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1. Conclusions for monetary policy

The National Bank intends to adhere to its generous monetary policy. While it is true that economic prospects for the coming months have improved gratifyingly, it remains to be seen whether these expectations will actually be fulfilled. The outlook for inflation continues to be favourable. The development of the monetary aggregates, which provides useful information on the medium-term development of inflation, clearly indicates that consumer prices should remain stable for some time to come.

2. Economic and monetary developments

The National Bank continued to conduct a generous monetary policy in the first few months of 1999, duly taking into account the levelling off of economic activity. Overall, monetary conditions were somewhat more expansionary than at the end of 1998; short-term interest rates remained at a low level, and the real export-weighted exchange rate declined slightly. On 8 April the National Bank decided to lower the discount rate by half a percentage point to 0.5% in the wake of a cut in the key interest rate by the European Central Bank. With the reduction in the interest rate in April, the National Bank primarily sought to prevent the Swiss franc's appreciation against the euro, which would have fitted badly into the economic environment.

Real gross domestic product grew year-on-year by a mere 0.7% in the first quarter. No stimuli emanated from the export industry, and domestic demand lost momentum. According to major indicators, however, the period of sluggish growth was gradually drawing to an end. Change in sentiment was particularly marked in the export industry, due to a more optimistic assessment of the world economic situation. In a number of East Asian countries the economy stabilised. Continued strong growth in the United States and the renewed calm in the international financial markets also inspire confidence.

3. General Meeting of Shareholders

In his opening speech the retiring President of the Bank Council, Jakob Schönenberger, looked back on the significant events during his six-year term of office. Of particular relevance were the developments in the financial markets and the structural changes in the Swiss banking sector. Many of these can be summarised under the headings globalisation and rationalisation. Overall, he drew a picture of a period characterised by radical change and concluded by saying that Switzerland's path into the future and the path of the National Bank had not become any easier in a new European environment.

In his address the Chairman of the Governing Board, Hans Meyer, discussed economic developments and Switzerland's monetary policy in 1998. Favourable monetary conditions helped in large measure to promote the economic recovery despite the difficult international environment. While criticism of the IMF voiced in the wake of the crises in East Asia, Russia and Brazil is to some extent understandable, it is also exaggerated. In Switzerland, the amendments to the monetary constitution to meet the needs of the times are making good progress. The National Bank regrets the dark sides of its conduct during the difficult war years; it believes that the official efforts being made are a valid and convincing contribution to coming to terms with the past.

4. The influence of exchange rate volatility on Swiss trade

The traditional view states that exchange rate volatility has a negative effect on export volume, whereas its influence on export prices is ambiguous. This contribution investigates the empirical relationship between exchange rate volatility and Swiss exports using a multivariate "GARCH-in-mean" model. Apart from total exports, several export categories (raw materials and semi-finished products, consumer goods and investment goods) and several export destinations (Germany, France and Italy) are examined. The results establish no clear empirical relationship between the Swiss exports and the volatility of the Swiss franc defined by the variance of the GARCH process. Exchange rate volatility is found to be statistically insignificant in the equation for export volume and for export prices.

5. Chronicle of monetary events

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1. Conclusions for monetary policy

The Swiss economy underwent modest growth during the first quarter of 1999, with hardly any stimuli emanating from the export sector. Domestic demand continued to be the main support for the economy; it lost some of its dynamic, however. Another factor aggravating the situation was the bad weather, which affected severely tourism and the construction industry. Traces of slow growth were also evident in the labour market. The number of employed persons has increased at a slower pace since mid-1998. Even though unemployment continued to fall, the decline continues to be overstated by the high number of long-term unemployed (i.e. persons who are no longer eligible for unemployment benefits). It was nevertheless obvious that the situation had clearly improved, which was a testimony to the Swiss labour market's flexibility.

Inflation remained at a very low level. From January to May, the consumer price index was 0.4% higher on average compared to the corresponding level in the previous year. According to estimates by the Federal Statistics Office, the VAT increase was only partially passed on. In view of existing excess capacities and international competitive pressure, it is difficult, especially in the case of goods, to implement price increases. There is more room for manoeuvre in the services sector, where prices went up significantly in some instances. This was not enough to cause concern, however.

The National Bank continued its generous monetary policy in the first half of 1999. Overall, monetary conditions were somewhat more expansive than at the end of 1998: short-term interest rates remained at their low level of 1%, and the real, export-weighted exchange rate of the Swiss franc declined slightly. On 8 April, the National Bank lowered its discount rate by half a percentage point to 0.5%, after the European Central Bank had lowered its key rate. While this resulted in the Swiss money market rates dropping below 1%, capital market rates remained largely unchanged. By lowering its discount rate in April, the National Bank wanted to keep the leash on a marked appreciation of the Swiss franc vis-à-vis the euro. Such a development would have marred the overall economic picture.

In addition to weak economic growth and declining capacity utilisation, the development of monetary aggregates also left some leeway for lower interest rates. From January to April, the money stock M3 had grown by 0.8% on average, which is only slightly higher than the corresponding level last year. This weak growth can be mostly attributed to the economy levelling off. The monetary base, which has shrunk since December 1998, continued to be of little significance.

While economic growth remained weak at the beginning of the year, the outlook was clearly brighter as the year went on. The turnaround was especially pronounced in the export sector – a consequence of the more optimistic assessment of the global economy. Some countries in East Asia saw their economies stabilise and demand from this region started to bounce back, albeit from a very low level. Another factor contributing to an optimistic outlook is the sustained boom of the US economy and the fact that a measure of calm has returned to international financial markets. In the euro zone, several indicators point to a gradual overcoming of the economic slump. The National Bank expects the Swiss economy to advance in the second half of the year. Even though real GDP recorded only weak growth in the first quarter, the Bank reckons that an average rise of around 1.5% in 1999 is still plausible.

The prospects for inflation remain favourable. The consumer price index is likely to increase by less than 1% on average. As a result of robust consumer demand, price hikes, which go beyond the VAT effect, are most likely to occur in the private service sector. Deregulation measures in the area of telecommunications and the reduction of price support measures in agriculture continue to curb inflation. There is no inflationary pressure coming from the wage side either, even though some sectors of the labour market are experiencing certain shortages of available labour. The development of the monetary aggregates, which provide useful information on medium-term inflation prospects, indicates that consumer prices should remain stable also in the longer term.

The National Bank intends to adhere to its basically generous monetary policy. While it is true that the forecasts for the coming months have improved and are indeed encouraging, it remains to be seen whether these expectations will be met. It is unlikely that the capacity utilisation will already rise significantly in the foreseeable future. Against the backdrop of a still fragile economy, the Swiss franc exchange rate remains of considerable importance.

5. Chronicle of monetary events

Lowering of the discount rate

The Swiss National Bank lowered its discount rate by half a percentage point to 0.5% with effect from 9 April 1999.

New monetary article passed by parliament

Following the first deliberations in parliament on the new monetary article in the Federal Constitution, a slight divergence of opinion arose between the National Council and the Council of States with respect to the legal nature and the exact wording of an additional norm on the use of excess monetary reserves (cf. Quarterly Bulletin 1/1999, p. 67). On 17 June 1999, the National Council endorsed the version of the Council of States. Accordingly, a transitional provision will be included in the Constitution to the effect that federal legislation regulates the use of those monetary reserves that are no longer needed for the conduct of monetary policy at the time this provision enters into force. This solution underlines that National Bank reserves are allocated to other public uses in exceptional cases only.

Message concerning a federal law on currency and payment instruments

On 26 May 1999 the Federal Council passed the message on a federal law on currency and payment instruments. This law serves to sever the Swiss franc's link to gold, a step which had been realised on a constitutional level when the total revision of the Federal Constitution was approved in the referendum of 18 April 1999. The federal law on currency and payment instruments definitively abolishes the obligation of the National Bank to redeem banknotes in gold; it removes the minimum gold coverage of banknotes in circulation and the gold parity of the Swiss franc. The creation of a new law is all the more urgent as the newly introduced constitutional article 99 regulates the notes and coins privileges of the Confederation by a single provision and no longer divides them - in conformity with the physical cash form - into a coinage article and a central bank article. The federal law on currency and payment instruments governs all the features of currency and government money (coins, banknotes, sight deposits at the SNB) that are relevant for the public. The current coinage law will be fully incorporated in the new federal law; the provisions on banknotes will be transferred from the National Bank Law to the Federal law on currency and payment instruments.