SCHWEIZERISCHE NATIONALBANK
BANQUE NATIONALE SUISSE
BANCA NAZIONALE SVIZZERA
BANCA NAZIUNALA SVIZRA

News Conference

Zurich, 7 December 2001

Introductory remarks by Jean-Pierre Roth

The Swiss National Bank has decided to lower the target range for the three-month Libor rate by 0.5 percentage points to 1.25%-2.25%. For the time being, the three-month Libor is to be kept in the middle of the target range. Recently, the National Bank has adjusted its monetary policy twice already. On 17 and 24 September 2001, we lowered the target range for the three-month Libor rate by 0.5 percentage points each. At the time, we acted in response to the decrease in inflationary pressures and the undesirable development of the Swiss franc exchange rate. The economic outlook has since continued to deteriorate around the globe. In Switzerland, there are no signs that price stability might be jeopardised in the medium term. Due to this development, we are now in a position to reduce rates again. Accordingly, since the beginning of 2001, we have lowered the target band for the three-month Libor by a total of 1.75 percentage points, thus easing monetary policy considerably. Assuming that the three-month Libor rate will remain stable at 1.75%, inflation is expected to hover between 0.9% and 1.5% in the next three years. The National Bank projects real gross domestic product to increase by 1.5% in 2001. For 2002 we anticipate a growth rate of around 1%.

In the following, I would like to describe the development of inflation over the past few months and explain our latest inflation forecast in more detail. The dotted curve in the graph shows our inflation forecast of June 2001. At the time, we expected inflation to climb slightly to 1.6% by mid-2002 and, subsequently, to recede gradually towards 1.2% by the beginning of 2004. This forecast was based on the assumption of a robust development of the world economy and a stable three-month Libor rate of 3.25%. We assumed at the time that the economic slowdown experienced in the United States and Europe would be overcome as early as in the second half of 2001 and that the Swiss economy would be able to perform according to its potential. The price of oil was expected to stand at approximately USD 25 per barrel.

Our forecast of June overestimated the inflationary development of the last few months. Year-on-year inflation, as measured by the national consumer price index, dropped to 1.0% in the third quarter 2001 from 1.5% in the second quarter. In October inflation amounted to 0.6%, and to 0.3% in November. This sharp decrease can be mainly attributed to the marked fall in oil prices and prices of other foreign goods. Moreover, upward price pressure on domestic goods also eased markedly in November after still having been substantial until October.

The dashed curve in the graph shows our latest inflation forecast. The table contains the average annual inflation rate according to the new forecast. Since our forecast of June 2001, the world economy has moved towards recession. Short-term inflationary pressures have subsided considerably. On the assumption that the three-month Libor rate will remain stable at 1.75% during the next three years, inflation should amount to 0.9% in 2002, move up to 1.3% in 2003 and reach 1.5% in 2004. The fluctuations in the anticipated 2002 inflation rate are due to basis effects that do not reflect the inflationary trend. Inflation is expected to remain within the range of price stability throughout the forecasting period. From mid-2002 on, however, it will follow a slight upward trend through the rest of the forecasting horizon. This slight rise in anticipated inflation is attributable to two factors. First, the world economy will recover in due course. Second, Swiss monetary policy at a constantly low interest rate - which is currently 1.5 percentage points lower than in the June 2001 forecast - will tend to have an increasingly expansive effect as time passes. These two factors combined will cause inflation to rise somewhat over time.

Our forecast is based on the assumption that the US economy will remain in recession until mid-2002 and will subsequently gradually return to its potential growth path. In Europe, the economy will presumably stagnate until mid-2002 and pick up momentum afterwards. We expect the US dollar to remain roughly at its current level vis-à-vis the euro. The forecast assumes that today's relatively low oil prices will eventually climb back slightly.

At this point, I would like to briefly comment on the interpretation of our forecast. It is based on the above-mentioned assumptions regarding the development of the world economy, and on the three-month Libor remaining stable throughout the forecasting horizon. In other words, the forecast shows the development of inflation on the condition that monetary policy is left unchanged. However, monetary policy will certainly need to be adjusted during the forecasting period. The economic environment changes continuously as new disruptions occur, and the National Bank responds to these changes in order to meet its objective of maintaining price stability. Therefore, it is important to bear in mind that the forecast is made for a three-year period but is valid for only six months at most, i.e. until the publication of the next forecast. The relatively long forecasting period reflects the time lag with which monetary policy measures impact on the price level. We publish our forecast in order to inform the public of our assessment of the inflation outlook, at the time of the forecast, on the basis of an unchanged monetary policy. The publication is a means of making our monetary policy decisions more transparent and easier to understand.

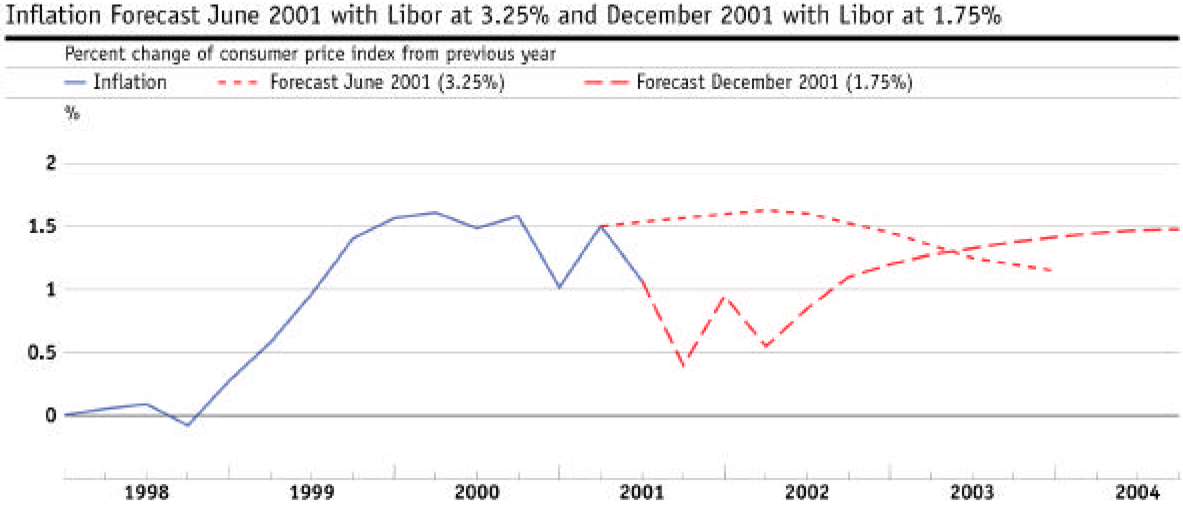
I will now make a few remarks about the development of the Swiss economy in the year now ending and the coming year. The recessionary trends witnessed across the globe will not leave Switzerland unscathed. Both this year and next, growth will be considerably slower than we predicted only a short time ago. We expect the economy to go into virtual stagnation in the second half of 2001. Overall, the economy will presumably grow by about 1.5% in 2001. In line with the development in the major economic blocs, notably exports and capital spending have shrunk drastically, putting a major break on economic growth. Although consumer confidence has been dented, consumption has so far turned out to be a cornerstone of growth. The decline in construction investment is also clearly more moderate than the fall in capital spending. We expect the economy to follow a path of muted growth and to perform below its potential until the middle of next year. Only the second half of 2002 should see the economy expanding in line with the development abroad. We project average growth of approximately 1.0% for 2002. Unemployment is likely to climb in the months ahead.

We consider the current interest rate level and the existing monetary conditions to be adequate to enable the economy to return to sustainable, non-inflationary growth. Our forecasts, however, are fraught with uncertainties. In the aftermath of the terror attacks in the United States, these uncertainties are now particularly substantial. Investment and consumption depend on whether market participants have confidence in the quality and stability of the basic conditions. Depending on the development of the political situation, the global economy may thus recover at a faster or slower pace than we anticipated, and the exchange rates might be subject to major fluctuations. In this case, the National Bank would have to review its monetary policy. In the short run, the price of oil will also have a considerable influence on inflation. If it continues to erode, measured inflation might fall below zero for a few months. Should this situation arise, it is important to bear in mind that it cannot be equated with sustained - and thus economically dangerous - deflation. On the contrary, a low oil price level would create a positive supply shock and, under the current circumstances, would impact favourably on production. Inflation would be dampened temporarily. We also keep a close watch on the development of the money supply M_3 in order to assess the medium-term inflationary risks. Following a phase of low, or even negative, growth rates, M_3 is now expanding at a somewhat faster pace. So far, however, there has been no excess supply of liquidity in the economy, and the money stock M_3, therefore, does not point towards inflationary risks at present.

Finally, I would like to make some closing remarks about the imminent introduction of euro notes and coins. For about three years now, the euro has existed as deposit money. It has led to fixed exchange rates and a uniform interest rate level in the euro area countries. The introduction of euro notes and coins will have additional positive effects on the economic development in Europe, as it will be easier to compare prices and confidence in the new currency will be strengthened. Moreover, the euro is to be regarded positively not only with regard to the Swiss economy but also Swiss monetary policy. The Swiss export sector will profit from lower transaction costs, and currency devaluations - as previously implemented by some European countries in order to improve their competitiveness - will be a thing of the past. Swiss monetary policy will benefit from the fact that a large economic bloc now exists in Europe which pursues similar goals in terms of monetary policy. All in all, exchange rate fluctuations between Switzerland and the EMU countries should thus remain below the levels seen before the launch of the euro. Furthermore, the markets will realise in due course that there is no reason why the Swiss franc, with regard to the role as a safe haven currency, should be assessed differently than the euro. This realisation should reduce the risk of sharp appreciations.

As a result of the introduction of euro notes and coins, the euro will increasingly be used as a means of payment in the tourism sector and the hotel and restaurant industry as well as in foreign trade, to some degree simply as a substitute for the D-mark. Apart from very few viable exceptions, however, employment and loan contracts will continue to be concluded in Swiss currency, and the large majority of domestic payments, too, will be effected in Swiss francs in future. The euro will thus not emerge as a parallel currency in Switzerland. The purview of Swiss monetary policy will remain unaffected by the arrival of the euro. By retaining the Swiss franc, we are able to pursue an independent monetary policy that is oriented to the needs of the Swiss economy, and to keep interest rates at a low level. In this respect, the exchange rate is a key element for producing our inflation forecast and, therefore, for determining our policy.

Graph



The main tick marks on the horizontal axis indicate the first quarter of the respective year.

Table

Inflation Forecast December 2001 with Libor at 1.75%	2001	2002	2003	2004
Annual average inflation in %	1.0	0.9	1.3	1.5