Review of economic developments

1 International developments

1.1 Economic development

Economic upswing

After two years characterised by economic problems and geopolitical tension, the situation for the world economy improved in 2003. The US economy, which was steadily accelerating on the back of expansive monetary and fiscal policies, supplied major growth stimuli. An upswing in Asia's emerging economies (notably China) also exerted a positive effect on the global economy. The dynamic growth in this region spread to Japan, which finally emerged from its lengthy period of stagnation. Economic developments in Europe were relatively subdued, though in the second half of the year this region too began to experience a recovery.

Gloomy prospects at the start of the year

At the beginning of the year, the prospect of a rapid economic upturn had seemed remote. The impending war in Iraq had already cast its shadow over the economy at the end of 2002 and had started pushing the oil price sharply upwards. In the first quarter of 2003, the situation was further aggravated by an outbreak of the respiratory disease SARS, which impacted severely on the East Asian economies in particular and paralysed international tourism. As a result, the recession deepened in many parts of the world. Share prices continued to tumble, hitting new lows in March.

Recovery later on in the year

When the Iraq war ended at the beginning of May and the SARS outbreak was successfully contained, the economic situation took a turn for the better. Global commerce revived, and Asia's emerging economies made a particularly large contribution to the higher volume of trade. On the equity markets, share prices started to recover.

Expansionary monetary and fiscal policies

The fact that the industrialised countries continued to pursue expansionary monetary policies helped to drive the economic upswing. By mid-2003, with the inflation outlook still bright, central banks had reduced the key interest rates to their lowest levels for decades. In most of the industrialised countries, fiscal policies also helped to stimulate the business climate. The United States in particular implemented far-reaching tax cuts. These expansionary fiscal policies were reflected in a marked widening of budget deficits.

Upswing in the US

In the United States, the recovery gathered momentum as the year went on. Domestic demand was pushed up by low interest rates, tax cuts and pent-up demand for capital spending in the corporate sector. An acceleration in the international economy, coupled with a sharp depreciation of the dollar, lent further impetus to the upswing. Over 2003 as a whole, real gross domestic product (GDP) rose by 3.1% in 2003 compared with 2.2% in 2002. The economic recovery was accompanied by a surge in productivity. The situation on the labour market thus showed little improvement, and the unemployment rate did not begin to fall until the second half of the year.

Further increase in US current account deficit

The United States' current account deficit was widened further by the brisk domestic demand, gaining half a percentage point year-on-year to reach 5% of GDP.

Pace of UK economy quickens

The United Kingdom also saw an improvement in the business climate. Initially, the upswing was driven mainly by private consumption and demand from abroad, but as the year went on capital spending also picked up. The 2.3% rise in real GDP exceeded the 2002 figure, and unemployment declined slightly.

Weak growth in the euro area

In the euro area, the economic recovery took hold only slowly. The sluggishness was due among other things to the euro's appreciation against the dollar, which impaired export growth. Domestic demand grew at a leisurely pace. A major contributory factor was the continued decline in capital spending. On average over the year, real GDP edged up by 0.4% compared with a 0.9% rise in 2002. As a result, the unemployment rate continued to climb.

Mixed developments within the euro area

Growth rates varied from one euro-area country to another. Averaged over the year, real GDP remained unchanged at the year-back level in Germany, whereas it grew slightly in France. The Netherlands and Portugal slid into recession. In most of the other euro-area countries, however, growth rates exceeded the average for the area as a whole. The highest growth rates were registered by Greece, Ireland and Spain.

Surprising recovery in Japan

Japan experienced a strong economic recovery in the second quarter of 2003. Buoyant demand from Southeast Asia and China sparked an upturn in equipment investments. By contrast, private consumption was hit by the persistently sluggish labour market.

Inflation declining in most OECD countries

During the course of 2003, inflation receded in most industrialised countries. Although energy prices rose sharply, this was offset in many countries by low price rises for other commodity groups and a fall in the dollar exchange rate. The downturn in inflation was particularly striking in the United States and in the United Kingdom. Averaged out over the year, however, inflation in these two countries was still higher than in 2002 (2.3% and 2.8% respectively) whereas in the euro area it edged down to 2.1%. In Japan, the deflationary trend continued.

Strong growth in Asia,...

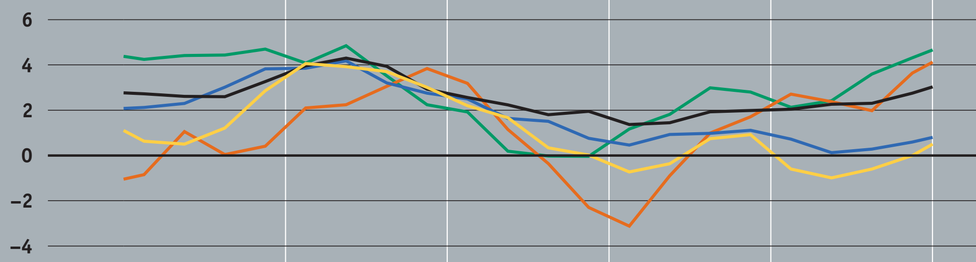
Asia was the fastest-growing region in 2003. Most Asian countries saw a broad-based upswing, with substantial growth in domestic demand as well as exports. The respiratory disease SARS had only a short-lived impact on growth. In South Korea and the Philippines, however, the recovery was impeded by political imponderables.

1999 2000 2001 2002 2003

Real gross domestic product

United States
Japan
Euro area
United Kingdom
Switzerland

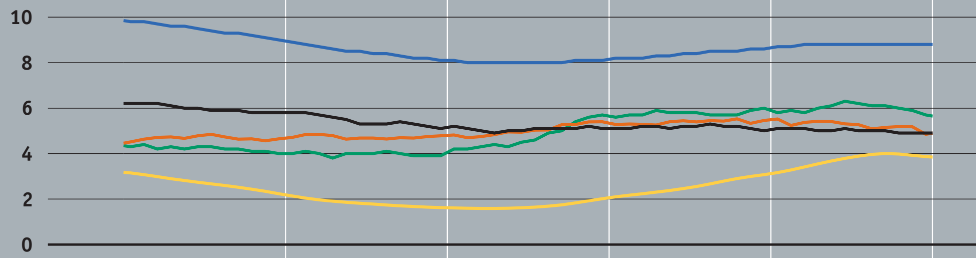
Change from previous year
in percent.
Source: OECD



Unemployment

United States
Japan
Euro area
United Kingdom
Switzerland

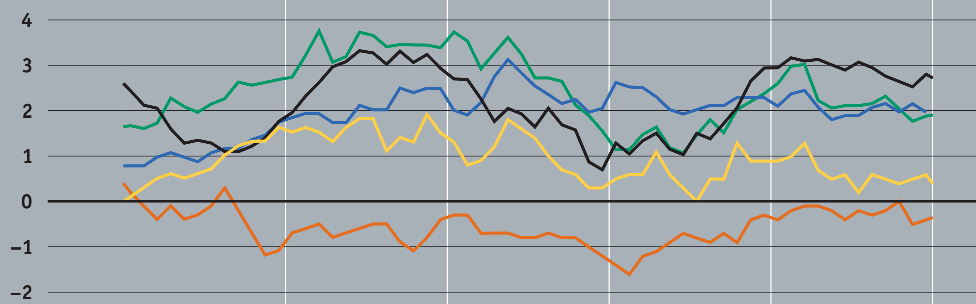
Seasonally adjusted, in percent.
Source: OECD



Inflation

United States
Japan
Euro area
United Kingdom
Switzerland

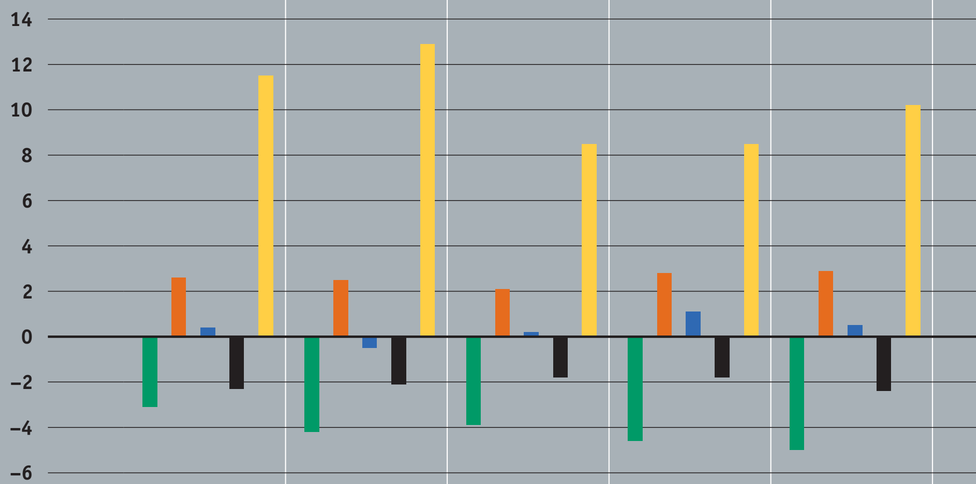
In percent.
Source: OECD



Current account balance

United States
Japan
Euro area
United Kingdom
Switzerland

Net balance in percent
of GDP.
Source: OECD



1999 2000 2001 2002 2003

Summary of economic development parameters

	1999	2000	2001	2002	2003
Real GDP Change from previous year in percent					
United States	4.1	3.8	0.3	2.2	3.1
Japan	0.1	2.8	0.4	−0.3	2.7
Euro area	2.8	3.5	1.7	0.9	0.4
Germany	1.9	3.1	1.0	0.2	−0.1
France	3.2	4.2	2.1	1.3	0.2
Italy	1.7	3.3	1.7	0.4	0.4
United Kingdom	2.8	3.8	2.1	1.7	2.3
Switzerland	1.5	3.2	0.9	0.2	−0.5
Unemployment in percent					
United States	4.2	4.0	4.8	5.8	6.1
Japan	4.7	4.7	5.0	5.4	5.3
Euro area	9.4	8.4	8.0	8.4	8.8
Germany	8.0	7.3	7.4	8.1	8.9
France	10.7	9.4	8.7	9.0	9.6
Italy	11.5	10.7	9.6	9.1	8.9
United Kingdom	6.0	5.5	5.1	5.2	5.0
Switzerland	2.9	2.5	2.5	3.1	3.9
Consumer price inflation in percent					
United States	2.2	3.4	2.8	1.6	2.3
Japan	−0.3	−0.7	−0.7	−0.9	−0.3
Euro area[1]	1.1	2.2	2.4	2.3	2.1
Germany[1]	0.6	1.4	1.9	1.3	1.1
France[1]	0.6	1.8	1.8	1.9	2.1
Italy[1]	1.7	2.6	2.3	2.6	2.8
United Kingdom[2]	2.3	2.1	2.1	2.2	2.8
Switzerland	0.8	1.6	1.0	0.6	0.6
Current account balance in percent of GDP					
United States	−3.1	−4.2	−3.9	−4.6	−5.0
Japan	2.6	2.5	2.1	2.8	2.9
Euro area	0.4	−0.5	0.2	1.1	0.4
Germany	−1.2	−1.4	0.2	2.7	2.1
France	2.9	1.3	1.6	2.0	0.9
Italy	0.7	−0.6	−0.1	−0.6	−1.2
United Kingdom	−2.3	−2.1	−1.8	−1.8	−2.7
Switzerland	11.5	12.9	8.5	8.5	10.2

1 Harmonised inflation figures
2 Inflation excluding mortgage costs
Some 2003 figures are estimates.
Source: OECD, national statistics offices

The Chinese economy displayed particularly dynamic growth. Exports were boosted by demand both from the US and from other Asian countries. Owing to the surge in export earnings along with massive inflows of capital, China's currency reserves ballooned. This development, coupled with the Chinese authorities' decision to adhere to a fixed exchange rate versus the dollar, sparked controversy about China's monetary policy at an international level. The rapid growth gave rise to strains within the country itself. Lending expanded dramatically, triggering a sharp rise in property prices, especially in the cities.

... and especially in China

The Russian economy expanded vigorously. This was due in large part to the oil sector, which benefited from the rise in world market prices for oil. High oil revenues boosted Russia's currency reserves and resulted in a substantial budget surplus. This meant that a large portion of foreign debt could be paid back. Owing to a rise in government-controlled prices, inflation remained in the double-digit range.

Oil boom in Russia

Most of the Central and Eastern European economies grew at a brisk pace. The expansion was driven primarily by private consumption, though exports also played their part. As in the previous year, there was a strong inflow of direct investments as free-market structures became more established. Inflation fell in the majority of these countries.

Sound economic situation in Central and Eastern Europe

After being plunged into a crisis in 2001, the Turkish economy continued its recovery in 2003. Domestic demand rose strongly. With inflation falling from 45% to about 25%, confidence in the Turkish financial markets returned. As a result, the Turkish currency rebounded significantly and interest rates declined.

Turkish economy improving

During the course of 2003, the economic situation brightened in many Latin American countries. Argentina saw renewed growth in GDP and a fall in inflation following its severe crisis. In September, a somewhat controversial three-year loan agreement was concluded with the International Monetary Fund (IMF) whereby Argentina undertook to meet its financial obligations. No debt restructuring agreement was reached with private foreign creditors, however. The Brazilian government pursued solid monetary and fiscal policies and began to institute major structural reforms. As a result, the risk premium on government paper narrowed and the currency appreciated. The restrictive monetary policy needed in order to combat inflation had a dampening effect on domestic demand. Growth stimuli thus emanated mainly from exports. At the end of the year, the improved economic situation prompted the IMF to step up its lending to Brazil and extend the corresponding agreement on a contingent basis. Uruguay, too, succeeded in restructuring its government debt. In Venezuela, however, the economic situation remained difficult owing to political imponderables.

Latin America brightens up

1.2 Monetary policy

Continuation of expansionary monetary policies

In most of the industrialised countries, the central banks continued the expansionary monetary policies which they had been pursuing since 2001. Low inflation rates and a favourable outlook for future inflation gave them the necessary scope for implementing monetary measures to aid an economic recovery.

Key rate cuts in the US and Canada …

At the beginning of June, the US Federal Reserve lowered its target Federal Funds rate by a quarter of a percentage point to 1.0%. This was 5.5 percentage points below the peak it reached in the year 2000. The Canadian central bank cut its key rate in the third quarter of 2003 after having tightened its monetary stance in the spring.

… as well as in Europe

Short-term interest rates in most of Europe's industrialised countries were significantly higher than in the US. However, spreads narrowed considerably compared with the previous year. At the beginning of March, the European Central Bank lowered its minimum bid rate for main refinancing operations by a quarter of a percentage point to 2.5%, with a further half-point cut at the beginning of June to 2.0%. The central banks of Norway, Sweden and Denmark also eased their monetary policy in stages.

Interest rate turnaround in the UK

The Bank of England lowered its key lending rate to 3.5% by way of two quarter-point cuts in February and July. At the beginning of November, however, it raised this rate back to 3.75% in order to prevent the economy from overheating.

Japan's zero percent interest policy

As in the previous year, the Japanese central bank continued to expand bank liquidity in order to stimulate the economy and halt the deflationary trend. The call money rate, which had dropped close to zero in 2001, remained at this level.

Interest rate rise in Australia

Contrary to developments in most other industrial countries, Australia's central bank tightened up its monetary policy towards the end of the year. It did so in order to counter a feared overheating of the economy.

Sweden remains outside the euro area

In a referendum held on 14 September, the Swedish electorate rejected the introduction of the euro. Like the United Kingdom and Denmark, Sweden is an EU member but not part of the euro area.

1.3 Fiscal policy

Sharp deterioration in public finances …

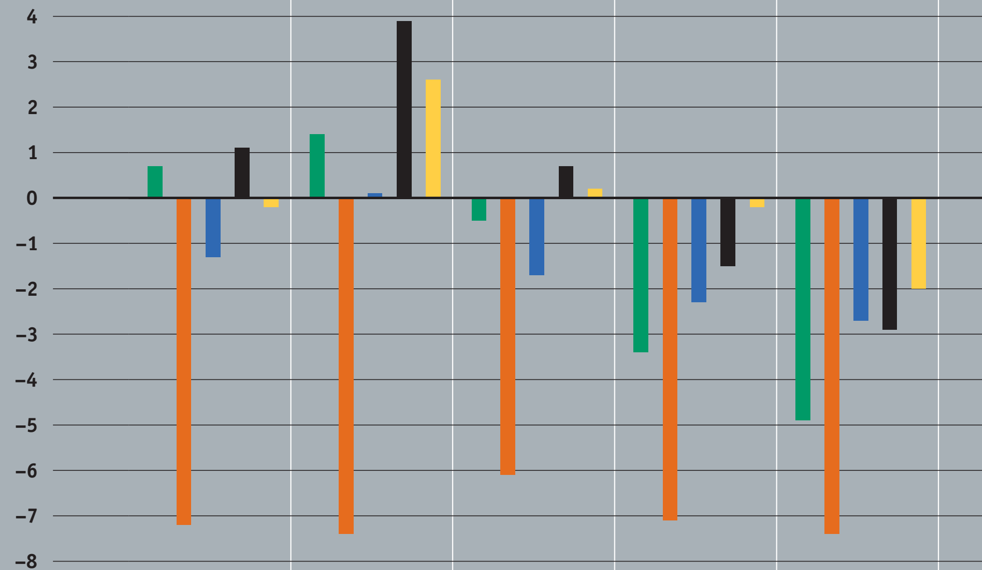
In most industrialised countries, budget deficits and government debt rose sharply in 2003. This was largely a reflection of the weak economic situation, which eroded tax revenues while giving rise to additional spending on unemployment benefits. In the United States, moreover, tax-cutting programmes coupled with high military spending occasioned by the Iraq war also had an adverse impact on government finances.

… in the US and UK, …

According to OECD estimates, the United States' budget deficit rose from 3.4% of nominal GDP in 2002 to 4.9% in 2003. In the United Kingdom, the budget deficit doubled to 2.9% of GDP. The US and the UK had posted surpluses in 2000 and 2001 respectively. Gross government debt in the US rose by 2.6 percentage points to 64% of GDP in 2003, while in the UK it increased by 1.5 percentage points to 54%.

1999 2000 2001 2002 2003

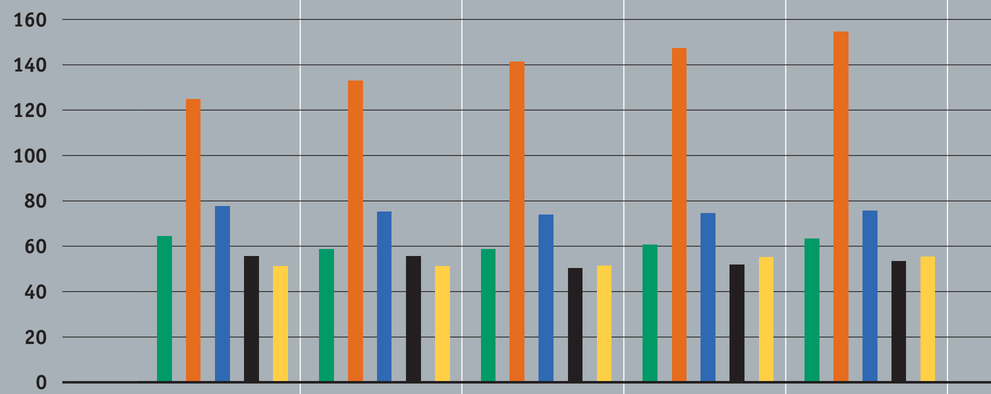
Public-sector financial balances



United States
Japan
Euro area
United Kingdom
Switzerland

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

Government indebtedness



United States
Japan
Euro area
United Kingdom
Switzerland

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

1999 2000 2001 2002 2003

... in the euro area ...

In the euro area, budget deficits rose overall by 0.4 percentage points to 2.7%. This deterioration can be ascribed mainly to developments in the large economies. The deficit expanded to 4% in both Germany and France, exceeding the 3% threshold stipulated in the Maastricht Treaty for the second year running. As the EU Commission's recommendations on measures to reduce deficits in the event of protracted violation of the deficit ceiling have been toned down by the Council of EU Economics and Finance Ministers, however, these two countries will now probably only be obliged to bring their deficits within the 3% limit in 2005. At 2.7%, Italy's deficit was close to the figure for the two previous years. By contrast, other euro-area countries managed either to balance their budgets (Spain) or post a small surplus (Denmark and Belgium). Government debt in the euro area increased from 75% to 76% of GDP. The highest levels of debt were recorded by Italy (117%), Greece (103%) and Belgium (102%) while the lowest figures were posted by Luxembourg (5%) and Ireland (33%).

... and in Japan

In Japan, the budget deficit widened to 7.4% of GDP. Meanwhile, government debt grew by 7 percentage points to 155%, thus continuing the trend of the 1990s.

1.4 Foreign exchange markets

Dollar continues to weaken

The dollar continued the downtrend that had begun in 2002, losing considerable ground to the major currencies. Its slide was probably due among other things to a worsening of the macroeconomic imbalances, especially the growth of the US current account deficit. The US dollar sustained sharp falls against the euro (–17.0%), the Canadian dollar (–15.7%), the Swiss franc (–12.1%) and the yen (–11.6%). It lost 9.3% against the pound sterling. In trade-weighted real terms, the dollar's exchange rate in December was 10.9% lower than a year previously.

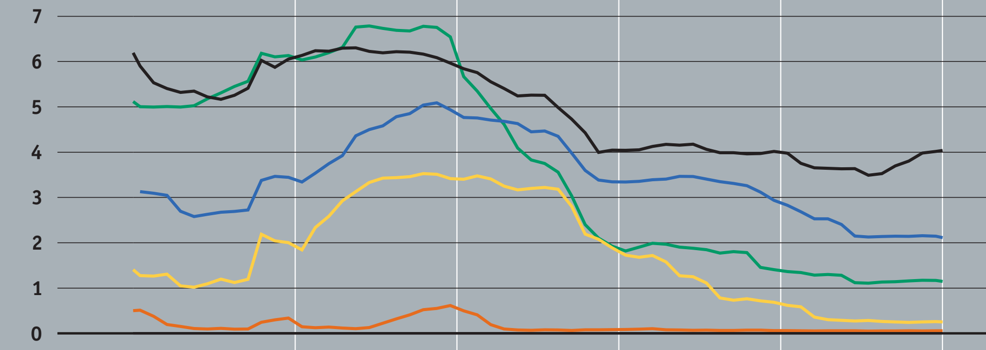
Rise of the euro

The euro appreciated steadily during the year. By December, it was fetching USD 1.23, i.e. 20.5% more than a year earlier. Against sterling, the euro gained 9.3% to reach GBP 0.70 by December. In the first half of 2003, it also strengthened against the Swiss franc, rising from CHF 1.47 to CHF 1.55; it then remained roughly at this level in the second half of the year. In the year to December, it advanced by 5.9% against the Swiss currency. The euro's trade-weighted real exchange rate rose by 11.5%, exceeding its value at launch in January 1999.

Slight strengthening of the yen

The yen's performance was mixed. It posted a substantial (13.1%) gain versus the dollar despite major interventions by the Bank of Japan on the foreign exchange market. However, the yen showed little change over the year as a whole in relation to the Swiss franc, and it lost 6.2% against the euro. Overall, the yen recovered from its weakness of the two preceding years. By December, its trade-weighted real exchange rate was 2.0% above its year-back level.

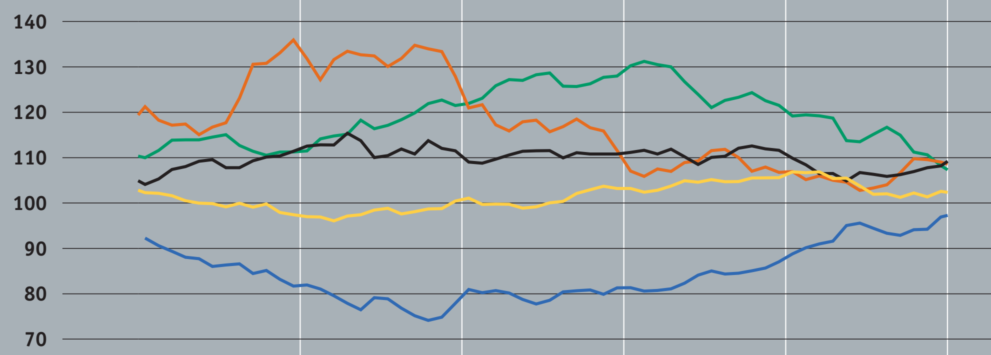
Short-term interest rates



Dollar
Yen
Euro
Pound sterling
Swiss franc

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

Trade-weighted real exchange rates



Dollar
Yen
Euro
Pound sterling
Swiss franc

Index: 1990 = 100.
Source: BIS

1999 2000 2001 2002 2003

1.5 Capital and credit markets

Interest rates turn in mid-year

In the first half of the year, yields on long-term government bonds receded slightly in the industrialised countries. The trend turned in June, however. By September, yields had risen by 1.0 percentage point to 4.3% in the US, from 3.7% to 4.2% in the euro area and from 0.5% to 1.5% in Japan. Yields then stabilised in the fourth quarter.

Decreasing risk premium for low-rated corporate bonds

While the yield spread between bonds of top-rated private issuers and government bonds narrowed only slightly during the year, the spread between corporate bonds with good and poor credit ratings decreased sharply. In the US, the yield on low-rated corporate bonds was halved from 16% in February to 8% in December – the lowest level for two years. Accordingly, the yield gap between corporate bonds with high and low ratings narrowed dramatically from 10 percentage points in February to 3 points in December. The steep decline in the risk premium reflects the economic recovery and the associated revival of investor confidence.

Share prices on the rise

After continuing to fall in the first quarter, share prices staged a recovery on all major stock exchanges during the rest of the year. By the end of December, the Standard & Poor's 500 share index had risen 26% year-on-year. The European indices also rose: the EuroSTOXX 50 gained 16% while Germany's DAX soared by 37% and the UK's Financial Times SE 100 index gained 14%. In Japan, the Nikkei 225 rose by 24%.

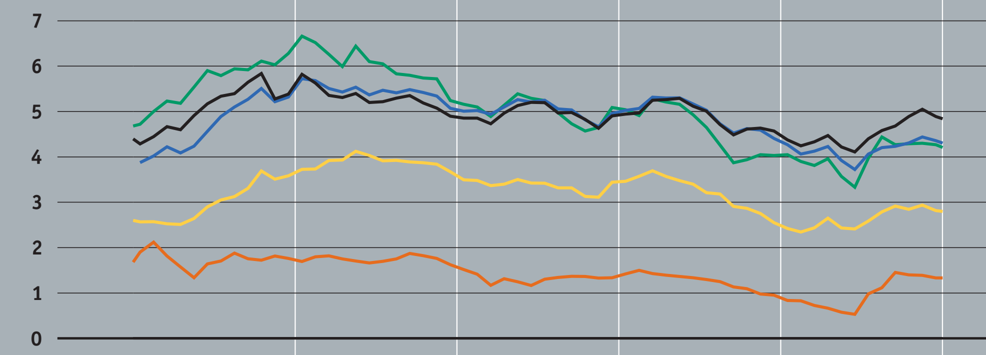
Borrowing on the financial markets rising

Net borrowing on the international financial markets rose by 43% to USD 1,462 billion during 2003. Net borrowing through medium- and long-term bonds rose to USD 1,387 billion, due mainly to a sharp increase in new issues totalling USD 2,883 billion. The portion of this figure attributable to money market instruments remained negligible. While the percentage of new issues accounted for by the euro rose by 7 percentage points to 45%, the dollar's share receded from 47% to 40% and that of the yen fell from 4% to 3%. The percentage accounted for by the pound sterling and the Swiss franc remained stable at 6% and 2% respectively.

Collective action clause introduced for bonds of emerging economies

At the beginning of 2003, Mexico – responding to a recommendation of the Group of Ten – became the first emerging economy to issue a bond with a collective action clause under New York law. Collective action clauses allow a qualified majority of creditors to modify the payment terms in the event of a crisis. The Mexican bond was well received by the market, and further countries followed Mexico's example by issuing similar bonds.

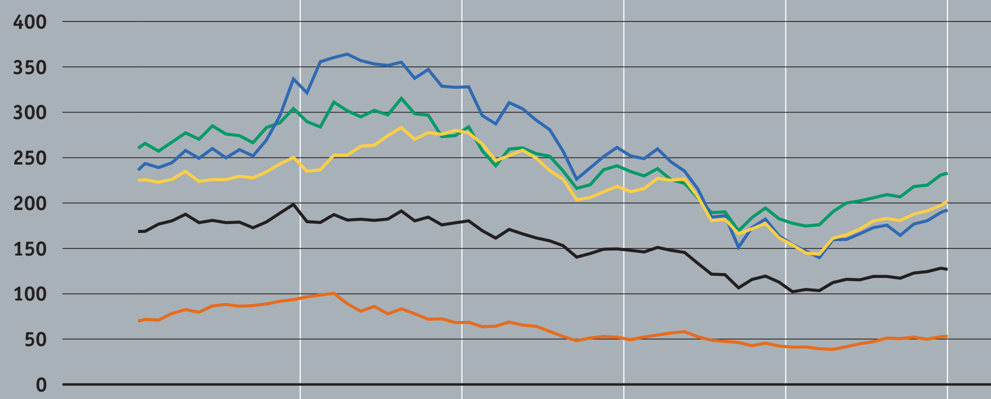
Long-term interest rates



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 50
United Kingdom: FTSE 100
Switzerland: SPI

Index: January 1994 = 100.
Source: Bloomberg,
Swiss Stock Exchange

1999 2000 2001 2002 2003

1.6 Banks and other financial institutions

Improved situation of US banks

Banks in the United States posted higher earnings in 2003 than in the previous year. Retail banking yielded especially good results, though the situation in investment banking also improved. The earnings of US banks were favourably influenced by the fact that bad-debt provisions were lowered owing to the economic upswing.

Cost-cutting by European banks

European banks' results also improved. Cost-cutting measures, which resulted in workforce reductions and the closure of branches, were a contributory factor. With banks focusing increasingly on their core competencies, a number of business units changed hands.

Profitability of German banks improving

After a sharp deterioration in business the previous year, the profitability of Germany's banking sector improved again slightly. In addition to the weak economy, structural problems – reflected primarily in low interest margins and high fixed costs – are responsible for the German banks' low profitability in international terms.

Continuing problems of the Japanese banking sector

The Japanese banking sector again had to contend with non-performing loans and low profitability. When the equity ratio of the country's fifth biggest banking group dropped below the prescribed minimum, the government acquired a majority stake in it. A sizeable regional bank was also nationalised in order to head off impending insolvency. The Bank of Japan continued its programme to buoy up the banking sector. In particular, this involves the purchase of shares from the banks' own portfolios.

Problems at US housing-finance institutions

The two big US housing-finance institutions Fannie Mae and Freddie Mac moved into the forefront of public debate. As early as 2002, Fannie Mae hit the headlines because of a major discrepancy between the maturities of its assets and its liabilities ("duration gap"). In 2003, Freddie Mac had to admit to accounting irregularities: the earnings it had disclosed for the years 2000–2002 were too low by a total of USD 4.5 billion. It had illicitly accumulated reserves so that its future figures would exhibit as much earnings stability as possible. As a result of these events, legal measures were taken to tighten up supervision of the housing-finance institutions.

2 Switzerland

2.1 Economic development

Economic climate brightens in the second half

Like most industrialised countries, Switzerland was faced with a sluggish economy at the beginning of 2003. Uncertainty about the outbreak of war in Iraq, upward pressure on the Swiss franc and the SARS epidemic all had an adverse impact on business and investment. Unemployment continued to rise, and sentiment among producers and consumers worsened. The signs of economic stabilisation multiplied once the Iraq war was over, however, and the climate became generally more upbeat in the second half. After real GDP had contracted in the first half of the year, it expanded slightly in the second half thanks to livelier exports and higher capital spending. Averaged over the year, it declined by 0.5%.

Inventory reductions push down overall demand

Economic activity was bolstered in 2003 by private and government consumption and by residential construction, whereas exports stagnated and equipment investment declined. Along with a reduction in inventories, this resulted in lower overall demand. The industries worst hit by the slack economy were manufacturing, company-related services and tourism. By contrast, the financial sector – which had borne the brunt of the share-price slide in 2002 – staged a recovery.

Industrial output stagnating

In the first half of the year, manufacturing was hit by the fall-off in both domestic and foreign demand. As the business situation worsened, capacity utilisation declined. Around mid-year, however, order intake began to pick up and the outlook brightened. The change in sentiment was especially pronounced in the export industry. Towards the end of the year, industrial production rose slightly. Averaged out over the year, it remained flat compared with a decline of almost 6% in 2002.

Private consumption robust

Despite higher unemployment, private consumption rose by 0.9% – a similar rise to that in the previous year. However, as it grew less rapidly than disposable income, the savings rate increased. As in the previous year, expenditures on the less cyclical items (food, housing and healthcare) rose while purchases of consumer durables and luxury goods receded. The consumer sentiment index remained low. Domestic tourism failed to extricate itself from the stagnation: the number of overnight stays by domestic guests decreased again slightly.

Gross domestic product and components
Change from previous year in percent, in real terms

	1999	2000	2001	2002	2003
Private consumption	2.2	2.5	2.0	0.7	0.9
Government consumption	0.3	2.4	4.0	0.8	0.9
Investment in fixed assets	1.2	4.4	−3.1	−4.8	0.1
Equipment	5.0	5.6	−3.0	−10.1	−0.7
Construction	−3.7	2.7	−3.4	2.2	0.9
Domestic demand	**0.3**	**2.1**	**1.9**	**−0.9**	**−0.1**
Exports of goods and services	6.5	12.2	0.2	−0.5	−0.4
Aggregate demand	**2.1**	**5.2**	**1.4**	**−0.8**	**−0.5**
Imports of goods and services	4.3	9.5	2.2	−3.1	−0.1
GDP	**1.3**	**3.7**	**1.0**	**0.2**	**−0.5**

Source: Swiss Federal Statistical Office, seco

Equipment investment stabilises

The decline in equipment investments that had begun in 2001 initially continued in 2003. As the business climate picked up, however, and due also to rising replacement requirements, investment activity picked up in the second half. Averaged out over the year, equipment investment receded by 0.7% following a 10.1% fall in 2002.

Mixed trend in building sector

Construction investment rose by 0.9% in 2003, down from 2.2% in 2002. The only bright spot was residential construction, which benefited from favourable financing terms and a low vacancy rate. By contrast, commercial construction and civil engineering continued to decline as a result of cost-cutting in the public sector.

Recovery of goods exports in the second half

In the second half of the year, the pickup in the international economy, coupled with the depreciation of the Swiss franc, helped goods exports to stage a recovery. On average over the year, however, they declined by 1.1% compared with a slight increase in the previous year. While initially the rises were confined to shipments of raw materials and semi-manufactures, towards the end of the year the recovery spread to capital and consumer goods.

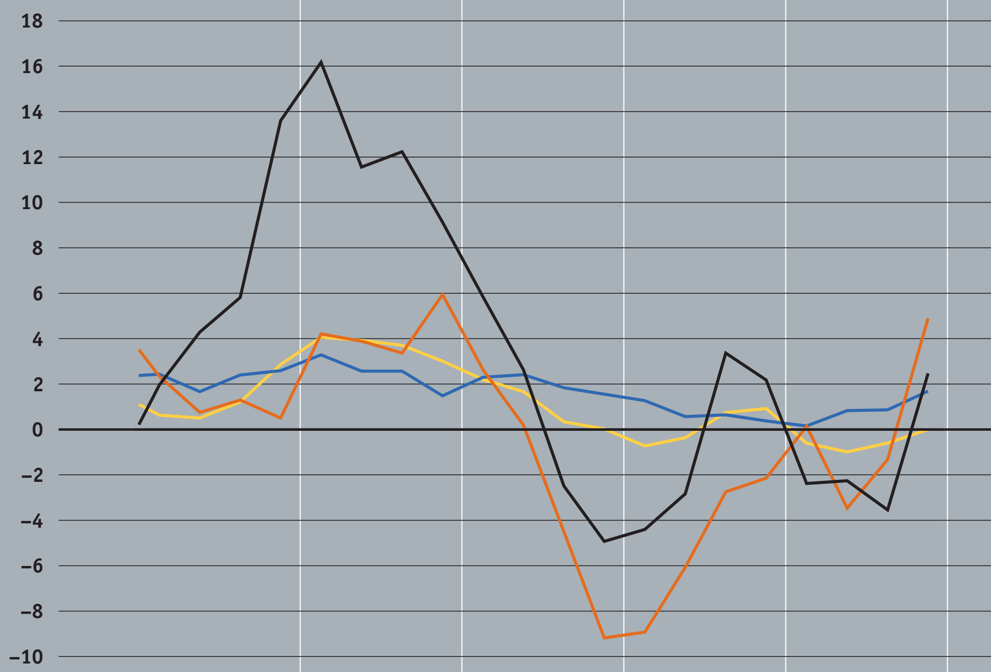
Higher demand from Asia and Central Europe

The growth was driven to a considerable extent by rising demand from Asia (China and Japan in particular) and from the transition economies of Central Europe. Exports to the US and the emerging Asian economies fell off sharply at the beginning of the year, but recovered gradually thereafter. On the other hand, nominal exports to the EU – which account for about 60% of Swiss exports – remained flat. Export prices (mean values) remained stable after declining by 2.7% in 2002.

Rising exports of services

Exports of services rose by 1.2% after having dropped by a total of 8% in the two preceding years. While the tourist industry was hit by dwindling numbers of foreign visitors, the foreign business of banks and insurance companies recovered.

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

Imports recover

Imports of goods and services rose during the course of 2003. The turnaround for imports of capital goods and services was particularly marked. On average over the year, imports of goods and services were stable after a 3.1% drop in the previous year. Average import prices dropped by 0.5%, and the terms of trade thus improved slightly.

Declining employment

Employment receded by an average of 0.7% in 2003 after having remained steady in the previous year. The steepest decline was in manufacturing (−3.3%), where mechanical engineering, precision instruments and watchmaking saw particularly sharp falls in their workforces. Employment in the construction industry decreased by 0.3% while in the service sector it stagnated. The 3.0% cutback in bank jobs played a significant role. Workforce reductions in the insurance industry were relatively minor, however, while the number of jobs in the public sector increased (2.7%).

Employment and unemployment

		1999	2000	2001	2002	2003
Full-time employment[1]	change in %	−0.3	1.2	1.9	−0.8	−2.2
Full- and part-time employment[1]	change in %	1.6	2.4	1.6	0.1	−0.7
Unemployment rate	in %	2.7	1.8	1.7	2.6	3.7
Number of unemployed	in thousands	98.6	72.0	67.2	100.5	145.7
Number on short working hours	in thousands	2.9	0.7	2.4	9.1	8.9
Manpower job index[2]	change in %	26.0	25.1	−11.8	−43.4	−33.7

1 According to employment statistics
2 Space occupied by job advertisements in Swiss newspapers
Source: Swiss Federal Statistical Office, seco, Manpower

Job vacancies declining

Weak demand for labour was reflected in a sharp decline in the number of job vacancies. In December the Manpower Index, which measures the area of job advertisements in newspapers, was 17.6% lower than a year earlier. The Jobpilot Index, which measures the number of job ads in the Internet, showed a similar result.

Short-time working rising only slightly

After a strong rise in the previous year, the number of people on short-time work edged up only slightly. This was due in part to the gloomy economic outlook at the beginning of the year, which prompted companies to dismiss staff rather than introduce short-time working.

Unemployment moves higher

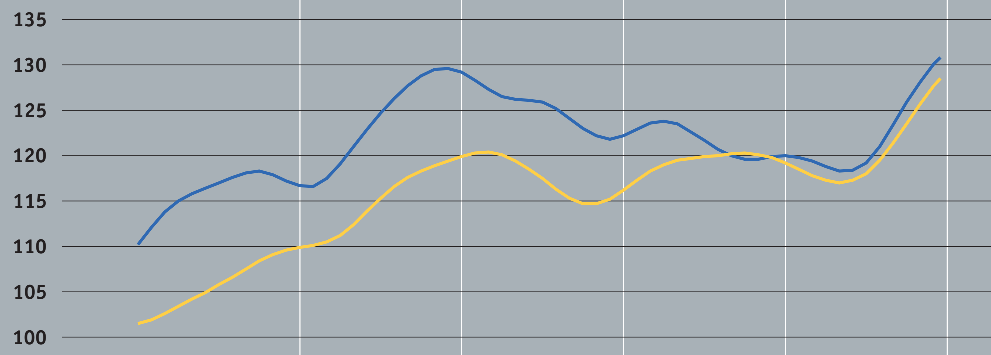
The unemployment rate rose appreciably again, though the rise slowed down in the second half of the year. In December the number of persons out of work totalled 155,500 compared with 129,700 a year earlier (seasonally adjusted figures). The unemployment rate rose year-on-year from 3.2% to 3.9%. Over the same period, the percentage of job-seekers climbed by 1.1 percentage points to 5.6%. In addition to registered unemployed persons, job-seekers include people who are looking for casual jobs, are participating in a work creation scheme or are training or retraining.

Foreign trade

Imports

Exports

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

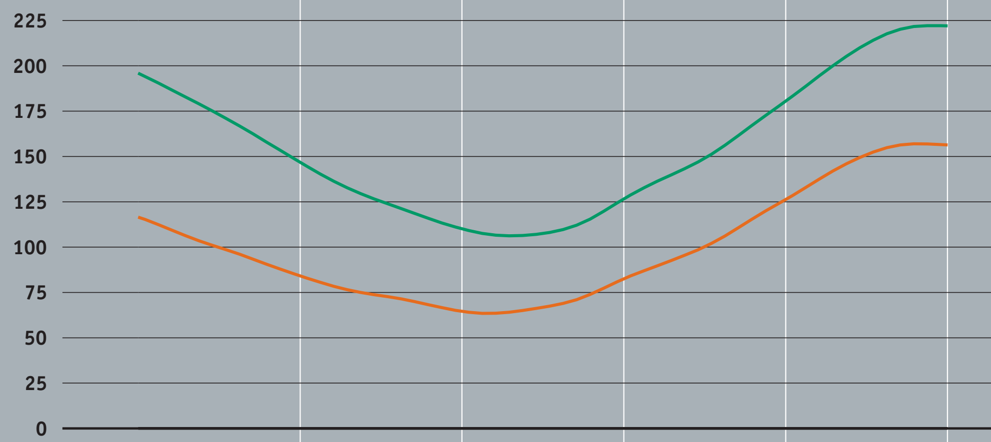


Labour market

Unemployed persons

Job seekers

In thousands,
seasonally adjusted.
Source: seco



Regional differences

On average over the year, the unemployment rate was 4.7% in French-speaking Switzerland and 4.3% in Ticino. At 3.5%, the figure for German-speaking Switzerland was below the national average of 3.7%, but it rose faster here during the year than it did in the other parts of the country. Once again, cantons dominated by one large city were especially hard hit by unemployment: the rate was 6.5% in Geneva, 4.5% in Zurich and 4.3% in Basel-Stadt.

No change in inflation

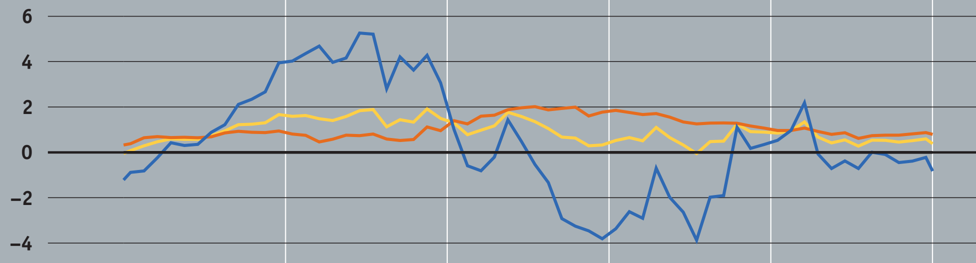
Inflation, as measured by the national consumer price index, averaged 0.6% in 2003 – the same as in 2002. While inflationary pressures from abroad mounted, domestic inflation slackened off. Averaged out over the year, it came to 0.8%. Upward price pressure eased both for goods and for private services and apartment rentals. The only year-on-year acceleration was recorded in public-sector services.

National consumer price index
Change from previous year in percent

	1999	2000	2001	2002	2003
Total	**0.8**	**1.5**	**1.0**	**0.6**	**0.6**
Domestic goods and services	0.7	0.7	1.7	1.4	0.8
Goods	0.3	1.6	1.5	1.1	0.6
Services	0.9	0.4	1.8	1.5	0.9
Private services excluding rents	1.6	0.3	1.5	1.9	1.0
Rents	0.7	1.5	2.8	1.0	0.3
Public services	0.0	−1.4	0.5	1.5	2.9
Foreign goods	1.0	4.1	−1.2	−1.7	0.1
Excluding oil products	0.5	0.9	−0.4	−0.8	−0.5
Oil products	5.7	31.3	−4.7	−6.8	3.3

Source: Swiss Federal Statistical Office, SNB

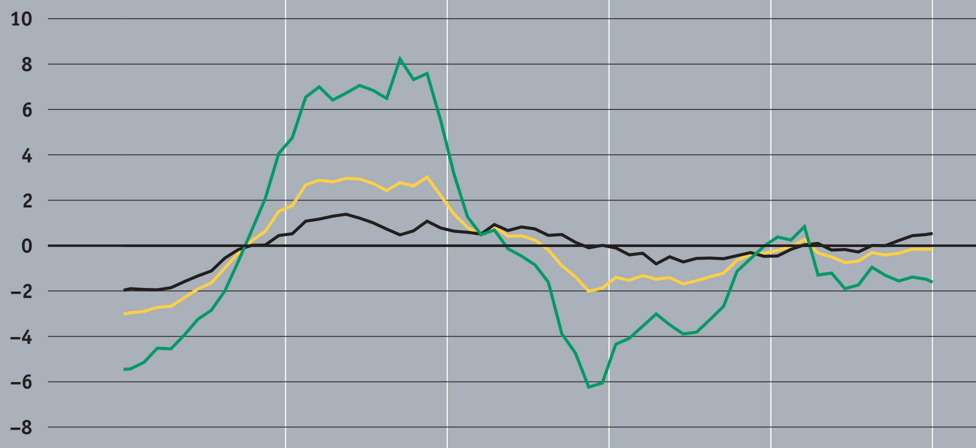
Consumer prices



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

Higher oil prices

Declining total supply prices

Rising current account surplus

After declining in both of the preceding years, prices of imported consumer goods edged up again in 2003. Averaged out over the year, they rose by 0.1%. This rise was due mainly to oil products, which appreciated by 3.3%. By contrast, other foreign goods exerted a deflationary influence, though the 0.5% drop in these prices was less pronounced than in the previous year.

Producer and import prices continued to have a dampening effect on inflation, though less so than in 2002. Total supply prices declined on average by 0.4%, compared with a 1.2% drop in the previous year. While import prices receded by 0.9%, prices for goods manufactured in Switzerland were stable.

The current account surplus widened by CHF 7.7 billion to CHF 44 billion in 2003, owing primarily to higher net investment income. As a percentage of GDP, the current account surplus came to 10.2%, compared to 8.5% in 2002.

Current account balances in CHF billions

	1999	2000	2001	2002	2003
Goods	−0.3	−4.2	−4.6	5.2	4.6
Special trade	1.0	−2.1	1.7	7.3	6.9
Electrical energy	0.6	0.5	1.1	1.0	1.0
Other goods	−1.9	−2.6	−7.4	−3.1	−3.3
Services	21.6	25.6	22.1	22.1	23.2
of which tourism	1.6	2.4	2.1	1.9	2.2
of which private insurance	2.7	2.3	1.7	3.6	4.5
of which transportation	1.4	1.7	2.0	1.0	0.7
of which financial services	11.1	13.3	11.8	10.4	10.4
Labour income and investment income	30.5	37.0	25.1	15.6	21.6
Labour income	−6.5	−7.8	−8.6	−9.2	−10.4
Investment income	37.0	44.8	33.7	24.8	32.0
Current transfers	−6.2	−4.9	−6.7	−6.5	−5.3
Total current account	**45.7**	**53.5**	**35.8**	**36.6**	**44.0**

In nominal terms, goods imports and exports increased slightly. The trade balance (special trade) closed with a surplus of CHF 6.9 billion compared with CHF 7.3 billion in the previous year. Total goods trade, which includes special trade in addition to precious metals, precious stones and gems as well as objets d'art and antiques plus electrical energy, posted a surplus of CHF 4.6 billion. At CHF 23.2 billion, the surplus from services was CHF 1.1 billion above the previous year's figure. This rise was primarily due to higher exports of insurance-related services. The banks' earnings from commissions business remained at their year-back levels. The surplus from labour and investment income rose by CHF 6 billion to CHF 21.6 billion. This increase was due to higher net earnings from direct investments, which had fallen sharply in the previous year. The deficit from current transfers amounted to CHF 5.3 billion, as against CHF 6.5 billion in the previous year.

2.2 Fiscal policy

Deficit in the federal budget

The Federal Government posted a deficit for the third year running in 2003. At CHF 2.8 billion or 0.7% of GDP, the deficit exceeded the budgeted figure of CHF 246 million because of a sharp drop in tax revenues. The Federal Government had based its forecast on real economic growth of over 1%, which proved over-optimistic. Revenues from direct federal income tax and value added tax in particular were substantially lower than forecast. At CHF 50 billion, spending was lower overall than budgeted. This includes payments of around CHF 1.1 billion into the fund for major rail projects (NEAT, Rail 2000), expenditure on which totalled CHF 2.0 billion in 2003. The volume of additional credits was well below the average for the period 1990–2002.

2004 budget

For 2004, the Federal Government is anticipating a budget deficit of CHF 3.5 billion. Whereas expenditure is set to remain stable in real terms compared with the 2003 estimate, the government expects revenues to fall.

2003 relief programme

In July, the Federal Council passed a Message on its budget relief programme for 2003. This aims to bring the budget into line with the requirements of the "debt brake" rule. The relief programme seeks to eliminate the present structural deficit by 2007. It envisages savings of CHF 1.0 billion in 2004 and CHF 2.1 billion in 2005 compared with the figures currently budgeted. As of 2006, it will relieve the federal budget permanently by CHF 3.0 billion a year, primarily by way of spending cuts.

Higher deficits at the cantonal and municipal level

Owing to the sluggish economic climate, the budget situation of the cantons and municipalities also deteriorated. According to the available data, the cantons and municipalities posted an aggregate deficit of CHF 2.5 billion and CHF 700 million respectively. The consolidated deficit of the Federal Government, the cantons and the municipalities thus amounted to 1.6% of GDP.

Debt ratio rises

As a percentage of GDP, the consolidated debt ratio of the Federal Government, the cantons and the municipalities rose to 55.8%. Of total debt, 51.9% was attributable to the Federal Government, 31.4% to the cantons and 16.7% to the municipalities.

Restructuring of the fiscal equalisation system

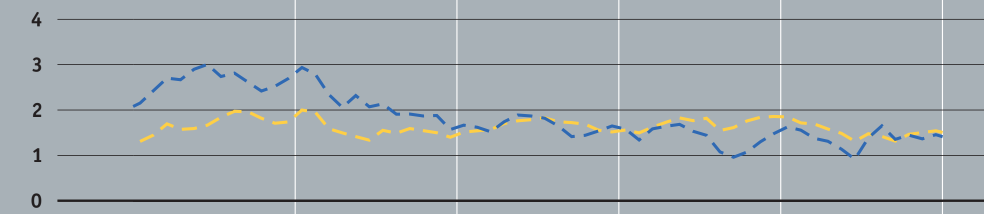
In its autumn session, the Federal Parliament concluded its deliberations on the restructuring of the fiscal equalisation system and on the division of tasks between the Federal Government and cantons (referred to as the "NFA"). It approved both the constitutional basis for this change and the Federal law on financial perequation. The mandatory referendum on the incorporation of this legislation into the Constitution is due to be held in the second half of 2004. The referendum will bring the first phase of the NFA process to a close. The second phase, in which the NFA is implemented, will involve adapting a large number of individual laws. The NFA aims to unbundle the tasks and financial flows between the Confederation and the cantons, allocate the responsibilities clearly and distribute expenditures more equitably. These reforms seek to strengthen the powers of the Federal Government and the cantons in terms of government and fiscal policy, and to reduce the financial disparities between financially stronger and weaker cantons.

1999 2000 2001 2002 2003

Spreads for long-term interest rates

Euro area – Switzerland
United States – Switzerland

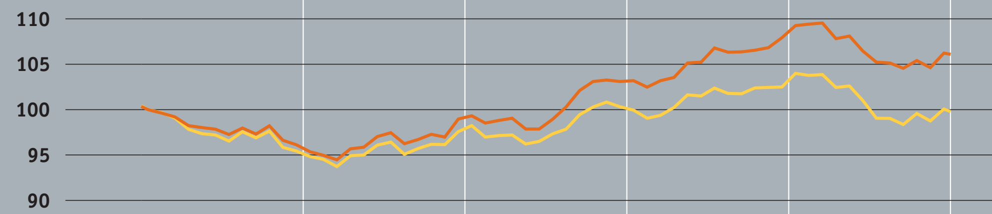
Spread in percentage points.
Source: BIS



Export-weighted Swiss franc exchange rates

Real
Nominal

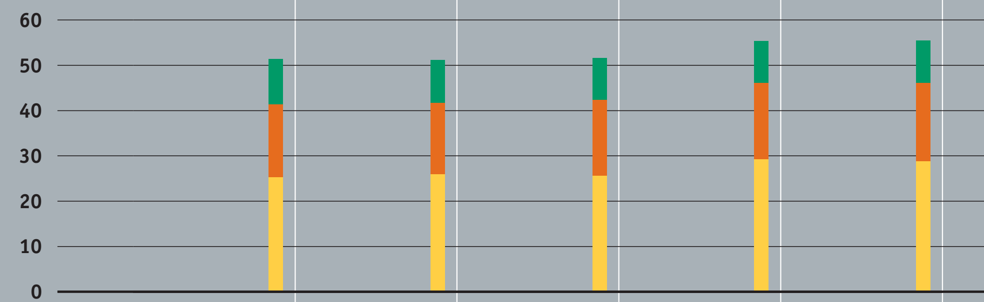
Index: January 1999 = 100.



Public-sector indebtedness

Confederation
Cantons
Municipalities

In percent of GDP.
Source: Federal Finance Administration



1999 2000 2001 2002 2003

2.3 Capital and credit markets

Rise in long-term interest rates

Aside from an upward blip in April, long-term interest rates remained at their December 2002 level through the first five months of 2003. In June, however, they began moving upwards. The average yield on ten-year Confederation bonds rose from 2.4% at the end of May to 2.8% in December. The interest rate rise reflected the market's expectations that an economic recovery would set in and that monetary policy would sooner or later be tightened. Short-term interest rates, however, remained low after the key rates were cut by the National Bank in March. The yield differential between ten-year Confederation bonds and money market debt register claims, which stood at 2.1 percentage points in the previous year, continued rising to just under 2.7 percentage points in December.

Lower risk premiums for bonds of private debtors

Owing to expectations of an economic recovery, the yield spread between corporate bonds and government paper narrowed substantially. By December, the yield on three-year bank bonds was about 16 basis points higher than that on comparable Confederation bonds, as against a differential of almost 50 points a year earlier. The corresponding yield spread for industry bonds narrowed even more strikingly, falling from 152 to 61 basis points.

Recovery on the equity markets

After a two-year bearish spell, the Swiss Performance Index (SPI) recovered by 22% during 2003. At the end of December 2003, it stood at 3,962 points compared with 3,246 points a year earlier. The negative trend persisted at the beginning of the year, and by mid-March the index had dropped to a low of 2,603 points. Since then, however, the SPI has risen almost without interruption. Gaining 20%, share prices of large companies advanced less sharply than those of small (up 32%) and medium-sized companies (up 35%). All sectors of industry gained ground, though to varying degrees. The biggest winners were banks and retailers, as well as the electrical, machinery and energy sector. Other sectors made significantly smaller advances.

Brisker borrowing on the capital markets

Borrowing on the Swiss capital market was much brisker in 2003 than in the previous year. Net borrowing in the form of publicly issued stocks and bonds amounted to CHF 23 billion compared with CHF 17 billion in 2002. This can be ascribed to a marked increase in domestic borrowing: net issuing of Swiss franc bonds by domestic borrowers doubled from CHF 3.7 to CHF 7.6 billion. Unlike the previous year, share issues exceeded buybacks. Net borrowing on the equity market came to CHF 1.3 billion, as against a negative figure of CHF −1.7 billion in 2002. The net issuing value of Swiss franc bonds issued by foreign borrowers declined by 5% to approximately CHF 14 billion.

1999 2000 2001 2002 2003

Existing mortgages at cantonal banks

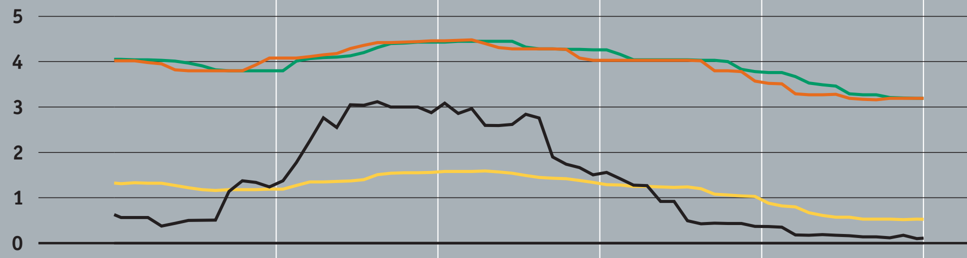
New mortgages at cantonal banks

Savings deposits at cantonal banks

Three-month time deposits at big banks

In percent.

Selected bank interest rates



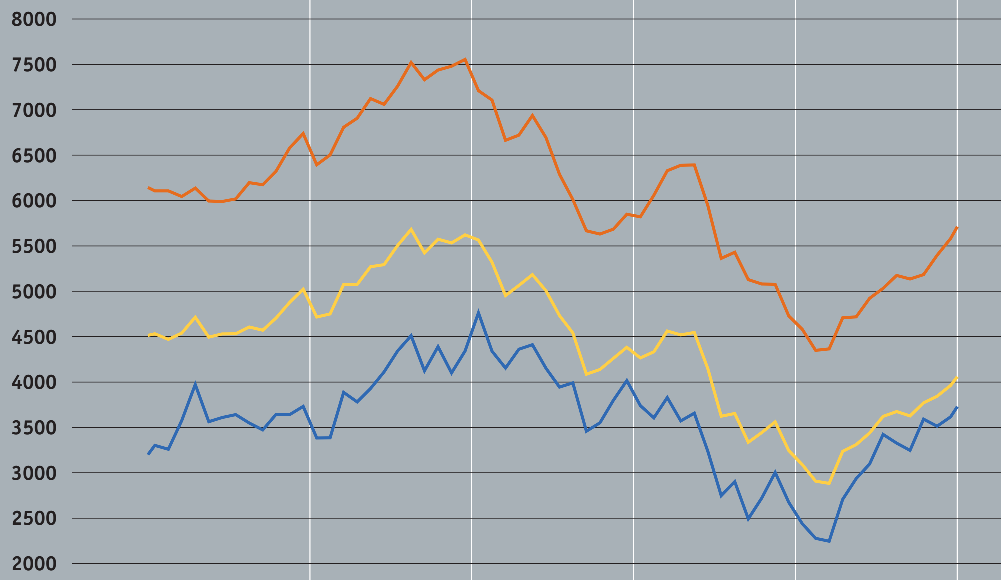
Total

Banks

Industry

Swiss Performance Index.
Source: Swiss Stock Exchange

Share prices



1999 2000 2001 2002 2003

Slight rise in credit volume

The volume of domestic credit taken up in 2003 rose by 2.5%. 82% of the banks' domestic lending was accounted for by mortgage loans and 18% by domestic customer claims. The positive trend in mortgage lending continued (+5.3%). At the same time, domestic customer claims declined by 7.5%, although the downturn was less pronounced than in the previous year (-11.1%). Apart from the Raiffeisen banks and foreign-controlled institutions, all the major banking groups reported a decrease in loan portfolios. The fall-off in lending to manufacturing and industry as well as lending institutions was particularly pronounced. Owing to this development, the proportion of secured bank claims continued to rise. On the refinancing side, liabilities towards customers in the form of savings and investment instruments rose by 12% while liabilities towards banks were up by 15%. The volume of medium-term notes was 16% lower than a year previously, accounting for less than 10% of traditional savings instruments.

2.4 Banks and other financial institutions

Recovery at the banks ...

Despite the lack of economic growth, the Swiss banks' results for 2003 were an improvement on the previous year. Across the entire banking sector, interest-earning business proved especially profitable. Moreover, a recovery became evident in the investment banking and private banking fields, which had come under heavy pressure in 2002.

... and insurance companies

After two turbulent years, the situation eased at the insurance companies too. Profitability rose, and insurers were able to consolidate their depleted equity base. Thanks to the recovery on the financial markets, the pension funds' financial situation also improved. The low level of interest rates prompted the Federal Council to lower the minimum interest rate for occupational insurance schemes to 2.25% as of 2004.

Pronounced restructuring and consolidation

In addition to the rise in share prices and the favourable interest rate environment, far-reaching restructuring measures helped to alleviate the problems in the banking and insurance sectors. Owing to the recent stockmarket slump and the sluggish business climate, many of these companies were forced to implement cost-cutting measures and to focus on their core competencies.

Agreement with the EU on taxation of interest

Switzerland reached agreement with the EU on cross-border taxation of interest earnings, while at the same time retaining banking secrecy. The crux of the agreement is that Switzerland will levy a withholding tax on interest income earned by EU taxpayers, initially at a rate of 15% and most probably with effect from 2005. The rate will then be raised in stages to 35% by 2011. Three-quarters of the revenues will be remitted to the relevant countries of origin. In addition, Switzerland is committed to providing administrative assistance in cases of tax fraud, though not in cases of tax evasion.

Guidelines on the independence of financial analysis

Owing to a number of incidents abroad, the Swiss Bankers Association issued guidelines on the independence of financial analysis which were then adopted by the Federal Banking Commission as a binding minimum standard. Since 1 July 2003, these rules have been applicable to all banks domiciled in Switzerland. They are intended to improve the transparency of analysis and to avoid conflicts of interest through appropriate adjustments to organisational structures.