d'art and antiques
Source: SECO

2.2 Foreign trade, consumption and investment

Exports declining more slowly

In the wake of the incipient economic stabilisation in Switzerland's main trading partners, the decline in goods and services exports slowed in the second quarter but, at –10.8% (excluding valuables), was still clearly negative compared to the previous quarter. Goods exports presented a mixed picture. On the one hand, exports of intermediate goods benefited from the recovery in foreign industrial activity (in particular in the EU). Overall, exports of commodities and semi-manufactured goods rose slightly compared to the previous period, having fallen by around 25% over the winter half-year. On the other hand, the downward trend in capital goods exports continued unabated, with the machinery industry, in particular, showing no signs of improvement as yet. The fall in consumer goods exports slowed, mainly as a result of the less negative trend in sales of pharmaceuticals.

For services exports, there was no sign of an improvement in the second quarter. The ongoing strong decrease was primarily due to a renewed fall in receipts from merchanting and private insurance services. Banks' commission business with foreign customers, for its part, registered a slight increase for the first time since the start of the crisis, as a result of rising prices on the stock exchanges. Tourism exports benefited from the fact that, unlike in 2008, the Easter holidays fell in the second quarter this year.

In July, evidence mounted that the export trend might have reached its trough. This was confirmed by the turnaround in exports of commodities and semi-manufactured goods in particular. In addition, the pace of decline in consumer goods exports began to slow, and there were signs that the decline in capital goods was also abating. In terms of a regional breakdown, the western European economies were the main factor behind the stabilisation in exports; there was also a noticeable easing of the situation with regard to exports to other regions. The growing confidence among export-oriented companies, as reported by the KOF Swiss Economic Institute, indicates that a further improvement can be expected over the coming months.

Chart 2.3
Factors contributing to export growth

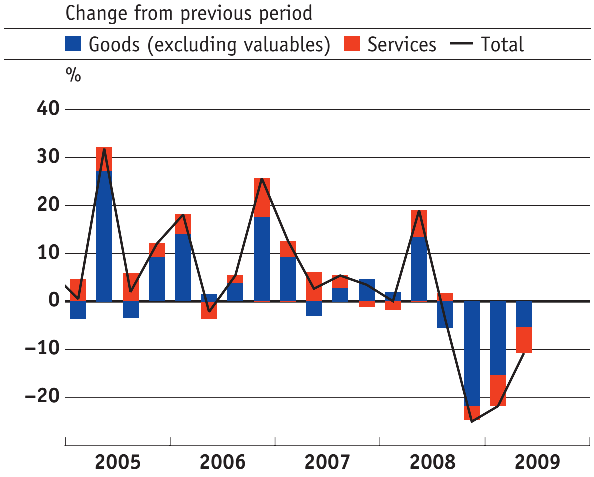


Chart 2.4
Goods exports, regional growth contributions

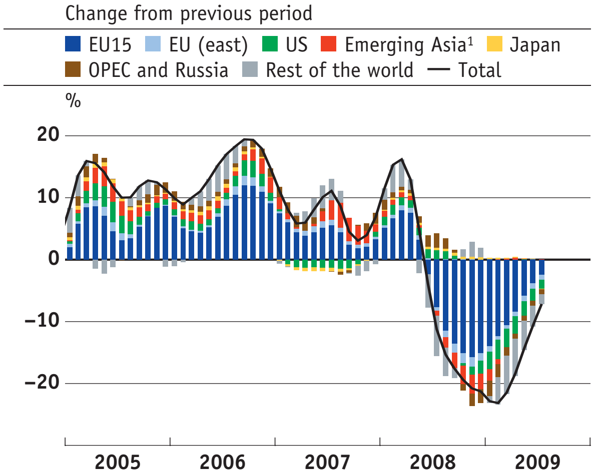


Chart 2.5
Expected new orders

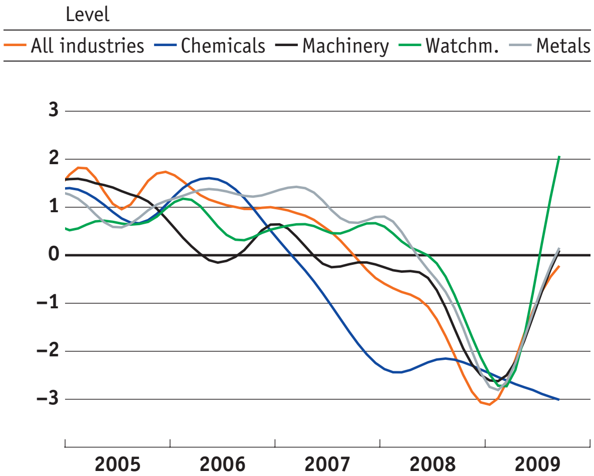


Chart 2.3:
Source: SECO

Chart 2.4:
1 Asia's emerging countries: China, Hong Kong, India, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan, Vietnam
Source: Federal Customs Administration (FCA)

Chart 2.5:
Source: KOF Swiss Economic Institute

Buoyant construction activity

Having stagnated in the first quarter due to adverse weather conditions, construction investment rose substantially in the second quarter (up 14.7%). According to surveys, the level of construction activity remains high and, with the exception of the commercial category, the outlook for the construction industry continues to be stable. Rising employment in the construction industry is another sign that construction activity is set to remain stable. This is especially true for residential construction, which is supported by low mortgage rates and falling construction costs, and the civil engineering sector, which is benefiting from fiscal stimulus measures. By contrast, commercial construction will decrease markedly, as a result of reduced corporate investment.

Falling equipment investment

Unlike for construction investment, the impact of the recession on equipment investment is clearly visible. This segment suffered a 3.2% decline in the second quarter, following a 10.3% fall in the first three months of the year. Both domestic sales by the Swiss capital goods industry and imports of capital goods are on a downward trend.

Companies are currently being very reticent about investing. This is due to the very low capacity utilisation in industry.

Robust growth in consumption

Private consumption in the second quarter once again provided a boost to the economy. The robust growth in private consumption is one of the factors which distinguishes Switzerland from a number of other countries, in terms of how the recession has developed to date.

Consumption growth accelerated to 2.3%, from only 1.2% in the first quarter. In part, this strong growth was the result of falling prices and an associated rise in households' purchasing power. In the medium term, consumption also benefited from the strong rate of population growth.

Most subcomponents of consumption increased during the second quarter. Sales figures were up in a number of retail industry segments. For example, spending on health/personal hygiene and on consumer and office electronics rose considerably once again. However, demand for consumer durables weakened, as evidenced by the drop in new car registrations, among other things.

Chart 2.6
Construction

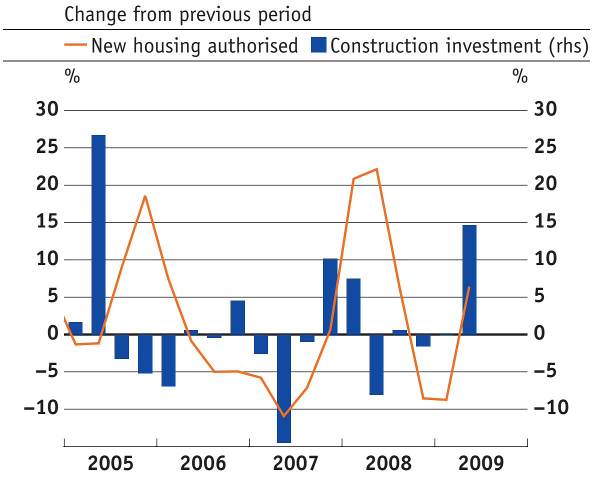


Chart 2.7
Mortgage rates and 3M Libor

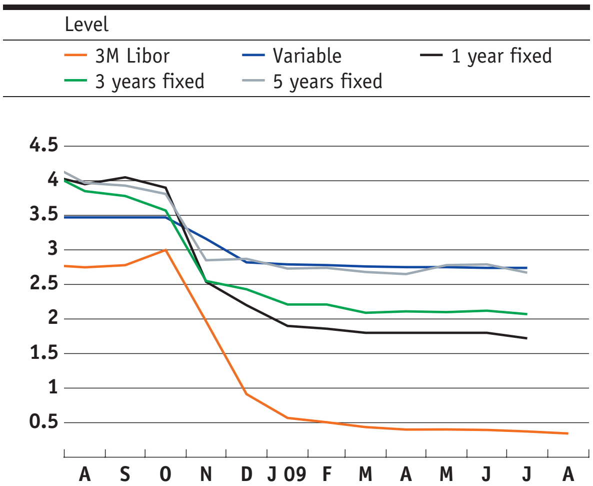


Chart 2.8
Equipment

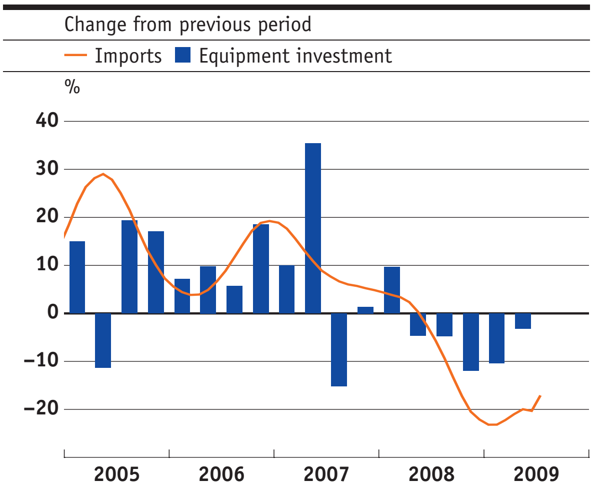


Chart 2.6:
Sources: SECO, SFSO

Chart 2.7:
Source: SNB

Chart 2.8:
Sources: FCA, SECO

Consumer spending expected to weaken

Consumer confidence continued to weaken during spring and summer; in July it dropped from –38 to –42 points. This fall was above all due to a slightly more pessimistic assessment of general economic developments and personal financial circumstances. Moreover, concerns about job security remain high, with people considerably more worried about losing their jobs than they were in autumn last year.

Compared with 2009, households will be confronted with substantially less favourable developments in real disposable income next year. For consumption growth, this means that downside risks predominate.

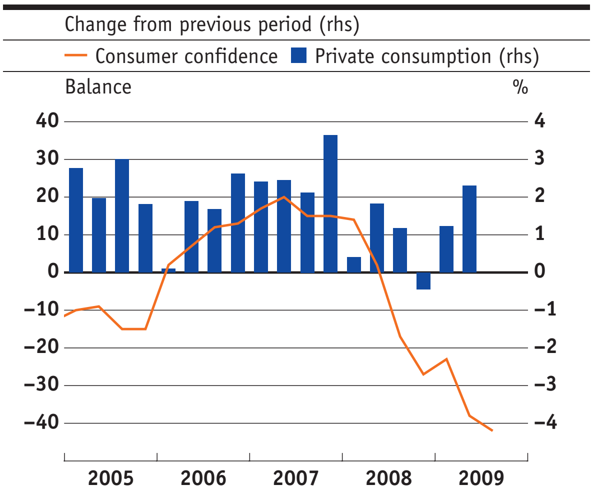
Substantial fall in imports

Imports (excluding valuables) registered a substantial fall of 15.1% in the second quarter. This is partly due to the disappearance of a one-off effect: in the first quarter, unusually high imports of gold jewellery were recorded. These fell back to normal levels in the second quarter, leading to a sharp downward correction in the figures for consumer goods imports. As regards other categories, consumer goods imports presented a mixed picture. Whereas the decline in imports of household furnishings continued, imports of cars, consumer electronics and clothing, but also pharmaceuticals, recorded a slight increase following the sharp fall during the 2008/2009 winter half-year. Growth remained weak in the other main goods categories: in the wake of the ongoing crisis in manufacturing, imports of industrial intermediate goods and capital goods experienced a renewed fall.

With regard to imports of services, there was an increase in spending on tourism services. However, imports of services excluding tourism were unchanged: a renewed decline in expenses for licences and patents, owing to reduced production activity, was offset by higher spending on financial services abroad.

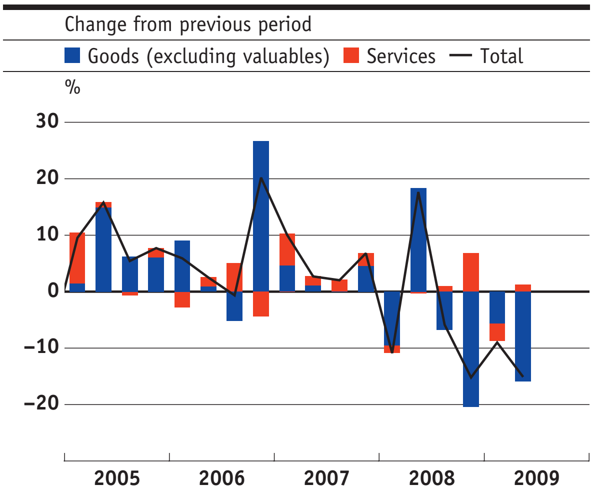
In July, a slowing of the downward trend in goods imports was discernible. Imports of commodities and semi-manufactured goods stabilised, albeit at a level around 20% lower than one year previously. Moreover, capital goods imports decreased across the board. For consumer goods imports, however, the picture was uneven. Whereas the recovery in cars and consumer electronics continued in July, imports of pharmaceuticals and household furnishings trended downwards.

Chart 2.9
Private consumption



Source: SECO

Chart 2.10
Factors contributing to import growth



Source: SECO

2.3 Employment and labour market

Decline in employment gathers pace

The fall in employment, which had begun in the first quarter, gathered pace in the second. Full-time-equivalent employment declined by 1%, following a 0.6% fall in the first three months of the year.

Broken down by sector, developments in employment were very uneven. In manufacturing, there was another sharp and broad-based fall in employment (by 5.2%). In the services industry, by contrast, employment levels remained unchanged overall. They increased in the public sector (public administration, education, health) but decreased in the financial industry, the hospitality segment and in the trade and repair categories. In the construction industry, on the other hand, employment rose – as indeed it had in the previous quarter.

Unfavourable employment outlook

The fall in labour demand indicators continued, albeit at a slightly slower pace. All indicators are at very low levels, and consequently the situation in the labour market is not expected to improve in the second half of this year.

Chart 2.11
Employment

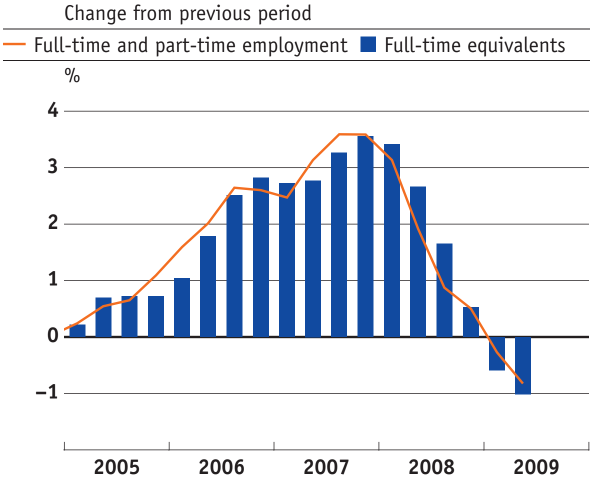


Chart 2.12
Employment outlook indicator

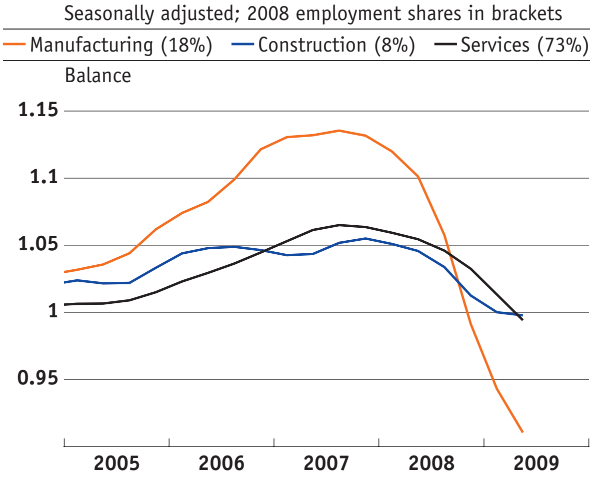


Chart 2.13
Unemployment rates and vacancies

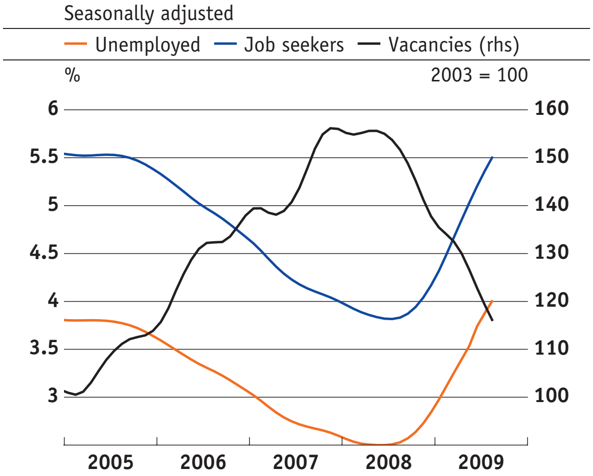


Chart 2.14
Short-time working

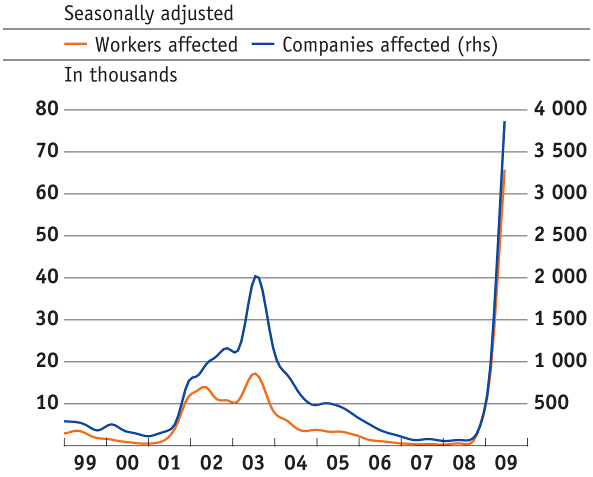


Chart 2.11:
Source: SFSO

Chart 2.12:
Source: SFSO

Chart 2.13:
Unemployed and job seekers registered with the regional employment offices, as a percentage of the labour force according to the 2000 census (labour force: 3,946,988 persons). Adjusted for the new calculation method introduced in June 2009.
Source: SECO

Chart 2.14:
Source: SECO

Sharp rise in unemployment and short-time working

Unemployment rose at a faster pace. From May to August, seasonally adjusted unemployment rose by 0.5 percentage points, to reach 4.0%. The percentage of jobseekers, which, in addition to the registered unemployed, also includes people who are on training or employment programmes or have accepted an interim placement, rose from 5.0% to 5.5% over the same period.

Those manufacturing segments badly affected by the recession continued to make intensive use of short-time working. Correspondingly, there was another marked rise in the number of employees on short-time working. In June, 3,870 companies and 65,800 employees were affected. These figures are comparable to the peaks recorded during the recession of the early 1990s. At that time, however, it was the construction industry that was responsible for the majority of short-time working.

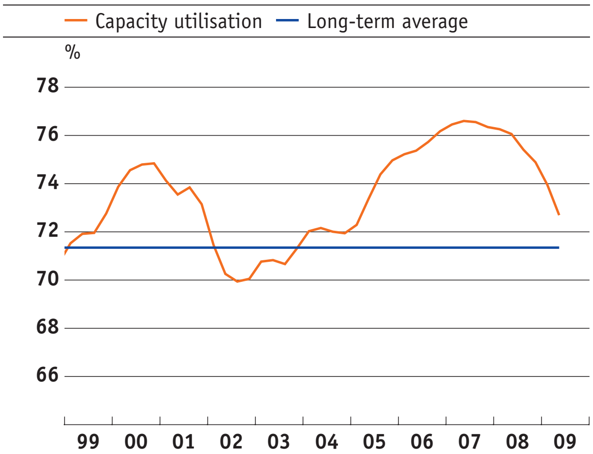
2.4 Capacity utilisation

If aggregate demand does not move in step with aggregate supply over the medium term, inflationary or deflationary trends may arise. Aggregate supply – which is determined by the availability of capital and labour as well as technological progress – is usually relatively static in the short term. Fluctuations in demand are therefore reflected in a change in technical capacity utilisation and staffing levels. If their utilisation rate exceeds the normal level for an extended period of time, this points to excess demand and, consequently, to greater inflationary pressure. Conversely, an excess supply suggests deflationary pressure.

Very low capacity utilisation in industry

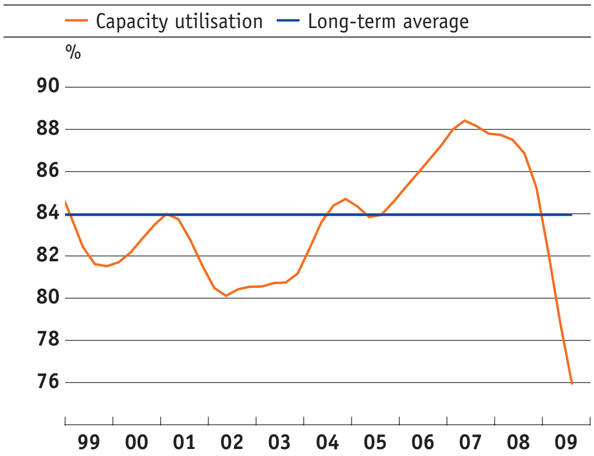
The decline in capacity utilisation continued until July, due in large part to the unfavourable developments in manufacturing. Survey data from the KOF Swiss Economic Institute show that capacity utilisation in this segment is at its lowest level since the recession in the mid-1970s. According to the survey, in July capacity utilisation was only 76.3%, compared with a long-term average of around 84%. Capacity is also under-utilised in parts of the services industry, for example in the hospitality segment. A reduction in capacity utilisation is expected over the second half of this year in the retail industry. By contrast, capacity utilisation in construction remains above its long-term average.

Chart 2.15
Capacity utilisation in construction



Source: KOF Swiss Economic Institute

Chart 2.16
Capacity utilisation in manufacturing



Source: KOF Swiss Economic Institute

Output gap and potential growth

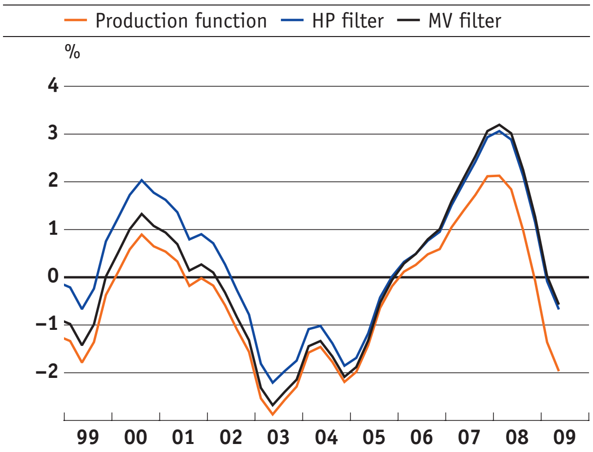
The output gap, which is calculated as the percentage difference between real GDP and estimated potential output, serves as a measure of capacity utilisation in the economy and the associated inflationary pressure.

In the second quarter, the negative output gap widened further. Using the production function (PF) approach, the output gap is –2.0% of potential output, compared with –1.4% in the first quarter of 2009 (cf. chart 2.17). With the Hodrick-Prescott filter (HP), the gap is –0.7% of potential (first quarter: –0.1%). The uncertainty over the size of the output gap, as evidenced by the disparate results, is not untypical for periods of recession.

Potential growth will weaken over the next few quarters. In addition to less immigration and a lower participation rate, which leads to reduced growth in the supply of jobs, weak investment activity results in a slowdown in capital accumulation. This is compounded by the fact that the banking industry, whose output potential grew at above-average rates in the past, has only just began to make a tentative recovery.

Since actual GDP growth is still lower than potential growth, the output gap will widen further in the near term. For the third quarter of 2009, the output gap is expected to be –2.3% (PF) or –0.7% (HP) of potential. It will probably not start to narrow again until next year.

Chart 2.17
Output gap



Source: SNB

2.5 Prices

Price index of aggregate supply: lower consumer goods prices

Since last May, the subcomponents of the price index of aggregate supply have moved in opposite directions. While producer prices continued to decline slightly, import prices were already increasing somewhat. At producer level, lower prices were registered, particularly for non-durable consumer goods and agricultural products. Year on year, inflation remained distinctly negative owing to a base effect from the prices of fuel and intermediate goods, but nevertheless increased to –5.5% in August. Due to the gradually decreasing base effect, a further rise in annual inflation at aggregate supply level is expected.

Negative inflation expectations

Both the wholesale and manufacturing industries continue to expect prices to fall over the coming months. Although some forward-looking indicators have stabilised (cf. charts 2.19 and 2.20), they remain at low levels. Together with the substantial drop in producer and import prices over the past six months, this suggests that the downside inflation pressure on consumer prices is likely to persist for some time yet.

Consumer price index continues to fall

Annual inflation, as measured by the national consumer price index (CPI), increased slightly, from –1.0% to –0.8%, between May and August. The increase was largely the result of the gradual fading of base effects connected with oil products. Excluding these base effects, inflation fell to 0.6% in August (May: 0.9%).

Slight fall in domestic inflation

Inflation in domestic goods and services declined further to 1.0% in August. An increase in tobacco tax and higher prices for certain foods meant that domestic goods inflation temporarily rose to 1.7% in June (May: 1.3%). In August, domestic goods inflation was back down to 1.2%. Inflation in services decreased by a further 0.3 percentage points to 1.0% in August. Prices in the healthcare segment rose, while those in the air travel and hotel industries declined year on year. Rents were around 2.0% above their year-back level. As recently as May, inflation of 2.6% had been recorded.

Chart 2.18
Prices of total supply

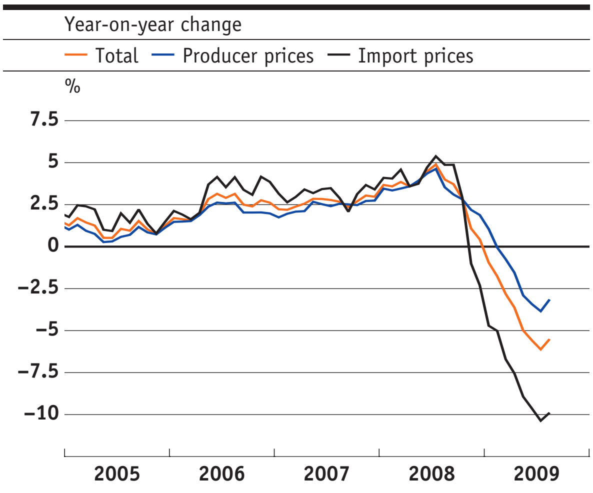


Chart 2.19
Expected purchase prices

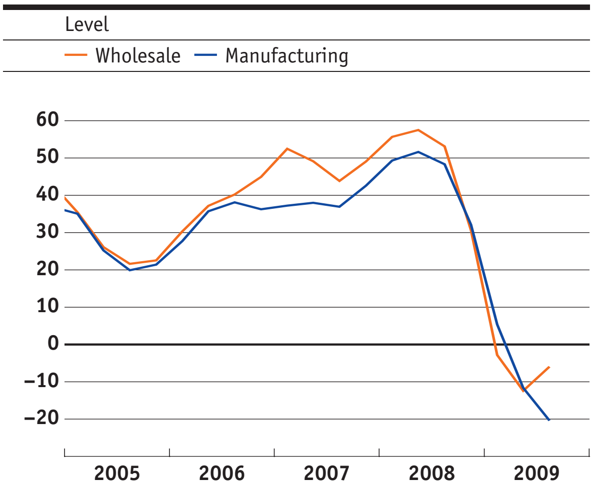


Chart 2.20
Expected sale prices

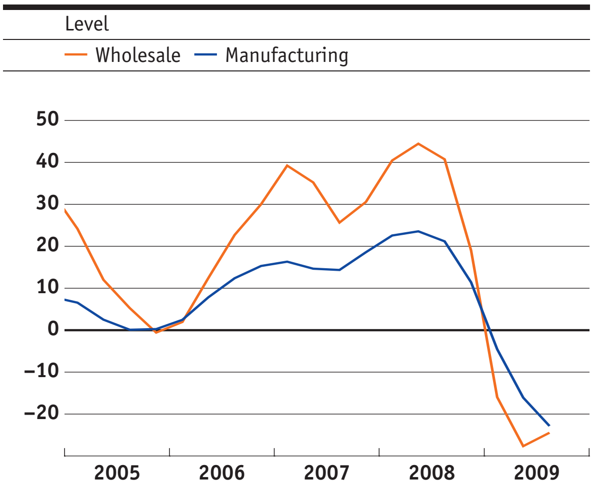


Chart 2.18:
Source: SFSO

Charts 2.19 and 2.20:
Source: KOF Swiss Economic Institute

Negative imported inflation

Annual inflation for imported goods and services continued to be dominated by base effects, although these weakened in August. The temporary dip in crude oil prices in mid-July led the year-on-year inflation figure for oil products to fall to −35.6% in July (May: −34.2%), before rising again to −27.9% in August. Inflation for other imported goods and services declined from 0.5% to 0.1% in the same period.

Core inflation still declining slightly

Inflation, as measured by the CPI, is subject to short-term fluctuations that may distort perceptions of the general price trend. To counter this, core inflation rates are calculated. The SNB computes two measures of core inflation (cf. chart 2.23). The trimmed means method (TM15) excludes from the consumer price index, for any given month, those 15% of goods prices with the highest and those 15% with the lowest annual rate of

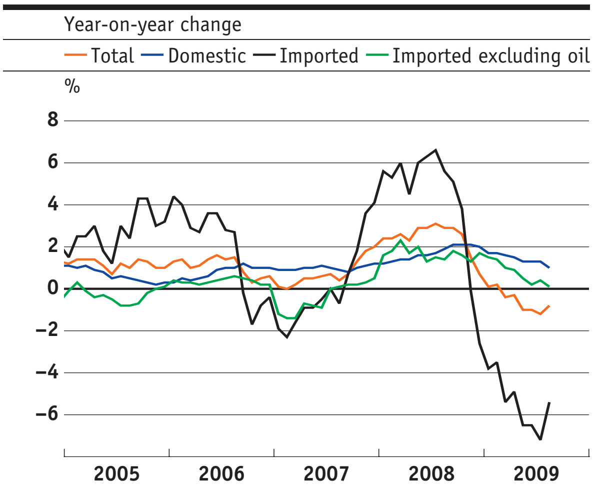
National consumer price index and components
Year-on-year change in percent

Table 2.2

	2008	2008	2009		2009			
		Q4	Q1	Q2	May	June	July	August
Overall CPI	**2.4**	**1.6**	**−0.0**	**−0.7**	**−1.0**	**−1.0**	**−1.2**	**−0.8**
Domestic goods and services	1.7	2.1	1.7	1.4	1.3	1.3	1.3	1.0
Goods	1.7	1.9	1.2	1.3	1.3	1.7	1.5	1.2
Services	1.7	2.1	1.8	1.4	1.3	1.2	1.2	1.0
Private services excluding rents	1.4	1.9	1.3	0.8	0.8	0.6	0.6	0.5
Rents	2.4	3.0	3.3	2.9	2.6	2.6	2.6	2.0
Public services	0.9	0.8	0.6	0.8	0.8	0.8	0.9	0.9
Imported goods and services	4.3	0.3	−4.2	−6.0	−6.5	−6.5	−7.2	−5.4
Excluding oil products	1.7	1.6	1.3	0.6	0.5	0.2	0.4	0.1
Oil products	17.8	−5.0	−27.2	−32.1	−34.2	−32.6	−35.6	−27.9

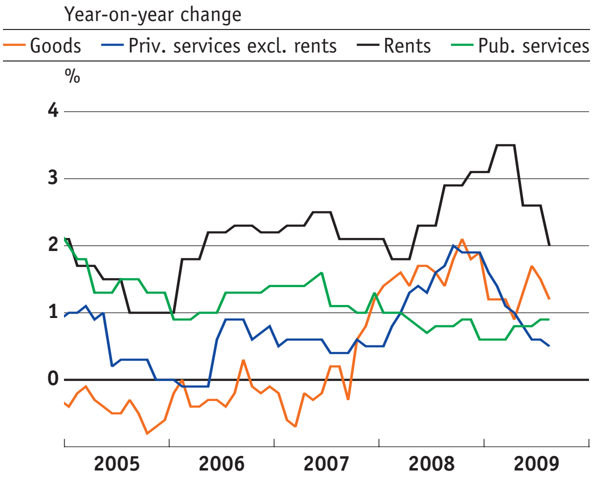
Sources: SFSO, SNB

Chart 2.21
CPI: domestic and imported goods and services



Sources: SFSO, SNB

Chart 2.22
CPI: domestic goods and services



Sources: SFSO, SNB

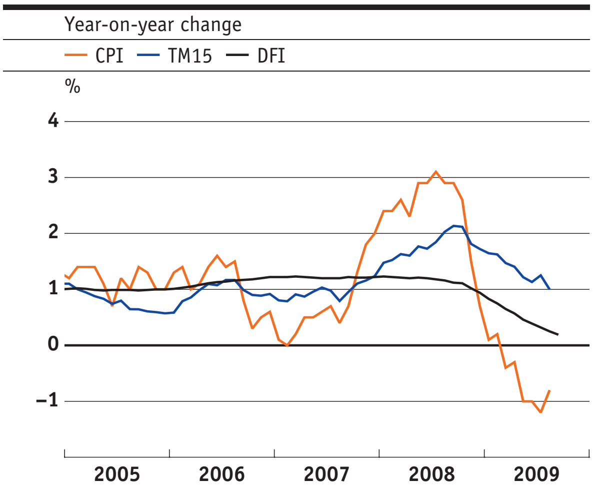
change. Dynamic factor inflation (DFI), by contrast, extracts underlying inflation using a large amount of data on the real economy, financial market indicators and monetary variables. The two core inflation rates calculated by the SFSO always exclude the same price-volatile items from the basket of goods in each period (cf. chart 2.24). In the case of core inflation 1 (SFSO1), these are food, beverages, tobacco, seasonal products, energy and fuel. Core inflation 2 (SFSO2) also factors out products with administered prices. The core inflation rate calculated by the SNB using the trimmed means method fell by 0.2 percentage points to 1.0% between May and August. Core inflation 1 and core inflation 2 also declined, by 0.1 and 0.3 percentage points respectively, to 0.7% in each case. The decrease in the core inflation rates indicates that the negative inflation pressure from upstream production stages and the under-utilisation of capacity are now starting to be reflected in consumer prices, albeit with a lag. This is also implied by the SNB's DFI rate, which declined from 0.5% to 0.3% between May and August.

2.6 Outlook

As described in section 1, the SNB is expecting clearly positive growth in all major economic regions as from the third quarter. The expected global economic recovery will impact positively on Switzerland's goods exports, and will facilitate an improvement in conditions for the manufacturing industry. If the recovery on financial markets continues, value creation in the banking industry will also increase further. Private consumer spending, by contrast, will probably lose some momentum, and equipment investment will act as a constraint on the economy.

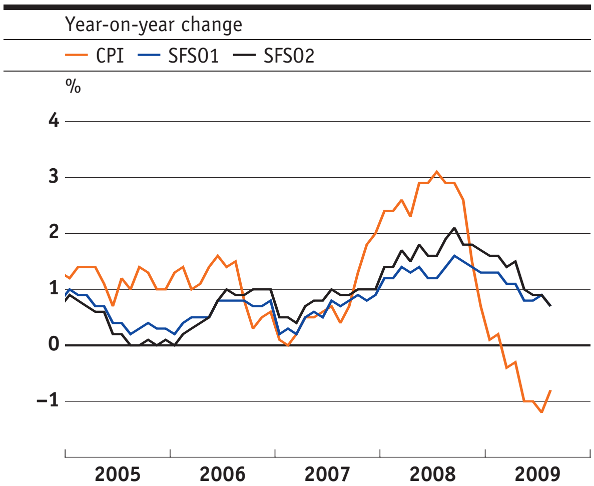
For 2009, the SNB is now forecasting a decline in GDP of 1.5% to 2%, compared to a decline of between 2.5% and 3% forecast at the June assessment. This adjustment is essentially based on two factors: first, according to SECO estimates, GDP figures have, on the whole, clearly exceeded expectations; second, the more positive assumptions about the global economy are having a favourable impact on the second half of the year.

Chart 2.23
Core inflation rates (SNB)



Sources: SFSO, SNB

Chart 2.24
Core inflation rates (SFSO)



Source: SFSO

3 Monetary developments

3.1 Interest rates and inflation expectations

At its monetary policy assessment in June, the SNB left the target range for the three-month Libor unchanged at 0–0.75%, aiming for a three-month Libor of 0.25%. In view of the unfavourable economic situation and the ongoing risk of deflation, an expansionary monetary policy still appeared advisable. The SNB continued to provide the economy with generous amounts of liquidity. It announced that it would carry on purchasing Swiss franc bonds to help reduce risk premia on long-term bonds issued by private sector borrowers. The SNB also reiterated its intention of acting decisively to prevent the Swiss franc from appreciating against the euro.

This policy has contributed to a further easing on the money market. The three-month Libor dropped from 40 basis points in mid-June to 30 basis points in mid-September (cf. chart 3.1). The risk premium – measured by the spread between the three-month Libor and the OIS – decreased further from 0.34 percentage points in the second quarter to 0.23 percentage points in the third quarter (cf. chart 3.2). The Libor/OIS spread remains above its historical average, but has nevertheless dropped substantially from the record levels reached following the collapse of Lehman Brothers.

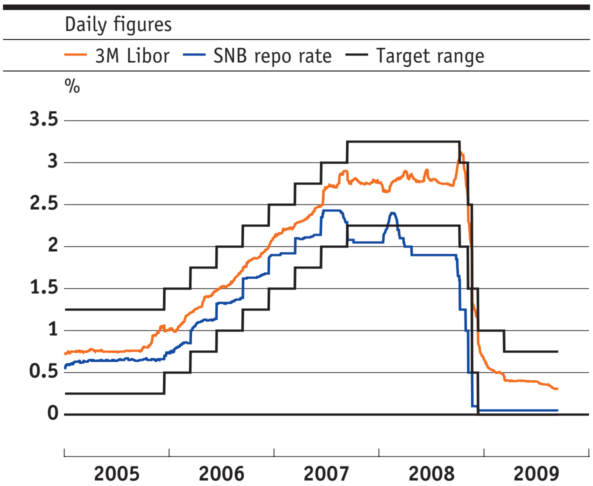
Central banks continued to cooperate. On 25 June 2009, the SNB, in conjunction with other central banks, announced an extension of the swap arrangement with the Fed. The temporary swap arrangement (swap line) between the Fed and further central banks, including the SNB, has been extended up to 1 February 2010. In coordination with the European Central Bank (ECB) and the Bank of England, the SNB concluded further repo transactions with terms ranging from 7 to 84 days in the third quarter of 2009 in order to supply the market with US dollar liquidity. Since less use is now being made of the dollar transactions, the SNB ceased its auctions with terms of 28 days as of the end of July 2009.

Also on 25 June 2009, the SNB, ECB, Narodowy Bank Polski and Magyar Nemzeti Bank announced that they would, up to 31 October at least, conduct further EUR/CHF foreign exchange swaps with terms of seven days. The aim of this measure is to further ease the situation on the short-term Swiss franc money market.

The SNB also issued SNB Bills in Swiss francs on a weekly basis to absorb Swiss franc liquidity in a targeted manner. Since the quarterly assessment of 18 June 2009, only SNB Bills with terms of seven days have been placed. On average, CHF 12.3 billion were absorbed by the SNB Bill auctions in June and July 2009 (with bids amounting to CHF 23.4 billion). The volume-weighted average yield per auction fluctuated between 0.01% and 0.02%.

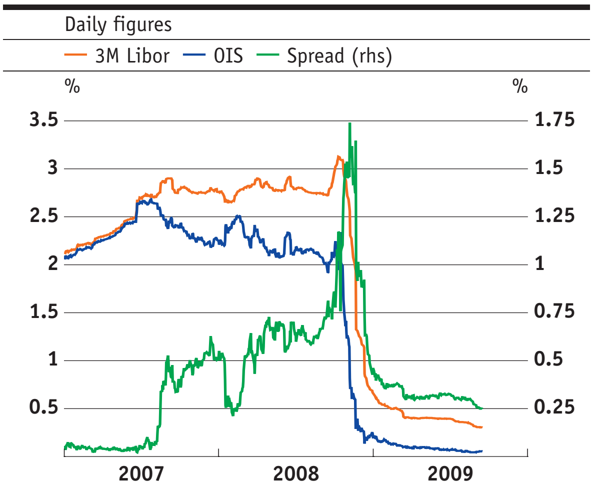
Furthermore, the SNB continued to issue SNB USD Bills to finance its loan to the SNB StabFund. The SNB USD Bills were issued on a fortnightly basis with terms of 28, 84 or 168 days. In mid-September, the outstanding volume amounted to approxi-

Chart 3.1
Money market rates



Sources: Reuters, SNB

Chart 3.2
Spread between 3M Libor and OIS



Sources: Bloomberg, Reuters

mately USD 20 billion. The SNB USD Bills' premium vis-à-vis the yields on the corresponding US Treasury bonds has gone down markedly since the June assessment.

Term structure of interest rates shifts downwards

Yields have sunk since the last quarterly assessment in June not only for short-term securities, but also in the medium and long-term segments. The yield on ten-year Swiss Confederation bonds, for instance, dropped from 2.48% in mid-June to 2.25% in mid-September. Thus, the entire term structure curve for interest rates has shifted downwards (cf. chart 3.3).

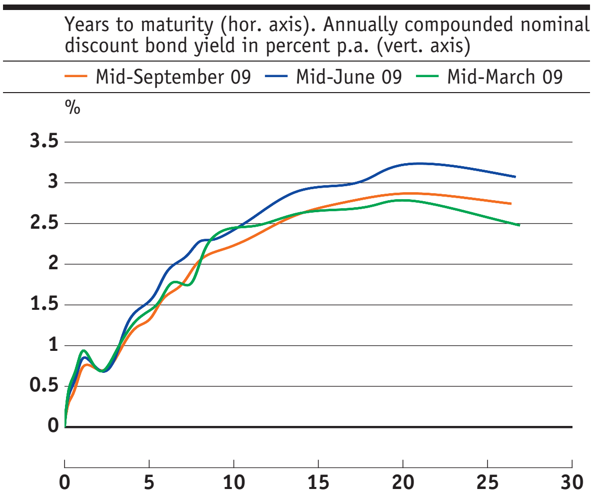
New Swiss franc reference rates

In the quarter under review, the SNB and SIX Swiss Exchange Ltd jointly launched new Swiss franc reference rates for the financial markets, the Swiss Reference Rates. These are based on transactions concluded and tradable Swiss franc repo interbank market quotes provided by Eurex Zurich Ltd. The Swiss Reference Rates are calculated for a term spectrum ranging from overnight to six months. The introduction of the Swiss Reference Rates takes into account the increasing market demand for reference rates based on the secured money market. Using the Swiss Reference Rates, the SNB can better monitor developments on the money market, enabling it to optimise interest rate steering operations. At the same time, the introduction of the new Swiss Reference Rates creates a risk-neutral Swiss franc interest rate curve for the financial markets. The call money rate of this reference rate group – Swiss Average Rate Overnight (SARON®) – will assume an important role in the financial markets and function as the basis of the Swiss franc yield curve. The SNB sees SARON® as the most important of these rates, since up to now there has been no overnight rate with a high level of relevance for the financial markets, either for secured or unsecured transactions. SARON® shows the strongest reaction to conditions on the repo market and serves as a general indicator of changes in short-term rates. Since 25 August 2009, it has replaced the former repo overnight index (SNB) in all areas where the latter served as a reference rate. As of that date, publication of the repo overnight index (SNB) ceased.

International interest rates lower too

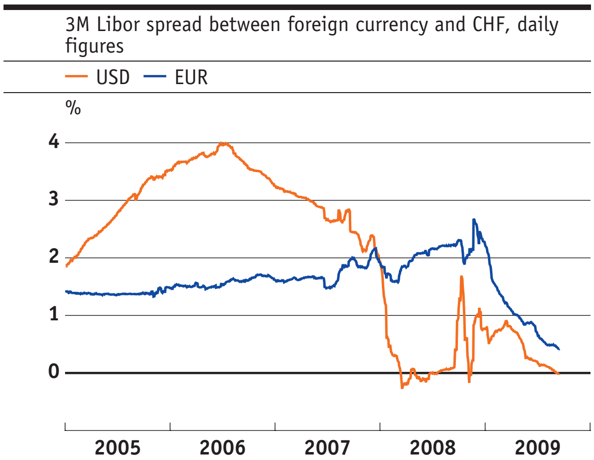
Globally, short-term interest rates registered an even stronger decline than in Switzerland, which led to a narrowing of the interest rate spreads vis-à-vis the dollar and the euro. In mid-September, they amounted to 0 and 42 basis points respectively, as against 21 and 84 basis points in mid-June (cf. chart 3.4). The downward trend in money market interest rates is, on the one hand, due to the generous supply of liquidity by several central banks. On the other, the decreasing yield levels probably reflect market participants' renewed confidence in the financial system. Long-term international interest rates also moved downwards (cf. chart 3.5) – in Germany, for example, to roughly the same extent as in Switzerland. In the US, the yield on ten-year government bonds dropped some-

Chart 3.3
Term structure of Swiss Confederation bonds



Source: SNB

Chart 3.4
Spreads between international short-term interest rates



Sources: Reuters, SNB

what more significantly than that in Switzerland, which narrowed the yield differential between US and Swiss bonds. The trend towards lower yields was boosted by the policy of quantitative easing pursued by the central banks in numerous countries, effected mostly through the purchase of long-term government or corporate bonds.

Further improvement in corporate financing conditions

Corporate financing conditions have continued to improve over the past few months. In particular, the yields on Swiss corporate bonds with lower ratings declined, which suggests that investors are becoming increasingly confident about companies' solvency and profit outlook. SNB purchases of Swiss franc bonds issued by private sector borrowers are also likely to have contributed to the recent easing of the situation.

Real interest rates still low

The real interest rate is a key determinant in the savings and investment behaviour of companies and households and is therefore extremely important for future business cycle developments. Chart 3.6 shows movements in the three-year real interest rate. This rate is defined as the difference between the three-year nominal interest rate and the expected rise in consumer prices during the same period. These inflation expectations are an average of the unconditional forecasts obtained from various SNB models. The real interest rate measured in this way amounted to 0.3% in the third quarter of 2009. By historical standards, the level of real interest rates is very low for medium-term maturities and is having a stimulating effect on the economy.

The results of SECO's household survey on consumer confidence suggest only slightly higher short-term inflation expectations (cf. chart 3.7). Compared to the previous survey, the number of people who expect prices to go down in the coming 12 months has decreased somewhat, and the share of those anticipating price increases has risen slightly. Overall, however, inflation expectations for the coming year remain low.

Chart 3.5
International long-term interest rates

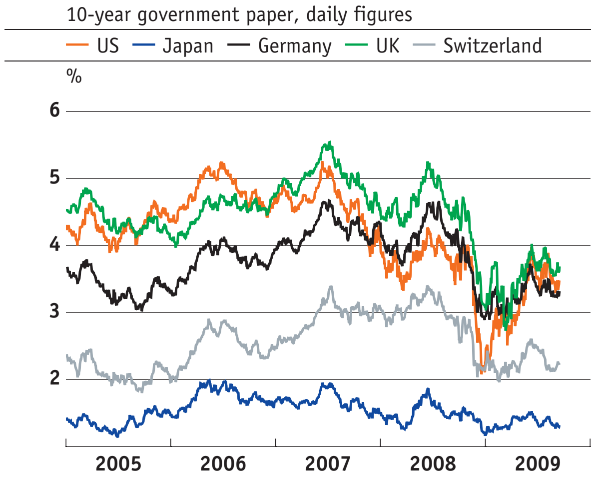


Chart 3.6
Estimated real interest rate

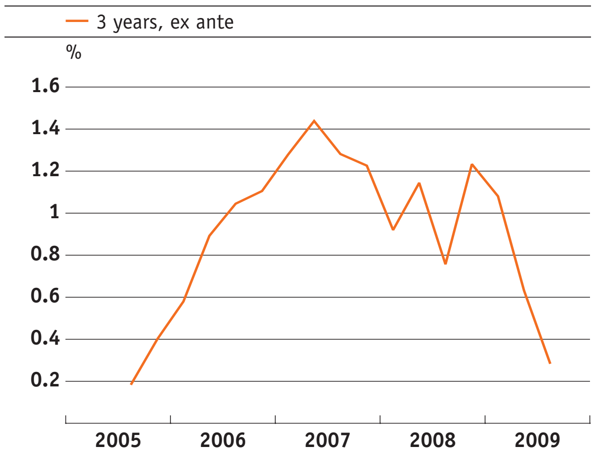


Chart 3.7
Survey on expected movements in prices

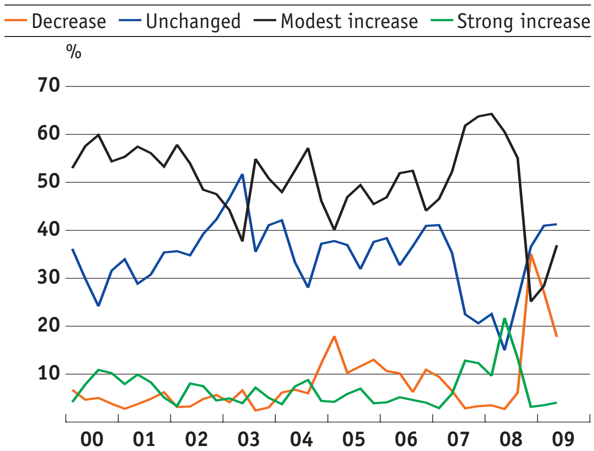


Chart 3.5:
Sources: SNB, Thomson Financial Datastream

Chart 3.6:
Source: SNB

Chart 3.7:
Sources: SECO, SNB

3.2 Exchange rates

Less volatility on the currency markets

Developments on the currency markets have been calm recently, particularly in comparison with the marked fluctuations occurring after the onset of the financial crisis in August 2007. Between mid-June and mid-September, the US dollar weakened against the euro by 5.1%, compared to the 11% depreciation against the euro registered in the second quarter of 2009.

Since the quarterly assessment in June, the Swiss franc has appreciated against the US dollar by 4.2%. In mid-September, the Swiss franc was trading at 1.03 versus the US dollar. Against the euro, the Swiss franc depreciated by 1.0%, standing at 1.52 (CHF/EUR) in mid-September (cf. chart 3.8). The development of the Swiss franc is also connected to the unconventional measures taken by the SNB, the aim of which is to prevent any further appreciation of the Swiss franc against the euro.

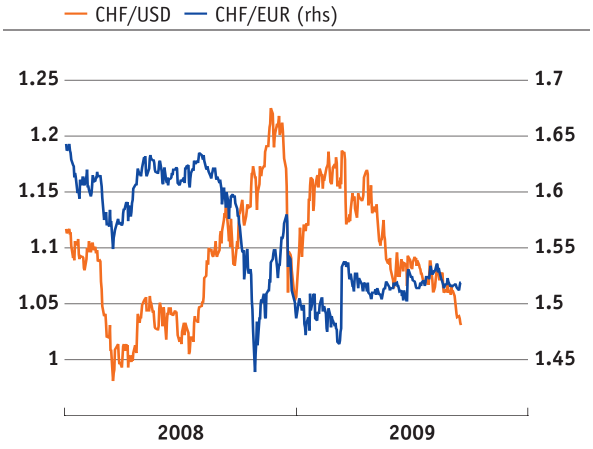
Since the last assessment in June, the nominal trade-weighted Swiss franc exchange rate has hardly changed. However, taken from the beginning of the crisis in August 2007, the Swiss franc has gained 11% in value (cf. chart 3.9).

Real external value stable over the long term

Chart 3.9 also shows the Swiss franc's trade-weighted real external value. Its relatively stable path suggests that, over a long-term period, movements in the nominal exchange rate have tended to balance out inflation differentials between economic areas.

Chart 3.8
Exchange rates

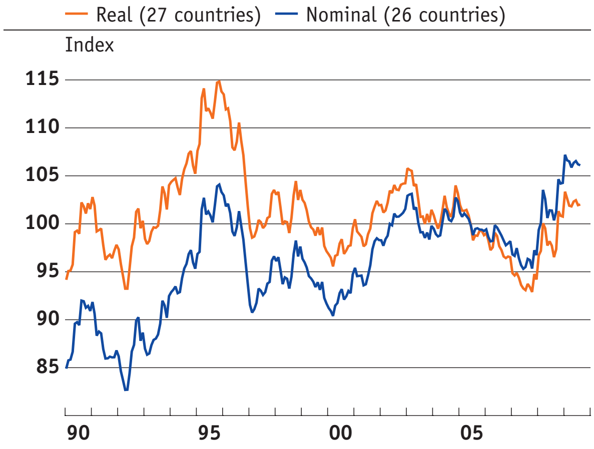
Daily figures



Source: SNB

Chart 3.9
Trade-weighted external value of Swiss franc

2005 = 100



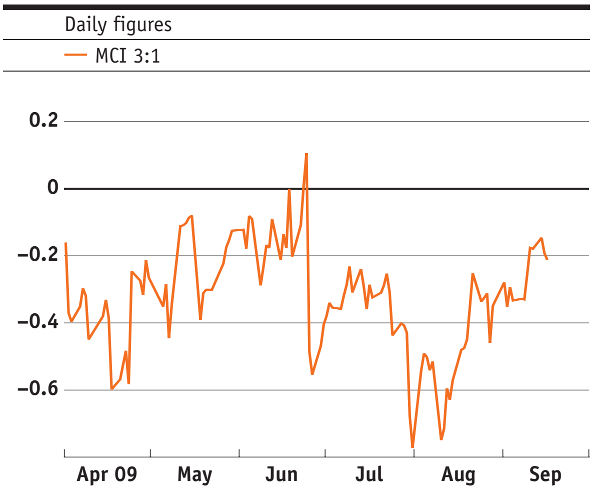
Source: Bank for International Settlements

Slight easing of monetary conditions

The Monetary Conditions Index (MCI) combines the three-month Libor and the trade-weighted nominal value of the Swiss franc. It provides a measure of the monetary conditions that businesses in Switzerland have to contend with. The MCI is reset to zero immediately after each monetary policy assessment. An increase to positive values (decline to negative values) thus signifies a tightening (loosening) of monetary conditions (cf. box 'The Monetary Conditions Index', *Quarterly Bulletin* Q1/2004, p. 27).

By mid-September, the slight drop in the three-month Libor and the somewhat weaker export-weighted nominal external value of the Swiss franc had led to a decline in the MCI, which corresponds to an easing of monetary conditions (cf. chart 3.10).

Chart 3.10
MCI nominal



Source: SNB

3.3 Equity, commodity and real estate prices

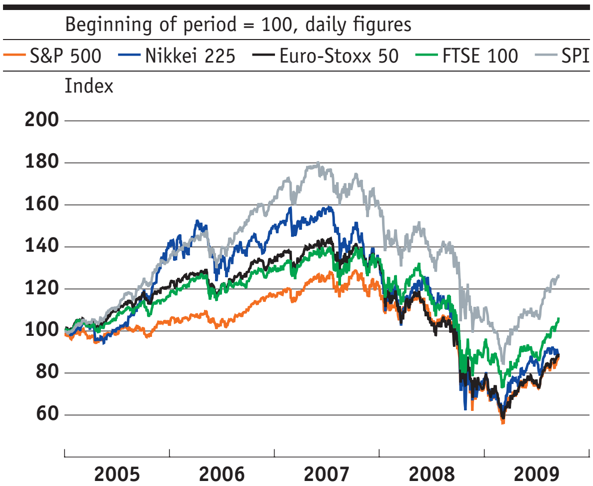
Equities, commodities and real estate are investment assets. Their prices are relevant for an analysis of the economic situation for two main reasons. First, fluctuations in these prices alter the volume of assets held by households and companies. This in turn affects their creditworthiness as well as influencing consumer and investment behaviour. Second, changes in inflation expectations lead to equities, commodities and real estate being revalued. Commodities are also of interest for a third reason: they are inputs in the production process of many goods. Consequently, their prices affect costs and may thus exert pressure on the general price level.

Recovery on equity markets

International equity markets picked up substantially in the third quarter of 2009. Since mid-June, the Swiss Performance Index (SPI) has risen by 16%. The European Euro-STOXX 50 and the US S&P 500 have climbed at roughly the same pace. The scale of the recovery must be considered against the background of the repeated plunges in share prices that had preceded it. The rise in prices is probably due to several factors. Market participants appear to be increasingly convinced that the worst has passed. In addition, the results of numerous companies – especially in the US – were better than expected, which boosted share prices. Furthermore, the low interest rates for government bonds are also adding to the relative attractiveness of shares.

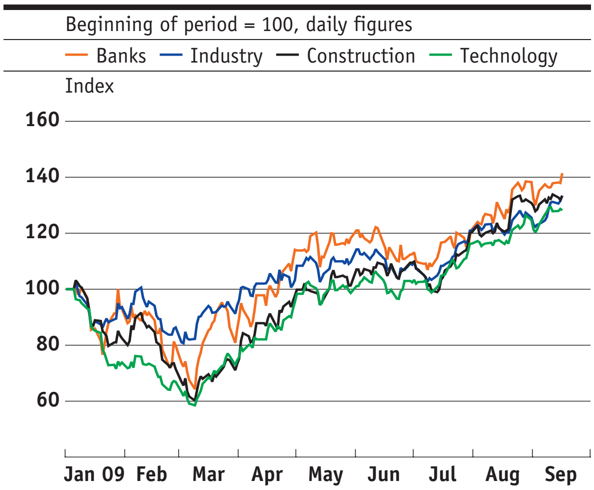
A breakdown of the individual SPI components by company size shows that medium-sized and large Swiss companies, in particular, benefited from the latest upward trend. Large cap companies saw their share prices rise by 16% between mid-June and mid-September, while the increases were 17% and 12% for mid and small cap firms respectively. In particular, technology and construction stocks benefited. The massive pressure on bank stocks also eased.

Chart 3.11
Share prices



Sources: Bloomberg, Thomson Financial Datastream

Chart 3.12
Selected SPI sectors



Source: Thomson Financial Datastream

Chart 3.13 shows the expected volatility for the following thirty days based on the Chicago Board Options Exchange Volatility Index (VIX) and the actual volatility measured by the annualised standard deviation in monthly returns on the S&P 500. Volatility, which is a sign of uncertainty, has declined to a level that is normal during a recession.

Rise in commodity prices

Commodity prices increased during the period under review. According to the Commodity Research Bureau (CRB) Index, they rose by 7% between mid-June and mid-September. In particular, prices for manufactured goods went up (19%), while wheat prices plunged (–19%). Initially, in July, the oil price in US dollars declined, before rising again to USD 70 per barrel by mid-September. The price of gold, however, increased substantially during the reporting period and at times climbed to over 1,000 dollars an ounce.

Mixed price trends for real estate

Real estate prices in Switzerland showed mixed trends in the second quarter of 2009 (cf. charts 3.14 and 3.15). Prices for owner-occupied apartments and single-family homes were up by 6% and 4.5% respectively. Switzerland's housing market mostly consists of rental apartments. As in the previous quarter, rents increased by 3.9% overall. However, rental costs for new apartments, which react more strongly to market forces, fell by 3.1%. Rents for commercial property plummeted by another 10.5%, following an 8.7% drop in the previous quarter.

Chart 3.13
Volatility of equity returns

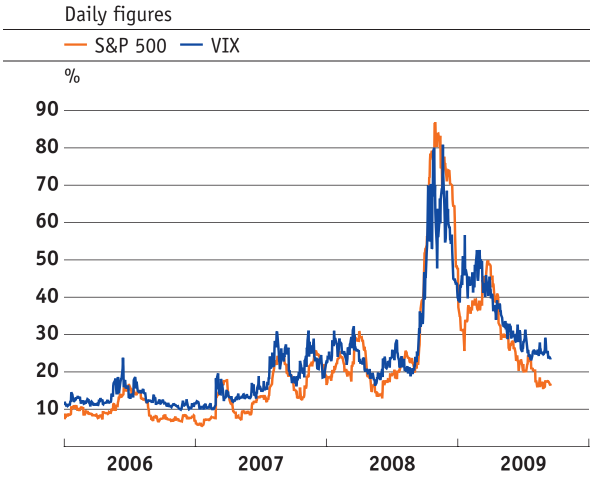


Chart 3.14
Nominal real estate prices and rents

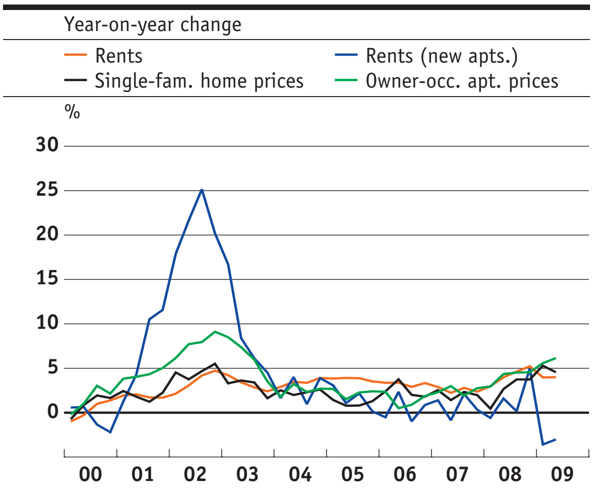


Chart 3.15
Nominal commercial and office rents

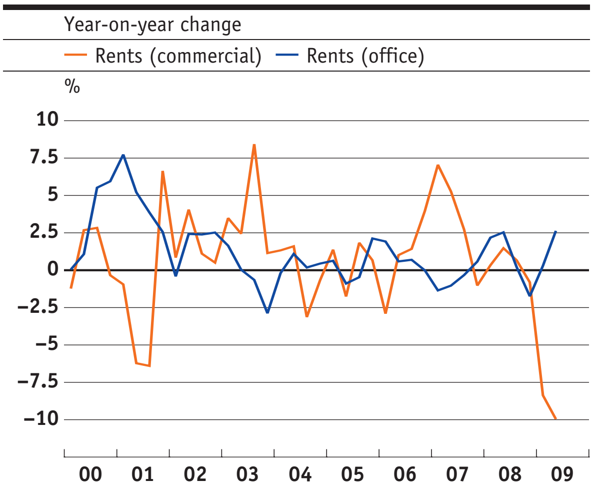


Chart 3.13:
Sources: SNB, Thomson Financial Datastream

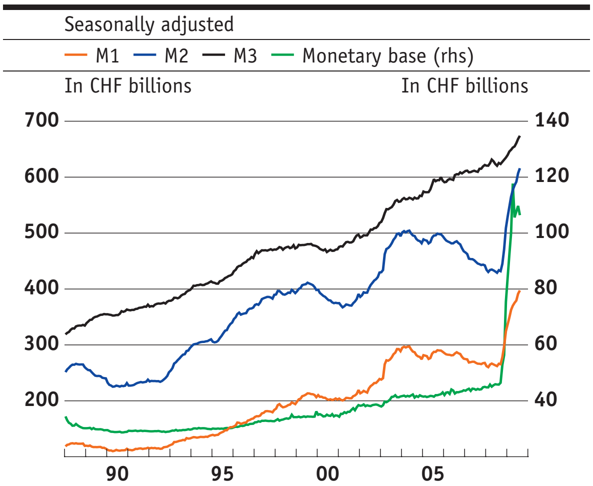
Charts 3.14 and 3.15:
Source: Wüest & Partner

3.4 Monetary aggregates

Substantial expansion in monetary aggregates

The SNB continued to provide the market with generous liquidity to satisfy the high demand on the part of commercial banks. On the back of general uncertainty, demand for high-denomination banknotes also increased. Consequently, the fact that the monetary base shot up by 134.5% in August compared with the year-back figure does not mean that the economy is over-supplied with money. This is substantiated by the fact that the broader monetary aggregates did not exceed their trend level until quite recently (cf. chart 3.16). After strong growth in 2003–2005, both M1 (notes and coins in circulation, sight deposits and transaction accounts) and M2 (M1 plus savings deposits) declined from the beginning of 2006 as a result of rising interest rates. From autumn 2007, both of these monetary aggregates stabilised again in line with the flatter path of short-term interest rates. Following the latest interest rate reductions, M1 and M2 began to grow strongly. In August, M1 was 48.9% above the year-back level, while M2 was up by 41.8%. M3 (M2 plus time deposits), which is generally less volatile than the other aggregates, expanded by 7.7% (cf. table 3.1).

Chart 3.16
Monetary aggregates



Source: SNB

Higher medium-term inflation

One way of assessing potential inflationary or deflationary risks emanating from an excessive or insufficient supply of liquidity to the economy is to calculate a money gap or monetary overhang. This corresponds to the positive deviation (monetary overhang) or negative deviation (money gap) of the actual M3 aggregate from an equilibrium value which is calculated on the basis of the transaction volume in the economy and the opportunity cost of holding money (cf. box 'Money supply growth and inflation', *Quarterly Bulletin* Q1/2005, p. 33). Chart 3.17 shows the percentage deviations of the M3 monetary aggregate from the calculated equilibrium value. In order to take account of statistical uncertainty, the money gap or monetary overhang is presented as a range that spans one standard deviation. This gap closed in the second quarter, while the third quarter saw a monetary overhang, indicating higher medium-term inflation.

Monetary aggregates[1]

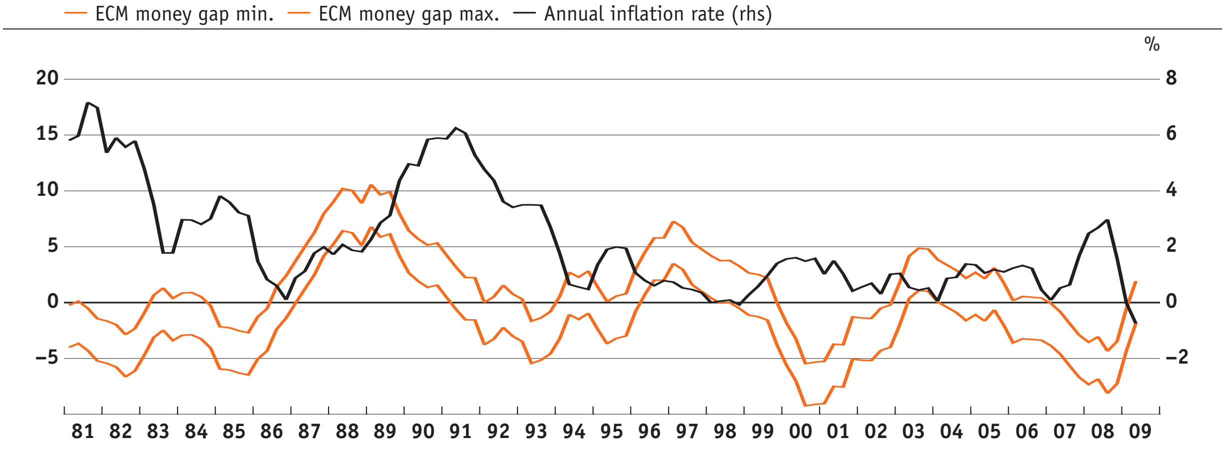
Table 3.1

	2007	2008	2008 Q2	Q3	Q4	2009 Q1	Q2	2009 June	July	August
Monetary base[2]	**44.2**	**49.6**	**45.4**	**45.3**	**61.7**	**92.9**	**110.2**	**107.3**	**109.3**	**105.5**
Change[3]	*2.5*	*12.1*	*3.3*	*4.4*	*37.8*	*102.9*	*142.6*	*135.4*	*140.4*	*134.5*
M1[2]	**268.9**	**273.1**	**265.3**	**258.4**	**302.2**	**355.2**	**375.2**	**373.8**	**381.8**	**384.9**
Change[3]	*–4.8*	*1.5*	*–1.7*	*–1.1*	*12.5*	*33.3*	*41.4*	*43.7*	*49.1*	*48.9*
M2[2]	**450.5**	**443.1**	**434.3**	**423.8**	**475.8**	**554.9**	**586.2**	**586.0**	**596.1**	**601.8**
Change[3]	*–6.4*	*–1.6*	*–4.3*	*–3.5*	*7.3*	*26.5*	*35.0*	*37.1*	*41.3*	*41.8*
M3[2]	**612.8**	**626.0**	**629.4**	**618.1**	**631.3**	**648.3**	**657.9**	**658.0**	**664.0**	**667.6**
Change[3]	*2.1*	*2.2*	*2.9*	*1.8*	*2.0*	*3.7*	*4.5*	*5.9*	*7.7*	*7.7*

1 1995 definition
2 Level in CHF billions
3 Year-on-year change in percent
Source: SNB

Chart 3.17
Money gap and annual inflation rate

Percentage deviation from equilibrium (lhs)



Source: SNB

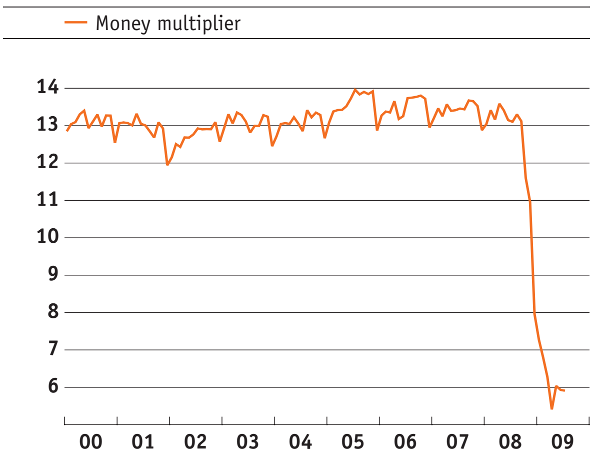
High demand for central bank money

The monetary base, consisting of banks' sight deposits at the SNB plus banknotes in circulation, is a measure of the liquidity in the interbank market. The monetary base has more than doubled since September 2008, because since the start of the financial crisis the banks have not been extending as much credit to each other as they previously did. The central banks – and among them the SNB – have taken over this function, which would normally be exercised by the commercial banks. The increase in bank demand for central bank money is evident from the ratio of banks' sight deposits to public deposits (sight, time and savings deposits), which are included in M3.

There is generally a stable relationship between the liquidity in the interbank market, sight deposits and the M3 aggregate, and this is expressed as the money multiplier (cf. chart 3.18). The latter expresses the fact that, on the basis of the liquid funds available to them, the banks are able to multiply the amount of money available to the general public through lending. The M3 money multiplier is a quotient of the M3 aggregate and the monetary base. Banks' sight deposits, which form part of the monetary base, have increased significantly since the autumn of 2008, and this is reflected in a steep fall in the multiplier. Recently, it has hardly recorded any more change.

Sooner or later, the multiplier will return to its normal value. Basically, this can happen in one of two ways. The first, which is to be avoided for monetary policy reasons, would see the multiplier rise while the monetary base remains unchanged. The banks' high liquidity would thus be made available to the rest of the economy via the granting of loans. The associated rise in M3 could have an inflationary effect eventually. Alternatively, if the multiplier rises because the SNB is absorbing the liquidity from the interbank market, thus reducing the banks' sight deposits, M3 growth and inflation will remain under control.

Chart 3.18
Money multiplier M3



Source: SNB

3.5 Credit

Corporate lending still robust

Annual credit growth slowed in the second quarter of 2009 for the fifth consecutive time. It was down at 3.2% from 4.1% in the first quarter of 2009. This slowdown is primarily due to the growth in other loans (cf. chart 3.19), which turned negative for the first time since 2006 (from 4.7% in the first quarter to –0.9% in the second quarter of 2009). This decline reflects the economic situation: The growth rate of other loans is highly correlated with growth in real GDP. The decline is mostly the result of a strong slowdown in the growth of other unsecured loans, which expanded by a mere 2.1% in the second quarter of 2009, as against 10.9% in the previous quarter. Other secured loans declined by 6.2%, a similar rate to that of the previous quarter. Mortgage growth, by contrast, increased from 3.9% in the first quarter to 4.3% in the second quarter of 2009. The mortgage volume soared, mirroring the latest interest rate reductions.

A breakdown of lending by households and companies shows that household loans increased by over CHF 17 billion year-on-year (cf. chart 3.20). This corresponds to a growth rate of 3.2%, as compared to 2.2% in the previous quarter. At 4.6%, household mortgages rose significantly faster than in the previous quarter (3.7%). However, other household loans plunged by 15%. Whereas mortgages were buoyed up by the easing of monetary policy, other loans declined on the back of lower consumption.

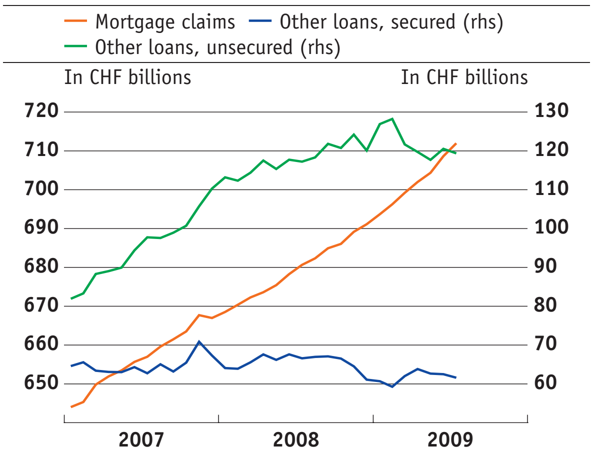
Loans to private companies grew by more than CHF 16 billion in the same period. The rate of growth was down from 9.5% in the first quarter to 6.2% in the second quarter of 2009, but remained relatively robust given the current recessionary phase. The slowdown in growth is due to the lower growth rate of other loans, which receded from 14.6% in the first quarter to 6.4% in the second quarter of 2009, whereas mortgage claims increased at a somewhat faster pace (5.7%).

Generally, loans to private companies grew at a faster pace than loans to households. In July, mortgages to companies expanded by 6.0% while household mortgages were up by only 4.8%. Moreover, loans to small enterprises rose faster than household loans.

This development is in line with the SNB's bank lending survey,[1] which points to a slight tightening of lending standards for companies. Although the figures indicate a deceleration in credit growth, there is no clear indication of any credit crunch at present on the basis of lending trends. According to the bank lending survey, the number of banks expecting to tighten their lending standards in the third quarter has decreased for the first time since December 2008.

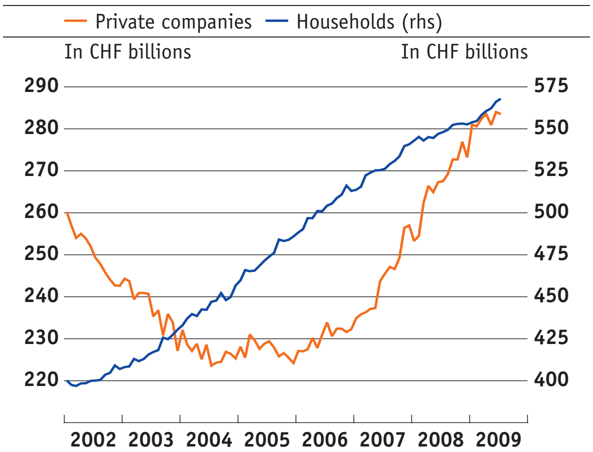
1 The bank lending survey is a survey of lending conditions carried out quarterly by the SNB since the beginning of 2008 with 20 banks. It covers 85% of the domestic credit market.

Chart 3.19
Mortgage claims and other loans



Source: SNB

Chart 3.20
Bank loans



Source: SNB

Bank loans

Table 3.2

Year-on-year change in percent

	2007	2008	2008			2009		2009		
			Q2	Q3	Q4	Q1	Q2	May	June	July
Total[1]	**5.8**	**5.7**	**6.4**	**5.8**	**4.2**	**4.1**	**3.2**	**3.2**	**3.2**	**3.3**
Mortgage claims[1]	4.0	3.5	3.4	3.5	3.4	3.9	4.3	4.3	4.5	4.6
of which households[2]	4.3	3.3	3.0	3.4	3.2	3.7	4.6	4.6	4.7	4.8
of which private companies[2]	2.2	3.8	4.3	3.4	3.6	5.2	5.8	5.6	6.2	6.0
Other loans[1]	13.4	14.8	19.0	15.0	7.1	4.7	–0.9	–0.6	–1.2	–1.6
of which secured[1]	8.2	1.2	5.7	5.1	–5.6	–6.0	–6.2	–5.3	–7.6	–7.5
of which unsecured[1]	17.2	24.2	28.2	21.4	15.3	10.9	2.1	2.0	2.4	1.8
of which in CHF[1]	5.7	20.3	23.6	19.3	16.3	6.2	1.2	1.6	0.7	1.3
of which in other currencies[1]	44.3	–1.8	5.2	2.3	–18.5	–3.2	–9.7	–10.3	–9.2	–12.7

1 Monthly balance sheets
2 Credit volume statistics
Source: SNB

4 SNB inflation forecast

4.1 Assumptions for global economic developments

In addition to domestic factors, exogenous effects also have a major influence on Swiss inflation rates. Various models used in drawing up the SNB's inflation forecast take this into account by embedding the expected outlook for Switzerland in an international economic setting. The assumptions with regard to the international economic scenario reflect what the SNB considers to be the most likely development in the global economy over the next three years. Table 4.1 shows the major assumptions for this scenario, as compared to those for the June forecast.

Rapid recovery expected

Since growth in the global economy has been better than expected over the last few months, assumptions for 2009 have been revised upwards. For the current year, a 2.4% fall in GDP is assumed for the United States and, for Europe, a 3.6% drop. For 2010, by contrast, positive growth rates are anticipated. Due to the fiscal support measures that have been implemented worldwide, they have been substantially revised upwards from the figures published in the June forecast.

For oil, a price of USD 72 per barrel is assumed for the next few quarters, edging down to USD 70 per barrel thereafter. Stable international consumer prices are assumed for 2009. For 2010 and 2011, however, slightly positive inflation rates are expected. The USD/EUR exchange rate for the forecast period is set at USD/EUR 1.42.

Inflation forecasting as part of the monetary policy concept

The SNB has a statutory mandate to ensure price stability while taking due account of economic developments.

The SNB has specified the way in which it exercises this mandate in a three-part monetary policy strategy. First, it regards prices as stable when the national consumer price index (CPI) rises by less than 2% per annum. This allows it to take account of the fact that the CPI slightly overstates actual inflation. At the same time, it allows inflation to fluctuate somewhat with the economic cycle. Second, the SNB summarises its assessment of the situation and of the need for monetary policy action in a quarterly inflation forecast. This forecast, which is based on the assumption of a constant short-term interest rate, shows how the SNB expects the CPI to move over the next three years. Third, the SNB sets its operational goal in the form of a target range for the three-month Swiss franc Libor. The target range provides the SNB with a certain amount of leeway, enabling it to react to unexpected developments in the money and foreign exchange markets without having to change its basic monetary policy course.

Assumptions for inflation forecasts

Table 4.1

September 2009	2009	2010	2011
GDP US [1]	–2.4	2.4	2.5
GDP EU15 [1]	–3.6	2.2	2.3

	Short term	Long term
Exchange rate USD/EUR [2]	1.42	1.42
Oil price in USD/barrel [2]	72	70
Oil price in CHF/barrel [3]	77	75

June 2009	2009	2010	2011
GDP US [1]	–2.8	1.7	2.9
GDP EU15 [1]	–4.6	0.2	2.1

	Short term	Long term
Exchange rate USD/EUR [2]	1.34	1.34
Oil price in USD/barrel [2]	60	54
Oil price in CHF/barrel [4]	65	58

1 Change in percent
2 Level
3 Level, exchange rate on 17 September 2009
4 Level, exchange rate on 18 June 2009
Source: SNB

4.2 Inflation forecast and monetary policy decision

The SNB is maintaining the expansionary monetary policy which it initiated last March. Despite the recent increase in the number of encouraging economic signs, uncertainty as to future developments remains considerable. In these circumstances, the SNB is opting for caution and retaining its monetary policy unchanged.

Consequently, the SNB is holding the Libor target range at 0–0.75%. It is still aiming to keep the Libor within the lower end of this range, i.e. at approximately 0.25%. It will continue to provide the economy with a generous supply of liquidity and, if necessary, to purchase Swiss franc bonds with a view to reducing risk premia on long-term debt instruments issued by private sector borrowers. In addition, it will continue to act decisively to prevent any appreciation of the Swiss franc against the euro.

The global economy has improved over the past few months and the downturn in the Swiss economy has proved to be considerably less substantial than had been forecast in the second quarter. The SNB has therefore revised its GDP growth forecast for the current year. It now expects real GDP to fall by between 1.5% and 2%. Growth is likely to pick up again gradually during the months ahead.

The inflation forecast is almost unchanged for 2009 but is slightly higher for the subsequent years. This is mainly due to the fact that developments in both the Swiss and the global economies are less negative than had been expected. Average annual inflation for 2009 will be negative, amounting to around –0.5%, and the SNB expects prices to increase by 0.6% in 2010 and 0.9% in 2011. This inflation forecast is associated with major risks. The recovery anticipated in the global economy may fail to materialise. Moreover, although the financial industry is well into the process of recovery, another deterioration cannot be entirely ruled out. A risk of deflation therefore remains. Consequently, an immediate tightening of monetary conditions is not necessary. However, the inflation forecast shows that the expansionary monetary policy cannot be maintained indefinitely without compromising medium and long-term price stability.

In view of the uncertainties, the SNB is adopting a cautious approach and pursuing the expansionary monetary policy outlined last March. By continuing to use an inflation forecast as its guide, the SNB can ensure that the exceptional measures currently in force do not compromise medium and long-term price stability.

Global economic outlook

The global economy has a strong impact on the Swiss economic outlook. Consequently, the SNB bases its inflation forecast on the most likely assumptions with respect to future developments in the global economy. Its current assumptions are based on growth rates that are slightly higher than those foreseen in June. Positive growth rates are expected before the end of the year, both in the US and in Europe. However, there are still major risks to global economic developments.

Swiss economic outlook

The economic situation in Switzerland remains difficult. GDP contracted again in the second quarter. The rate of capacity utilisation continued to fall, particularly in manufacturing. Unemployment and short-time working shot up, while consumer confidence persisted at a low level.

However, goods exports are likely to pick up in the next few months as the global economy recovers. The upturn in activity will affect the various export sectors in different ways. The demand for capital goods and consumer durables, in particular, is likely to remain modest. In the area of domestic demand, the combined softness in both private consumption and investment should result in a sluggish GDP.

For 2009 as a whole, the SNB now expects GDP to fall less substantially (–1.5% to –2%, compared with –2.5% to –3% in June). There are two reasons for this revision: global economic growth has resumed more quickly than expected and, as early as the second quarter, the fall in Swiss GDP was less deep than anticipated. Nevertheless, the SNB still holds the view that the return to full capacity utilisation will be slower and more uncertain overall than is usually the case at the end of a recession.

Changes in monetary and financial conditions

Monetary conditions remain extremely relaxed. The Libor has declined, in line with the SNB's stated intention, which is to bring the Libor down gradually to the lower end of the target range. Yields on Swiss Confederation bonds have also fallen. For a ten-year term, the yield is around 2.2%. Risk premia on the capital market have dropped.

The Swiss franc is stable in trade-weighted terms. It is also stable against the euro, which shows that the monetary policy measures taken last March were effective. However, the situation will remain tenuous as long as the level of financial uncertainty at the international level remains high. Consequently, the SNB will continue to act decisively to prevent any strengthening in the Swiss franc against the euro.

Developments in lending and money aggregates provide confirmation of the major relaxation in monetary conditions. In July, mortgage loans – which constitute 80% of all loans – increased by 4.6%. This rate had previously been falling, but began rising again after the SNB substantially lowered its Libor target range in November 2008. Most mortgage loans are construction loans. Loans other than mortgage loans, referred to as 'other loans', declined by 1.6% in July. This category of loans is reacting as it has in the past to a contraction in economic activity. The information obtained from the statistics is corroborated by the quarterly survey on lending conditions conducted by the SNB since the beginning of 2008 with the 20 most important banks in Switzerland. The survey shows that 40% of the banks questioned have slightly tightened their lending conditions.

No credit crunch of any kind has been observed in the lending statistics, neither in the household lending figures nor in the data on lending to small and large companies. With the decline in the quality of certain borrowers during a recession and the contraction in economic activity, it is inevitable that a cyclical tightening of lending conditions, or even a fall in the amount outstanding, will occur. This kind of development cannot be likened to a rationing effect, since it is not due to an autonomous fall in supply. In the current circumstances, the SNB considers that it would not be appropriate for the public authorities to introduce new support measures in the credit market.

The volume of central bank money has more than doubled since the beginning of the financial crisis, but has already fallen considerably in past months. This reflects the efforts of the SNB to provide the interbank market with sufficient liquidity as a response to the increased demand for liquidity which, for its part, was due to a climate in which financial sector agents had lost trust in one another.

The amount of liquidity is significant, not just in the banking and financial industry but also in the household and corporate sectors. This is reflected in the increasingly rapid growth of the monetary aggregates since the beginning of the year. The M3 aggregate, which was still increasing at a moderate rate at the last assessment in June, has begun to advance more rapidly. The SNB is keeping a close watch on movements in the monetary aggregates.

Inflation and the risk of inflation

For six months, inflation has been negative and core inflation is still declining. Given the economic outlook in March and June, the forecast was for a rate of inflation close to zero for 2010 and 2011. It was associated with a deflationary risk. The inflation forecast has now been revised slightly upwards and, as a result, the risk of deflation has somewhat abated. Nevertheless, two scenarios could provoke a resurgence of deflation if they were to materialise.

First, the recent signs with regard to the development of the global economy have yet to be confirmed. The current improvement is being supported by certain factors whose impact is of limited duration, such as fiscal stimulus programmes and inventory depletion. In addition, the US has acted as a locomotive driving global economic growth because of its strong demand for imported goods. However, should US consumers step up the process of debt reduction, the country might no longer be in a position to maintain this role, particularly since there is no other source of domestic demand that could fill it.

Second, the financial industry is in the midst of a period of recuperation. Central banks are still providing financial markets with a generous supply of liquidity. It is difficult to assess how the banking industry will be affected by the expected deterioration in the financial position of households and companies.

Monetary policy decision

The long-term inflation outlook has changed since the June assessment. The outlook now shows that the expansionary monetary policy cannot be maintained for the next three years because price stability would be compromised in the long term.

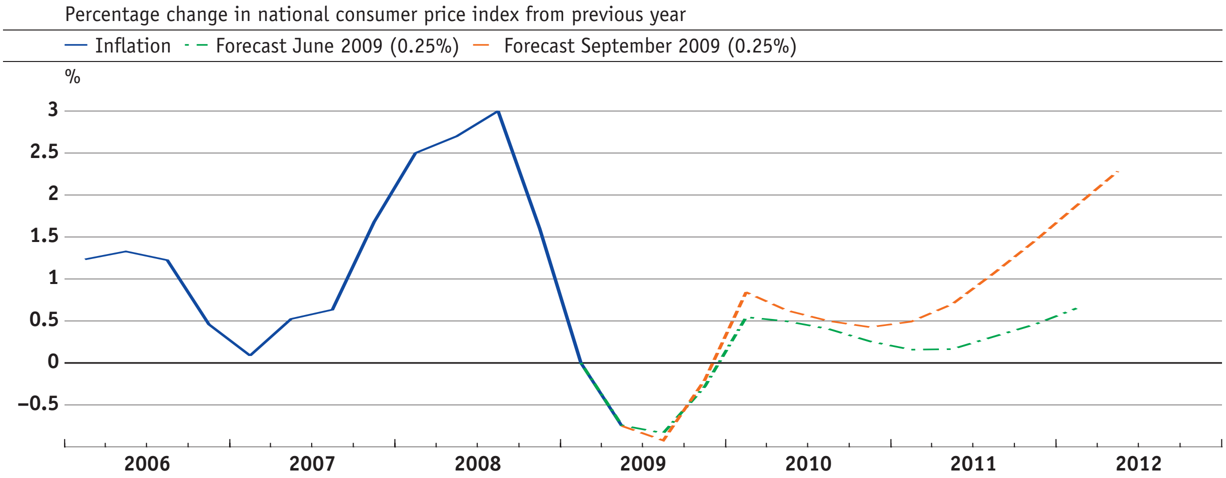
However, an immediate correction in monetary policy would be precipitate since the inflation outlook is associated with major downside risks. If these risks materialised, the threat of deflation could re-emerge. The uncertainties relate to the global economy and to the level of recovery within the financial industry. These factors have persuaded the SNB to opt for a cautious approach, and to adhere to its present monetary policy course for the time being.

Inflation forecast chart

The new inflation forecast (dashed red curve on the chart) covers the period from the third quarter of 2009 to the second quarter of 2012. Like the previous forecast (dash-dotted green curve), it is based on the assumption that the three-month Libor remains unchanged at 0.25%.

The new inflation forecast is almost unchanged for 2009 and 2010. The explanation for both the negative inflation in 2009 and the increase in prices at the beginning of 2010 is to be found in a base effect attributable to changes in energy prices. Until the end of 2009, oil prices are likely to be lower than those recorded one year previously. From the beginning of next year, this pattern should once again be reversed. In 2010, inflation will remain weak since production capacity will be under-utilised. The new forecast is based on the assumption that the gap between actual and potential output will close more rapidly than the SNB had been expecting as recently as June. As a result, inflation will be higher in 2011 and, particularly, in 2012, if the current policy of relaxing monetary conditions is maintained indefinitely. Consequently, inflation will exceed the 2% mark from the end of the forecasting period.

Chart 4.1
Inflation forecast of June 2009 with Libor at 0.25% and of September 2009 with Libor at 0.25%



Source: SNB

Observed inflation in September 2009

Table 4.2

	2006				2007				2008				2009				2006	2007	2008
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Inflation	1.23	1.33	1.22	0.46	0.09	0.52	0.63	1.68	2.50	2.70	3.00	1.60	0.00	–0.75			1.1	0.7	2.5

Inflation forecast of June 2009 with Libor at 0.25% and of September 2009 with Libor at 0.25%

	2009				2010				2011				2012				2009	2010	2011
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Forecast June 2009, Libor at 0.25%		–0.74	–0.83	–0.28	0.55	0.50	0.40	0.26	0.16	0.17	0.31	0.46	0.65				–0.5	0.4	0.3
Forecast September 2009, Libor at 0.25%			–0.92	–0.20	0.84	0.63	0.50	0.43	0.49	0.70	1.07	1.46	1.87	2.28			–0.5	0.6	0.9

Source: SNB

The economic situation from the vantage point of the delegates for regional economic relations

Summary report for the attention of the Governing Board of the Swiss National Bank for its quarterly assessment of September 2009

The SNB's delegates for regional economic relations are constantly in touch with a large number of enterprises from the different industries and economic sectors. Their reports, which contain the subjective evaluations of these companies, are an important additional source of information for assessing the economic situation. On the following pages, the most important results of the talks held in July and August 2009 on the current and future economic situation are summarised.

Summary

In the talks held by the SNB delegates for regional economic relations in July and August, most of the 160 or so representatives of various economic sectors and industries said the pace of economic decline was easing. This was most obvious in industries that hold an early position in the economic cycle. Assessment of the outlook also improved, although in many cases respondents conceded that the situation remained vulnerable. Outstanding orders and production are still below the year-back level, and quite substantially so in some areas.

In the past few months, differences between export-based companies and those with a domestic market focus have become less pronounced. In principle, export-based companies are still much more strongly affected by the crisis than domestically-focused companies. However, an increasing number of respondents are mentioning firmer foreign demand and favourable indications, particularly from Asia. By contrast, the domestic economy – which had held up well for a long time – has been increasingly affected by the crisis. Construction has remained relatively robust. Sentiment has improved in the banking industry.

Complaints about bank financing conditions and the exchange rate remain rare. Clearly, financing conditions have not worsened very much more than is normally the case in a cyclical downturn in which companies' production and earnings come under pressure. Nevertheless, there are widespread concerns that interest rates could rise again next year and that the Swiss franc might regain strength.

1 Production

Manufacturing

The assessment of the new orders situation by respondents in the manufacturing industry varied considerably. However, the number of positive evaluations was substantially greater than in previous months. We can therefore assume that the average level of new orders for all companies is likely to have stabilised. In many cases, however, outstanding orders and production have fallen further, although the decline appears to have slowed considerably.

Variation between the different industries remains considerable. In machinery, business has deteriorated further and expectations for the near future remain negative. By contrast, the mood has changed recently in the chemicals industry, which – like machinery – was affected by the crisis at an early stage. The food and pharmaceuticals industries are still holding up well. In geographical terms, Asia and South America appear to have been the main source of positive momentum in the past few months, since their demand for infrastructure projects is still strong. By contrast, most respondents describe demand from the US and western Europe as weak.

Most company representatives are cautious in their evaluation of the outlook. Although a bottoming out of the cycle was often mentioned, many company representatives were assuming that the recovery would not begin until 2010, and even then would be tentative. Some respondents drew attention to the fact that the good news primarily related to industries that were benefiting indirectly from government support packages in other countries and that, consequently, the risk of a short-lived recovery was considerable. Other representatives noted the worldwide development of large capacities in manufacturing over the past few years and stated their expectation that this overcapacity was likely to cause financial difficulty for many companies, and that a wave of consolidations with works closures and mergers was likely. They concluded that a continuation of the low level of investment could be expected in the medium term.

Services

The situation in retailing is better than in manufacturing, but since spring the crisis has been perceptible in this area too. Industry representatives often spoke of consumers substituting cheaper articles for expensive ones. Variations between the different segments remain considerable. In general, the food segment is holding up better than the non-food segment. Within the non-food segment, demand for clothing, furniture and consumer electronics has suffered most. Most respondents in retailing (and also from other consumer-related areas) were expecting a further deterioration in consumer confidence. In general, they based this on the expected rise in unemployment.

Respondents from the hospitality industry expressed similar views. Expenditure per guest has declined perceptibly. Numbers of guests are also falling, although in most important tourism regions they are still at the level of 2006 and 2007 – which at the time were considered to be good years. The drop in numbers is greater for guests from abroad than it is for Swiss guests. Some businesses have even managed to compensate the drop in the number of foreign guests by attracting more Swiss guests; usually, however, this has necessitated special deals and corresponding loss of margin. Other types of accommodation and same-day travel from Switzerland and neighbouring areas across the border continue to hold up well. As was the case three months ago, the biggest losses have been recorded in business travel and in conferences and seminars. In these areas, the cost-saving efforts of companies are making a clear impact.

Other business-related services have also suffered a decline. In most areas, business remains slow. This is as true for consulting and market research as it is for advertising. Since July, however, the situation has improved in transportation, with the largest Swiss providers reducing their capacity. A number of software providers also spoke of continuing robust demand for IT solutions.

In the banking industry – in particular in asset management – the mood has improved in recent months due to the worldwide revival of the financial markets. Corporate results were better than expected, and investor risk appetite again appears to have increased somewhat. The solution of the tax dispute with the US also caused a certain amount of relief. In general, demand for mortgage loans has remained high, while demand for commercial loans has continued to suffer as a result of the recession. Despite a rise in credit volume, income from interest rate business is still under pressure. However, a healthy stock exchange has stimulated commission business, which has given rise to higher income in this area.

Construction and real estate

As was the case three months ago, representatives of the construction industry reported that business had been good. Although construction volume has slipped slightly in seasonally adjusted terms, the levels of new orders and outstanding orders have remained satisfactory. Since the level of outstanding orders has remained high, respondents are expecting a high level of construction activity again in the second half of the year.

Residential construction and civil engineering are making particularly strong contributions to the good business results in the construction industry.

By contrast, commercial and industrial construction is struggling, since numerous projects have been frozen or abandoned. Residential construction is supported by the low mortgage rates and demographic developments. Moreover, the finishing industry is benefitting from government promotion of energy-saving measures.

This construction cycle has been supported, in general, by the fact that the current recession was not preceded by overheating of the real estate market, as has so often been the case in the past. Most respondents from the real estate industry assessed the current price level as appropriate. Only in the case of commercial and industrial properties and expensive residential properties in locations that could not be described as truly first-class did they see the need for (further) price correction.

2 Labour market

In the past few months, the labour market has deteriorated steadily. Companies reacted to receding demand first, by introducing short-time working, next, by placing an embargo on new recruitment and then, by taking advantage of natural fluctuation in employment. Finally, over the past few months, there has been a rise in the number of redundancies.

The talks with industry representatives confirmed the impression gained three months ago that further lay-offs were to be expected. It is likely that short-term working, which is being used extensively, will increasingly give way to unemployment. Although companies are still trying to retain well-trained staff, many respondents spoke of increased pressure to further reduce employee numbers as simple cost reduction measures had been exhausted and the pressure to step up efficiency was increasing.

However, variation between industries and between companies within the same industry is considerable. Once again, some respondents mentioned the difficulties in recruiting specialists. Moreover, there are even a number of companies in the manufacturing industry that have ceased short-term working over the past few weeks and are now back up to full production.

3 Lending conditions

As in past discussion rounds, respondents from the banking industry stressed the fact that, in the vast majority of cases, access to credit and lending conditions were unchanged, and that the rate of growth in credit volume had fallen off because demand had weakened. In addition, they pointed out that many of the remaining investment projects were being funded by the companies themselves.

Representatives of other industries basically confirmed this picture. In almost all cases, financing conditions were described as essentially unchanged. However, many respondents expected a tightening in the near future because of the deterioration in key data. Furthermore, there was frequent mention of the fact that large loans have become harder to obtain. General worries with regard to future interest rate developments were aired in several discussions. On various occasions, concern was expressed that central banks would not be able to reabsorb the massive expansion of liquidity supplied to banks in good time without disruption.

4 Prices, margins and earnings situation

Most respondents noted that prices had remained unchanged or had fallen slightly, although there were substantial variations between the different industries. Weak demand and tough competitive pressure are forcing down sale prices. Monetary conditions as well as commodity prices and transportation costs are providing some relief. Commodity prices and transportation costs have risen in the past few months, but they are still lower than a year ago.

Margins have dropped due to overcapacity, strong competition and the shift in demand to cheaper products. In some discussions, respondents spoke of substantial worldwide overcapacity affecting most manufacturing industries. Given expected growth, utilisation of this capacity would only increase slowly. They concluded that the outlook for earnings and margins therefore remained gloomy.

Various company representatives mentioned that, in addition to their own earnings position, those of their suppliers and customers had also become more important. Generally speaking, they were paying particular attention to the areas of liquidity management and enforcement of payment arrangements.

The exchange rate gave little cause for discussion. Representatives of the export industry welcomed the foreign currency sales announced by the SNB in March, which are aimed at preventing a further appreciation in the Swiss franc against the euro. They said this had substantially reduced uncertainty with respect to movements in the exchange rate. However, some respondents expressed the concern that the Swiss franc might become stronger again next year.

SNB Working Papers: Summaries

Inflation risk premia and survey evidence on macroeconomic uncertainty

Paul Söderlind
Working Paper 2009-4

This paper tries to explain the observed 'total premium' (the difference between nominal and real interest rates, minus survey data on inflation expectations) by a liquidity premium as well as survey data on inflation and output uncertainty/disagreement. The data are for the US and cover the period from 1997 (when inflation-indexed Treasury bonds were introduced) to mid-2008.

The survey data are from the quarterly Survey of Professional Forecasters (administered by the Federal Reserve Bank of Philadelphia). This is a panel of 30–40 forecasters, who supply forecasts of many economic variables and probabilities for different outcomes of inflation and GDP growth. The author constructs measures of uncertainty from the probabilities, and measures of disagreement from the dispersion of individual forecasts.

It is found that these variables are statistically and economically significant. Inflation uncertainty and disagreement seem to capture an inflation risk premium, while the nominal off-the-run liquidity premium and real growth uncertainty together capture the real liquidity premium.

Chronicle of monetary events

Current monetary policy maintained

Following its quarterly monetary policy assessment of 17 September 2009, the SNB decided to maintain the expansionary monetary policy initiated in March, to leave the target range for the three-month Libor unchanged at 0–0.75% and to adhere to its objective of keeping the Libor within the lower area of this range at approximately 0.25%. The SNB also announced that it would continue to provide the economy with a generous supply of liquidity and, if necessary, continue purchasing Swiss franc bonds with a view to reducing risk premia on long-term debt instruments issued by private sector borrowers. In addition, it will take firm action to prevent an appreciation of the Swiss franc against the euro.

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