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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 June 2012

This report is based primarily on the data and information available as at 14 June 2012.

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 2–5 of the present report were drawn up for the Governing Board's monetary policy assessment of June 2012. Section 1 ('Monetary policy decision of 14 June 2012') is an excerpt from the press release published following the assessment.

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

1 Monetary policy decision of 14 June 2012

Swiss National Bank maintains minimum exchange rate

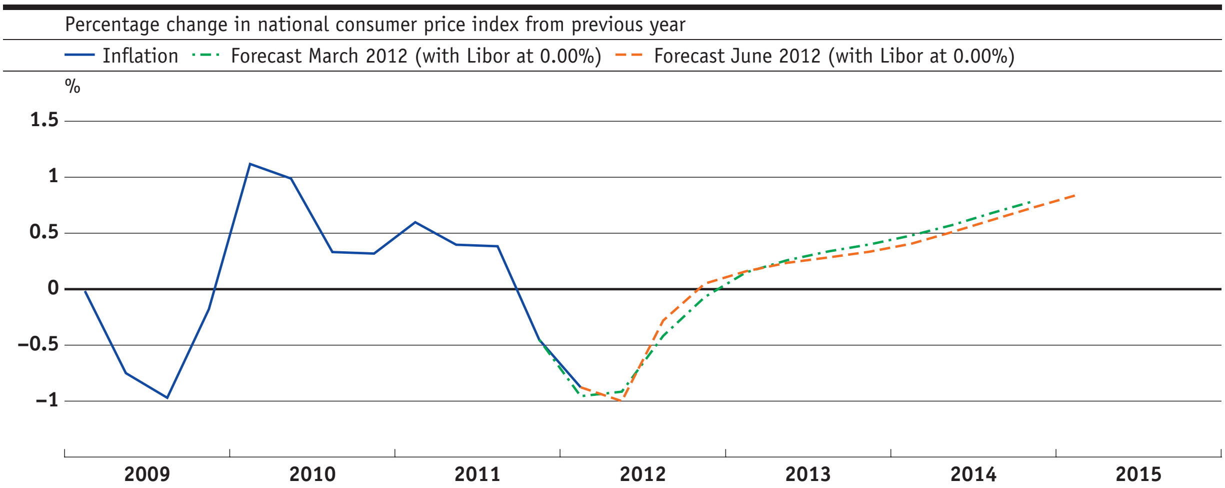
The Swiss National Bank (SNB) will maintain the minimum exchange rate of CHF 1.20 per euro and will enforce it with the utmost determination. It remains prepared to buy foreign currency in unlimited quantities for this purpose. Even at the current rate, the Swiss franc is still high. Another appreciation would have a serious impact on both prices and the economy in Switzerland. The SNB will not tolerate this. If necessary, it stands ready to take further measures at any time.

The target range for the three-month Libor remains at 0.0–0.25%. Essentially, the SNB's conditional inflation forecast is unchanged from its March forecast. It is based on a three-month Libor of 0.0% and continues to assume that the Swiss franc will weaken over the forecast horizon. For 2012, the forecast shows an inflation rate of –0.5%. For 2013, the SNB is expecting inflation of 0.3% and for 2014, of 0.6%. Consequently, in the foreseeable future, there is no risk of inflation in Switzerland.

The SNB expects that the global economy will only recover slowly. While the emerging economies make a major contribution to global growth, momentum in the advanced economies will remain subdued. In Europe, in particular, economic activity will be extremely weak on account of the financial and debt crisis. Switzerland will experience a significant economic slowdown over the rest of the year. Only because of the unexpectedly strong winter half-year does the SNB now expect growth of around 1.5% for 2012.

The risks for the Swiss economic situation remain exceptionally high. The uncertainty about future developments in the euro area has again risen. If global activity proves disappointing or the turmoil on the financial markets increases, downside risks will again emerge for the economy and price stability in Switzerland. The imbalances in the Swiss residential mortgage and real estate markets increased further last quarter. Consequently, the SNB welcomes the Federal Council decision to make available a countercyclical capital buffer which can counter adverse developments on the domestic credit market.

Chart 1.1
Conditional inflation forecast of March 2012 and of June 2012



Source: SNB

Observed inflation in June 2012 Table 1.1

	2009				2010				2011				2012				2009	2010	2011
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Inflation	0.0	−0.7	−1.0	−0.2	1.1	1.0	0.3	0.3	0.6	0.4	0.4	−0.5	−0.9				−0.5	0.7	0.2

Conditional inflation forecast of March 2012 with Libor at 0.00% and of June 2012 with Libor at 0.00%

	2012				2013				2014				2015				2012	2013	2014
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Forecast March 2012, Libor at 0.00%	−1.0	−0.9	−0.4	−0.1	0.1	0.3	0.3	0.4	0.5	0.6	0.7	0.8					−0.6	0.3	0.6
Forecast June 2012, Libor at 0.00%		−1.0	−0.3	0.1	0.2	0.2	0.3	0.3	0.4	0.5	0.6	0.7	0.8				−0.5	0.3	0.6

Source: SNB

Monetary policy strategy at the SNB

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. In addition, a minimum exchange rate against the euro is currently in place.

2 Global economic environment

In the first quarter of 2012, the global economy continued to grow at a moderate pace, although this varied considerably from one region to another. The emerging economies were still making a major contribution to global growth. By contrast, overall momentum in the advanced economies was subdued, although here, too, differences from one country to another are considerable. Japan experienced strong growth in the first quarter due to a catch-up effect. In the US, momentum was moderate. In the euro area, a number of countries are in deep recession, while in Germany, GDP continued to expand strongly. Overall, the economy in the euro area stagnated.

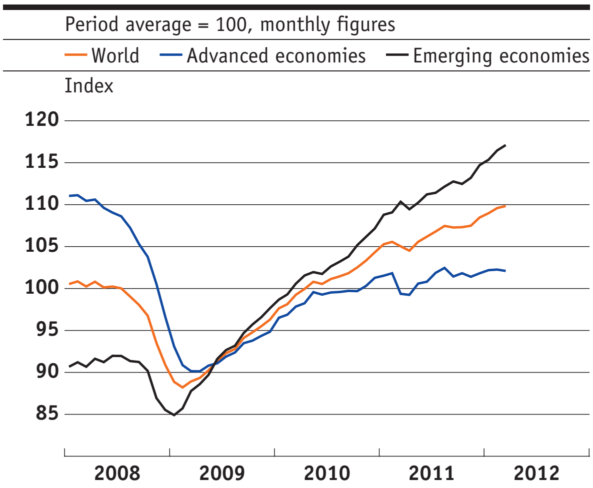
As in the last monetary policy assessment, the SNB assumes that the global economy will continue to recover slowly. This will be driven by globally expansionary monetary policy and strong domestic demand in the emerging economies. In the euro area and the US, developments are likely to be more subdued. Here the SNB assumes that the European financial and sovereign debt crisis will gradually ease. However, risks in this respect remain high. In particular, the difficult situation in Greece and Spain has already led to a significant deterioration in the confidence of households and companies in the euro area. As a result, the economic situation remains vulnerable.

2.1 International financial and commodity markets

Financial market tensions have increased again since the quarterly assessment in mid-March, with the European financial and debt crisis becoming a key issue once more. Contributing factors were uncertainty in France and Greece after the elections at the beginning of May, discussions of Greece potentially withdrawing from the monetary union and concerns surrounding the recapitalisation requirements of the Spanish banking sector.

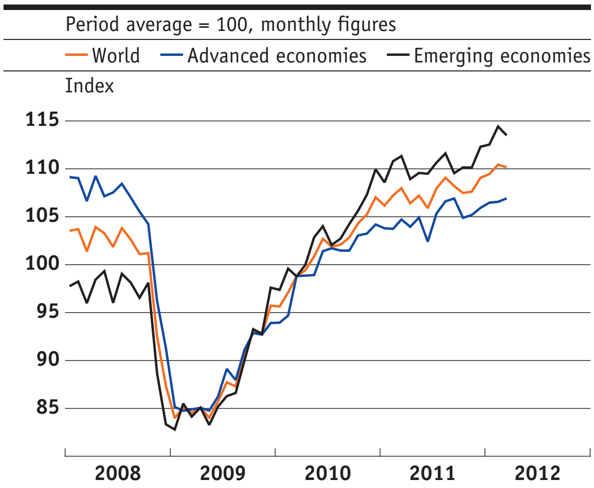
The considerable gains on the equity markets from the first three months of the year were lost again, while uncertainty – as measured in terms of volatility indices – increased (cf. chart 2.3). Uncertainty was also reflected in the higher yield mark-ups of government bonds issued by various member states in the euro area over German government bonds, with the German government bonds reaching an all-time low (cf. chart 2.13). The euro was under pressure on the foreign exchange markets from April, while the US dollar gained in value as a safe haven. At the beginning of June, the euro fell against the US dollar to USD 1.24 per euro, its lowest level since the middle of 2010 (cf. chart 2.4).

Chart 2.1
Global industrial production



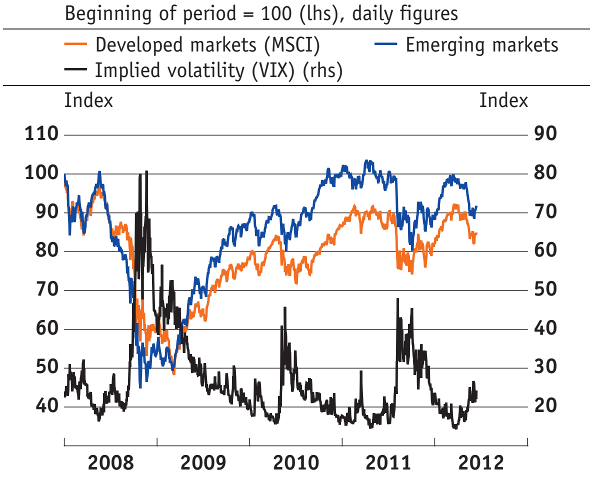
Sources: Netherlands Bureau for Economic Policy Analysis (CPB), Thomson Financial Datastream

Chart 2.2
Global exports



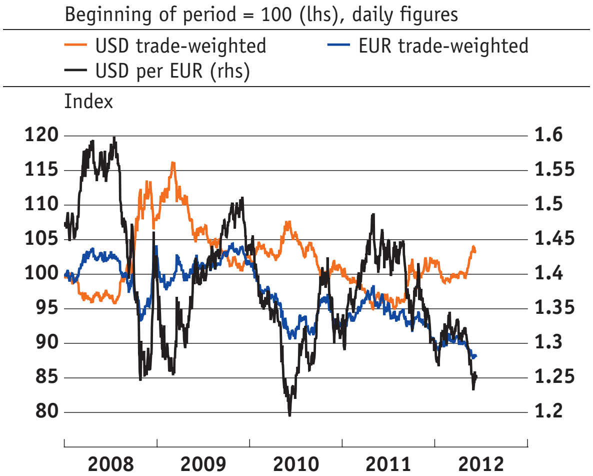
Sources: CPB, Thomson Financial Datastream

Chart 2.3
Stock markets



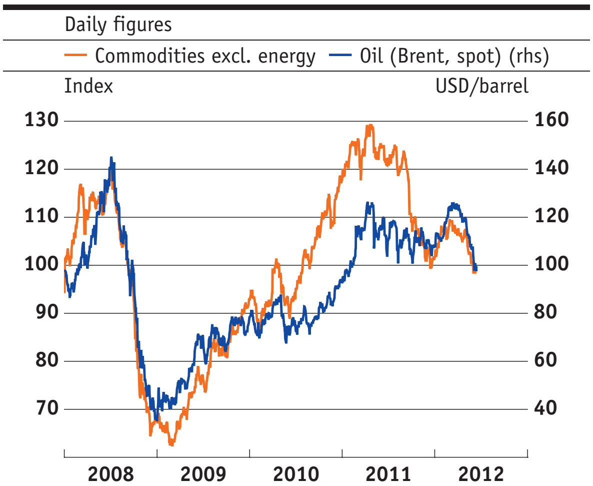
Sources: Reuters, Thomson Financial Datastream

Chart 2.4
Exchange rates



Sources: Reuters, Thomson Financial Datastream

Chart 2.5
Commodity prices



Sources: Reuters, Thomson Financial Datastream

In this environment, commodity prices also eased from April. The drop in energy prices not only reflected fears of a renewed slowdown in economic activity, but also the easing of geopolitical tensions in Iran and appreciation of the US dollar (cf. chart 2.5).

The SNB's forecasts are based on assumptions about the oil price and the EUR/USD exchange rate, which are USD 120 per barrel of Brent crude and USD 1.30 per euro over the entire forecast horizon.

2.2 United States

GDP in the US grew by 1.9% in the first quarter. The growth was driven by private consumption, housing construction and exports, while government demand declined. The unemployment rate continued to fall, however it did remain high at 8.2% in May (cf. chart 2.9).

Compared with historical experience, it is likely that the economy will continue to recover somewhat slowly. One reason for this can be ascribed to the surplus of empty houses, which in turn means that construction activity is only reacting weakly to the low key interest rates. Another reason is the fall in real estate prices, which continues to put a strain on the financial situation of numerous private households and thus consumer confidence. These inhibiting factors are, however, gradually being eliminated and growth is expected to pick up slightly in the coming quarters. The SNB expects GDP growth of 2.3% in 2012, although the development of the European financial and debt crisis and the difficulties in assessing developments in fiscal policy for 2013 continue to provide cause for unusually high levels of uncertainty.

Inflation as measured by consumer prices decreased to 1.7% in May (cf. chart 2.10). Core inflation was last recorded at 2.3% (cf. chart 2.11). Continued high unemployment and weak wage growth should ensure that inflation pressure remains low for the medium term.

American monetary policy continued to be very expansionary. The Federal Reserve left the target range for its reference interest rate at 0.0–0.25% (cf. chart 2.12). It also confirmed its previous assessment, that in view of the economic and inflation outlook, an exceptionally low interest rate would be needed until the end of 2014, at least. Likewise, it increased the average maturity of the US government bonds in its holdings as planned in order to reduce long-term interest rates and thereby stimulate the economy. This portfolio shift (Operation Twist) comprises approximately USD 40 billion and is expected to be concluded by the end of June.

2.3 Euro area

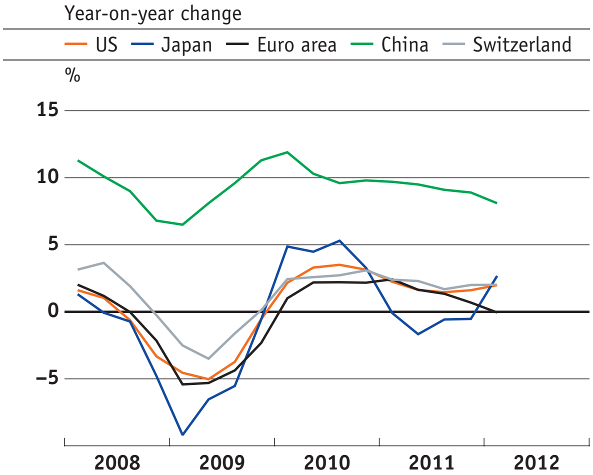
GDP stagnated in the euro area during the first quarter, having fallen by 1.3% in the previous period. Surprisingly strong rates of growth in Germany were a contributing factor, while recession in Italy, Spain and the Netherlands continued. In terms of demand, exports recovered, while investment activity continued to decline as a result of a continued high level of uncertainty. Unemployment rose to 11.0% in April, the highest rate since the beginning of the monetary union.

The economic environment remained very difficult. Restrictive fiscal policy and uncertainties surrounding the financial and sovereign debt crisis are restricting the growth outlook throughout the entire euro area. Any signs of sustainable recovery have yet to be seen. Consumer and corporate confidence remain subdued. Many manufacturing companies have reduced their investment plans for 2012 and assess their export outlook as being even less favourable in the coming months than in the last quarter. The SNB is continuing to project a slight contraction in the euro area in 2012 and expects modest growth of approximately 1% in 2013.

Consumer price inflation in the euro area declined slightly and stood at 2.4% in May, mainly due to base effects from energy and food prices. Core inflation has remained at around 1.6% since last September, though inflation is likely to fall even further as a result of the weak economic situation.

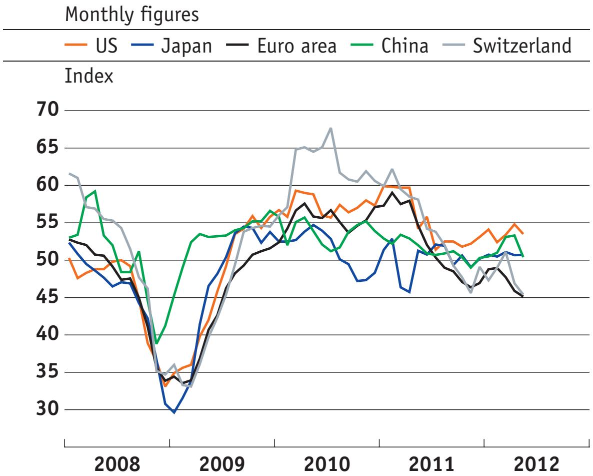
The European Central Bank (ECB) continued with its expansionary monetary policy, leaving its main refinancing rate unchanged at 1.0% and deciding to provide the banks with unlimited liquidity until at least mid-January 2013. The risk premia on the money market, which decreased considerably after the three-year refinancing transactions were effected in December and February, stabilised in the second quarter. The ECB ceased to acquire any further government bonds as of mid-March.

Chart 2.6
Real GDP



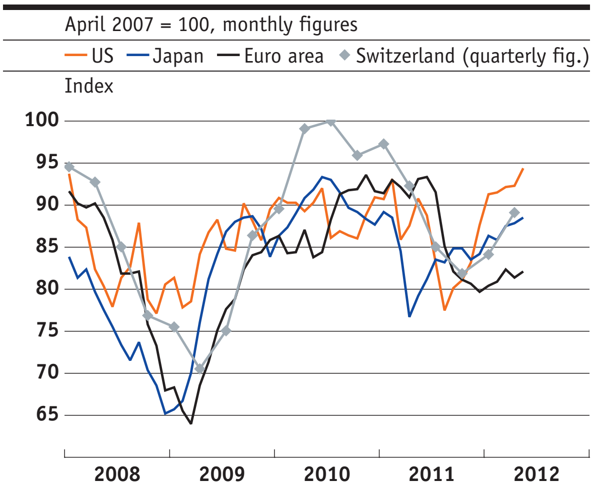
Sources: State Secretariat for Economic Affairs (SECO), Thomson Financial Datastream

Chart 2.7
Purchasing managers' indices (manufacturing)



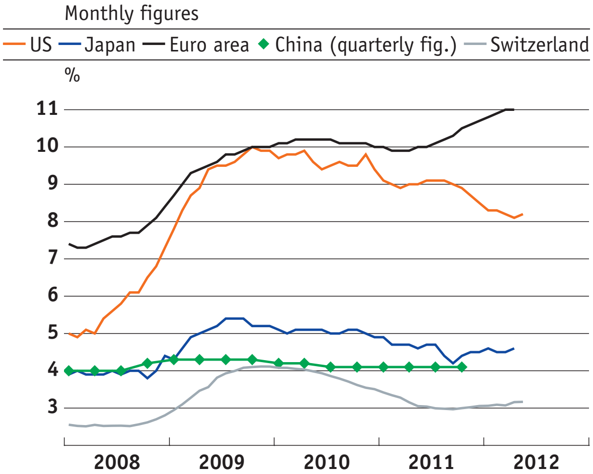
Source: Thomson Financial Datastream; copyright and database rights: Markit Economics Ltd 2009; all rights reserved

Chart 2.8
Consumer confidence index



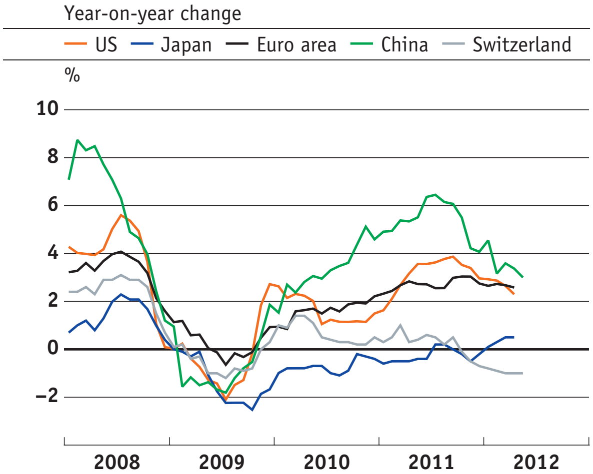
Sources: SECO, Thomson Financial Datastream

Chart 2.9
Unemployment rates



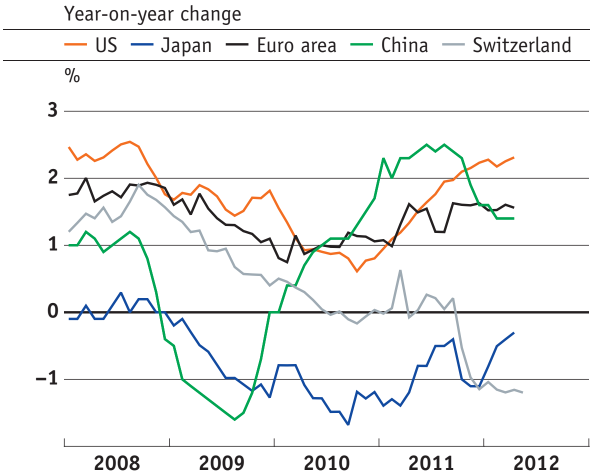
Sources: SECO, Thomson Financial Datastream

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 economic recovery in Japan continued. With growth of 4.7% in the first quarter, GDP exceeded the level prior to the earthquake and tsunami of March 2011 for the first time. However, it still remains considerably lower than the level that was attained before the global financial and economic crisis in 2008. The reintroduction of fiscal incentives to purchase energy-efficient cars as well as public investment in the reconstruction work resulted in substantial growth of domestic demand in the first quarter. Furthermore, industrial production recovered after the floods in Thailand in autumn last year had caused supply shortages for industrial parts.

Continued expansionary monetary policy and further public expenditure on the reconstruction continues to support the economy this year. In contrast, the sales outlook for Japanese companies remains constrained in view of low global demand and the high value of the yen, and this is dampening the private investment climate. The temporary shutdown of all nuclear power plants may also lead to energy shortages in summer. Based on the surprisingly strong growth in the first quarter, the SNB now expects Japan's GDP to grow by 2.5% in 2012.

As a result of a one-off surge in prices for certain consumer durables, the index of Japanese consumer prices rose significantly in the first quarter. In April, consumer prices exceeded the previous year's level by 0.5%. Increasing costs to generate energy may be reflected in higher electricity costs from the middle of the year. Inflationary pressure should remain constrained, however, as production capacities are still far from their normal level of utilisation.

At the end of April, the Bank of Japan decided to further increase its securities programme, increasing its budget for the purchase of Japanese government bonds to JPY 29,000 billion (CHF 350 billion). Japanese government bonds with terms of up to three years are also to be purchased. The maximum term had previously been two years. The timeframe for purchasing bonds has been extended by half a year until the end of June 2013.

2.5 Emerging economies

Despite the slowing of growth seen throughout the course of last year, economic activity in the emerging economies continued to support global growth in the first quarter of 2012. Investment demand suffered under particularly restrictive monetary conditions, however, and also from the uncertainty triggered by the European financial and sovereign debt crisis.

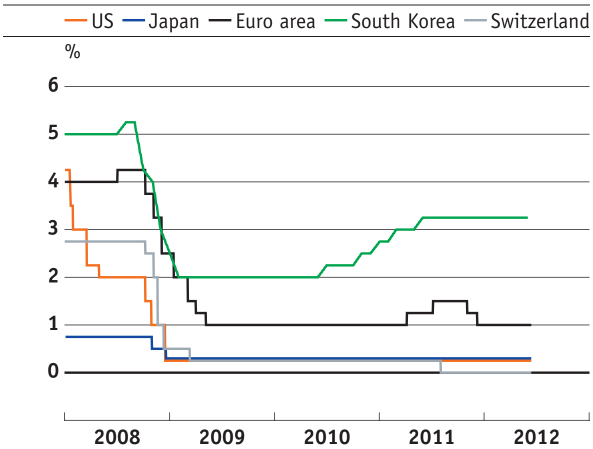
In the first quarter, Chinese GDP was up by 8.1% on the previous year, its lowest level in the last three years (cf. chart 2.6). This growth was largely due to consumer demand, which was supported by new government subsidies. Investment continued to lose momentum due to a tightening in monetary policy and the implementation of economic policy measures to curb demand in the real estate market, while export demand remained modest. In India, economic growth was subdued by the restrictive lending conditions and also uncertainty, which was triggered by the delay in state reforms. In contrast, growth in the newly industrialised economies (NIEs) – South Korea, Taiwan, Hong Kong and Singapore – picked up momentum as the electronics industry experienced catch-up effects after the catastrophe in Thailand. The economies of many Latin American countries continued to slow. To some extent, this was desirable in view of the danger of overheating, however growth in Brazil nearly ground to a complete halt. A comprehensive economic stimulus package should help inject new momentum into Brazilian industry and create incentives to invest more.

Growth is likely to strengthen again in the emerging economies during the second half of 2012. Declining inflation and economic policy measures will support households' purchasing power. Private consumer demand will be an important driving factor in the major emerging economies such as China, India and Brazil. Certain infrastructure projects are also to be prioritised to support the economy in China.

Consumer price inflation in the emerging economies has been gradually weakening. In China, inflation reached a three-year high of 6.5% in July 2011; in May 2012 it still stood at 3.0%. In India, the annual inflation rate fell from around 10% in the middle of last year to 7.5% in May. In Brazil, it declined to 5.0%. While in some emerging economies inflation expectations remained high, domestic pressure on prices subsided further as a result of moderate growth.

The central banks of the major emerging economies relaxed their monetary policy. Brazil's central bank again lowered the key interest rate. In May, China's central bank again reduced the minimum reserve requirements for banks, in order to manage the supply of liquidity, and in June it reduced the key rate for lending and deposits for the first time since 2008. In addition, it has permitted no further appreciation of the Chinese currency on a trade-weighted basis since the beginning of the year. India's central bank lowered the key interest rate after tightening it for almost two years. Monetary policy in the smaller Asian economies remains essentially the same.

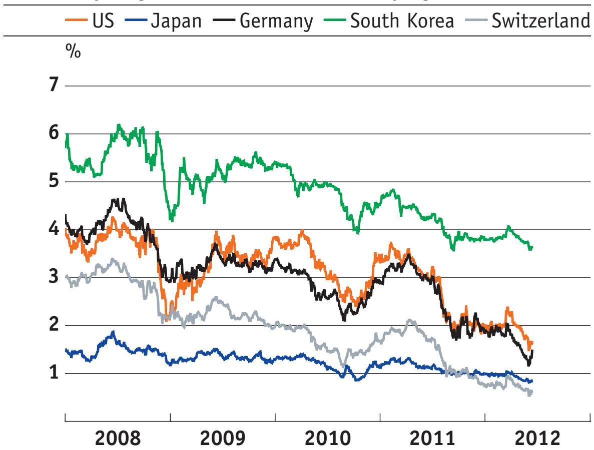
Chart 2.12
Official interest rates



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 Switzerland, real GDP rose faster than expected in the first quarter. The stabilising effect of the minimum exchange rate against the euro played a major role in this development, with goods exports declining only slightly in the first quarter, in an international environment that remained weak, while exports of services rose. An improvement in consumer confidence encouraged a substantial increase in private consumer spending.

However, GDP growth was also supported by temporary effects. Value added in the banking industry benefited from the optimistic mood on the financial markets during the first months of the year. In manufacturing and the hospitality industry, however, activity declined, underscoring the particularly negative impact of the strong Swiss franc on these industries.

For the second quarter, the SNB expects a significant slowdown in GDP growth. Since the global economy is expected to recover slowly, and the value of the Swiss franc is still high, the demand for exports is likely to remain subdued, even in the subsequent period. The high level of uncertainty and the pressure on profit margins are impacting negatively on corporate investment. Only because of the unexpectedly strong winter half-year does the SNB now expect growth of around 1.5% for 2012.

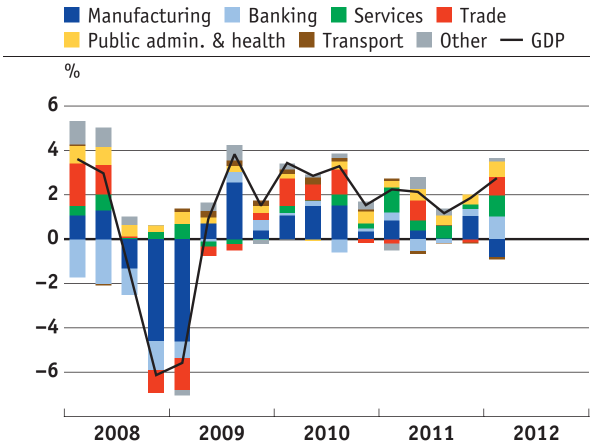
3.1 Aggregate demand and output

Robust growth in value added

According to a provisional estimate by the State Secretariat for Economic Affairs (SECO), GDP increased by 2.8% in the first quarter of 2012. In addition, the growth figure for the fourth quarter of 2011 was revised upwards from 0.4% to 1.9%. While growth in the fourth quarter was largely the result of a temporary upturn in manufacturing, the rise in GDP in the first quarter was mainly driven by the banking sector, domestic trade (wholesaling and retailing) and corporate services (cf. chart 3.1). By contrast, value added in manufacturing declined. The downward trend in the hospitality industry continued unabated.

Chart 3.1
Contributions to growth, by sector

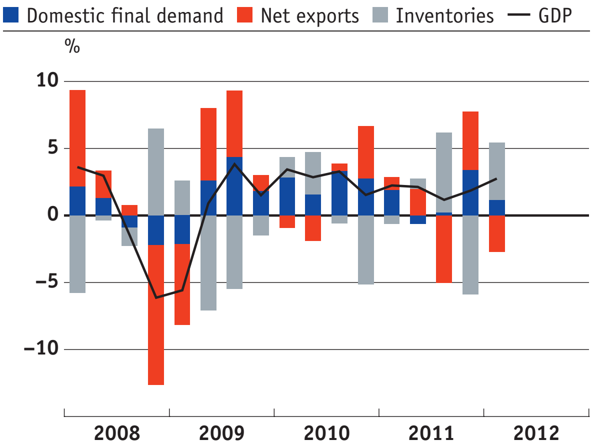
Change from previous period



Source: SECO

Chart 3.2
Contributions to growth in demand

Change from previous period



Source: SECO

Weak export momentum

Net exports (excluding valuables) were negative in the first quarter (cf. chart 3.2). While exports posted a slight increase of 1.7% compared with the previous quarter (cf. chart 3.3), there was a strong 9.1% rise in exports (cf. chart 3.4). Overall, this resulted in a negative foreign trade contribution of 2.7 percentage points.

The export trend was mixed. Goods exports declined slightly following significant growth in the previous quarter. The downward trend in machine exports continued, and exports of chemicals and pharmaceuticals also fell, following a sharp rise in the previous quarter. Looking at individual markets, goods exports to western Europe and Asia decreased, whereas demand for Swiss goods increased in the US.

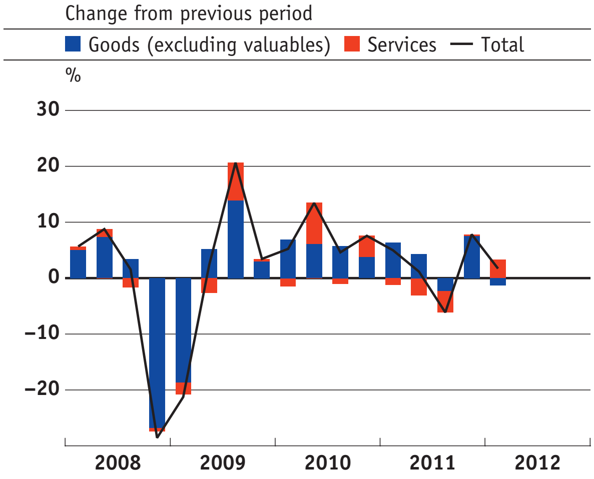
Unlike goods exports, exports of services grew substantially in the first quarter. Since commodity prices rose, net receipts from merchanting made a substantial contribution to the rise in exports of services. Income from cross-border banking transactions also increased. Tourism exports slipped further, owing to the continuing strength of the Swiss franc.

Imports rose appreciably in the first quarter. Robust consumer confidence was reflected in high demand for imported consumer goods. While imports of capital goods also rose perceptibly, only slight growth was registered in imports of preliminary products and intermediates. In addition, the rise in imports of services (especially financial services and transport) gained momentum.

Consumer-driven demand

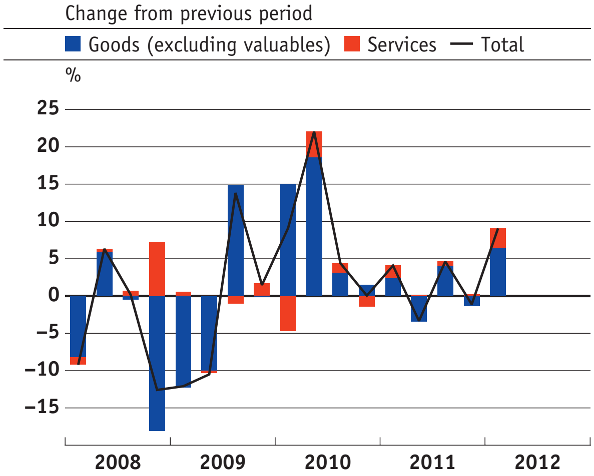
Domestic final demand continued to rise at the start of the year (cf. chart 3.5 and table 3.1). Private consumption increased across the board (2.6%) in the first quarter. Spending on financial services and residential property rose particularly strongly, but consumers also spent far more on food and clothing. The higher spending on clothing was boosted by further price cuts. Consumer confidence improved further in April, driven by the positive employment trend in the first quarter and greater optimism about the economic outlook.

Chart 3.3
Contributions to export growth



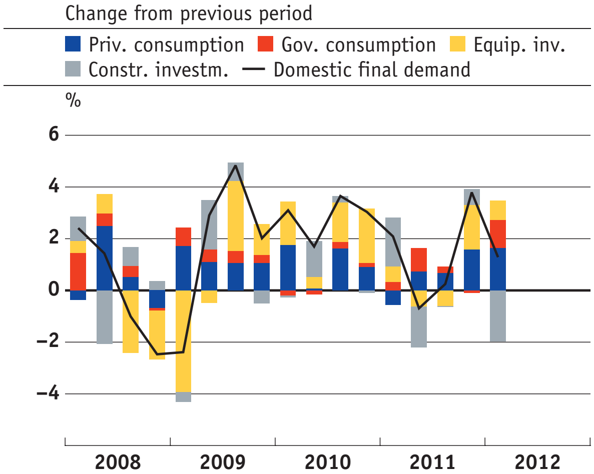
Source: SECO

Chart 3.4
Contributions to import growth



Source: SECO

Chart 3.5
Domestic final demand, growth contributions



Source: SECO

Real GDP and components Table 3.1

Growth rates on previous period, annualised

	2008	2009	2010	2011	2010			2011				2012
					Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1
Private consumption	1.4	1.4	1.7	0.9	0.1	2.5	1.4	–0.9	1.1	1.0	2.5	2.6
Government consumption	2.7	3.3	0.8	2.6	–1.2	2.0	1.2	2.5	7.2	2.1	–0.8	8.3
Investment in fixed assets	0.5	–4.9	7.5	3.9	7.9	7.7	8.6	10.4	–9.2	–2.8	10.2	–5.8
Construction	0.0	3.0	3.5	2.5	13.5	2.5	–0.8	18.1	–14.5	–0.4	5.7	–18.4
Equipment	0.8	–10.8	10.9	5.1	3.5	12.3	16.6	4.7	–4.7	–4.7	13.9	6.0
Domestic final demand	**1.3**	**0.1**	**2.9**	**1.8**	**1.7**	**3.7**	**3.0**	**2.1**	**–0.7**	**0.2**	**3.8**	**1.3**
Domestic demand	**0.5**	**0.6**	**1.5**	**1.2**	**3.2**	**7.0**	**–5.0**	**2.3**	**0.2**	**6.9**	**–4.6**	**8.8**
Total exports	3.1	–8.6	8.4	3.6	10.4	0.9	8.2	6.3	1.3	–5.8	5.1	–1.6
Goods[1]	2.1	–11.1	9.4	6.3	8.8	8.5	5.4	9.3	6.3	–3.3	11.0	–1.8
Services	4.3	–1.7	5.4	–1.4	24.0	–3.1	12.3	–3.9	–9.5	–12.4	0.7	10.8
Aggregate demand	**1.5**	**–3.0**	**4.0**	**2.1**	**5.9**	**4.6**	**–0.2**	**3.7**	**0.6**	**1.9**	**–1.0**	**4.8**
Total imports	0.3	–5.5	7.3	2.1	13.4	7.8	–4.0	7.3	–2.8	3.7	–7.6	9.9
Goods[1]	–1.0	–8.5	10.8	2.6	23.3	3.9	1.9	3.0	–4.2	5.1	–1.7	8.1
Services	4.1	7.4	–1.9	3.0	17.2	6.5	–6.9	8.6	0.3	2.8	1.3	13.1
GDP	**2.1**	**–1.9**	**2.7**	**2.1**	**2.9**	**3.3**	**1.5**	**2.2**	**2.1**	**1.2**	**1.9**	**2.8**

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

There was a renewed rise in equipment investment in the first quarter (6.0%). However, considerable differences were observed between the various industries. While there was a strong rise in investment in vehicles and software products, spending on machines and metal products declined. The previous quarter's recovery thus proved temporary.

Construction investment was held back by unusually low temperatures in the first quarter, resulting in a sharp downturn (–18.4%). However, various indicators suggest that construction investment recovered in the second quarter. For example, the order situation reported by members of the Swiss Federation of Master Builders indicates sustained high building activity, especially in the residential segment. In addition, there are first signs of a recovery in commercial construction, which has been weak in recent years. By contrast, civil engineering has recently registered a slight loss of momentum.

3.2 Labour market

Moderate growth in employment

Employment continued to rise in the first quarter. Full and part-time employment increased by 1.1%. Expressed in full-time equivalents, this constitutes an increase in employment of 1.4% (cf. chart 3.6).

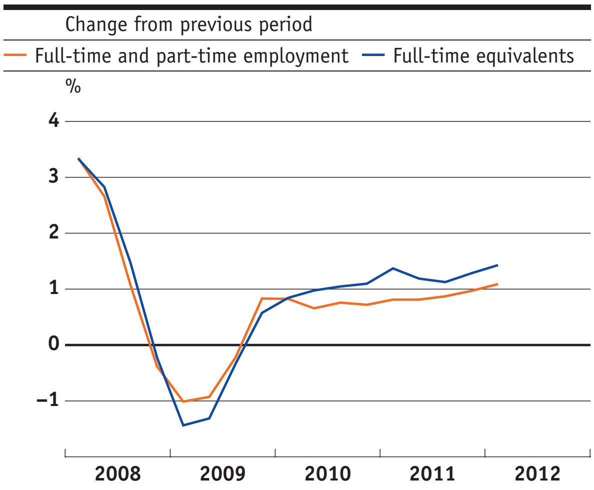
Despite a decline in value added, employment momentum remained positive in the construction and manufacturing industries. Employment momentum in the services sector as a whole also remained upbeat, although some industries, such as hospitality, trade, financial services and transport, cut jobs.

Rising unemployment

Unemployment has increased in recent months. Between February and May, the number of people registered as unemployed with regional employment offices increased by around 3,040 (seasonally adjusted), which represents a rise in the unemployment rate from 3.1% to 3.2% (cf. chart 3.7). On a non-seasonally adjusted basis, unemployment fell from 3.4% to 3.0% over the same period.

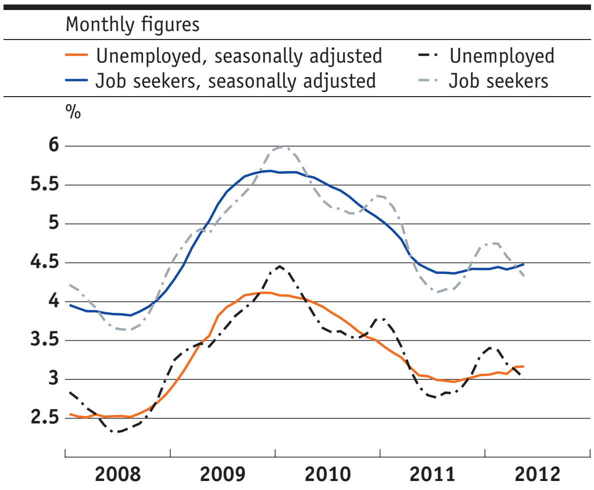
Short-time working increased slightly in the first quarter, but the number of people affected is still low (cf. chart 3.8).

Chart 3.6
Employment



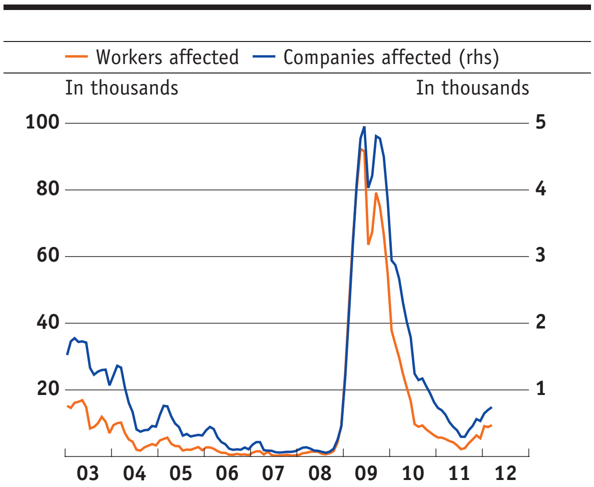
Source: SFSO, seasonal adjustment: SNB

Chart 3.7
Unemployment and job seeker rates



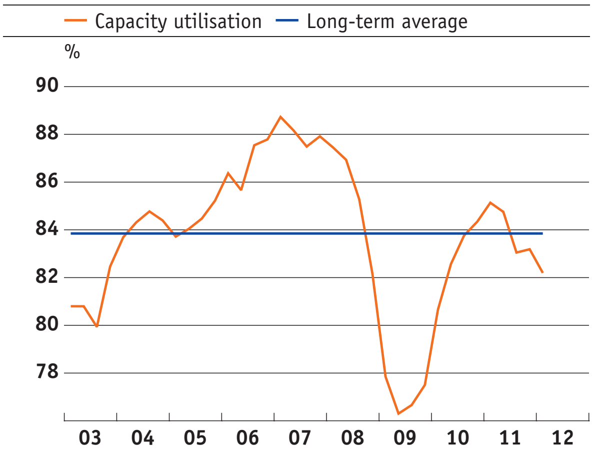
Unemployed and job seekers registered with the regional employment offices, as a percentage of the labour force according to the 2000 census (labour force: 3,946,988 persons).
Source: SECO

Chart 3.8
Short-time working



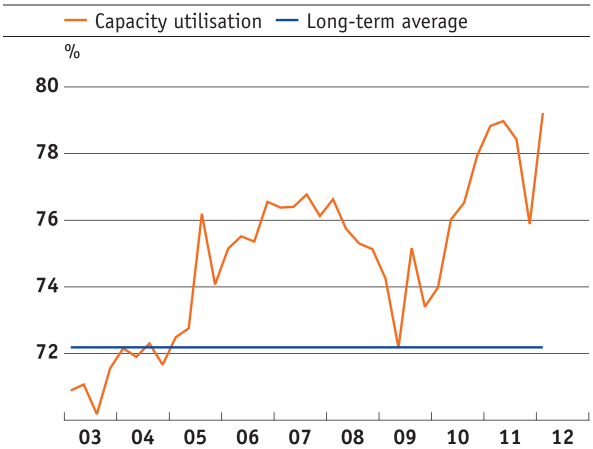
Source: SECO

Chart 3.9
Capacity utilisation in manufacturing



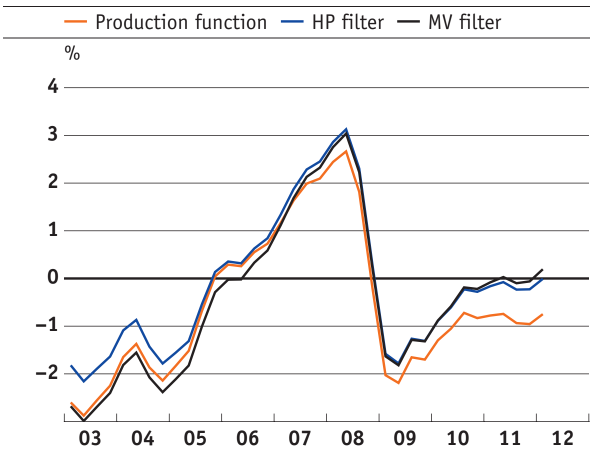
Source: KOF Swiss Economic Institute

Chart 3.10
Capacity utilisation in construction



Source: KOF Swiss Economic Institute

Chart 3.11
Output gap



Source: SNB

3.3 Capacity utilisation

Declining capacity utilisation in manufacturing

Technical capacity utilisation in manufacturing declined in the first quarter. According to the survey conducted by the KOF Swiss Economic Institute, it slipped to 82.2%, thereby remaining below its long-term average (cf. chart 3.9).

Capacity utilisation remains very high in construction. Machine utilisation reached a historical high of 79.2% (cf. chart 3.10). Accordingly, many of the companies surveyed were still reporting bottlenecks in machine and equipment capacity as well as labour shortages.

Capacity utilisation in the services sector as a whole remained average in the first quarter. However, it declined considerably in the hospitality industry, probably owing to the strength of the Swiss franc and declining economic activity in other countries.

Output gap narrowed

The output gap, which is defined as the percentage deviation of observed GDP from estimated aggregate potential output, shows how well the production factors in an economy are being utilised.

The negative output gap narrowed somewhat in the first quarter as a result of robust GDP growth. Estimated potential output based on the production function approach indicates that the output gap was −0.7% in the first quarter, compared with −1.0% in the fourth quarter (cf. chart 3.11). Estimates using other methods (Hodrick-Prescott filter and multivariate filter) suggest that the output gap has already closed (0% and 0.2%).

The different estimates reflect the various ways of calculating potential output. The production function approach considers the labour market situation and the stock of capital in the economy. Since potential labour levels have increased steadily in recent years – to some extent because of immigration – potential output and, hence, the output gap are larger when calculated with this method than with statistical filter methods.

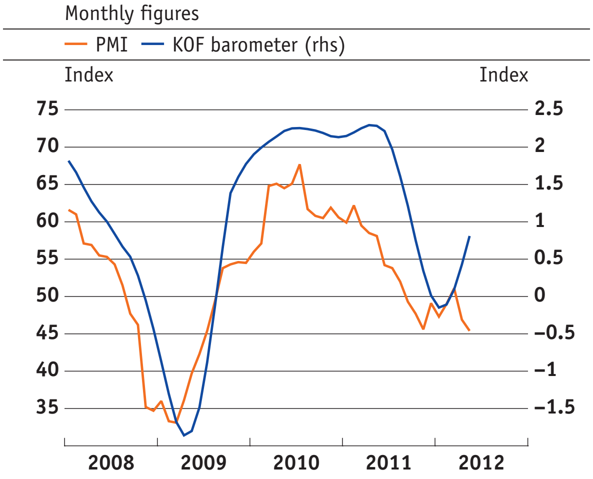
3.4 Outlook for the real economy

Despite the strong growth at the start of the year, the short-term outlook for the Swiss economy remains subdued. The renewed tension on the financial markets, muted corporate confidence in Europe and the persistently high valuation of the Swiss franc will hamper growth.

Virtually no stimulus is expected to come from export-based industries in the next few months. Owing to the high level of uncertainty and the pressure on profit margins, corporate investment is likely to be restrained. Supported by low interest rates and steady immigration, private consumption and construction investment should, however, emerge as growth drivers.

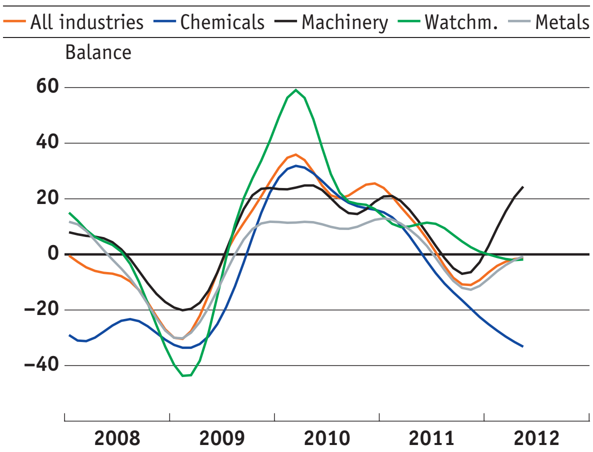
The SNB is expecting significantly slower GDP growth in the second quarter. For 2012 as a whole it is predicting GDP growth of around 1.5%. The higher GDP forecast compared with the last monetary policy assessment reflects the fact that growth was above expectations in the fourth quarter of 2011 and the first quarter of 2012. The output gap is expected to remain negative this year, so there is likely to be a further slight rise in unemployment. Since the Swiss economy is exposed to considerable downside risks as a result of the fragile situation in Europe, the economic outlook remains highly uncertain.

Chart 3.12
Leading indicators



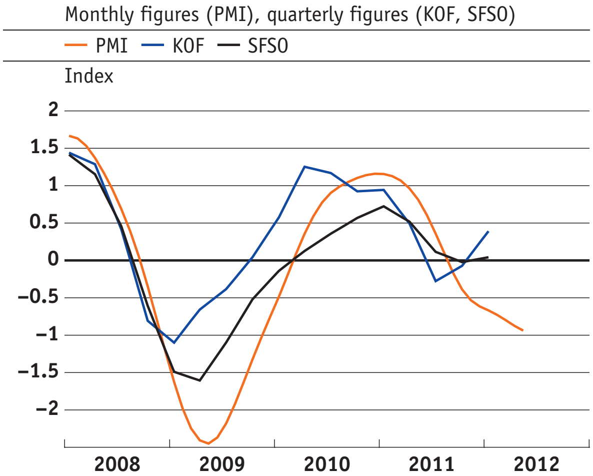
Sources: Credit Suisse, KOF Swiss Economic Institute

Chart 3.13
Expected new orders



Source: KOF Swiss Economic Institute

Chart 3.14
Employment leading indicators



Sources: Credit Suisse, KOF Swiss Economic Institute, SFSO

4 Prices and inflation expectations

The annual inflation rate turned negative in October 2011 and has continued to fall since then. However, a month-on-month comparison shows that the downward trend has slowed considerably. The minimum exchange rate against the euro set in September 2011 has virtually halted the deflationary trend resulting from the strong appreciation of the Swiss franc last summer. The strength of the Swiss franc and underutilisation of capacity (output gap) mean that there is no risk of inflation in the foreseeable future. Surveys show that medium-term inflation expectations are within a range compatible with the SNB's definition of price stability.

4.1 Consumer prices

CPI inflation hit a low in April

The annual inflation rate as measured by the national consumer price index (CPI) has been negative since October 2011. In May, as in March and April, it was –1.0%, the lowest level since 2009 (cf. table 4.1).

The negative annual inflation rate is mainly due to the sharp drop in prices of foreign goods (cf. chart 4.1). Although oil products became more expensive year-on-year, prices of other foreign goods fell considerably in the same period. Driven by the lagged effects of the Swiss franc appreciation, prices of foreign goods initially declined further following the introduction of the minimum exchange rate against the euro. However, the price decline slowed significantly.

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

	2011	2011			2012	2012		
		Q2	Q3	Q4	Q1	March	April	May
Overall CPI	**0.2**	**0.4**	**0.4**	**–0.5**	**–0.9**	**–1.0**	**–1.0**	**–1.0**
Domestic goods and services	0.6	0.6	0.7	0.3	0.0	0.0	0.0	0.0
Goods	–1.3	–1.0	–1.1	–2.1	–2.3	–2.2	–2.1	–2.0
Services	1.1	1.1	1.2	1.1	0.7	0.7	0.6	0.6
Private services excluding rents	0.8	0.8	0.9	0.9	0.7	0.7	0.6	0.6
Rents	1.3	1.3	1.3	1.2	0.8	0.7	0.7	0.7
Public services	1.8	1.8	1.8	1.4	0.6	0.6	0.3	0.3
Imported goods and services	–0.7	–0.3	–0.4	–2.6	–3.4	–3.6	–3.6	–3.8
Excluding oil products	–2.5	–1.9	–1.8	–5.0	–5.2	–5.2	–4.9	–5.0
Oil products	9.3	8.9	7.5	10.5	6.2	4.5	3.1	2.5

Sources: SFSO, SNB

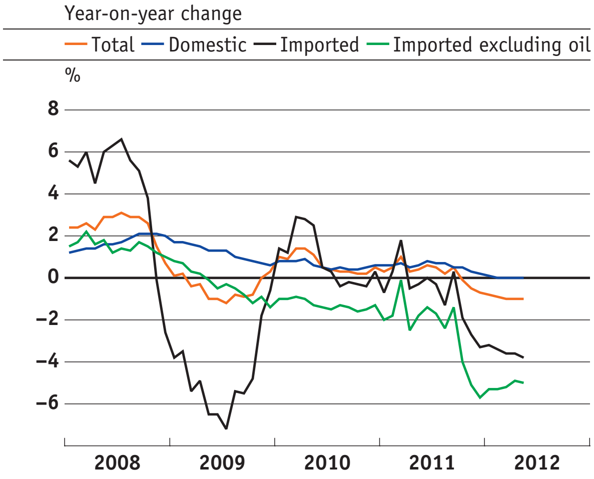
Between February and May, prices of domestic goods were at the same level as a year earlier. However, there is still a clear disparity between goods and services (cf. chart 4.2). The annual inflation rate for domestic goods, which are more exposed than services to competition from abroad, was clearly negative. By contrast, services became slightly more expensive year-on-year, with rent inflation coming in slightly above the inflation rate for other services.

Low and stable core inflation

The core inflation rates calculated by the SNB (cf. chart 4.3) – the trimmed mean (TM15) and dynamic factor inflation (DFI) – are 0.1% and 0.4%, considerably higher than the CPI inflation rate. The negative CPI rate is mainly due to last year's appreciation of the Swiss franc. By contrast, the SFSO's core inflation rate (SFSO1) is still below CPI inflation, at –1.2% when last calculated. The discrepancy between SFSO1 and the SNB's core inflation rates is due to the fact that TM15 and DFI are better able to exclude temporary exchange rate effects from inflation trends.

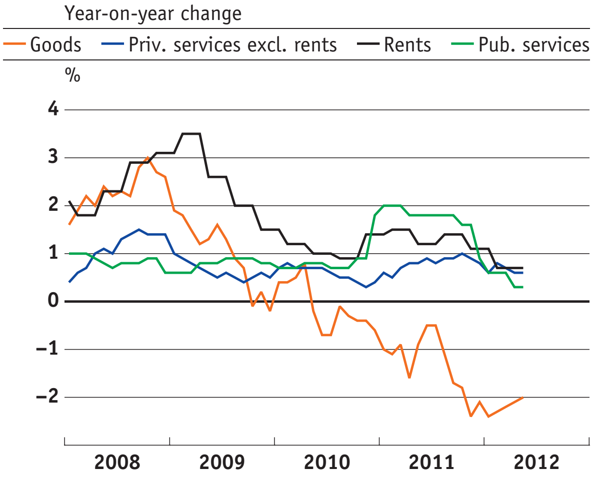
SFSO1 and TM15 are both based on a reduced version of the CPI basket of goods. SFSO1 eliminates the same goods each month (fresh and seasonal products, energy and fuel), while TM15 excludes the goods with the highest and lowest inflation rates over the past 12 months (15% at either end of the distribution). DFI, which is calculated by the SNB alongside TM15, is based on an estimated dynamic factor model, which takes account of monetary and real economic data as well as price data.

Chart 4.1
CPI: domestic and imported goods and services



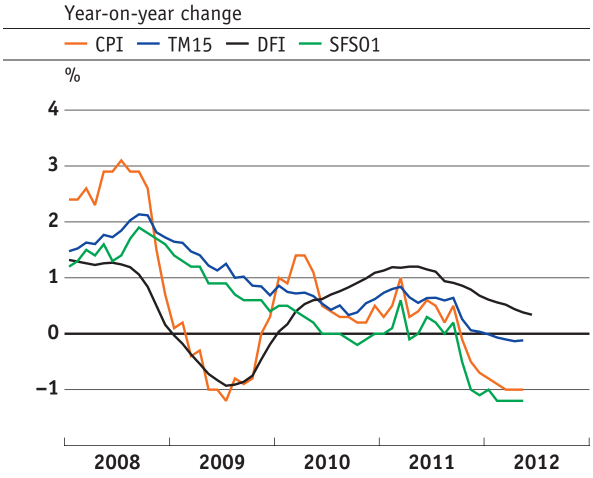
Sources: SFSO, SNB

Chart 4.2
CPI: domestic goods and services



Sources: SFSO, SNB

Chart 4.3
Core inflation rates



Sources: SFSO, SNB

4.2 Producer and import prices

Absence of upward pressure continues

In the case of producer and import prices, no clear price trend is yet in sight. Some of the price increase at the beginning of the year was reversed in April and May. Consequently, producer and import prices are still not exerting upward pressure on consumer prices further down the line.

Chart 4.4 shows that the year-on-year inflation rate for producer and import prices remains negative. This mainly reflects the decline in producer and import prices to November 2011. The negative year-on-year inflation should gradually normalise in the second half of 2012.

4.3 Real estate prices

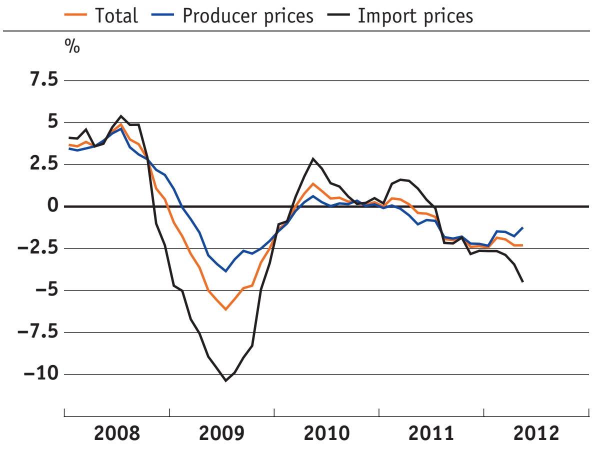
Substantial rise in house prices in the first quarter

The strong price momentum on the residential real estate market is unbroken. According to Wüest & Partner, there was a further significant rise in the offer price of owner-occupied apartments and single-family houses in the first quarter. The indices also point to a continued rise in transaction prices.

Chart 4.5 shows the change in prices paid for owner-occupied apartments in the past ten years. The average for the three indices shows a rise of around 60%, which is well above the increase registered in nominal per capita income in the same period. The sharp hike in prices is being driven mainly by a low level of vacancies – despite buoyant construction activity – and by low interest rates. The longer prices for owner-occupied housing continue to rise at this pace, the greater the associated risks to financial stability.

Chart 4.4
Producer and import prices

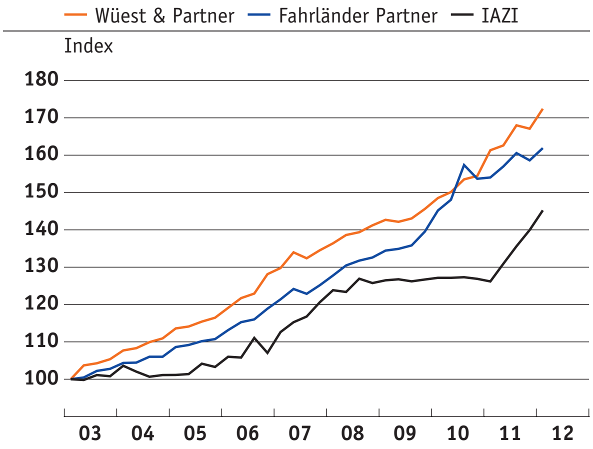
Year-on-year change



Source: SFSO

Chart 4.5
Transaction prices, owner-occupied apartments

Beginning of period = 100, nominal (hedonic)



Sources: Fahrländer Partner, IAZI, Wüest & Partner

Growing discrepancy between rents for new and existing contracts

In the first quarter, rents for apartments offered on the market (offer rents) were considerably higher than a year earlier (cf. chart 4.6). By contrast, rents under existing contracts hardly changed over the year. They are tied by law to the reference mortgage rate, which declined last year. Given the further reduction in the reference rate on 2 June 2012, the discrepancy looks set to increase further in the coming quarters.

4.4 Inflation expectations

Inflation expectations almost unchanged

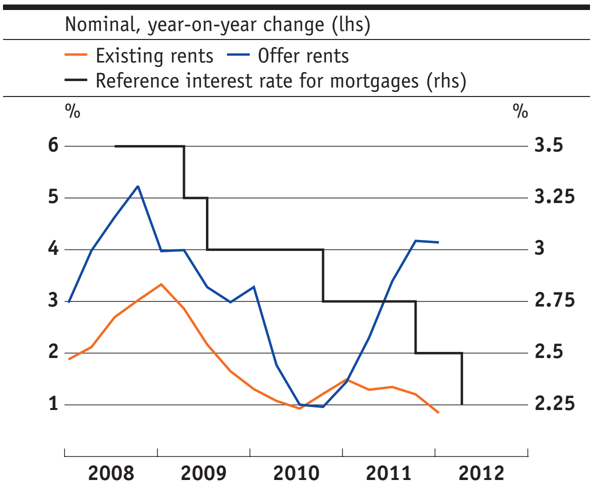
Surveys of households and experts on expected price trends and inflation rates are still pointing to slightly higher inflation expectations. However, medium-term inflation expectations are still in the low positive range, which is consistent with the SNB's definition of price stability.

The quarterly survey of households conducted by SECO shows that the percentage of respondents who expected prices to rise over the next 12 months increased from 38% in January to 45% in April (cf. chart 4.7). By contrast, fewer households than in January expected prices to fall. The percentage of households that expected prices to remain unchanged declined as well, but nevertheless remained high.

The *Credit Suisse ZEW Financial Market Report* published in May showed that the majority of the experts surveyed still expected inflation rates to remain unchanged over the next six months. However, the proportion expecting higher inflation rose slightly, while the proportion expecting to see falling inflation receded somewhat.

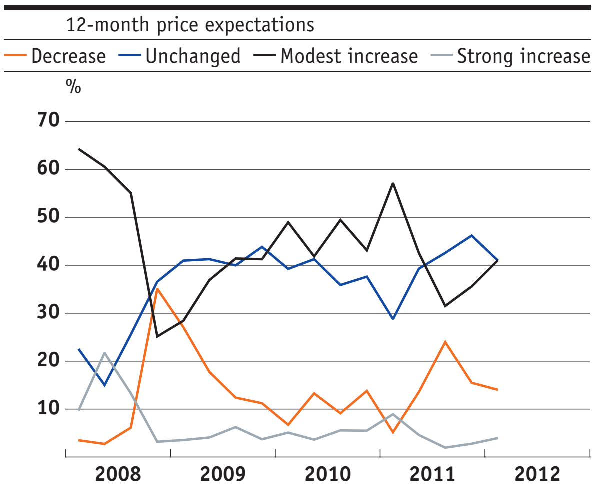
Talks held by the SNB delegates for regional economic relations with companies from all sectors of the Swiss economy, and the survey conducted by Deloitte among CFOs and heads of finance at companies based in Switzerland, provide quantitative information on inflation expectations. The talks held by the SNB delegates in April and May indicate that the companies included in the survey expect the inflation rate to be just over 0.2% in six to twelve months. The survey by Deloitte in the first quarter showed that the inflation rate was expected to be 1.5% in two years, above the short-term inflation expectations registered by the SNB delegates.

Chart 4.6
Apartment rents and reference interest rate



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

Chart 4.7
Survey on expected movements in prices



Sources: SECO, SNB

5 Monetary developments

Monetary and financial conditions remained virtually unchanged compared with the first quarter. Interest rates on the money market are still close to zero. The Libor persists at around 10 basis points, and interest rate expectations are exceptionally low. Under the impact of the European financial and debt crisis, yields on bonds with high credit ratings are also very low. On the foreign exchange market, the euro has weakened by around 5% against the US dollar since the beginning of May. As a result, the Swiss franc has depreciated slightly in export-weighted terms, even if the exchange rate has remained unchanged with regard to the euro.

The low interest rates continue to be reflected in robust growth in lending and rising real estate prices. As a result, the imbalances on the Swiss residential mortgage and real estate markets have increased further.

5.1 Summary of monetary policy since the last assessment

Continuation of monetary policy announced in September 2011

The SNB has continued to pursue the monetary policy which it announced on 6 September 2011 and reiterated at subsequent assessments. On 6 September, the SNB had set a minimum exchange rate of CHF 1.20 to the euro. It had already reduced the target range for the three-month Libor to 0.0–0.25% in August while greatly increasing liquidity.

Higher sight deposits at the SNB

Enforcement of the minimum exchange rate led to a rise in total sight deposits at the SNB in the second quarter. In the week ending 8 June 2012 (last calendar week before the mid-June assessment), sight deposits totalled CHF 266.1 billion. Between the assessments in mid-March and mid-June, they averaged CHF 226.0 billion. Of this amount, CHF 163.3 billion was accounted for by the sight deposits of domestic banks and the remaining CHF 62.7 billion by other sight deposits. Sight deposits thus remain high.

Liquidity-providing open market operations

Between the assessments in mid-March and mid-June, the SNB conducted liquidity-providing repo operations with one-week maturities. In addition, foreign exchange swaps were concluded to create temporary liquidity in Swiss francs and foreign exchange transactions were undertaken on the spot market.

At the time of the March 2012 assessment, SNB Bills amounting to CHF 7.3 billion were outstanding. Since then, SNB Bills worth approximately CHF 6.8 billion have fallen due.

Banks' surplus reserves remain high

Statutory minimum reserves averaged CHF 11.2 billion between 20 February 2012 and 19 May 2012, a decline of around CHF 0.5 billion compared to the preceding period (20 November 2011 to 19 February 2012). On average the banks exceeded the requirement by around CHF 153.7 billion (previous period: CHF 169.3 billion). The average compliance level fell from 1,547% to 1,469%.

5.2 Money and capital market interest rates

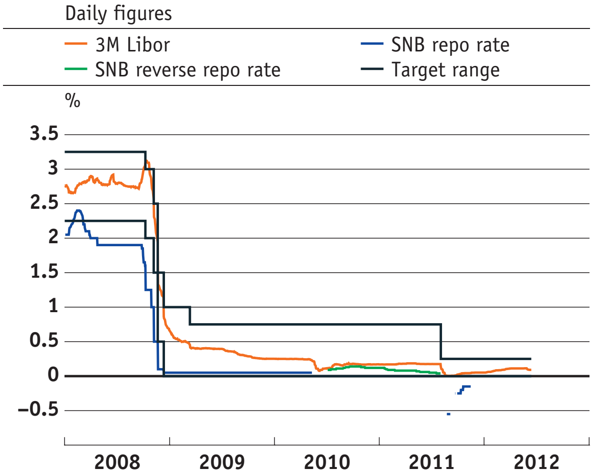
Money market rates close to zero

Money market rates have remained close to zero in recent months. In June, the three-month Libor amounted to 0.09%, which was almost exactly the same level as at the last monetary policy assessment in March 2012 (cf. chart 5.1). The reference rates for repo transactions (Swiss Average Rates) were slightly lower and descended, at times, into negative territory.

Long-term interest rates driven by the sovereign debt crisis in Europe

Safe investments have become more attractive in the light of the escalating financial and debt crisis in Europe. As a result, yields on medium and long-term Confederation bonds have dropped to new historical lows. In June, the yield on the ten-year Confederation bond was just 0.5% at times.

Chart 5.1
Money market rates



Sources: Bloomberg, Reuters, SNB

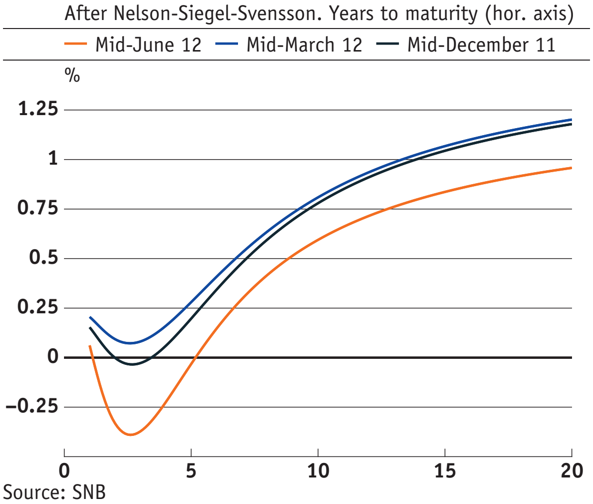
Further flattening of the yield curve

The decline in medium and long-term interest rates led to a further flattening in the yield curve (cf. chart 5.2). The spread between the yield on ten-year Confederation bonds and the three-month Libor was around 0.5 percentage points in mid-June, compared with 0.6 percentage points at the time of the monetary policy assessment in March. Another striking fact is that the negative yields on maturities of between two and four years have widened.

Real interest rates remain low

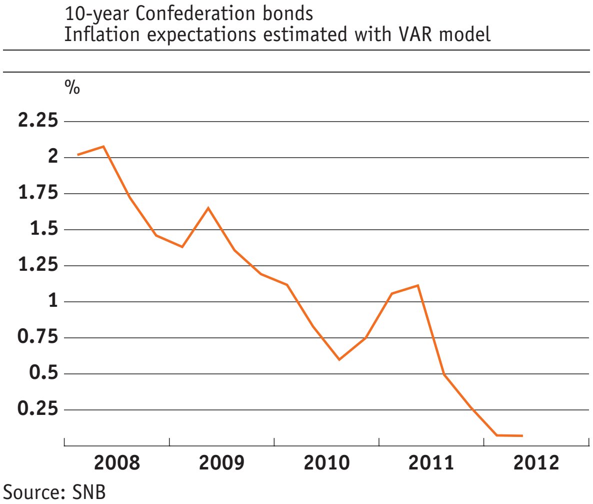
Estimated real ten-year interest rates are currently around 0.1%, practically unchanged over the previous quarter (cf. chart 5.3). Real interest rates are calculated using the ten-year yield on Confederation bonds and the estimated inflation expectations for the same time horizon, determined using a VAR model.

Chart 5.2
Term structure of Swiss Confederation bonds



Source: SNB

Chart 5.3
Estimated real interest rate



Source: SNB

5.3 Exchange rates

CHF/EUR exchange rate close to minimum exchange rate of CHF 1.20

The CHF/EUR exchange rate dropped below CHF 1.21 in mid-January. Since then, it has moved in a narrow band between the minimum exchange rate of CHF 1.20 announced in September 2011 and CHF 1.21 (cf. chart 5.4). Unlike the very low actual volatility of the CHF/EUR exchange rate, the expected volatility, calculated from option prices, has risen considerably. This reflects the financial markets' uncertainty about the situation in the euro area.

The CHF/USD exchange rate has mainly been influenced by changes in the EUR/USD rate in recent months. In the first few weeks of June, one US dollar cost CHF 0.96, compared with an average of CHF 0.91 in March.

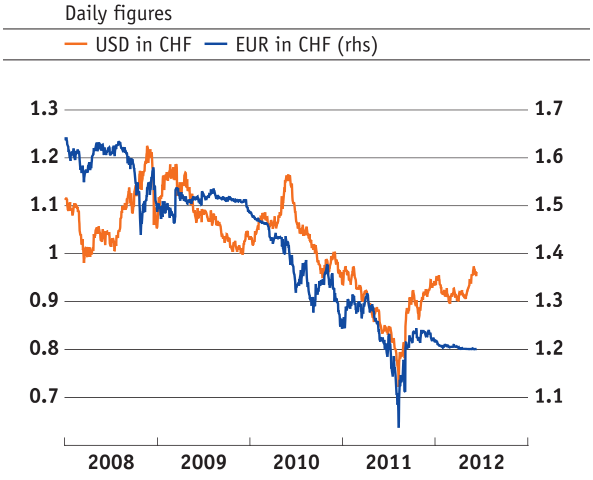
Slight decline in the MCI

Exchange rates and interest rates together determine monetary conditions. The Monetary Conditions Index (MCI) indicates that monetary conditions were slightly more relaxed in mid-June than at the time of the monetary policy assessment in mid-March (cf. chart 5.5). The MCI combines changes in the three-month Libor and in the nominal export-weighted external value of the Swiss franc. To take account of uncertainty regarding the relative impact of changes in interest rates and exchange rates, indices with different weightings (3:1 and 5:1) are used, as shown in chart 5.5. The indices are reset to zero at the time of the last monetary policy assessment so a negative MCI value indicates an easing of monetary conditions. Since the three-month Libor has hardly changed in recent months, at present the MCI mainly reflects changes in the export-weighted exchange rate.

Real external value of the Swiss franc remains high

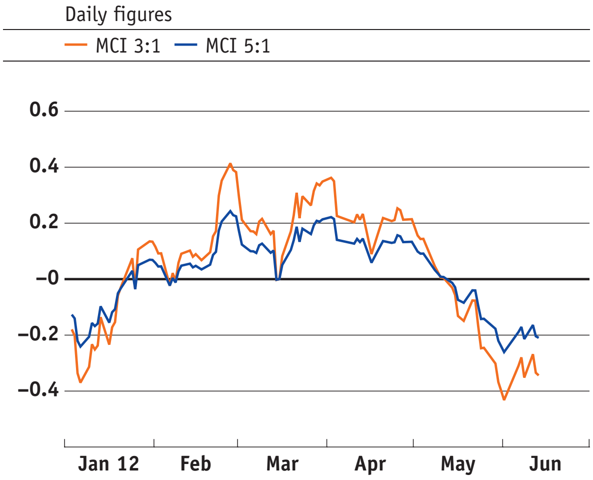
Between January and April, there was a slight rise in the real export-weighted external value of the Swiss franc, which adjusts changes in the nominal external value of the currency to take account of the difference in inflation compared with other countries (cf. chart 5.6). In May, it probably dropped back to the level registered at the start of the year, as the Swiss franc weakened against the US dollar. The real external value is still well above the long-term average, so the Swiss franc is still high.

Chart 5.4
Exchange rates



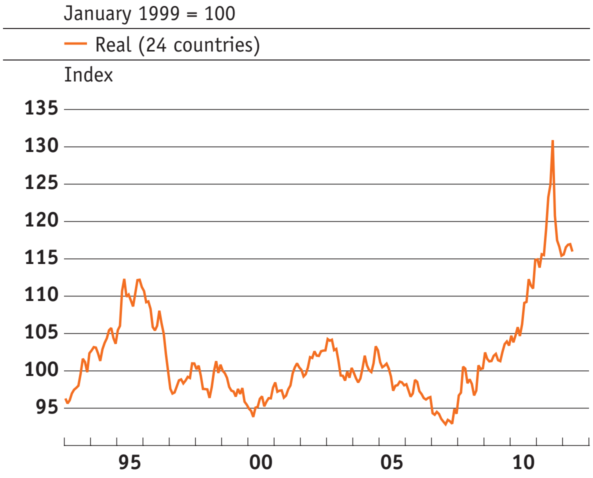
Source: SNB

Chart 5.5
MCI nominal



Source: SNB

Chart 5.6
Export-weighted external value of Swiss franc



Source: SNB

5.4 Stock markets

Recovery interrupted by renewed uncertainty

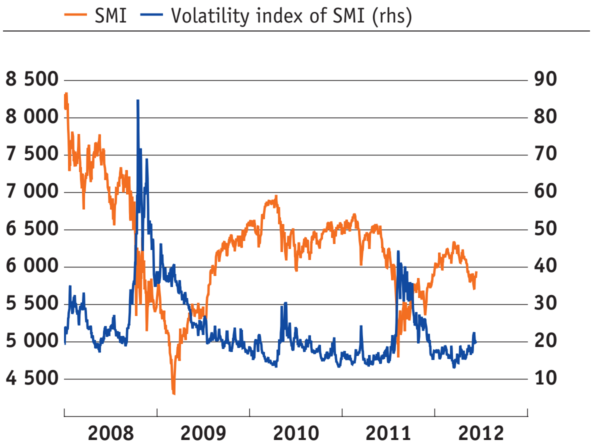
Since mid-March, share prices have been trending downwards in Europe – and, to a lesser extent, in the US and the rest of the world as well – due to disappointing news from the euro area. That halted the rally on the international equity markets following last year's price slide.

Swiss share prices also eased. By mid-June, the SMI stood at approximately the same level as at the start of the year. Although it was still well above the level registered after the price slides in 2008/2009 and 2011, it had not equalled the levels it reached during the economic recovery between mid-2009 and mid-2011. Chart 5.7 also shows that the index of 30-day expected SMI volatility, a measure of the uncertainty on the equity market, has risen since March. However, the rise was very modest compared with 2008/2009 and 2011.

The sectoral breakdown shows that share prices in the healthcare sector were relatively stable. As usual, shares in financial and industrial companies reacted more sharply to the increased uncertainty on the financial markets (cf. chart 5.8).

Chart 5.7
Share prices and volatility

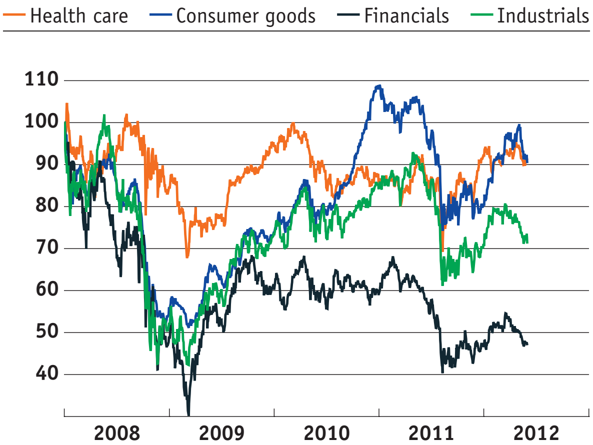
Daily figures



Source: Thomson Financial Datastream

Chart 5.8
Selected SPI sectors

Beginning of period = 100, daily figures



Source: Thomson Financial Datastream

5.5 Monetary and credit aggregates

High monetary base

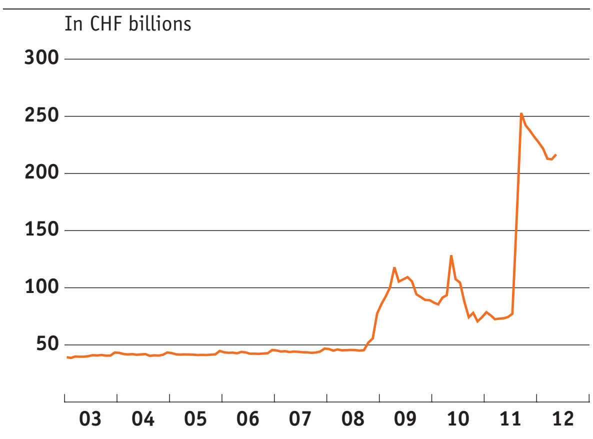
The monetary base, which comprises banknotes in circulation plus domestic banks' sight deposits with the SNB, remained stable in April and rose slightly in May. Having declined slightly in previous months, it is thus once again close to its historical peak of September 2011, which reflects the measures taken in August and September to expand liquidity (cf. chart 5.9). In May 2012, it amounted to an average of CHF 217 billion compared to CHF 253 billion in September 2011 and around CHF 45 billion before the escalation of the financial and economic crisis in autumn 2008.

Sustained strong growth in broad monetary aggregates

The broad monetary aggregates, which are defined as means of payment held by households and companies, have once again shown strong growth over the past few months (cf. chart 5.10). In May, M1 (cash in circulation, sight deposits and transaction accounts) was 9.9% above its level a year earlier, while M2 (M1 plus savings deposits) was 8.6% higher in the same period and M3 (M2 plus time deposits) rose by 6.2% (cf. table 5.1). The strong growth in the monetary aggregates shows that lending is still rising strongly in the present low-interest environment. As the banks have high surplus reserves, moreover, lending and money creation within the banking system is not currently being constrained by regulatory minimum reserve requirements.

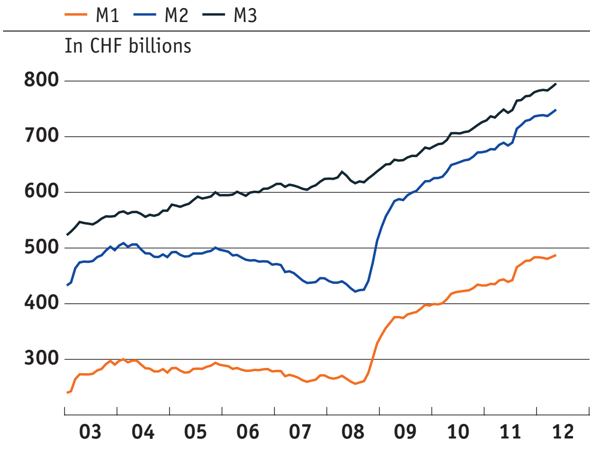
In autumn 2008, M1 and M2 increased very substantially owing to the shift of funds from time deposits to sight and savings deposits. Since then, the development of the broad monetary aggregates has mainly reflected interest rate trends. Following relatively low growth rates in mid-2011, reflecting a temporary rise in long-term interest rates, strong growth in the broad monetary aggregates has resumed as long-term rates have dropped.

Chart 5.9
Monetary base



Source: SNB

Chart 5.10
Monetary aggregates



Source: SNB

Robust growth in lending

Growth in bank lending remained robust in the first quarter of 2012. There is still no sign of a credit squeeze (cf. chart 5.11 and table 5.1).

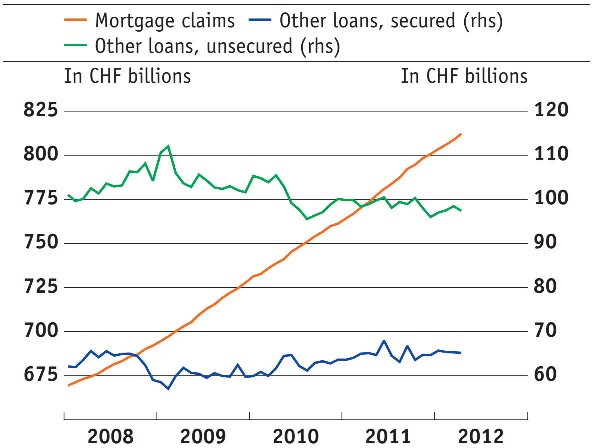
Supported by low interest rates, as in the previous quarter mortgage lending was up by 5.1% year-on-year. When interest rates are low, long-term, fixed rate mortgages tend to be preferred to those with variable interest rates. In October 2008, callable mortgages, which are mainly variable rate mortgages, made up around 30% of all mortgages (cf. chart 5.12). By April 2012, they accounted for just 11% of total mortgages. Accordingly, the proportion of mortgages with a residual term of over one year increased from 51% to 65%.

The volume of other loans was virtually unchanged year-on-year. The division of other loans into secured and unsecured loans shows that, in the past two quarters, secured loans have expanded more slowly than before, while unsecured loans declined slightly year-on-year (cf. table 5.1).

The development of other loans is in keeping with the SNB's bank lending survey,[1] which suggests that lending conditions for companies and households have been slightly tightened. Unsecured loans are highly cyclical. Consequently, the decline can be interpreted as an indication of a slowdown in economic activity.

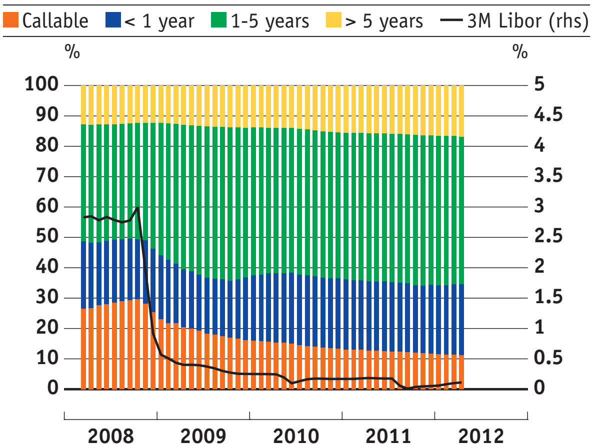
1 The bank lending survey is an SNB survey of banks' lending conditions. It has been conducted quarterly since 2008 and covers 20 banks, which account for 85% of the domestic lending market.

Chart 5.11
Mortgage claims and other loans



Source: SNB

Chart 5.12
Breakdown of mortgages by residual term



Source: SNB

Monetary aggregates and bank loans Table 5.1

Year-on-year change in percent

	2011	2011 Q2	Q3	Q4	2012 Q1	2012 March	April	May
M1	**8.7**	**6.3**	**8.7**	**11.0**	**10.9**	**10.4**	**9.5**	**9.9**
M2	**7.8**	**6.2**	**7.8**	**9.3**	**9.1**	**8.9**	**8.4**	**8.6**
M3	**7.0**	**6.0**	**7.3**	**7.6**	**6.8**	**6.6**	**6.3**	**6.2**
Bank loans total [1, 3]	**4.1**	**3.8**	**4.6**	**4.3**	**4.1**	**4.2**	**4.0**	
Mortgage claims [1, 3]	4.8	4.8	4.9	5.1	5.1	5.0	5.0	
Households [2, 3]	4.5	4.4	4.5	4.8	5.1	5.1	5.1	
Private companies [2, 3]	5.6	5.5	5.7	6.1	5.3	5.0	5.3	
Other loans [1, 3]	0.6	−0.3	3.1	0.3	−0.3	0.2	−0.9	
Secured [1, 3]	4.0	3.6	4.4	1.7	1.9	0.5	0.1	
Unsecured [1, 3]	−1.6	−2.8	2.4	−0.6	−1.7	0.1	−1.5	

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 practices. Consequently, they may deviate from growth rates published in the *Monthly Bulletin of Banking Statistics*

Source: SNB

Business cycle trends
SNB regional network

Report for the attention of the Governing Board of the Swiss National Bank for its quarterly assessment of June 2012

Second quarter of 2012
The Swiss National Bank's delegates for regional economic relations are constantly in touch with a large number of companies from the different economic sectors and industries. Their reports, which contain 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 April and May 2012 with 235 representatives of various industries on the current and future situation of their companies and the economy in general. The selection of companies is made according to a model that reflects Switzerland's industrial structure. The reference parameter is GDP excluding agriculture and public services. The companies selected differ from one quarter to the next.

Region	Delegate
Central Switzerland	Walter Näf
Eastern Switzerland	Jean-Pierre Jetzer
Geneva	Marco Föllmi
Italian-speaking Switzerland	Fabio Bossi
Mittelland	Martin Wyss
Northwestern Switzerland	Daniel Hanimann
Vaud-Valais	Aline Chabloz
Zurich	Markus Zimmerli

Summary

The economic situation remained robust in the second quarter of 2012. The problem of contracting margins has eased somewhat but was still the focus of attention for company efforts at optimisation. Many are therefore taking further action to reduce costs and raise efficiency. Companies appreciate the increased planning security resulting from the minimum exchange rate for the Swiss franc against the euro. The main worries about future developments relate to an increased number of unknown factors in connection with the consequences of the European debt crisis and – linked to this – further exchange rate developments.

There are still considerable differences between industries. Construction saw a strong rise in business activity following a decline in the previous quarter due to weather conditions. In manufacturing and the services sector, business stagnated. Demand for labour was also unchanged, overall, from the previous quarter.

The outlook for real growth in turnover remained moderately positive in all sectors. However, capital expenditure and demand for staff are likely to continue to stagnate. Average utilisation of technical production capacity and infrastructure is normal in manufacturing and the services sector and is still relatively high in construction. It is expected to increase slightly in the coming months in both construction and manufacturing.

1 Business activity

Manufacturing

Business activity in manufacturing remained stable. Overall, real turnover remained unchanged compared with both the previous quarter and year-on-year. The exchange rate problem has continued to ease in many industries thanks to the measures taken by the SNB and companies themselves.

In the watchmaking, chemical, plastics and metal products industries, turnover was higher than in the previous quarter, while in the textile and machinery industries, it was unchanged. By contrast, lower turnover was reported by the clothing and food industries, in particular.

Demand from the emerging economies of Asia was again the main driver for the export sector, but momentum was once again lower than in the previous quarter. Stimulus also came from the US. In Europe, demand originated mainly from Germany, Scandinavia and Eastern Europe. Demand was particularly sluggish in Spain and Italy, and was also weaker in France.

Construction

Following the relatively significant fall-off in business activity in the first quarter due to weather conditions, turnover picked up perceptibly in the second quarter. In many cases, the declines registered in the previous quarter were offset. Developments were particularly buoyant in civil engineering, but turnover also rose in structural engineering, the finishing trade and preparatory construction work. While residential construction continued to boom, the situation in commercial and industrial construction remained subdued.

Some respondents pointed to real estate market risk, which was referred to, in some cases – depending on the region – as 'overheating'. The banks' lending policy tends to be perceived as increasingly cautious.

Services

In the services sector as a whole, real turnover was still slightly higher than in the previous quarter and the corresponding quarter of 2011.

Good business momentum was reported by the IT industry, architectural practices and engineering firms, insurance companies and the travel industry. Business activity in the banking industry stagnated, with developments in the various areas of business offsetting each other. The situation has stabilised in the retail and wholesale trade and the hotel industry. Real turnover in these areas of activity was virtually unchanged quarter-on-quarter. However, extensive price erosion exerted downward pressure on nominal turnover figures in the retail industry. At many hotels, large-scale special offers and price discounts were necessary to maintain capacity utilisation at a high level. The tourism industry in mountain regions is still complaining of a marked decline in the number of European visitors owing to exchange rates and weather conditions. However, in some regions this has been partially offset by increased demand from visitors from Asia and Russia, and from within Switzerland.

2 Capacity utilisation

Overall, utilisation of production capacity and infrastructure was judged to be normal. The previous wide variation between industries has decreased further. Finished product inventories are still considered somewhat too high, especially in the textile industry, but also in wholesaling (notably the car trade).

In manufacturing, capacity utilisation was rated as normal overall. It remained comparatively high in watchmaking and the related supply trade as well as in parts of the pharmaceutical industry. In the machinery and metal products and processing industries, the previous negative situation had improved somewhat. By contrast, capacity utilisation was very low at textile firms and in the food industry.

In construction, technical capacity utilisation was still relatively high, with capacity utilisation considerably higher in structural engineering than in civil engineering. The great majority of the companies that took part in the survey were very satisfied with their level of capacity utilisation. Some reported that they were unable to fully meet demand, owing mainly to staff shortages.

In the services sector, infrastructure utilisation was rated as normal overall. As in the previous quarter, a relatively high level of capacity utilisation was recorded by architectural practices and engineering firms, real estate companies and IT companies. Representatives from the financial industry, retailing and wholesaling reported normal levels of utilisation. Hotels and restaurants continued to report persistently low utilisation, although hotels in cities reported buoyant business tourism. There is also a trend to downgrade from higher to lower hotel categories or room categories.

3 Demand for labour

Overall, the demand for labour has remained practically unchanged. The manufacturing companies included in the survey still considered that their headcounts were slightly too high. Their handling of this situation remained unchanged: they continued to exercise restraint in their personnel policy, did not replace employees when they left and covered any seasonal increases in demand by taking on temporary staff or through overtime work. In border areas, especially in Ticino, there has been a sharp rise in the number of job-seekers from neighbouring countries.

In construction, the demand for labour increased slightly faster than in the previous quarter. A number of companies again said they were having considerable difficulties recruiting and retaining suitable personnel. Some specialised workers such as construction supervisors, foremen and machinery specialists are in very short supply. Alongside cost considerations, staff shortages were often given as the reason why more contracts were being awarded to foreign firms.

In the services sector, staff levels were generally considered appropriate. Architectural practices and engineering firms indicated that their recruitment needs were fairly high. The previously strong demand for personnel in the IT industry has dropped off somewhat. The hotel and catering industry was still overstaffed. In addition, a few banks reported that headcounts were on the high side.

Overall, recruiting was considered to be as difficult and time-consuming as usual. Staff availability was very tight in the plastics production and processing industry and, to some extent, in pharmaceuticals. The situation was comparatively relaxed for companies in the food industry. In the services sector, recruitment was considered slightly easier than normal, especially at IT companies and banks.

Per capita labour costs increased slightly across all three sectors. In many industries, the market for specialists has dried out. This is particularly true for pharmaceuticals, watchmaking, civil engineering, as well as architectural practices and engineering firms, which therefore faced higher per capita labour costs. New collective agreements have also increased costs in the industries affected.

4 Prices, margins and earnings situation

Many companies are still confronted with the problem of low or below-average profitability, accompanied by relatively high capacity utilisation. In all sectors of the economy, margins were judged to be lower than usual, although this view was held by fewer respondents or was less pronounced than in the previous quarter. The reasons given were the same as in the past: tougher competition, waning demand and the sustained strength of the Swiss franc. The pressure to cut costs therefore remains as high as ever. At the same time, however, margin-improvement measures in the past are increasingly having an impact, as is an easing of raw material prices.

There was further confirmation that the minimum exchange rate for the Swiss franc against the euro has brought welcome planning security for many companies and even prevented some from going out of business. However, some manufacturing companies and service providers still rate the current exchange rate as critical (and expressed a desire for a higher minimum exchange rate). It was felt that the situation would worsen if sales volume were to come under pressure as well as margins.

Manufacturing was still suffering badly from pressure on profit margins. All industries are affected, but the phenomenon was particularly pronounced in the textile and plastics processing industries. On average, companies do not expect purchase prices to decline much in the coming months, but they anticipate that they will have to make further concessions in selling prices in Swiss francs.

In construction, the phenomenon of below-average margins mainly affected structural engineering, whereas margins were close to normal in civil engineering and the finishing trade. Expected purchase and selling prices are both now assessed as being virtually stable.

In the services sector, hotels, restaurants and wholesaling continued to suffer from unusually low margins. Margins at transport and logistics companies and IT firms had deteriorated considerably compared with the assessment given in the previous quarter. Representatives of the financial industry rated their situation as fairly negative, but considerably less so than in previous quarters.

5 Outlook

The uncertainty about future developments has increased slightly again. Companies' domestic employment and investment plans remain cautious to restrained. Despite the potential risks, turnover expectations for the coming months remain positive in all sectors, as they were in the previous quarter.

In manufacturing, representatives of all industries, apart from some companies in the metals and machinery sector, expect turnover to rise slightly over the next six months. Accordingly, technical capacity utilisation in these industries should be somewhat higher, although there are no signs that this could have a positive effect on employment.

In construction, seasonally adjusted turnover and capacity utilisation should improve slightly in the coming months. Some companies report that orders books are well-filled or very full into next year. A slightly positive stimulus may also be expected in employment. The acceptance of a popular initiative that puts a ceiling on the proportion of second homes has led to some uncertainty about the medium-term outlook for construction.

In general, companies in the services sector are cautiously upbeat about the business trend in the next six months. All industries assume that turnover will be stable or rise slightly. Capacity utilisation and headcounts are likely to remain fairly stable at the present level. Architectural practices and engineering firms and companies in the travel industry report more optimistic turnover expectations. Representatives of the retail trade have recently been comparatively optimistic about their turnover prospects.

In terms of global risks, the unknown factors in connection with the European debt crisis were cited most frequently.

The unusually low margins are still demanding the full attention of the companies affected. Further price discounts are already in the pipeline at many companies and, together with the persistently tough competitive situation, could maintain the high pressure on margins. Low interest rates are often seen as an advantage, but the fact that this situation has lasted so long is giving rise to concern. In connection with the increased real estate market risk, banks are becoming noticeably more cautious about granting loans.

The slightly higher overall uncertainty with regard to the future path of the economy is reflected in investment plans: equipment investment in manufacturing and the services sector is likely to remain unchanged at current levels or only grow slightly, and could even recede somewhat in construction. Manufacturing is showing a slightly lower tendency to invest in construction, while services companies are planning a modest increase.

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* at www.snb.ch.

June 2012

At its quarterly assessment of 15 March 2012, the SNB reaffirms that it will maintain the minimum exchange rate of CHF 1.20 per euro and will enforce it with the utmost determination. It remains prepared to buy foreign currency in unlimited quantities for this purpose. Even at the current rate, it considers the Swiss franc to be still high. If necessary, the SNB stands ready to take further measures at any time. The target range for the three-month Libor will remain unchanged at 0.0–0.25%.

March 2012

At its quarterly assessment of 15 March 2012, the SNB reaffirms that it will continue to enforce the minimum exchange rate of CHF 1.20 per euro with the utmost determination and is prepared to buy foreign currency in unlimited quantities for this purpose. The target range for the three-month Libor will remain unchanged at 0.0–0.25%. The SNB will continue to maintain liquidity on the money market at an exceptionally high level. Even at the current rate, it considers the Swiss franc to be still high. The SNB stands ready to take further measures at any time if the economic outlook and the risk of deflation so require.

On 8 March, the SNB publishes its annual results for 2011, reporting a consolidated profit of CHF 13.5 billion, following a loss of CHF 19.2 billion in the previous year. At CHF 13.0 billion, the result for the parent company, upon which the profit distribution is based, is CHF 440.2 million less than the consolidated result. The difference is due to the inclusion of the stabilisation fund companies in the consolidated result.

December 2011

At its quarterly assessment of 15 December, the SNB reaffirms that it will continue to enforce the minimum exchange rate with the utmost determination and is prepared to buy foreign currency in unlimited quantities. It is leaving the target range for the Libor at 0.0–0.25%, and continues to aim for a three-month Libor close to zero. Even at the current rate, the SNB considers the Swiss franc to be still high and should continue to weaken over time. The SNB goes on to say that it will continue to maintain liquidity at exceptionally high levels, but has decided not to set a specific target level for sight deposits at present. The SNB stands ready to take further measures at any time if the economic outlook and the risk of deflation so require.

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