Review of economic developments

1 International developments

1.1 Economic development

Tentative recovery

Economic growth was disappointing in 2002, and the recovery in most OECD countries was slow to get under way after the previous year's downturn. There were also significant differences in the growth rates recorded in different regions around the world. North America, as well as the majority of industrialised and threshold economies of Asia, reported above-average growth, while Europe in general languished in a trough. Japan saw gradual signs of a revival, but expansion was patchy and the economy's structural problems remained an obstacle. In Latin America, several countries found themselves grappling with economic and financial crises.

Global trade stimuli weak

Persistent economic weakness meant that global trade volumes, which had stagnated in 2001, rose by only a little in 2002. Trade outside the Organisation for Economic Cooperation and Development (OECD) expanded more vigorously than trade between OECD countries. To put this into context, the 1990s saw a significant escalation in world trade volumes.

Positive initial outlook

International economic growth looked promising during the first few months of 2002. Sentiment among companies and consumers brightened, and industrial output began to rise, boosted by the central banks' relaxation of monetary policies and the previous year's fall in oil prices. Investment appeared to be recovering, as profit forecasts improved and share prices gained ground after the losses sustained in 2001. One of the main factors driving growth was strong demand for consumer goods in the United States.

Rest of year more subdued

Contrary to expectations, growth failed to pick up during the second half of the year. Clouds had begun to gather even before the mid-year point. The second and third quarters then saw a renewed drop in equity prices, partly as a reaction to revelations of accounting irregularities at several companies. Some major sectors, especially the telecommunications industry, were forced into another round of severe write-downs, and economic sentiment suffered further as the geopolitical situation continued to worsen. Oil prices rose as a result, taking the price of a barrel of Brent to 30.15 dollars, or 46.6% higher than at the beginning of the year. Corporate investment activity was particularly hard hit by the increased uncertainty.

Monetary policy relaxation

The fourth quarter saw the US Federal Reserve and the European Central Bank respond to the economic slow-down by cutting their key interest rates again. This relaxation was favoured by the easing of inflationary pressures.

US economy improves

Momentum in the US economy was stronger than in most other industrialised countries in 2002, although growth still failed to live up to expectations. Real gross domestic product (GDP) advanced by 2.3%, having remained more or less unchanged in 2001. This increase was driven primarily by private spending and investment in residential construction, which was bolstered by low interest rates and rising real estate prices. By contrast, corporate investment rose by only a little. During the first half of the year, extensive stockpiling and a marked increase in exports also helped to shore up the recovery. Capacity utilisation in industry remained at the previous year's level, as the economic recovery progressed in tandem with a surge in productivity. This meant little expansion in employment, and the average unemployment rate for the year was one percentage point higher at almost 6%.

Rise in US current account deficit

Growing domestic demand meant that imports into the United States expanded much more strongly than exports during the first half of the year. This produced a further rise in the current account deficit for 2002 to around 5% of GDP.

Slow growth in the euro currency area

GDP growth in the euro currency area slowed to 0.8%, compared with 1.5% the previous year. France, Spain and various smaller countries posted above-average expansion, while Germany and Italy all but stagnated. In the first part of the year, the euro area was boosted by rebounding exports and a modest increase in private and government spending. This momentum slackened as the year went on, however. Capital spending continued to fall. The sluggish economy was reflected in rising joblessness, and the unemployment rate – which had receded in the previous years – increased from 8.1% in January to 8.5% in December. The export revival produced a current account surplus of just under 1% of GDP, after a neutral result in 2001.

UK situation better

The United Kingdom economy staged a better performance than the euro area. Although a capital spending decline weakened growth by half a percentage point to 1.5%, there was a vigorous rise in private consumption. This was also supported by a comparatively favourable labour market, where the unemployment rate was 5.2%. As in most other industrialised countries, exports lost ground in the course of the year.

Slight improvement in Japan

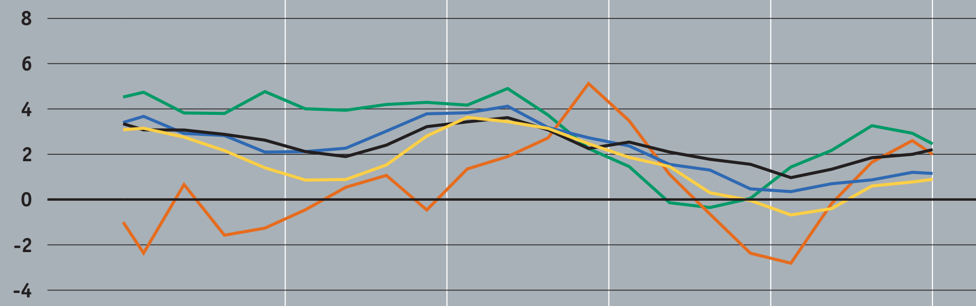
The Japanese economy made only a little headway after the previous year's sharp downturn. Exports to Asia, in particular, picked up, and private spending increased despite the persistent weakness of consumer sentiment. Investment activity remained volatile, however. This is attributable in part to the Japanese economy's ongoing structural problems. These resulted in a further decline in employment, which raised the unemployment rate to an average of 5.5%.

1998 1999 2000 2001 2002

Real gross domestic product

United States
Japan
Euro area
United Kingdom
Switzerland

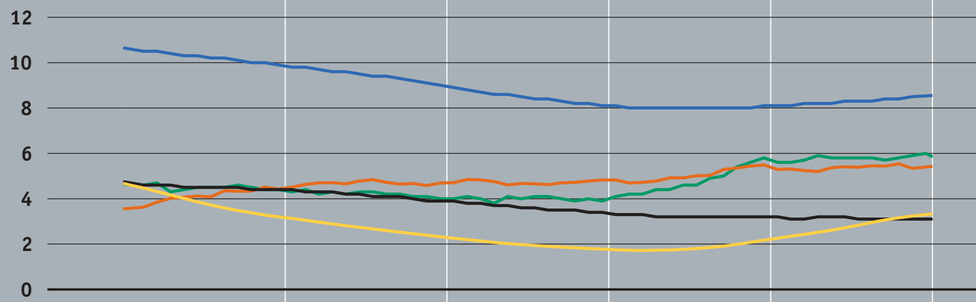
Change from previous year in percent.
Source: OECD



Unemployment

United States
Japan
Euro area
United Kingdom
Switzerland

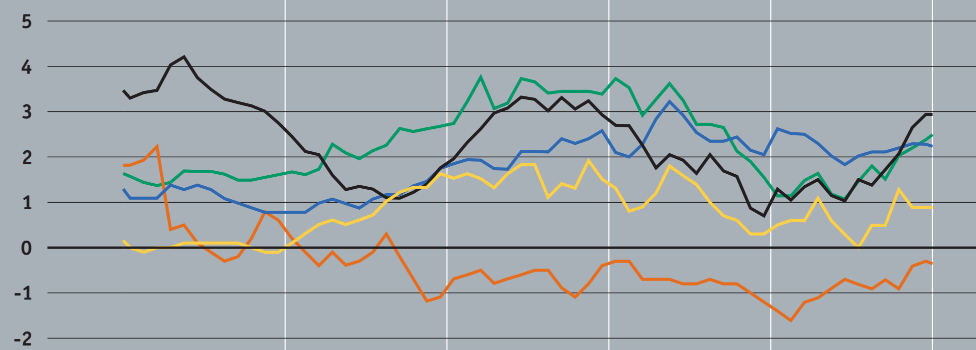
Seasonally-adjusted; in percent.
Source: OECD



Inflation

United States
Japan
Euro area
United Kingdom
Switzerland

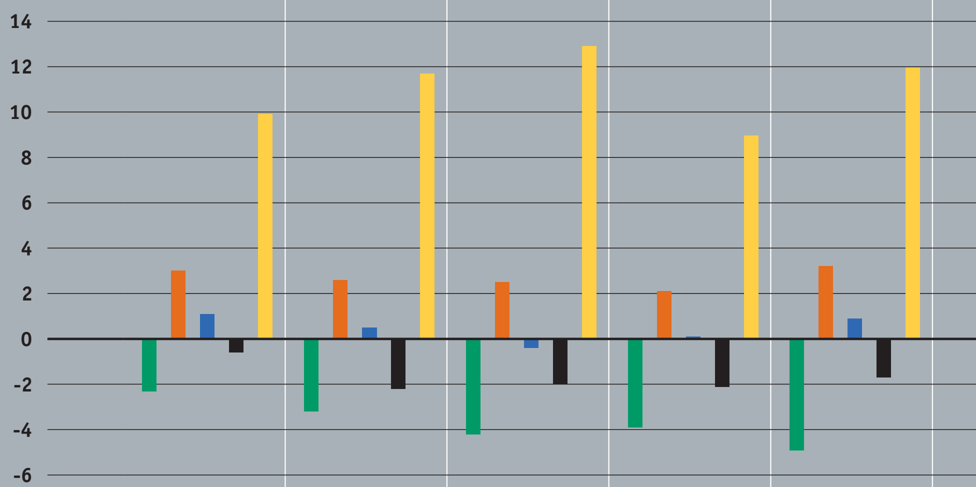
In percent.
Source: OECD



Current account balance

United States
Japan
Euro area
United Kingdom
Switzerland

Net balance in percent of GDP.
Source: OECD



1998 1999 2000 2001 2002

Summary of economic development

	1998	1999	2000	2001	2002
Real GDP Change from previous year in percent					
United States	4.3	4.1	3.8	0.3	2.3
Japan	−1.1	0.7	2.6	−0.3	0.3
Euro area	2.9	2.8	3.6	1.5	0.8
Germany	2.0	2.0	2.9	0.6	0.4
France	3.5	3.2	4.2	1.8	1.0
Italy	1.8	1.6	2.9	1.8	0.3
United Kingdom	2.9	2.4	3.1	2.0	1.5
Switzerland	2.4	1.5	3.2	0.9	0.1
Unemployment in percent					
United States	4.5	4.2	4.0	4.8	5.8
Japan	4.1	4.7	4.7	5.0	5.5
Euro area	10.2	9.4	8.4	8.0	8.3
Germany	8.7	8.0	7.3	7.3	7.8
France	11.5	10.7	9.4	8.7	9.0
Italy	11.9	11.5	10.7	9.6	9.2
United Kingdom	6.3	5.9	5.4	5.1	5.2
Switzerland	3.9	2.7	2.0	1.9	2.8
Consumer price inflation in percent					
United States	1.5	2.2	3.4	2.8	1.6
Japan	0.7	−0.3	−0.7	−0.7	−1.1
Euro area[1]	1.2	1.1	2.4	2.5	2.4
Germany[1]	0.6	0.6	2.1	2.4	1.6
France[1]	0.7	0.6	1.8	1.8	1.9
Italy[1]	2.0	1.7	2.6	2.3	2.5
United Kingdom[2]	2.7	2.3	2.1	2.1	2.0
Switzerland	0.0	0.8	1.6	1.0	0.6
Current account balance in percent of GDP					
United States	−2.3	−3.2	−4.2	−3.9	−4.9
Japan	3.0	2.6	2.5	2.1	3.2
Euro area	1.1	0.5	−0.4	0.1	0.9
Germany	−0.3	−0.9	−1.1	0.1	2.0
France	2.7	2.9	1.3	1.6	1.8
Italy	1.9	0.7	−0.5	−0.0	−0.8
United Kingdom	−0.6	−2.2	−2.0	−2.1	−1.7
Switzerland	9.9	11.7	12.9	9.1	11.9

1 Harmonised inflation figures
2 Inflation excluding mortgage costs
Some 2002 figures are estimates.
Source: OECD

Lower inflation in the United States and Europe

Consumer price inflation fell or remained low in most industrialised countries in 2002. In the United States, the average for the year slid to 1.6%, compared with 2.8% in 2001. In the euro area, special factors such as tax increases and an extraordinary rise in a number of foodstuff prices drove inflation higher. The introduction of euro notes and coins at the beginning of the year did not, as had been feared, cause inflation to surge, although there were significant price rises on some items. Inflation weakened as the year progressed, yet remained above 2% during the second half. There were broad differences between the individual countries of the euro area: in Germany, Belgium, Austria and France, for example, inflation was less than 2%, while the figures for Spain, Portugal, Greece and the Netherlands were between 3.5% and 4%, and prices rose almost 5% in Ireland. Inflation in the United Kingdom remained unchanged at 2%.

Deflation in Japan

In Japan, inflation was negative for the fourth consecutive year. Prices fell by an average of 1.1%, compared with a 0.7% slide the previous year.

Varied picture in Asia

Having slowed down significantly the previous year, most Asian industrialised and emerging market economies, and South Korea in particular, returned to higher growth in 2002. The recovery was supported by more expansive monetary and fiscal policy, as well as the revival in intra-Asian trade. Nonetheless, economic activity in Hong Kong and Indonesia remained slack. While expansion in Hong Kong was held back by uncertainties over its economic and political future, Indonesia suffered from the repercussions of a terrorist attack.

State support in China

The Chinese economy recorded the strongest growth in the region on the back of generous state support and high levels of foreign investment. The fact that many industrial businesses are dependent on state aid, however, has kindled doubts about the sustainability of this growth.

Weak growth in Central and Eastern Europe …

In most countries in Central and Eastern Europe, 2002 saw growth in real GDP fall compared with the previous year. Exports were the main driving force behind economic growth, while domestic demand, and capital spending in particular, advanced only slightly. Inflation continued to trend downward.

… and in Russia

Russia also experienced a weaker rise in real GDP. Although private and government spending, as well as oil exports, bolstered the economy, growth in investment declined significantly. The increase in export income led to a rise in currency reserves and considerable budget surpluses, a portion of which was used to repay foreign debt.

Recovery in Turkey

The Turkish economy recovered from the crisis of the previous year. Export activity, especially, gathered considerable momentum as the value of the country's currency plummeted. Although inflation fell during the year, it was still over 30% at the end of December. The economic recovery was also hit by an increase in risk premiums on interest rates, reflecting the instability of the political situation.

Critical situation in Argentina and Brazil

The recession which has afflicted Argentina for some years worsened in 2002. At the beginning of the year, the country was forced to abandon its long-standing practice of pegging its currency to the dollar. Inflation picked up rapidly as a result, and insolvency had to be declared with respect to foreign creditors. Negotiations with the International Monetary Fund (IMF) on a new economic programme and loan package failed. The crisis in Argentina also spilled over into Uruguay and Paraguay. In the case of Uruguay, international financial institutions injected large amounts of capital in order to shore up a banking system facing massive capital outflows. In Brazil, uncertainty about the outcome of the presidential election led to a rise in the risk premium on government paper and substantial currency depreciation. To counter nascent fears of the country's insolvency, the IMF granted Brazil a loan facility of 30 billion US dollars in early September. Economic growth in the other major Latin American countries was mixed. While the Mexican economy continued to expand at a modest pace, growth in Chile slowed.

1.2 Monetary policy

Relaxation of monetary policy in the fourth quarter

After several rounds of interest rate cuts in 2001, the respective central banks of the United States and the euro area left rates unchanged until the latter part of 2002. Monetary policy was relaxed further in November and December in order to stimulate the economy.

Key rate cuts in the United States …

The US Federal Reserve lowered its key interest rate – the rate for overnight funds – by half a percentage point to 1.25% at the beginning of November. This came after a massive reduction totalling 4.75 percentage points in 2001.

… and in Europe

The weak economy prompted the European Central Bank (ECB) to cut the minimum bid rate on the main refinancing operations by half a percentage point to 2.75% in early December. The decision was made in the light of increasing signs that inflation would fall below the ECB's 2% price stability ceiling in the foreseeable future. The Swedish and Norwegian central banks also relaxed their monetary policies. By contrast, the Bank of England left its base rate unchanged throughout the year.

Zero percent interest in Japan

The Bank of Japan further extended the banks' liquidity in order to stimulate the economy and counter deflation. The overnight rate stayed at zero percent for the whole of the year.

1.3 Fiscal policy

Deteriorating public finances

Government budgets closed 2002 in a much worse state than the previous year in almost all OECD countries. Deficits were swelled primarily by weak economies, lower tax revenues and higher unemployment-related expenditure. The United States was also affected by higher spending on security and defence.

Deficits in the United States and Britain

Having achieved some large surpluses in recent years, both the United States and the United Kingdom reported public sector deficits. According to the OECD, the shortfall in the United States increased from 0.5% to 3.1% of GDP. In the United Kingdom, government finances were in the red for the first time since 1997. The deficit was 1.4%, compared with a surplus of 0.7% in 2001. Gross government debt rose by one percentage point to 61% of GDP in the United States and stayed steady at 51% in the United Kingdom.

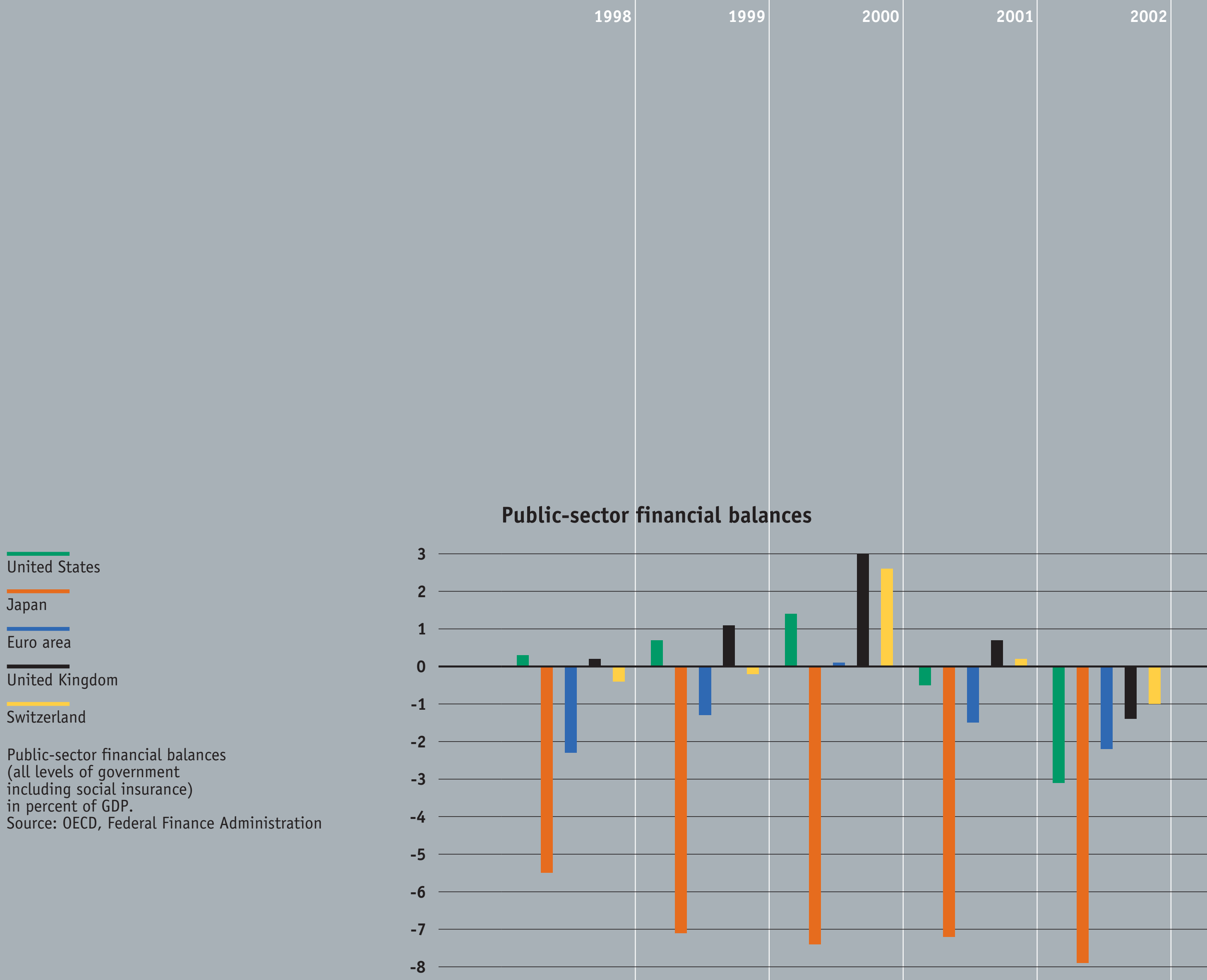
Rising deficits in the euro area …

Most countries in the euro area saw their budget deficits grow, producing an overall shortfall of 2.2% of GDP for 2002, according to the OECD. Having kept within the Maastricht criteria the previous year, Germany's public sector deficit rose to 3.7% – higher than the limit stipulated in the Treaty. In France, the deficit doubled to 2.7%, while in Italy it stayed at 2.3% – more or less the same as in the previous year. Only a few smaller countries within the euro area were still able to post a surplus. Aggregate government debt in the region rose from 72% of GDP in 2001 to 73% in 2002. In France and Germany, it met the 60% criterion laid down at Maastricht. The highest debt to GDP ratios were recorded by Italy (110%), Belgium (108%) and Greece (107%). Ireland (36%) and Luxembourg (6%) had the lowest debt.

… and in Japan

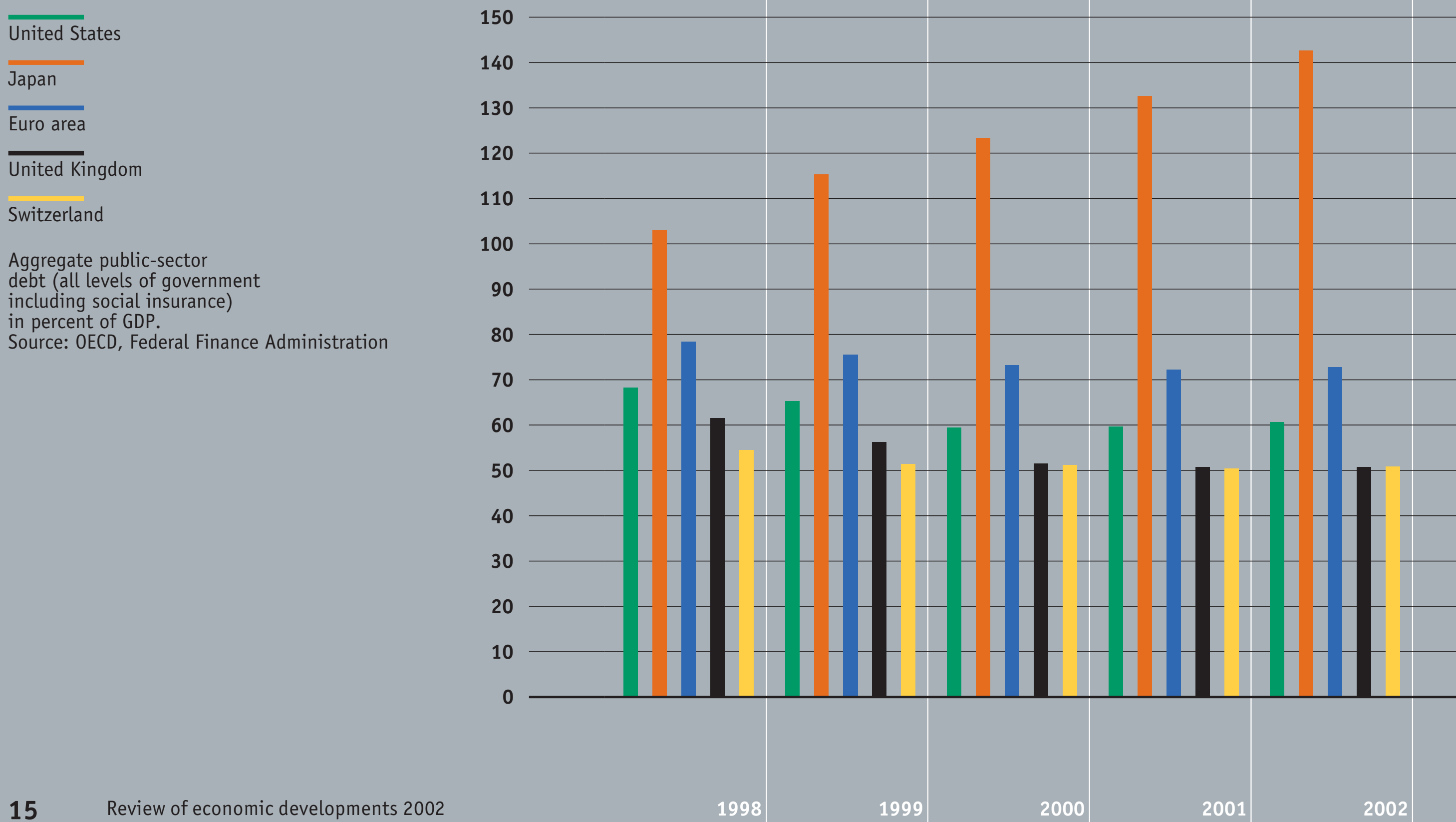
Figures from the OECD show that the Japanese public sector deficit expanded to 7.9% of GDP, compared with 7.2% the previous year. The sharp rise in public sector debt that began in the early 1990s thus continued. Overall debt has expanded by ten percentage points, taking the current figure to 143% of GDP. In net terms, however, Japan's debt is only around half as much, because the country's social security system has a high level of assets.

Public-sector financial balances



Public-sector financial balances (all levels of government including social insurance) in percent of GDP.
Source: OECD, Federal Finance Administration

Government indebtedness



Aggregate public-sector debt (all levels of government including social insurance) in percent of GDP.
Source: OECD, Federal Finance Administration

1.4 Foreign exchange markets

US dollar depreciates

The US dollar lost a great deal of its value compared with other currencies during the first half of 2002. After a brief resurgence, it fell back again in the fourth quarter. In addition to increasing political uncertainty, factors behind this loss in value include, in particular, the expansion of the United States current account deficit and the sharp deterioration in the budget situation. In nominal terms, the dollar was 12.7%, 12.3% and 9.3% lower year-on-year against the Swiss franc, euro and sterling respectively in December. Over the year as a whole, it lost a real and trade-weighted 5.1%.

Euro recovers

After a long period of weakness, the euro began to advance against the US dollar in March 2002, reaching 1.02 dollars in December. The mean exchange rate for the year was 0.95 dollars/euro. Against sterling, the single European currency gained 3.4% to 0.64 pounds in December. The euro fared a little worse on the Swiss franc market, although at 0.4% its decline was less than in 2001. The exchange rate stabilised at 1.47 francs to the euro towards the end of the year. In real and trade-weighted terms, the euro had gained 7.1% year-on-year by December. This is still 5.5% lower than when it was launched in January 1999.

No clear trend for the yen

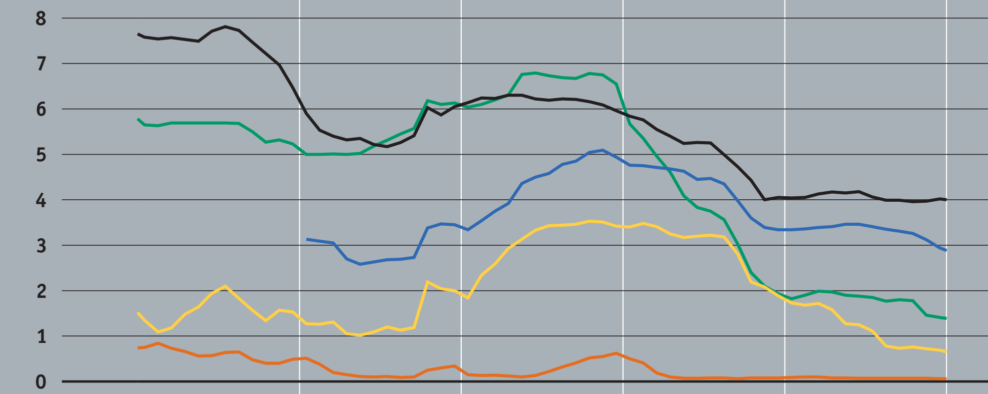
In 2002, the yen lost 8.7% against the euro and 9.1% against the Swiss franc, although it rose by 4.1% against the dollar. In real and trade-weighted terms, the yen exchange rate was 4.2% lower.

1998 1999 2000 2001 2002

Short-term interest rates

Dollar
Yen
Euro
Pound sterling
Swiss franc

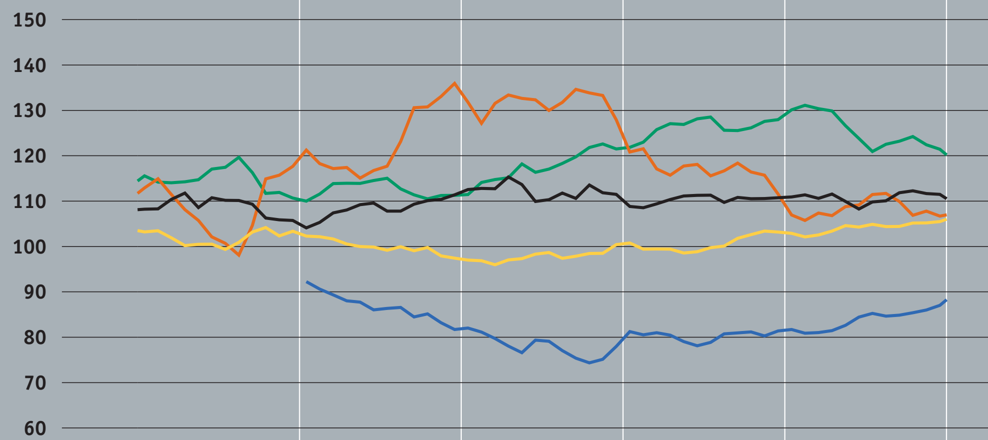
Three-month Euromarket rates, in percent.
Source: BIS



Trade-weighted real exchange rates

Dollar
Yen
Euro
Pound sterling
Swiss franc

Index: 1990 = 100.
Source: BIS



1998 1999 2000 2001 2002

1.5 Financial markets

Long-term yields on the decline

There was little increase in the yields on government bonds in industrialised countries during the first quarter of 2002. They fell further as the year went on owing to the slack business climate and stronger demand among investors for secure government paper. The decline in long-term yields was particularly stark in the United States: these slipped from 5.3% in March to 3.9% in September. In the euro area, they went from 5.3% to 4.5% and in Japan from 1.4% to 1.1% during the same period. Yields then stabilised in the fourth quarter.

Higher risk premium on bonds from low-rated borrowers

While the yield differential between bonds from top-class private borrowers and government paper remained approximately constant, the spread between bonds from highly creditworthy and poorly rated issuers widened. In the United States, this rating-related differential peaked in August at 18 percentage points, compared with 2 percentage points in August 2001. In the eight months from January 2002, the yield on low-rated bonds increased from 13% to 24% (the highest level for five years), before dropping back to 14% in December. This sharp rise in the risk premium reflects increasing uncertainty about the economy, as well as the turbulence that can be observed on the financial markets.

Equity prices fall

Having firmed during the first quarter of 2002, share prices dropped once again on all major stock exchanges during the second and third quarters, plumbing depths last seen around five years ago. The situation stabilised in the final quarter and equity prices began to creep up again overall. Despite this late recovery, the Standard and Poor's 500 share index was still down by 24% year-on-year in December. European indices recorded similar falls, with the EuroSTOXX 50 losing 23% and the British FTSE 100 closing the year 25% lower. In Japan, the Nikkei 225 declined by 19%.

Decline in borrowing on the financial markets

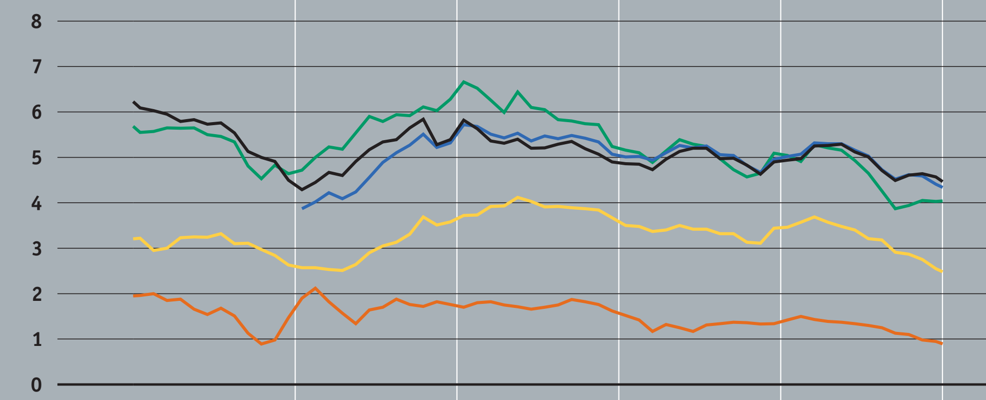
Net borrowing on the international financial markets slumped by 24% to 1,024 billion US dollars during 2002. The portion of this figure attributable to money market instruments remained negligible. Net borrowing in the form of medium- and long-term bonds declined to 1,023 billion dollars, although the level of planned issues, at 2,116 billion dollars, was significantly higher than in previous years. While the US dollar was the issuing currency in an unchanged 47% of cases, the popularity of the euro increased by 2.5 percentage points to 38% of the total. The euro has thus gained market share at the expense of sterling and the yen, which were the issuing currencies for 6% and 4% respectively of medium and long-term bonds. The Swiss franc accounted for 2%.

Lower earnings for banks in the United States and Europe

Banks in the United States and Europe reported lower net earnings in 2002. In addition to the weak economy, falls in prices on the financial markets and slower business were to blame. The failure of the two big US corporations, Enron and WorldCom, also made a tangible mark on the balance sheets of their creditor banks.

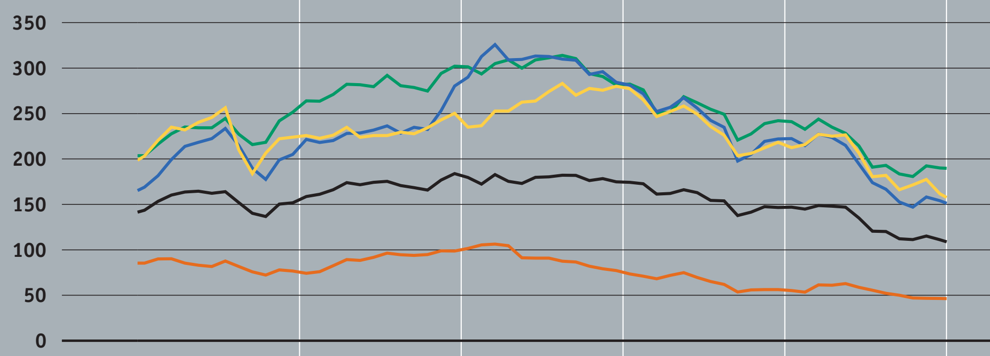
1998 1999 2000 2001 2002

Long-term interest rates



Yield on ten-year government bonds, in percent.
Source: BIS

Share prices



Index: January 1994 = 100.
Source: BIS

1998 1999 2000 2001 2002

Trend towards separating financial analysis and investment

In the United States, federal regulatory authorities and the Attorney General of New York conducted investigations into the business practices of several investment banks. These focused on possible conflicts of interest between the banks' financial analysis activities and their investment recommendations. The investigations came to an end in December with a global settlement between the investigating authorities and the banks concerned. The banks were forced to pay high fines and have also undertaken to make funds available for independent financial analysis and investor training programmes.

Difficulties for the Japanese banking sector …

In Japan, the banking sector continued to suffer from non-performing loans. The government has instituted reforms which provide for changes in the way that creditworthiness is assessed. Meanwhile, the Bank of Japan announced a purchase of securities from the banks at market prices.

… and in Argentina

During 2002, the Argentinian government eased a variety of measures which had restricted the withdrawal of funds from bank accounts. These measures had been introduced at the end of 2001 in order to prevent the threatened collapse of the banking system. The position of the Argentinian banking sector nonetheless remained difficult owing to the ongoing economic crisis.

2 Switzerland

2.1 Economic development

Sluggish economic development

In 2002, the Swiss economy failed to recover from its cyclical decline that had set in during the second half of the previous year. Although a pick-up seemed to be under way at the beginning of the year, signs of a delayed rebound and of continued slow growth in the economy multiplied. The disappointing development was mostly due to the unexpectedly weak global economic environment and the uncertainty after the downslide in the financial markets. The continued sluggish economic activity led to a significant deterioration on the labour market.

Investment crisis and weak foreign demand

Real GDP went up by 0.1% in 2002, following a 0.9% increase in the previous year. While the decrease in construction investment was less pronounced than in the previous year, investment in plant and equipment again dropped massively as companies became increasingly reluctant to commit resources. Exports of goods and services rose by 0.4%. Since imports dropped, foreign trade made a positive contribution to growth. Both consumer and government spending proved to be a mainstay of growth, even though both did not increase to the same degree as in the previous year.

Industrial output on the decline

Industrial output receded in 2002 after having stagnated in 2001. The machinery and electrical engineering industries were particularly affected by the decline, while the chemical industry was able to continue boosting production. After a revival of demand had been discernible in spring, the outlook became dimmer again in the second half of the year. The expected incoming orders failed to materialise and outstanding orders were down. As a result, companies revised down their near-term forecasts and slashed inventories for semi-finished and finished goods. Utilisation of production capacities remained at roughly 80%, thus falling well short of its long-term average of approximately 84%.

Weaker growth in private consumption

Private spending moved up by 0.9% in 2002 compared with 1.8% in the previous year. Growing unemployment and turbulence on the financial markets, however, led to a loss in consumer confidence, which was reflected in a massive drop of the consumer confidence index in the second half of the year. Households especially held back with purchases of durable consumer goods, such as motor vehicles and household furnishings. Gloomy consumer sentiment also hurt the Swiss hotel and restaurant industry. After having risen in the previous year, the number of overnight stays by Swiss guests fell off.

Sharp fall in equipment investment

The decline in equipment investment, which had started at the beginning of 2001, became more pronounced in 2002. Averaged over the year, it fell by 10.7% in real terms, twice as much as in the previous year. The fall was thus as steep as during the recession at the beginning of the nineties. Towards the end of the year, equipment investment plummeted to a level which was roughly on a par with replacement needs. Its share of real GDP dropped to 12.2% compared with 13.7% in the previous year.

Construction investment down

Construction investment was down 1.5%. The previous year had seen a decline of 4.8%. The slight upturn in the number of housing units under construction suggested a certain pick-up in investment in residential construction, benefiting mostly urban areas. Conversely, as a result of the weak economic situation, construction activity at companies was down during the entire year, with the decline in new office space being particularly pronounced. Cost-cutting in the public sector led to dwindling demand in the civil engineering sector. The major rail projects, the NEAT transalpine routes and Rail 2000, were an exception to the rule.

Slight rise in goods exports

The Swiss export industry suffered from the global economy's sluggish growth and subdued investment activity worldwide. Another handicap was the real appreciation of the Swiss franc, in particular vis-à-vis the US dollar, which had a negative impact on the competitiveness of export prices. Exports of goods grew by a modest 1% in real terms after 2001 had seen a rise of 2.1%. Exports of investment goods registered a sharper decline than a year earlier. While shipments of raw materials and semi-manufactures diminished at a lesser rate than in 2001, exports of consumer goods were boosted again.

Fewer exports to most industrial countries

Exports to the EU, which absorbs approximately 60% of Swiss exports, were down by 2.8% in nominal terms. Weak demand from Germany was especially troubling for Switzerland's export industry. Exports to the emerging economies in Asia and to Japan also fell short of the previous year's level. Exports to the US, which had fallen significantly in 2001, increased by 2.6%. As in the prior year, demand from the OPEC countries went up sharply. They only account for roughly 3% of exports, however. After having registered a 1.2% increase in the previous year, export prices – based on averages – slipped by 2.7%.

Demand for services down

Exports of services contracted by 1.8% compared with a 7.7% decline in the previous year. While the tourist industry suffered from the lacklustre global economy, the downslide in equity prices on international stock markets resulted in lower exports of banking services.

Decline in imports of goods …

As a result of the stagnating economy, Swiss demand for foreign goods waned. In 2002, imports of goods fell by 2.6% in real terms after having stagnated a year earlier. Persistently weak investment activity eroded the demand for investment goods. Imports of consumer goods also fell from the middle of the year onwards. In contrast to their growth of 5.8% in 2001, they stagnated on average over the year. Demand for energy sources went down. After import prices (average prices) had risen by only 0.1% in the previous year, in 2002 they contracted by 2.9% – a development which was mostly attributable to the stronger franc.

… and services

Imports of services diminished by 2.6% compared with 3.9% a year earlier. While expenditures for travel abroad were up slightly, those for banking services declined markedly.

Real GDP

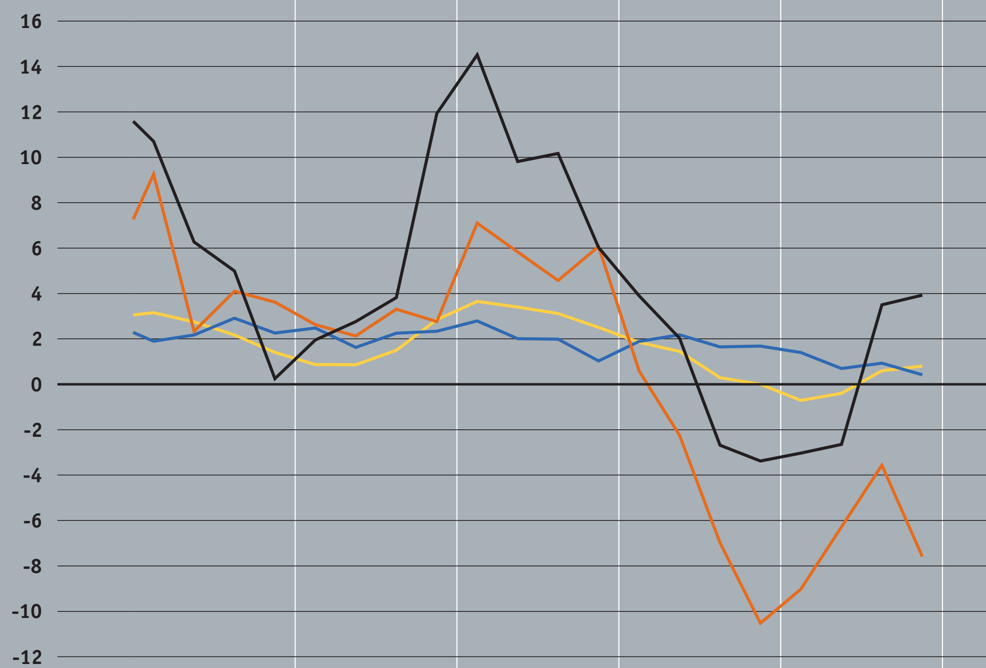
Private consumption expenditure

Fixed asset investment

Exports

Change from previous year
in percent, in real terms.
Source: State Secretariat for
Economic Affairs (seco)

Gross domestic product and components



GDP and components
Real change from previous year in percent

	1998	1999	2000	2001	2002
Private consumption	2.3	2.2	2.0	1.8	0.9
Government consumption	1.3	1.2	1.5	2.6	1.9
Investment in fixed assets	4.5	2.7	5.8	−5.2	−6.5
Equipment	8.9	8.7	8.8	−5.5	−10.7
Construction	0.4	−3.3	2.5	−4.8	−1.5
Domestic demand	**3.5**	**2.5**	**2.5**	**0.8**	**−1.3**
Exports of goods and services	5.4	5.1	10.0	−0.1	0.4
Aggregate demand	**4.0**	**3.3**	**4.8**	**0.5**	**−0.8**
Imports of goods and services	8.3	7.4	8.5	−0.3	−2.6
GDP	**2.4**	**1.5**	**3.2**	**0.9**	**0.1**

Source: Federal Statistical Office, seco

Employment drifting downward

The difficult economic situation worldwide had a deep impact on labour markets. The decline in employment which had begun in the third quarter of 2001 accelerated in 2002. Averaged over the year, employment shrank by 0.4% compared with an increase of 1.1% in the previous year. The processing industry was affected most severely (−2.5%). Jobs shed in the machinery and electronics industries as well as the metal industry accounted for a large part of this development. The number of persons employed in the chemical industry was up, however. The construction industry continued to trim its workforce (−1.6%). In the services sector, the number of jobs created was up 0.4%, compared with 1.3% in the previous year. While employment in the banking sector rose again, the insurance companies' payroll declined considerably.

Manpower Index on the decline

The declining demand for labour was also reflected in the Manpower Index, which measures the space occupied by job advertisements in newspapers. Between December 2001 and December 2002 it receded by 43% on a seasonally adjusted basis.

Short-time work on the increase

A growing number of companies introduced short-time work. On an annual average, persons on short working hours totalled 9,100, compared with 2,400 in the previous year.

Unemployment rises

Unemployment has continued to rise steadily since the spring. At year-end, the number of unemployed persons registered with the regional employment offices stood at 129,800. In seasonally adjusted terms, the unemployment rate rose from 2.2% to 3.3% between December 2001 and December 2002. The rate of jobseekers went from 3.4% to 4.8%, which represents approximately 173,200 persons. In addition to unemployed persons, jobseekers include people who are looking for casual jobs, are participating in a work creation scheme or are training or retraining.

Regional differences persist

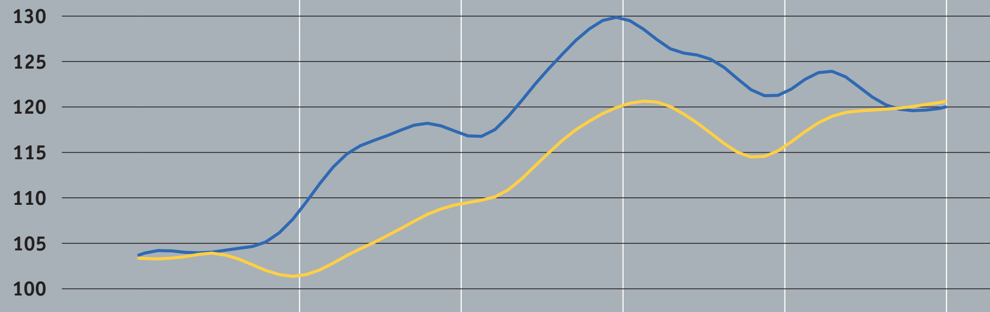
Regional differences in the unemployment situation persisted. In December, the unemployment rate reached 4.6% in French-speaking Switzerland and 4.8% in Ticino. In German-speaking Switzerland, it stood at 3.2%. Unemployment figures were up more sharply in German-speaking Switzerland than in the other areas of the country, notably in the canton of Zurich. This is why the differences diminished slightly compared to the previous year.

Imports

Exports

Volume, adjusted for seasonal
and exceptional factors.
Index: 1997 = 100.
Source: General Directorate of Customs

Foreign trade

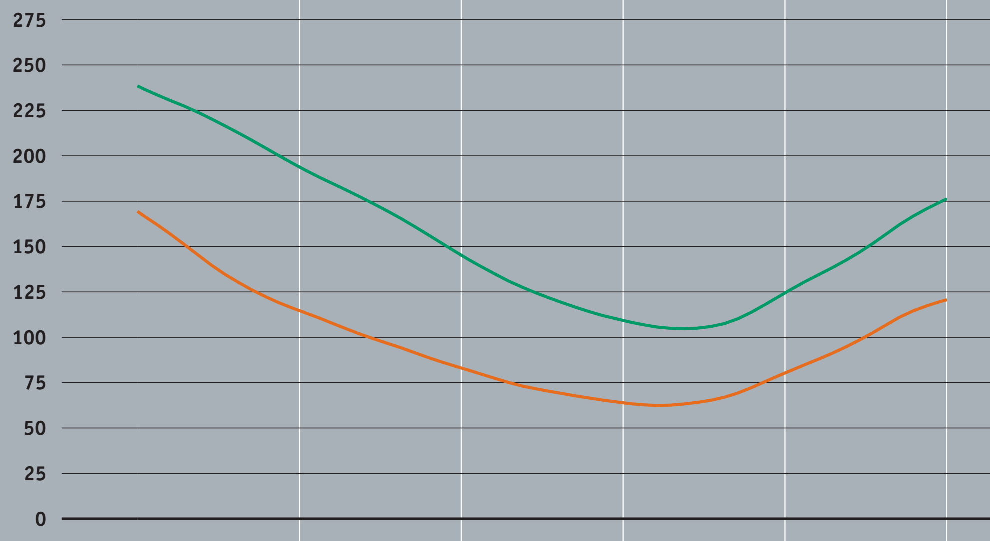


Unemployed persons

Job seekers

In thousands,
seasonally-adjusted.
Source: seco

Labour market



Small rise in workforce

According to the Swiss labour force survey (SAKE), which is conducted in the second quarter of every year, the number of gainfully employed persons grew by 0.5% year-on-year to 3,959,000 persons. This was despite the lacklustre economy. The employment ratio for women rose, while that for men decreased. This development confirms the slight upward trend in the participation rate for women, witnessed in the last few years. The share of foreign labour has moved up somewhat. While the number of individuals with short-term permits increased sharply, foreign employees holding seasonal work permits fell. The number of gainfully employed persons holding a residence permit, together with those holding one-year work permits and cross-border commuters, has remained stable.

Agreement on Free Movement of Persons between Switzerland and the EU enters into force

On 1 June 2002, the Agreement on the Free Movement of Persons – one of the seven bilateral agreements between Switzerland and the EU – entered into force. This Agreement accords EU and Swiss nationals the right of residence in each other's territory and the right to pursue an economic activity. The Agreement provides for a transitional period of five years for Switzerland during which access to the Swiss labour market will remain regulated and quotas will be maintained in respect of the incoming foreign labour.

Employment and unemployment

	1998	1999	2000	2001	2002
Full-time employment[1] change in percent	−0.4	−0.2	1.0	0.7	−1.3
Full- and part-time employment[1] change in percent	0.7	1.6	2.2	1.1	−0.4
Persons in employment[2] change in percent	1.8	0.8	1.2	1.5	0.5
Unemployment rate in percent	3.9	2.7	2.0	1.9	2.8
Number of unemployed in thousands	139.7	98.6	72.0	67.2	100.5
Number on short working hours in thousands	3.1	2.9	0.7	2.4	9.1
"Manpower job offer index"[3] change in percent	35.7	26.2	25.2	−11.5	−43.3

1 according to employment statistics
2 according to SAKE
3 space occupied by job advertisements in Swiss newspapers
Sources: Federal Statistical Office, seco, Manpower

Inflation, measured by the national consumer price index, receded in 2002. On an annual average, it came to 0.6% as against 1.0% in the previous year. As in 2001, inflationary stimuli emanated mostly from domestic goods and services. After posting a 1.7% rise in the previous year, price increases levelled off during the course of the year. Average inflation stood at 1.4%. Inflationary effects stemmed mostly from services, with prices rising by 1.5% compared to 1.8% in 2001. Weaker inflation was attributable in particular to apartment rents, which rose much less sharply (1.0%) than in the previous year. Inflationary pressure on private and public services, however, rose by 1.9% and 1.5% respectively.

Inflation low

As a result of the slack growth in the global economy and the stronger franc, prices of imported consumer goods continued to fall. Averaged over the year, they declined by 1.7% after having contracted by 1.2% in the previous year. Declining prices for oil products, which averaged 6.8% over the year, had a particularly inflation-dampening effect.

Inflation-dampening effects from abroad

National consumer price index
Change from previous year in percent

	1998	1999	2000	2001	2002
Total	**0.0**	**0.8**	**1.5**	**1.0**	**0.6**
Domestic goods and services	0.3	0.7	0.7	1.7	1.4
Goods	0.3	0.3	1.6	1.5	1.1
Services	0.3	0.9	0.4	1.8	1.5
Private services excluding rents	0.7	1.6	0.3	1.5	1.9
Rents	0.1	0.7	1.5	2.8	1.0
Public services	−0.2	0.0	−1.4	0.5	1.5
Foreign goods	−0.7	1.0	4.1	−1.2	−1.7
Excluding oil products	0.4	0.5	0.9	−0.4	−0.8
Oil products	−10.2	5.7	31.3	−4.7	−6.8

Source: Federal Statistical Office, Swiss National Bank

Inflationary pressure on producer and import prices also softened considerably. After the total supply index had remained virtually unchanged in the previous year, it fell by an average of 1.2% in 2002. Prices for goods produced in Switzerland dropped by 0,5%, and import prices declined by 2.8%. Prices of raw materials fell by 2.7% year-on-year; prices of semi-manufactures moved 2.1% lower. Prices of consumer and investment goods were almost unchanged from the year-earlier level.

Declining total supply index

Higher current account surplus

The current account surplus grew by Sfr 11.7 billion to Sfr 49.6 billion in 2002. The surplus from goods trade accounts for most of this increase. The current account surplus expanded from 9.1% to 11.9% of GDP. Due to the economic situation, imports declined more sharply than exports. The trade balance (special trade) thus closed with a surplus of Sfr 7.3 billion compared with Sfr 1.7 billion in the previous year. Total goods trade, which includes special trade in addition to precious metals, precious stones and gems as well as objets d'art and antiques plus electrical energy, posted a surplus of Sfr 4.5 billion vis-à-vis a deficit of Sfr 4.6 billion in the previous year. The surplus from services rose from Sfr 24.2 billion to Sfr 24.9 billion. This increase was primarily attributable to higher premium income in the private insurance sector, while the banks' commission income declined. Since net income from direct investment was slightly higher than in the previous year, the surplus on the labour and investment income account widened by Sfr 1.5 to Sfr 26.7 billion. The deficit from current transfers amounted to Sfr 6.6 billion, as against Sfr 6.9 billion in the previous year.

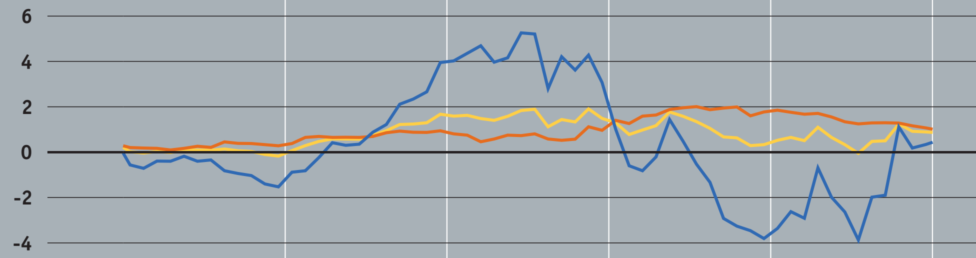
Current account balances in billions of Swiss francs

	1998	1999	2000 revised	2001 provisional	2002 estimated
Goods	−2.3	−0.3	−4.2	−4.6	4.5
Special trade	2.2	1.1	−2.1	1.7	7.3
Electrical energy	0.7	0.6	0.5	1.1	0.5
Other goods	−5.3	−1.9	−2.6	−7.4	−3.2
Services	19.6	21.6	25.6	24.2	24.9
of which tourism	1.7	1.6	2.4	2.0	1.1
of which private insurance	2.2	2.7	2.3	1.7	4.2
of which transportation	1.2	1.4	1.7	2.0	1.7
of which financial services	9.2	11.1	13.3	11.8	10.6
Labour income and investment income	25.9	30.5	37.0	25.2	26.7
Labour income	−6.4	−6.5	−7.8	−8.6	−9.2
Investment income	32.4	37.0	44.8	33.8	35.9
Current transfers	−5.3	−6.2	−4.9	−6.9	−6.6
Total	**37.8**	**45.7**	**53.5**	**37.9**	**49.6**

Consumer prices

Consumer prices
Domestic goods
Imported goods

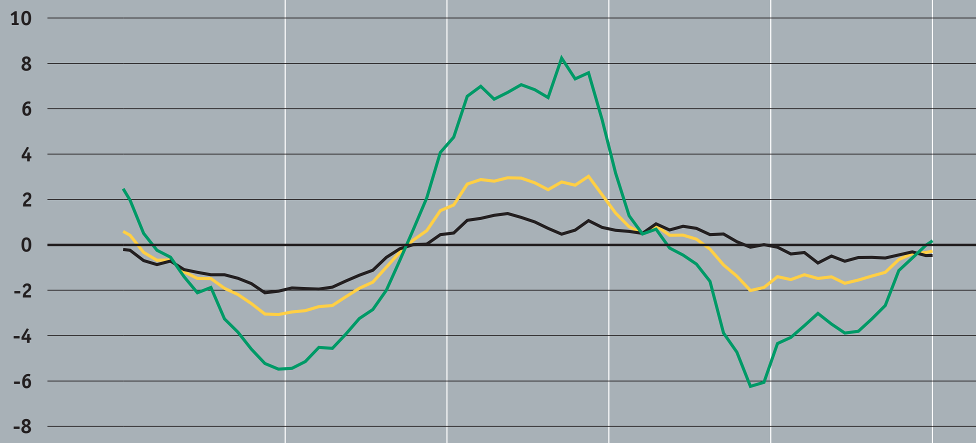
Change from previous year
in percent.
Source: Federal Statistical Office



Producer and import prices

Producer and import prices
Producer prices
Import prices

Change from previous year
in percent.
Source: Federal Statistical Office



2.2 Fiscal policy

Further deterioration of federal budget

The Federal Government posted a deficit of Sfr 3.3 billion or 0.8% of GDP for 2002 after a deficit of Sfr 1.3 billion had been recorded in the previous year. A deficit of Sfr 294 million had been budgeted. As a result of the weak economy and bearish stock markets, fiscal revenue – especially from federal tax and value added tax – was considerably lower than expected. Expenditure was slightly below the budgeted figures. Additional credits were more than offset by non-utilised budgetary credits. Outlays from the fund earmarked for major rail projects (NEAT transalpine routes, Rail 2000) totalling Sfr 1.9 billion and extraordinary income of Sfr 3.7 billion from a reduction in nominal value of Swisscom stock are not included in the federal budget. This latter income was used to reduce debt.

Constitutional budget target met thanks to extraordinary income

The transitional provision to Art. 126 of the Federal Constitution (federal budget) states that the deficit may not exceed 2% of revenue, i.e. Sfr 1.0 billion. The budget target was met owing to extraordinary income from the sale of Swisscom stock.

2003 Budget

According to the Budget passed by Parliament, the Federal Government anticipates a deficit of Sfr 246 million for 2003. The 2003 Budget is thus in conformity with the “debt brake”, a constitutional mechanism for managing the federal budget and keeping the level of debt in check, which was approved by the Swiss electorate and the cantons in a referendum at the end of 2001 and will be applied in 2003 for the first time.

Deficits at the cantonal and municipal levels

As a result of the weak economy, most cantons and municipalities posted a budget shortfall in 2002. According to the preliminary figures, the total deficit of all the cantons’ budgets amounted to approximately Sfr 600 million, and that of the municipalities to approximately 400 million. The consolidated deficit of the Federal Government, the cantons and the municipalities amounted to roughly 1% of GDP in 2002.

Debt ratio unchanged

The debt ratio (total debt expressed as a percentage of GDP) of the Confederation, the cantons and municipalities remained virtually unchanged at 50.4%. 51.6% of the debt was attributable to the Federal Government, 30.6% to the cantons and 17.8% to the municipalities.

Restructuring of the fiscal equalisation system

In the autumn, parliament began debating the restructuring of the fiscal equalisation system. The new financial equalisation project (NFA) aims to disentangle the tasks and financial flows between the Confederation and the cantons, allocate the responsibilities clearly and distribute expenditures more equitably. These reforms seek to strengthen the powers of the Federal Government and the cantons in terms of government and fiscal policy, and to reduce the financial disparities between financially stronger and weaker cantons.

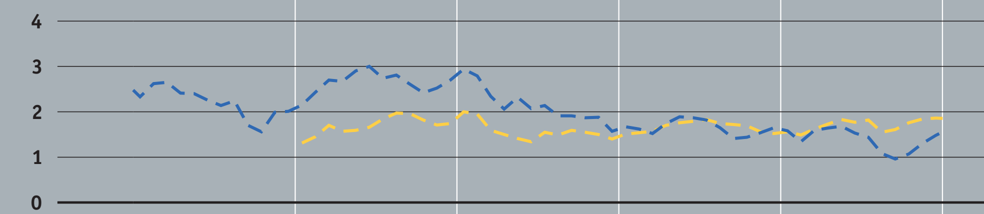
1998 1999 2000 2001 2002

Spreads for long-term interest rates

Euro area - Switzerland

United States - Switzerland

Spread in percentage points.
Source: BIS

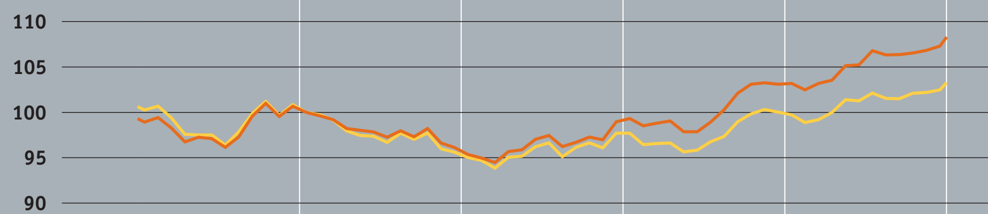


Export-weighted Swiss franc exchange rates

Real

Nominal

Index: January 1999 = 100.



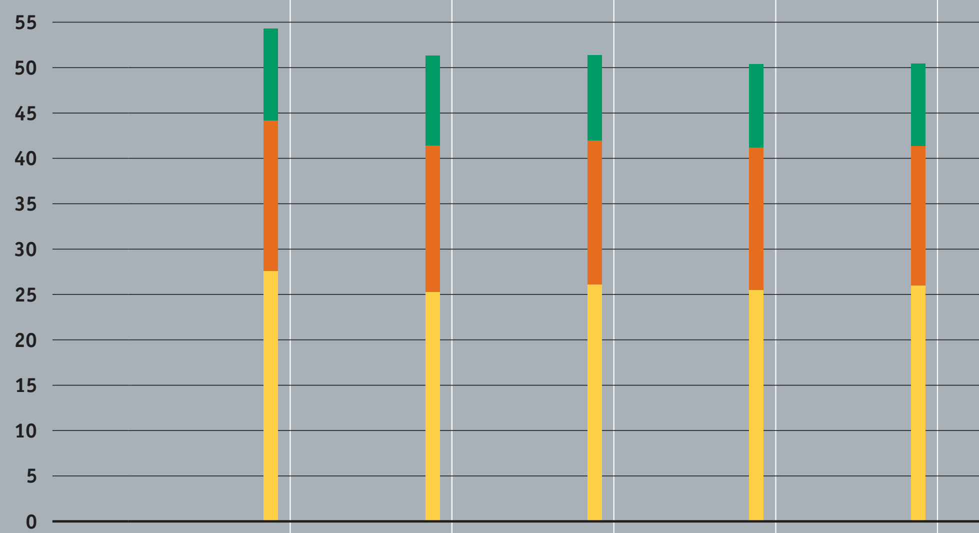
Public-sector indebtedness

Confederation

Cantons

Municipalities

In percent of GDP.
Source: Federal Finance Administration



1998 1999 2000 2001 2002

2.3 Financial markets

Lower long-term interest rates

Long-term interest rates remained at the previous year's level during the first months of 2002. June saw the beginning of a distinct downward slide. The average yield on 10-year Confederation bonds fell from roughly 3.5% in May to 2.4% in December. On the one hand, this development was due to declining short-term interest rates. On the other hand, many investors were prompted by the price collapse on the stock markets to invest their assets in bonds with high credit ratings, thus driving up the price of government bonds in particular. Reaching a high of 2.7 percentage points in July, the yield differential between 10-year Confederation bonds and money market debt register claims subsequently fell to 2.1 points in December. At the end of the previous year, this spread had amounted to 1.9 percentage points.

Higher risk premiums for bonds of private debtors

In the second half of the year, the differential between yields on government and private sector bonds widened as well. By December, the yield gap between a 3-year bank bond and Confederation bonds had grown to approximately 50 percentage points – an increase of 15 basis points vis-à-vis the previous year. The corresponding yield differential for the industry widened by 40 basis points to 150 basis points. This development suggests that investors considered the credit risks to be higher than a year earlier.

Continued fall in equity prices

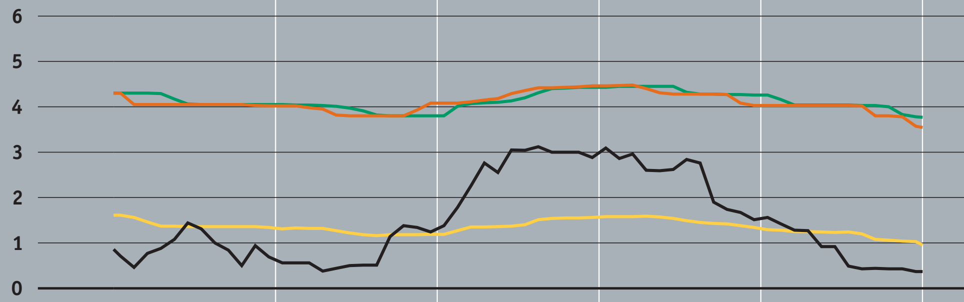
The Swiss Performance Index (SPI) lost nearly 26% in 2002. At the end of December, it stood at 3,246 points versus 4,383 points a year earlier. After climbing to over 4,500 points in the first quarter, the index suffered a first setback during the second quarter. After a short recovery phase, the SPI again fell sharply, reaching a low of 3,096 points at the beginning of October. Shedding 21%, share prices of large companies took less of a hit than those of small (–26%) and medium-sized companies (–25%). There were considerable differences between individual sectors of the economy. Financial stocks (insurance companies and banks) as well as the electrical, transport and construction industries suffered the largest losses. The decline in the chemical and foodstuffs segments was considerably less significant, and energy stocks picked up slightly. The New Market Index, which is composed of telecom, biotechnology and information technology stocks, fell by 52%.

Borrowing on the capital markets up

Even though low stock prices, high corporate bond yields and sagging demand for higher-risk securities made for difficult market conditions, borrowing on the Swiss capital market was higher in 2002 than in the previous year. Net borrowing in the form of publicly issued stocks and bonds amounted to just under Sfr 17 billion compared with Sfr 13 billion in the previous year. This was due to a significant increase in net issuance of Swiss franc bonds of foreign borrowers from Sfr 2 billion to almost Sfr 15 billion. At Sfr 2 billion, however, domestic borrowing clearly remained below the already low year-earlier figure of just under Sfr 11 billion. Equity redemptions surpassed equity issues so that net borrowing via the equity market amounted to Sfr –1.7 billion. The net issuing value of Swiss franc bonds by domestic borrowers fell by 37%.

1998 1999 2000 2001 2002

Selected bank interest rates



Existing mortgages at cantonal banks

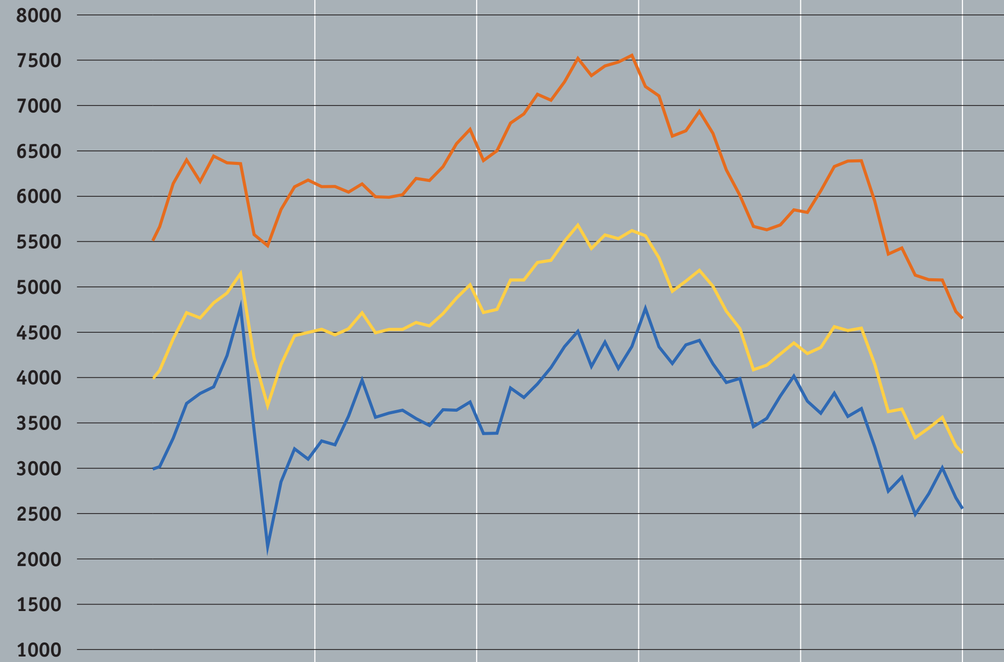
New mortgages at cantonal banks

Savings deposits at cantonal banks

Three-month time deposits at big banks

In percent.

Share prices



Total

Banks

Industry

Swiss Performance Index.
Source: Swiss Exchange

1998 1999 2000 2001 2002

Decline in credit volume

Domestic credit volume contracted by 0.7% in 2002. Four-fifths of banks' domestic lending was accounted for by mortgage loans and one-fifth by domestic customer claims. The latter registered a sharp 11.8% decrease. Most of this decline is attributable to reduced lending by the big banks (–17.1%); in particular, financial institutions, insurance companies and real estate firms were granted fewer loans. Mortgage loans, on the other hand, grew by 2.7%. On the refinancing side, customer deposits in the form of savings and investments climbed by nearly 10%, while sums due to banks were more than 6% below the previous year's level.

Difficult year for banks ...

As a result of the weak economy and the stock market slump, the banks' results deteriorated, albeit to varying degrees. In the areas of investment banking and asset management, earnings from commissions and services fell off; in addition, banks suffered considerable losses on their own securities holdings. However, satisfactory results were achieved in the traditional banking business, notably in retail banking. Banks primarily active in the classic interest-earning business were affected less by the development on the stock market than by the level of economic activity. As a result of the deterioration in loan quality, the provisioning requirements increased as well. This effect had little impact on the results, however.

... and insurance companies

At the insurance companies, especially in the life insurance segment, the fall in equity prices led to substantial losses on investments, necessitating considerable impairment charges. Several insurance companies had to subsequently strengthen their equity base. The turbulence in the stock markets also had a major impact on pension funds.

Recapitalisation of Banque Cantonale Vaudoise

In October 2002, after a review of the risk positions of Banque Cantonale Vaudoise (BCV), extraordinary provisioning requirements were again deemed necessary. The government and the parliament of the canton of Vaud subsequently approved financial resources in the amount of Sfr 1.25 billion to recapitalise the bank. The share capital had already been increased by Sfr 600 million in 2001, with the canton subscribing to practically the whole amount.

Financial Sector Assessment Program of the IMF and the World Bank

Switzerland was one of the first industrial countries to participate in the Financial Sector Assessment Program (FSAP) of the International Monetary Fund (IMF) and the World Bank. The programme, established in May 1999, aims to review the financial systems of individual countries with regard to their stability. The surveillance of the international currency and financial system is one of the IMF's main tasks. The IMF published the final report, the Financial Sector Stability Assessment (FSSA), in June 2002. The Swiss financial system is rated as robust overall and in conformity with internationally recognised standards.

Swiss Exchange Directive on Corporate Governance

The SWX Swiss Exchange regulations on Corporate Governance (RLCG) came into force on 1 July 2002. The directive stipulates that all SWX-listed companies domiciled in Switzerland must publish key data on Corporate Governance. This includes information on a corporation's structure, its shareholders, capital structure, the board of directors, and management.

Swiss Code of Best Practice established by economiesuisse

Also in July 2002, economiesuisse, the Swiss Business Federation, published the Swiss Code of Best Practice for Corporate Governance. This code spells out the principles of Corporate Governance taking into account circumstances specific to Switzerland. The Swiss Code is aimed at all Swiss corporations and takes the form of non-binding recommendations.