SCHWEIZERISCHE NATIONALBANK
BANQUE NATIONALE SUISSE
BANCA NAZIONALE SVIZZERA
BANCA NAZIUNALA SVIZRA
SWISS NATIONAL BANK

News conference

Geneva, 15 June 2006

Introductory remarks by Jean-Pierre Roth

Ladies and Gentlemen

As we have just announced in our press release, the Swiss National Bank is raising its target range for the three-month Libor by 0.25 percentage points to 1.0–2.0%. This change will take effect immediately. The SNB intends to hold the rate in the middle of the target range for the time being.

The economy continues to develop favourably, with economic activity becoming more broad-based and having an increasingly positive effect on the labour market. The National Bank now expects GDP to expand by a little more than 2.5% in 2006. Despite the most recent developments in oil prices, inflation has remained moderate. The SNB forecasts average annual inflation of 1.2%.

By raising the target range, the National Bank is further adjusting its monetary policy stance to economic activity. The SNB's move ensures that the inflation outlook will remain favourable. On the assumption that the three-month Libor will remain unchanged at 1.5%, annual inflation is expected to reach 1.2% in 2007 and 1.9% in 2008. Notwithstanding the interest rate increase, monetary policy remains expansionary. Should the economy perform as expected, the National Bank will further pursue the gradual adjustment of its monetary policy. If the Swiss franc were to appreciate rapidly, the SNB would respond appropriately.

Allow me to explain the reasons behind today's monetary policy decision. Our monetary policy is determined to a large extent by how we assess the inflation outlook. This assessment is based on an analysis of the international situation as well as of economic and monetary developments in Switzerland.

International environment

Little has changed in the international scene since the last quarterly assessment. Where the United States is concerned, we predict a soft landing. In other words, we expect GDP growth to move back above its potential growth path in 2006, but to gradually slip down again. A similar development can be expected in Europe, with the upswing that set in last year leading initially to above-potential growth, before slowly losing momentum.

Our assessment of oil price movements has changed once again, however. We are now forecasting a slightly higher price than expected back in March. Inflation in Switzerland will therefore be somewhat higher this year than anticipated.

Economic outlook

Like the global economy, economic performance in Switzerland is also positive. After slowing temporarily in the last quarter of 2005, growth picked up pace again this year. According to estimates by the State Secretariat for Economic Affairs (seco), real GDP in the first quarter exceeded the previous quarter by an annualised figure of 3.8%. Following the introduction of a new calculation method, the quarterly growth rates are subject to slightly greater fluctuations, however.

In the next few quarters, most demand components can be expected to shore up economic growth.

Exports continued to develop vigorously. Robust foreign demand, the rise in industrial output and the increase in technical capacity utilisation will continue to stimulate demand for capital goods. The only area that may experience a slight downturn this year is construction investment, which to date has exhibited very brisk growth.

Up until now, household consumption has been a source of support to the economy. With the brighter outlook for the labour market and the improved earnings prospects, consumption will be boosted further.

Owing to the broad-based economic recovery, labour market demand will also pick up. While employment levels in industry had increased already last year, employment in the services sector has now risen too – for the first time in over a year. Moreover, the growth rate was quite considerable. The unemployment rate fell from 3.7% in December to 3.4% in May and is due to retreat yet further in the course of the year.

On the whole, the National Bank expects GDP to expand by a little more than 2.5% in 2006. The output gap is likely to have closed in the first half of the year. By conducting a less expansionary monetary policy, interest-sensitive components of aggregate demand, such as consumer durables and real estate, will grow less vigourously, thus preventing resources from being overutilised and price pressure from developing.

I would now like to turn to the monetary analysis.

Monetary developments

Although the National Bank had begun to gradually normalise its expansionary monetary policy back in June 2004, the medium to long-term interest rates remained low for quite some time. Since the beginning of this year, however, they have risen considerably. The ten-year spot interest rate on Confederation bonds climbed to 2.9% in May, and although it has since declined, it is still well above the mid-March level, the time of our last quarterly assessment. This interest rate increase suggests that the effects of our monetary policy will soon be felt on more long-term investment projects, too. Although short-term interest rates had always reacted more quickly to our previous interest rate adjustments, real interest rates for short maturities remained negative for a long time. It was not until the last two interest rate hikes that the one-year real interest rates, for instance, became positive again.

It is expected that the higher interest rates will not only impact on construction investment, but also on demand for loans, although this is still hardly discernible from the statistics on mortgage loans. Mortgages are continuing to grow at a rate of roughly 5%. Having remained below the 1999 peak for a number of years, the ratio of mortgage loans to nominal GDP topped this value by 6% in the first quarter of 2006. We will therefore continue to monitor movements in the real estate market very carefully.

Monetary aggregates have developed in line with established patterns, with M1 and M2 remaining below the level recorded at the end of 2003 and M3 hovering around the level reached in November 2005. Demand for liquidity, meanwhile, is increasing in line with economic developments. Consequently, any surplus liquidity – which possibly stems from 2003 – should be slowly reduced further.

Monetary policy decision

What were the most important reasons behind our decision today? To answer this question, I need to go back a little further. Cast your minds back to the end of 2000, when the internet bubble burst, to the terrorist attacks of 11 September 2001 and to the real appreciation of the Swiss franc in 2002. When we adopted an expansionary monetary policy in 2001, the pace and extent of the interest rate reduction were key considerations in order to avoid a recession or even deflation. As a result, we brought the three-month Libor down to 0.25% in March 2003.

The question then arose as to how long this expansionary path could be maintained without compromising price stability. After five very expansionary quarters, this question was answered with the interest rate reversal in June 2004.

The next challenge facing us was how to continue with interest rate normalisation without nipping economic recovery in the bud. To achieve this, we decided to make this path towards normalisation dependent on the economy developing in line with our expectations. After a second increase in September 2004, the announced conditions for a further interest rate hike in December 2004 could no longer be fulfilled, as the economy had deteriorated and oil prices had begun to rise. It was not until September 2005 that signs of a broad-based recovery became apparent. We announced that we would have to adjust our monetary policy if the economic recovery were to be confirmed. Market participants began to anticipate an increase in the target range at the December quarterly assessment. This was reflected in a rise in the three-month Libor. The very same thing happened in March and also in the run-up to today’s assessment.

The main question we now have to ask ourselves is this: is the chosen pace of interest rate normalisation appropriate? According to our calculations, the inflation outlook has changed only very marginally since March and a policy of gradual normalisation is sufficient to maintain inflation at a low level. This confirms our conviction that the chosen path can also ensure price stability were the utilisation of resources to improve. Our delegates for regional economic relations support this assessment – while capacity utilisation has improved, spillovers of any significance from the increased energy and commodity prices seem hardly likely in the near term, given the high degree of competition. Furthermore, the economic outlook is positive, albeit not so much so that

there is a risk of excessive pressure building up. It is therefore important not to overinterpret an individual quarterly GDP value.

Inflation forecast graph

I will now turn briefly to the inflation forecast. The dashed red curve represents the new forecast, which covers the period from the second quarter of 2006 to the first quarter of 2009 and shows the inflation outlook after today’s interest rate increase. The dash-dotted green curve shows the inflation forecast at the time of the last monetary policy assessment and is still based on a three-month Libor of 1.25%. As already mentioned, inflation this year is likely to be somewhat higher than that forecast in March, given the temporary increase in the price of oil. Despite the dampening effect of today’s interest rate hike, the inflation forecast for 2007 and 2008 will remain largely unchanged owing to the increase in the utilisation rate in the economy.

The forecast shows that there is no immediate inflation risk. Inflation in 2007 is projected to remain low, at 1.2%. However, it is evident from the inflation dynamics that, even with a three-month Libor of 1.50%, monetary policy still has an expansionary effect.

With today’s decision to increase the three-month Libor by 25 basis points, we are adhering to our previous monetary policy course of gradual normalisation. This should guarantee price stability in the longer term.

Cosa initiative

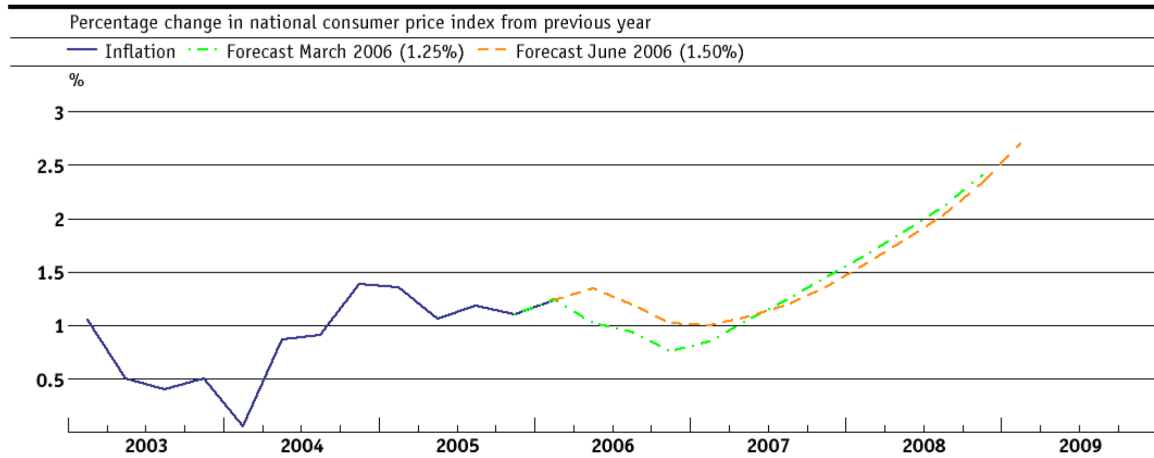
Before concluding my introductory remarks, let me come back once more to the Cosa initiative. You already know the SNB's position on this topic: we consider this initiative to be dangerously populist, since it presents an unrealistic picture of our profit potential. Those who launched the people’s initiative speak of an annual disposable profit of about CHF 2.5 billion, while our estimates put it at around CHF 1 billion.

In view of the growing financial needs facing the Old Age and Survivors' Insurance Fund (AHV/AVS) in the coming years, the gradual reduction of our distribution potential will inevitably lead to continuous tensions between political circles and the SNB. Even if our independence were left intact, this conflict-laden climate would be detrimental to our credibility in the markets. It is widely accepted that shielding the central bank from political pressure constitutes an important factor in the preservation of monetary stability. In fact, this is why there is no country whose central bank has become the direct financial source of funding of a social security scheme. Central banks everywhere deliver their profits to the government, and it is the government that allocates the funds to the different budget items. Moreover, establishing a direct link between the social security system and the central bank would give our fellow citizens the impression that the National Bank would be able to cover the future financial needs of the AHV/AVS without the need for further reforms.

In the final analysis, the elements to be considered in assessing the Cosa initiative are clear-cut. The initiative will not succeed in fulfilling its financial promises to the AHV/AVS, it will not bring in a single extra franc to the state coffers and – finally – it will

put the functioning of our institutions at serious risk. The wise thing to do, therefore, is to reject the initiative.

Inflation forecast of March 2006 with Libor at 1.25% and of June 2006 with Libor at 1.50%



Observed inflation June 2006

	2003				2004				2005				2006			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Inflation	1.05	0.50	0.40	0.50	0.06	0.87	0.91	1.38	1.35	1.06	1.18	1.10	1.23			

Inflation forecast of March 2006 with Libor at 1.25% and of June 2006 with Libor at 1.50%

	2006				2007				2008				2009			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Forecast March 2006, Libor at 1.25%	1.25	1.01	0.94	0.76	0.85	1.05	1.24	1.45	1.65	1.88	2.11	2.40				
Forecast June 2006, Libor at 1.50%		1.34	1.19	1.02	1.00	1.08	1.20	1.35	1.57	1.79	2.03	2.33	2.70			