Review of economic developments

1 International developments

1.1 Development of the real economy

End of economic boom

The economy witnessed a marked worldwide slowdown in the course of 2001. The cooling trend started in the US in the summer of 2000 and began to spill over into Europe, Asia and Latin America in 2001. Significantly higher oil prices in the previous years and the crisis that hit the technology sector in the fall of 2000 were a considerable burden for most industrial countries. Another factor contributing to the economic slowdown was the central banks' tightening of monetary policy in 2000 to counter the threatening signs of overheating. This had a particularly adverse effect on investment activity, which had supported the recovery in the preceding years. The unfavourable development and the resultant deteriorating profit expectations sent equity prices on a downward spiral.

Terrorist attacks in the US

The terrorist attacks of 11 September in New York and Washington not only hit the United States but also had grave consequences for the rest of the world. Air traffic and tourism in particular suffered massive losses. As a result of dwindling consumer confidence, private consumption, which had so far supported the economy, slowed down. In the second half of the year, real gross domestic product (GDP) contracted in the United States, growth in Europe came to a standstill, and the economic crisis in Japan deepened.

Stagnating world trade

The economic downturn put a considerable damper on world trade. According to an estimate of the Organisation for Economic Cooperation and Development (OECD), the volume of international trade stagnated in 2001 after still having grown by nearly 13% a year earlier. Trade between the OECD countries diminished, while it advanced slightly outside the OECD.

Subsiding inflation – easing of monetary policy

In most industrial countries, the cooling of the economy went in tandem with subsiding inflation. Receding inflationary pressure made it possible for central banks to loosen their monetary reins. The Fed's key interest rate cuts were particularly drastic.

Sharp decline of US economy

The economic downturn was especially marked in the United States. Real GDP grew by only 1.2% in 2001 compared with an increase of 4.1% in the previous year. Declining corporate investment and fewer exports were the main culprits for the slowdown. In the second half of the year, private consumption also failed to provide any noticeable stimulus. Industrial production fell off, and in the fourth quarter, capacity utilisation dropped significantly below the level it had reached during the last recession in 1991.

Slowdown in the euro area

During the course of the year, the cyclical decline also took hold of the economies of the euro area. Export activity lost momentum, and domestic demand increasingly suffered from eroding consumer confidence. The second half of the year saw a stagnation of economic activity in the euro area. Over the year, average growth of real GDP was 1.2% compared with 3.5% in the previous year. Germany recorded the lowest growth rate (0.6%), Ireland the highest (5.6%). At 2.0% and 1.8% respectively, economic growth was above average in France and in Italy.

UK economy remains favourable

Unlike in the United States and the euro area, the economic situation in the UK remained favourable. Even though investment and exports lost momentum, consumption remained more robust than in most other industrial countries. Real GDP increased by 2.3% compared with 2.9% in the previous year.

Recession in Japan

The Japanese economy was pushed into recession again in 2001. In addition to the deteriorating global economic environment, notorious structural problems put pressure on the economy. Real GDP fell by 0.5%, after an increase of 2.4% a year earlier.

Rise in unemployment

The weak global economy had a deep impact on labour markets. Employment only registered moderate increases in most industrial countries, and in Japan it was on the decline. As a result, jobless numbers climbed in most industrial countries, with the US and Japan experiencing an especially steep rise. At 5.8%, unemployment in the United States in December was nearly 2 percentage points above the previous year's figure; in Japan it exceeded the 5% mark in the second half-year for the first time since the early 1950s. In the euro area, the unemployment rate moved up in autumn as well, yet at 8.5% – averaged over the year – remained half a percentage point below the previous year's figure. Germany saw a particularly strong rise in unemployment. In the United Kingdom, too, the jobless rate rose slightly, i.e. to 5.3% until December, yet it remained below the previous year's level.

Receding inflation

After still having risen in the first half of the year, consumer price inflation in the OECD countries softened in the second half of the year. The decline was mainly attributable to falling oil prices. In December, a barrel of Brent crude oil traded at just under 19 dollars on the international market, i.e. roughly a third less than in the previous year. At year-end, consumer price inflation in the United States was 1.6% after having stood at an average of 3.4% during the first half-year. In the euro area, it advanced to a high of 3.4% until May and subsequently fell off continuously to a level of 2.1% in December. In the United Kingdom, by contrast, inflation held steady slightly above 3% during the entire year. In Japan, consumer prices declined, as had been the case already in the previous years. The drop became more pronounced, from 0.3% in January to 1.2% in December.

Converging current accounts

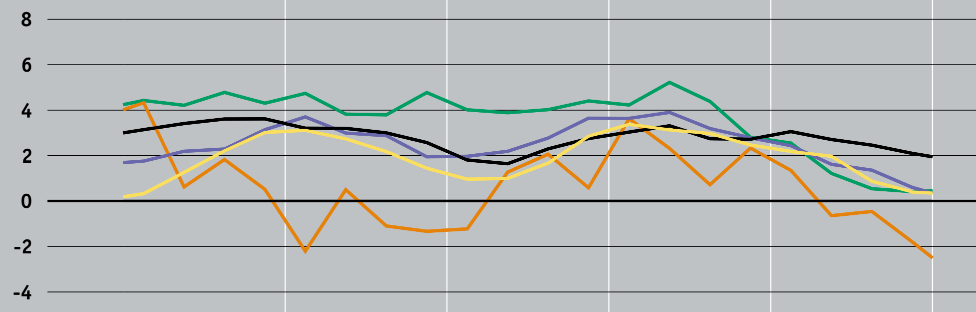
As a result of the economic slowdown and sinking oil prices, current account deficits receded in many industrial countries. In 2001, the OECD countries on average recorded a current account deficit of an estimated 1.2% of GDP compared with 1.3% a year earlier. The deficit decreased particularly sharply in the United States, dropping from 4.5% to 4.1%, while the current account in the euro area – after a small deficit in the previous year – was balanced again. In Japan, a softer foreign demand resulted in a smaller current account surplus, diminishing from 2.5% to 2.1% of GDP. In absolute figures, the deficit in the United States amounted to roughly 414 billion dollars, the surplus in Japan to 87 billion dollars.

1997 1998 1999 2000 2001

Real gross domestic product

United States
Japan
Euro area
United Kingdom
Switzerland

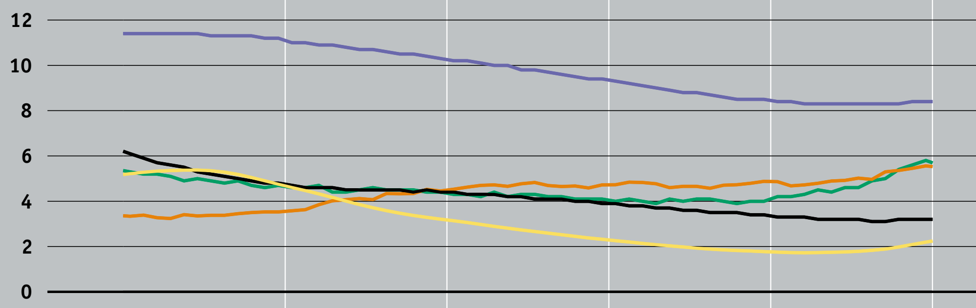
Change from previous year in percent.
Source: OECD



Unemployment

United States
Japan
Euro area
United Kingdom
Switzerland

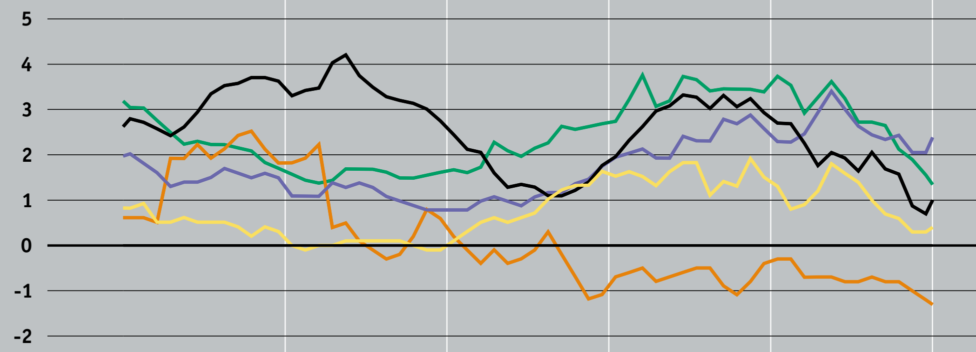
Seasonally-adjusted; in percent.
Source: OECD



Inflation

United States
Japan
Euro area
United Kingdom
Switzerland

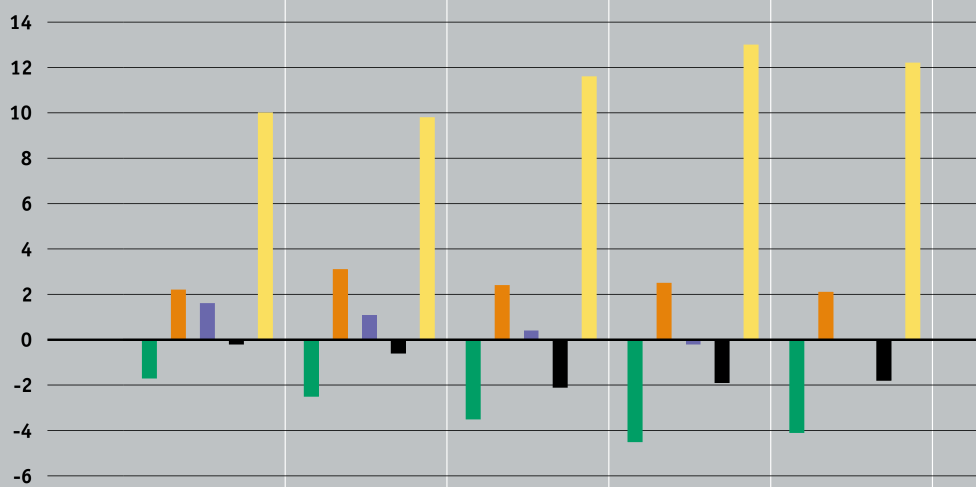
In percent.
Source: OECD



Current account balance

United States
Japan
Euro area
United Kingdom
Switzerland

Net balance in percent of GDP.
Source: OECD



1997 1998 1999 2000 2001

Summary of economic development

	1997	1998	1999	2000	2001
Real GDP Change from previous year in percent					
United States	4.4	4.3	4.1	4.1	1.2
Japan	1.8	−1.1	0.7	2.4	−0.5
Euro area	2.3	2.9	2.7	3.5	1.2
Germany	1.4	2.0	1.8	3.0	0.6
France	1.9	3.5	3.0	3.6	2.0
Italy	2.0	1.8	1.6	2.9	1.8
United Kingdom	3.4	3.0	2.1	2.9	2.3
Switzerland	1.7	2.4	1.6	3.0	1.3
Unemployment in percent					
United States	4.9	4.5	4.2	4.0	4.8
Japan	3.4	4.1	4.7	4.7	5.0
Euro area	11.4	10.8	9.9	8.9	8.5
Germany	9.4	8.9	8.2	7.5	7.5
France	12.2	11.6	10.9	9.5	8.9
Italy	11.8	11.9	11.5	10.7	10.0
United Kingdom	6.5	5.9	6.0	5.5	5.1
Switzerland	5.2	3.9	2.7	2.0	1.9
Consumer price inflation in percent					
United States	2.3	1.6	2.2	3.4	3.0
Japan	1.7	0.7	−0.4	−0.7	−0.7
Euro area	2.0	1.7	1.2	2.4	2.7
Germany	1.5	0.6	0.6	2.1	2.5
France	1.3	0.7	0.6	1.8	1.9
Italy	1.8	1.7	1.6	2.5	2.7
United Kingdom	3.1	3.4	1.6	2.9	3.1
Switzerland	0.5	0.0	0.8	1.6	1.0
Current account balance in percent of GDP					
United States	−1.7	−2.5	−3.5	−4.5	−4.1
Japan	2.2	3.1	2.4	2.5	2.1
Euro area	1.6	1.1	0.4	−0.2	0.0
Germany	−0.1	−0.3	−1.0	−1.0	−0.7
France	2,7	2,7	2,5	1,6	1.6
Italy	2.9	1.9	0.7	−0.4	0.1
United Kingdom	−0.2	−0.6	−2.1	−1.9	−1.8
Switzerland	10.0	9.8	11.6	12.8	9.9

Some 2001 figures are estimates.
Source: OECD

Emerging market economies in Asia also witnessed weaker growth in 2001. In addition to the economic downturn in the industrial countries and higher oil prices in the previous years, the unstable political situation in some countries was a contributing factor as well. The slump in the technology sector had a particularly severe impact on Taiwan, Singapore and Malaysia. In India, however, growth was on the wane mainly as a result of a drought and because the stimulus emanating from a sizeable fiscal package was tapering off. According to available data, China exhibited a favourable economic trend, since vigorous domestic demand compensated for sagging export growth.

Slowdown in the Asian emerging market economies

In most Central and Eastern European countries economic activity began to falter in 2001. While domestic demand generally remained strong, the weaker trend in the industrial countries interfered with exports. In Poland, flagging growth, which was also the result of tighter monetary policy in the previous year, was especially apparent. With inflation easing, the Polish central bank was able to loosen monetary policy again in the course of 2001. By contrast – due to signs of overheating – the central banks of the Czech Republic and Hungary tightened their monetary policy. Unlike most Central and Eastern European countries, Romania and Slovakia witnessed stronger economic growth, which was fuelled by vigorous domestic demand. The economic outlook remained favourable in Bulgaria as well, albeit to a lesser degree than in the previous year.

Weaker growth in Central and Eastern Europe ...

Market conditions in Russia continued to improve. Although real GDP did not climb as sharply as in the previous year, the growth rate (approximately 4% in real terms) was, nevertheless, again above average in an international comparison. Demand was underpinned mostly by real growth of income and tax cuts. The trend towards higher prices basically did level off, but since many administered prices were raised, the inflation rate – at almost 20% – remained at the previous year's level. Economic progress made it possible for the Russian government to repay a part of the government's debt with the IMF before the due date.

... and recovery in Russia

In Turkey, growing economic and political uncertainties led to a currency crisis in February. After the currency was allowed to float, Turkey's lira plummeted and interest rates skyrocketed. In May, the IMF provided approximately 8 billion dollars in additional loans to Turkey after the government had initiated further stabilisation measures. However, the economic situation improved only marginally. The rise in interest rates led to a significant increase in government debt, as well as putting an even greater strain on the already fragile banking system. As a result of the crisis in 2001, real GDP fell by approximately 7% according to estimates.

Economic crisis in Turkey

Slowdown in Latin America – crisis in Argentina

Latin America witnessed a significant slowdown in economic growth in 2001. The Mexican economy particularly felt the effects of the cyclical downturn in the US. In Argentina – in spite of extensive measures to stimulate the economy – the recession, which had been plaguing the country for more than three years, deepened. It thus became even more difficult for Argentina to service its high foreign debt. At the beginning of September, the IMF granted Argentina additional loans in the amount of 8 billion dollars, after sizeable amounts had already been committed at the end of 2000 to help manage a financial crisis. Since the economic situation continued to deteriorate, the new loans were only partially disbursed, however. In December, this deterioration led to serious unrest in the country. Brazil increasingly suffered from the crisis of its neighbour country. Growing uncertainty among foreign investors resulted in a devaluation of the Brazilian currency, forcing the authorities to adopt a more restrictive monetary and fiscal policy. In September, the IMF granted a 15.6 billion dollar loan to support the Brazilian economy.

1.2 Monetary policy

Easing of monetary stance

The central banks of the industrial countries reacted to the economic slowdown by relaxing monetary policy after key interest rates had still been lifted in the previous year. The easing of monetary policy was very aggressive in the United States, while Europe was more cautious in cutting its key rates. With inflation and fears of inflation waning, the decision to trim interest rates was facilitated.

Significant key rate cuts in the US

In the course of 2001, the Fed cut its key interest rate – the rate for overnight funds – in eleven steps from 6.5% to 1.75%. In doing so, it lowered interest rates more swiftly and more markedly than in earlier phases of interest rate cuts. In April, short-term interest rates fell below the corresponding interest rate level in the euro area, and by December, short-term interest rates in the United States had plunged to the lowest level in forty years.

Slower pace of easing monetary policy in the euro area …

The European Central Bank (ECB) lowered its key rate, the rate for the main refinancing operations, only marginally by 0.25 percentage points to 4.5% in the first half of the year, since inflation in the euro area was above the 2% upper limit of the range for price stability as set by the ECB. With inflation subsiding in the second half of the year, the ECB cut the key rate in three steps by another 1.25 percentage points to 3.25%.

… and in the United Kingdom

The Bank of England also eased its monetary policy and lowered the key interest rate in three steps by 0.75 percentage points to 5.25% in the first half-year and by another 1.25 percentage points to 4% in four steps in the second half-year.

Interest rate cuts in Japan

The Japanese central bank increased bank liquidity drastically, causing the interest rate for overnight funds to fall from 0.25% in January to 0.0% in December. It trimmed the discount rate in four steps from 0.5% to 0.1%.

1.3 Fiscal policy

Deteriorating fiscal position

Government budgets in all major industrial countries deteriorated in 2001 compared with the previous year. On the one hand, this was the result of the economic slowdown, which led to lower tax revenues and higher expenses for social welfare. On the other hand, tax relief measures introduced in several countries had a negative impact on the budget. Notably the United States, where the slowdown in growth was particularly pronounced, saw an increase in government spending and tax cuts. Notwithstanding mounting deficits, government debt – expressed as a percentage of GDP – diminished in many countries.

US and UK continue to post a surplus

Government budgets in the United States and the United Kingdom again showed a surplus, yet it was more modest in both countries than in the previous year. While it fell markedly from 1.7% to 0.6% of GDP in the United States, the drop was less significant in the UK – down to 1.1% from 1.9%. Government debt receded from 59% to 58% of GDP in the United States, and in the UK from 54% to 52%.

Sustained deficits in the euro area

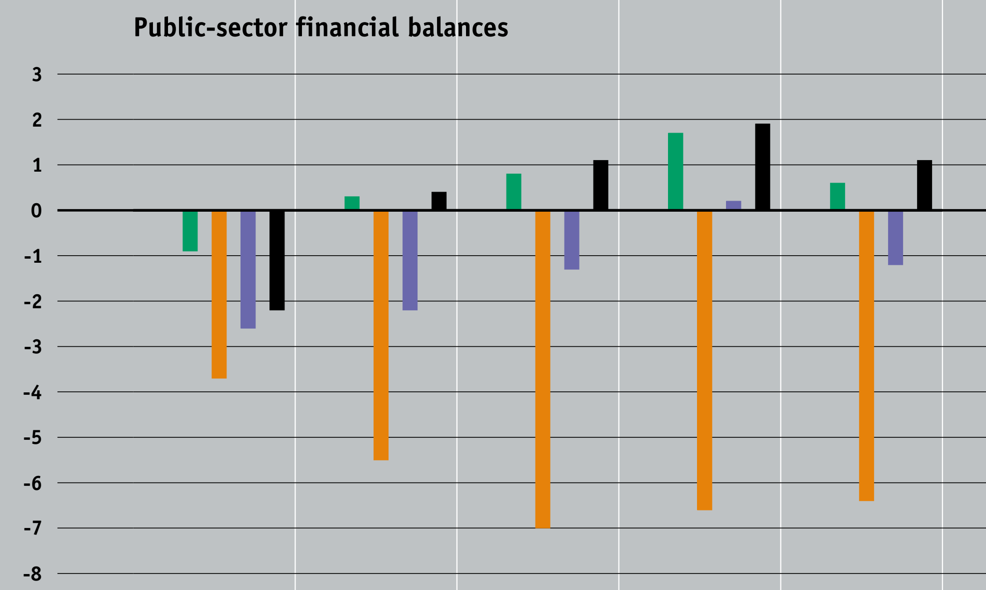
In 2001, public finances in the euro zone exhibited an overall deficit of 1.2% of GDP compared with a slight surplus in the previous year. However, this surplus had been primarily the result of extraordinary income generated in those countries which had granted licences for mobile telecommunications systems. Without this income, the deficit had amounted to 0.8% of GDP in the previous year. Since the deficit did not exceed the 3% mark in any member country of the euro zone, the Maastricht Treaty conditions for government budgets were met. Several small countries posted a surplus; Germany, France and Italy continued to show deficits of 2.5%, 1.5% and 1.4% respectively. Total government debt in the euro area declined slightly from 73% to 72% of GDP. The highest level of indebtedness was recorded in Italy (108%), the lowest in Luxembourg (5%).

Deficit in Japan remains high

In Japan the government deficit remained on a high level. At 6.4% of GDP, it was only slightly lower than in the previous year. More restraint in government spending contributed to this development; earlier governments had tried to stimulate the economy with comprehensive programmes. At 132%, government indebtedness in 2001 was almost 10 percentage points above the previous year's level.

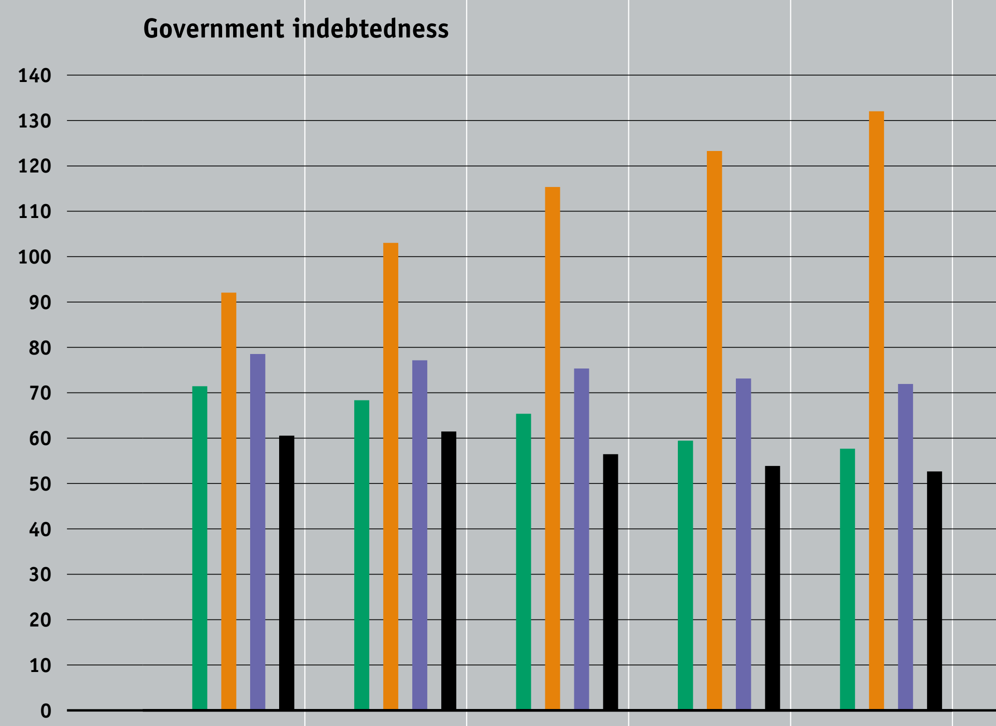
United States
Japan
Euro area
United Kingdom

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



United States
Japan
Euro area
United Kingdom

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



1.4 Foreign exchange markets

Dollar rising at a slower pace

As a result of the economic downturn and declining interest rates, the appreciation of the US dollar, which had lasted for several years, came to a halt by mid-2001. The dollar lost considerable ground in the third quarter, but rebounded in the fourth quarter. Average growth over the year was 3.1% against the euro and 5% vis-à-vis the pound sterling. The dollar remained stable against the Swiss franc. In real, trade-weighted terms, the dollar's exchange rate in December was 5.3% higher year-on-year.

Euro continues to weaken …

In the first half of 2001, the euro continued to lose ground against the dollar, but stabilised in the second half of the year. The annual average rate of 0.90 dollar/euro was thus only slightly below that of the previous year of 0.92 dollar/euro. The stabilisation of the euro was likely to have been helped by the fact that short-term interest rates in the US declined more markedly than those in the euro area. The euro fell against the franc during the course of the year, whereas it advanced vis-à-vis the pound sterling. In real, trade-weighted terms, the euro's value in December was 3.7% above the previous year's level, but 19% below its price at the time of its launch in January 1999.

… and so does the yen

The Japanese yen suffered a considerably stronger decline in 2001 than in the previous year. In December, it fell 13.3% short of the year-earlier level against the dollar and 12.8% against the euro. In real, trade-weighted terms, the yen receded by 12.8%.

1.5 Financial markets

Resilient international financial system

The terrorist attacks of 11 September in New York hit the heart of the international financial system. Despite massive destruction, the US banks, financial markets and the rest of the international financial system continued to function. This was first and foremost to the credit of the high professionalism of the financial markets. The Fed made a significant contribution in that it injected the markets with generous liquidity in those difficult days.

Long-term yields on the decline

After a modest decline and a subsequent increase in the first half-year of 2001, yields on long-term government bonds were on a downward path again until October. The drop reflects the cyclically induced weaker demand for capital, but also diminishing fears of inflation. In November and December, long-term yields moved upward again.

Sharp decline in interest rates in the US – but only for borrowers with excellent credit rating

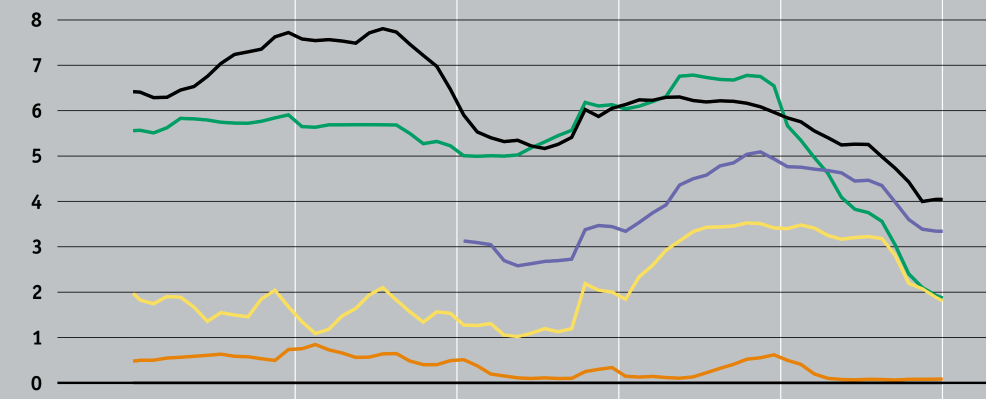
In the US, yields on government bonds fell, with short-term yields registering a considerably sharper decline than the long-term ones as a result of the expansionary monetary policy. In December, the yield on one-year government bonds stood at 2.2%, which was 3.4 percentage points below the year-earlier level. At 5.1%, however, the 10-year bonds fell only slightly short of the previous year's level. The differential between yields on government and private sector bonds widened in the fourth quarter; notably yields on bonds of borrowers of lesser financial standing picked up considerably. This development is a reflection of the less favourable assessment of the economic outlook.

1997 1998 1999 2000 2001

Short-term interest rates

Dollar
Yen
Euro
Pound sterling
Swiss franc

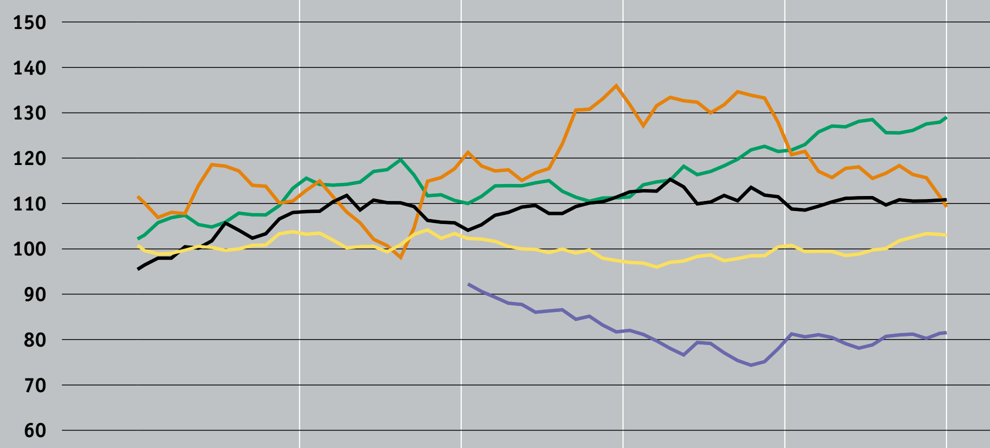
Three-month Euromarket rates, in percent
Source: BIS



Trade-weighted real exchange rates

Dollar
Yen
Euro
Pound sterling
Swiss franc

Index 1995 = 100.
Source: BIS



1997 1998 1999 2000 2001

Modest fall in interest rates in Europe …

In Europe, too, long-term yields fell only slightly. In December, the yield on 10-year government bonds in the euro area was, at 5.0%, only 0.1 percentage point below the previous year's level, while it remained constant in the United Kingdom, registering 4.9%. The relaxing of the monetary stance led to an increase in the differential between short-term and long-term interest rates. In September, short-term interest rates in the United Kingdom dropped below the level of the long-term ones for the first time in nearly two years.

… and in Japan

In Japan, the yield on 10-year government bonds receded to 1.2% up until June, but edged back up in the second half of the year. Registering 1.3% in December, it was 0.3 percentage points below the previous year's level.

Equity prices plummeted

In 2001, equity prices declined on all major stock exchanges. In the aftermath of the terrorist attacks in the US, equity prices recorded a steep decline, but recovered again by year-end. Nevertheless, in December, they were still markedly below their year-earlier level. The fall was more pronounced in Europe and in Japan than in the US.

Borrowing on financial markets down

Net borrowing on the international financial markets was down considerably in 2001, falling to 1,071 billion dollars (previous year: 1,243 billion dollars). While net borrowing in the form of medium- and long-term bonds continued to increase, the share of money market instruments declined sharply. The market shares of individual issuing currencies shifted in favour of the euro: at 44%, the proportion of the euro was 6 percentage points above the previous year's level. The share of the dollar dropped by 2 percentage points to 47%. Sterling and yen issues lost market share as well, while the Swiss franc's share remained insignificant.

Declining bank profits

Banks in the US and in Europe suffered profit losses – heavy in some cases – in 2001. In addition to the deteriorating economic situation, they particularly felt the slump in equity and bond business. The consolidation process in the banking sector in the industrial countries continued. Banks were bent on lowering their costs by mergers and acquisitions as well as alliances, thereby reaching critical mass in order to survive in an ever more competitive domestic and international market.

Difficult situation of banks in Japan …

The situation of Japanese banks continued to deteriorate. Inventories of non-performing loans swelled, and the price collapse on the stock exchanges necessitated higher securities write-downs. The government initiated several measures aimed at accelerating the reform of the banking sector. In particular – in cooperation with independent auditors – government supervision is to be strengthened and the functions of the existing government rescue corporation (Resolution and Collection Corporation) extended. This corporation takes over and restructures the business of banks experiencing difficulties and – as of late – bank loans of other borrowers.

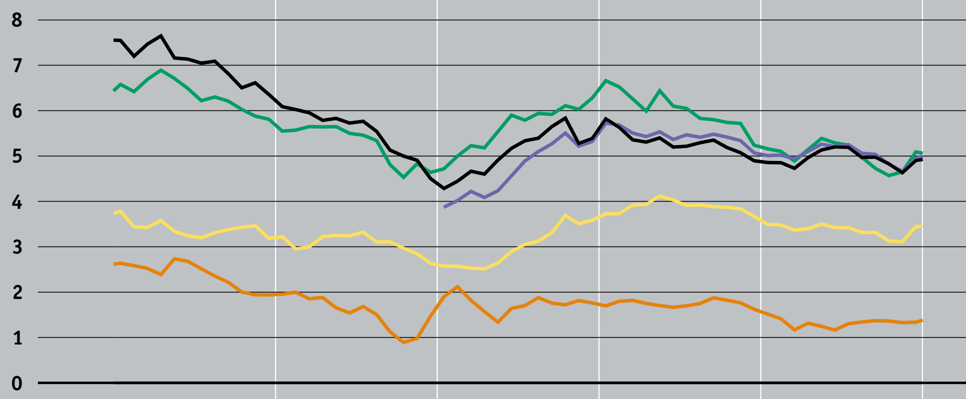
… and in Turkey

The economic crisis in Turkey led to closings and mergers in the banking sector. Several institutions were initially taken over by the government. Under pressure from the International Monetary Fund and the World Bank, the government began selling off these banks. Moreover, it initiated a reform of banking legislation as well as measures to improve the enforceability of these regulations.

Long-term interest rates

United States
Japan
Euro area
United Kingdom
Switzerland

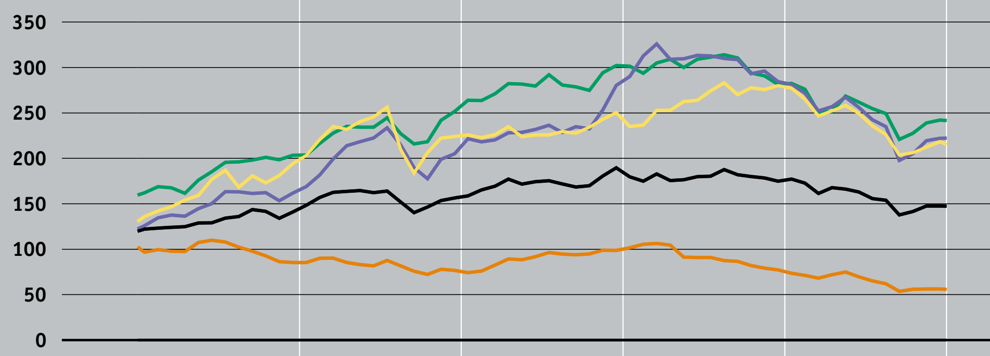
Yield on ten-year government bonds, in percent.
Source: BIS



Share prices

US: Standard & Poor's 500
Japan: Nikkei 225
Euro area: EuroSTOXX
United Kingdom: FT-SE
Switzerland: SPI

Index: January 1994 = 100.
Source: BIS



Increasing privatisation of banks in Central and Eastern Europe

The countries of Central and Eastern Europe pressed ahead with the privatisation of the banking sector. Banks from Western countries increasingly expanded into these countries. Banking reform in Russia progressed only haltingly.

Stock exchanges under pressure to consolidate

In Europe and North America pressure continued on the stock exchanges to increase their trading volume by means of mergers or alliances and to utilise the systems more efficiently to lower the average transaction costs for securities. This process led to the acquisition of the London technology exchange Liffe by Euronext, which in the previous year had been formed by the stock exchanges of Amsterdam, Brussels and Paris. In addition, Virt-x, founded by the Swiss stock exchange (SWX) and the British trading platform Tradepoint in 2000, began trading European blue chips.

Tighter measures to combat money laundering

Many countries implemented tighter measures in the fight against money laundering following the terrorist attacks in the US. In particular, they widened the scope of application of the existing legislation to discover monies of criminal origin and strengthened the powers of the supervisory authorities. At the end of October, the OECD's Financial Action Task Force on Money Laundering (FATF) published new recommendations for the prevention of the financing of terrorist organisations.

2 Switzerland

2.1 Development of the real economy

Economic downturn

The Swiss economy lost considerable momentum in 2001. As early as in the second half of 2000, there were some indications of a slowing tendency, but this was initially deemed desirable given the high capacity utilisation, the mounting signs of tightness in the labour market as well as a growing threat of inflation. Due to the rapid deterioration of the global economic climate and the pronounced crisis in the technology sector, however, the contraction was more marked than anticipated.

Broadly based slowdown

Real GDP rose by 1.3% in 2001, following a 3.0% increase in the previous year. Almost all components of demand lost momentum. The change was most pronounced in exports and investment in plant and equipment. Private consumption and, to a lesser degree, construction spending, however, continued to underpin the economy.

Sharp deceleration in the industrial sector

The cyclical deceleration particularly affected the industrial sector, namely the export industry and manufacturers of technology products. The composite indicator Business Sentiment in Industry, published by the Swiss Institute for Business Cycle Research at the Federal Institute of Technology, dropped significantly. In the second half of the year, it fell into negative territory for the first time since the Asian crisis of 1997/98. Incoming orders and output fell, whereas finished goods inventories were deemed too high. As a result, capacity utilisation dropped markedly to 80.3% at the end of the year, falling short of its long-standing average of slightly over 84%.

Robust private consumption until autumn

Private consumption expanded by 2.3% in 2001, as against 2.0% in the previous year. Driven by the increase in disposable income and the good employment situation, private consumption developed favourably until autumn. In the aftermath of the terrorist attacks of 11 September and a series of negative domestic news – such as the demise of Swissair – consumer sentiment deteriorated in October. Consequently, private households cut spending on expensive consumer durables, in particular, and increasingly preferred Swiss to foreign travel destinations. This helped the Swiss hotel and restaurant industry to partly offset the decline in the number of foreign guests.

End to booming investment in plant and equipment

Investment in plant and equipment levelled off after several years of vigorous growth. Averaged over the year, it fell by 3.4% compared with a 9.0% increase in the previous year. In particular, demand for technology products and means of transport suffered a severe decline. Investment in plant and equipment still accounted for 14.2% of real GDP, more than at the beginning of the 1990s (12.3%).

Slight increase in construction investment

Construction investment rose by 1.3% in 2001, at a lower rate than in 2000 (2.1%). With its high proportion of value added in Switzerland, it nevertheless made a considerable contribution to growth. As in the previous year, the major rail projects (New Alpine Rail Axis NEAT, Rail 2000) were a cornerstone of the construction industry. Rising employment had a favourable impact on commercial building. By contrast, residential construction expanded only in a few regions; the construction volume in this sector contracted slightly in Switzerland as a whole.

Weaker growth in exports

The Swiss export industry increasingly suffered from the global slowdown. The euro's weakness additionally hampered export activity. At 2.1%, exports grew considerably more slowly in real terms than in the previous year (7.1%). The brisk development in the first half of the year spurred exports to the EU, which absorbs around 60% of Swiss exports, by 5.2% in nominal terms. Exports to the United States, however, which had exhibited double-digit growth rates in the previous year, were down by 5.2% in nominal terms. Exports to the emerging economies in Asia fell short of the previous year's levels as well, whereas exports to the oil-exporting countries expanded sharply. Shipments of raw materials and semi-manufactures were on the decline, while shipments of capital goods stagnated. Exports of consumer goods increased, however. The 2% rise in export prices (average prices) was weaker than in the previous year (3.3%).

Lower exports of services

The faltering global economy particularly affected exports of services, which dropped by 6.3%, compared with a 15.4% rise in the year before.

Stagnating imports

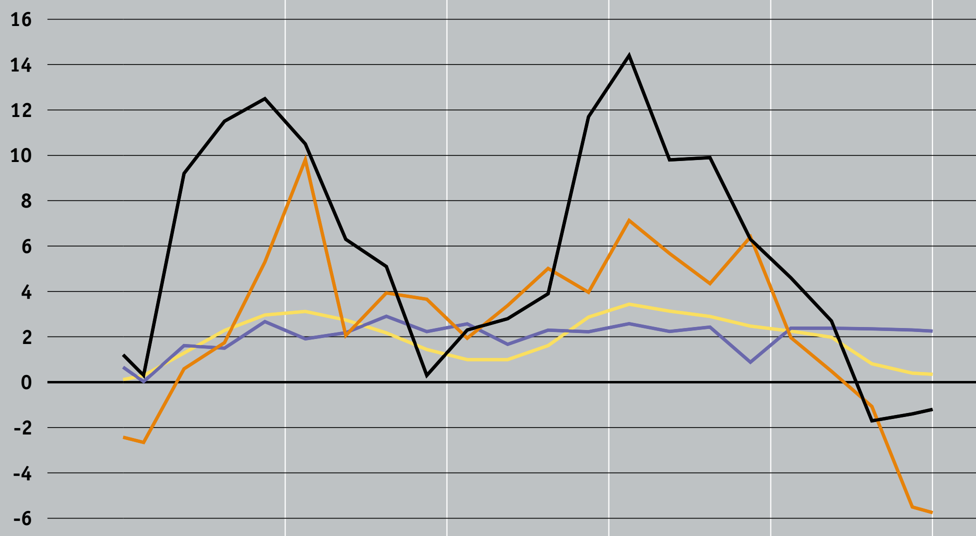
The economic slowdown in Switzerland undermined demand for goods from abroad. Real imports of goods stagnated (−0.4%) after having risen by 7.0% in the previous year. The subdued industrial activity resulted mainly in a decline in imports of capital goods as well as of raw materials and semi-manufactures. Imports of consumer goods also lost momentum. On the back of declining oil prices, only the demand for energy sources strengthened significantly. Import prices (average prices) climbed by 1.6%, compared with 6.0% a year earlier. The low dollar prices for oil products combined with the strengthening Swiss franc curbed prices.

GDP and components

Real change from previous year in percent

	1997	1998	1999	2000	2001
Private consumption	1.4	2.3	2.2	2.0	2.3
Government consumption	0.0	1.3	0.5	−0.4	0.1
Investment in fixed assets	1.5	4.5	3.7	5.8	−1.3
Equipment	4.9	8.9	10.6	9.0	−3.4
Construction	−1.5	0.4	−3.3	2.1	1.3
Domestic demand	**1.3**	**3.5**	**2.6**	**2.4**	**0.9**
Exports of goods and services	8.6	5.4	5.2	10.0	1.0
Aggregate demand	**3.4**	**4.0**	**3.3**	**4.7**	**0.9**
Imports of goods and services	7.6	8.3	7.5	8.5	0.0
GDP	**1.7**	**2.4**	**1.6**	**3.0**	**1.3**

Gross domestic product and components



Real GDP

Private consumption

Investment in fixed assets

Exports

Change from previous year
in percent, in real terms.
Source: SECO

Deterioration on the labour market

The deceleration of economic growth clearly impacted on the labour market. Since spring, the Manpower Index, which measures the space occupied by job advertisements in Swiss newspapers, was on the decline. The jobless number rose noticeably by the end of the year.

Weaker growth in employment

Averaged over the year, employment grew by 1.1% as compared with 2.2% in the previous year. This slowdown affected all sectors of the economy. In the service sector, the number of jobs created was up 1.3%, compared with 2.6% in the previous year. Whereas the banks and insurance companies as well as the IT industry again reported slightly higher employment numbers, jobs were cut in the hotel and restaurant industry, in the transportation and information service sectors as well as in public administration. Employment in the industrial sector rose by 1.0%; as in the year before, this rise was concentrated in a few segments, such as the chemical and metal industries, the electronics and electricity industries as well as the watchmaking and precision instruments sectors. Most other branches of industry saw shrinking employment. The workforce in construction was reduced somewhat, following a sharp increase in the previous year.

Growing number of foreign labour

In 2001, a considerable proportion of newly created jobs were again filled by foreign labour. The highest rise was recorded in the employees holding residence permits, but cross-border commuters and the workforce holding one-year work permits also increased in numbers. The number of foreign employees holding seasonal work permits, however, rose only slightly.

Rising unemployment

The downtrend in unemployment, which has continued since mid-1997, came to a standstill in the first half of 2001. Unemployment climbed again by year-end. In December, the job-seekers and unemployed registered with the regional employment offices numbered 123,500 and 79,500 respectively (seasonally adjusted numbers), thus exceeding the year's low of March by 18,700 and 17,200 persons respectively. The proportion of job seekers increased by 0.5 percentage points to 3.4% by December, the unemployment rate by 0.5 percentage points to 2.2%.

Regional differences persisted

Regional differences persisted. Averaged over the year, the unemployment rate was 2.8% each in Ticino and in French-speaking Switzerland, and 1.5% in German-speaking areas.

More "short-time work"

Moreover, companies increasingly introduced "short-time work" (reduction of working time or periodic interruptions of work). In December, persons on short working hours numbered 7,200, compared with 400 at the beginning of the year.

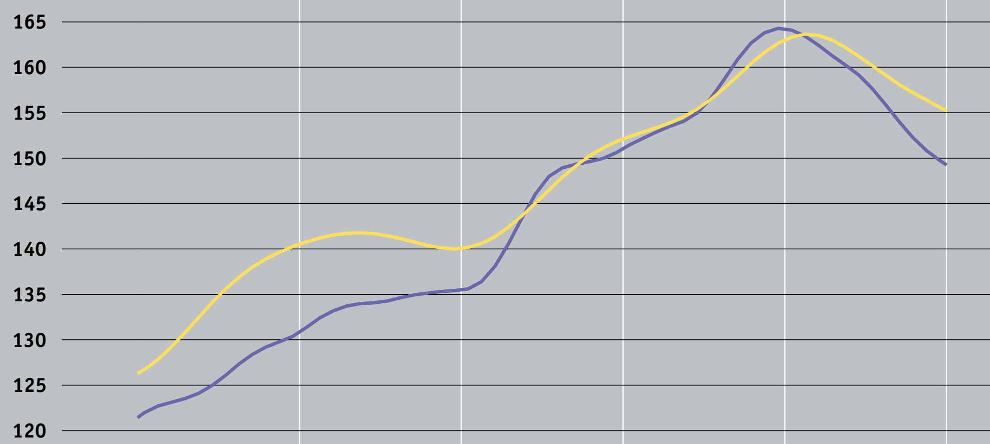
1997 1998 1999 2000 2001

Foreign trade

Imports

Exports

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

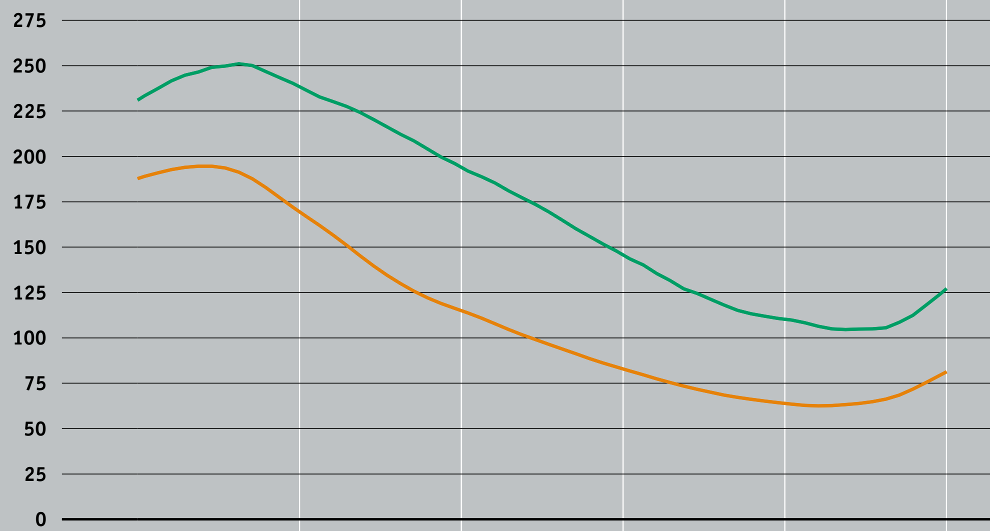


Labour market

Unemployed persons

Job seekers

In thousands,
seasonally-adjusted.
Source: SECO



1997 1998 1999 2000 2001

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 1.5% year-on-year to 3,938,000 persons. The accelerated growth in comparison with the previous year is due exclusively to an increase in part-time employment. The number of persons working between 50% and 90% climbed by 7.3% and the number of persons working less than 50% was up by 4.8%; the number of persons in full-time employment, however, dipped somewhat. As a consequence, the proportion of part-time workers in the overall workforce rose from 29.3% to 30.7% within a year. The rising trend to work part-time was more pronounced among women than among men. The employment ratio was 73.2% for women and 89.2% for men. In addition to a higher participation rate of women, increased immigration of foreign labour, in particular, contributed to the expansion of the workforce.

Employment and unemployment

	1997	1998	1999	2000	2001
Full-time employment[1] change in percent	−1.9	−0.4	−0.2	1.0	0.7
Full- and part-time employment[1] change in percent	−1.3	0.7	1.6	2.2	1.1
Persons in employment[2] change in percent	−0.4	1.8	0.8	1.2	1.5
Unemployment rate in percent	5.2	3.9	2.7	2.0	1.9
Number of unemployed in thousands	188.3	139.7	98.6	72.0	67.2
Number of persons on short working hours in thousands	6.6	3.1	2.9	0.7	2.4
"Manpower job offer index"[3] change in percent	0.4	35.7	26.2	25.2	−11.5

1 according to employment statistics

2 according to SAKE

3 space occupied by job advertisements in Swiss newspapers

Sources: Swiss Federal Statistical Office, State Secretariat for Economic Affairs (seco), Manpower

Receding inflation

Inflation, as measured by the national consumer price index, receded in 2001. On an annual average, it came to 1.0%, as against 1.6% in the previous year. The lower prices of oil products, in particular, curbed inflation after the rise in oil prices had boosted inflation in the previous year. Prices of goods stagnated, following a 3.1% rise in 2000. Services, however, recorded a price increase from 0.4% to 1.8%. This development was mainly brought about by higher residential rents, which almost doubled their annual inflation rate from the previous year to 2.8%.

Stronger rise in prices of domestic goods

In contrast to the previous year, inflationary pressure was mainly attributable to domestic goods and services. Prices of goods produced in Switzerland rose by 1.7%, compared with 0.7% in 2000. Prices of imported goods, however, eased by 1.2%, following a 4.1% increase in the previous year.

Stable producer prices and import prices

Inflationary pressure on producer prices and import prices also receded. Having increased by 2.7% in 2000, the aggregate supply price level remained virtually unchanged in 2001 (−0.1%). Whereas prices of Swiss-produced goods were up by 0.5%, import prices fell by 1.6%. Prices of raw materials plunged by 9.4% year-on-year; prices of semi-manufactures inched 0.2% lower. Prices of consumer goods and capital goods, however, climbed 0.9% and 1.0% respectively.

1997 1998 1999 2000 2001

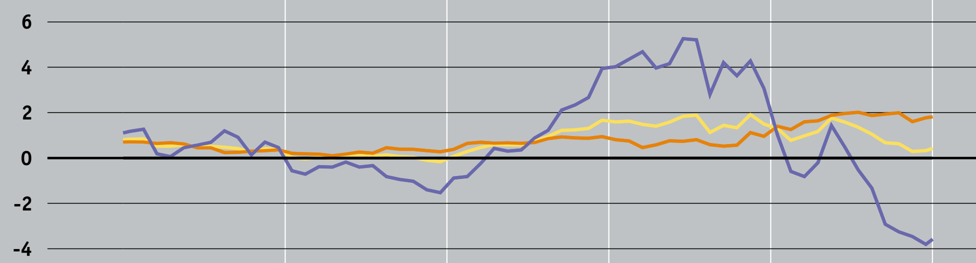
Consumer prices

Consumer prices

Domestic goods

Imported goods

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



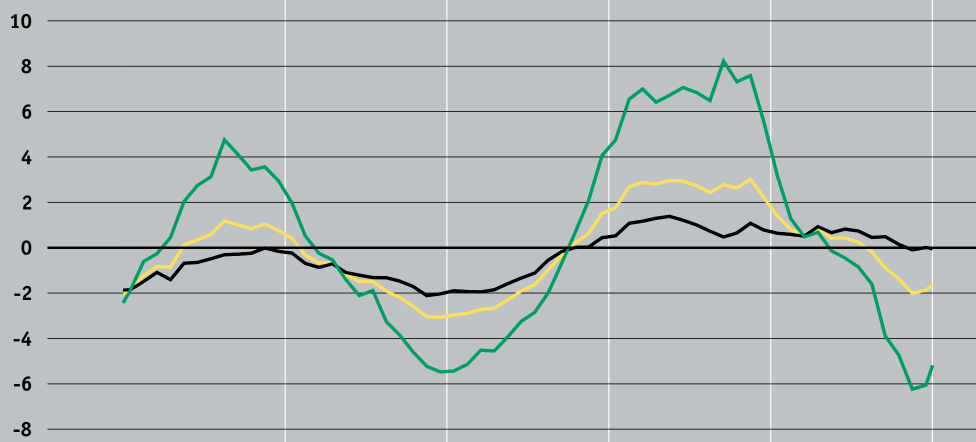
Producer and import prices

Producer and import prices

Producer prices

Import prices

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



1997 1998 1999 2000 2001

Shrinking current account surplus

The current account surplus shrank by Sfr 10.8 billion to Sfr 41.5 billion in 2001. This decrease was mainly due to the lower surplus from services and from investment income. The current account surplus slipped from 12.8% to 9.9% of GDP.

Lower deficit from trade – smaller net investment income

Exports and imports of goods classified as special trade expanded by 4.1% and 1.1% respectively in terms of value after having exhibited double-digit growth rates in 2000. The trade balance of this category closed with a surplus of Sfr 1.7 billion. 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 slightly smaller deficit than in the previous year, i.e. Sfr 3.6 billion. The surplus from services amounted to Sfr 22 billion, falling Sfr 1.4 billion below the year-earlier level. Higher spending by Swiss residents abroad led to a declining surplus from travel, and the banks' income from financial services dropped markedly. On the back of receding net earnings from portfolio investments and direct investments as well as from the banks' interest business, the surplus on the labour and investment income account contracted from Sfr 39.6 billion in 2000 to Sfr 30.2 billion in 2001. The deficit from current transfers amounted to Sfr 7.1 billion, as against Sfr 6.5 billion in the previous year.

Current account balances in billions of Swiss francs

	1997	1998	1999 revised	2000 provisional	2001 estimate
Goods	−0.5	−2.3	−0.3	−4.2	−3.6
special trade	2.0	2.2	1.0	−2.1	1.7
electrical energy	0.7	0.7	0.6	0.5	0.9
other goods	−3.2	−5.2	−1.9	−2.6	−6.4
Services	18.9	19.6	20.0	23.4	22.0
of which tourism	1.4	1.7	1.6	2.2	1.6
of which private insurance	2.0	2.2	2.7	2.3	2.4
of which transportation	1.3	1.2	1.4	1.7	2.4
of which financial services	8.8	9.2	11.1	13.3	11.8
Labour income and investment income	23.4	25.9	31.4	39.6	30.2
labour income	−6.5	−6.4	−6.5	−6.9	−7.7
investment income	30.0	32.4	37.8	46.5	38.0
Current transfers	−4.9	−5.3	−7.5	−6.5	−7.1
Total current account	37.0	37.8	43.5	52.3	41.5

2.2 Fiscal policy

Deterioration of federal budget

The Federal Government posted a deficit of Sfr 1.3 billion or 0.3% of GDP for 2001 after a surplus of Sfr 4.6 billion had been recorded in the previous year. A small surplus of Sfr 18 million had been budgeted. On the revenue side, notably income from withholding tax fell short of the projected figure. Non-fiscal revenue (in particular a loan repayment from the unemployment insurance and a capital repayment by Swisscom), however, showed a more favourable development than had been anticipated. Overall, revenue in 2001 was only slightly below the estimate, while expenditures were significantly higher than budgeted. An additional loan for Expo.02, the Swiss National Exhibition, and the Federal Government's financial assistance to Swissair for building up a new airline accounted for most of the negative impact.

2002 budget

According to the budget passed by Parliament, the Federal Government anticipates a deficit of Sfr 294 million for 2002. While at 4.8%, expenditures are likely to increase at a stronger rate than nominal GDP compared with the 2001 budget, projected revenue is expected to climb more slowly (4.2%).

Constitutional budget requirements not met

The budget deficit of Sfr 1.3 billion did not meet the constitutional target set in 1998 for 2001. The constitutional requirements stipulated a maximum deficit of 2% of revenue, i.e. Sfr 1.2 billion.

Deficit at the cantonal level

The available data indicate that the cantons closed with a deficit totalling Sfr 500 million in 2001. A deficit of Sfr 600 million had been budgeted.

Surplus at the communal level

According to first assessments, the financial situation of most communes was sound. As had been budgeted, an overall surplus of Sfr 200 million resulted.

Further declining debt ratio

The debt ratio (total debt expressed as a percentage of GDP) of the Confederation, cantons and communes dropped further from 51.3% to 49.6%. Just over half the debt was attributable to the Federal Government, 30% to the cantons and just under 20% to the communes.

Message on the new fiscal equalisation system

In November 2001, the message on the revision of the law levelling the differences between financially strong and financially weak cantons was passed by the Federal Council and submitted to Parliament. The new financial equalisation project 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 of the cantons in terms of government and fiscal policy and to reduce the financial disparities between financially stronger and weaker cantons.

Yes to the debt-brake package

The instrument of the "debt brake", a constitutional mechanism for managing the federal budget and keeping the level of debt in check, was approved by a large majority of the Swiss people and the cantons in a referendum on 2 December. The aim of this debt brake is to prevent increases in federal debt and to safeguard the budget against structural imbalances. The new instrument replaces the transitional provision to the 2001 budget target and is incorporated in the Federal Constitution. It consists of a concrete rule governing the development of expenditure permitted in the federal budget: the budget should basically remain balanced over an entire economic cycle, but cyclically-induced fluctuations are acceptable. The permitted maximum for expenditures will be pegged to the revenue received. However, this amount will be adjusted by a factor which takes into account the economic situation.

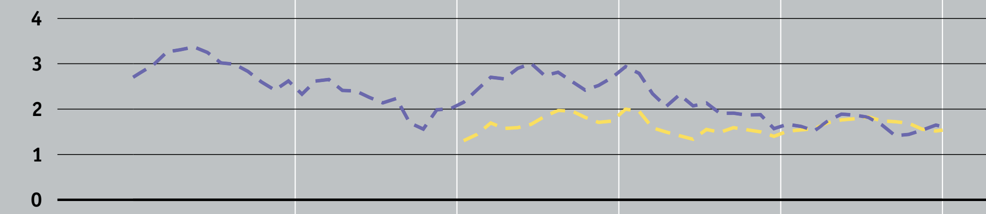
1997 1998 1999 2000 2001

Euro area - Switzerland

United States - Switzerland

Spread in percentage points.
Source: BIS

Spreads for long-term interest rates



Real

Nominal

Index: January 1999 = 100.

Export-weighted Swiss franc exchange rates

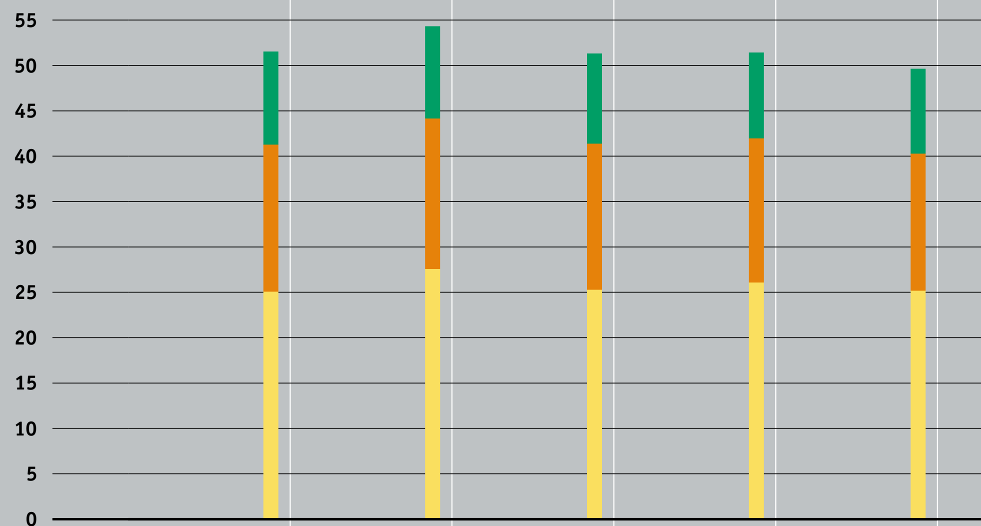
Confederation

Cantons

Communes

In percent of GDP (2001: estimate).
Source: Federal Finance Administration

Public-sector indebtedness



1997 1998 1999 2000 2001

2.3 Financial markets

Considerable fluctuations in long-term interest rates

During the first nine months of 2001, the yield on 10-year Confederation bonds fluctuated within a range of 3.3%–3.6% after having dropped from 4.0% to 3.6% in the second half of 2000. The uncertainty among capital market participants after the terrorist attacks in the United States in September and the collapse of Swissair in October led to an increase in demand for government paper at the expense of commercial paper. The yield on 10-year Confederation bonds fell to 3.0% in October, thus considerably widening the yield differential to commercial paper. With interest rates beginning to pick up worldwide, yields in both capital market segments moved ahead again in November and December. In December, 10-year Confederation bonds yielded 3.4%.

Sharp fall of equity prices

The Swiss Performance Index (SPI) decreased by 22% in 2001. Registering 5621 points at the end of December 2000, the index declined markedly during the first nine months of 2001, reaching a low of 3547 points on 21 September after the terrorist attacks in the US. It rebounded in November and December, closing at 4383 points at year-end. Shedding 20%, share prices of large companies fell at a slower pace than those of small (26%) and medium-sized companies (33%). There were considerable differences between individual sectors as well. The transport sector, retail, health care, industry and the technology and media sectors suffered the most severe setback; banks and the chemical, food and insurance sectors were not nearly as hard hit. The New Market Index, which is composed of telecom, biotechnology and information technology stocks, fell by 51%.

Significantly less net borrowing on the capital markets

Due to the economic situation, borrowing on the Swiss capital market was lower in 2001 than in the previous year. Net borrowing (i.e. new issues less redemptions) only amounted to Sfr 13 billion as against Sfr 25.8 billion in the previous year. Net borrowing of both domestic and foreign borrowers declined. The former registered a drop from Sfr 14.1 billion to Sfr 5.9 billion, the latter dipped from Sfr 8.5 billion to Sfr 2.0 billion.

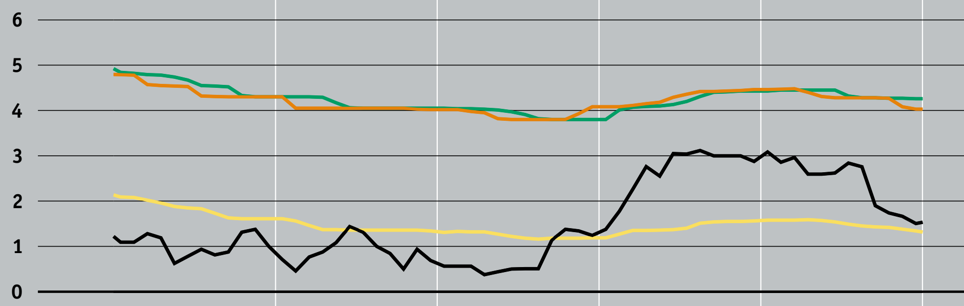
Higher growth in lending

The volume of domestic lending increased by 1.8% in 2001, which was slightly more than in the previous year (1.7%). Approximately three-quarters of the banks' domestic lending were accounted for by mortgage loans and one-quarter by customer claims. While domestic customer claims saw a marginal decline, mortgage loans went up by just under 3%. Classic savings instruments (i.e. customer deposits in savings accounts and similar investments plus medium-term notes) rose by 1.5%.

Receding profits in the banking sector

The global economic downturn and the slump in stock prices led to a decline in profits for most banks. In the previous year, however, profits had been extraordinarily high.

Selected bank interest rates



Existing mortgages at cantonal banks

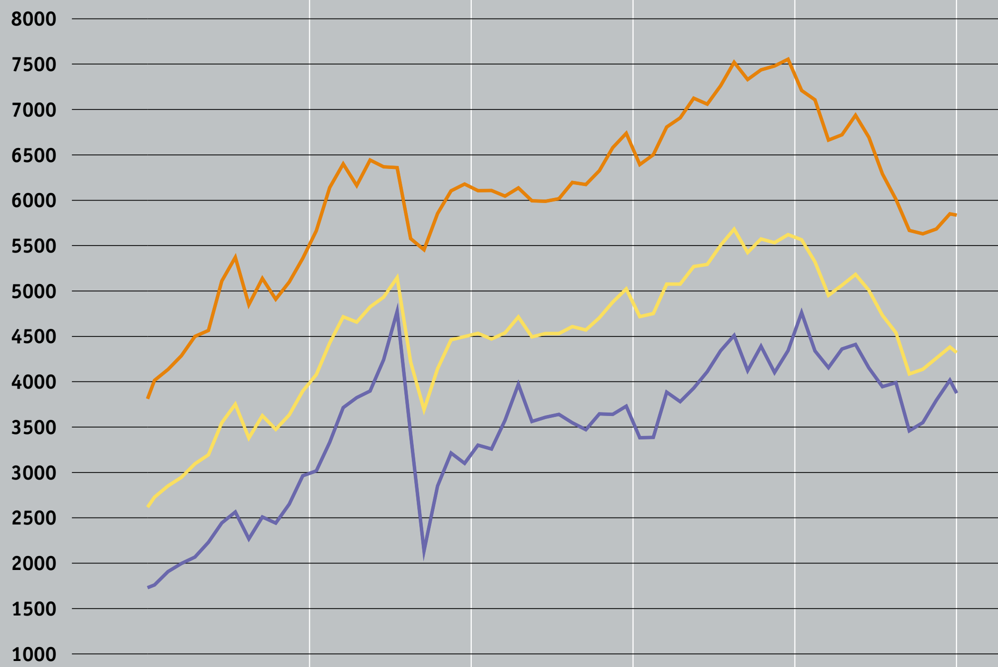
New mortgages at cantonal banks

Savings deposits at cantonal banks

Three-month time deposits at big banks

In percent.

Share prices



Total

Banks

Industry

Swiss Performance Index.
Source: Swiss Stock Exchange

Launch of Virt-x

Virt-x, a joint venture between SWX Swiss Exchange and the British trading platform Tradepoint, was launched in London and started trading European blue-chip stocks. Trading went smoothly on a technical level, but the targeted turnover was not reached in 2001.

Robust Swiss financial system

The Swiss financial system proved to be resilient in the aftermath of the terrorist attacks of 11 September in the United States. The biggest immediate problem for some Swiss banks is likely to have been the inability to act of a major correspondence bank in New York. Crisis management in Switzerland was facilitated by the fact that the large majority of banks, the markets and the financial market infrastructure were in good shape.

More problems at the Geneva cantonal bank

The Banque Cantonale de Genève had problems with its loan portfolio. This bank, which had been restructured in the previous year, had to transfer further high-risk loans to a special management company. Unlike the cantonal bank, this company benefits from a full state guarantee.

Restructuring of the Banque Cantonale Vaudoise

An extraordinary audit at the Banque Cantonale Vaudoise resulted in a massive increase in provisions. As a consequence, the 2001 annual accounts of the cantonal bank posted a loss, and a capital increase became necessary. The cantonal government of Vaud agreed to a 51% participation in the capital increase. In September, a draft bill which would have allowed the canton to lower its interest in the cantonal bank from 50% to 30% was rejected.