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Press release

Monetary policy assessment of 15 September 2005

National Bank leaves the target range for the three-month Libor rate unchanged at 0.25-1.25%.

The Swiss National Bank is leaving the target range for the three-month Libor rate unchanged at 0.25–1.25%. It intends to keep the rate in the middle of the target range at around 0.75% for the time being.

The recovery in the Swiss economy continues. The National Bank expects the economy to expand by around 1% in 2005. As a result of the latest development in the price of oil, it estimates that, averaged over the year, inflation will be slightly higher at 1.2% (June: 1%). Inflation prospects for 2006 are slightly less favourable than in the June forecast, but for 2007 they have remained virtually unchanged. On the assumption that the three-month Libor remains unchanged at 0.75%, annual inflation is forecast to stand at 0.8% in 2006 and reach 1.4% in 2007. The impact of the latest rise in oil prices on the economy and on inflation are difficult to gauge. Against this background, the National Bank remains cautious. Provided the economic recovery is substantiated, the SNB will adjust the expansionary monetary policy it has pursued for a long time now. If the Swiss franc were to appreciate rapidly, the Swiss National Bank would respond appropriately.

International environment

The SNB's inflation forecast is embedded in a global economic scenario. At the time of the forecast, this scenario is considered to represent the most likely development. Economic recovery abroad is proceeding as anticipated. Assumptions on further international economic development have been somewhat modified compared with June 2005. While higher oil prices have a slightly dampening effect on the recovery in Europe, this effect is overcompensated by other factors in the US. Consequently, growth may well be somewhat more robust there than was assumed in the June forecast.

Oil price

At the June assessment, the National Bank still assumed that the price of oil would recede gradually. Contrary to what was expected, oil has become significantly more expensive since then. It is now assumed that oil prices will persist at a high level.

Economic outlook

After the slowdown at the end of 2004, the Swiss economy has returned to its growth path. Several indicators were already pointing to a brighter outlook for the economic situation, and second-quarter economic data now confirm the picture of a broad-based recovery. Following a period of pronounced weakness in the 2004/2005 winter half-year, construction investment has seen a marked increase. After several quarters of weak or even negative growth rates, equipment investment rose. Private consumption has picked up noticeably, somewhat exceeding the long-term average. Exports exhibited a sharp increase. This did not, however, have an impact on the labour market. The economy's output capacities are not fully utilised yet.

Economic growth is expected to continue in the second half of the year. Exports and construction investment will continue to be the main driving force, although the momentum will slow somewhat. High oil prices and persistent unemployment are having a dampening effect on consumption. For 2005, the National Bank anticipates that real GDP growth will remain at around 1%. The moderate economic recovery will thus continue. With the economy expected to accelerate in 2006, the situation on the labour market is likely to improve so that we should see consumer spending picking up. Based on this scenario, economic resources should be fully utilised towards the end of 2006. If monetary policy were to remain unchanged until then, inflation rates would rise subsequently.

Monetary development

The development of prices at the end of the three-year forecasting horizon is primarily determined by monetary developments. Monetary aggregates M1 and M2 are no longer contracting. In July, they were at or above their year-earlier level for the first time since August 2004. The growth rate for the broad aggregate M3 has picked up again. There is still ample liquidity in the economy, but this poses no reason for concern at this point. Mortgage loans continue to grow strongly. Other loan categories

that had long been on a downtrend have meanwhile stabilised. The National Bank is aware of the fact that the expansive monetary policy it has been pursuing for a considerable period of time has a strong impact on the real estate sector. It is therefore keeping a close watch on this sector.

Reasons behind the monetary policy decision

In view of the above-mentioned developments, the Swiss National Bank has decided to leave the target range for the three-month Libor rate unchanged at 0.25-1.25%. The reasons for this decision are two-fold. Firstly, even though oil prices are high, the inflation forecast until mid-2006 is at a low level. This affords the National Bank leeway for its monetary policy, which it can use without jeopardising price stability. Secondly, there is considerable uncertainty with respect to economic developments. Real oil prices have reached their highest level in twenty years. Given these factors, the National Bank is not taking any action for the time being.

Inflation forecast following the monetary policy decision

The National Bank uses the inflation forecast to summarise its assessment of the inflation prospects and to communicate the future need for action in monetary policy. The new inflation forecast (dashed red line) extends from the third quarter of 2005 until the second quarter of 2008. Like the June forecast (dash-dotted green line), it is based on the assumption of the three-month Libor rate remaining constant at 0.75%.

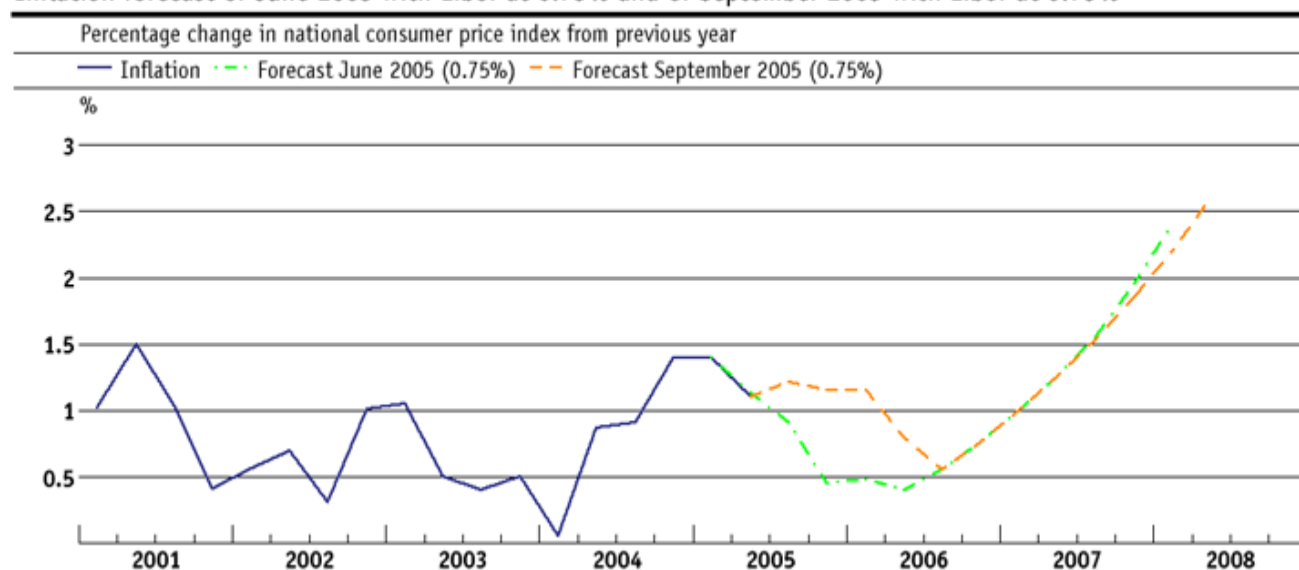
As a result of the higher oil prices, the new forecast exceeds the June forecast until mid-2006. The projected inflation rate will persist at a higher level for some quarters. Since economic development is liable to be relatively muted and the recovery on the labour market slow, the higher price of oil is not expected to produce any second-round effects. Assuming that oil prices stabilise, expected inflation will begin to subside in the first half of 2006 due to the statistical effect of a high baseline in the preceding period. As a result of the expected utilisation of economic resources and high liquidity, it will increase at an accelerated pace starting at the end of 2006. Should the three-month Libor rate remain unchanged at 0.75%, inflation would reach 2.6% by the end of the forecasting horizon. This would be above the range which the SNB equates with price stability.

The forecast shows that a three-month rate of 0.75% cannot be maintained in the event of a normalisation of the economic situation. Since monetary policy has been expansionary for a long time now, the inflationary risk will intensify in the future. If the recovery in the economic situation is substantiated, it will be necessary to make adjustments to monetary policy.

Continuation of the monetary policy pursued to date

With its decision to leave the three-month Libor unchanged, the National Bank is adhering to its previous monetary policy course and is making use of its monetary policy leeway to support the recovery of the economy without jeopardising long-term price stability. If the Swiss franc appreciates rapidly, the National Bank will respond appropriately. As in the past, it will keep all its options open.

Inflation forecast of June 2005 with Libor at 0.75% and of September 2005 with Libor at 0.75%



Observed inflation September 2005

	2002				2003				2004				2005			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Inflation	0.56	0.69	0.31	1.01	1.05	0.50	0.40	0.50	0.06	0.87	0.91	1.40	1.40	1.10		

Inflation forecast of June 2005 with Libor at 0.75% and of September 2005 with Libor at 0.75%

	2005				2006				2007				2008			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Forecast June 2005, Libor at 0.75%	1.13	0.91	0.45	0.48	0.40	0.55	0.75	1.00	1.25	1.55	1.95	2.40				
Forecast September 2005, Libor at 0.75%		1.21	1.15	1.15	0.80	0.55	0.75	1.00	1.25	1.53	1.85	2.20	2.60			

Inflation forecast of September 2005

Swiss National Bank