Review of economic developments

1 International developments

1.1 Real economic performance

Stronger world economic growth – regional variations

The world economy as a whole experienced an upturn in growth over the past year. Developments were very mixed from one region to another, however. Real gross domestic product (GDP) in the OECD countries grew by 2.4% on average, compared with 2% in 1995. The strongest growth stimuli emanated from the United States and the United Kingdom. Only in the second half of the year did the economies of continental Europe show signs of emerging from the economic downturn they had entered in autumn 1995. The Japanese economy recovered only slowly. Outside the OECD, the boom observable for several years in Southeast Asia lost some of its former vigour. While the economic fortunes of central Europe's structural reform economies improved, the situation in the other former Eastern Bloc countries remained bleak.

Expansion in the USA and the UK

The economic expansion in the United States and the United Kingdom gained momentum in the course of the year. While domestic demand – especially consumer spending – was buoyant in both countries, export performance was mixed. American exports were restrained by a stronger dollar and declining demand from Europe. By contrast, exports from the UK continued to rise.

Gradual improvement in Germany and France during the year

In Germany and France, the economic slowdown which had set in during 1995 made itself felt well into 1996. The sluggishness can be traced back to the currency turbulences of early 1995, which had caused most of the European currencies to appreciate sharply. The resulting stagnation in export and investment activity had triggered a renewed rise in unemployment, thus impacting on consumer sentiment. Restrictive fiscal policies also contributed to the slowdown. As the year went on, however, economic activity in both countries began to revive, due in large part to brisker demand from abroad.

Marked levelling-off in Italy

In Italy, the – mainly export-driven – economic expansion came to a standstill. Flagging demand from Italy's principal European trading partners, combined with a rise in the lira from mid-1995 onwards, were the main contributory factors. Owing to the tight monetary policy adopted by the Italian central bank in a bid to combat inflation, domestic demand also receded.

Improvement in Japan

After several years of stagnation, Japan witnessed significant growth in real GDP. This was due primarily to the public sector's large-scale investment programme. Despite low interest rates, however, private demand never really took off – very possibly another result of the crisis in the Japanese banking system. Export growth was brought almost to a standstill by the massive appreciation of the yen between early 1993 and mid-1995, whereas imports rose sharply.

Lower jobless numbers in the USA and the UK – unemployment high in Europe

Robust economic growth in the United States and the United Kingdom was accompanied by expansion in employment and a fall in the number of people out of work. This was in contrast to continental Europe: in Germany and France, in particular, unemployment increased. In the EU as a whole, the average rate of unemployment persisted at around 11%.

Continued low inflation

Inflation in the OECD countries remained low. In Europe – especially Italy and the UK – it fell off sharply. The average inflation rate in the EU countries amounted to 2.5%. In the United States, prices showed no sign of an upsurge despite almost full utilisation of production capacity: inflation was virtually unchanged at 2.9%. In Japan, consumer prices stagnated at 1995 levels.

Summary of data on economic activity

	1992	1993	1994	1995	1996
Real GDP change from previous year in percent					
United States	2.7	2.3	3.5	2.0	2.5
Japan	1.0	0.3	0.7	1.3	3.4
Germany	1.8	−1.2	3.0	2.1	1.3
France	1.2	−1.3	2.8	2.2	1.3
United Kingdom	−0.5	2.1	3.9	2.5	2.3
Italy	0.6	−1.2	2.1	3.0	0.8
Switzerland	−0.3	−0.8	1.2	0.1	−0.7
Unemployment in percent					
United States	7.5	6.9	6.1	5.6	5.4
Japan	2.2	2.5	2.9	3.2	3.4
Germany	7.7	8.9	9.6	9.5	10.4
France	10.4	11.7	12.3	11.8	12.4
United Kingdom	9.9	10.3	9.3	8.3	7.5
Italy	8.8	10.2	11.3	12.0	12.1
Switzerland	2.4	4.5	4.7	4.2	4.7
Inflation consumer prices, in percent					
United States	3.0	3.0	2.6	2.8	2.9
Japan	1.7	1.2	0.7	−0.1	0.1
Germany	5.1	4.5	2.7	1.8	1.5
France	2.4	2.1	1.7	1.8	2.0
United Kingdom	3.7	1.6	2.5	3.4	2.5
Italy	5.3	4.2	3.9	5.4	3.8
Switzerland	4.0	3.3	0.9	1.8	0.8
Current account balance in percent of GDP					
United States	−1.0	−1.5	−2.2	−2.0	−2.1
Japan	3.0	3.1	2.8	2.2	1.4
Germany	−1.1	−0.7	−0.9	−0.7	−0.2
France	0.3	0.7	0.5	1.1	1.3
United Kingdom	−1.6	−1.7	−0.4	−0.4	−0.1
Italy	−2.3	1.2	1.5	2.5	3.5
Switzerland	6.3	8.4	6.9	6.9	6.9

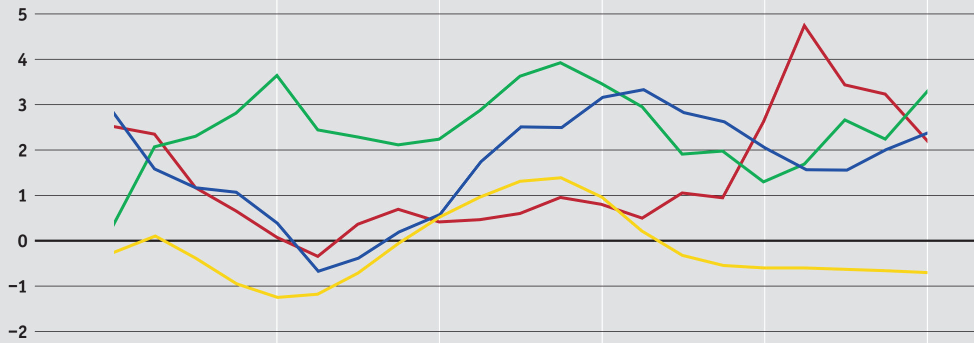
Some of the figures for 1996 are preliminary estimates.
Source: OECD

1992 1993 1994 1995 1996

Gross domestic product

USA
Japan
OECD Europe
Switzerland

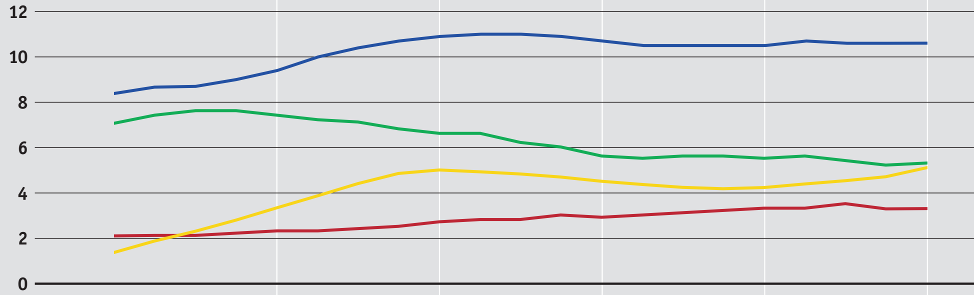
Change in percent
from previous year.
Source: OECD



Unemployment

USA
Japan
OECD Europe
Switzerland

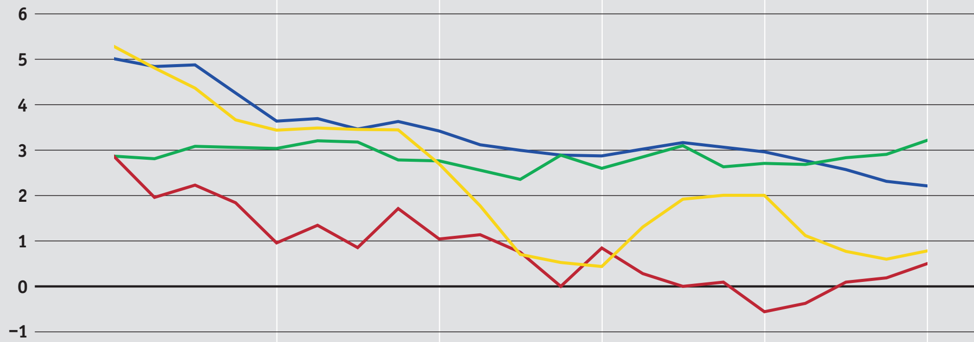
In percent of labour force.
Source: OECD



Inflation

USA
Japan
OECD Europe
Switzerland

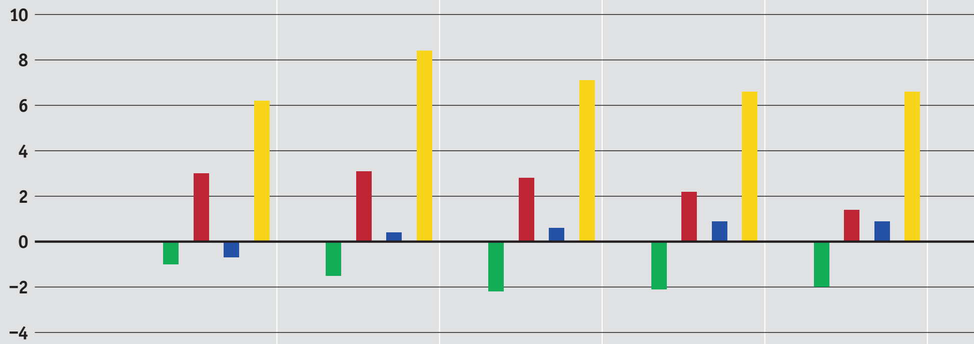
In percent.
Source: OECD



Current account balance

USA
Japan
OECD Europe
Switzerland

Net balance in percent
of gross domestic product.
Source: OECD



1992 1993 1994 1995 1996

Slower growth in central Europe

Due mainly to a downturn in exports to the EU countries, the structural reform economies of central Europe experienced lower rates of growth in 1996. On the other hand, domestic demand picked up: private consumption rose in most countries while investment activity was distinctly up in the Czech Republic, Poland and Slovenia. The decline in employment slowed down, even though in general the privatisation of state-owned industries (often involving heavy job losses) continued to make progress.

Continuing decline in output in eastern Europe

In the easternmost countries of the former Eastern bloc, output continued to shrink. Structural reform made little headway and investment thus remained low. Owing to exports of raw materials and energy, however, Ukraine and Russia recorded large trade surpluses.

Lower growth in Asia – recovery in Latin America and Africa

The industrial countries of eastern and southeastern Asia experienced lower growth. This was due in part to the higher interest rates implemented by the region's central banks in an effort to counter rising inflation and growing current account deficits. The economic situation in Latin America improved in the year under review – the entire region had previously been suffering from the impact of the Mexico crisis at the end of 1994. Structural reform began to bear fruit in a number of African countries: on average, there was a slight rise in per-capita income on this continent.

Slower expansion of world trade

World trade grew by an estimated 5% in 1996, i.e. rather less than in the previous year. The fall-off was due primarily to the slower economic growth in continental Europe as well as to the rise of the dollar, which worsened the competitive position of numerous Asian countries that peg their currencies to the US dollar.

1.2 Monetary policy

Monetary policy was influenced by mixed economic performance in the major industrial nations.

Monetary policy in the United States and Japan unchanged

In the United States, the Federal Reserve Board left the federal funds rate unchanged after having lowered it to 5.25% in two quarter-point steps in December 1995 and January 1996. Since inflation remained muted, there was no need to raise interest rates despite the acceleration in economic growth. Having reduced its discount rate to 0.5% in September 1995, the Bank of Japan left it at this low level during the year under review owing to the sluggish economy and the banking system's continuing problems.

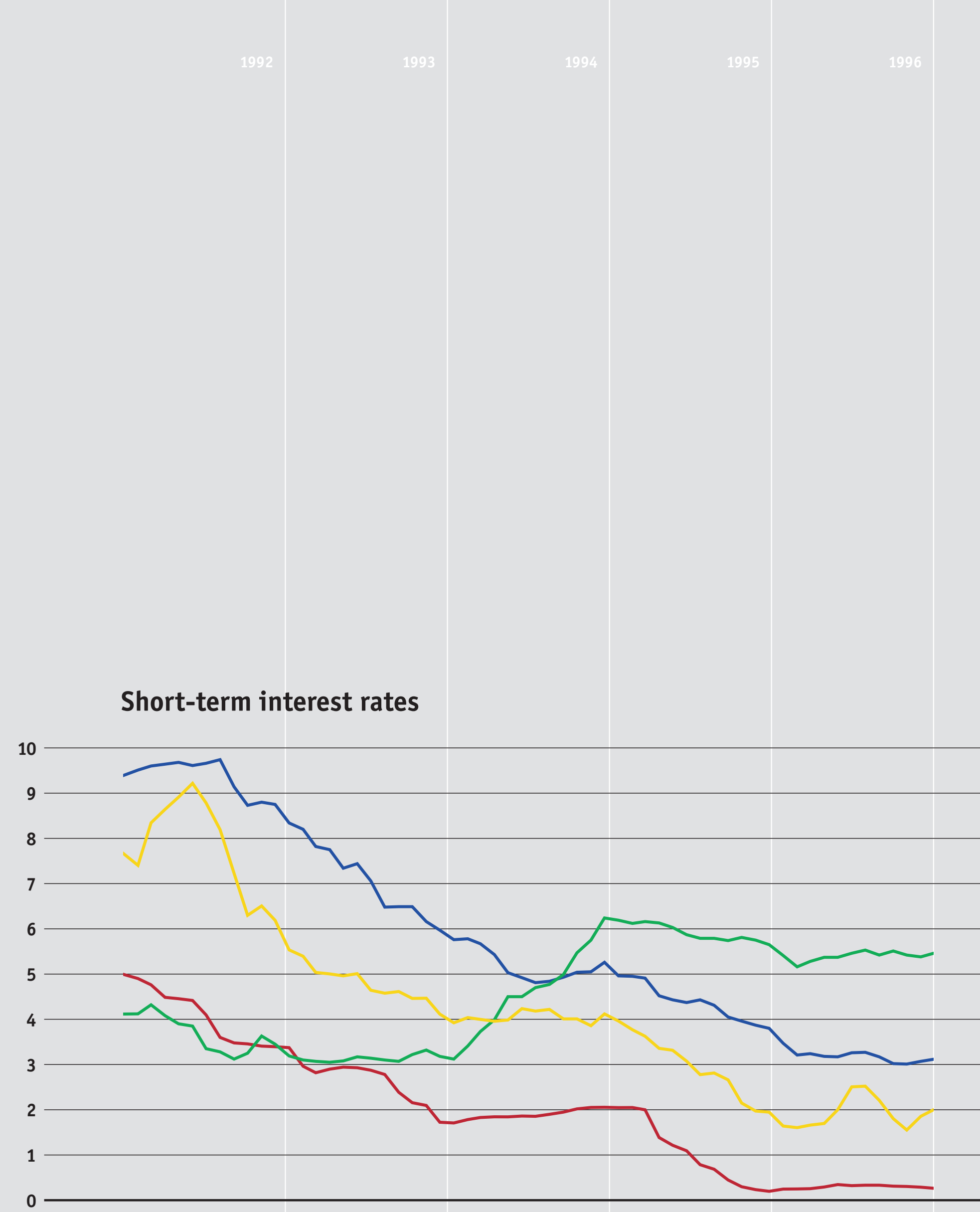
Interest rate cuts in Germany and France

In the first half of the year, the Bundesbank eased its monetary stance even though growth in the M_3 money supply aggregate was well above the target range. The repo rate – which Germany's central bank applies to securities repurchase agreements with the commercial banks – dropped almost one percentage point between January and August to 3%, and then remained at this level. In April the Bundesbank also lowered both the discount and Lombard rates by half a percentage point to 2.5% and 4.25% respectively. In a parallel move, the Banque de France lowered its key interest rates, as did the other central banks participating in the exchange rate mechanism (ERM) of the European Monetary System (EMS). By December, France's benchmark rates were one percentage point lower than a year earlier.

Eurodollar
Euroyen
Euro-DM
Euro-Sfr

Three-month
Euromarket rates.
Source: BIS

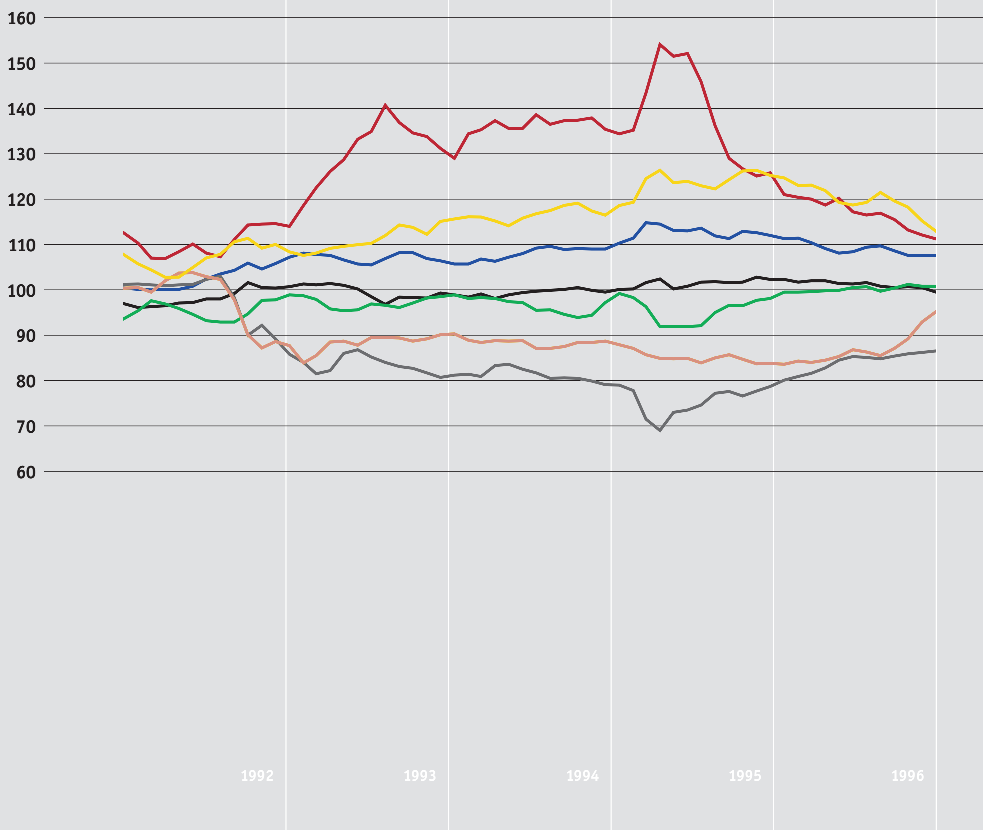
Short-term interest rates



Dollar
Yen
D-mark
French franc
Pound sterling
Lira
Swiss franc

Real, trade-weighted exchange
rates; index: 1990 = 100.
Source: OECD

Exchange rates



Growing concern over inflation in the UK

In the UK, the Bank of England successively lowered its base lending rate in the first half of the year. In October, however, this benchmark rate was lifted slightly owing to buoyant consumer spending and rising inflation expectations.

Inflation successfully combated in Italy

With inflation close to 6% in the fourth quarter of 1995, the Italian central bank continued to pursue its restrictive monetary policy for the time being. As the year progressed, however, inflation eased steadily while the lira strengthened, thus permitting a substantial lowering of the discount and Lombard rates in the second half.

Sharp rise in the dollar

The US dollar appreciated sharply during 1996. Its rise was interrupted only briefly when share prices on Wall Street dipped in the third quarter. Over the course of the year, the dollar rose by 11.8% against the yen, by 7.7% against the D-mark and by 14% against the Swiss franc. In real, trade-weighted terms, the dollar was 2.8% higher in December than it had been a year before.

D-mark declines

The D-mark lost ground slightly against most other currencies. Over the year as a whole it dropped by 1.9% against the French franc but rose 5.9% against the Swiss franc. In December, the real, trade-weighted value of the D-mark was 3.9% below the level of a year earlier.

Calm in the EMS

Within the exchange rate mechanism (ERM) of the EMS, the spread between the strongest and weakest currency narrowed from 6% in January to 2% in October. The peseta, the guilder and the Irish punt each had a spell at the top of the currency grid. In November and December, the spread widened considerably again owing to a sharp rise in the punt.

ERM expanded

In October the ERM was expanded to include the Finnish mark. Moreover, the lira returned to the mechanism in November after having dropped out in September 1992.

1.3 Fiscal policy

Major industrial countries still applying tight budget policies

In contrast to monetary policy, most of the major industrial countries maintained a tight budgetary stance in 1996. In the EU in particular, governments – mindful of the 1999 deadline for economic and monetary union – accorded top priority to putting their public finances in order. Owing to the cooler economic climate, however, the government deficits of many EU countries grew in relation to GDP.

Deficits falling in the USA and the UK but growing in Japan

Budget deficits in the USA and the UK shrank owing to the abundant inflow of tax revenues. At $ 107 billion, or 1.4% of GDP, the federal deficit in the United States was below budget. The government's target is to balance the federal budget by the year 2002. The UK budget deficit narrowed to 3.4% of GDP. By contrast, Japan's deficit for the 1996-97 fiscal year rose to 4.4% of GDP owing to the government's large-scale programmes aimed at revitalising the economy. While the American deficit will probably increase again owing to the expected slower economic growth in the USA, the deficit in Japan should shrink significantly in fiscal 1997-98. The Japanese government is planning an increase in value added tax to ease the public authorities' financial situation.

USA

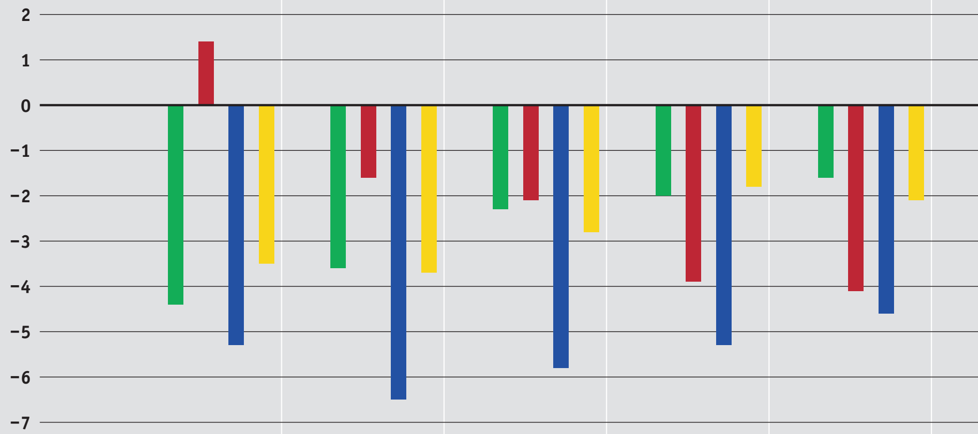
Japan

European Union

Switzerland

Public-sector budget balances
(all levels of government
including social insurance)
in percent of GDP.
1996: budget forecasts.
Source: OECD

Public-sector budget balances



USA

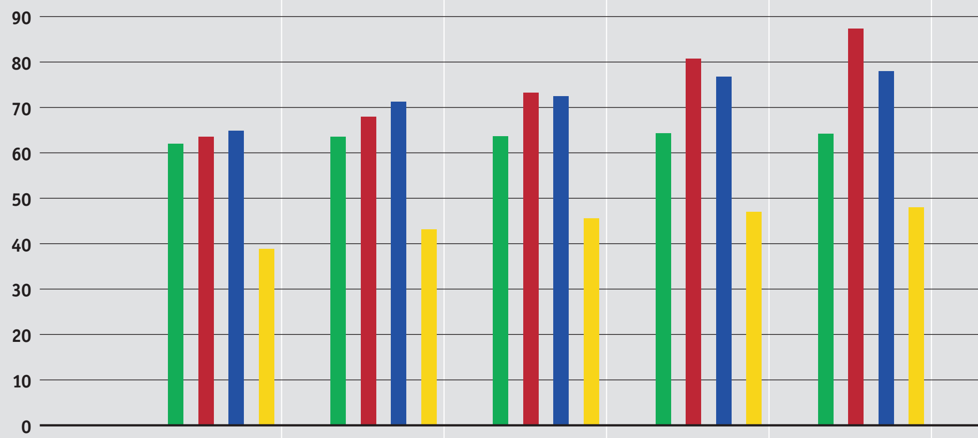
Japan

European Union

Switzerland

Aggregate public-sector
debt (all levels of government
including social insurance)
in percent of GDP.
1996: budget forecasts.
Source: OECD

Debts



Slowdown-induced worsening of public finances in Germany and Italy, improvement in France

In Germany, contracting tax revenues and higher outlays on welfare benefits pushed the budget deficit up to 3.5% of GDP. Italy also witnessed a rise in its deficit, whereas France saw a considerable improvement from the previous year.

Belt tightening throughout Europe in 1997

The fiscal programmes announced for 1997 indicate that European governments will be continuing to keep a tight rein on their budgets. In Germany, expenditure is to be cut by 2.5% in order to bring the budget deficit within the 3% ceiling stipulated in the Maastricht Treaty. For the same reason, France has frozen nominal spending, and government revenues are to be augmented by taking over the pension fund of a corporation which is to be privatised. Italy has taken steps to cut its deficit by addressing both revenues and expenditures. The British government plans to meet the Maastricht target figure despite its planned tax cuts.

1.4 Financial markets

Easing of interest rates in second half of year

In most OECD countries, long-term interest rates rose appreciably in the first half of 1996. The upturn was particularly marked in the United States owing to the economic expansion. Interest rates in Europe and Japan initially rose in step with the American increase, though with economic growth muted and little inflation anticipated, they fell back again by the end of the year. The yield gap between the D-mark and most other EU currencies narrowed significantly, partly because EMU is now given a much better chance of materialising.

Share prices advance

Share prices rose on most markets, with particularly big gains being recorded in the USA. Germany and France also enjoyed a boom year for equities, though in France prices started to soar mainly in the latter part of the year. By contrast, Japanese stocks were hit by the country's persistent economic and structural problems, and advances in the first half turned into losses later in the year.

Rising volume of new issues on the international financial markets

Borrowing on the international financial markets totalled $ 1,572 billion in 1996, compared with $ 1,284 billion in the previous year. The volume of bond issues rose at a particularly impressive rate. Convertible and warrant issues as well as floating-rate paper gained in popularity at the expense of fixed-interest securities – a shift that can be ascribed partly to the stock market boom and partly to uncertainty about the future course of interest rates. Issuing programmes for notes also became busier, whereas the volume of syndicated loans remained at the previous year's levels. Helped by the bull market for equities, the number of share flotations increased substantially. The dollar, the French franc and the pound sterling all gained market shares as issuing currencies. The D-mark and the lira maintained their shares while the importance of the yen, Swiss franc and Ecu receded.

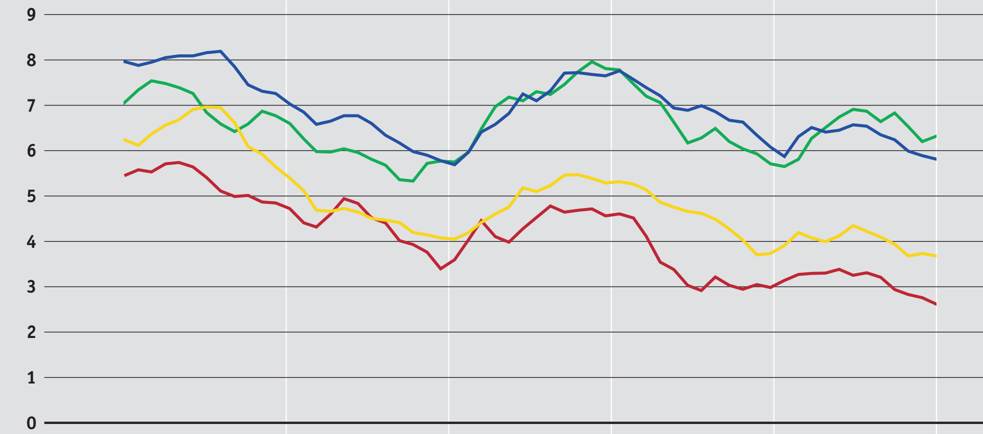
US bank profits up

1996 saw a further rise in US bank profits. This was due, on the one hand, to an increase in net interest earnings – resulting from high levels of lending – and, on the other, to buoyant trading income. At the same time, most banks increased their provisions for doubtful loans. The intended reform of the Glass-Steagall Act, which forms the basis of the two-tier system of banking in the

Dollar
Yen
D-mark
Swiss franc

Long-term government bonds,
in percent.
Source: BIS

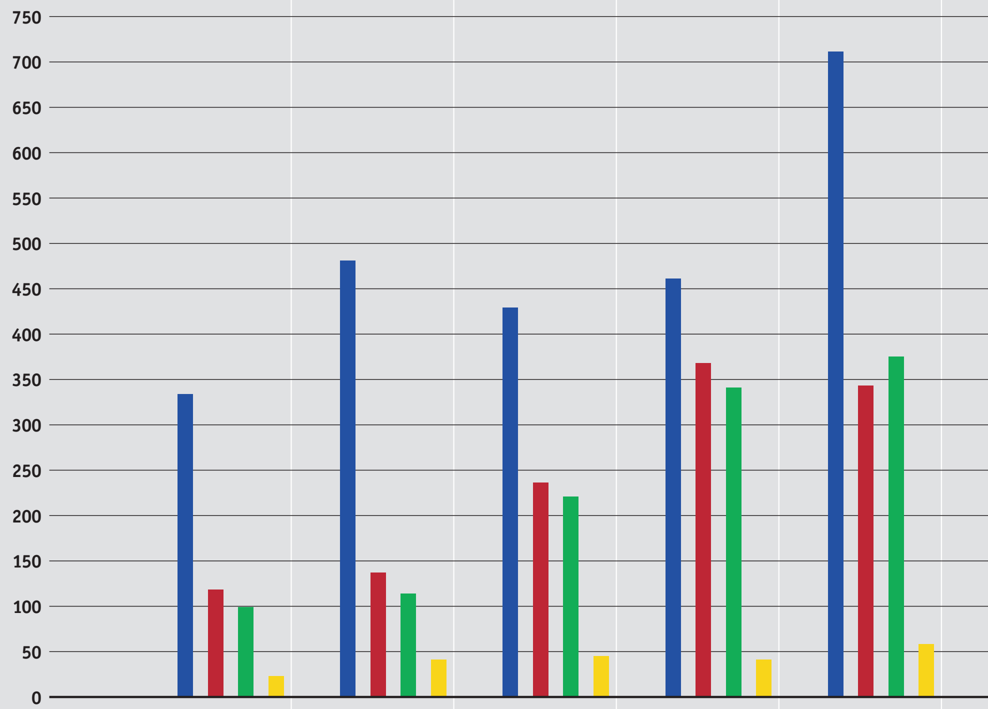
Long-term interest rates



Bonds
Bank loans
Medium-term paper
Shares

Billions of dollars.
Source: BIS

Borrowing in the international financial markets



United States, did not materialise. As a result, the US monetary authorities have submitted new proposals which envisage giving the savings and loan banks access to securities trading.

Japanese banks still struggling

Despite a slight improvement in profitability, the Japanese banks were still beset by problems. Following a thorough restructuring of their balance sheets in the previous year, the big lending institutions reduced their allocations to provisions slightly; in the rest of the banking sector, however, provisions were increased again. As part of a government restructuring programme, two companies were founded for liquidating the assets of insolvent real estate companies and credit unions. In addition, the government announced deregulation plans aimed at improving the competitiveness of Japan's financial sector.

Improved position of Western European banks

The profitability of the banking sector in most Western European countries improved. The banks benefited from the stock market boom and lower provisioning requirements for doubtful loans. Owing to slack demand for loans, however, net interest earnings were flat in some countries. In France and Italy two large banking houses ran into difficulties and, with the help of public-sector funds, underwent state-organised restructuring.

Harmonisation of EU's financial sector continues

The EU continued its efforts to harmonise the financial sector. The European Parliament and the Council issued a directive extending the recognition of contractual netting in the calculation of capital adequacy requirements. In addition, the Commission submitted new proposals for directives on the finality of settlements and the provision of security in payment systems, as well as on the enhanced exchange of information with nonbank supervisory authorities in non-EU countries.

1.5 European monetary integration

Progress in various areas in the EU

The European Union continued to prepare for the introduction of a single European currency, the euro. The monetary policy of the future European Central Bank (ECB) began to take on concrete form, and the exchange rate system between the EMU participants and those EU member states which will not be included in the monetary union from the start was defined. Moreover, a stability and growth pact was signed by the EU nations.

Monetary policy concept

The European Monetary Institute proposed that the ECB's monetary policy should be oriented either to a money supply or an inflation target. Open-market transactions are to be the main instrument of monetary policy. The ECB will also have the option of issuing regulations on minimum reserves if necessary.

Exchange rate system

The European Council reached agreement on the new exchange rate system which is to link the EU member states within and outside the euro currency area after the implementation of EMU. The euro will be the lead currency in this system. Exchange rate parities will be fixed by agreement with all countries and institutions involved, notably the ECB. Exchange rates will be allowed to fluctuate around these parities by a relatively wide margin. If a currency reaches the lower edge of its band, all participants are in principle obliged to intervene automatically and to an unlimited extent in support of the currency concerned. Such intervention may be suspended, however, if it jeopardises the prime objective of the European System of Central Banks – price stability.

Stability and growth pact

The pact on stability and growth seeks to ensure that all countries participating in EMU continue to pursue stability-oriented fiscal policies even after the introduction of a joint monetary policy. The pact requires these countries to keep their budget deficits permanently below 3% of GDP. They will be allowed to exceed this figure only in exceptional situations, for instance in a severe recession (i.e. where real GDP declines by more than 2% within a year). If a country's deficit becomes excessive, it will be obliged to set up a precisely defined programme of measures according to a specified timetable. The country concerned will initially have the option of eliminating the deficit within a given time-span. If it fails to do so, it will be obliged to put down a non-interest-bearing deposit which will be converted into a fine if the excessive deficit persists beyond a specified period.

2 Switzerland

2.1 Real economic performance

Slight decline in real GDP

The economic situation in Switzerland deteriorated in 1996. Real GDP declined by 0.7% after having remained flat in the previous year. The recession may be attributed to structural as well as cyclical factors. In the domestic economy, the construction industry's crisis persisted while the industrial and service sectors continued to undergo a process of structural change. The associated job losses dampened consumer sentiment. At the same time, the public sector continued to implement austerity measures. With the franc remaining strong until mid-year, and also because of weak economic performance in the EU, export growth fell off. Despite sluggish domestic demand, imports increased slightly.

Decline in industrial output and capacity utilisation

Low levels of demand at home and abroad, coupled with attempts to reduce excessive inventory levels, caused a downturn in industrial output. Capacity utilisation dropped from 85.1% at the end of 1995 to 83.5% at the end of 1996. While some export-oriented industries – notably the chemicals sector – managed to improve capacity utilisation slightly in the course of the year, the corresponding figures for building-related and metals industries declined sharply.

Consumer spending flat

Following an 0.7% rise in 1995, consumer spending – at 0.3% – only showed a slight increase in the year under review. The stagnation was due in large part to a decline in real disposable income. In addition, purchasing power was undermined by the massive increase in health insurance premiums, and rising unemployment had negative repercussions on consumer sentiment. In real terms, retail sales declined markedly. Turnover in the tourist industry also fell. By contrast, spending by Swiss tourists abroad continued to rise.

Investment spending levels off

The growth of investment in plant and equipment decelerated to 1.3% in 1996. While investment in machinery and equipment rose appreciably, building investment continued to decline.

Strong demand for capital goods

Despite the drop in capacity utilisation, investment in machinery and equipment soared by 8.4%, though falling short of the previous year's rise of 14.1%. Competitive pressure triggered further outlays on modernisation and rationalisation. Investment activity was boosted by the continuing reduction in the prices of imported capital goods.

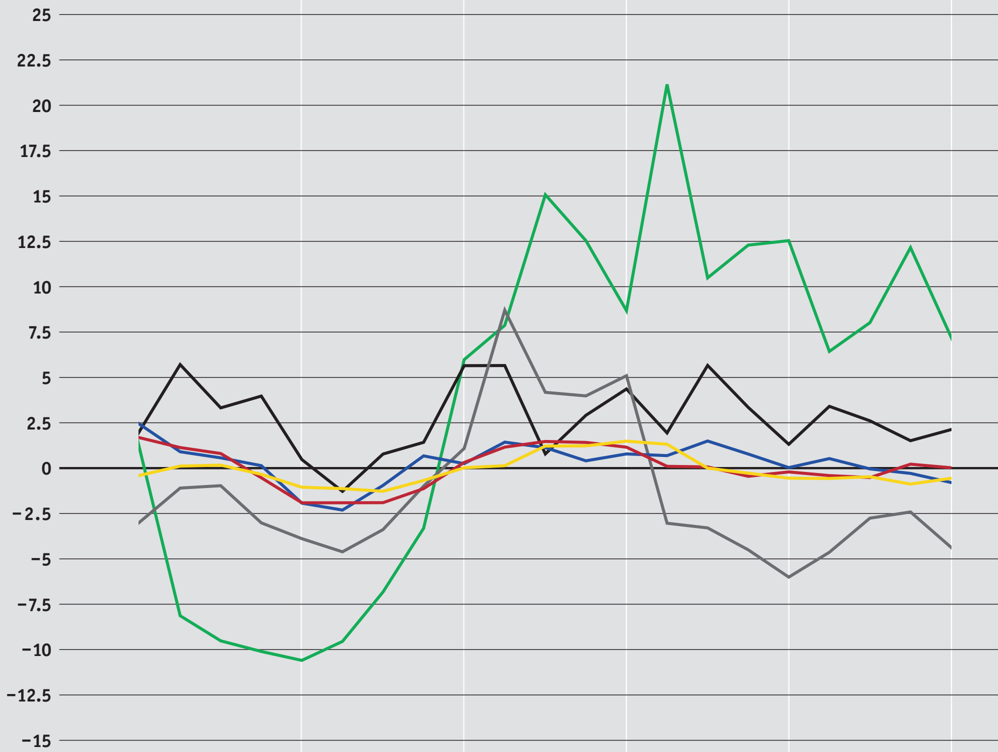
Building industry crisis continues

Building investments continued their decline, falling by 3.5% in the year under review after a drop of 4.3% in 1995. Residential construction fell off sharply owing to lack of demand. With public authorities continuing their drive at fiscal consolidation, government spending on construction projects was also cut drastically. On the other hand, commercial and industrial construction stabilised after having dwindled to a low level over the preceding years.

Lower growth in exports…

Export growth – and particularly shipments to Germany and France – fell off markedly. Overall, real merchandise exports grew by 2.1%, compared with a rise of 4.2% in 1995. Weaker growth in foreign demand for capital goods was largely responsible for the slowdown in the growth of exports. The volume of consumer goods, raw materials and semifinished goods exported barely increased at all.

Gross domestic product and its components



Real GDP

Private consumption expenditure

Government consumption expenditure

Building investment

Machinery and equipment investment

Exports

Change from previous year
in percent.
Source: Federal Office
for Economic Policy

…and imports

Owing to the decline in domestic economic activity, real growth in imports, at 1.5%, was also lower than in 1995 (+6.5%). The fall-off in imports of raw materials and semifinished goods reflected the decline in Switzerland's industrial output. Imports of capital goods grew less rapidly than in the previous year. By contrast, the growth rate in consumer goods imports was higher despite muted consumer sentiment.

Further decline in employment

Employment shrank by an average of 0.9% in 1996 after an 0.8% drop in the previous year. In the services sector, the number of employed persons remained stable while above-average job losses were registered in the construction sector and in manufacturing. The trend observable since mid-1990 thus continued. In six years, the proportion of the labour force employed in industry dropped from 26.3% to 23.7% while the percentage working in construction fell from 10.3% to 9.8%.

Rising unemployment

After having fallen until October 1995, the unemployment rate rose again in 1996, reaching a seasonally-adjusted 5.3% in December. At 7.1%, unemployment in French-speaking and Italian-speaking Switzerland was significantly higher than in the German-speaking areas, where the rate was 4.5%. Non-Swiss citizens accounted for 45% of unemployment, as against about 25% of the total population. Probably because of the larger number of layoffs, there was only a small increase in short-time working.

Employment and unemployment

	1992	1993	1994	1995	1996
Full-time employment change in percent	[1]	−3.4	−2.2	−1.3	−1.2
Full- and part-time employment change in percent	−2.6	−2.8	−1.8	−0.8	−0.9
Unemployment rate in percent	2.6	4.5	4.7	4.2	4.7
Number of unemployed thousands	92.3	163.1	171.0	153.3	168.6
Short-time working thousands	34.0	42.0	22.6	9.9	13.1
"Manpower" job offer index change in percent	−38.2	−27.7	27.2	18.4	−19.1

1 Figure cannot be calculated

Data not seasonally-adjusted, annual averages.
"Manpower" job offer index: total area of job advertisements in Swiss newspapers.
Sources: Federal Office for Industry and Labour, Federal Statistics Office, "Manpower"

Survey reveals slight growth in employment

According to the 'SAKE' survey of the Swiss labour force carried out in the second quarter of 1996, the number of persons in employment (including foreign nationals with seasonal or cross-border commuting permits) increased by 0.5%. The total, however, was still 2.9% below the 1991 level. In contrast to the employment index described above, this data also includes part-time jobs amounting to less than 50% of a full working week. The increase in the total figure is attributable to this category. The number of persons in full-time employment remained unchanged and the number of part-time employees working more than 50% declined by 2.1%. The number of men in employment decreased by 0.8% while the number of women increased by 2.3%. The latter rise is accounted for mainly by the services sector, which provides a large number of part-time jobs. The number of employed foreign nationals declined by 1% while the number of Swiss in employment increased by 1%. The percentage of the potential labour force without gainful employment climbed from 3.2% to 3.7% during the year under review; the figure for women (4.4%) was substantially higher than that for men (3.3%).

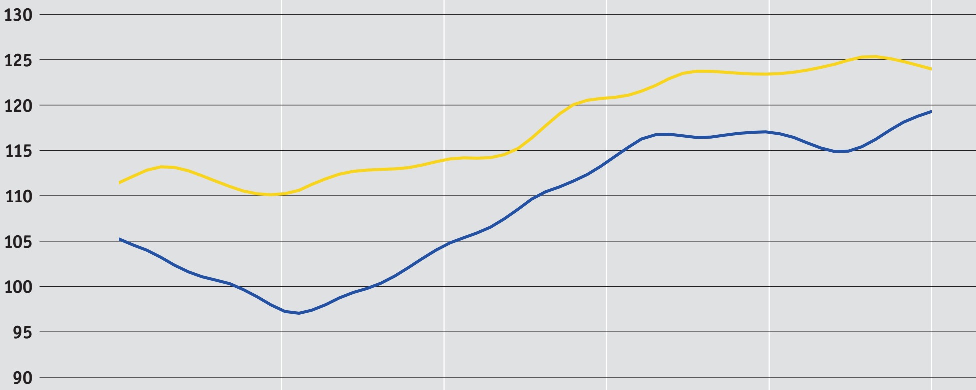
1992 1993 1994 1995 1996

Imports

Exports

Volume, adjusted for seasonal and exceptional factors.
Index: 1988 = 100.
Source: General Directorate of Customs

Foreign trade



Consumer prices

Consumer prices for domestic goods

Consumer prices for imported goods

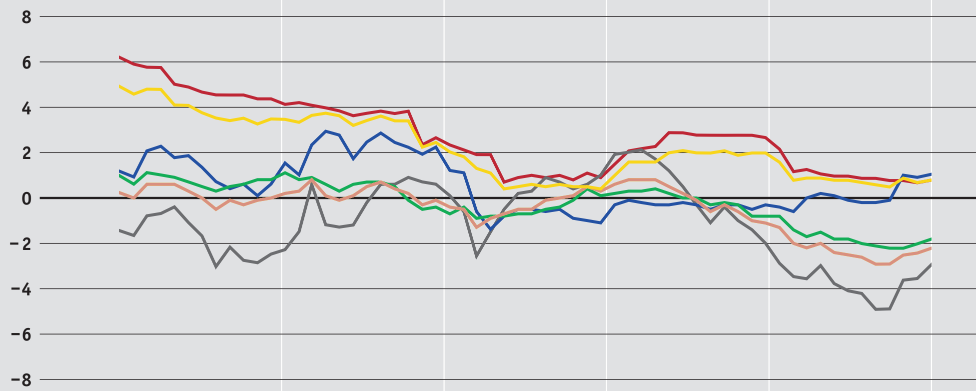
Producer and import prices

Producer prices

Import prices

Percent change from previous year.
Source: Federal Statistics Office

Price trends



Nominal

Real

Wage and salary earnings of employed persons;
percent change from previous year (1996: estimate).
Source: Federal Department of Economic Affairs

Wages and salaries

1992 1993 1994 1995 1996

Steady fall in inflation

Inflation, as measured by the national consumer price index, fell steadily during 1996. By December it had dropped to 0.8%, compared with 1.6% in January. The average rate for the year was 0.8%.

Goods prices remain stable – inflation in services sector declines

Prices of goods remained stable throughout the year, whereas inflation in services declined from 2.7% in January to 0.7% in December. In both the private and public sectors, price rises were less pronounced than in 1995, when the introduction of value added tax (VAT) had resulted in an average 3% rise in charges for services. Imported goods and services became somewhat more expensive during the year as the franc depreciated; prices of goods and services produced in Switzerland edged up by 1%.

Producer and import prices fall sharply

The producer and import price index receded by 2.4%. Producer prices fell for the third year in succession, this time by 1.8%. Prices of raw materials and semifinished goods showed the steepest falls. The import price index declined by 3.7% whereas in 1995 it had remained virtually unchanged.

Stable current account surplus

Switzerland's current account surplus rose by Sfr 0.1 billion in 1996 to Sfr 25.1 billion, which corresponds to 6.9% of nominal gross domestic product. The trade surplus (special trade) widened somewhat to Sfr 1.9 billion and the surplus from services increased to Sfr 15 billion. While the banks' commissions income rose sharply owing to the stock market boom in the first half of the year, revenues in the tourist industry declined. The surplus from employee compensation and invested capital rose slightly to Sfr 14 billion. By contrast, current transfers again produced a deficit of Sfr 4.9 billion.

Current external transactions account balances in billions of Swiss francs

	1992	**1993**	**1994**	**1995** revised	**1996** preliminary
Goods trade	−1.4	2.4	2.2	1.0	1.0
of which special trade	−0.2	3.5	3.2	1.8	1.9
Services trade	15.1	16.8	16.1	14.9	15.0
of which personal travel	2.8	2.4	2.7	2.1	1.2
Employee compensation and investment income	11.7	13.5	10.8	13.9	14.0
of which investment income	19.2	20.7	17.7	20.8	20.9
Current transfers	−4.2	−4.0	−4.7	−4.9	−4.9
Total current account	21.3	28.8	24.4	25.0	25.1

2.2 Fiscal policy

Federal deficit higher than budgeted

In 1996, the federal budget deficit (excluding the pension fund surplus) amounted to Sfr 5.4 billion or 1.5% of GDP. It was thus Sfr 1 billion higher than in the previous year and Sfr 0.4 billion over the budget figure. The Confederation's rapidly growing contributions to the cantons' current spending were a major expense item. On the income side, VAT revenues exceeded the budget figure, whereas the growth in direct federal tax revenues was lower than expected. Repayments from loans granted to the unemployment insurance scheme fell considerably short of the 1995 figure. The 1997 budget anticipates a deficit of Sfr 5.8 billion, or 1.5% of GDP.

Mixed trends in cantonal and communal deficits

According to available preliminary data, the cantons' aggregate budget deficit grew again in 1996 for the first time in two years and will probably even exceed the budgeted Sfr 2.6 billion by Sfr 0.5 billion. The worsening financial situation is due mainly to mounting welfare expenditures, notably further loans to the unemployment insurance schemes. On the other hand, higher-than-expected savings were achieved in the personnel area. Revenues stagnated or even declined slightly. In contrast to the cantons, the communes on the whole managed to improve their financial situation. Their aggregate deficit will probably be less than Sfr 1 billion.

Rising indebtedness

The debt ratio (government debt as a percentage of GDP) for the Confederation, cantons and communes rose from 47% to 48% (the figure was 31% in 1990). Almost half this debt was accounted for by the Federal Government, about 30% by the cantons and 20% by the communes.

2.3 Financial markets

Slide in capital and money market rates

Following a steep decline in long-term interest rates in 1995, the average yields on federal bonds rose appreciably in the first half of 1996. They receded again in the second half, however, and by December they had dropped to 3.7% – equal to their end-1995 level. Short-term rates followed a similar, though somewhat more pronounced, pattern. The yield on three-month money market debt register claims issued by the Confederation rose by 1.1 percentage points to 2.5% in mid-year, but subsequently declined to 1.7% by the end of the year. The yield curve remained steep.

Swiss franc weakens

Early in 1996, the Swiss franc stabilised after having advanced steadily ever since the beginning of 1993. By December 1996, the franc had depreciated by almost 10% in real, export-weighted terms compared with a rise totalling nearly 9% in the two preceding years. The franc's decline in real terms was particularly marked against the pound sterling (-20%), the lira (-17.1%) and the dollar (-14.6%), whereas it lost only 5.6% against the D-mark.

Lower level of capital market borrowing

Net borrowing on the Swiss capital market (i.e. the gross volume of bond issues less redemptions) declined sharply. The net uptake of capital by domestic borrowers amounted to just Sfr 0.6 billion compared with Sfr 9.8 billion in 1995. Whereas the gross volume of issues was within the normal range, redemptions were far higher than in the previous year. At Sfr 18.4 billion, net borrowing by foreign bond issuers was also far lower than in 1995. On the Swiss equity market, redemptions exceeded new issues by Sfr 0.1 billion, compared with a net result of Sfr 1.1 billion in the previous year.

Share prices rise

The Swiss Performance Index of the stock market climbed by 18% in 1996 after already having increased by 23% in 1995. The rise was due in large part to the share quotations of a number of multinational corporations.

Banks continue to restructure

In 1996 the big banks made massive increases in their provisions. They also announced a radical restructuring of their domestic business and the closure of a large number of branch offices. The planned measures will probably result in substantial job losses in the banking sector. As in the previous year, several regional banks were acquired by one of the big banks or by cantonal banks while others merged to form groups. Two of the cantonal banks established the legal basis for becoming public limited companies.

Expansion of 'Allfinanz'

The banks expanded their activities in the field of 'Allfinanz', i.e. combined banking and insurance services. Several banks began selling insurance policies (primarily life assurance) under their own names, while many others concluded cooperation agreements with insurance companies.

Uneven growth in balance sheets

The aggregate balance sheet total of the Swiss banks grew by 14% in 1996. Owing partly to acquisitions, the regional and cantonal banks' share of this total fell while that of the big banks rose. The cantonal banks' aggregate balance sheet total increased by 2.7%. While the interbank business conducted by these institutions expanded vigorously, loans and deposits saw little growth. The balance sheet totals of the big banks (which also saw rapid growth in interbank business) rose by 19%. Overall, gross financial assets, which comprise liquid assets, amounts due from banks, bills of exchange, money market paper and securities increased by a third within the reporting year. Compared with the regional and cantonal banks, the big banks attracted a disproportionately

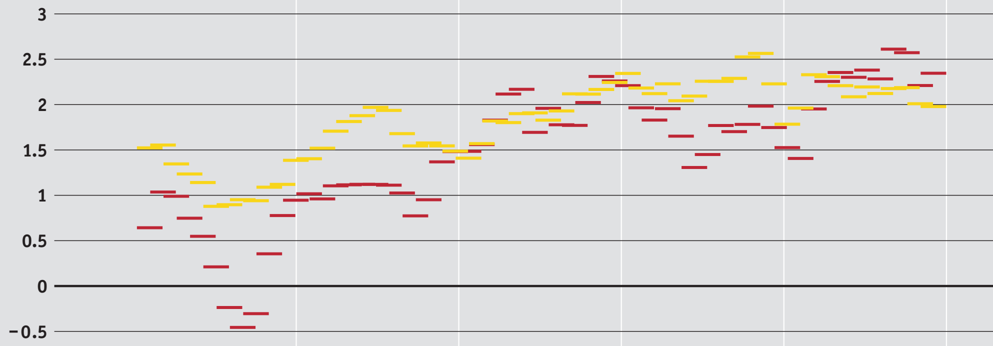
1992 1993 1994 1995 1996

Spreads for long-term interest rates

Germany – Switzerland

United States – Switzerland

Spread in
percentage points.
Source: BIS



Swiss franc exchange rates

Total (15 countries)

Dollar

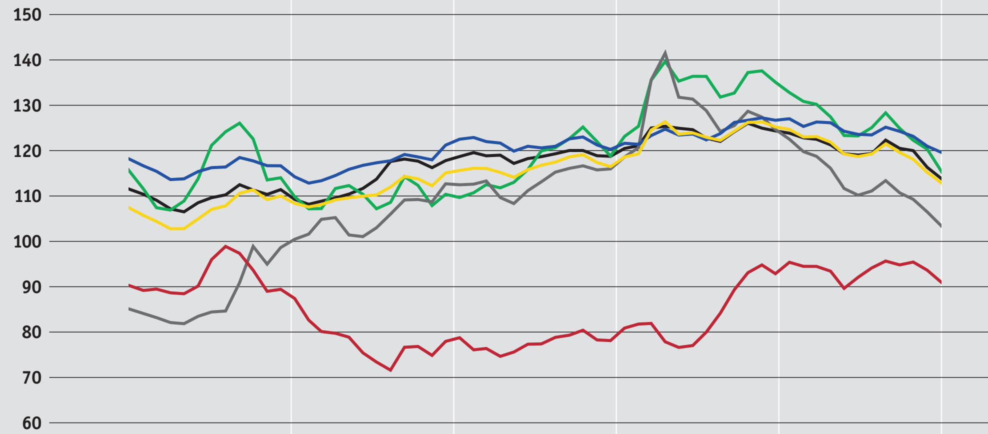
D-mark

Yen

French franc

Lira

Real value of the Swiss
franc in foreign currencies.
Total: export-weighted and
consumer-price deflated.
Index: November 1977 = 100



Public-sector debt

Communes

Cantons

Confederation

In percent of GDP.
Source: Federal Department
of Economic Affairs

1992 1993 1994 1995 1996

large volume of customer deposits; domestic lending business, however, was muted.

Stock market trading goes electronic

In 1996, the open-outcry method of stock market trading was superseded by an electronic system. When fully electronic trading began in August, the Swiss Exchange (SWX) was connected up to the SECOM securities management and settlement system operated by the Swiss securities clearing organisation SEGA. The Swiss Interbank Clearing (SIC) system had already been linked up to SECOM in the previous year. The interlinked SWX, SECOM and SIC systems now provide an integrated electronic platform for securities trading and settlement.

Selected bank interest rates

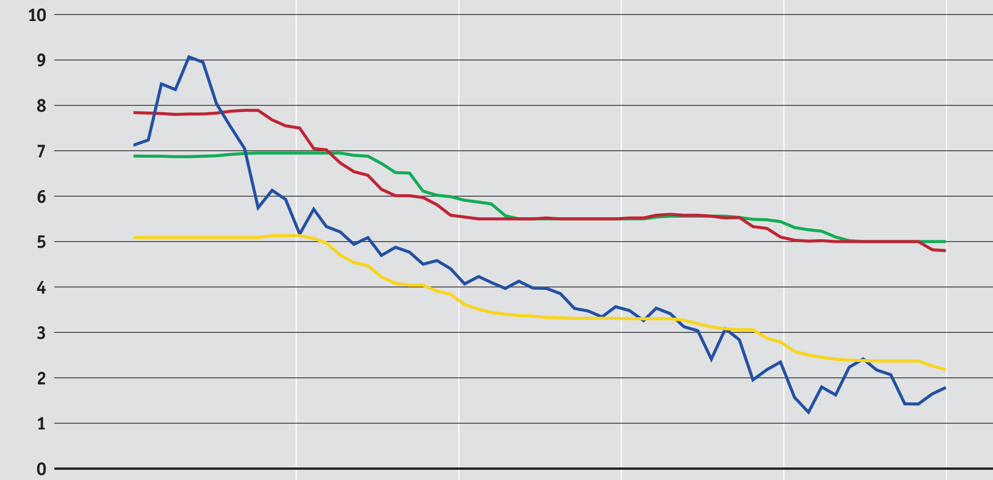
Existing mortgages
at cantonal banks

New mortgages
at cantonal banks

Savings deposits
at cantonal banks

Three-month time deposits
at big banks

Quarterly averages
in percent



Share prices

Total

Banks

Industry

Swiss Performance Index.
Source: Swiss Exchange