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Contents

Monetary policy report

Report to the attention of the Governing Board of the Swiss National Bank for its quarterly assessment of March 2011.

This report is based primarily on the data and information available as at 17 March 2011.

Monetary policy report

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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 the implications for monetary policy it draws from this assessment.

Sections 2–3 of the present report were drawn up for the Governing Board's assessment of March 2011. Section 1 ('Inflation forecast and monetary policy decision') is an excerpt from the press release published following the monetary policy assessment of 17 March 2011.

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

1 Inflation forecast and monetary policy decision

The Swiss National Bank (SNB) is maintaining its expansionary monetary policy. It is leaving the target range for the three-month Libor rate unchanged at 0.0–0.75%, and intends to keep the Libor within the lower part of the target range at around 0.25%.

Global economic developments, especially in the US and Asia, have been somewhat more dynamic than the SNB had expected in December. Despite the continued strength of the Swiss franc, the Swiss economy also grew more vigorously in the fourth quarter of 2010 than anticipated. Positive business expectations suggest favourable developments in the economy in the coming months, even though stagnating goods exports indicate that growth will slow during the course of the year. For 2011, the SNB expects Swiss GDP to advance by approximately 2%.

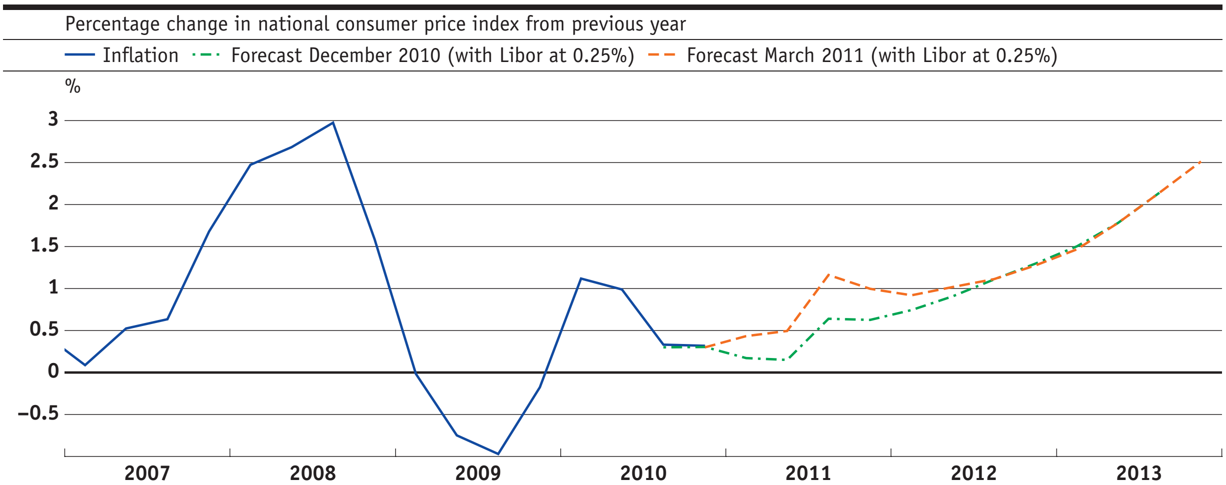
With the strengthening of the global economic recovery, the prospects for Switzerland's economy have improved since the last quarter. However, continuing debt problems in Europe and the possible dampening effects of high oil prices on economic activity pose considerable downside risks. In addition, the consequences of the earthquake catastrophe in Japan are, at this stage, difficult to assess. At the same time, geopolitical tensions and rising commodity and food prices lead to upside risks to inflation across the globe. Survey data show however that inflation expectations in Switzerland remain stable.

Chart of conditional inflation forecast

The (dashed) red curve on the chart represents the new conditional inflation forecast. It shows the future path of inflation, assuming that the three-month Libor remains constant at 0.25% over the entire forecast horizon, and it covers the period from the first quarter of 2011 to the fourth quarter of 2013. For purposes of comparison, the (dash-dotted) green curve shows the conditional inflation forecast published in December, which was also based on the assumption of a three-month Libor of 0.25%.

The new conditional inflation forecast shows a slight rise in inflation for 2011. This is due to a renewed sharp increase in oil prices, more dynamic domestic growth and more positive assumptions for the global economy. The peak in inflation in the third quarter of 2011 is due to a base effect, because inflation in the third quarter of 2010 was comparatively low. From mid-2012 onwards, the new conditional inflation forecast follows that of December. This is a reflection of the fact that the assessment of the inflation outlook has not changed significantly compared to the previous quarter. Assuming an unchanged three-month Libor of 0.25% during the forecast horizon, average inflation is expected to amount to 0.8% for 2011,

Chart 1.1
Conditional inflation forecast of December 2010 and of March 2011



Source: SNB

to 1.1% for 2012 and to 2.0% for 2013. The conditional inflation forecast shows that there is no threat to price stability in the short term. Towards the end of the forecast horizon, inflation rises briskly and exceeds the upper bound of 2%, assuming that the three-month Libor remains at the current level. This shows that the current expansionary monetary policy cannot be maintained over the entire forecast horizon without compromising price stability in the longer term. Due to the risks mentioned previously, this conditional inflation forecast is associated with a very high level of uncertainty.

Observed inflation in March 2011

Table 1.1

	2007				2008				2009				2010				2008	2009	2010
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Inflation	0.1	0.5	0.6	1.7	2.5	2.7	3.0	1.6	0.0	−0.7	−1.0	−0.2	1.1	1.0	0.3	0.3	2.4	−0.5	0.7

Conditional inflation forecast of December 2010 with Libor at 0.25% and of March 2011 with Libor at 0.25%

	2010				2011				2012				2013				2011	2012	2013
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Forecast December 2010, Libor at 0.25%				0.3	0.2	0.2	0.6	0.6	0.7	0.9	1.1	1.3	1.5	1.8	2.1		0.4	1.0	
Forecast March 2011. Libor at 0.25%					0.4	0.5	1.2	1.0	0.9	1.0	1.1	1.3	1.5	1.8	2.1	2.5	0.8	1.1	2.0

Source: SNB

Inflation forecasting as part of the monetary policy strategy

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.

2 Global economic environment

The expansion in the global economy is progressing somewhat faster than expected in December. After a brief slowdown, growth in the emerging economies picked up again in the fourth quarter, particularly in Asia. In the advanced economies, the pace of the recovery still varies significantly from one country to another. In the US, growth became more broad based. As the labour market continued to recover, consumer spending picked up. In Europe, the recovery has remained modest overall and dependent on foreign demand. However, Germany's economic upturn stands out considerably from the European average.

The global economic outlook is encouraging. The latest indicators point to robust growth in industrial output and trade in the first quarter. The export industry in the advanced economies is likely to benefit further from the vigorous demand coming from the emerging economies. In the US, the fiscal measures decided in December boosted domestic demand. As a result of the stronger growth momentum in the US and the emerging economies, the SNB revised its global growth assumptions upwards for 2011. Furthermore, inflationary pressure is rising, owing to commodity and food prices as well as the increasing capacity utilisation.

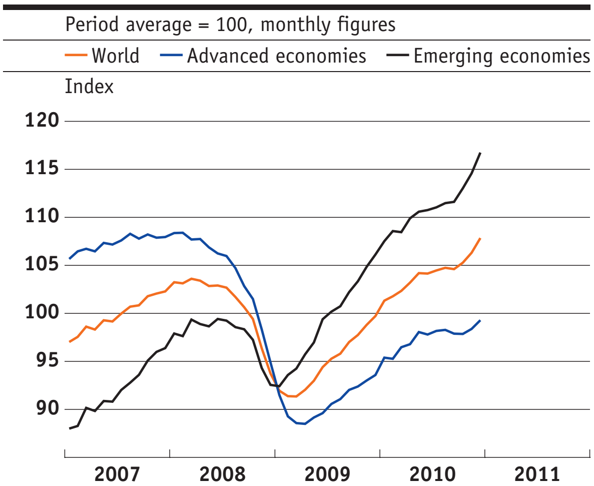
Although uncertainty about the future outlook for the global economy has abated, it still remains considerable. Since worries about the stability in the euro area and geopolitical concerns could lead to renewed tensions, downside risks continue to dominate. Uncertainty about developments in Japan has introduced a new element of risk.

2.1 International financial and commodity markets

The situation on the international financial markets had been improving after the quarterly assessment in December, until the severe earthquake hit Japan. With the economic recovery becoming more broad based, share indices in the advanced economies had made up ground against the emerging economies. In the wake of the earthquake in Japan, share indices dropped and the uncertainty on the stock markets as measured by the Volatility Index (VIX) increased (cf. chart 2.3). Since December, the US dollar has continued to lose ground against the currencies of the United States' principal trading partners. The euro, by contrast, recovered slightly after measures to overcome the European debt crisis were announced (cf. chart 2.4).

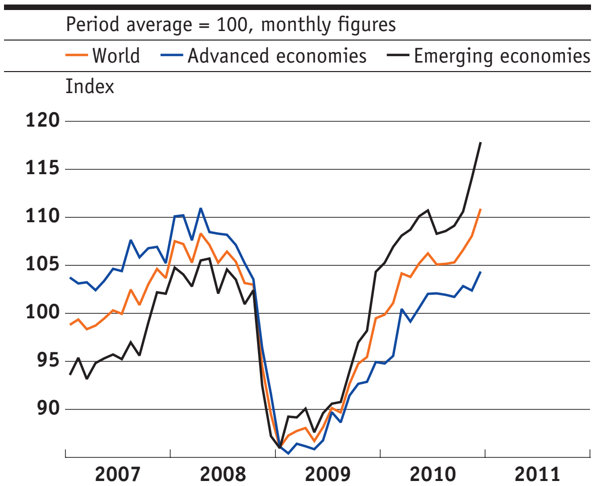
As the economy continued to recover, demand for commodities increased and contributed to a further rise in commodity prices (cf. chart 2.5). Food prices reached record levels as a result of natural disasters and poor harvests, and political upheaval

Chart 2.1
Global industrial production



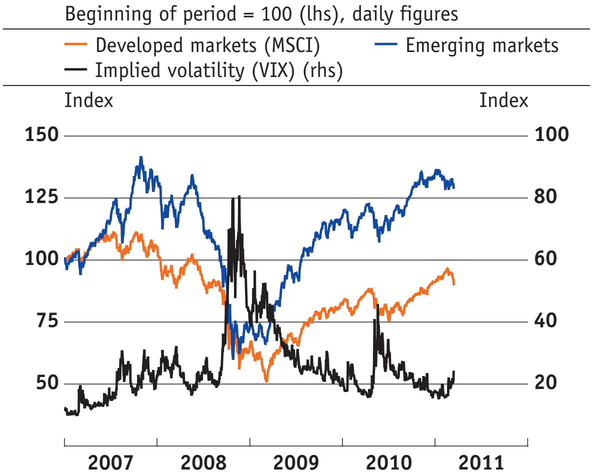
Sources: Netherlands Bureau for Economic Policy Analysis (CPB), Thomson Financial Datastream

Chart 2.2
Global exports



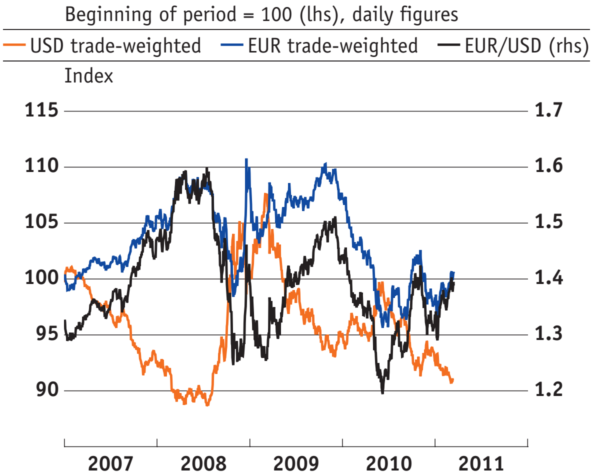
Sources: CPB, Thomson Financial Datastream

Chart 2.3
Stock markets



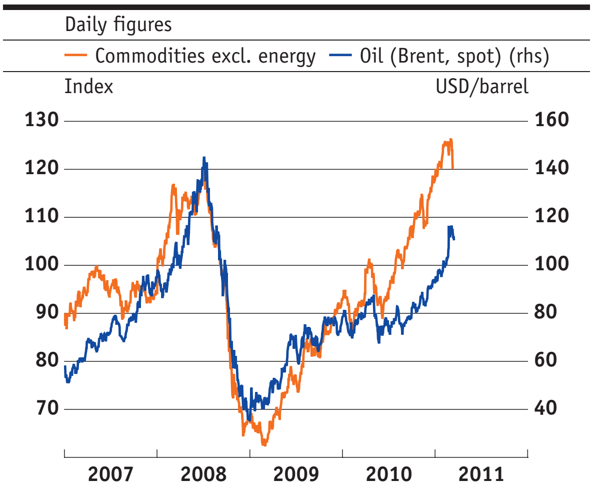
Sources: Reuters, Thomson Financial Datastream

Chart 2.4
Exchange rates



Sources: Reuters, Thomson Financial Datastream

Chart 2.5
Commodity prices



Sources: Reuters, Thomson Financial Datastream

in North Africa and the Middle East pushed the price for European Brent crude oil up beyond the USD 110 per barrel mark.

All forecasts in this report regarding the global and the Swiss economy are based on the following assumptions by the SNB: an oil price of USD 109 per barrel in the short run and thereafter USD 97 per barrel (compared to USD 83 per barrel in December), and a USD/EUR exchange rate of 1.35, which takes into account the appreciation of the euro.

2.2 United States

US growth has regained internal momentum. After a 2.8% increase in the fourth quarter of 2010, GDP exceeded its pre-crisis level for the first time. Contrary to market participants' fears of a renewed weakening of the US economy, domestic final demand in the private sector, in particular consumer demand, strengthened considerably.

The outlook for the US economy has improved considerably. The package of measures approved by Congress in December has reduced the tax burden on households and companies and extended the duration of unemployment benefits. This is likely to prove a significant stimulus for domestic demand. First signs of hope have appeared on the labour market, although the rate of unemployment remains high. In the corporate sector, too, the outlook has become brighter. Increasing business optimism, solid earnings and easier access to loans suggest that sustained, robust growth in equipment investment can be expected. The situation on the housing market, by contrast, remains gloomy, since high vacancy rates still have a dampening effect on selling prices and construction activity. The SNB has raised its growth forecast for 2011 from 2.6% to 3.2% and anticipates a 3.5% growth rate for 2012.

Consumer price inflation in the US has remained moderate. Although annual inflation advanced to 1.6% in January in connection with rising energy prices, core inflation has clearly receded since the onset of the crisis some two years ago, amounting to 1.0% in January. Inflationary pressure resulting from commodity prices is likely to increase in the coming months, but high unemployment and low utilisation of production capacity should prevent any steep rise in inflation.

The US Federal Reserve has left its monetary policy unchanged since the launch of its second major securities programme in November 2010, in connection with which the Fed plans to purchase US Treasury bonds for a total amount of USD 600 billion to June 2011. The target range for the federal funds rate has been left at 0.00–0.25%.

2.3 Euro area

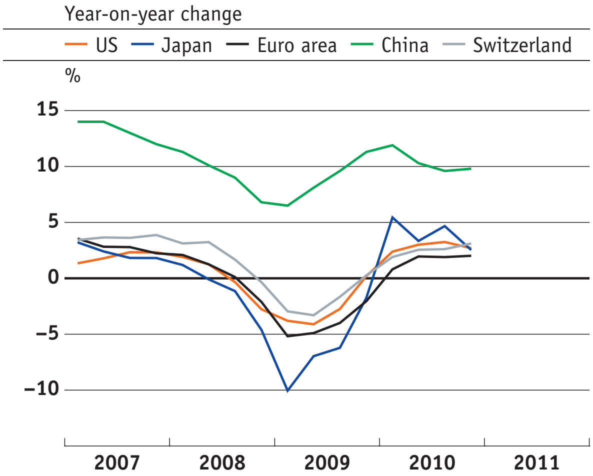
The economy in the euro area continued to recover. GDP advanced only moderately in the fourth quarter of 2010 (1.1%), however, still remaining below the pre-crisis level. Growth was hampered by a weather-related decline in construction activity, whereas private consumption and exports regained further ground.

The economic outlook is favourable. Deferred construction projects are likely to be taken in hand in the first quarter of 2011 and, according to surveys, manufacturing companies in Germany and France are planning to invest significantly more this year, which should give labour markets a boost. The debt problems continue to burden the economic outlook despite efforts to overcome it. Only a slight dampening effect from peripheral member states is to be expected in view of their low share in the euro area's GDP. The SNB has raised its growth forecast for 2011 from 1.7% to 1.9%. Due to catch-up effects, it anticipates a 2.4% growth rate for 2012.

Consumer price inflation in the euro area has again increased since October, the main reasons being rising commodity and food prices and inflation-driving exchange rate movements. In January, annual inflation reached 2.3% after standing at 1.9% in October. Core inflation, however, remained at 1.1%. Cyclical inflationary pressure resulting from capacity utilisation is still low, but surveys show that manufacturers increasingly expect sale prices to rise.

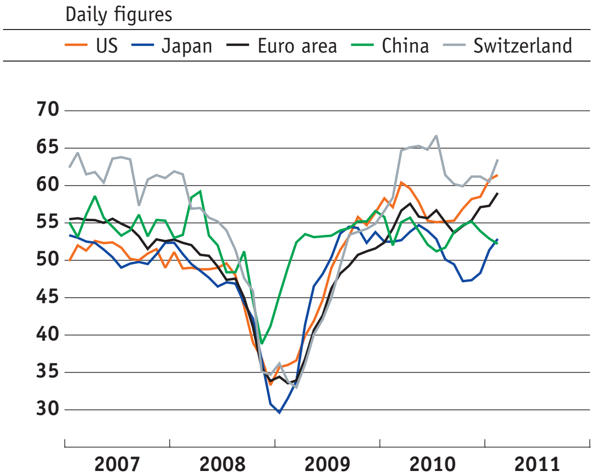
The European Central Bank (ECB) has retained its expansionary monetary policy, leaving its main refinancing rate unchanged at 1.0% and purchasing further securities under its Securities Markets Programme. It plans to provide banks with unlimited liquidity in the second quarter of 2011, too. Since the ECB's press conference in March, markets have assumed that the ECB will raise key rates in the near future.

Chart 2.6
Real GDP



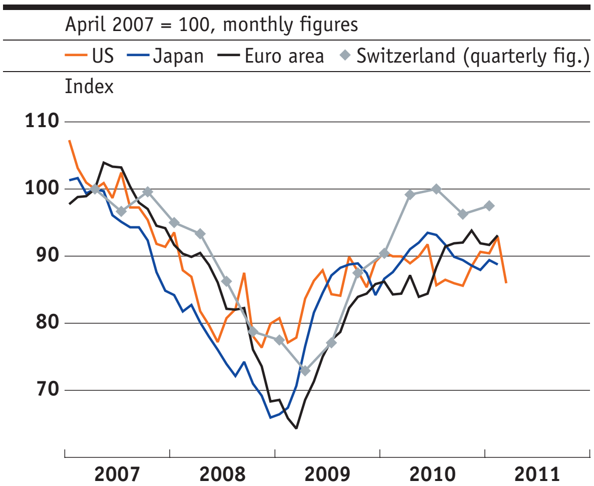
Sources: State Secretariat for Economic Affairs (SECO), Thomson Financial Datastream

Chart 2.7
Purchasing managers' indices (manufacturing)



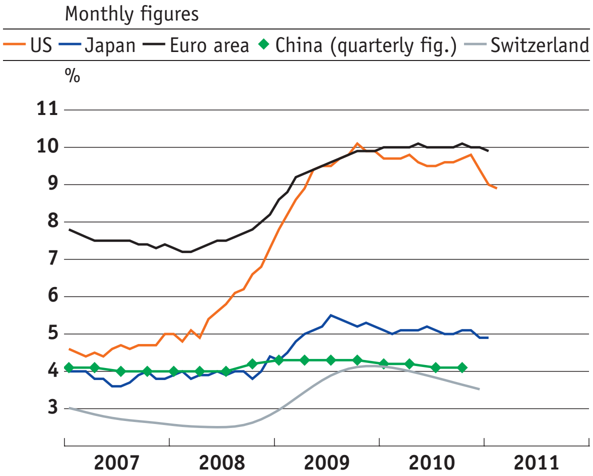
Source: Thomson Financial Datastream; copyright and database rights: Markit Economics Ltd 2009; all rights reserved

Chart 2.8
Consumer confidence index



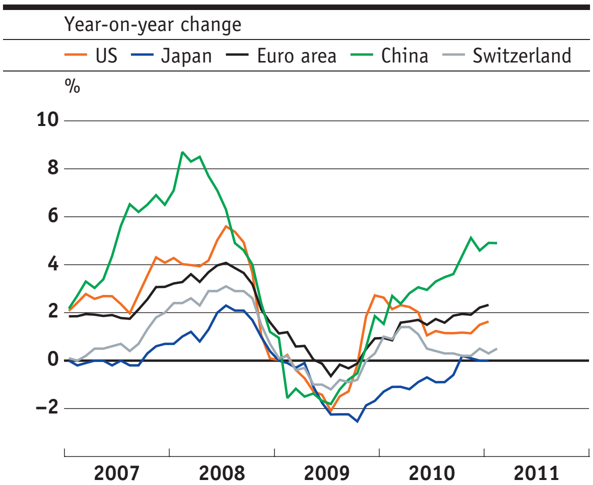
Sources: SECO, Thomson Financial Datastream

Chart 2.9
Unemployment rates



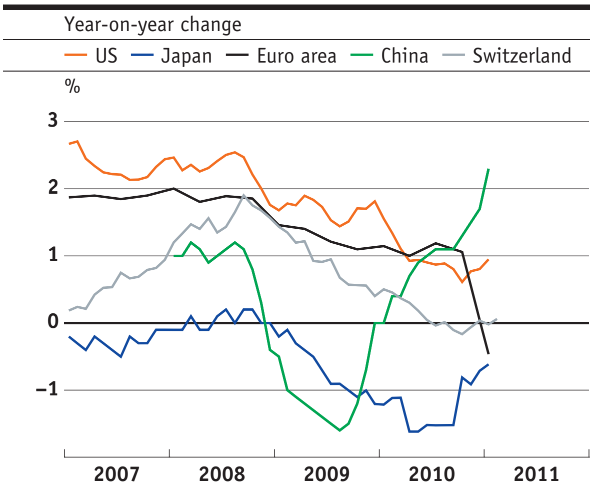
Sources: SECO, Thomson Financial Datastream

Chart 2.10
Consumer prices



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

Chart 2.11
Core inflation rates



Sources: SFSO, Thomson Financial Datastream

2.4 Japan

The pace of Japan's economic recovery is uneven. Especially in the second half of 2010, limited-term subsidies on environmentally friendly goods led to strong fluctuations in private consumption. At the same time, investment and export activity lost momentum. As a result, GDP declined by 1.3% in the fourth quarter after growing strongly in the three months before.

Currently, it is difficult to assess the economic impact of the events surrounding the earthquake. Before the earthquake, the SNB expected Japan's GDP to grow by 1.5% in 2011 and by 3.0% in 2012. Experience from past natural disasters suggests that loss of production will noticeably hamper growth in the short term. Forthcoming reconstruction activity should, however, trigger a surge in investment, which could stimulate the Japanese economy over an extended period of time. The outlook for exports remain favourable. Moreover, there is a large amount of catching up to be done in capital investment, and companies generally have a strong capital base.

Japanese consumer prices remain under pressure. Although rising food and energy prices together with an increase in tobacco tax led to a slight increase in consumer prices in the fourth quarter compared to the previous year, core inflation, which excludes food and energy prices, remained negative up to the end of January.

The Japanese central bank, the Bank of Japan, has reacted to the natural disaster by adopting additional monetary policy measures. Banks have been provided with more liquidity, and the amount budgeted for the purchase of assets (including private sector assets) has been doubled to JPY 10,000 billion. The Bank of Japan has left the call money rate at 0.0–0.1%.

2.5 Emerging economies in Asia

After a temporary slowdown, growth in the emerging economies of Asia again picked up pace in the fourth quarter of 2010. China's GDP advanced by 9.8% year-on-year in the last three months of the year. Domestic demand continued to expand vigorously, buoyed by the influence of economic stimulus measures included in the 2010 budget. Exports regained momentum after a setback due to reduced refunding of VAT on exports.

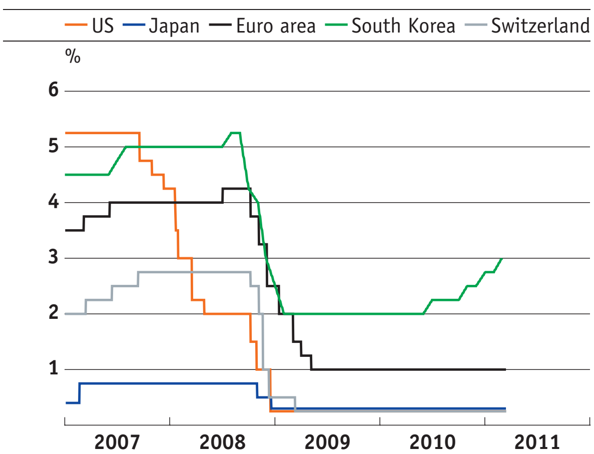
China's outlook for 2011 appears favourable. Latest industrial surveys as well as the high growth in lending suggest continued momentum in the economy. The threat of overheating in the real estate market has receded since mortgage lending conditions were tightened about one year ago. The SNB's GDP growth forecast for China remains in the vicinity of 10% for 2011.

Economic growth in the export-oriented economies of South Korea, Taiwan, Hong Kong and Singapore fell short of potential growth in the second half of 2010. Since the end of the year, however, signs of reviving manufacturing and trading activities have increased, especially in the significant electronics industry. Expansionary monetary policies continue to bolster domestic final demand. The framework agreement between China and Taiwan that was signed in mid-2010 is also expected to stimulate activity. The SNB anticipates above-average growth rates for the four economies mentioned above in the first half of 2011. Overall, however, growth in 2011 is expected to be more moderate than in 2010.

Inflationary pressure in the region has become stronger. China's consumer price inflation advanced to 4.9% in January, exceeding the 4% limit envisaged by the government for 2011. Rising food prices were a principal factor, but core inflation was up, too.

The central banks of Asia's emerging economies have continued to tighten their monetary policy. The People's Bank of China has introduced stricter minimum reserve requirements for banks and again raised key rates. South Korea's central bank has also increased key rates in reaction to growing inflationary pressure and rising prices for real estate (cf. graph 2.12).

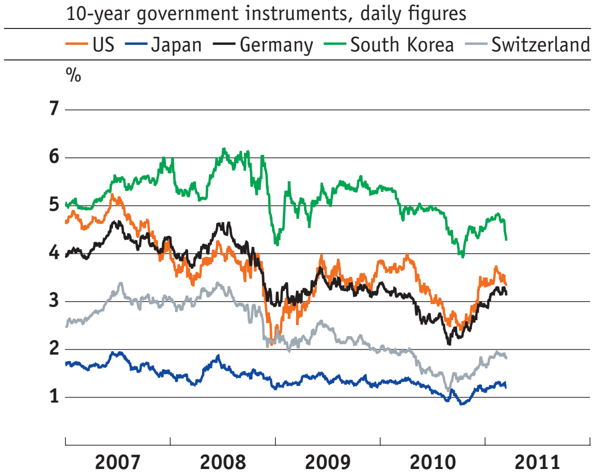
Chart 2.12
Official interest rates



Sources: SNB, Thomson Financial Datastream

Chart 2.13
International long-term interest rates

10-year government instruments, daily figures



Sources: SNB, Thomson Financial Datastream

3 Economic developments in Switzerland

In spite of the marked appreciation of the Swiss franc, the economic recovery in Switzerland recently proved to be more dynamic than anticipated. GDP growth again exceeded potential growth and was broad based. Technical capacity utilisation continued to increase. In manufacturing and in the services sector, it is at a satisfactory level, while in the construction industry it is high. At the same time, demand for labour has firmed, resulting in a renewed drop in unemployment and short-time work. Despite the noticeable dampening effect of the Swiss franc appreciation, the continued positive business expectations suggest favourable developments in the coming months.

During the course of 2011, the SNB continues to anticipate weakening growth. First, surveys point to increased competitive pressure and narrow margins for many Swiss export firms. Second, with the continued strength of the Swiss franc, goods exports have lost considerable momentum since the spring of 2010, and spending on tourism services has even declined. The SNB now expects real GDP to expand by roughly 2% for the year as a whole.

3.1 Aggregate demand and output

Broad-based growth in added value

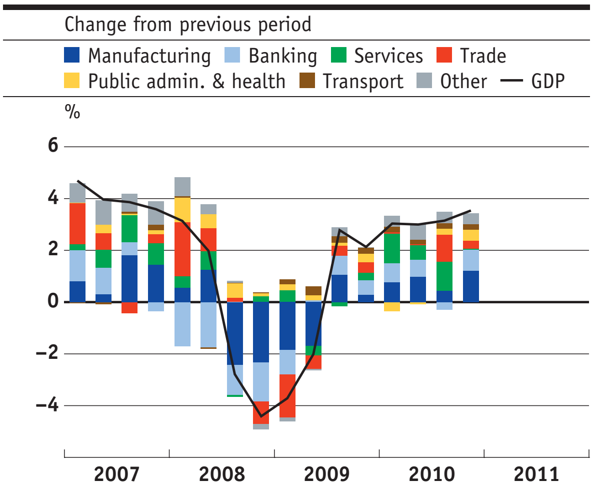
According to provisional estimates by the State Secretariat for Economic Affairs (SECO), GDP rose by 3.5% in the fourth quarter, following growth of 3.1% in the previous quarter. The year-on-year change in the fourth quarter amounted to 3.1%. On the output side, growth was broad based (cf. chart 3.1). The industries making the biggest contribution to growth were banking and manufacturing, generating value added of 9.3% and 6.9% respectively. Other industries recording above-average increases in value added were insurance (6.0%), transport and communications (5.8%) and construction (3.8%). The only industries to report a decrease in value added were agriculture, hospitality and education; these industries, however, together only account for a small proportion of GDP.

Robust domestic final demand

A breakdown of GDP by components shows that in the fourth quarter, growth was driven primarily by domestic final demand (cf. chart 3.2 and table 3.1 on page 19).

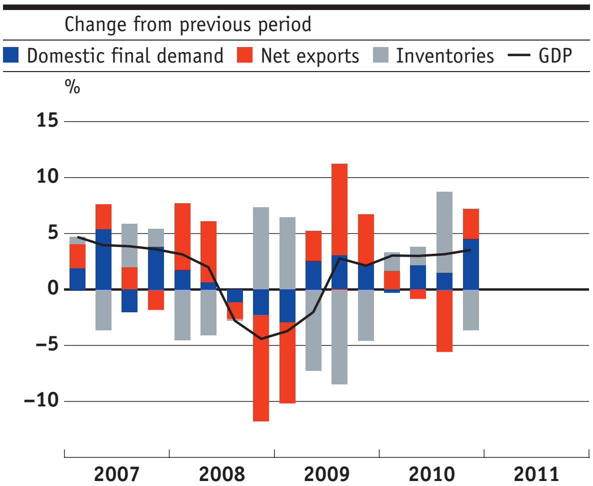
Private consumption slackened in the fourth quarter, but still remained an important driver of growth. A breakdown by goods and services shows that developments are relatively homogeneous. According to the latest SECO survey, households remain optimistic with regard to both their personal financial circumstances and the economic outlook.

Chart 3.1
Contributions to growth, by sector



Source: SECO

Chart 3.2
Contributions to output growth



Source: SECO

Construction investment continued to increase, and is now not far off its record level of the mid-1990s. According to surveys conducted by the Swiss Federation of Master Builders (SBV/SSE), trends that were evident in the previous quarters continued. Civil engineering again reported strong results, but residential construction also remained buoyant, driven by low interest rates and by immigration. The level of capacity utilisation in construction, viewed in historical terms, is high.

Equipment investment picked up considerably in the fourth quarter, resulting in growth of 5.7% for the whole of 2010. Investment in vehicles posted especially strong growth, and investment in IT also increased. By contrast, investment in machinery recovered only slightly.

Weak growth in exports

Following a marked decline in the previous quarter, total exports increased only to a limited extent in the fourth quarter. A rise in goods exports was offset by a further drop in services exports (cf. chart 3.4).

After two weak quarters, goods exports, benefiting from an additional work day, picked up. Exports of chemicals and pharmaceuticals contributed strongly to this growth, whereas exports of other major industries developed sluggishly for the most part. A breakdown by sales markets reflects a continued strong expansion in exports to Asian emerging economies. Alongside this, exports to Europe and to oil-exporting countries recovered, while exports to the US stagnated, and exports to Japan even contracted.

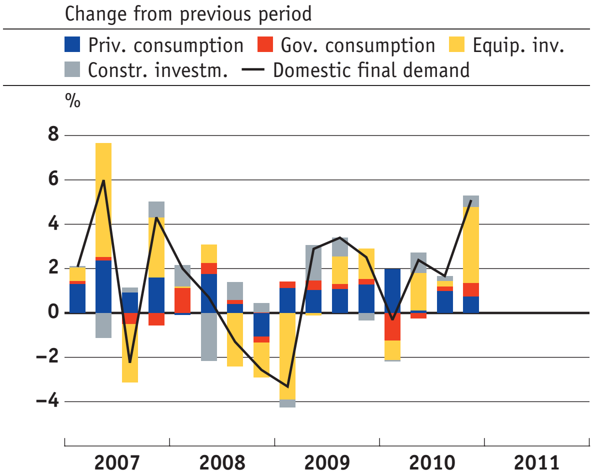
In contrast to goods exports, services exports declined again. Tourism exports fell for the first time since the end of the financial crisis. Exports of other services accounted for the major part of the decline, however. These include earnings from cross-border banking operations and the export of insurance services, but most of all net revenues from merchanting.

Stagnating imports

Imports practically stagnated in the fourth quarter, although a rise in goods imports offset a decline in services imports (cf. chart 3.5).

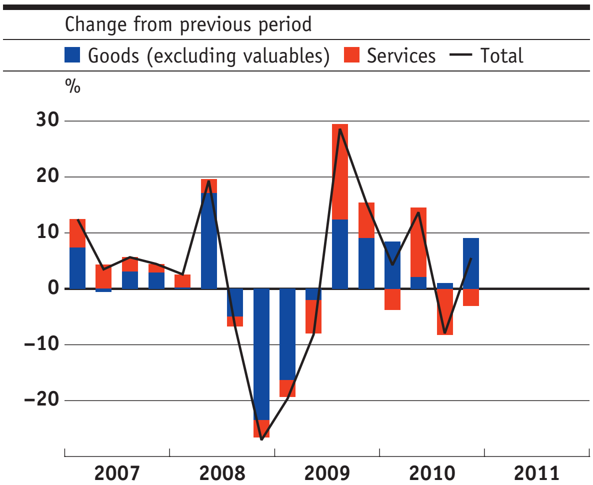
With regard to goods, imports of automobiles rose unusually strongly, but imports of most other major industries also increased. The only sharp decline was in imports of jewellery. This is probably mainly attributable to a return to normal following the presence of one-off factors in previous quarters (imports of gold ornaments from Vietnam).

Chart 3.3
Domestic final demand, growth contributions



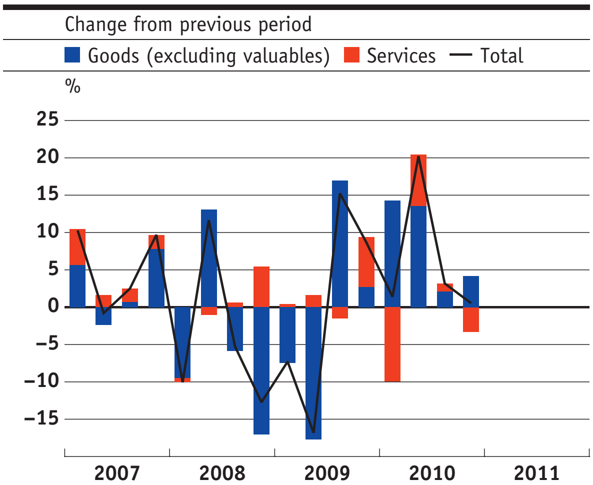
Source: SECO

Chart 3.4
Contributions to export growth



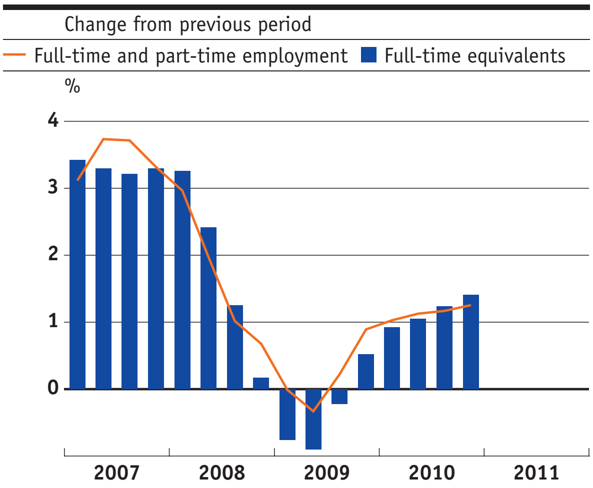
Source: SECO

Chart 3.5
Contributions to import growth



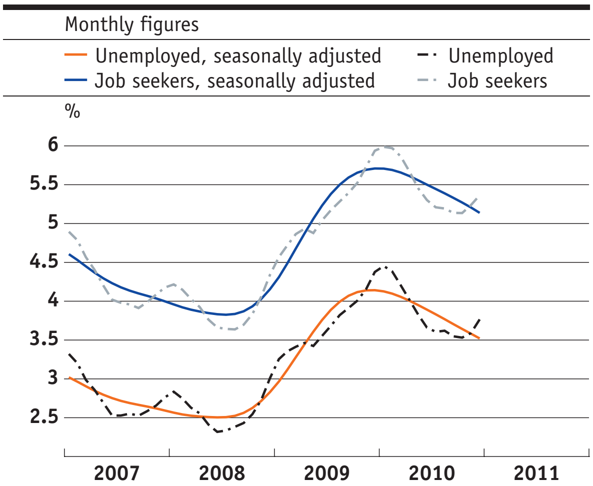
Source: SECO

Chart 3.6
Employment



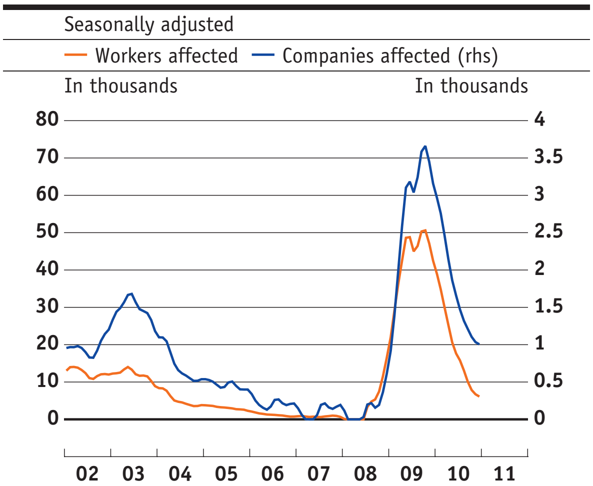
Source: SFSO, seasonal adjustment: SNB

Chart 3.7
Unemployment and job seeker rates



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 3.8
Short-time working



Source: SECO, seasonal adjustment: SNB

With regard to services, consumer spending by Swiss residents when abroad (which is recorded under tourist imports) declined slightly, while imports of other services (mainly spending on licence and patent fees abroad) even showed a marked decline.

3.2 Labour market

Stronger growth in employment

In the fourth quarter, some 12,700 new jobs were created in Switzerland (seasonally adjusted). While the number of employees rose by 1.3%, the volume of work (based on full-time equivalents) increased by 1.4% (cf. chart 3.6). The rate of employment growth is thus once more above its long-term average. Nevertheless, the pace of expansion is significantly slower than before the financial crisis.

A breakdown by sector reveals considerable differences in the pace of employment growth. The strongest growth in employment was recorded in manufacturing. On account of the size of its share, the services sector continued to be the biggest driver of growth in total employment, even though there was a loss of momentum in this sector. In construction, growth remained robust.

Fall in unemployment

The rate of unemployment (seasonally adjusted) continued to fall between November and February. The number of unemployed people registered with regional employment offices decreased by 2,800 (seasonally adjusted), which is equivalent to a decline in the rate of unemployment from 3.6% to 3.4% (cf. chart 3.7). During the same period, the percentage of job seekers decreased from 5.2% to 5.0%.

Evidence of the economic recovery was especially apparent in the reduction in short-time working. The manufacturing industry, in particular, made considerable use of this option during the recession. In December, about 6,200 people (seasonally adjusted) were still working short time. This is equivalent to an eighth of the peak number registered during the recession (cf. chart 3.8).

3.3 Capacity utilisation

Increase in capacity utilisation

As the economy recovered, technical capacity utilisation continued to strengthen in the fourth quarter. According to a survey by KOF Swiss Economic Institute (KOF), in manufacturing, capacity utilisation rose from 83.6% to 84.3%, and was again slightly above its long-term average (cf. chart 3.9). Among the companies surveyed by KOF, a growing proportion complained of a shortage of labour.

In the construction industry, the level of machine utilisation also increased; at 77.6%, the level was higher than any values recorded since the introduction of the survey in 1994 (cf. chart 3.10). In fact, KOF surveys indicate that many companies in this industry have complained about a bottleneck in machinery and equipment capacity. In contrast to manufacturing, the shortage of labour eased.

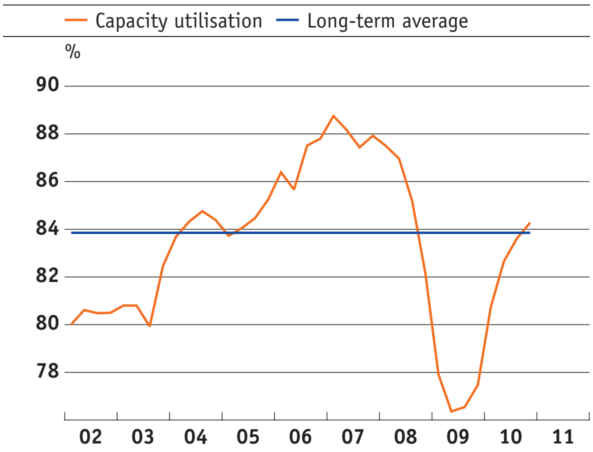
Output gap almost closed

The extent to which the production factors in an economy are utilised is indicated by the output gap, which is defined as the percentage deviation of GDP from estimated aggregate potential output.

Estimates of potential output using different methods all indicate that, in the fourth quarter, GDP was only slightly below potential. Depending on the method used, the output gap amounted to –0.4% (production function), –0.3% (Hodrick-Prescott filter) or –0.2% (multivariate filter). All three methods show that the utilisation of production factors has increased further (cf. chart 3.11).

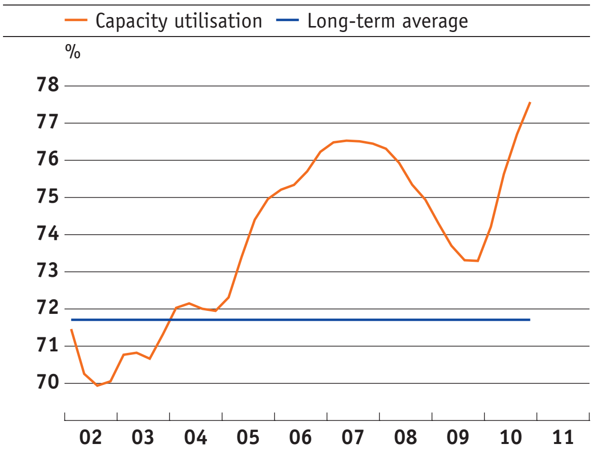
With surveys indicating technical capacity utilisation largely returning to a normal level, the output gap shown by the production function method mainly reflects a slight underutilisation of labour force potential.

Chart 3.9
Capacity utilisation in manufacturing



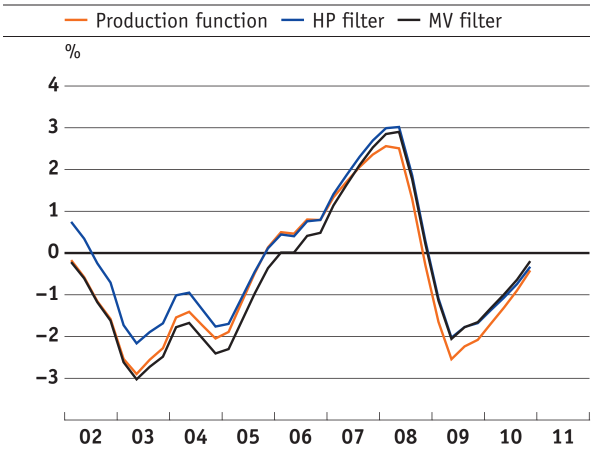
Source: KOF Swiss Economic Institute

Chart 3.10
Capacity utilisation in construction



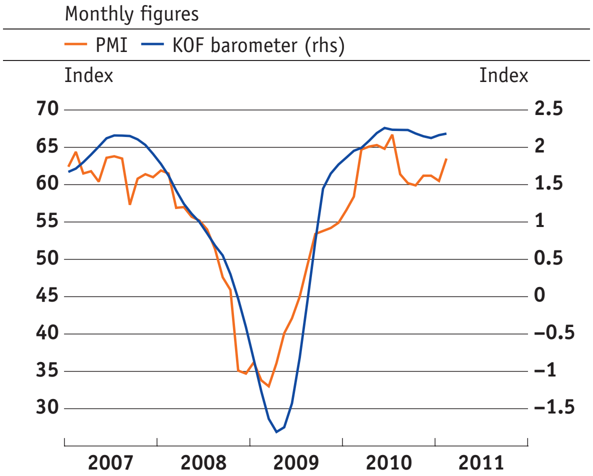
Source: KOF Swiss Economic Institute

Chart 3.11
Output gap



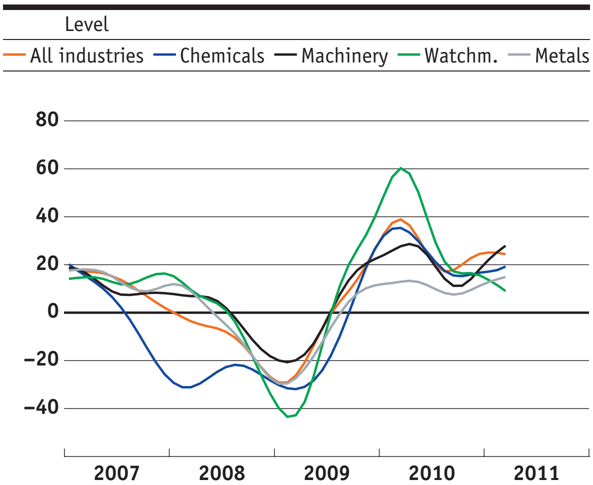
Source: SNB

Chart 3.12
Leading indicators



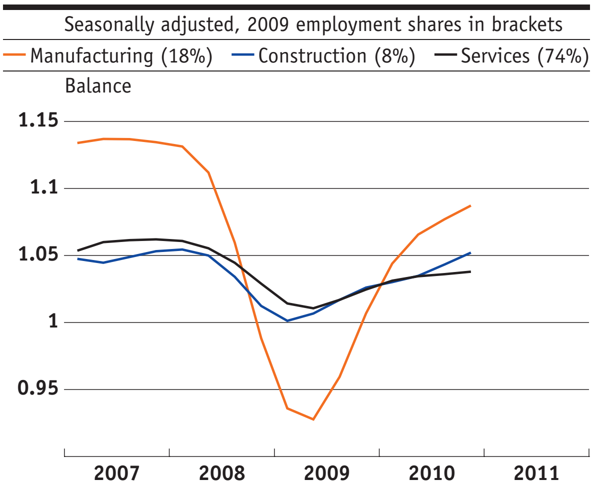
Sources: Credit Suisse, KOF Swiss Economic Institute

Chart 3.13
Expected new orders



Source: KOF Swiss Economic Institute

Chart 3.14
Employment outlook indicator



Source: SFSO, seasonal adjustment: SNB

3.4 Outlook for the real economy

The SNB expects that the economic recovery will continue. Domestic demand will probably again provide growth stimuli. First, households are benefiting from rising incomes and the gradual recovery in the labour market. Second, the high level of orders in hand in the construction industry suggest robust construction activity. Third, increasing technical capacity utilisation is likely to boost corporate investment.

By contrast, exports are unlikely to provide much momentum in the coming months. First, surveys point to increased competitive pressure and narrow margins for many Swiss export firms. Second, with the continued strength of the Swiss franc, goods exports have lost considerable momentum since the spring of 2010, and spending on tourism services has even declined.

After the strong recovery dynamics in 2010, economic activity is likely to lose some momentum during the year. The SNB is forecasting GDP growth of roughly 2% for 2011.

Real GDP and components Table 3.1

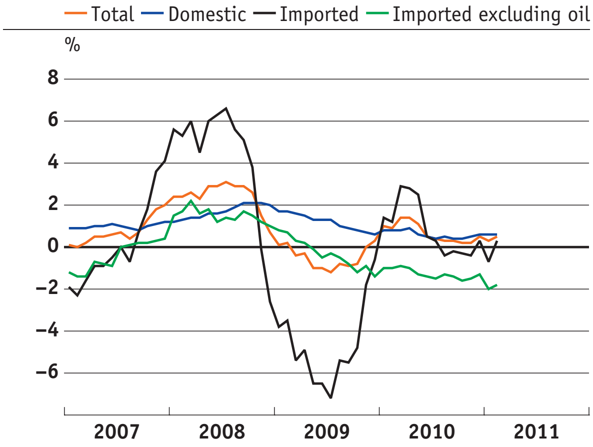
Growth rates on previous period, annualised

	2007	2008	2009	2010	2009				2010			
					Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Private consumption	2.3	1.3	1.0	1.7	1.7	1.6	1.7	2.0	3.1	0.2	1.5	1.1
Government consumption	0.3	1.7	1.6	–1.6	2.4	3.4	1.8	2.0	–9.7	–1.9	1.7	4.9
Investment in fixed assets	5.1	0.5	–4.9	4.6	–18.9	6.5	9.4	4.3	–4.2	11.6	2.1	16.9
Construction	–2.3	0.0	3.0	3.3	–3.4	15.6	8.3	–3.2	–0.7	8.8	2.3	5.0
Equipment	11.1	0.8	–10.8	5.7	–29.7	–0.8	10.5	11.2	–7.2	13.9	1.9	27.7
Domestic final demand	**2.7**	**1.2**	**–0.3**	**2.0**	**–3.3**	**2.9**	**3.4**	**2.5**	**–0.3**	**2.4**	**1.7**	**5.1**
Domestic demand	**1.4**	**0.2**	**0.6**	**0.5**	**7.3**	**–6.2**	**–5.9**	**–0.5**	**–2.0**	**3.5**	**12.5**	**3.0**
Total exports	9.6	3.3	–8.7	9.3	–20.7	–8.6	31.4	12.3	11.9	12.7	–10.4	3.6
Goods[1]	8.3	2.1	–11.1	9.2	–23.8	–3.0	18.2	13.5	12.7	3.1	1.5	13.3
Services	12.8	4.8	–2.0	6.6	–9.6	–18.3	53.7	19.3	–11.2	39.0	–24.6	–9.6
Aggregate demand	**4.4**	**1.4**	**–3.0**	**3.7**	**–3.8**	**–7.1**	**6.3**	**4.2**	**3.1**	**7.0**	**3.0**	**3.2**
Total imports	6.1	0.3	–5.4	6.7	–4.2	–17.7	14.9	8.9	3.7	17.1	2.5	2.4
Goods[1]	6.7	–1.0	–8.5	9.8	–9.3	–22.4	22.0	3.5	18.4	16.9	2.6	5.2
Services	11.2	3.9	8.1	–4.5	2.1	7.9	–6.5	30.4	–43.6	34.8	5.4	–16.5
GDP	**3.6**	**1.9**	**–1.9**	**2.6**	**–3.7**	**–2.0**	**2.8**	**2.1**	**3.0**	**3.0**	**3.1**	**3.5**

1 Goods: excluding valuables (precious metals, precious stones and gems as well as works of art and antiques)
Source: SECO

Chart 4.1
CPI: domestic and imported goods and services

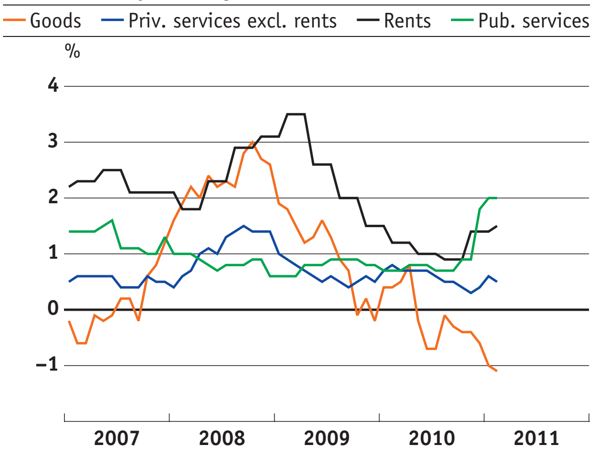
Year-on-year change



Sources: SFSO, SNB

Chart 4.2
CPI: domestic goods and services

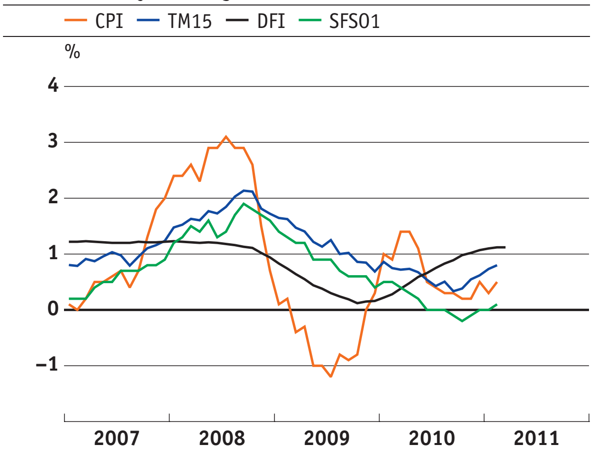
Year-on-year change



Sources: SFSO, SNB

Chart 4.3
Core inflation rates

Year-on-year change



Sources: SFSO, SNB

4 Prices and inflation expectations

Both consumer and wholesale price inflation have remained at a low level over the past few months. Prices for primary products as well as for real estate rose significantly. Surveys indicated stable inflation expectations overall.

4.1 Consumer prices

Slight rise in CPI inflation

Annual inflation, as measured by the national consumer price index (CPI), climbed from 0.2% to 0.5% between November and February. This was mainly attributable to higher prices for petroleum products. The delayed effect of the strong Swiss franc – which is particularly apparent in the lower prices for package holidays – resulted, however, in a further decrease in prices of imported goods excluding oil. Inflation for domestic goods also remained in the negative range. Prices of services, by contrast, made a positive contribution to annual CPI inflation. The sharp increase in prices of public sector services is striking. This is primarily due to the higher prices for public transport introduced in December. Although rents rose significantly between November and February, the change – at 1.5% – was marginal compared to the corresponding month in the previous year.

Moderate core inflation

In order to estimate the inflation trend, the SNB calculates two core inflation rates – the trimmed mean (TM15) and dynamic factor inflation (DFI). The trimmed mean method excludes from the consumer price index, for any given month, those 15% of goods prices with the highest annual rates of change and those 15% with the lowest annual rates of change. The broader-based DFI, by contrast, calculates core inflation using an empirically estimated model that includes other real and nominal economic data as well as price data. According to the trimmed mean method, core inflation rose from 0.5% to 0.8% between November and February. The DFI, which trends slightly ahead of the path of inflation, remained virtually unchanged at 1.1% during the same period. The trimmed mean has thus drawn closer to the DFI.

In February, the two core inflation rates calculated by the Swiss Federal Statistical Office (SFSO) remained below those of the trimmed mean and the DFI, as was also the case in November. In contrast to the core inflation rate calculated using the trimmed mean method, the SFSO core inflation rates exclude the same goods from the CPI basket in any given month. Since the revision of the CPI in 2010, the list of commodities excluded from the calculation of SFSO1 (core inflation 1) includes fresh and seasonal products, energy and fuel (previously: food, beverages, tobacco, seasonal products, energy and fuel).

Annual inflation rate temporarily distorted

One of the changes introduced as part of the 2010 revision of the CPI is that the frequency with which statistics on clothing and footwear prices are collected has been increased. As a consequence, the data collected in January and July on clearance prices are no longer carried forward two months, as was previously the case. The annual inflation rate is thus likely to have an upward bias in the first and third quarters of 2011, as the prices for clothing and footwear recorded in February/March and August/September 2011 are compared to the clearance prices from January and July 2010 respectively.

National consumer price index and components Table 4.1
Year-on-year change in percent

	2010	2010			2010		2011	
		Q2	Q3	Q4	November	December	January	February
Overall CPI	**0.7**	**1.0**	**0.3**	**0.3**	**0.2**	**0.5**	**0.3**	**0.5**
Domestic goods and services	0.6	0.6	0.4	0.5	0.5	0.6	0.6	0.6
Goods	–0.1	–0.0	–0.4	–0.5	–0.4	–0.6	–1.0	–1.1
Services	0.8	0.9	0.7	0.8	0.8	0.9	1.1	1.1
Private services excluding rents	0.6	0.7	0.5	0.4	0.3	0.4	0.6	0.5
Rents	1.1	1.1	0.9	1.2	1.4	1.4	1.4	1.5
Public services	0.9	0.8	0.7	1.2	0.9	1.8	2.0	2.0
Imported goods and services	0.9	1.9	–0.1	–0.1	–0.4	0.3	–0.7	0.3
Excluding oil products	–1.3	–1.2	–1.4	–1.5	–1.5	–1.3	–2.0	–1.8
Oil products	13.9	21.0	8.6	8.5	6.9	11.1	6.8	12.4

Sources: SFSO, SNB

4.2 Producer and import prices

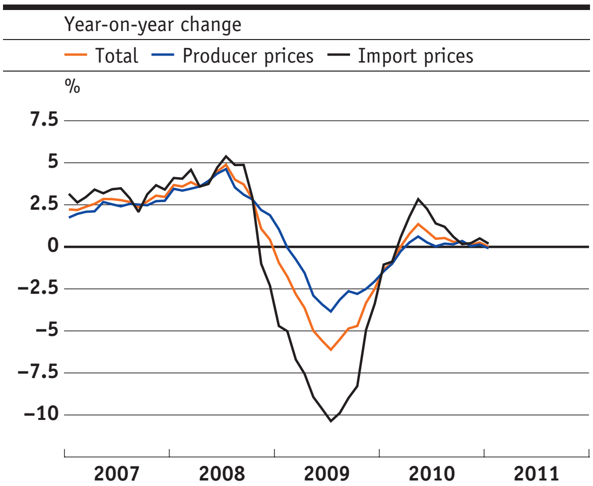
Higher prices for primary products

The total supply price index (producer and import prices) rose slightly between November and January. This increase was due in large part to rising energy and commodity prices. Given the fact that the index had moved up more sharply in the year-back period, the annual inflation rate fell marginally from 0.1% to 0.0%. Upon exclusion of price-volatile goods (this includes many primary products), the prices of total supply fell slightly between November and January and, at –1.3%, were in fact lower than a year earlier.

Moderate impact of strong Swiss franc

The growing strength of the Swiss franc since November has so far had only a moderate effect on the import price index. Aside from the increase in global market prices of many primary products, this is attributable to two other factors. First, the Swiss franc prices of some import goods react with a time lag to movements in the exchange rate, as they are adjusted by companies at only irregular intervals. Second, not all prices in the import price index are collected on a monthly basis, but rather only those of particularly price-volatile goods.

Chart 4.4
Producer and import prices



Source: SFSO

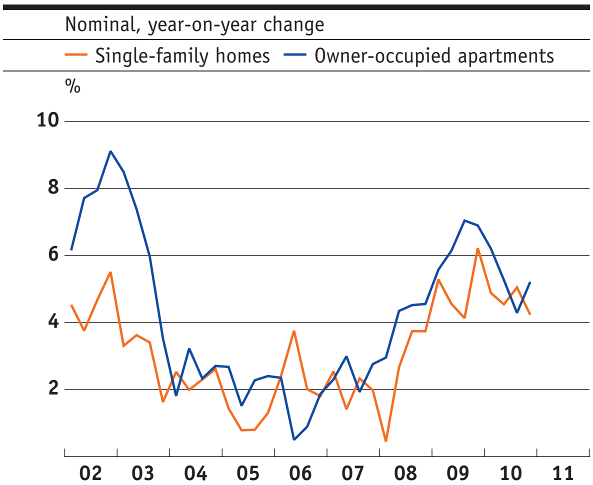
4.3 Real estate prices

Rising prices for residential property

In the fourth quarter of 2010, offer prices exceeded the previous year's level by 4.2% for single-family homes and by 5.2% for owner-occupied apartments. The current price level for residential property appears to be mainly attributable to fundamentals such as the interest rate level, population growth and income trend. The persistently strong inflationary trend in certain regions and market segments cannot, however, be regarded as sustainable and is an indicator of overheating. Against the background of the exceptionally low interest rates and reports of fiercer competition on the mortgage market, these developments should be regarded as warning signals. The current environment continues to provide ample scope for excesses on the real estate market.

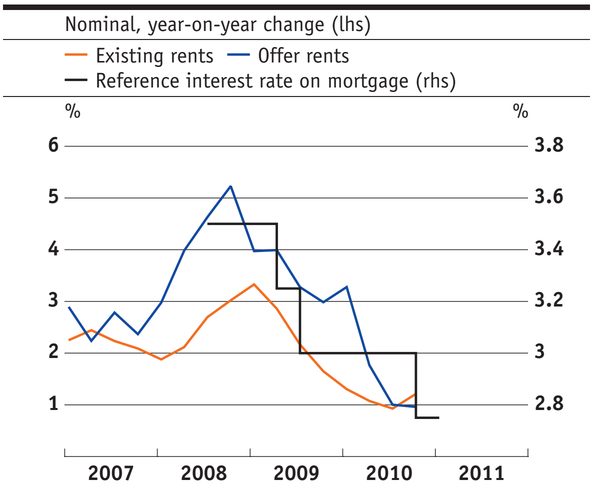
Rent levels are linked to price developments in the residential property market in the long term. After having risen in previous years – sometimes sharply – rents of apartments advertised in the market were a mere 1.0% above the year-back figure. The national consumer price index (CPI), whose rent component is representative of rents paid in Switzerland, showed a similar rent increase. Rent increases reflected in the CPI are characterised by existing tenancies. These are mainly determined in the short term by changes in the mortgage reference rate.

Chart 4.5
Offer prices for residential property



Source: Wüest & Partner

Chart 4.6
Apartment rents and reference interest rate



Sources: Federal Office for Housing (FOH), SFSO, Wüest & Partner

4.4 Inflation expectations

Stable inflation expectations

Surveys of households and companies on future price developments suggest that inflation will remain stable overall. These estimates are essentially derived from three surveys: the SECO survey of private households, the *Credit Suisse ZEW Financial Market Report* and the KOF survey of companies.

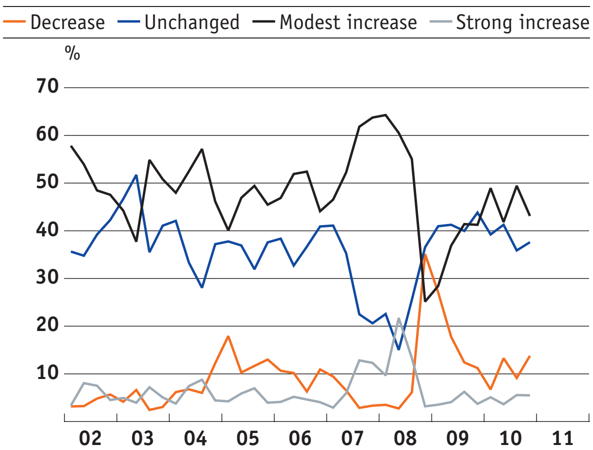
The SECO survey of private households conducted in January shows that the majority of respondents expect prices to remain unchanged or rise somewhat over the course of the next 12 months (cf. chart 4.7). The share of households anticipating falling prices rose slightly compared to the October survey. However, it is under 15% and thus considerably lower than during the recession.

According to the *Credit Suisse ZEW Financial Market Report,* the CPI inflation expectations for the next six months as reported by some 70 analysts surveyed in February tended to be higher than those in December 2010. Of these respondents, 49% expected inflation rates to be higher and 46% unchanged. Contrary to the SECO survey of private households, the share of respondents expecting falling prices declined. While in December 15% expected prices to drop, this figure was only 5% in February.

Mixed sale price expectations in wholesale and manufacturing

The results of the quarterly survey by KOF Swiss Economic Institute show that, in January, wholesalers expected purchase and sale prices to rise over the coming three months. Wholesalers' price expectations shifted upwards considerably compared to the surveys conducted in the second half of 2010. The January survey indicated that manufacturing – unlike the wholesale industry – expected higher purchase prices, but slightly lower sale prices. Expectations in manufacturing remained fairly stable in the second half of the year.

Chart 4.7
Survey on expected movements in prices



Sources: SECO, SNB

5 Monetary developments

The effect of the expansionary monetary policy continues to be reflected in monetary and financial conditions in Switzerland. Since December, the three-month Libor has remained virtually unchanged within the lower part of the target range. Long-term interest rates have risen since August, but remain low.

After the Swiss franc had appreciated sharply between June and December, its value remained essentially unchanged compared to the December assessment. At the same time, its performance was characterised by considerable fluctuations. Overall, the real trade-weighted external value of the Swiss franc remained at a historically high level.

The vigorous growth of the broader monetary aggregates has continued since the last monetary policy assessment. The rise in long-term interest rates can be expected to stabilise money growth to a certain degree.

Lending activity remained brisk in the fourth quarter of 2010. According to the SNB survey on bank lending, there were virtually no changes in corporate lending. Banks reported the same lending standards and no change in the demand for loans. Growth in mortgage lending decelerated marginally, but remains at a high level. The situation on the mortgage and real estate markets still requires the full attention of the SNB.

5.1 Summary of monetary policy since the last assessment

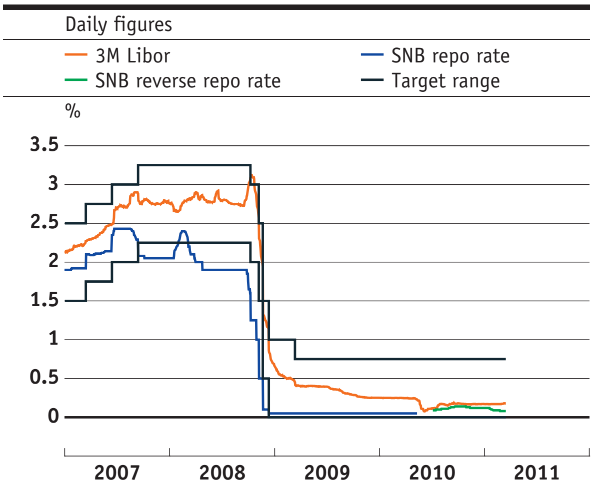
Expansionary monetary policy maintained

At its monetary policy assessment of December 2010, the SNB decided to maintain its expansionary monetary policy. It left the target range for the three-month Libor unchanged at 0.0–0.75% and announced that it would aim for the lower part of the range, at around 0.25%. Since the last assessment, the three-month Swiss franc Libor had remained virtually unchanged, at 0.17%. The SNB held domestic banks' sight deposits at a high level, similar to that of the previous period. Between mid-December 2010 and mid-March 2011, it continued to issue SNB Bills and engage in liquidity-absorbing repo operations to manage liquidity in the Swiss franc market.

Liquidity-absorbing repo transactions

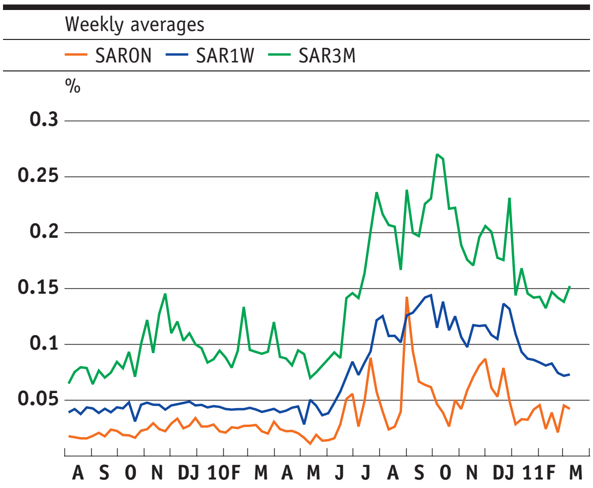
The average amount outstanding for liquidity-absorbing repo transactions rose slightly between December and March, to CHF 25 billion. Auctions for one-week repos were carried out daily. The average amount bid by market participants was CHF 37 billion, which was sometimes well above the amount allocated. The interest rate for repo auctions was lowered from 0.12% to 0.08%.

Chart 5.1
Money market rates



Sources: Reuters, SNB

Chart 5.2
Swiss Reference Rates



Source: SIX Swiss Exchange Ltd

Stock of SNB Bills unchanged

The total stock of SNB Bills remained virtually unchanged between December and March, at CHF 116 billion. The SNB issued bills on a weekly basis; as a rule, 28-day terms are offered, together with a longer term which alternates between 84, 168 and 336 days (always in that order). The amounts bid by market participants varied between CHF 2 billion and CHF 22 billion, depending on the term offered. An average of 64% of SNB Bills that were bid for was allotted. Owing to heavy demand from market participants, marginal yields on SNB Bills have been declining steadily since mid-January 2011, ranging between 0.09% and 0.38% depending on the term. The average residual maturity of the overall stock of SNB Bills rose from 63 days to 74 days.

Domestic banks' average sight deposits between mid-December and mid-March amounted to CHF 27 billion. Between 20 November 2010 and 19 February 2011, average statutory minimum reserves were CHF 9.8 billion, virtually unchanged from the previous period (20 August to 19 November 2010). On average, banks exceeded the requirement by around CHF 22.6 billion (previous period: CHF 24.5 billion). The average degree of compliance fell from 349% to 331%.

5.2 Money and capital market interest rates

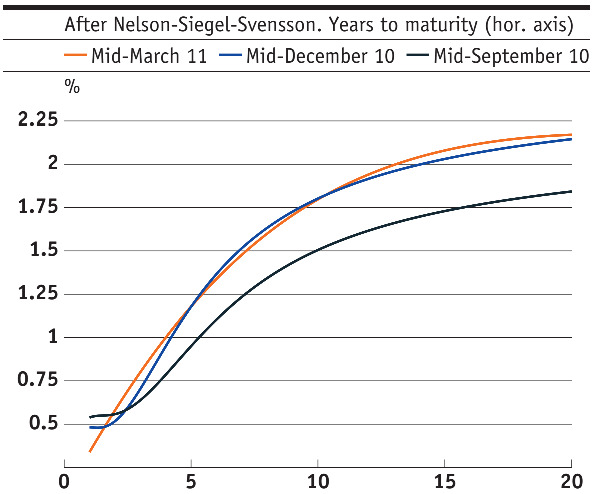
Money market interest rates remain low

Rates for unsecured money market investments hardly changed between mid-December and mid-March. The three-month Libor, which had dipped below 0.10% last June, remained relatively steady at around 0.17% (cf. chart 5.1). Money market rates for secured investments, by contrast, fell slightly (cf. chart 5.2). Thus, the weekly average for the three-month Swiss Average Rate (SAR3M) declined from around 0.20% in December to 0.15% in March.

Rising long-term rates

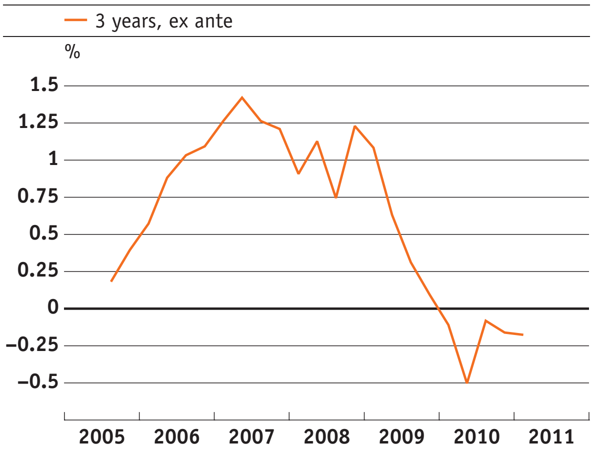
In contrast to short-term money market rates, bond yields continued their moderate upwards trend. The shift towards higher long-term interest rates reflects an international trend, although it is less pronounced in Switzerland compared to other countries. At 1.8% in mid-March, the yield on ten-year Swiss Confederation bonds was markedly higher than at the beginning of the year (1.6%). Taking the August 2010 trough (1.1%) as a starting point, they have increased by some 70 basis points over the last seven months. Yields also rose on highly rated Swiss corporate bonds. Thus the yield differential between corporate and government bonds was virtually unchanged. Despite the increase, long-term interest rates continue to be at historically low levels.

Chart 5.3
Term structure of Swiss Confederation bonds



Source: SNB

Chart 5.4
Estimated real interest rate



Source: SNB

Steeper yield curve

The divergent movements in short and long-term rates led to a slightly steeper yield curve in mid-March (cf. chart 5.3). For the same reason, the term spread – the difference between the yield on ten-year Confederation bonds and the three-month Libor – also widened. In mid-March, it was 1.6 percentage points, and thus above the historical average of 1.2 percentage points.

Stimulus from real interest rates

The three-year real interest rate continues to be slightly negative, at an estimated –0.2% for the first quarter of 2011 (cf. chart 5.4). This is virtually unchanged compared to the previous quarter, as both inflation expectations and nominal interest rates have risen slightly. The inflation expectations used in calculating the real interest rate are based on the inflation forecasts generated by various SNB models. It is therefore likely that real interest rates will continue to stimulate domestic demand.

5.3 Exchange rates

Swiss franc volatility continues

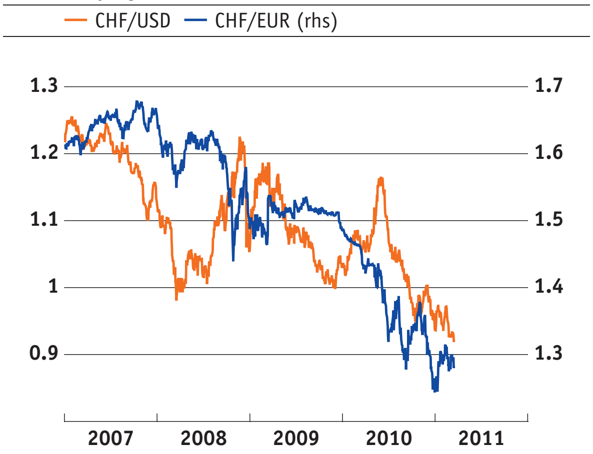
Having risen strongly against the euro at the end of the year, the Swiss franc gave back some of those gains in January. The unrest in the Middle East and North Africa prompted a renewed appreciation in the Swiss franc against the euro and the US dollar.

Slightly tighter monetary conditions

The exchange rate developments meant that monetary conditions, as measured by the Monetary Conditions Index (MCI), tightened somewhat between the December assessment and mid-March (cf. chart 5.6). Since there was no change in the three-month Libor, the tighter conditions are due entirely to the export-weighted external value of the Swiss franc. The MCI combines changes in the three-month Libor and in the nominal trade-weighted external value of the Swiss franc in a ratio of 3:1. The MCI is reset to zero at the time of each monetary policy assessment. A positive value indicates tighter monetary conditions.

Chart 5.5
Exchange rates

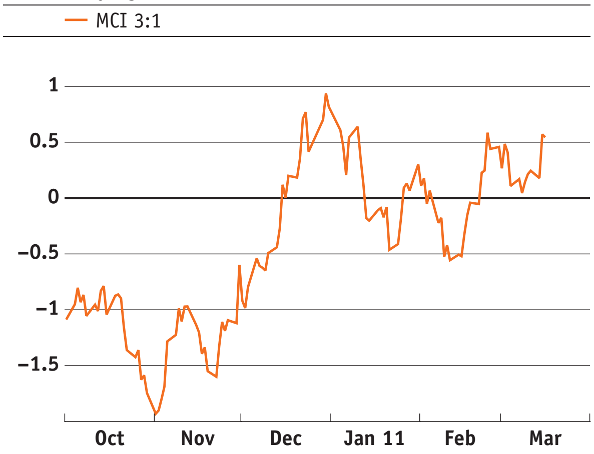
Daily figures



Source: SNB

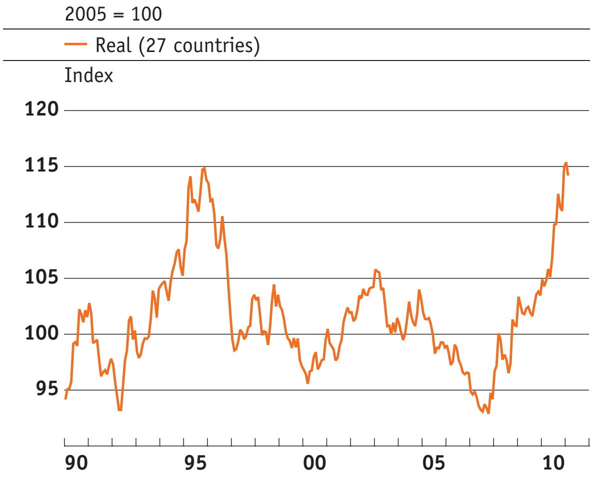
Chart 5.6
MCI nominal

Daily figures



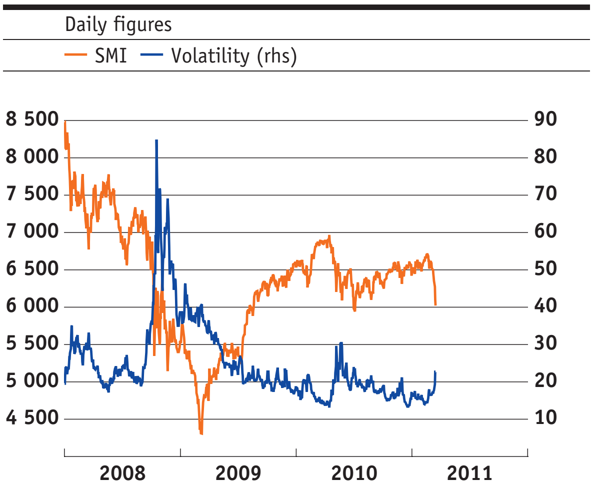
Source: SNB

Chart 5.7
Trade-weighted external value of Swiss franc



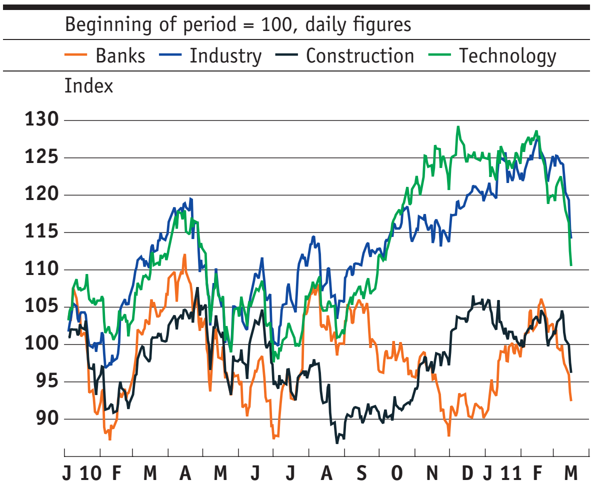
Source: Bank for International Settlements

Chart 5.8
Share prices



Source: Thomson Financial Datastream

Chart 5.9
Selected SPI sectors



Source: Thomson Financial Datastream

Swiss franc at historically high level

As the real trade-weighted external value of the Swiss franc shows, the Swiss franc is at a historically high level, a situation comparable to that experienced in 1995 (cf. chart 5.7). To arrive at the real external value, nominal exchange rates are adjusted for the different price developments in different countries. The recent increase in this value shows that exchange rate developments are weighing on export competitiveness.

5.4 Stock markets

Rising share prices up to mid-February

Up to mid-February, the prices of Swiss shares listed in the SMI and SPI indices rose further, although, as in previous months, the rise was somewhat smaller than that in other countries. These price gains were quickly reversed, however, partly due to the political unrest in the Middle East and Africa as well as the devastating earthquake in Japan (cf. chart 5.8).

Between the December assessment and mid-February, positive economic news was a factor driving banks' shares, in particular. Manufacturing and technology companies also saw price gains, while construction industry shares fell (cf. chart 5.9). This reversed the trend observed between mid-September and mid-December, when banks' share prices had suffered the heaviest losses while construction company shares had experienced the largest price increases.

In addition, until mid-February stock markets benefited from a decline in market uncertainty. The market's volatility expectations can be derived from the share index options traded on futures exchanges. The SMI volatility index, which measures the expected volatility of the SMI 30 days ahead, was 16 on average in the first two months of 2011, compared to 26 in 2009 and 18 in 2010 (cf. chart 5.8).

5.5 Monetary and credit aggregates

Low money multiplier

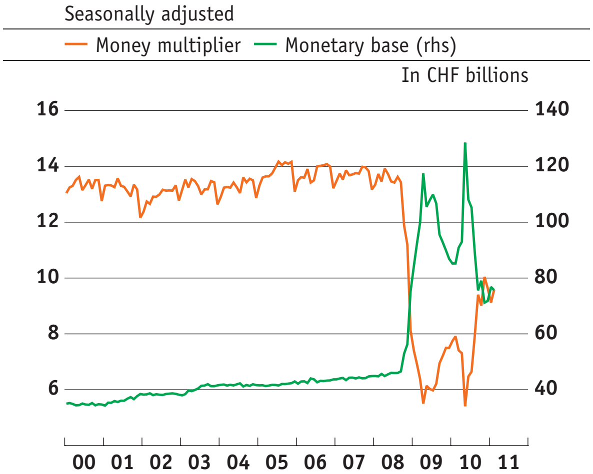
The money multiplier – which is the ratio of the broad M3 monetary aggregate to the monetary base M0 – is still substantially below its pre-crisis levels (cf. chart 5.10). However, in the second half of 2010 it recovered from its low level as a result of liquidity-absorbing operations by the SNB and a further expansion of M3.

The multiplier 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 financial crisis, the monetary base, which consists of banks' sight deposits at the SNB and banknotes in circulation, has increased sharply, due to banks holding greater supplies of liquidity for precautionary reasons. Consequently, the money multiplier has fallen sharply. For over two years now, it has remained at a very low level and been subject to considerable fluctuations, whereas before the crisis it had been comparatively stable.

Rising monetary aggregates

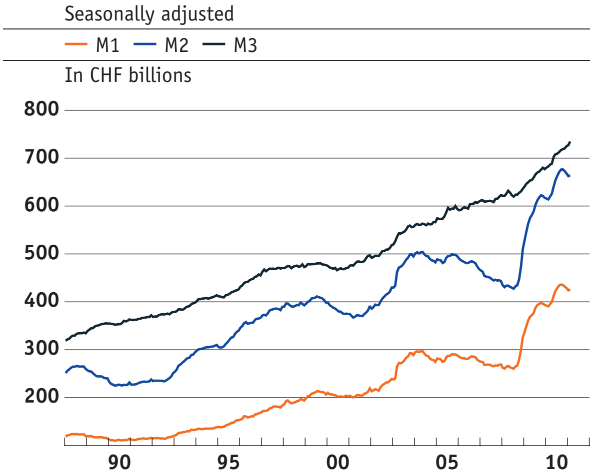
Despite the fall in the money multiplier, the M1, M2 and M3 monetary aggregates have registered strong growth since autumn 2008 (cf. chart 5.11). In February 2011, M1 (banknotes in circulation, sight deposits and transaction accounts) and M2 (M1 plus savings deposits) were up by 9.2% and 8.3%, respectively, year on year. M3 (M2 plus time deposits), which is typically less volatile than the other aggregates, expanded by 7.7% (cf. table 5.1).

Chart 5.10
M3 money multiplier



Source: SNB

Chart 5.11
Monetary aggregates



Source: SNB

Monetary aggregates and bank loans
Year-on-year change in percent

Table 5.1

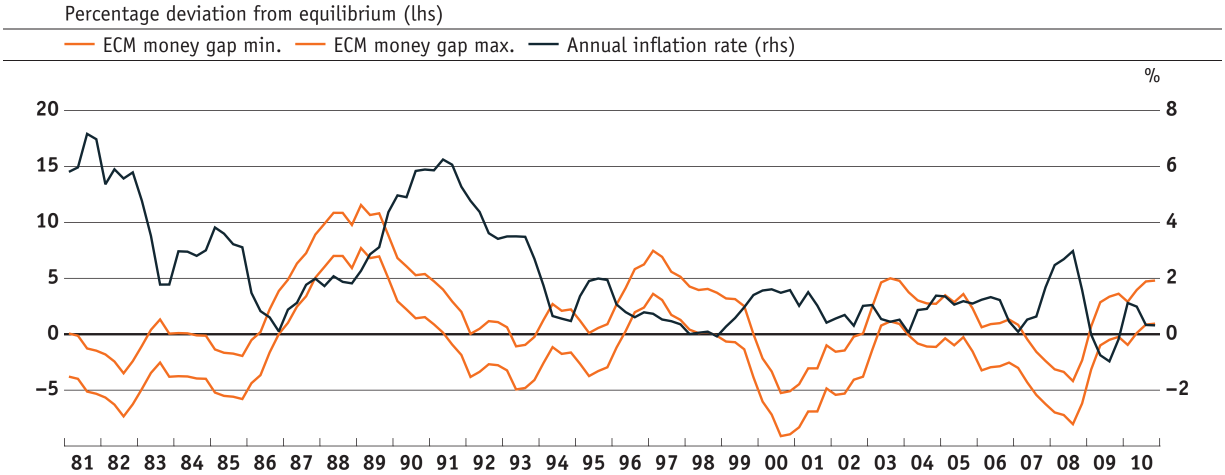
	2010	2010 Q1	Q2	Q3	Q4	2010 December	2011 January	February
M1	**10.6**	**12.5**	**10.6**	**10.3**	**9.1**	**9.0**	**8.3**	**9.2**
M2	**10.2**	**12.9**	**10.2**	**9.6**	**8.4**	**8.3**	**7.7**	**8.3**
M3	**6.4**	**5.8**	**6.8**	**6.5**	**6.4**	**7.0**	**6.8**	**7.7**
Bank loans total[1,3]	**3.8**	**3.8**	**4.2**	**3.5**	**3.8**	**4.1**	**3.5**	**–**
Mortgage claims[1,3]	5.0	5.2	5.1	4.9	4.7	4.6	4.5	–
Households[2,3]	4.9	5.3	4.9	4.7	4.7	4.6	4.4	–
Private companies[2,3]	5.2	5.7	5.3	5.1	4.6	4.8	5.0	–
Other loans[1,3]	–1.1	–1.9	0.7	–2.8	–0.5	1.9	–1.1	–
Secured[1,3]	3.6	2.7	4.2	3.1	4.4	7.4	5.8	–
Unsecured[1,3]	–3.9	–4.4	–1.4	–6.4	–3.5	–1.5	–5.2	–

1 Monthly balance sheets.
2 Credit volume statistics.
3 Growth rates for the bank loans item and for its components include information provided by banks on changes in their classification.
Source: SNB

The money gap indicator presented in chart 5.12 is positive, which indicates rising inflation in the medium term. The money gap is the percentage deviation of the 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.[1] This indicator can be used to assess potential inflation or deflation risks resulting from an excessive or insufficient supply of liquidity to the economy. Chart 5.12 shows the calculated money gap in the form of a range that spans one standard deviation, thereby taking account of statistical uncertainty.

1 Cf. box 'Money supply growth and inflation', *Quarterly Bulletin*, 1/2005, p. 33.

Chart 5.12
Money gap and annual inflation rate



Source: SNB

Robust credit growth

In the fourth quarter, year-on-year growth in bank loans was stronger than in the previous quarter. The main factor behind the slight acceleration in loan growth was other (i.e. non-mortgage-backed) loans, which, while still decreasing, did so at a more modest pace than one quarter earlier. As a rule, other loans keep pace with the development of the economy. However, as chart 5.13 shows, the decrease during the recent recession was very much smaller than that during the recession at the beginning of the last decade. The breakdown of other loans into secured and unsecured loans makes it clear that, in the fourth quarter, both components contributed to the faster growth of other loans.

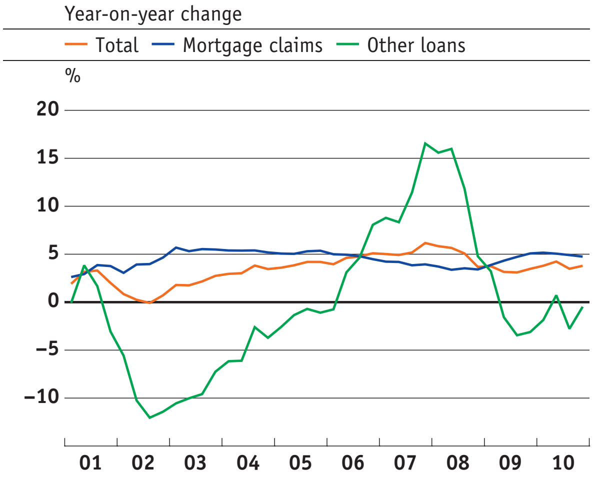
Mortgage claims grew strongly because of the low interest rates. The rate of growth in mortgage claims had risen sharply following the reduction of the three-month Libor in autumn 2008, and has remained at a high level ever since. At 4.7% in the fourth quarter of 2010, the growth rate for mortgages was only slightly lower than in the previous quarter. In the SNB survey on bank lending, banks with a market share of around 15% reported that they had slightly tightened their lending standards for mortgage loans to households. All other banks reported unchanged lending standards. According to the same survey, the demand for mortgages on the part of households was virtually unchanged from the previous quarter.

Chart 5.14 shows the effect of the interest rate cut in autumn 2008 on the remaining terms of mortgage claims. Experience shows that, when interest rates are low, long-term fixed rate mortgages are preferred to variable rate mortgages. In October 2008, mortgages with an early repayment option, which generally tend to be variable rate mortgages, still accounted for 30% of all mortgage claims. By December 2010, this percentage had fallen to 13%. Over the same period, the share of mortgages with a remaining term of more than one year increased from 51% to 63%.

Increase in loan/GDP ratio

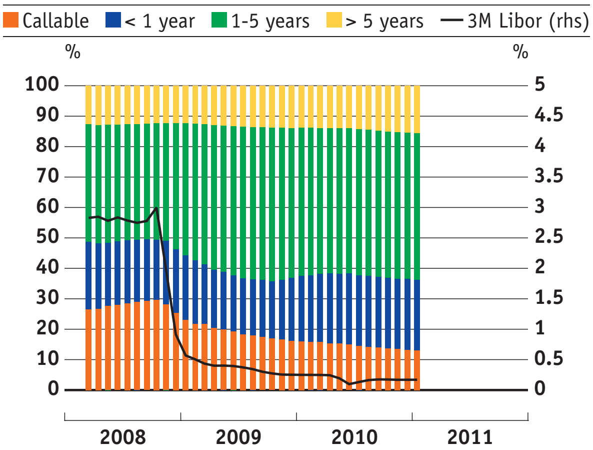
The strong growth in bank lending is also reflected in the ratio of bank loans to GDP (cf. chart 5.15). Since the outbreak of the financial crisis, this ratio has increased markedly. Prior to that, it had been fairly stable up until mid-2008 – following a sharp rise in the 1980s. The increase observed in recent years suggests that banks' lending activities have supported aggregate demand over the past few years.

Chart 5.13
Growth in bank loans



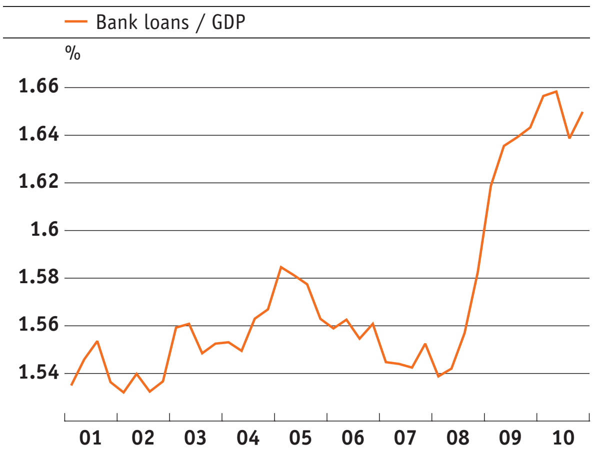
Source: SNB

Chart 5.14
Breakdown of mortgages by term remaining



Source: SNB

Chart 5.15
Bank loans as a percentage of GDP



Source: SNB

Business cycle trends
SNB regional network

Summary report for the attention of the Governing Board of the Swiss National Bank for its quarterly assessment of March 2011

First quarter of 2011
The Swiss National Bank's delegates for regional economic relations are constantly in touch with a large number of enterprises from the different economic sectors and industries. Their reports, which contain subjective evaluations by these companies, are a valuable 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 2011 with 243 company representatives on the current and future situation of their companies and the economy in general. The selection of companies was made according to a model that reflects Switzerland's production structure. The companies selected differ from one quarter to the next. The reference parameter is GDP excluding agriculture and public services.

Region	Delegate
Geneva	Marco Föllmi
Mittelland	Anne Kleinewefers Lehner
Northwestern Switzerland	Thomas Kübler
Eastern Switzerland	Jean-Pierre Jetzer
Italian-speaking Switzerland	Mauro Picchi
Vaud-Valais	Aline Chabloz
Central Switzerland	Walter Näf
Zurich	Markus Zimmerli

Summary

The favourable economic trend continued in the first quarter. As in the previous quarters, the continued upward movement was most evident in manufacturing, despite a slight decline in momentum. The growth trend also continued in the services sector, although it weakened a little. Business activity in the construction industry stabilised at a high level. Overall, the demand for labour increased only marginally.

Respondents remain confident as regards developments in the near future. Expectations for coming months suggest continued growth in turnover in manufacturing, services and, to a lesser extent, construction. The manufacturing industry, in particular, is planning to increase investment. In all three sectors, technical production capacity utilisation in the Swiss economy is normal to good.

Despite the improvement in business activity, a number of concerns remain as regards the sustainability of the global economic recovery. Although uncertainties related to the state of government finances at international level have declined, the conflicts in North Africa have given rise to a new situation, whose risks are still difficult to appraise. In addition, some of the respondents fear that inflation risks and sudden interest rate hikes could result from the very expansionary monetary policies still being pursued around the world.

As was already the case in the fourth quarter of 2010, reactions to the appreciation of the Swiss franc vary considerably. Overall, however, the pressure on the economy has hardly changed at all (cf. ‘Exchange rate survey: Effects of Swiss franc appreciation and company reactions’, pp. 38–43).

1 Business activity

Manufacturing

In the first quarter of 2011, the economic situation for manufacturing improved, both quarter-on-quarter and year-on-year. However, growth was no longer as strong as in the fourth quarter of 2010. Turnover in real terms rose noticeably compared to the previous year, with only a few companies posting turnover figures that were still below last year's level. The improvement in watchmaking, metal processing, machinery and machine tools has been particularly pronounced within the past year. Favourable developments were also recorded in plastics, chemicals and pharmaceuticals and in the electronics and furniture industries.

Domestic demand held strong while demand from abroad also remained lively. Demand from the emerging economies of Asia was still exceptionally strong, while stimuli from the US strengthened and those from South America remained vigorous. Demand from Germany showed sustained momentum, as did that from France and Italy, albeit to a lesser degree. Various industries continued to benefit, directly or indirectly, from strong demand on the part of the European automotive industry.

Construction

Business momentum in the construction industry was maintained, at a slightly diminished level. Utilisation levels are good in both building construction and civil engineering, and resources are accordingly scarce. Current turnover is above last year's levels and those of the previous quarter, although momentum has declined somewhat. Residential construction is still the main driver of growth, although the finishing sector is also making a contribution. At present, the positive overall trend looks set to continue.

Once again, a number of respondents expressed their concern about increasing real estate market risks associated with the ongoing low interest rate policy and the strong demand for mortgages that it engenders. In some regions there is talk of 'unrealistic' or 'irrational' movements in the prices of land and real estate.

Services

In the services sector, turnover figures were good, exceeding the levels of both the previous year and the previous quarter. Assessments were almost unchanged by comparison with the fourth quarter of 2010. The greatest momentum was recorded by travel agencies, recruitment firms, insurance companies, banks, IT and hospitality, where turnover was well above that of the previous quarter. Architects, engineering and consulting firms, and wholesalers also recorded continued robust growth in turnover. However, retail business was very volatile. In border regions, in particular, the weakness of the euro is making itself felt in the form of a noticeable loss of custom to neighbouring countries. Overall, the momentum of business activity weakened somewhat for retailers, although lower turnover was often attributable to substantial price reductions rather than a drop in demand.

2 Capacity utilisation

Overall, the degree of capacity utilisation was judged to be not quite as high as in the fourth quarter of 2010. In manufacturing, construction and services, capacity utilisation exceeded the normal level by a smaller margin than it had in the previous quarter.

Manufacturing representatives continued to report good utilisation of technical capacity overall, although a number of companies mentioned a conflict between capacity and profitability which had even caused a few of them to turn down orders. Utilisation was on the high side in plastics manufacturing, watchmaking, chemicals and timber processing. Underutilisation was reported by some individual representatives in pharmaceuticals and textiles.

In construction, technical capacity utilisation remained at a high level, although it was markedly lower than that of the previous quarter. No companies reported unsatisfactory capacity utilisation. While, in the previous quarter, companies had still tended to expect a decline in utilisation, this quarter's survey showed that they were once again anticipating a slight increase in the months ahead.

In the services sector, capacity utilisation was normal, as in the previous quarter. The areas with the highest level of capacity utilisation, by far, were architects and engineering and consulting firms. Travel agents and software manufacturers also reported relatively high capacity utilisation. Trade reported normal capacity utilisation overall. Underutilisation was recorded by the hotel industry and by banks, whose representatives expressed dissatisfaction in connection with unfavourable business results achieved in asset management.

3 Demand for labour

In manufacturing, the further recovery in business activity continued to have a favourable impact on the demand for labour. Overall, representatives of manufacturing companies considered their staff levels to be on the low side, although these levels have been approaching requirements. However, a certain amount of caution as regards new recruitment was still evident. A shortage of labour was reported in electronics, watchmaking and chemicals. Personnel resources were also tight among timber processing firms. Individual companies from the textiles, metal manufacturing and processing industries reported that staff numbers were on the high side.

In the construction industry, too, the demand for labour continued to rise slightly. The majority of respondent companies were satisfied with their current staff numbers, although a number of them reported increasing difficulties filling vacant positions. In some instances, a lack of adequate personnel resulted in bottlenecks.

In the services sector, staff levels were generally considered appropriate to a little too low. Architects, engineering firms, planning offices, recruitment and IT firms all reported a need to recruit staff. The hotel industry was slightly overstaffed.

In general, difficulties in finding new staff have increased further. Compared to the previous quarter, recruitment has become more arduous and time-consuming in all sectors. This phenomenon was particularly pronounced in chemicals, electronics, recruitment firms, architectural and engineering firms. Generally speaking, well qualified personnel still tended to be hard to find. Although the free movement of persons has had a beneficial effect overall, the labour market for certain job sectors appears to have dried up. Retailers did not have any significant recruitment problems.

Per capita labour costs showed a slight upward tendency in most business sectors. This mainly reflects pay rises agreed for this year. Compared to the previous quarter, wage pressure has increased, particularly in parts of the manufacturing industry but also in the services sector. Companies in machinery, watchmaking and pharmaceuticals, in particular, were faced with higher per capita costs. Wage pressure was also maintained in construction. In the services sector, increased labour costs were mainly reported by insurance companies, retailers, IT and recruitment firms.

4 Prices, margins and earnings situation

As in the previous quarters, profit margins in manufacturing were judged to be significantly tighter than usual. Although higher production and turnover volumes, per se, again helped to improve margins since fixed costs were more fully absorbed, this effect was unable to offset the general pressure on margins. Margins are likely to remain under pressure since companies expect purchase prices to continue rising, while it is unlikely that sale prices in Swiss francs can be increased to the same extent – partly due to intense competition and partly because of the exchange rate effect.

In construction, profit margins were judged to be close to normal. Compared to the previous quarter, the assessment of the situation has improved. Company representatives continued to expect further increases in commodity purchase prices. They considered it somewhat less likely than in the previous quarter that they would be able to charge higher sale prices. Competition with foreign providers in Switzerland has further intensified.

Overall, respondents in the services sector regarded their profit margins as largely normal.

Indeed, their assessment has improved over that of the previous quarter. As in the previous quarters, the overall result was negatively affected by banks' margins, which were clearly unsatisfactory. The reasons for these poor margins – apart from the low rate of interest – were the continued intense competition in mortgage lending as well as exchange rate movements which impaired asset management income. Representatives of recruitment firms, fiduciary companies, consultancy firms, transport companies and hotels also classified their profit margins as unsatisfactory. By contrast, travel agencies, IT firms and real estate management companies reported a relatively comfortable margin situation.

5 Impact of Swiss franc appreciation

As in the two previous quarters, the exchange rate situation was again raised with companies in the survey conducted in January and February 2011. When asked specifically about the impact of the appreciation of the Swiss franc on their business, 47% of the companies said they had experienced negative effects overall. This means that the situation remains unchanged from the assessment in the fourth quarter of 2010. A total of 37% of companies were unaffected by the appreciation, while 16% reported positive effects.

However, the effects varied considerably, depending on the production sector in question. Once again, manufacturing felt the most negative effects of the strength of the Swiss franc. These effects mainly took the form of greatly reduced profit margins and, to a lesser extent, a decline in sales volumes. By contrast, positive effects were mainly derived from lower import prices and, in some cases, lower investment costs.

In both the construction industry and the services sector, a majority of companies remained unaffected by the strength of the Swiss franc. However, its impact was perceptible in the tourism industry, in particular.

6 Outlook

The outlook for business activity, employment and investment remains favourable overall. Most company representatives are cautiously optimistic.

The great majority of manufacturing company representatives anticipate continuing growth in turnover and higher capacity utilisation in the coming six months. More staff recruitment is planned, but the pace of recruitment will be somewhat less forced than in the fourth quarter of 2010. With regard to the longer-term perspective, companies still have reservations about the sustainability of the current economic momentum, although their confidence has increased a little.

Companies in the construction industry remain largely optimistic, maintaining that a 'trend break' cannot be distinguished. They anticipate a further slight increase in turnover and capacity utilisation – in this respect, the positive assessment has actually risen slightly compared to the previous quarter. Companies are also planning a slight expansion in staff numbers. In the residential and finishing areas, companies are anticipating a stabilisation of capacity utilisation at the current high level.

In the services sector, expectations with regard to business activity over the next six months remain favourable. Compared to the previous quarter, assessments have trended upwards – this relates to expected turnover, capacity utilisation and recruitment plans alike. Representatives of IT, travel agencies and a number of hospitality businesses are particularly optimistic about their turnover prospects, but there is also confidence among bank, real estate and wholesaling representatives. By contrast, hotel operators in tourist regions express reservations.

The global risk factors that were most often mentioned in past quarters – uncertainty about the sustainability of the global recovery and risks in connection with the indebtedness of European countries and banks – have diminished somewhat. Risks emanating from the unrest in North Africa have now become the focus of attention. Quite a few industries are faced with sharp rises in the prices of commodities.

As regards further economic developments, overall uncertainty has declined. Business representatives are mainly concerned about the erosion of margins, staff shortages, a further appreciation in the Swiss franc and the sharp increases in the prices of some commodities. As in previous quarters, some respondents expressed unease about the continued low level of interest rates and the possible risk of inflation.

Investment plans continue to show an upward trend, particularly in manufacturing as well as, to a lesser extent, in the services sector. In manufacturing, the assessment in this respect has firmed up, compared to the fourth quarter, for both equipment investment and construction investment. In construction, the aim is to hold investment steady at the current level.

Exchange rate survey:
Effects of Swiss franc appreciation and company reactions
SNB regional network

Summary report for the attention of the Governing Board of the Swiss National Bank for its quarterly assessment of March 2011

First quarter of 2011
In the economic survey for the first quarter, which was carried out in January and February 2011, delegates from the SNB's regional network systematically raised the exchange rate question a third time with companies, posing questions with the aim of quantifying the effects of the Swiss franc appreciation. A total of 243 companies took part in the survey. The selection of companies is made according to a model that reflects Switzerland's production structure. The companies selected differ from one quarter to the next. The reference parameter is GDP excluding agriculture and public services.

1 Overall results of the survey

Since mid-2007, upward pressure has been exerted on the Swiss franc. The sectors of the economy are very differently affected, as is evident from chart 1. Overall, 47% of respondent companies spoke of negative effects (23% significantly negative and 24% slightly negative). This is in line with the result already observed in the final quarter of 2010, when companies with negative effects had accounted for 45% of the total sample.

A total of 37% of companies said they had not felt any significant effect on their business activities from the appreciation of the Swiss franc. As can be seen from chart 2, most of these companies either lack exchange rate exposure or benefit from hedging strategies or compensatory factors which help to neutralise the exchange rate effects. Accordingly, the vast majority of these companies are not anticipating any impact in the near future either (cf. chart 3).

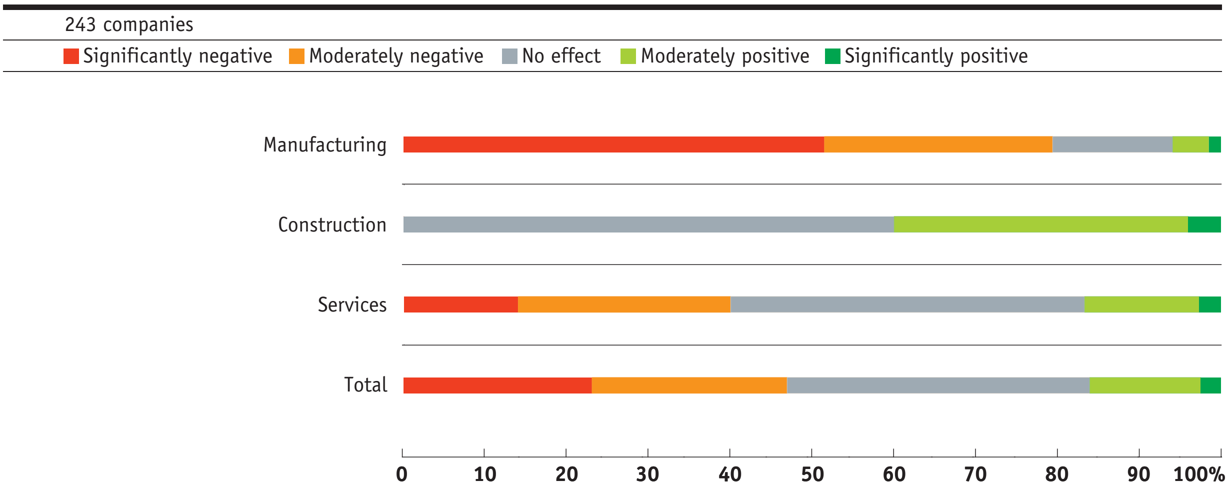
Positive effects from the appreciation of the Swiss franc were experienced by the remaining 16% of companies included in the survey.

Companies in the manufacturing industry were most frequently negatively affected by the strength of the Swiss franc. Compared to the previous quarter, the level of negative effects in this industry has remained more or less unchanged. This time, 28% of companies were slightly negatively affected and 51% significantly negatively affected. In the services sector, the majority of companies (60%) were spared negative effects from the strength of the Swiss franc. However, a greater proportion of companies than in the fourth quarter was faced with significantly negative effects (14%, compared with 7% in the previous quarter). In the construction industry, the results of former surveys – that the appreciation has had virtually no negative effect to date – were confirmed. Indeed, 40% of respondent construction companies registered positive rather than negative effects on their business activity. However, mention should be made of the existence of manufacturing companies with construction-related activities that experienced negative effects due to strong competition from abroad. These companies are included under manufacturing and therefore do not affect the results for the construction industry.

2 Negative effects – where and how?

Just under half of the respondent companies (114) reported slightly negative or significantly negative effects from the appreciation of the Swiss franc. Chart 4 shows the markets where these negative effects were observed and the form they took. Export activities continued to be most strongly affected. A large majority of the companies that were negatively affected found themselves faced with lower profit margins in their foreign sales markets. In most cases this resulted from lower Swiss franc-equivalent prices. A total of 37% of companies also recorded losses in sales volume. In addition to the direct effects on the export economy, indirect effects were also reported (cf. lower third

Chart 1
Effects of appreciation of Swiss franc, by sector



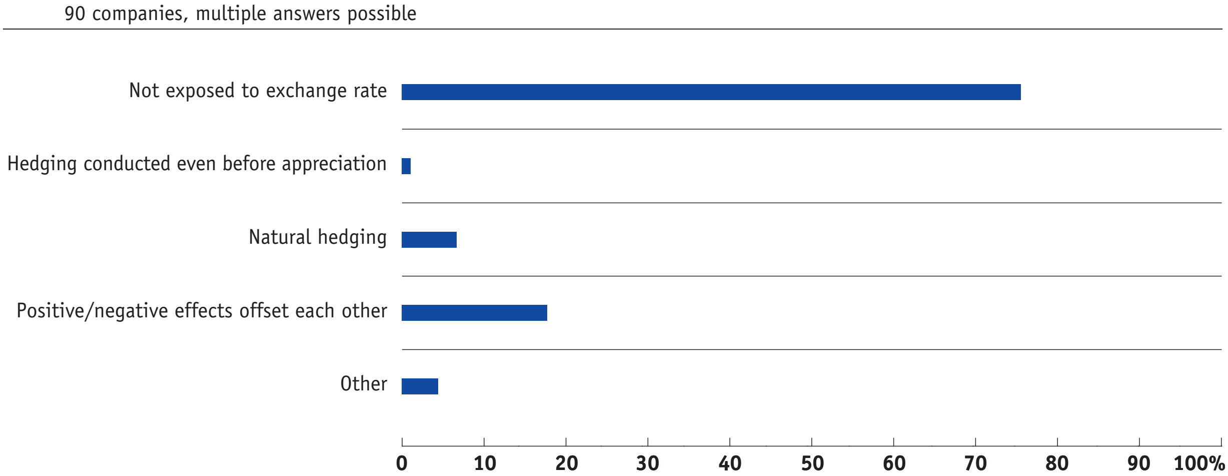
Source: SNB

of chart 4). In 11% of cases, these negative effects took the form of a reduction in sale prices by export industry supply companies. Companies exposed to competition from cheaper imports faced negative effects in the form of lower prices and margins as well as lower sales volume. There is a marked increase in reports that more buyers are trying to pay in euros.

The industries most heavily impacted by the negative effects of appreciation were the metal and capital goods industry (manufacture of electronic products, precision instruments and large segments of the machine industry), as well as the food and textiles industries. Compared to last quarter's survey, the results for the hotel industry were markedly worse. Of a total of 20 hotel representatives interviewed, eight spoke of slightly negative effects from the appreciation and four of significantly negative effects. The other eight hotel representatives said the strength of the Swiss franc had not affected them. Among representatives of the tourism industry, the exchange rate issue had become more acute than it was last quarter. In addition, concern was expressed that the negative effects could become even stronger after the middle of the year.

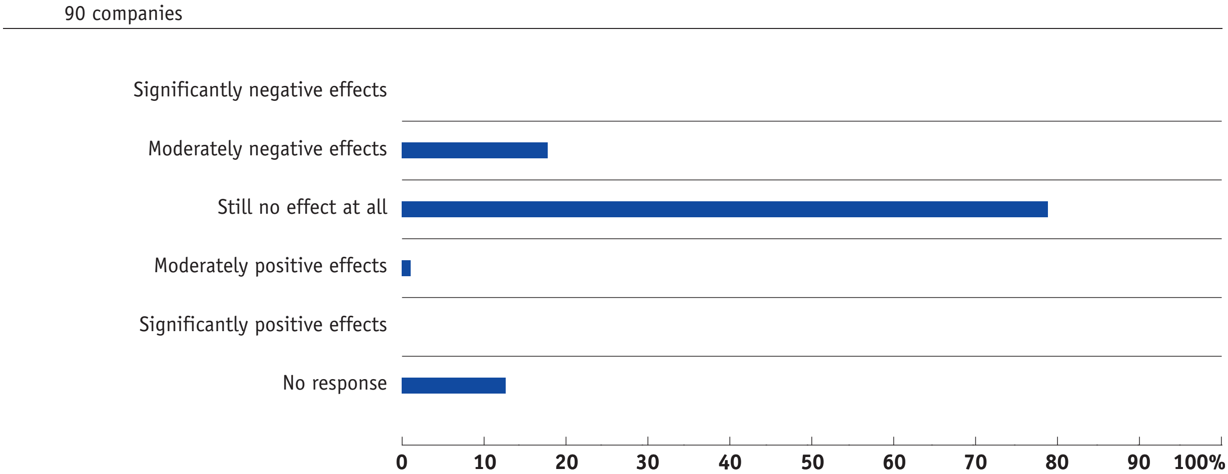
The situation in the retail industry varied considerably. In border areas, particularly, retailers faced unfavourable developments in cross-border shopping tourism. Where sales losses had been recorded, however, these were in part attributable to very large price reductions. In other parts of the

Chart 2
Companies not affected: explanations



Source: SNB

Chart 3
Companies not affected: expectations while the exchange rate remains unchanged



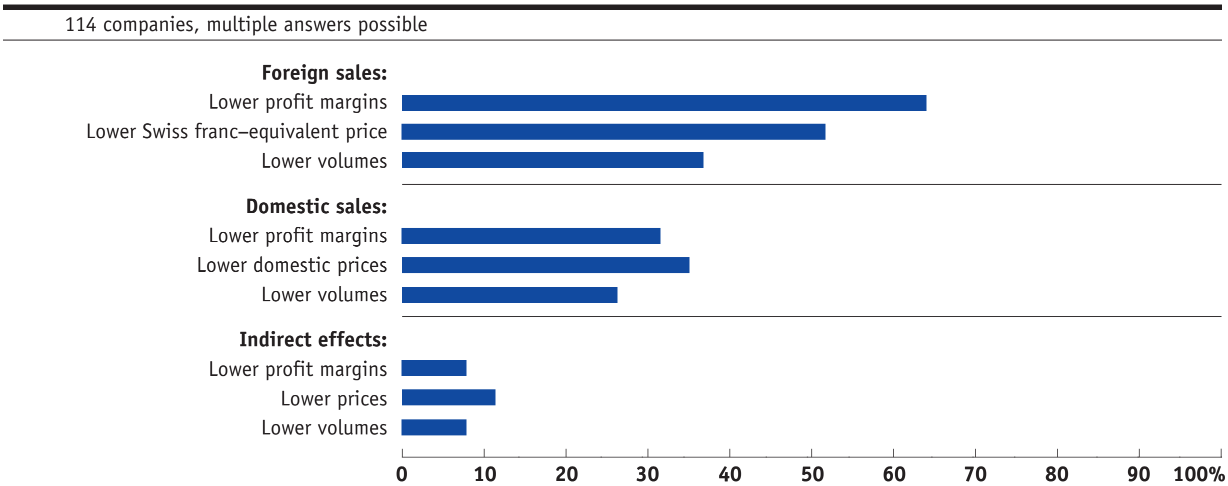
Source: SNB

country, by contrast, the favourable effects of lower purchase prices prevailed. In the wholesale sector, too, responses ranged between these two extremes, with the average effect assessed as slightly negative. In general, banks and insurance companies stated that the effect had been negative. By contrast, representatives of the hospitality industry, transportation and logistics, IT, fiduciary companies, architectural practices and recruitment agencies generally reported either no effect or positive effects.

3 Negative effects – how do companies react?

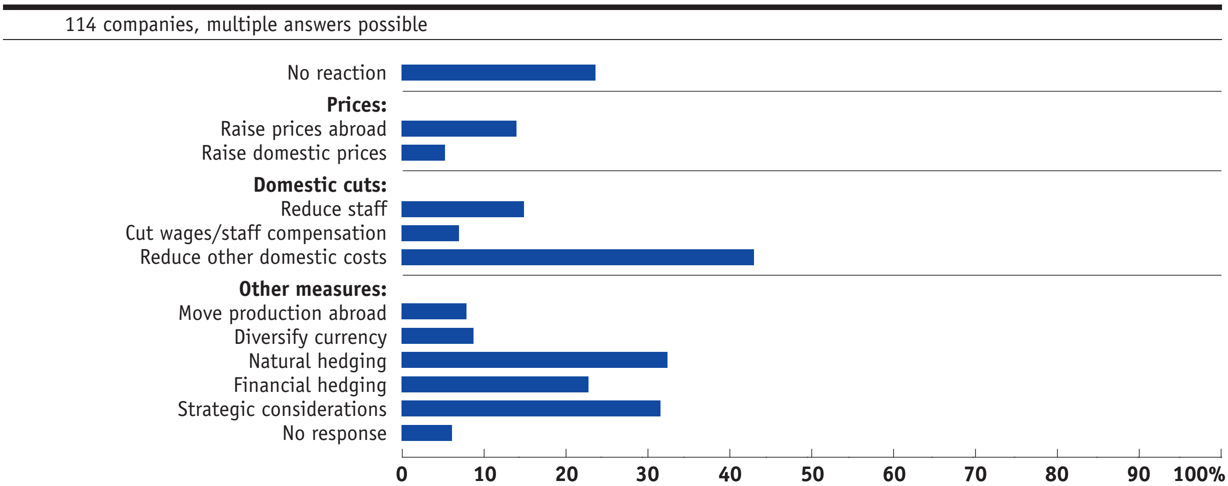
In addition, companies were asked about the measures they had already taken to counter the effects of the appreciation in the currency. Chart 5 shows the range of these reactions. A large majority of companies have taken measures. Only in a limited number of cases could compensatory price increases be implemented. Measures aimed at reducing production costs have been more frequent. Labour costs have mainly been cut by lowering the headcount or doing without new staff. In most cases, however, the cost-cutting measures have affected the other costs of production. Hedging strategies are very widespread. In addition,

Chart 4
Negatively affected companies: effects of appreciation of Swiss franc



Source: SNB

Chart 5
Negatively affected companies: reactions to appreciation of Swiss franc



Source: SNB

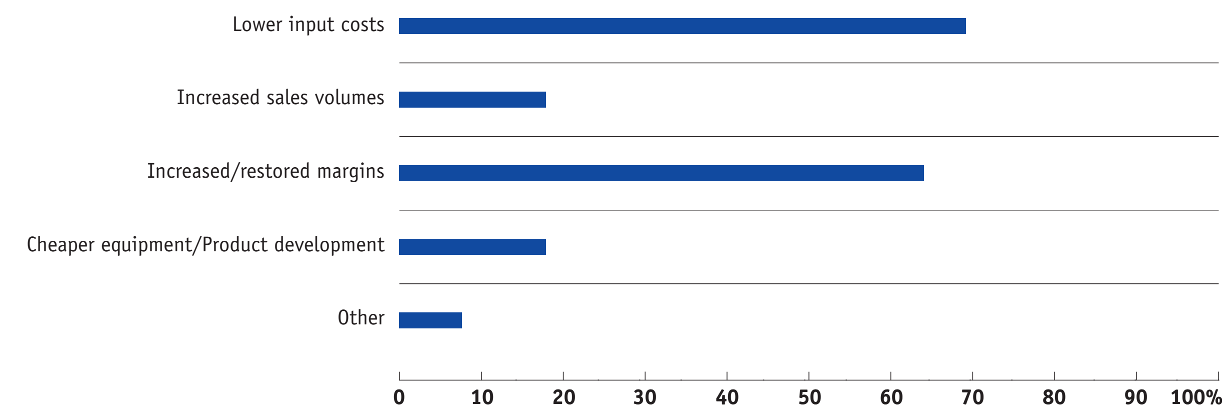
over 30% of negatively affected companies said they were also engaging in fundamental strategic considerations about the future of their company (previous quarter: 25%).

4 Positive effects – where and how?

A total of 39 respondent companies (16%) experienced minimal or even significantly positive effects from the appreciation of the Swiss franc. The greater part of the positive effects came in the form of lower input costs and/or improved profit margins, as can be seen in chart 6. In addition, some company representatives reported more favourable conditions for investment and for research and development. As can be seen in chart 7, this improvement in business conditions will probably lead primarily to an increase in these companies' profits and liquidity, since only 36% of companies that were positively affected by the appreciation of the Swiss franc reduced their prices as a reaction to this development.

Chart 6
Positively affected companies: effects of appreciation of Swiss franc

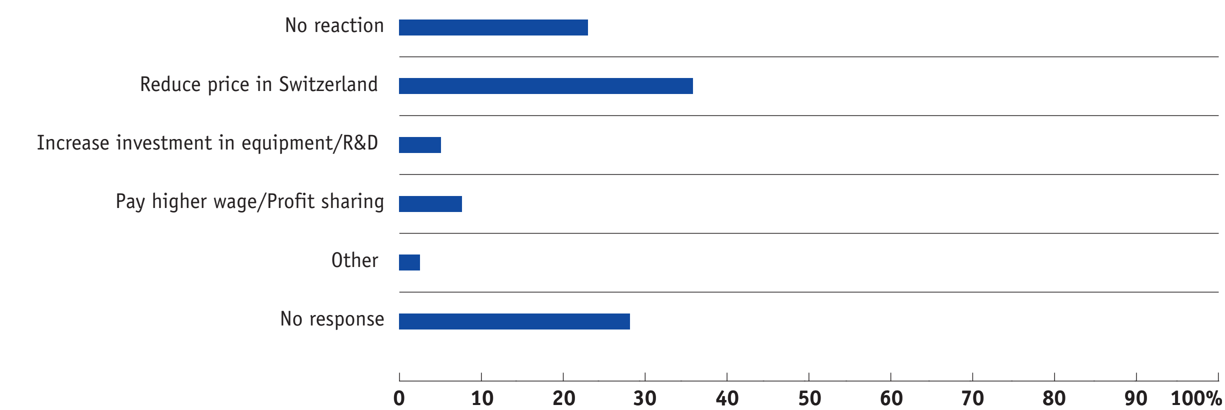
39 companies, multiple answers possible



Source: SNB

Chart 7
Positively affected companies: reactions to appreciation of Swiss franc

39 companies, multiple answers possible



Source: SNB

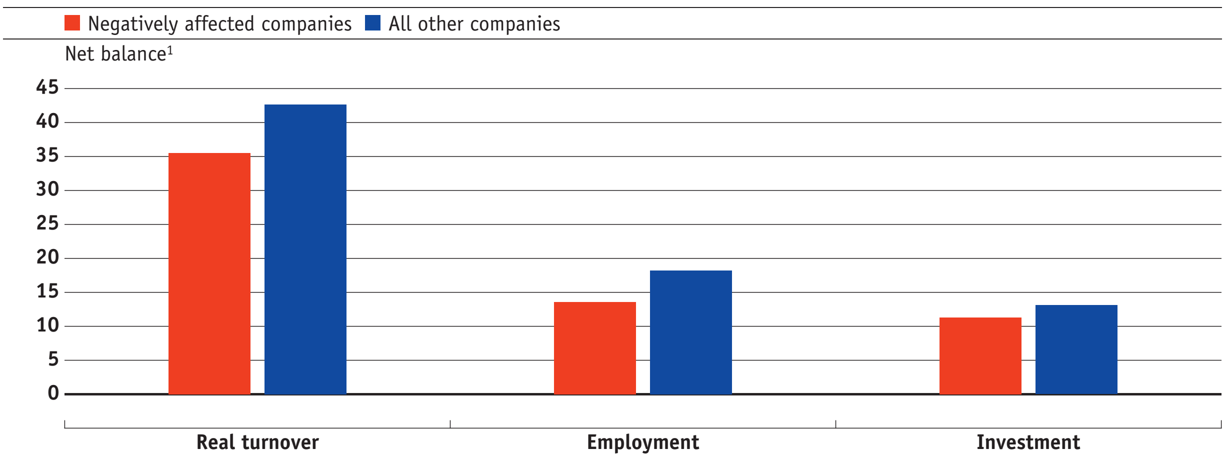
5 Expectations for the near future remain positive

In the survey, companies were asked about their expectations about real turnover, staff numbers and investment in the coming six/twelve months. Their answers are recorded on a scale ranging from 'significantly higher' to 'significantly lower'. Based on this information, an index is created by subtracting the negative assessments from the positive ones (net assessments). Significantly positive and significantly negative assessments are assigned higher weights than slightly positive or slightly negative assessments. The index is constructed in such a manner that its value can range between +100 and –100. A positive index value reflects positive assessments overall, while a negative value shows negative assessments overall.

The evaluation was conducted for two subgroups – first, companies affected negatively by the appreciation of the Swiss franc, and second, all other companies. On balance, company assessments show that they are expecting increasing turnover and a moderate rise in staff numbers and investment expenditure, as can be seen in chart 8. The chart also reflects the fact that expectations for these three areas do not differ significantly in the two company sub-groups.

Compared to the previous quarter, the index results for real turnover were better, particularly for the companies that are not affected negatively by the appreciation of the Swiss franc.

Chart 8
Expectations: turnover, employment and investment



1 Weighted positive estimates of companies minus weighted negative estimates regarding the future development of real turnover, employment and investment. The time horizon is 6 months (for real turnover and employment) or 12 months (for investment).
Source: SNB

Chronicle of monetary events

The chronicle summarises the most recent monetary events. For events dating further back, please refer to SNB press releases and the *Annual Report* under www.snb.ch.

March 2011

At its quarterly assessment on 17 March 2011, the SNB decides to maintain its expansionary monetary policy. It leaves the target range for the three-month Libor rate unchanged at 0.0–0.75%, and intends to keep the Libor within the lower part of the target range at around 0.25%. Although global economic developments were better than the SNB had expected, international risks remain considerable. The conditional inflation forecast shows, however, that the expansionary monetary policy cannot be maintained over the entire forecast horizon without compromising price stability in the longer term.

On 3 March 2011, the SNB reports a consolidated loss of CHF 19,170.8 million for 2010, following a profit of CHF 9,955.0 million in 2009. The annual result was overwhelmingly dominated, once again, by currency movements, not least the substantial appreciation of the Swiss franc towards the end of 2010.

December 2010

On 21 December, the SNB announces that – in coordination with the Bank of Canada, the Bank of England and the European Central Bank – the swap agreement with the US Federal Reserve will be extended until August 2011.

At its quarterly assessment of 16 December, the SNB decides to hold the target range for the three-month Libor at 0.0–0.75% and to keep the Libor in the lower end of the range, at around 0.25%. It also stresses that it would take the measures necessary to ensure price stability should the tensions in the financial markets be exacerbated and a deflation threat emerge.

September 2010

On 16 September, at its quarterly assessment, the SNB leaves the target range for the three-month Libor unchanged at 0.0–0.75% and still intends to keep the Libor at around 0.25%. It also points out that it would take the measures necessary to ensure price stability should downside risks materialise and lead to a renewed threat of deflation.

June 2010

At its quarterly assessment of 17 June, the SNB decides to maintain its expansionary monetary policy. It leaves the target range for the three-month Libor unchanged at 0.0–0.75% and continues to aim for a Libor around 0.25%. It also notes that the threat of deflation has largely disappeared. In view of the high downside risks, however, it stresses that it would take all measures necessary to ensure price stability should these risks materialise and, via an appreciation of the Swiss franc, lead to a renewed threat of deflation.

The SNB announces its new procedure for implementing monetary policy, which is based on the periodic absorption of excess liquidity by means of repo operations and the issuance of SNB Bills.

May 2010

On 10 May, the SNB, the US Federal Reserve, the Bank of Canada, the Bank of England and the European Central Bank reactivate the swap agreement designed to provide the markets with US dollar liquidity. In so doing, the central banks are reacting to the renewed tensions in the US dollar money markets.

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