Swiss National Bank
Quarterly Bulletin

March 1/2010 Volume 28

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Sectional breakdown of bulletin Q1/2010

Monetary policy report (p. 6)

The global economy reached the bottom of the cycle in the first half of 2009 and has been moving upwards since then. The recovery firmed in the fourth quarter of 2009 and the first months of 2010, and even proved somewhat stronger than had originally been anticipated. However, there were considerable regional variations in the pace of expansion. The emerging markets in Asia revived earliest and most strongly. By contrast, the recovery in the industrialised countries has so far been fairly sluggish.

In the fourth quarter of 2009 and at the beginning of the new year, the Swiss economy continued to gain momentum. GDP grew faster than in the preceding quarter, in contrast to the euro area, where the GDP growth rate weakened in the fourth quarter. The seasonally adjusted rate of unemployment has stabilised in the last few months, but, like the overall output gap and other indicators, it shows the continued under-utilisation of Switzerland's economic capacity. Inflationary pressure has therefore remained low to date.

The SNB expects the global economic recovery to continue in 2010. However, the revival is likely to be relatively sluggish, at least in Europe. For Switzerland, the SNB forecasts economic growth of about 1.5% in the current year, which will be driven mainly by domestic demand. The contribution of net exports to growth will probably be slight. The inflation outlook remains favourable, although the inflation forecast based on an unchanged three-month Libor suggests that the current expansionary monetary policy cannot be maintained throughout the entire forecast horizon without compromising medium and long-term price stability.

At its quarterly monetary policy assessment on 11 March, the SNB decided to leave the target range for the three-month Libor unchanged at 0.00–0.75% and to adhere to its objective of keeping the Libor within the lower part of the target range, at around 0.25%. In addition, it said it would act decisively to prevent an excessive appreciation of the Swiss franc against the euro.

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

The economy continued to recover in the first quarter of 2010. In manufacturing, a significantly wider group of companies was affected by the uptrend than had been the case just a few months earlier. Most industry sectors showed a modest increase in demand and real turnover. This led to a reduction in short-time work, which until that point had been heavily used. However, because many manufacturers were recovering from a very low level, under-utilisation of production capacity in some industries remained substantial. As in previous quarters, the situation in the construction and finishing industries was favourable. At the beginning of the year, the level of construction activity ranged from satisfactory to high and the continuation of a moderately upward trend was also evident in the services sector.

Expectations for the coming six months are cautiously optimistic. At the international level, the successful combating of the banking crisis and the recovery of the financial markets have resulted in a more positive mood. However, there is a certain residual crisis-related uncertainty, especially with regard to the sustainability of the recovery. Many are concerned by the financial state of the world's governments and the effects this could have on foreign exchange markets, and on the propensity to consume and invest. In general, the earnings situation of companies is most likely to be improved by a rise in the volume of sales, with few companies expecting increased profit margins.

SNB Working Papers (p. 50).

Summaries of three *SNB Working Papers*: Sébastien Kraenzlin and Martin Schlegel, 'Bidding behaviour in the SNB's repo auctions', *SNB Working Paper* 2009-14; Martin Schlegel and Sébastien Kraenzlin, 'Demand for reserves and the central bank's management of interest rates', *SNB Working Paper* 2009-15; Carlos Lenz and Marcel Savioz, 'Monetary determinants of the Swiss franc', *SNB Working Paper* 2009-16.

Monetary policy report

Report for the attention of the Governing Board of the Swiss National Bank for its quarterly assessment of March 2010

This report is based primarily on the data and information available as at 11 March 2010.

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. Moreover, it is obliged by law to inform 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 March 2010. The sections entitled 'Monetary policy decision' and 'SNB inflation forecast' take due account of the Governing Board's monetary policy decision of 11 March 2010.

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

Monetary policy decision

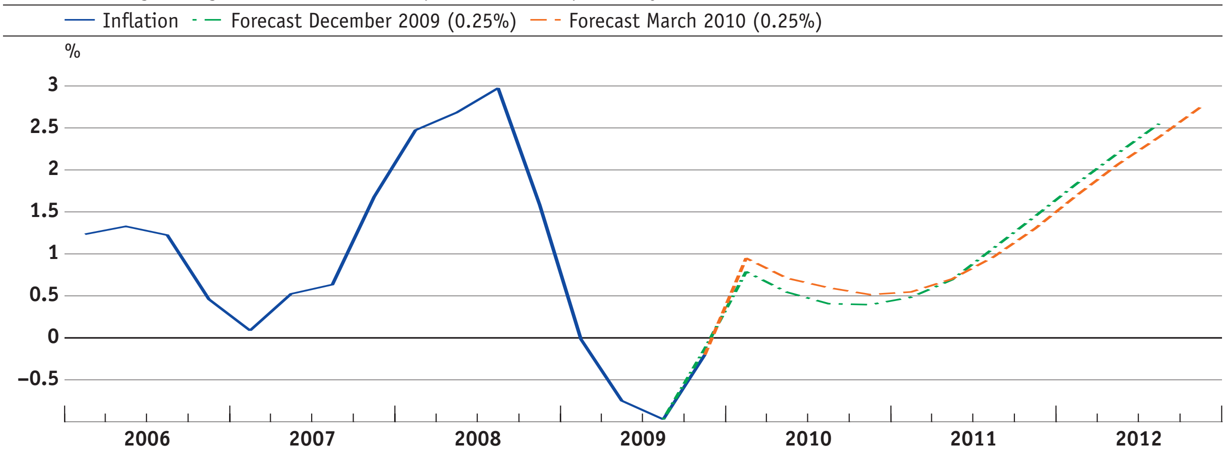
At its monetary policy assessment of 11 March 2010, the Swiss National Bank (SNB) decided to maintain its expansionary monetary policy. Consequently, it left the target range for the three-month Libor unchanged at 0.00–0.75% and announced that it would continue to aim for a Libor within the lower end of this range at around 0.25%. In addition, it said it would act decisively to prevent an excessive appreciation of the Swiss franc against the euro.

The signs of a global economic recovery have become more tangible since the monetary policy assessment in December. The improvement is beginning to assist the Swiss export sector, while the domestic sector is performing well. However, the revival remains fragile and is associated with uncertainties. Should more external shocks occur, the danger of deflation cannot be entirely ruled out.

The inflation outlook remains favourable. However, the three-year inflation forecast based on an unchanged three-month Libor suggests that the current expansionary monetary policy cannot be maintained throughout the entire forecast horizon without compromising medium and long-term price stability.

Inflation forecast of December 2009 with Libor at 0.25% and of March 2010 with Libor at 0.25%

Percentage change in national consumer price index from previous year



Source: SNB

Inflation forecast of December 2009 and of March 2010
Average annual inflation in percent

	2010	2011	2012
Forecast December 2009, Libor at 0.25%	0.5	0.9	
Forecast March 2010, Libor at 0.25%	0.7	0.9	2.2

Source: SNB

1 Developments in the global economy

The global economy reached the bottom of the cycle in the first half of 2009 and has been moving upwards since then. The recovery firmed in the fourth quarter, and proved somewhat stronger than had originally been anticipated. However, there were considerable regional variations in the pace of expansion. The emerging markets in Asia revived earliest and most strongly. By contrast, the recovery in the industrialised countries has so far been fairly sluggish. It is still being driven by the expansionary monetary and fiscal policy adopted at the start of the crisis and by the marked easing of tension on the financial markets. In the industrialised countries, momentum is coming principally from exports and the turnaround in the inventory cycle.

Despite this positive trend, the outlook remains modest. It is still unlikely that the industrialised countries will stage a smooth and rapid return to their previous growth path. Since unemployment is continuing to rise in many countries, the pressure on consumer spending is likely to persist. Moreover, in the light of massive under-utilisation of capacity, capital spending in the corporate sector seems unlikely to recover quickly. Rising state debt and the deterioration in the asset positions of companies and households are also likely to dampen the pace of recovery compared with previous economic cycles.

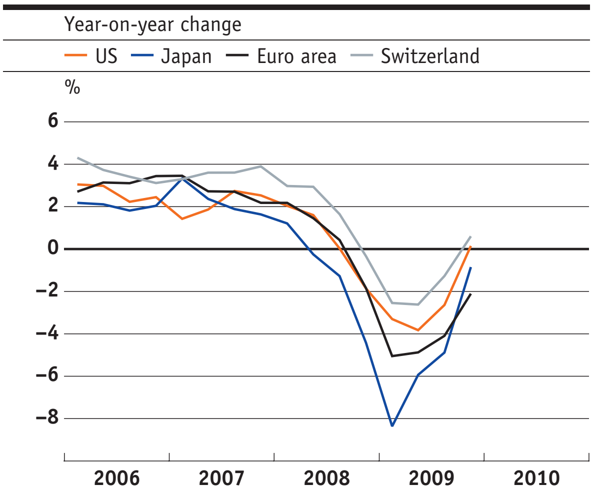
The modest outlook has prompted the central banks to continue biding their time before tightening their expansionary monetary policy. Nor is there any need to do so from an inflation viewpoint. Although annual inflation rates rose in many countries, this was principally due to the base effects resulting from the drop in energy prices in the previous year. Inflation expectations have also remained low.

The SNB has adjusted its global growth forecast for 2010 and 2011. The forecasts for the US and the emerging markets in Asia have been revised upwards, and those for the euro area slightly downwards.

Strong quarterly growth in the US

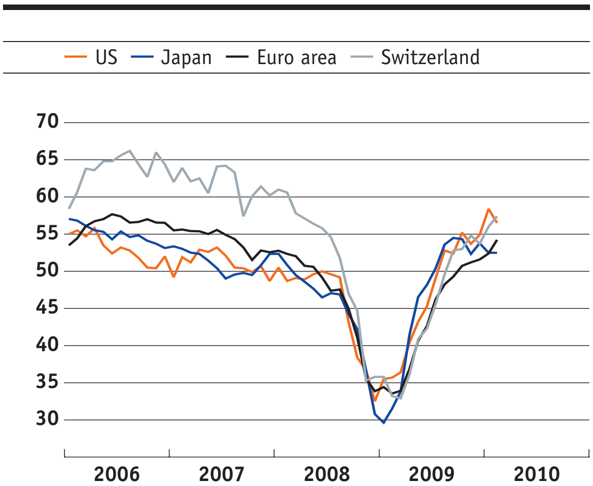
In the US, fourth quarter GDP surged by 5.9%, following growth of 2.2% in the third quarter. Despite this strong growth, GDP contracted by 2.4% year-on-year in 2009, which was the sharpest decline since 1946. The key drivers of the strong fourth quarter growth were slower destocking and increasing consumer spending. Equipment investment rose considerably for the first time in more than a year, but investment in the construction of commercial property decreased further. Although the recovery in residential construction continued, the increase was low in spite of the tax credit for first-time home buyers. The situation on the labour market remained difficult, but there were at least some signs of stabilisation. Unemployment fell from 10% in November to 9.7% in February.

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; copyright and database rights: Markit Economics Ltd 2009; all rights reserved

Strong economic growth in the US in the fourth quarter was partly due to temporary factors. Consequently, growth is unlikely to continue at the same pace in the coming quarters. Although consumer sentiment is brightening (cf. chart 1.3), in view of the high unemployment rate and sharp drop in household wealth, consumer spending cannot be expected to post strong growth. Similarly, construction investment seems unlikely to recover rapidly given the high stock of empty homes and the end of the fiscal programmes introduced to support the housing market. Exports should continue to improve, supported by the weakness of the dollar. A rise in new orders and a significant brightening of producer sentiment in the manufacturing industry also point to a potential rise in equipment investment. The impetus injected by state stimulus packages will gradually tail off in 2010. US Congress is, however, currently debating additional measures to boost employment.

The SNB is now forecasting that the US economy will grow by 2.9% in 2010, compared with a forecast of 2.4% last December. It thus still assumes that the recovery will be modest by historical standards.

Sluggish recovery in the euro area

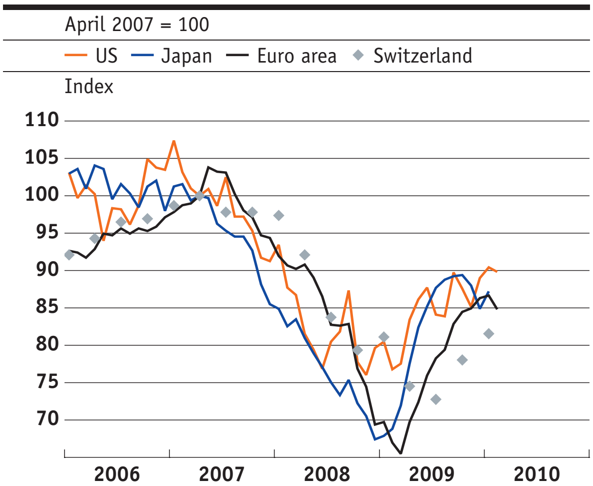
Unlike the US, GDP slowed significantly in the euro area at the end of 2009, dropping from 1.7% in the third quarter to 0.5% in the fourth quarter. As in previous quarters, growth rates differed considerably in the member states. In terms of GDP, economic activity in the fourth quarter stagnated in Germany, lost momentum in France and slipped back in Italy, which had posted growth in the third quarter. Similarly to the US, euro area GDP was far lower in 2009 than in the previous year (–4.1%).

Foreign demand increased further in the fourth quarter, while domestic demand slowed somewhat. Private consumption stagnated. Investment activity, which now as previously is suffering from low capacity utilisation, fell for the seventh time in a row in comparison to the previous quarter.

Economic activity in the euro area should gradually recover in the next few quarters. Expectations in the manufacturing industry have improved, suggesting that the recovery in this important area of the economy is set to continue. Economic growth remains vulnerable, however, in view of the likely increase in unemployment in the near future. Downside risks are associated in particular with some of the southern member countries, due in part to reduced competitiveness and pressure exerted by the markets to restructure their government finances.

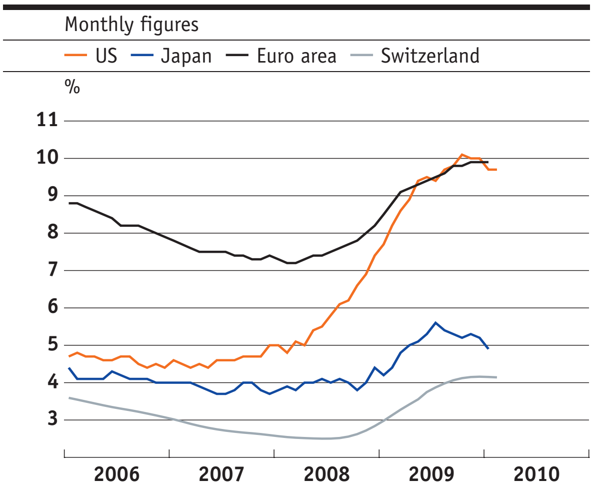
The SNB forecasts economic growth of 1.0% in the euro area this year, compared with its forecast of 1.3% last December.

Chart 1.3
Consumer confidence index



Sources: SECO, Thomson Financial Datastream

Chart 1.4
Unemployment rates



Sources: SECO, Thomson Financial Datastream

Volatile growth in Japan

The economic upturn in Japan has also continued. Following a lull in growth in the previous period, GDP advanced 3.8% in the fourth quarter. Overall it shrank by 5.2% in 2009, the biggest drop in economic activity in a single year since the Second World War.

Growth broadened in the fourth quarter, although domestic and foreign fiscal stimuli played a key role in this. Following a prolonged and serious downturn, equipment investment in the private sector started to pick up. Exports continued to revive but were still well below the pre-recession level.

Economic prospects for Japan remain subdued. Domestic demand has provided little self-sustaining momentum as yet so a dip in growth is probable in the first half of 2010 when the impetus provided by economic stimulus packages peters out. Consumer spending remains fragile in the light of high unemployment and massive bonus cuts. Fiscal policy incentives are still having a positive effect, although the main growth impetus was probably felt in the second half of 2009. Investment by the corporate sector will probably be held back for some time by the fact that capacity utilisation is still very low and corporate profits are weak. Foreign demand is therefore likely to remain the main buttress of growth. Based on the strong upswing in the emerging markets of East Asia and the manufacturing industry's production plans for the start of the year, the export recovery is likely to continue.

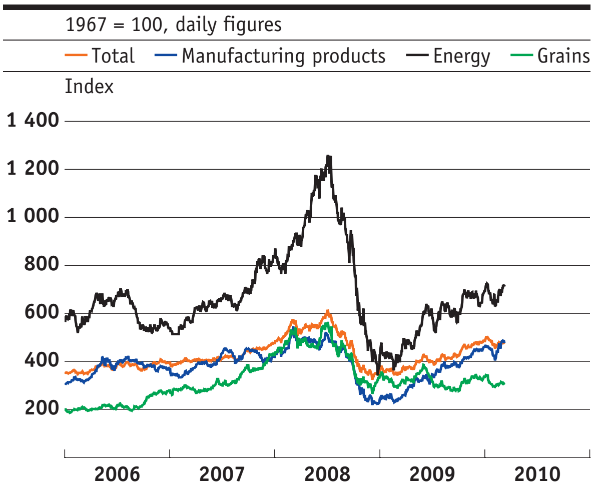
The SNB anticipates that the Japanese economy will grow by 1.9% in 2010, compared with its forecast of 2.0% in December.

Sustained strong growth in emerging Asian markets

The emerging markets in Asia recovered astonishingly quickly from the crisis. China's economic performance in the fourth quarter of 2009 was 10.7% higher than in the same period of 2008, indicating strong growth. Although domestic demand is still China's main driver, exports, which in previous periods had recorded only modest growth, are catching up. Growth in private demand in China is also shifting slightly from investment to consumption, which is benefiting from state incentives and rising household incomes.

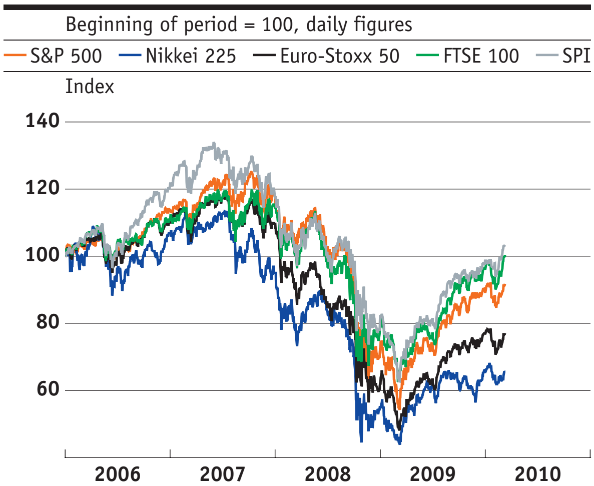
The outlook for China is favourable. The export recovery seems to have a broad geographical base and to be gaining momentum, while recent surveys show that industrial output is expanding further. The steady growth in imports seen since the start of last year goes hand-in-hand with strong domestic demand. Owing to the massive economic stimulus package, which includes measures for 2010, domestic demand is likely to remain robust. The persistently buoyant level of investment, which has now risen to almost 43% of GDP, is one explanation for the extraordinarily high credit figures. However,

Chart 1.5
Commodity indices



Sources: Reuters, Thomson Financial Datastream

Chart 1.6
Share prices



Sources: Bloomberg, Thomson Financial Datastream aggressive lending at the start of the year has raised concerns about the quality of banks' assets and the possibility that the Chinese economy could overheat.

The economic recovery also continued through the fourth quarter in East Asia, in South Korea, Taiwan, Singapore and Hong Kong. GDP, which as a result of the crisis dropped nearly 7% within a year, was back at the pre-crisis level by year-end. The driving forces were strong demand from China and monetary and fiscal stimuli. Industrial output hit new highs in South Korea and Taiwan in December, and industrial capacity utilisation returned to normal. Rising export orders, strong demand from China and low inventories are sources of optimism for the upcoming quarters. The data obtained from surveys of companies in the region in recent months portray a rather more mixed impression, reflecting uncertainty surrounding the gradual ending of the economic stimulus packages. Overall though, the survey data suggest that economic growth will be close to the long-term trend.

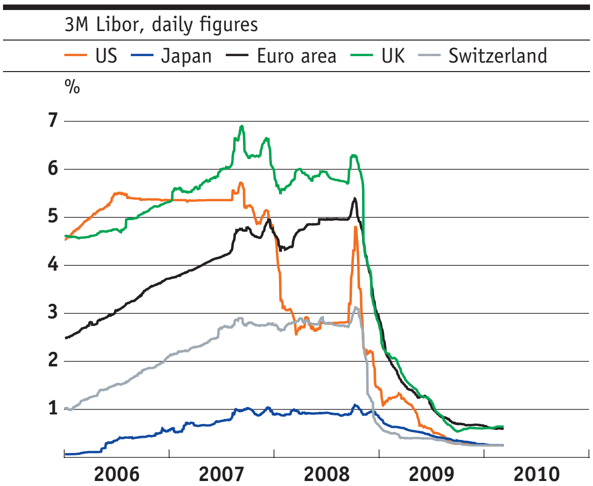
Low core inflation rates

Inflationary pressure has remained low throughout the world. Based on consumer prices, the annual inflation rate in the industrialised countries has nonetheless gradually increased in recent months, and with the exception of Japan it is now back in positive territory (cf. chart 1.9). However, this principally reflects base effects from the drop in energy prices in the second half of 2008.

In the US, the annual rate of inflation rose from –0.2% in October to 2.6% in January due to substantial base effects. The core inflation rate, which factors out food and energy prices, remained virtually unchanged and was 1.6% in January. Annual inflation in the euro area rose from –0.1% to 1.0% in the same period, while the core inflation rate declined from 1.2% to 0.9%. Unlike the situation in the euro area and in the US, the annual inflation rate in Japan remained negative, although it was –1.3% in January compared with –2.5% in October. The core inflation rate slipped to –1.2%, Japan's lowest level since records began in 1971. Base effects also pushed up the annual inflation rates in the Asian tiger states and China to an average of 1.7% and 1.5% respectively. China's core inflation rate moved out of negative territory for the first time in a year (0.0%).

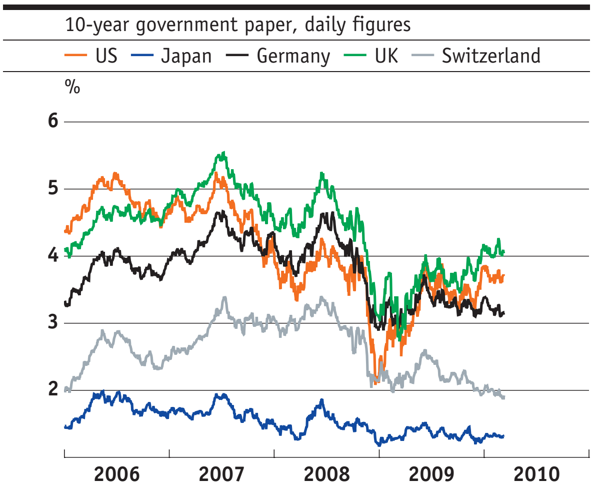
In the euro area, the annual inflation rate for 2009 as a whole dropped to the lowest level since monetary union (0.3%). In the US it was negative (–0.3%) for the first time since 1955, while in Japan it dropped back into the negative range (–1.4%) after a three-year break. Low capacity utilisation and high unemployment should keep inflationary pressure in the industrialised countries at a low level this year too.

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

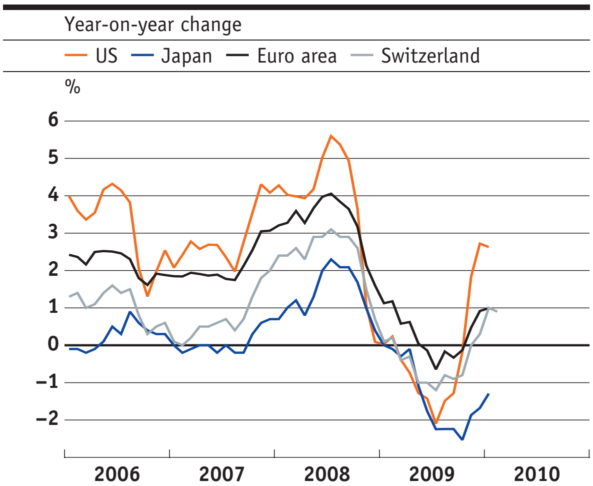
Expansionary interest rate policy has not yet normalised

The central banks in the main industrialised countries have maintained their expansionary monetary policy (cf. chart 1.10). The Federal Reserve left the target range for the federal funds rate at 0.00–0.25% but increased the discount rate by 25 basis points to 0.75%. It also announced that it would complete the planned purchase of mortgage-backed securities totalling USD 1.425 trillion in the first quarter of 2010. It has not yet started to reduce the surplus reserves of USD 1 trillion held by banks at the Federal Reserve.

In view of uncertain prospects for growth and slower expansion in lending and the money supply, the ECB also held its main refinancing rate unchanged at 1.0%. It has, however, taken further steps to phase out unconventional measures introduced during the crisis. To this end, it plans to again offer the longer-term three-month refinancing transactions at a variable interest rate, from April onwards. It will continue to acquire secured financial instruments denominated in euros (covered bonds). These purchases should attain a total of EUR 60 billion by mid-2010.

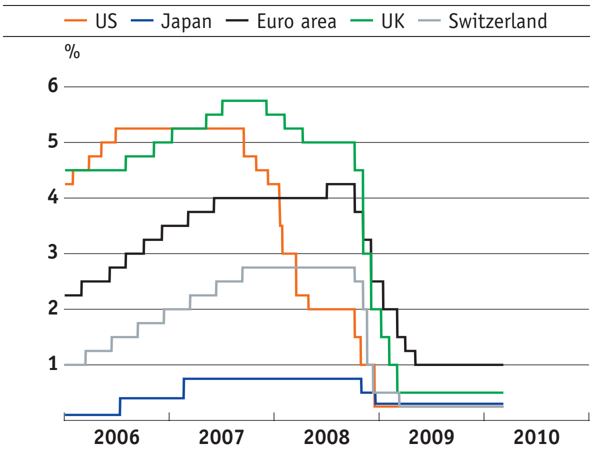
The Bank of Japan kept its overnight call money rate unchanged (0.1%) and reiterated that it would not tolerate an annual inflation rate equal to or less than 0%. The Chinese central bank increased its reserve rate for the first time since 2008, mainly in response to the high rate at which lending is growing.

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

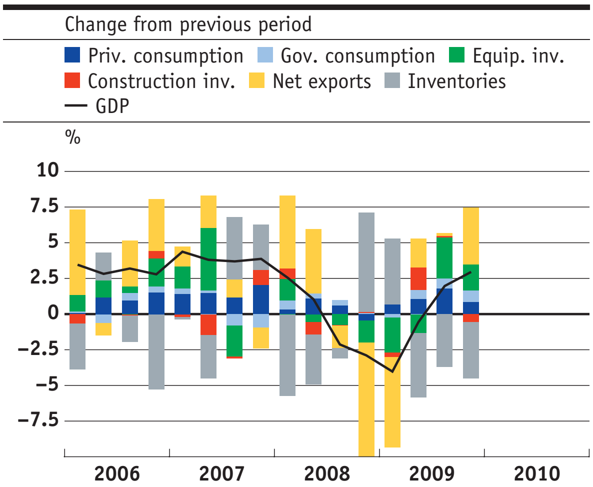
2 Developments in the Swiss economy

The Swiss economy continued to gain momentum in the fourth quarter. GDP grew faster than in the preceding quarter, in contrast to the euro area, where the GDP growth rate weakened in the fourth quarter.

Employment also fared better in the fourth quarter than had been expected, and the unemployment rate only rose marginally compared to the previous quarter. At the same time, like the output gap, unemployment indicates persistent under-utilisation of Switzerland's economic capacity. Inflationary pressure therefore remained low. Although the annual inflation rate as measured by the national consumer price index increased, this was mainly due to base effects, and the core inflation rate remained virtually unchanged at a low level.

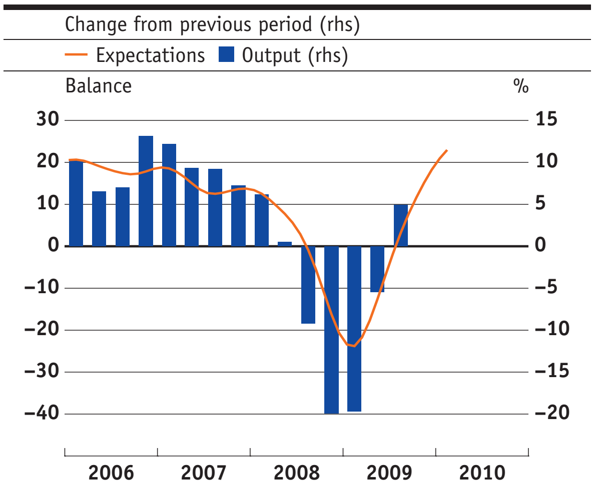
The recovery will probably continue in the first six months of 2010, although possibly not at the same pace. In January and February, the leading indicators suggested a continued expansion of economic activity.

Chart 2.1
Contributions to output growth



Source: SECO

Chart 2.2
Manufacturing output



Sources: KOF Swiss Economic Institute, SFSO

2.1 Gross domestic product (GDP)

Strong economic growth in the fourth quarter

GDP growth accelerated in the fourth quarter. According to a provisional estimate by the State Secretariat for Economic Affairs (SECO), it rose by 3.0% compared to the previous quarter, which translated into growth of 0.6% compared with the year-back quarter.

When it published the results for the fourth quarter of 2009, SECO also revised its quarterly estimates from 2008. On the basis of the revised forecasts, the picture for the 2008/09 recession is as follows: GDP grew until the second quarter of 2008, when the growth rate was 1.0%. This was followed by four quarters of negative growth rates between the third quarter of 2008 and the second quarter of 2009 (–2.1%, –2.9%, –4.0%, –0.6%). It has been rising again since the third quarter of 2009, with growth coming in at 2.0% in the third quarter and 3.0% in the fourth quarter of 2009. Over the full year, GDP therefore shrank by 1.5% compared with 2008.

SECO's forecasts indicate that during the 2008/09 recession the cumulative drop in output measured by GDP was 2.4%, which was larger than the declines recorded in the 1981/82, 1992/93 and 2002/03 recessions. However, Switzerland suffered its sharpest fall in output in the post-war era in 1975/76, when the cumulative drop in GDP was around 10%.

All components of final demand apart from construction spending contributed to the growth in GDP in the fourth quarter. As in the second and third quarters, inventories made a significant negative contribution to GDP growth.

As had already been the case in the previous quarter, the sectoral breakdown of SECO's GDP forecast shows significant growth in the value added in the banking industry. Value added also increased in large parts of the remainder of the services sector apart from tourism and corporate services. In the industrial sector, by contrast, the trend was weak. Since the sharp downturn, which lasted until the third quarter of 2009, industrial value added has stagnated at a low level.

Real GDP and components Table 2.1

Growth rates on previous period, annualised

	2006	2007	2008	2009	2008				2009			
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Private consumption	1.6	2.4	1.7	1.2	0.6	1.9	1.0	–0.7	1.1	1.8	3.1	1.4
Government consumption	0.3	0.5	–0.1	2.5	6.0	3.0	3.6	0.6	–2.2	5.9	6.2	7.1
Investment in fixed assets	4.7	5.2	0.4	–3.7	10.6	–6.5	–3.8	–7.4	–13.3	0.5	14.3	5.9
Construction	–1.4	–2.3	0.9	1.3	8.1	–9.5	–0.3	0.6	–3.4	17.1	1.3	–6.0
Equipment	10.1	11.1	0.1	–7.5	12.4	–4.3	–6.3	–13.0	–20.6	–11.7	26.8	16.5
Domestic final demand	**2.1**	**2.8**	**1.1**	**0.2**	**3.5**	**–0.0**	**0.2**	**–2.2**	**–2.8**	**2.0**	**5.9**	**3.1**
Domestic demand	**1.4**	**1.3**	**0.4**	**1.7**	**–5.6**	**–0.3**	**–3.5**	**7.1**	**5.9**	**–3.4**	**0.4**	**0.2**
Total exports	10.3	9.5	2.9	–10.0	6.4	16.2	–4.1	–27.4	–19.3	–7.8	13.8	6.4
Goods	11.1	8.4	2.6	–11.8	9.2	16.7	–3.7	–34.5	–22.8	–5.6	17.3	9.7
Excluding valuables[1]	11.2	8.3	2.1	–11.0	3.4	23.2	–9.6	–33.2	–20.5	–4.0	13.7	13.5
Services	8.4	12.5	3.4	–5.7	–0.2	15.0	–5.1	–7.4	–10.4	–12.6	6.1	–0.9
Aggregate demand	**4.5**	**4.3**	**1.4**	**–2.9**	**–1.1**	**5.9**	**–3.7**	**–7.9**	**–4.0**	**–5.0**	**5.0**	**2.4**
Total imports	6.5	6.0	0.4	–5.9	–8.8	17.4	–7.1	–18.1	–4.1	–14.5	12.3	1.2
Goods	7.8	5.1	–0.5	–8.5	–9.8	22.4	–10.3	–26.6	–1.1	–20.8	15.1	–0.3
Excluding valuables[1]	7.4	6.7	–1.0	–8.2	–9.7	20.1	–10.4	–23.3	–4.3	–20.1	17.2	–0.8
Services	0.6	10.3	4.8	5.9	–4.2	–3.6	9.4	31.6	–14.6	16.9	2.0	7.6
GDP	**3.6**	**3.6**	**1.8**	**–1.5**	**2.6**	**1.0**	**–2.1**	**–2.9**	**–4.0**	**–0.6**	**2.0**	**3.0**

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

Continued export recovery

Boosted by rising foreign demand, Swiss exports continued to pick up in the fourth quarter. However, only goods exports rose; exports of services stagnated. Taken together, exports of goods and services (excluding valuables) rose by 8.9%. Nevertheless, export volume was well below the pre-recession level.

The sustained high momentum in exports of goods gained a broader base in the fourth quarter. Driven by strong expansion in goods in transit, exports of capital goods rose for the first time since the start of the crisis. At the same time, exports of pharmaceuticals remained very dynamic, and made an appreciable contribution to growth as they now account for one-third of exports. Exports of commodities and semi-manufactured goods also experienced a continued upward momentum. The market breakdown shows that growth was more broadly based in the fourth quarter than in the previous quarter. Alongside the Asian economies, substantial contributions also came from Western Europe and the US.

The recovery in exports of services did not continue in the fourth quarter. Income from private insurance transactions and merchanting increased slightly, while tourism exports posted a perceptible rise in parallel with the increasing number of overnight stays by foreigners. However, since the banks' commission business with foreign customers remained weak, service exports as a whole saw a slight decline.

According to the KOF Swiss Economic Institute, order expectations brightened considerably in the manufacturing industry. The upturn in exports will therefore probably continue. On the other hand, the upswing is likely to lose some momentum in the face of a renewed deterioration in the ability of Swiss exports to compete on price. Thus, monthly growth in goods exports slowed somewhat up to January.

Decline in construction investment, but at a high level

Unlike the situation in many other countries, construction activity remained high throughout 2009, boosting GDP growth. Despite a slight quarter-on-quarter decline in the fourth quarter, it was still above the previous year's level. Mortgage rates

Chart 2.3
Contributions to export growth

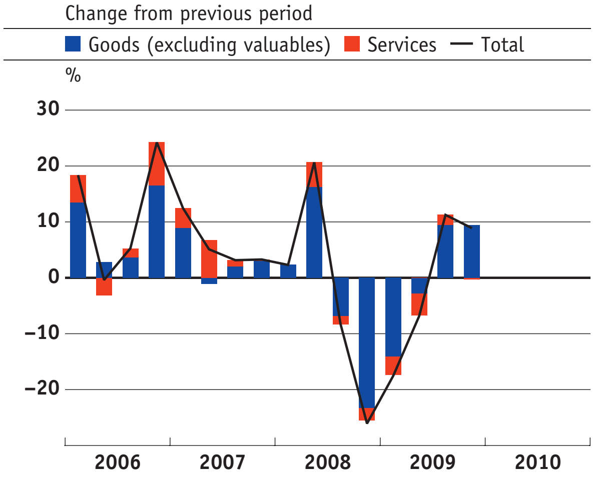


Chart 2.4
Expected new orders

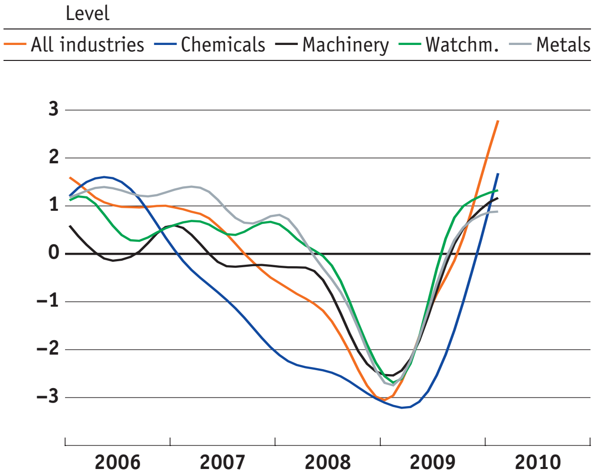


Chart 2.5
Goods exports, regional growth contributions

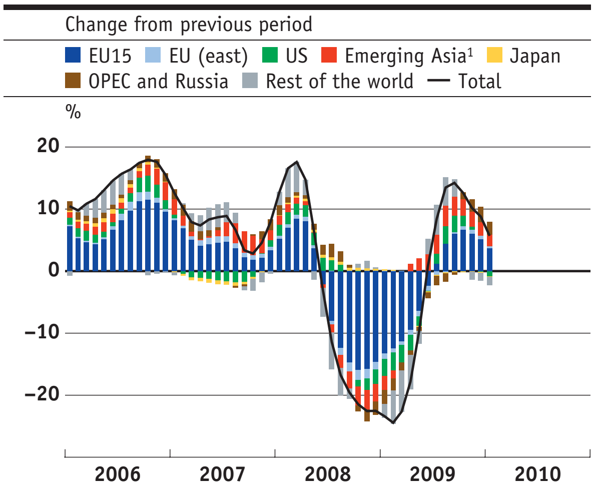


Chart 2.3:
Source: SECO

Chart 2.4:
Source: KOF Swiss Economic Institute

Chart 2.5:
1 Emerging Asia: China, Hong Kong, India, Indonesia, Malaysia, Philippines, Singapore, South Korea, Taiwan, Vietnam
Source: Federal Customs Administration (FCA)

continued to be very low and the fact that the rise in construction costs was only marginal meant that the favourable conditions for investment in residential real estate were practically unchanged. Civil engineering also remained robust in 2009, benefiting first and foremost from the economic stimuli adopted by the Swiss Confederation and the cantons. Only investment in commercial construction was very weak. This is confirmed by surveys by the Swiss Contractors' Association (SBV/SSE), which showed a substantial drop in both new orders and commercial construction activity. Nevertheless, there were signs of recovery in the fourth quarter.

Patchy growth in equipment investment

Growth in equipment investment slipped back slightly in the fourth quarter, having risen sharply in the third quarter. It became evident that, in this quarter too, growth in equipment investment can be explained largely by high demand for imported telecommunications appliances. Imports of other categories of capital goods were relatively weak, as was domestic production of capital goods. This indicates that industrial companies have hardly stepped up capital spending. This impression is supported by the survey data collected by the KOF Swiss Economic Institute. Capacity utilisation in the manufacturing industry only rose marginally in the fourth quarter and remained at an exceptionally low level. Moreover, the majority of manufacturing companies said that their technical capacity was more than adequate, suggesting that few are considering investing in equipment.

Robust growth in private consumption

Private consumption showed a quarter-on-quarter increase of 1.4% in the fourth quarter and was up 2.1% year-on-year. It once again proved a sound buttress of economic growth. Moreover, this growth was broadly based. Seasonally adjusted retail sales rose by 3% in the fourth quarter, with particularly strong demand for food and beverages. Sales of household goods and furniture were also robust, whereas demand for clothing and shoes remained weak. New car registrations increased in the fourth quarter, but the low figures in the first six months resulted in an overall decline in 2009. The picture was similar for domestic tourism, which is an indicator of demand for services. The seasonally adjusted number of overnight stays increased by 2.9% in the fourth quarter. However, over the full year, demand was down by around 2.5%.

Chart 2.6
Construction

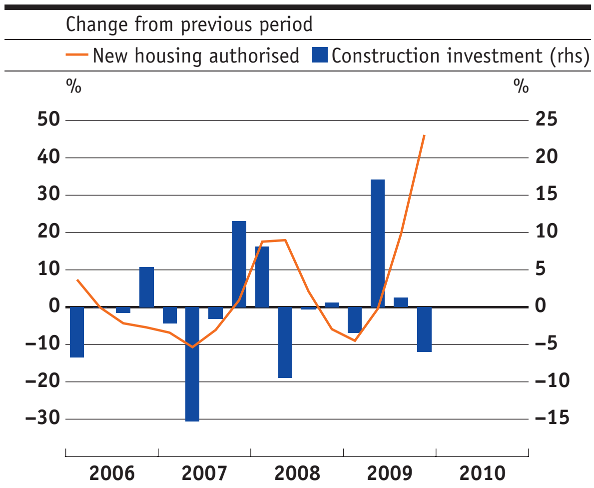


Chart 2.7
Mortgage rates and 3M Libor

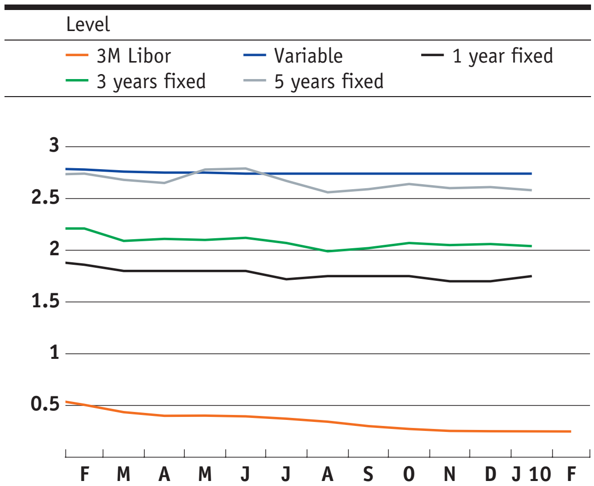


Chart 2.8
Equipment

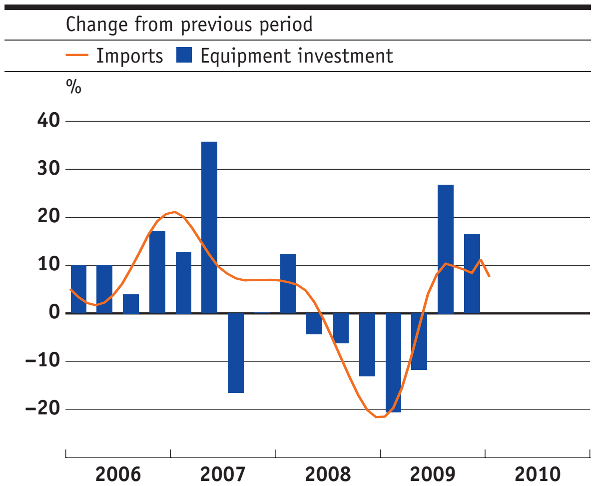


Chart 2.6:
Sources: SECO, SFSO

Chart 2.7:
Source: SNB

Chart 2.8:
Sources: FCA, SECO

Improvement in consumer confidence

Consumer confidence has improved significantly in recent quarters. In January, the internationally comparable index published by SECO since 2007 was at its highest level since spring 2008. However, the old index, which is also still calculated, shows that consumer confidence nevertheless remains well below the long-term average.

Expectations with regard to the general economic situation over the next 12 months have improved substantially. They were last at a similarly high level in 2007. There was also an improvement in expectations regarding changes in people's financial situation and – albeit at a very low level – unemployment.

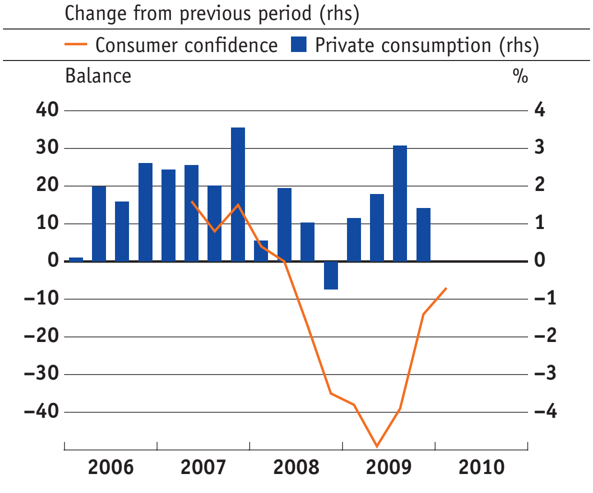
Stagnating imports

Imports grew strongly in the third quarter, but the recovery did not continue in the fourth quarter. Imports of goods and services (excluding valuables) only increased by 0.9%. This slowdown was principally due to a slight decline in imported goods compared with the third quarter. Imports of commodities and semi-finished products did not rise further, following strong growth in the previous quarter. The same applies to imports of capital goods, which had posted strong growth in the third quarter thanks to a large shipment of railway rolling stock. Finally, imports of consumer goods rose more slowly as faster growth in pharmaceutical imports was offset by a slowdown in imports of other categories of consumer goods.

Imports of services showed a modest rise in the fourth quarter. This was driven by a sharp rise in spending on licenses and patents, which traditionally fluctuates greatly. By contrast, imports of transport services remained low despite the upturn in trade, while foreign travel, which is recorded as tourism imports, slipped back from its high level.

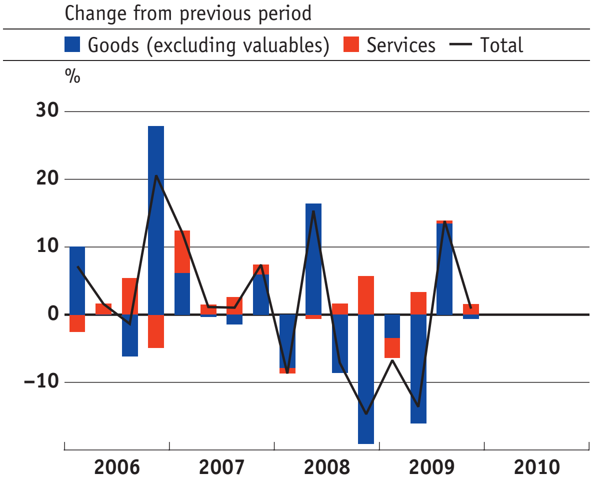
Since the situation in manufacturing remains fragile, the weakening of imports continued in January. However, the survey data compiled by the KOF Swiss Economic Institute indicate that expectations regarding purchases of preliminary products have improved. Consequently, imports of goods should increase again in the coming months.

Chart 2.9
Private consumption



Source: SECO

Chart 2.10
Contributions to import growth



Source: SECO

2.3 Employment and labour market

Slight increase in employment ...

Employment picked up in the fourth quarter, having declined in the three previous quarters. In terms of full-time equivalents, employment rose by 0.3%, after registering a 0.4% fall in the third quarter. Driven by strong growth in part-time employment, the number of people in employment rose by 0.6%, following a decline of 0.1% in the previous quarter.

Employment increased in most sectors, apart from the manufacturing industry, trade, transport and communications. The declines registered by these sectors were lower than in preceding quarters, however.

Overall, the number of people in employment increased by 0.1% in 2009, whereas full-time equivalent employment dropped by 0.1%. The sectors that posted the sharpest drop in employment in 2009 were the manufacturing industry (–2.8%), trade and repair of vehicles (–1.1%), the hospitality segment (–1.6%) and transport and telecommunications (–1.3%).

... and improved employment outlook

The improvement in the economic outlook is also reflected in the leading indicators for employment. The job vacancy index and the employment outlook indicator published by the Swiss Federal Statistical Office rose. The improvement covers almost all sectors. The development of these lead-

Chart 2.11
Employment

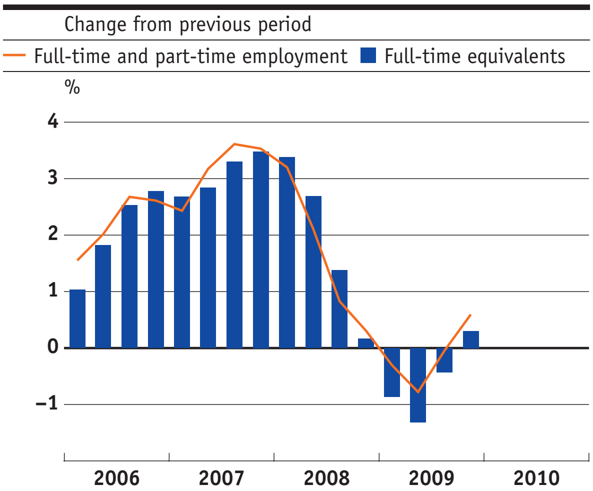


Chart 2.12
Employment outlook indicator

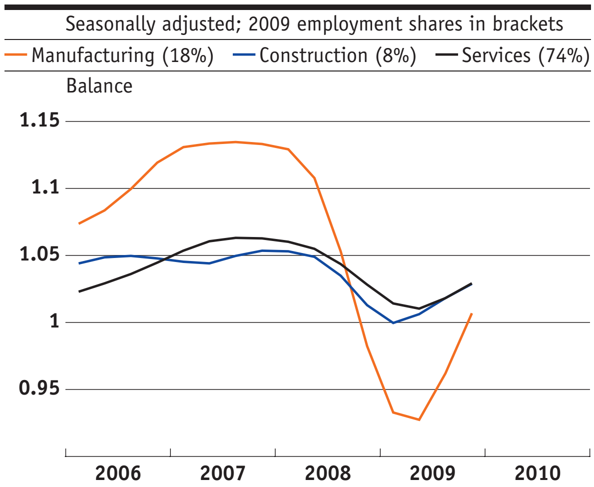


Chart 2.13
Unemployment and job seeker rates

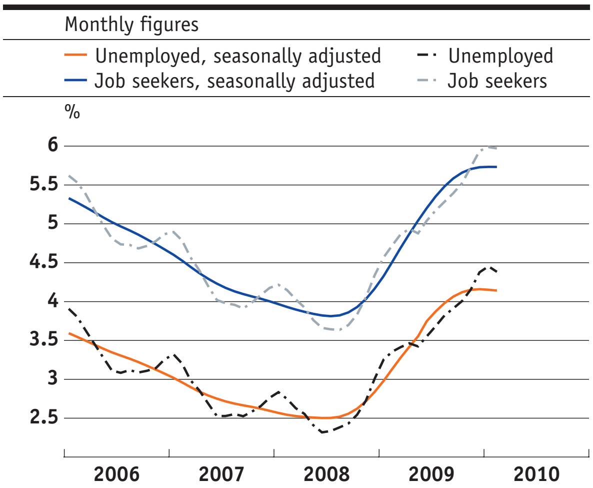


Chart 2.14
Short-time working

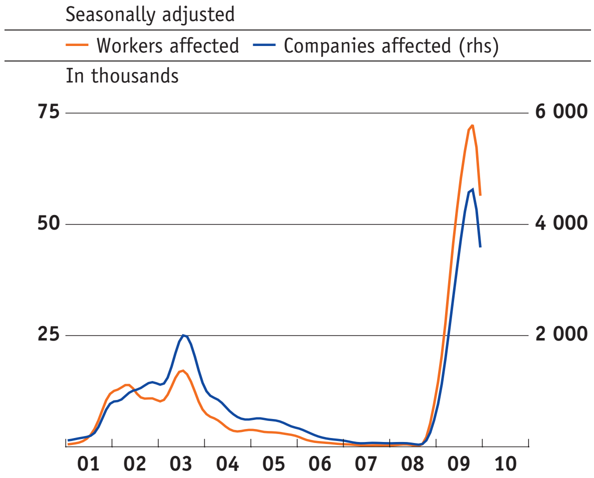


Chart 2.11:
Source: SFSO; seasonal adjustment: SNB

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).
Source: SECO

Chart 2.12:
Source: SFSO; seasonal adjustment: SNB

Chart 2.14:
Source: SFSO; seasonal adjustment: SNB

ing indicators points to modest growth in employment in 2010.

Unemployment stabilising

Unemployment stood at 4.3% both in February and in November. This stabilisation contrasts with the first three quarters in 2009, when the number of unemployed persons registered with the regional employment offices rose by an average of 5,000 persons per month on a seasonally adjusted basis. The percentage of job seekers, which, in addition to the registered unemployed, also includes people who are on training or employment programmes or have accepted an interim placement, amounted to 5.7% in February – which was no more than had already been registered in November.

The official unemployment figures measure only one aspect of under-employment. Although there were signs of a turnaround as early as last autumn, short-time working remained at a high level between October and December. On a seasonally adjusted basis, 3,500 companies were on short-time work in December, and 60,400 people were affected. The stabilisation of unemployment observed in the past few months gives rise to hopes that lay-offs of short-time workers will not be excessive.

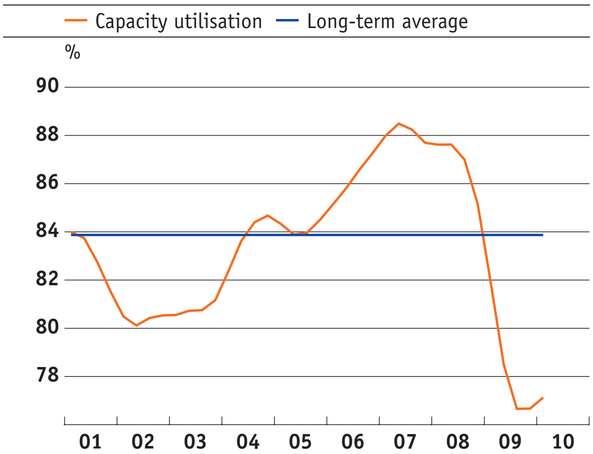
2.4 Capacity utilisation

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 the utilisation rate exceeds (falls below) the normal level for an extended period of time, this points to excess demand (excess supply) and, consequently, to greater (less) inflationary pressure.

Low industrial capacity utilisation

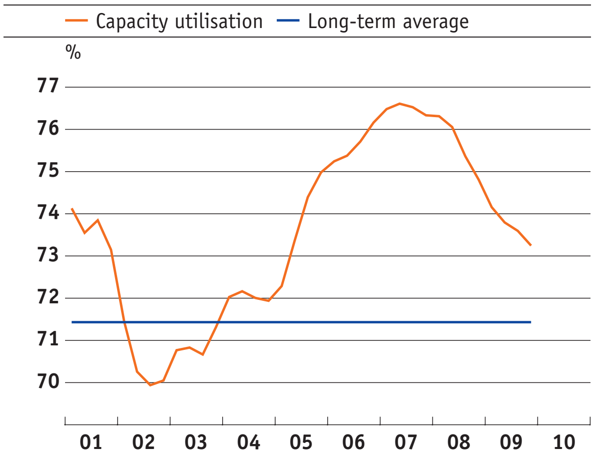
Capacity utilisation in the manufacturing industry only improved slightly in the fourth quarter according to survey data from the KOF Swiss Economic Institute. At 77.1% it was only 0.4 percentage points higher than in the third quarter and well below the long-term average of 83.9%. This indicates that industrial capital is still massively under-utilised, and suggests that the signs of a perceptible improvement have not yet really filtered through to production. The situation could hardly be more different in the construction sector. Here, utilisation of machinery and equipment was well above the long-term average. However, it declined further, pointing to a deceleration of the construction cycle in 2010.

Chart 2.15
Capacity utilisation in manufacturing



Source: KOF Swiss Economic Institute

Chart 2.16
Capacity utilisation in construction

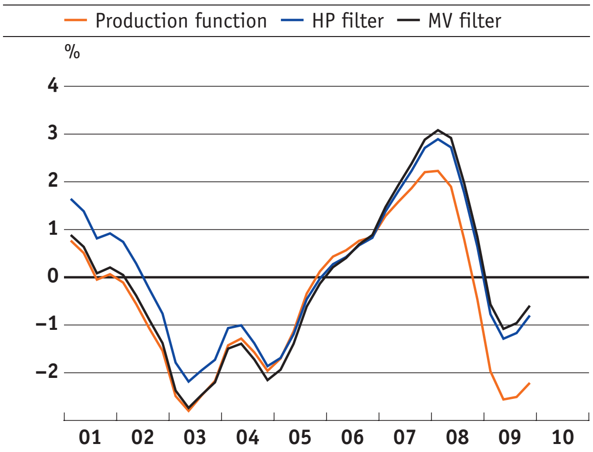


Source: KOF Swiss Economic Institute

Negative output gap

The continued deeply negative output gap saw a slight improvement in the fourth quarter. The production function (PF) approach indicates that production potential is under-utilised by 2.2%, while the Hodrick-Prescott (HP) filter and the multivariate (MV) filter indicate a more moderate – although still negative – output gap of –0.5%. Potential growth, which had declined slightly during the recession, continued to weaken in the fourth quarter. This can be explained principally by lower immigration and a lower participation rate. However, potential growth remains positive and is roughly comparable with the level seen in 2004 and 2005.

Chart 2.17
Output gap



Source: SNB

2.5 Prices and inflation expectations

Price index of aggregate supply driven by rising commodity prices

Overall, prices of total supply (producer and import prices) rose between November and January. Higher prices were mainly registered for energy goods and, to a lesser extent, agricultural produce and intermediate goods. While prices of consumer goods were stable, prices of capital goods declined, principally because of price reductions on imported processed metal goods. The price rises mainly affected goods at the beginning of the value chain, suggesting that there will not be any upward pressure on consumer prices in the short term.

Although prices of total supply rose between November and January, they remain lower than a year earlier. The decline was 3.3% in November, but only 1.3% in January.

CPI annual inflation rate of 0.9% in February

Annual inflation as measured by the national consumer price index (CPI) was 0.9% in February, as compared to 0.0% in November. The main reasons for this rise were the higher price of oil products, combined with a favourable base effect. The price of oil products dropped significantly into the first quarter of 2009, but have been edging up again since then. When oil products are excluded, annual inflation was virtually stable at 0.4% in February.

Measured by the domestic goods and services included in the CPI, domestic inflation stabilised in February, following a significant drop between the third and fourth quarters. The stabilisation was partly attributable to the higher price of electricity and of hotel and restaurant services. By contrast, rent increases of 1.2% (year-on-year) in February were somewhat lower than in the previous months.

Annual CPI inflation in imported goods and services was positive in January (1.4%) for the first time since October 2008. In February, due to lower fuel and heating oil prices, imported inflation fell to 1.2%. When oil products are excluded, however, the inflation rate was still negative (–0.8%), mainly due to lower prices for gas and electronic items.

Chart 2.18
Prices of total supply

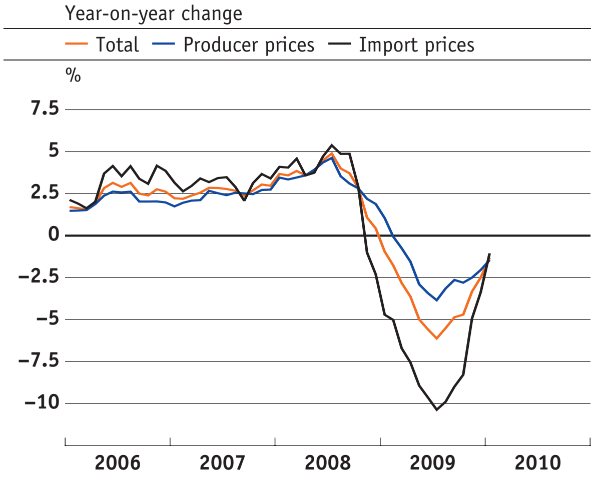


Chart 2.19
CPI: domestic and imported goods and services

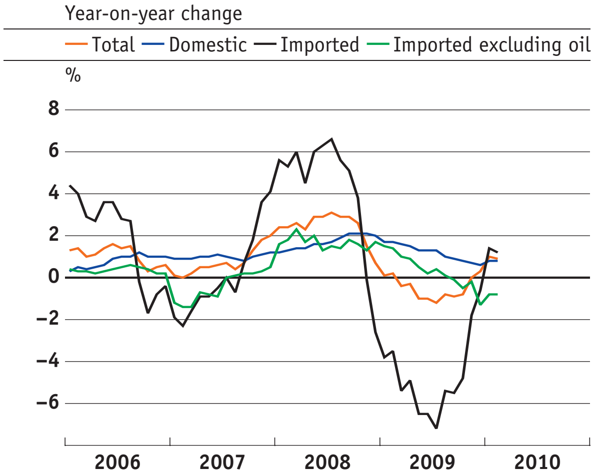


Chart 2.20
CPI: domestic goods and services

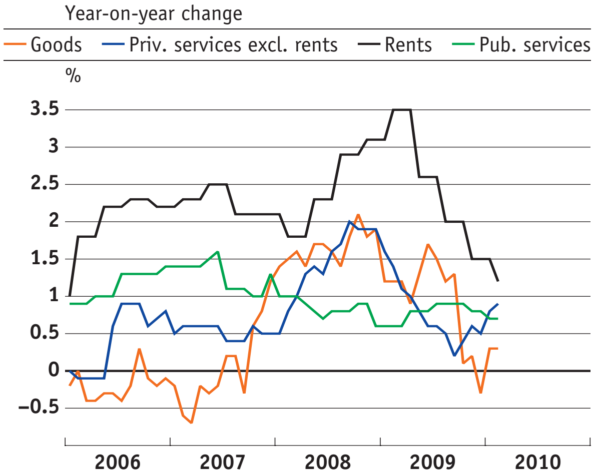


Chart 2.18:
Source: SFSO

Charts 2.19 and 2.20:
Sources: SFSO, SNB

Stable core inflation

Inflation, as measured by the CPI, is subject to numerous short-term fluctuations that may distort perceptions of the general price trend. To counter this, core inflation rates are calculated with the aim of capturing the longer-term price movements. The SNB computes two measures of core inflation (cf. chart 2.21): 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 change. The broader-based dynamic factor inflation (DFI), by contrast, extracts underlying inflation using a wide range of prices, data on the real economy, financial market indicators and monetary variables. The two core inflation rates calculated by the SFSO, in their turn, always exclude the same price-volatile goods from the basket of goods in each period (cf. chart 2.22). In the case of core inflation 1 (SFSO1), these are food,

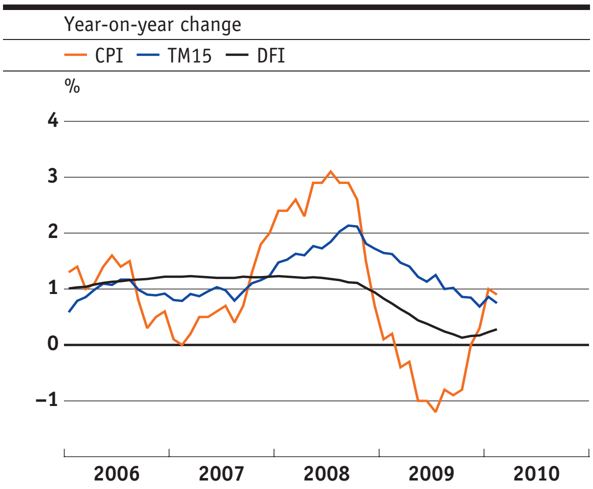
National consumer price index and components
Year-on-year change in percent

Table 2.2

	2008	2008 Q2	Q3	Q4	2009 November	December	2010 January	February
Overall CPI	**–0.5**	**–0.7**	**–1.0**	**–0.2**	**0.0**	**0.3**	**1.0**	**0.9**
Domestic goods and services	1.2	1.4	1.1	0.7	0.7	0.6	0.8	0.8
Goods	1.0	1.3	1.3	0.0	0.2	–0.3	0.3	0.3
Services	1.3	1.4	1.0	0.9	0.9	0.8	1.0	0.9
Private services excluding rents	0.8	0.8	0.5	0.5	0.6	0.5	0.8	0.9
Rents	2.5	2.9	2.2	1.6	1.5	1.5	1.5	1.2
Public services	0.8	0.8	0.9	0.8	0.8	0.8	0.7	0.7
Imported goods and services	–4.7	–6.0	–6.0	–2.4	–1.8	–0.6	1.4	1.2
Excluding oil products	0.3	0.6	0.1	–0.7	–0.2	–1.3	–0.8	–0.8
Oil products	–25.9	–32.1	–30.5	–10.9	–8.8	3.4	15.7	13.4

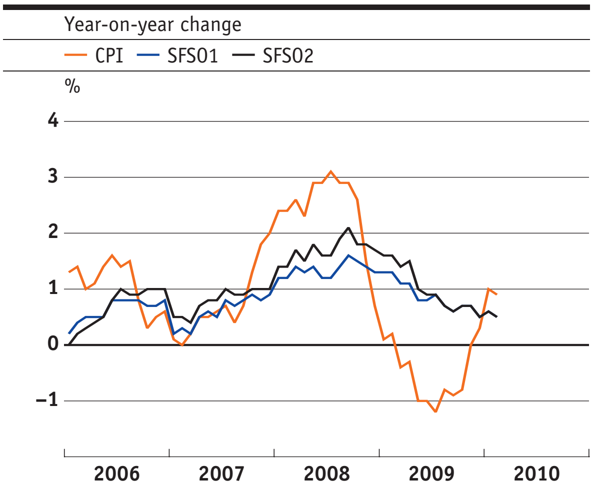
Sources: SFSO, SNB

Chart 2.21
Core inflation rates (SNB)



Sources: SFSO, SNB

Chart 2.22
Core inflation rates (SFSO)



Source: SFSO

beverages, tobacco, seasonal products, energy and fuel; core inflation 2 (SFSO2) additionally factors out products with administered prices.

The different core rates of inflation changed only slightly between November and February and – with the exception of the DFI – came to between 0.5% and 1.0% in February. The DFI reached its low (0.1%) in October and had risen slightly to 0.3% by February. The DFI thus indicates that the risk of deflation has receded somewhat.

Low inflation expectations

Inflation expectations of companies and households are appraised on the basis of various surveys. The quarterly survey by the KOF Swiss Economic Institute relies on a survey of senior employees from companies active in Switzerland, as does the PMI. Accordingly, the results show how companies anticipate developments in purchase and sale prices over the coming three months. While expectations of falling prices predominated for several quarters, both wholesaling and manufacturing industry recently showed an overriding expectation of higher purchasing prices (cf. chart 2.23). A similar picture is provided by the 'purchasing prices' component of the monthly PMI, which has rebounded markedly since reaching its low-water mark in February 2009, and was back above the long-term average in February. Although survey data from the KOF Swiss Economic Institute show a similar shift in the weighting of sale prices, in the last survey slightly more than half of companies still expected prices to decline rather than rise (cf. chart 2.24).

The quarterly SECO survey of Swiss households measures the expected price trend over the coming 12 months from the viewpoint of consumers. The results published in January indicated that inflation expectations were largely unchanged from the previous survey (cf. chart 2.25). Over the past four quarters, there has been a substantial drop in the proportion of surveyed housholds that expected prices to fall. At the same time, the number of participants expecting moderate price rises has increased. There was virtually no change in the proportion expecting stable or sharply rising prices. Almost half of those surveyed expected prices to remain stable, while only a few anticipated a sharp rise. At the consumer price level, therefore, inflation expectations for the coming year are very moderate.

Chart 2.23
Expected purchase prices

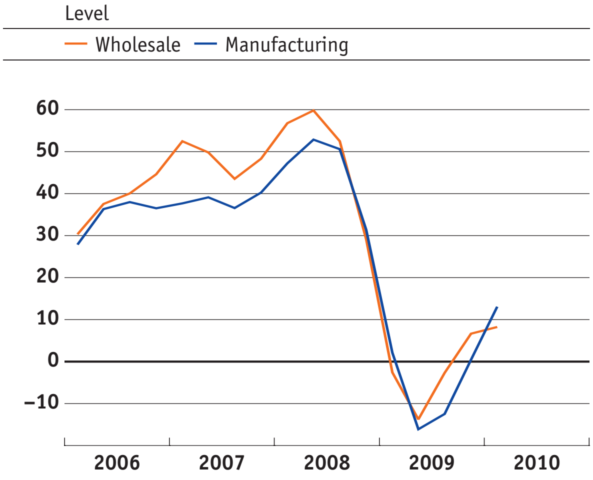


Chart 2.24
Expected sale prices

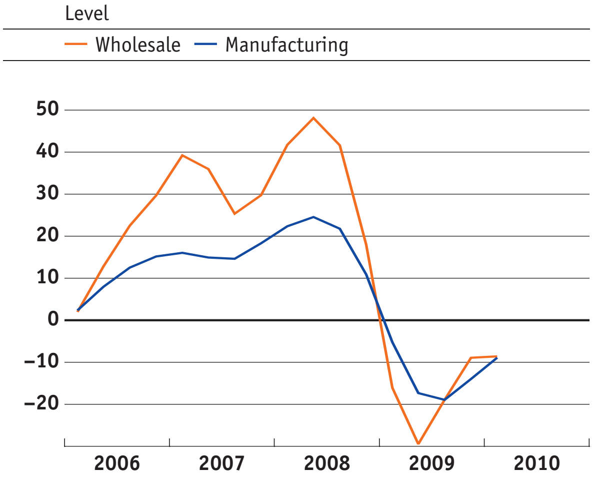
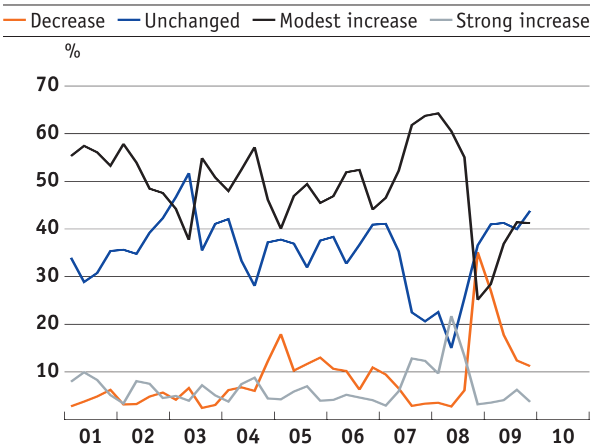


Chart 2.25
Survey on expected movements in prices



Charts 2.23 and 2.24:
Source: KOF Swiss Economic Institute

Chart 2.25:
Sources: SECO, SNB

2.6 Outlook for the real economy

Moderate economic upswing

The SNB anticipates that Swiss GDP will grow by roughly 1.5% in 2010, following a decline of 1.5% in 2009. With potential growth remaining positive, if weaker, the expected increase in GDP would not be sufficient to close the estimated overall output gap by the end of 2010.

Domestic demand will probably be the prime factor driving GDP growth in 2010. Since the recovery is proving sluggish in many major European countries and the Swiss franc has appreciated on the currency markets, net exports will probably make a modest contribution to growth.

At present, the upside and downside risks are relatively balanced. On the one hand, global trade could recover faster, giving a boost to Swiss exports. On the other hand, it is not impossible that economic growth will stall again when government stimulus programmes come to an end. Similarly, an unexpectedly strong hike in raw material prices or an excessive appreciation of the Swiss franc could hamper the anticipated recovery.

3 Monetary developments

3.1 Interest rates

Summary of monetary policy since the December assessment

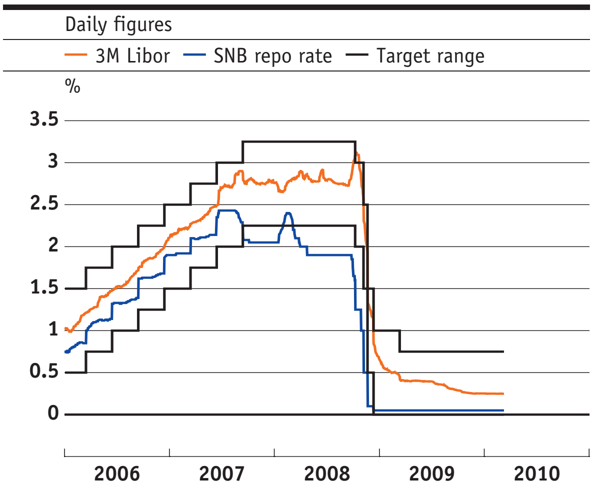
At the monetary policy assessment in December, the SNB decided to leave the target range for the three-month Libor unchanged at 0.0–0.75%, and to continue to aim for a three-month Libor of 0.25%. It also announced that it would continue to provide the economy with a generous supply of liquidity, but would discontinue its purchases of Swiss franc bonds issued by private sector borrowers. Moreover, it affirmed its intention to counter any excessive appreciation of the Swiss franc against the euro.

In response to improving conditions on the short-term money markets, a number of other measures were taken to normalise monetary policy. In January 2010, the SNB, in coordination with other central banks, confirmed the expiration of its temporary reciprocal currency arrangements (swap lines) with the US Federal Reserve as of 1 February 2010, following an improvement in conditions on US dollar funding markets over the past year. The purpose of these swap arrangements had been to counter the tense situation on US dollar funding markets around the world. The central banks will continue to work together where necessary. In agreement with the Federal Reserve, the European Central Bank, the Bank of England and the Bank of Japan, the SNB discontinued its US dollar repo auctions with effect from 31 January 2010. The SNB also announced, jointly with the European Central Bank, the National Bank of Poland and the Hungarian central bank, that it was discontinuing its EUR/CHF currency swaps, as conditions on the Swiss franc funding market had improved. The last of these swap transactions was performed on 25 January 2010. However, banks based in Switzerland and abroad still have access to Swiss franc liquidity via the Swiss franc repo system and the interbank market.

As in previous quarters, the SNB continued to issue SNB Bills in Swiss francs on a weekly basis, to absorb Swiss franc liquidity in a targeted manner. Only SNB Bills with terms of seven days have been placed in recent quarters. On average, CHF 13.9 billion was absorbed through SNB Bill auctions in December 2009 and January 2010 (bids amounted to CHF 15.3 billion). The average marginal yield per auction was 0.026%.

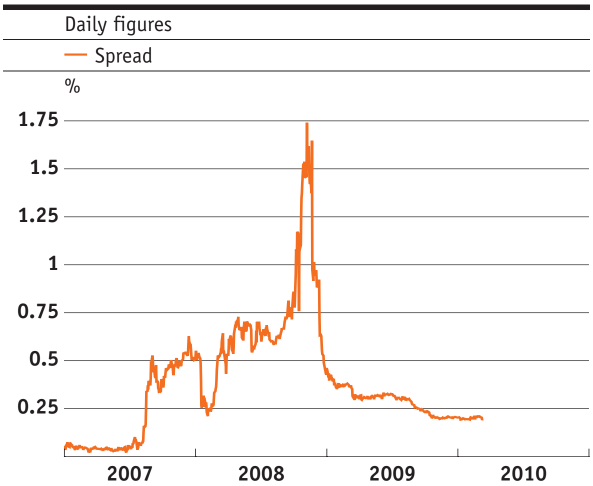
In addition, the SNB continued to issue its own debt securities in US dollars (SNB USD Bills). These securities were issued at fortnightly intervals and have terms of 28, 84 and 168 days. In mid-March, the outstanding volume amounted to around USD 17 billion. The SNB USD Bills' premium over the yield on the corresponding US Treasury bonds widened slightly in the fourth quarter of last year, especially for longer maturities. Since the monetary policy assessment in December, however, it has been broadly unchanged.

Chart 3.1
Money market rates



Sources: Reuters, SNB

Chart 3.2
Spread between 3M Libor and OIS



Sources: Bloomberg, Reuters

Calm on money markets

Interest rates in the unsecured Swiss franc money market showed little change over the past three months. Between mid-December and mid-March, the three-month Swiss franc Libor remained close to the targeted level of 0.25% (cf. chart 3.1). Money market risk premia stayed stable, as evidenced by the fact that the spread between the three-month Libor and the corresponding overnight index swap (OIS) remained broadly unchanged at around 0.20%. Chart 3.2 shows that, while the spread continues to be slightly elevated relative to its pre-crisis level, it is significantly below the record level of 1.74% reached after the collapse of Lehman Brothers.

Rates on the secured Swiss franc interbank market also showed very little movement over the past three months, due to the continuing generous supply of liquidity from the SNB. In August 2009, the SNB and SIX Swiss Exchange Ltd launched a new series of Swiss franc reference interest rates based on the Swiss secured interbank money market. Chart 3.3 plots developments in different maturities of the Swiss Reference Rates since their introduction. The Swiss Average Overnight Rate (SARON) fluctuated around 0.03% in the reporting period while the one-week market rate, SAR1W, at just below 5 basis points, was close to the SNB's one-week repo rate.

Yield curve slope relatively steep in historical terms ...

The yield on 10-year Swiss Confederation bonds fell slightly between mid-December and mid-March, to 1.8%. As short-term interest rates showed very little change, the term spread (difference between short-term and long-term interest rates) narrowed slightly over the past three months. The term spread, as measured by the difference between the three-month Libor and the yield on 10-year Swiss Confederation bonds, is plotted in chart 3.6 and provides a summary measure of the steepness of the yield curve. In mid-March it stood at around 1.5 percentage points, after recovering early last year from the record low levels reached during the crisis. The term spread is still high in historical terms, and reflects the expansionary monetary policy stance.

Chart 3.3
Swiss Reference Rates

Weekly averages

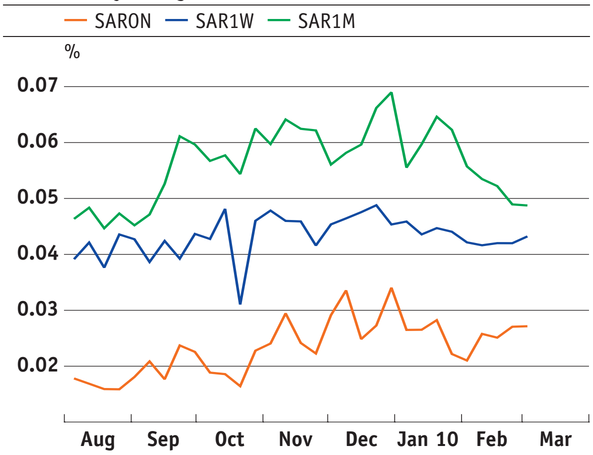


Chart 3.4
Term structure of Swiss Confederation bonds

Years to maturity (hor. axis). Annually compounded nominal discount bond yield in percent p.a. (vert. axis)

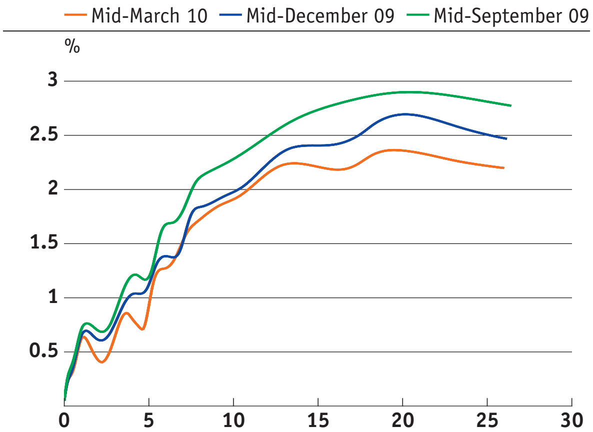


Chart 3.5
Spreads between international short-term interest rates

3M Libor spread between foreign currency and CHF, daily figures

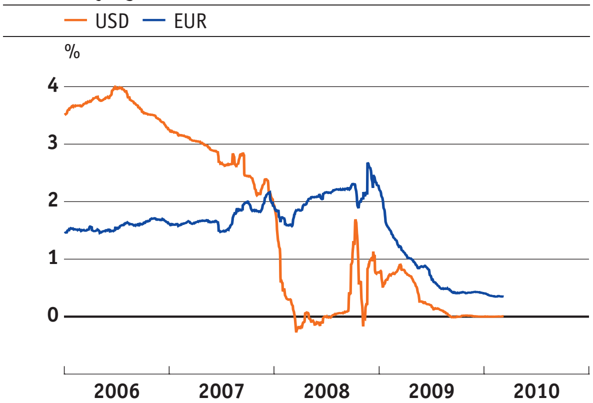


Chart 3.3:
Source: SIX Swiss Exchange AG

Chart 3.4:
Source: SNB

Chart 3.5:
Sources: Reuters, SNB

... but moderate in an international comparison

At the international level too, short-term interest rates remained unchanged, resulting in essentially unchanged Swiss short-term interest rate spreads vis-à-vis the euro and dollar (cf. chart 3.5). In contrast to developments in Switzerland, however, long-term government bond yields have risen in some other countries, probably due to fiscal concerns. This has resulted in a widening of foreign sovereign yield spreads vis-à-vis Swiss government bonds for a number of countries. As a consequence, term spreads in the rest of the world continued to increase over the past quarter (cf. chart 3.6). In the US, the term spread was around 3.5 percentage points in mid-March, the highest level seen since 2004.

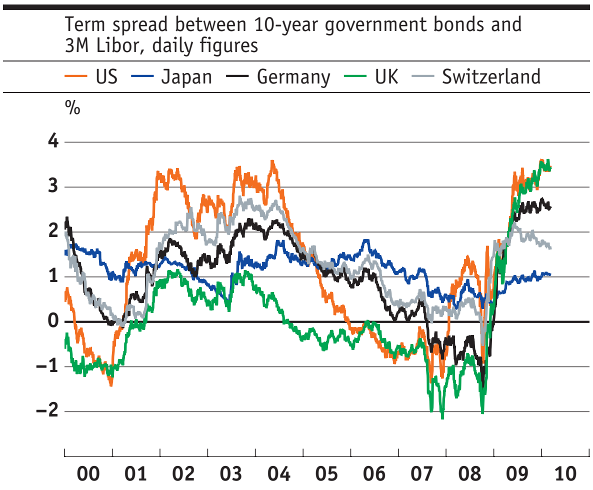
Corporate bond yields declined further

In line with developments on international markets, Swiss franc corporate bond yields declined further in the reporting period, as all rating categories benefited from improvements in credit conditions and corporate results. However, in mid-March the spread between higher and lower-rated corporate bonds was still higher than in summer 2007, before the crisis.

Real interest rates remain low

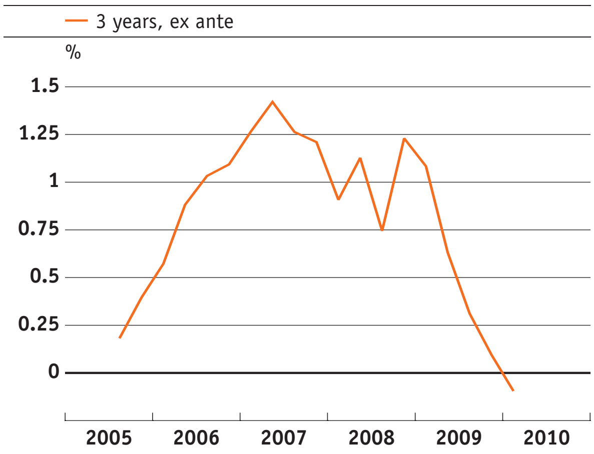
The real interest rate is a key determinant of the saving and investment behaviour of companies and households, and is thus important for future business cycle developments. Chart 3.7 plots the three-year real interest rate, defined as the difference between the three-year nominal interest rate and the expected rise in consumer prices over the same period. Inflation expectations are approximated by an average of the unconditional forecasts obtained from various SNB models. Since the nominal interest rate for three-year maturities has dropped slightly and forecast inflation has edged upwards, the three-year real interest rate has decreased further, to –0.1% in the first quarter of 2010. The real interest rate is still very low in historical terms, and is having a stimulating effect on economic activity.

Chart 3.6
Term spreads



Sources: SNB, Thomson Financial Datastream

Chart 3.7
Estimated real interest rate



Source: SNB

3.2 Exchange rates

Strengthening of the US dollar

The leitmotif of the foreign exchange market since the last monetary policy assessment in mid-December 2009 has been a strengthening dollar. Most obviously seen against the euro, the dollar gained 8.0% between mid-December and mid-March. This contrasts with the dollar's prior weakening between mid-March 2009 and December 2009.

The Swiss franc has also depreciated against the dollar. In mid-March, it was 4.7% lower than its mid-December value, but virtually unchanged relative to its 2009 average. The CHF/EUR rate has, in comparison, been steadier. Between mid-December 2009 and mid-March 2010, the Swiss franc gained 3.3% against the euro and 3.2% compared to its average for 2009 as a whole. Recent movements of the franc against the euro should, however, be seen in the light of the unconventional measures put in place by the SNB in mid-March 2009 to prevent any further appreciation of the Swiss franc relative to the euro.

Effective nominal appreciation during the crisis

In nominal effective (trade-weighted) terms, in January 2010 the Swiss franc was 2% above its 2009 average, and 12% above its pre-crisis level of August 2007 (cf. chart 3.9). Nearly the same is true of the real effective rate. Over a longer horizon, the real effective rate has been trading around a stable average since the mid-1990s. Real exchange rate relations tend to be stable in the long run, as movements in nominal exchange rates are largely offset by inflation differentials between different economic areas.

Chart 3.8
Exchange rates

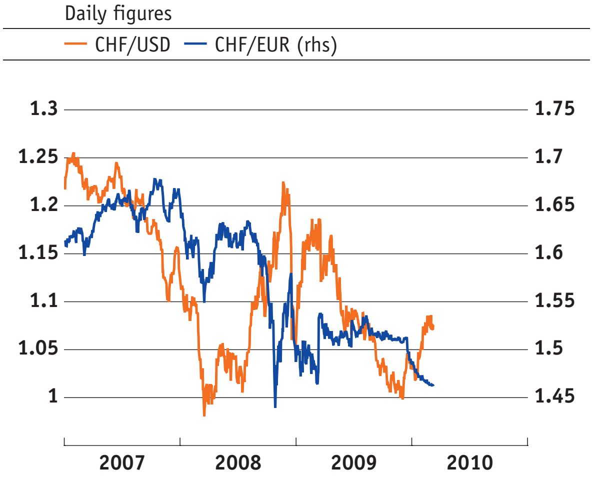


Chart 3.9
Trade-weighted external value of Swiss franc

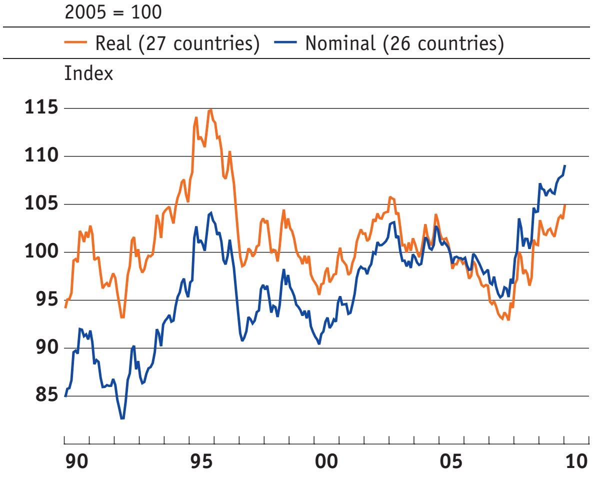
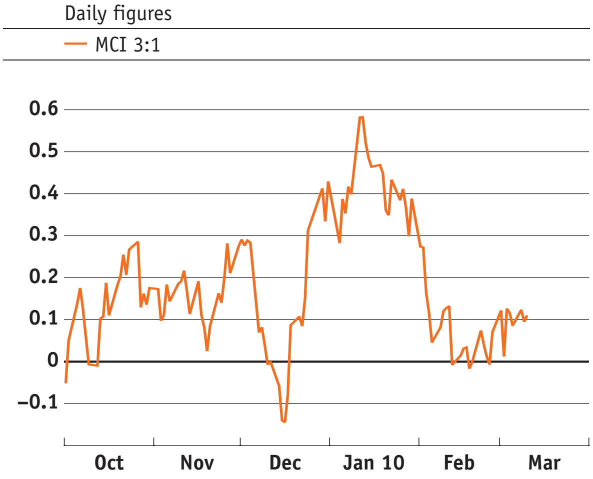


Chart 3.10
MCI nominal



Charts 3.8 and 3.10:
Source: SNB

Chart 3.9:
Source: Bank for International Settlements

Somewhat tighter monetary conditions

The Monetary Conditions Index (MCI) combines the three-month Libor and the trade-weighted nominal external value of the Swiss franc to provide a measure of the monetary conditions affecting the Swiss economy. 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 (MCI)', *Quarterly Bulletin* 1/2004, p. 27).

With a 3:1 ratio of changes in the three-month Libor to changes in the trade-weighted nominal external value of the Swiss franc, in mid-March 2010 the MCI indicated somewhat tighter monetary conditions, as a result of a slight appreciation in the nominal effective exchange rate combined with a practically unchanged three-month Libor (cf. chart 3.10).

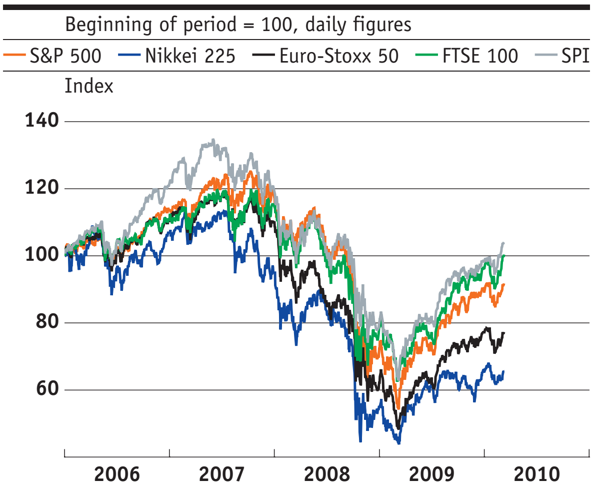
3.3 Equity, commodity and real estate prices

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 level 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.

International equity markets move upwards

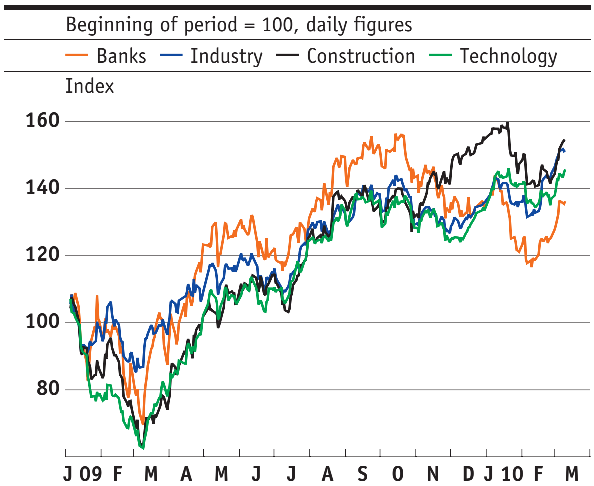
Prices on the main global equity markets have risen in recent months. Between mid-December 2009 and mid-March 2010, the US S&P 500 rose by 4% and the European Euro-STOXX 50 index was up 5%, while the Swiss Performance Index (SPI) recorded even stronger gains with 8%. However, fluctuations in prices were registered in the period under review. Economic indicators, such as unemployment rates in Europe, as well as uncertainty about public deficits in some European countries weighed on equity indices from time to time.

Chart 3.11
Share prices



Sources: Bloomberg, Thomson Financial Datastream

Chart 3.12
Selected SPI sectors



Source: Thomson Financial Datastream

An analysis of the SPI components shows that small, mid and large caps all made gains that were of roughly the same size. However, the breakdown by sector reveals clear differences. While the shares of manufacturing companies rose by 16%, those of financial services providers only increased by 1%. More generally, consumer spending in Switzerland remained relatively resilient in 2009. Thus, sectors and firms focused on the domestic economy, in particular, were spared the most severe effects of the crisis.

Volatility in the equity markets represents a measure of market uncertainty. Chart 3.13 shows the expected volatility for the next 30 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. Since the December monetary policy assessment, the VIX has fallen slightly to 19. It is thus still well below its pre-crisis highs and lies roughly at the level of its long-term historical average.

Slightly higher oil price

Most commodity prices have been trending sideways. However, energy prices have risen substantially in the past three months, while cereals have dropped by 7%. The oil price rose from USD 72 per barrel in mid-December 2009 to USD 79 per barrel in mid-March. The gold price was trading at around USD 1,125 per ounce in mid-March, as in mid-December, but below the high seen in early December 2009.

Mixed price trends for real estate

Nominal rents and real estate prices continued to display mixed trends in the fourth quarter of 2009. Prices for owner-occupied apartments rose by 6.7%, while those for single-family homes were up by 6%, but Switzerland's housing market is for the most part made up of rental apartments, and the increase in rents was rather more modest (2.9%). However, rental costs for new apartments, which are a better reflection of market forces, fell by 8% in the fourth quarter, the fourth successive quarterly decline. Rents for commercial property likewise recorded their fourth successive decline in the reporting period, falling by 4.8%. By contrast, office rents rose by 6.6%.

Chart 3.13
Volatility of equity returns

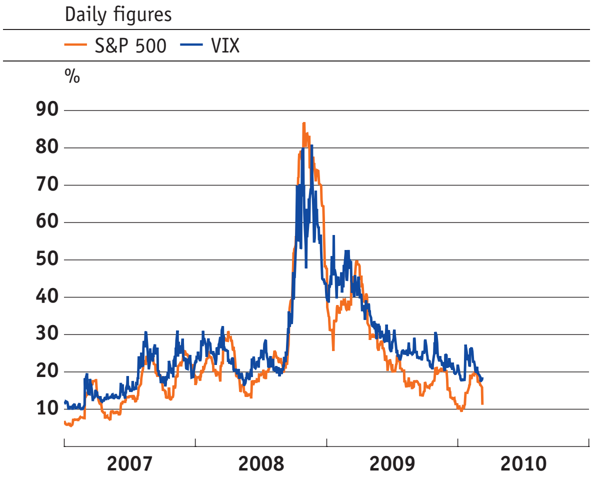


Chart 3.14
Nominal real estate prices and rents

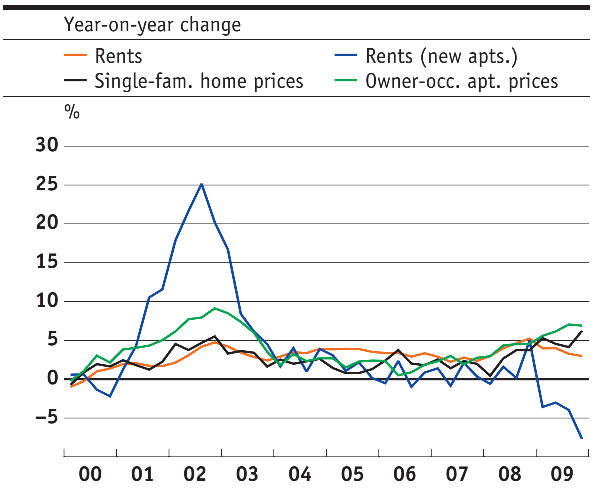


Chart 3.15
Nominal commercial and office rents

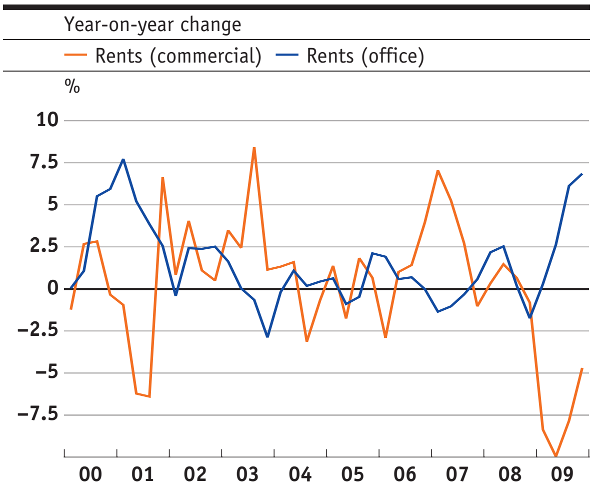


Chart 3.13:
Sources: SNB, Thomson Financial Datastream

Charts 3.14 and 3.15:
Source: Wüest & Partner

3.4 Monetary aggregates

Fall in demand for base money

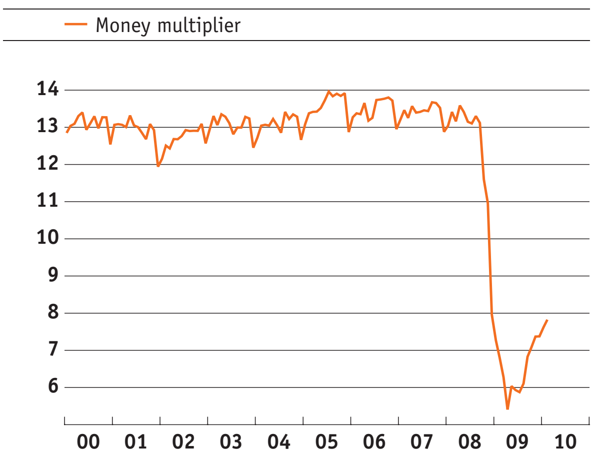
Banks' demand for liquidity has declined in recent months, so the SNB has reduced their sight deposits. The monetary base, consisting of banks' sight deposits at the SNB plus banknotes in circulation increased significantly between September 2008 and April 2009 but has been declining since then. However, the monetary base is still considerably higher than it was before the crisis, underscoring the continued uncertainty.

Before the crisis, the ratio of the monetary base to the broadly defined monetary aggregates was very stable, as is clear from the path of the M3 money multiplier (cf. chart 3.16). The M3 money multiplier is a quotient of the M3 aggregate and the monetary base. It expresses the extent to which, on the basis of the liquid funds available to them, banks are able to multiply the amount of money available to the general public through lending. Since the outbreak of the financial crisis, banks have scaled down their interbank lending activity and are holding greater supplies of liquidity for precautionary reasons. This is reflected in a sharp decline in the money multiplier. However, the multiplier is gradually approaching its normal value because the SNB has reduced banks' sight deposits and thus absorbed liquidity. The multiplier's increase towards its normal value is not worrying from a monetary policy perspective as it is caused primarily by a decline in the monetary base rather than by increased money creation on the part of banks.

Expansion of broad monetary aggregates

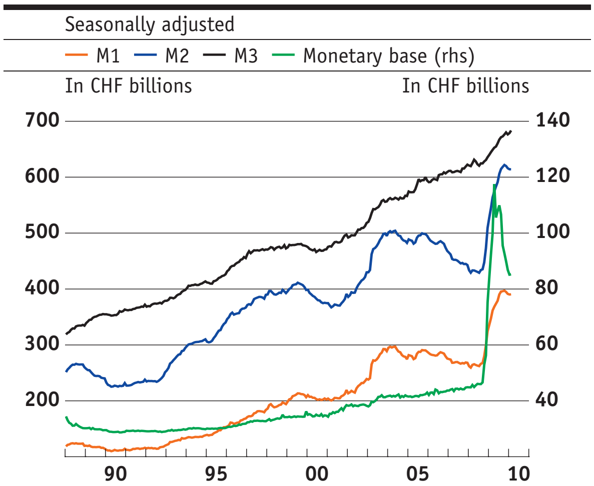
The broader monetary aggregates (M1, M2 and M3) recently exceeded their trend levels (cf. chart 3.17), and are now significantly above these levels. After strong growth in 2003–2005, both M1 (notes and coins in circulation, sight deposits and transaction accounts) and M2 (M1 plus savings deposits) declined until summer 2007 as a result of rising interest rates. From autumn 2007 onwards, both of these monetary aggregates stabilised in line with the flatter path of short-term interest rates. However, following the most recent interest rate reductions, M1 and M2 began to grow strongly again. In February, M1 was 12.5% above the year-back level, while M2 was up by 12.9%. M3 (M2 plus time deposits), which is typically less volatile than the other aggregates, expanded by 6.1% (cf. table 3.1).

Chart 3.16
Money multiplier M3



Source: SNB

Chart 3.17
Monetary aggregates



Source: SNB

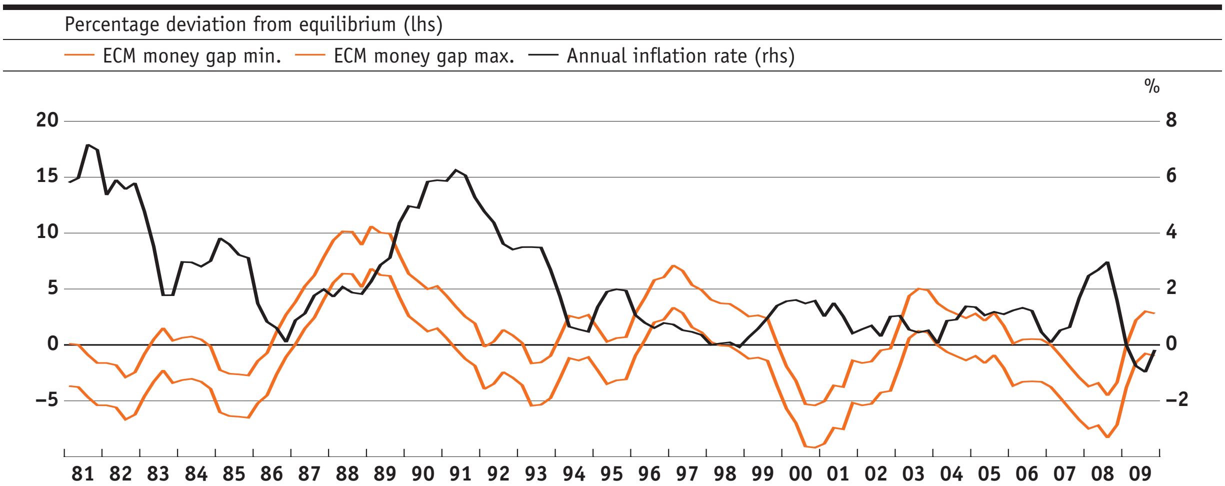
Monetary aggregates[1]

Table 3.1

	2008	2009	2008	2009				2009	2010	
			Q4	Q1	Q2	Q3	Q4	December	January	February
Monetary base[2]	**49.6**	**99.1**	**61.7**	**92.9**	**110.2**	**103.0**	**90.1**	**89.2**	**87.0**	**85.5**
Change[3]	*12.1*	*99.9*	*37.8*	*102.9*	*142.6*	*127.4*	*46.1*	*15.2*	*1.2*	*−7.7*
M1[2]	**273.1**	**377.2**	**302.2**	**355.2**	**375.4**	**383.0**	**395.3**	**396.7**	**399.5**	**401.1**
Change[3]	*1.5*	*38.1*	*12.5*	*33.3*	*41.5*	*48.2*	*30.8*	*20.7*	*16.3*	*12.5*
M2[2]	**443.1**	**589.7**	**475.8**	**554.9**	**586.4**	**599.5**	**617.8**	**621.0**	**626.2**	**629.0**
Change[3]	*−1.6*	*33.1*	*7.3*	*26.5*	*35.0*	*41.5*	*29.8*	*21.0*	*16.5*	*12.9*
M3[2]	**626.0**	**662.1**	**631.3**	**648.3**	**657.9**	**664.7**	**677.4**	**678.6**	**683.1**	**689.7**
Change[3]	*2.2*	*5.8*	*2.0*	*3.7*	*4.5*	*7.5*	*7.3*	*6.4*	*6.1*	*6.1*

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

Chart 3.18
Money gap and annual inflation rate



Source: SNB

Higher inflation rates in the medium term

One way of assessing potential inflationary or deflationary risks resulting from an excessive or insufficient supply of liquidity to the economy is to calculate the money gap. This corresponds to the positive (monetary overhang) or negative (money gap) percentage deviation 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 3.18 shows the money gap in the form of a range that spans one standard deviation, thereby taking account of statistical uncertainty. According to this measure, the money gap closed in the second quarter of 2009. The zero line may still have been within the range during the fourth quarter, but the general picture is one of monetary overhang, indicating that higher medium-term inflation may be expected.

3.5 Credit

Stronger growth in lending

Credit growth rates increased in the fourth quarter of 2009, for the first time since the end of 2007. This was principally attributable to mortgages: here there was a continuation of the rise in demand (5.1%) that has persisted since October 2008 as a result of declining interest rates. As in the previous quarter, other loans declined by 3.2% on cyclical grounds.

Chart 3.20 shows how declining interest rates affect the terms of mortgages. When interest rates are low, long-term, fixed-rate mortgages tend to be preferred to those with variable interest rates. In October 2008, redeemable mortgages, which mainly comprise those with variable rates, still accounted for 30% of the total. By December 2009, they made up just 16% of total mortgages. In keeping with this, the proportion of mortgages with a remaining term of one to five years increased from 38% to 50% in the same period.

Breaking down lending by companies and households shows that loans to households grew faster, while loans to companies stabilised (cf. chart 3.21). The annual rate of growth in loans to households rose to 4.3% in the fourth quarter of 2009, driven mainly by mortgage loans. By contrast, other types of household loan, which account for less than 6% of the total, continued to contract significantly. Growth in corporate lending slowed from over 9% in the first quarter of 2009 to 3.1% in the fourth quarter. This was mainly attributable to other loans, which showed a slight decline in the fourth quarter, the first downturn since 2005.

The survey which the SNB conducts with banks every quarter shows that the phase associated with stringent lending conditions is nearing an end. For the second quarter in succession, the banks reported no further noticeable tightening.

Chart 3.19
Growth in bank loans

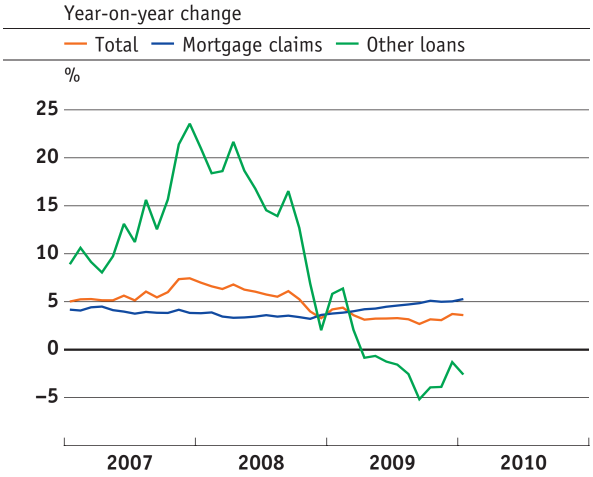


Chart 3.20
Share of mortgages by term to maturity

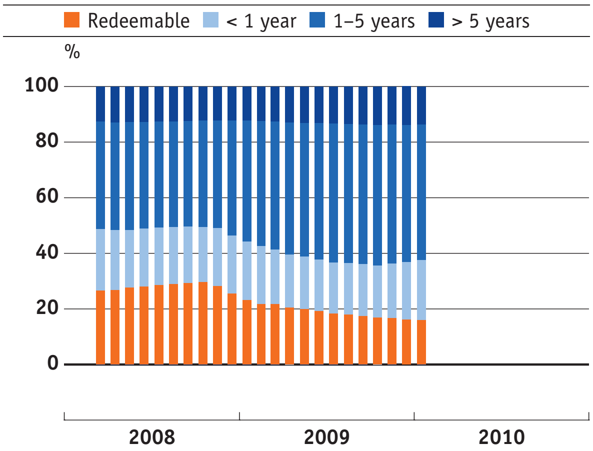
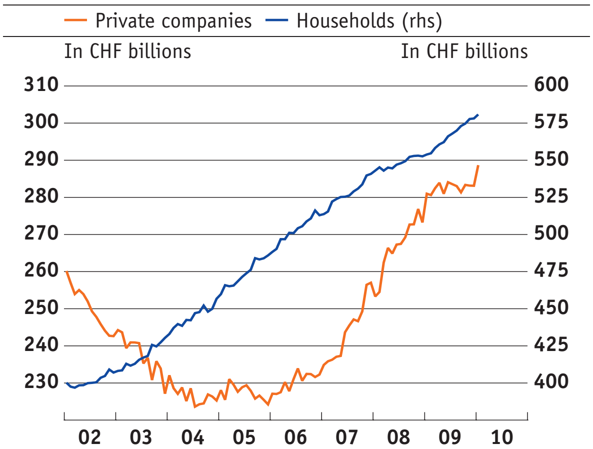


Chart 3.21
Bank loans



Charts 3.19, 3.20 and 3.21:
Source: SNB

Bank loans
Year-on-year change in percent

Table 3.2

	2008	2009	2008 Q4	2009 Q1	Q2	Q3	Q4	2009 November	December	2010 January
Total[1]	**5.7**	**3.4**	**4.2**	**4.1**	**3.2**	**3.0**	**3.3**	**3.1**	**3.7**	**3.6**
Mortgage claims[1]	3.5	4.5	3.4	3.9	4.3	4.7	5.1	5.0	5.2	5.3
of which households[2]	3.3	4.7	3.2	3.7	4.6	5.0	5.4	5.4	5.5	5.5
of which private companies[2]	3.8	5.8	3.6	5.2	5.8	6.2	6.1	6.1	5.8	5.9
Other loans[1]	14.8	−0.7	7.1	4.7	−0.9	−3.1	−3.2	−3.9	−1.8	−2.6
of which secured[1]	1.2	−5.4	−5.6	−6.0	−6.2	−7.2	−2.2	−0.1	1.0	2.2
of which unsecured[1]	24.2	2.0	15.3	10.9	2.1	−0.8	−3.8	−5.8	−3.2	−4.9
of which in CHF[1]	20.3	1.5	16.3	6.2	1.2	0.4	−1.7	−1.9	−2.9	−4.1
of which in other currencies[1]	−1.8	−10.0	−18.5	−3.2	−9.7	−16.5	−9.8	−11.6	3.0	4.4

1 Monthly balance sheets
2 Credit volume statistics
Source: SNB

4 SNB inflation forecast

Monetary policy affects output and prices with a considerable time lag. In Switzerland, monetary policy stimuli have their maximum effect on inflation after a period of approximately three years. For this reason, the SNB's monetary policy is guided not by current inflation, but by the inflation rate to be expected in two to three years if monetary policy were to remain unchanged. The inflation forecast published four times a year is one of the three key elements of the SNB's monetary policy strategy, together with its definition of price stability and the target range for the three-month Libor. The inflation forecast is derived from the analysis of different indicators, model estimates and the assessment of any special factors. It maps the future development of prices on the assumption that the three-month Libor remains constant over the forecasting period.

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 developments 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 December 2009 forecast.

Economic recovery is becoming firmer

In view of the strong growth in the US in the fourth quarter of 2009, the growth assumptions for 2010 have been upped slightly compared with the last quarter. By contrast, the current forecasts for growth in Europe are largely unchanged. An annual growth rate of 2.9% is now expected for the US in 2010, while the European growth forecast is a more moderate 1.0%. In the longer term it is assumed that a gradual recovery from the recession will push growth to 3.4% in the US and 2.9% in Europe by 2012.

For oil, a price of USD 76 per barrel is anticipated for the next few quarters, falling to USD 75 per barrel thereafter. It is assumed that the inflation rate in the industrialised countries will remain moderate at around 1.6% in the coming years. The USD/EUR exchange rate for the forecast period is set at 1.38 USD/EUR.

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

March 2010	2010	2011	2012
GDP US[1]	2.9	2.6	3.4
GDP EU15[1]	1.0	2.2	2.9

	Short term	Long term
Exchange rate USD/EUR[2]	1.38	1.38
Oil price in USD/barrel[2]	76	75
Oil price in CHF/barrel[3]	81	80

December 2009	2009	2010	2011
GDP US[1]	−2.4	2.4	2.5
GDP EU15[1]	−4.0	1.1	2.1

	Short term	Long term
Exchange rate USD/EUR[2]	1.47	1.47
Oil price in USD/barrel[2]	77	75
Oil price in CHF/barrel[4]	79	77

1 Change in percent
2 Level
3 Level, exchange rate on 11 March 2010
4 Level, exchange rate on 10 December 2009
Source: SNB

4.2 Inflation forecast and monetary policy decision

The Swiss National Bank is maintaining its expansionary monetary policy. Consequently, it is leaving the target range for the three-month Libor unchanged at 0.00–0.75% and intending to keep the Libor within the lower part of the target range at around 0.25%. It will act decisively to prevent an excessive appreciation of the Swiss franc against the euro.

The signs of an economic recovery are becoming more tangible. The improvement is beginning to assist the Swiss export sector, while the domestic sector is performing well. For 2010, the SNB is now expecting real GDP growth of about 1.5%. However, the revival remains fragile and is associated with uncertainties.

Since December, the SNB's conditional inflation forecast has remained almost unchanged at an average of 0.7% for 2010 and 0.9% for 2011. This forecast shows that short-term price stability is not threatened. Although the global economy is continuing to recover, it remains fragile. Should more external shocks occur, the danger of deflation cannot be entirely ruled out. However, the inflation forecast shows that the current expansionary monetary policy cannot be maintained throughout the entire forecast horizon without compromising medium and long-term price stability. The forecast is still associated with considerable uncertainties.

Global economic outlook

Developments in the global economy are largely as expected. In the emerging economies, particularly in Asia, growth momentum has been strong since the last policy assessment. The economy is also reviving in the US and Europe. However, although growth in the US in the past few months has been surprisingly positive, economic performance has been disappointing in Europe. The SNB anticipates the continuation of a moderate upward trend. Nevertheless, there are still significant risks for the development of the global economy. It is likely that final demand will still be curbed, in particular, by the high levels of unemployment and the bleak outlook for public finances.

Swiss economic outlook

Economic recovery is also underway in Switzerland. In the fourth quarter of 2009, real GDP was up by 0.7% compared to the previous quarter. This growth was driven by both domestic demand and exports. Particularly strong advances were recorded by retail and wholesale trade, the financial industry and construction. Signs of recovery were increasingly evident in the manufacturing sector – which had been hardest hit by the recession – and were recorded in a considerable number of these industries. The improvement in the economic situation also began to be felt in terms of the demand for labour. In the final months of 2009, short-time work declined slightly, and unemployment did not rise any further. The recovery in the economy should continue. However, because of various after-effects of the crisis on the global economy, it is likely to remain fragile. Consequently, companies do not expect a rapid reduction in their excessive production capacities – neither in the manufacturing industry nor in the services sector. In the construction industry, capacity utilisation is likely to remain at the current satisfactory level.

The SNB now expects real GDP to increase by approximately 1.5% in 2010 as a whole.

Monetary and financial conditions

Monetary conditions reflect the SNB's expansionary monetary policy.

The Libor is at the desired level of 25 basis points. By historical standards, yields on Confederation bonds are very low. This level reflects both the healthy state of public finances and long-term inflation expectations, which are consistent with price stability. Risk premia are now minimal; indeed, on occasion they have fallen even further. Consequently, corporate bond conditions on the capital markets have become attractive.

The trade-weighted external value of the Swiss franc has increased further, mainly as a result of the recent weakness of the euro. Since the SNB no longer has any room for manoeuvre, it has been intervening in the foreign exchange market. In doing so, it is aiming to act decisively to counter an excessive appreciation of the Swiss franc against the euro, since an appreciation of this kind would result in an undesired tightening of monetary conditions.

Although the monetary base has declined, it is still very high. It needs to be reduced in good time to ensure that excessive money creation by the banking sector can be prevented. Due to the substantial growth in the monetary aggregates since autumn 2008, private households and companies now have access to high levels of liquidity. For some months now the situation has been stabilising and the growth of the monetary aggregates has slowed. In January, the annual growth rate of M2 attained 16.5% or half the rate recorded just three months ago. In the same month, the growth rate of M3 was 6.1% as compared to 7.9% in November. Despite these changes, liquidity held by private households and companies remains high. The SNB is keeping a close watch on movements of money aggregates.

Low interest rates are leading to an acceleration in mortgage lending. In January, the growth rate attained 5.3%. Generally, in times of slow economic activity, a decline is recorded in loans not secured by mortgages. This phenomenon can be observed at present, with Swiss franc loans in this category falling by 4.1% in January. However, the level of loans not secured by mortgages is still considerably higher than in comparable phases of past economic cycles.

The SNB is keeping a careful watch on the lending market. Its quarterly survey of banks shows that the phase in which lending conditions are tightened is coming to an end. For the second consecutive quarter, banks have reported no more discernable tightening in conditions.

The SNB is warning banks and borrowers to be extremely cautious, in view of the growth in mortgage loans and the continuing increase in residential real estate prices. It is reminding them that, in assessing the viability of carrying the debt burden, the fact that interest rates are exceptionally low by historical standards must be taken into account. Particular caution is needed when setting the loan-to-value ratio.

The SNB is currently conducting an in-depth survey of banks, the purpose of which is to provide more information on banks' practices when granting mortgages for residential real estate. On the basis of the insights obtained, the SNB will work closely with the bank supervisory authority to assess whether there is any need for action.

Monetary policy decision

The inflation forecast has remained almost unchanged as compared to the monetary policy assessment of December 2009. It shows that short-term price stability is not threatened. However, it confirms that the current expansionary monetary policy cannot be maintained throughout the entire forecast horizon without compromising medium and long-term price stability. The recovery of the global economy is continuing, but remains fragile. Should more external shocks occur, the danger of deflation cannot be entirely ruled out. The SNB is leaving the target range for the three-month Libor unchanged at 0.00–0.75%. In doing so, it still aims to keep the Libor within the lower part of the target range at around 0.25%. It will act decisively to prevent an excessive appreciation of the Swiss franc against the euro.

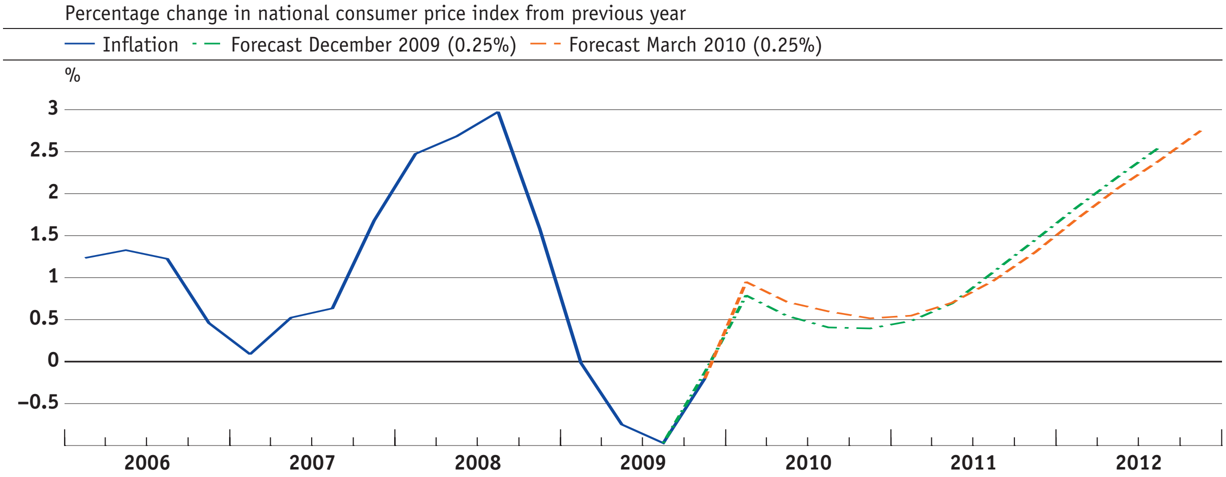
The forecast remains associated with considerable risks with regard to the global economic recovery. The economy is still benefiting strongly from government support measures. Not until these have been phased out will it become clear whether the stabilisation or recovery evident in certain markets is sustainable.

Inflation forecast chart

The new inflation forecast (dashed red line) extends from the first quarter of 2010 to the fourth quarter of 2012. Like the December forecast (dash-dotted green line), it is based on the assumption of the three-month Libor remaining constant at 0.25%. Consequently, it is a conditional forecast.

In the first quarter of 2010, the new inflation forecast temporarily reaches a peak because of a base effect attributable to oil prices. It then sinks slowly throughout the year due to a gradual weakening in the oil-price related base effect and the fact that GDP remains below its potential, which curbs price rises. However, economic activity is more robust than was expected in December. Consequently, the path of the new forecast initially lies above that of the December forecast. The trade-weighted external value of the Swiss franc has risen further, and this has resulted in a tightening of monetary conditions since the last monetary policy assessment. This will offset the tendency for prices to rise because of the more favourable economic situation. The new forecast is therefore slightly below that of December from 2011 onwards. Nevertheless, in the fourth quarter of 2012, inflation attains 2.75%. Consequently, the inflation forecast shows that the current expansionary monetary policy cannot be maintained throughout the entire forecast horizon without compromising medium and long-term price stability.

Chart 4.1
Inflation forecast of December 2009 with Libor at 0.25% and of March 2010 with Libor at 0.25%



Source: SNB

Observed inflation in March 2010

Table 4.2

	2006 Q1	2006 Q2	2006 Q3	2006 Q4	2007 Q1	2007 Q2	2007 Q3	2007 Q4	2008 Q1	2008 Q2	2008 Q3	2008 Q4	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2007	2008	2009
Inflation	1.23	1.33	1.22	0.46	0.09	0.52	0.63	1.68	2.47	2.68	2.97	1.58	–0.02	–0.75	–0.97	–0.20	0.7	2.4	–0.5

Inflation forecast of December 2009 with Libor at 0.25% and of March 2010 with Libor at 0.25%

	2009 Q1	2009 Q2	2009 Q3	2009 Q4	2010 Q1	2010 Q2	2010 Q3	2010 Q4	2011 Q1	2011 Q2	2011 Q3	2011 Q4	2012 Q1	2012 Q2	2012 Q3	2012 Q4	2010	2011	2012
Forecast December 2009, Libor at 0.25%				–0.13	0.79	0.54	0.41	0.40	0.48	0.69	1.07	1.45	1.84	2.20	2.55		0.5	0.9	
Forecast March 2010, Libor at 0.25%					0.95	0.71	0.60	0.52	0.55	0.70	0.96	1.30	1.70	2.07	2.39	2.75	0.7	0.9	2.2

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 March 2010

The SNB's delegates for regional economic relations are constantly in touch with a large number of enterprises from different industries and economic sectors. Their reports, which contain subjective evaluations of these companies, are an important additional source of information for assessing the economic situation. The following pages contain a summary of the most important results of the talks held in January and February 2010 with some 220 company representatives on the current and future economic situation.

Summary

The economy continued to recover in the first quarter of 2010. The uptrend in manufacturing was significantly broader than had been the case just a few months earlier. Most industries showed a modest increase in demand and real turnover. This led to a reduction in short-time work, which until that point had been widely implemented. However, because many manufacturers were recovering from a severe low level, under-utilisation of production capacity in some branches remained substantial. As in previous quarters, the situation in the construction and finishing industries was favourable. At the beginning of the year, the level of construction activity ranged from satisfactory to high, and that stable to trending slightly upwards. The continuation of a moderately upward trend was also evident in the services sector.

Expectations for the coming six months are cautiously optimistic. All the companies surveyed continue to believe that in the short term, the recovery is likely to be moderate and somewhat fragile. At the international level, the successful combating of the banking crisis and the recovery of the financial markets have resulted in a more positive mood. However, there is a residual crisis-related uncertainty, especially with regard to the sustainability of the recovery. Many are concerned by the financial state of the world's governments and the effects this could have on foreign exchange markets as well as on the propensity to consume and invest.

In general, the earnings situation of companies is most likely to be improved by a rise in the volume of sales, with few companies expecting increased profit margins.

1 Developments in the first quarter of 2010

Manufacturing

The manufacturing industry had shown a noticeable revival in demand in the fourth quarter of 2009. This upward trend continued into the first months of 2010, although in a weaker form. The recovery also began to take hold in industry sectors which until then had been contending with stagnating or declining business activity. Compared to the fourth quarter of 2009, manufacturing exhibited a broadly based increase in turnover. In many cases, this turnover, however, remained lower than in the previous year. Outstanding orders rose, but incoming orders were characterised by an unusually high level of volatility.

The inventory adjustment process is largely complete: the level of stock of finished products was described by almost all companies surveyed as appropriate. Consequently, a further rise in demand should be immediately reflected in an increase in production. An exception is the watchmaking industry, where stocks are still above the desired level.

Looking at individual sectors, the recovery has taken hold recently in the metal and machinery industry in particular, although the level of growth varies considerably from one firm to another. The situation in the chemical industry, which produces preliminary products needed by the manufacturing sector, also brightened in the first quarter of 2010. In the food and pharmaceutical sectors, the positive trend of the previous period continued. Only in the textile and clothing industries did turnover persist at a very low level.

The increase in demand in the second half of 2009 was driven primarily by emerging markets. At the beginning of 2010, incoming orders originated from all markets. While demand from the Far East continued to play a supportive role, orders from traditional markets (US, euro area and Switzerland) increased. However, in the euro area particularly, the strength of demand varied substantially from one country to another, as well as over time.

Construction

In the construction sector, first-quarter turnover as well as outstanding orders were significantly higher than in the previous year. In comparison to the fourth quarter of 2009, the tendency is towards a continued upward trend, although with less momentum, with adverse weather perhaps playing a role. Growth was stimulated once again by the housing market and civil engineering, while development in commercial and industrial construction was weak. The companies surveyed foresee a stable to mildly increasing level of business activity in the coming months.

Services

In the services sector, turnover was roughly equal to that of the first quarter of 2009. A positive trend was observed in the period between the fourth quarter of 2009 and the first quarter of 2010. This growth was driven by the following sectors: retail, transport, travel agencies, banking and especially IT service provision for businesses. Clear signs of recovery were shown by companies active in business travel, seminars and congresses – companies which, prior to this, had been experiencing low levels of activity. In contrast, tourist-oriented hotels and restaurants reported a renewed decrease in turnover, especially in the high-price segment. This was caused mainly by the continued decline in the numbers of foreign guests. The logistics sector also reported a downturn.

On the strength of a marked recovery in the second half of 2009, turnover in the banking sector at the beginning of 2010 was roughly equal to that of the previous year. However, upward momentum slowed in comparison to the fourth quarter of 2009. Credit volume – especially mortgage loans – continued to rise, although interest rate margins remained very narrow. Positive growth was also recorded in the areas of trading and foreign trade financing.

2 Capacity utilisation

Technical capacity utilisation in the first quarter of 2010 differed considerably from one economic sector and industry to the next. In the manufacturing industry, technical capacity in general was still significantly under-utilised, although there were considerable differences from one company to another. In the metal, textile and clothing industries, as well in the automotive parts industry, under-utilisation remained especially pronounced. Production capacity in the machine and electronics industries was slightly less under-utilised. On the other end of the scale, the food, pharmaceutical and plastics industries reported their utilisation as ranging from normal to high.

In the construction industry, the rate of utilisation remained mostly very satisfactory. The finishing industry in particular exhibited good utilisation. In most cases, work orders ensure that capacity is fully utilised for several months. An exception is that of firms in commercial construction, where capacity utilisation is slightly less than satisfactory.

The services sector also showed widespread under-utilisation. This was particularly evident in the wholesale, travel and logistics industries. In transport, banking and insurance as well as in hotels and restaurants, the level of utilisation was insufficient. In retail, those most affected were specialised providers of consumer durables (household furnishings, electronics, exclusive apparel). There were, however, also cases of larger department stores and diversified shopping centres having to contend with excess capacity.

3 Demand for labour

In the manufacturing industry, the increase in production resulted in an increased deployment of labour. This had the effect of reducing the workforce overhang, which until then had been considerable. Several of the companies surveyed ended short-time work at the beginning of the year. In some cases, overtime had already been recorded, and there was talk among certain companies of the need to employ temporary workers. Despite this improvement, a quarter of the industrial businesses surveyed described their headcounts as being too high or much too high. For the time being, even firms with good utilisation are very wary of taking on new permanent employees. On balance, business activity in the manufacturing industry is likely to exhibit a slight decline over the next six months. A rise in production should be achieved by a return to increased labour productivity.

In the construction sector, the level of business activity was regarded on the whole as being adequate. Based on current business expectations, firms anticipate that employment will remain the same. In this as in other sectors, companies faced with the prospect of rising orders in the short term are making plans to take on temporary workers where necessary.

Employment in the services sector is also roughly at a desirable level. The only areas expected to yield new jobs in the coming months are IT service provision, business consultancy, and parts of banking and insurance.

There were selected instances of companies in different industries looking to take on specialists. Many companies surveyed indicated that the recession had not led to any meaningful easing in the employment market for this skill segment. Although less skilled personnel are relatively easy to recruit at the moment, specialised experts (chemists, laboratory assistants, technicians, civil engineers, financial experts, CEOs) remain difficult to find. One view repeatedly encountered was that employees were loath to risk changing employers given the current job market.

4 Lending conditions

In sum, given the state of the economy, the overwhelming majority of companies surveyed regarded the banks’ lending policies as normal. There were also a few isolated reports from the manufacturing, the hotel and restaurant and the transport industries of restrictive and risk-averse lending conditions. Construction companies' views of the banks' lending policies, by contrast, ranged from unproblematic to generous. This was explained by favourable current market conditions and an encouraging economic outlook. The banks surveyed view the weak development of corporate lending as a consequence of a lack of demand, for which they give two reasons: the generally modest level of capital expenditure, and the high degree of liquidity in many companies.

5 Prices, margins and earnings situation

The overwhelming majority of companies surveyed believe that the only way to improve earning situations in the short-term is by increasing the volume of sales.

In the manufacturing industry, the recession has led to a considerable reduction in profit margins. At the beginning of 2010, margins have on average remained significantly weaker than usual. The main reasons given for this were sluggish demand as well as tougher competition due to excessive capacity worldwide. The export industry suffered a further blow due to appreciation in the exchange rate, since prices in local currencies – especially in the euro area – could not be raised accordingly. It is likely that in the short term, profit margins will remain under pressure. On the one hand, a slight increase in purchase prices is expected, in particular in commodities. On the other, few firms are planning to raise their sales prices. In general, the expectation is that sales prices will either stagnate or decline further.

In the construction industry, the margins were generally considered normal. In residential construction and civil engineering, competition remains strong. Higher margins therefore appear difficult to implement, despite a lengthy expansionary phase and a good level of capacity utilisation. By contrast, in commercial construction, unsatisfactory margins are being attributed to relatively weak demand. Several of the companies surveyed are planning to introduce small price increases on a selective basis. These, however, are likely to do no more than partly compensate the anticipated rise in purchase prices.

Banks, travel agencies, logistics companies as well as tourist-oriented hotels and restaurants all see themselves faced with noticeably below-average profit margins. The insurance and consultancy industries assessed their margins as being slightly narrower than usual. Margins in both the wholesale and the retail trade were viewed as normal. Here the environment remains in a state of flux: all companies surveyed spoke of an unstoppable medium-term trend towards lower selling prices. By applying the Cassis de Dijon principle and using more efficient selling strategies, companies should stand to profit in future from lower purchase prices. These measures alone, however, are unlikely to suffice. To maintain margins, all providers are looking at ways of optimising their processes and increasing their productivity.

6 Outlook

Expectations for the coming six months are cautiously optimistic. They point to the continuation of the moderate economic recovery currently underway. In the manufacturing industry, most companies surveyed foresee a modest increase in turnover. Capacity utilisation is expected to recover to a limited extent only. Companies plan to secure the upturn in output by again cutting back short-time work and by increasing labour productivity.

In the construction industry proper, firms expect that turnover will stagnate, while the finishing industry predicts a slight increase in turnover. Capacity utilisation in both industries is likely to remain roughly the same.

Expectations in the services sector vary. Retailers are cautious – firms surveyed anticipate stagnating turnover as a result of modest pay increase figures, the rise in health insurance premiums as well as perceived unemployment. Hotels and restaurants anticipate a comparable scenario. Decidedly more upbeat is the mood among banks and insurance companies, IT service providers, business consultants, personnel consultants and recruitment firms, travel agencies and conference organisers. Companies surveyed in these industries expect an acceleration in growth in the next six months. Nonetheless, on average the services sector expects only a small rise in capacity utilisation.

The caution in these expectations is putting a damper on companies' investment plans, with the prevailing view being that equipment and building investment will increase only marginally.

SNB Working Papers: Summaries

Bidding behaviour in the SNB's repo auctions

Sébastien Kraenzlin and Martin Schlegel
Working Paper 2009-14

The Swiss National Bank (SNB) provides reserves to market participants via fixed rate tender auctions. In this paper, the authors analyse banks' bidding behaviour and identify the determinants of both the decision to participate and the amount to tender. Bidding functions are estimated for banks which participate regularly in the SNB's auctions. Among the liquidity variables, a bank's bids from the previous auction and its maturing repo operations with the SNB have the most effect. The autonomous factors (government balances at the SNB and currency in circulation) are of only minor importance. A further major determinant of bidding behaviour is the attractiveness of the SNB's rate compared with the prevailing repo market rate. The unsecured/repo spread and the attractiveness of euro funding via a Swiss franc repo transaction with the SNB followed by an FX swap into euros are significant for only a few banks. The authors also examine whether bidding behaviour changed during the recent turmoil. There is little evidence of a systematic change in bidding behaviour in the crisis. Fluctuations in the demand for reserves did not result in a change in bidding behaviour. The volatile demand was addressed by the SNB through overnight fine-tuning operations, rather than one-week auctions.

Demand for reserves and the central bank's management of interest rates

Martin Schlegel and Sébastien Kraenzlin
Working Paper 2009-15

The implementation of monetary policy is predominantly done by interest rate targeting, with a short-term market rate serving as operational target. The instruments for achieving the operational target are the provision of reserves and the interest rate charged in these transactions. This paper presents a model for the estimation of the demand curve for reserves, derived from the central bank's fixed rate tender auction and the interbank money market. Using data from Switzerland, the slope of the demand curve is estimated. In addition, properties of the demand curve, such as the slope patterns over the course of a maintenance period and the slope in different monetary regimes, are assessed. The authors find a steeper demand curve towards the end of the maintenance period and an increasing slope when the general interest rate level is high. Finally, the role of the SNB's interest rate in its fixed rate tender auctions is investigated. There is evidence that the SNB uses its auction rate to guide the interbank market rate.

Monetary determinants of the Swiss franc

Carlos Lenz and Marcel Savioz
Working Paper 2009-16

This paper looks into the determinants of the Swiss franc exchange rate against the euro. The authors base their analysis on the monetary approach to exchange rates, which links changes in the exchange rate to monetary policy. To measure this influence, the structural vector autoregression methodology is applied to a set of Swiss macroeconomic variables and the euro area interest rate.

A detailed event study of exchange rate movements and their driving forces provides an ex post explanation of the depreciation of the Swiss franc against the euro between 2003 and 2008. The decomposition of exchange rate movements into monetary policy and other shocks reveals that the relatively loose monetary policy stance between 2003 and 2005 contributed substantially to the weakness of the Swiss franc at that time. Overall, Swiss monetary policy explains between 7% and 15% of the exchange rate variations between the Swiss franc and the Deutschmark from 1981 to 1998 and the euro from 1999 to 2008.

Chronicle of monetary events

Continuation of expansionary monetary policy

Following its quarterly monetary policy assessment of 11 March 2010, the SNB decided to maintain its expansionary monetary policy, leaving the target range for the three-month Libor unchanged at 0.00–0.75% and adhering to its objective of keeping the Libor in the lower part of this range at around 0.25%. In addition, it announced it would act decisively to prevent an excessive appreciation of the Swiss franc against the euro.

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