

Quarterly Bulletin, 2, June 1998

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Abstracts

1. Conclusions for monetary policy

The Swiss National Bank considers the present course of monetary policy adequate. It expects real gross domestic product to grow at the current rate of 2% in the foreseeable future. The anticipated stronger expansion of the money supply does not jeopardise price stability. It should soon be back at a level that is compatible with medium- and long-term price stability. A review of the National Bank's monetary policy course would become necessary if the economic upswing accelerated more markedly than expected. An eye must also continue to be kept on the development of the Swiss franc rate.

2. Economic and monetary policy developments

At the beginning of 1998 the monetary situation in Switzerland was characterised by a renewed firming of the Swiss franc. The National Bank counteracted this development in February by considerably expanding liquidity. This led to a temporary strong rise in the banks' sight deposits at the National Bank, and concomitantly in the monetary base. At the same time, short- and long-term interest rates declined. In March the exchange rate situation returned to normal, and interest rates moved up slightly. While the monetary base expanded somewhat more markedly in the first quarter than in the previous period, the growth of the money stock M3 remained weak.

Real gross domestic product exceeded the previous year's level by 2.4% in the first quarter. The favourable economic situation in the industrialised countries continued to be a mainstay of growth. In the wake of the Asian crisis, however, exports grew at a slower pace. By contrast, stronger stimuli emanated from domestic demand. This was reflected by the vigorous rise in imports. For the first time in two years employment figures topped the previous year's level, and the jobless rate continued to fall. Consumer prices remained stable in the first five months of the year.

3. General Meeting of Shareholders

In his opening speech the President of the Bank Council, Jakob Schönenberger, dealt with structural change in the Swiss banking sector. The abolition of cartel practices and the slackening of economic activity at the end of the eighties made visible the unsound structures that had established themselves in the economy and in the banking industry. A particularly serious factor was the drastic fall in real estate prices, which forced the banks, between 1991 and 1996, into massive write-offs on domestic loans and to make painful adjustments to their business policies. The rapid pace of change in the financial sector also poses considerable challenges for the responsible authorities.

The Chairman of the Governing Board, Hans Meyer, addressed the principal developments in the field of monetary policy. The economic recovery was still weak in 1997. The chief concern therefore was the development of exchange rates. The National Bank counteracted the appreciation of the Swiss franc set off by the crises in East Asia. The reform of the monetary constitution made considerable progress. The

proposal for a new article on money and currency drawn up by the Federal Council met with a largely positive response. In the cash sector, the growing concentration of currency flows called for a reduction of cash processing centres to four locations. Following a new agreement with the Federal Council, the National Bank will increase its profit distribution in the period 1998-2002 to an annual CHF 1.5 billion.

4. Speech delivered at the Annual General Meeting of Shareholders of the Swiss National Bank on 24 April 1998

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5. Structural unemployment and inflation in Switzerland

The structural (or natural) unemployment rate represents the rate that is free of inflationary or disinflationary pressures. This article tries to estimate the structural unemployment rate in Switzerland and to evaluate their utility for monetary policy. To this end, we apply two methods: the Beveridge curve and an expectations-augmented Phillips curve, which leads to the computation of the NAIRU. The estimates show a significant degree of uncertainty, which reduces their information content for the central bank. We nevertheless observe an increase in the level of structural unemployment since the mid-seventies. The increase was particularly pronounced during the last recession.

6. Chronicle of monetary events

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1. Conclusions for monetary policy at the end of June 1998

Since the beginning of the year, the cyclical recovery of the Swiss economy has continued. Although the crises in East Asia led, as expected, to a slowdown in the rise of exports, its effect on the pace of overall economic activity was compensated by a gradual strengthening of domestic demand. Consumer sentiment showed a clear improvement, and business investment was stepped up. Construction demand, too, began to slowly rise from a low level. Domestic demand was stimulated by the decline in long-term interest rates, which had been triggered around the end of 1997 by the massive shifts in capital flows from East Asian countries and by receding inflation expectations around the world. The consumer climate was further enhanced by a perceptible improvement in the labour market and the return of slowly rising personal disposable incomes. In the first quarter the number of employed persons exceeded the year-earlier level for the first time in two years, while the unemployment rate dropped markedly in all parts of the country.

The positive cyclical performance was accompanied by stable consumer prices. The high degree of price stability was attributable to moderate price developments in general rather than to special factors, such as declining oil prices. This reflects the free capacities still existing in the economy, which limit the leeway for price rises. Increased competition both at home and abroad as well as productivity growth in manufacturing and in services also have a dampening effect on prices.

In the past few months the Swiss National Bank again endeavoured to support the economic upswing with its monetary policy. In February, therefore, it counteracted an impending appreciation of the Swiss franc by a large temporary infusion of liquidity in the money market. This measure proved a success. In March the Swiss franc exchange rate weakened markedly against all European currencies. At the same time, the additional liquidity was rapidly withdrawn. The decline of the Swiss franc's foreign exchange value was accompanied by moderately rising short- and long-term interest rates. In May they had more or

less regained the end-1997 levels. Since, however, the export-weighted real exchange rate was lower, monetary conditions were somewhat more expansionary than in December 1997.

The increase in liquidity in February temporarily led to a massive rise in the seasonally-adjusted monetary base. The broad monetary aggregate M3, however, was not affected accordingly; actually, it expanded much more slowly in the first quarter. In the second half of the year the National Bank expects the monetary base and the monetary aggregate M3 to expand more rapidly. Higher household consumption expenditure as well as the decline in interest rates on saving deposits and in the yield on federal bonds since the beginning of 1998 are likely to stimulate the demand for currency and other liquid assets. For the third quarter the National Bank forecasts a monetary base of Sfr 33.4 billion. The gap between the monetary base and the medium-term target path is thus likely to widen somewhat. The quarterly forecast of the monetary base is, however, fraught with considerable uncertainty as the normal cyclical and interest-rate dependent development of banknote circulation is liable to be affected by the issue of the new thousand-franc banknote in April.

Despite the anticipated acceleration of money growth the National Bank considers the present monetary policy course adequate and sees no need for a tightening at this juncture. It expects the real gross domestic product in the foreseeable future to continue growing at the present annual rate of 2%. The stronger money growth poses no threat to price stability. It is likely to be only temporary; a return to lower rates commensurate with medium- and long-term price stability can be expected soon. It would become necessary to reconsider the present course of monetary policy in the event of a unexpected marked acceleration in the economic upswing. An eye still needs to be kept on the development of the Swiss franc exchange rate.

6. Chronicle of monetary events

Agreement on profit distribution

On 8 April 1998, the Federal Council gave its approval to a new agreement with the Swiss National Bank (SNB) on the distribution of profit. In terms of this agreement, profit distribution will be laid down, based on an earnings forecast, for a five-year period. Between 1999 and 2003 an annual sum of CHF 1.5 billion will be distributed, 1/3 of this amount to the Confederation and 2/3 to the cantons. The new agreement between the Federal Department of Finance and the SNB will smooth out the distribution of profit even better than in the past, facilitating financial planning for the Confederation and the cantons. The agreement supersedes the profit distribution concept of 1992. At that time, the principle was adopted that the SNB's provisions should be increased in step with nominal gross national product. In order to allow distributions to be smoothed out, the upper ceiling was limited to CHF 600 million a year. The new agreement on profit distribution still adheres to the rule that the SNB's provisions should increase in line with the growth of nominal GNP. The earnings statement will now be kept even for a period of five years based on an earnings forecast of the SNB; however, provisions may not drop below 60% of envisaged holdings. It became possible to lift the annual distribution to CHF 1.5 billion since, commencing with the business year 1998, the revised National Bank Law permits the SNB to invest its currency reserves more profitably. Profits are to be transferred to the Federal Finance Administration for distribution to the Confederation and the cantons immediately following approval by the SNB's Annual General Meeting, i.e. for the first time at the end of April 1999. In order to spread profit distribution as evenly as possible in the intermediary phase between the old and the new agreement, the SNB remitted the profit from the fiscal year 1997 (CHF 600 million in terms of the old agreement) already at the end of April 1998, and not in January 1999 as originally envisaged.

Message concerning the new article "Money and currency" in the Federal Constitution

On 27 May 1998, the Federal Council submitted a message concerning the new article on "Money and currency" in the Federal Constitution (FC) to Parliament. With the amendment to the Constitution the outdated link between the Swiss franc and gold is to be severed and monetary law is to be brought into conformity with monetary reality. The planned revision is based on the preparatory work of the group of experts "Reform of the monetary order" (cf. Quarterly Bulletin No. 4/1997, pp. 379/381, [German/French]).

The proposed monetary article will replace the central bank and coinage articles in the FC with a modern monetary order by providing the National Bank with a clearly defined mandate and an independent status. The SNB's task is to pursue a monetary policy in the interests of the country as a whole, with priority

being accorded to price stability. In addition to the independent status, the obligation of the SNB to render account will also be laid down in the Constitution. Finally, the article in the Constitution puts the SNB under an obligation to maintain currency reserves - including gold - necessary for fulfilling its task. Since the SNB has more currency reserves at its disposal, when calculated at a market-related gold price, than it requires for implementing its monetary policy, approximately half of its total gold holdings of 2,590 tonnes can be put to other public uses. The Federal Council intends to leave these reserves - with the exception of the capital required for the Swiss Foundation for Solidarity - in the possession of the SNB, to have them shifted into more profitable investments and managed by external portfolio managers. The earnings will continue to be allocated in the ratio of one-third to the Confederation and two-thirds to the cantons.