

# Quarterly Bulletin, 1, March 2000

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## Abstracts

### 1. Monetary policy decisions for the 2nd quarter 2000

On 23 March 2000, the Swiss National Bank decided to further tighten its monetary policy and to increase the target range for the three-month Libor rate from 1.75%–2.75% to 2.25%–3.5%. This step was in response to the growing inflationary dangers emanating from accelerating economic activity and the development of the exchange rate.

### 2. Economic and monetary developments

Strengthening international economic activity and the favourable monetary environment caused economic growth to gain considerable momentum in Switzerland in the second half of 1999. Vigorously rising exports were the main factor contributing to the surge in growth. In line with overall economic output, employment levels also moved up significantly while jobless figures continued to fall. The inflation rate measured by consumer prices increased markedly in the fourth quarter in the wake of substantially higher oil prices. In January and February, it again declined slightly to 1.6%. Following a stronger economic upswing both in Switzerland and abroad than had originally been expected, inflation risks, however, grew overall.

In December 1999, the National Bank for the first time announced a target range for the three-month Libor rate. It fixed the target range at 1.25%–2.25%, initially aiming at the middle of the range. Near the end of January and at the beginning of February, the National Bank tightened its monetary policy course somewhat. It first allowed the three-month Libor rate to rise to the upper level before increasing the target range by one-half percentage point to 1.75%–2.75% on 3 February. The decisive factor was the growing inflationary dangers emanating from the weak trend of the Swiss franc vis-à-vis the US dollar and from the unexpectedly vigorous upswing of the Swiss economy.

### 3. Monetary policy in 2000

In a speech delivered at the University of St Gallen on 21 January 2000, the Chairman of the National Bank's Governing Board, Hans Meyer, elaborated on the three main elements of the monetary policy concept introduced at the beginning of 2000. With respect to the first element, the definition of price stability, it must be borne in mind that inflation cannot be measured with complete accuracy. Moreover, it is practically impossible for the National Bank to steer inflation precisely, which is why the National Bank does not pursue an actual inflation target. The second element, the inflation forecast over a period of three years reflects the National Bank's forward-looking stance. The third element, the target range for implementing monetary policy represents a deviation from quantitative standards in the money market. It became increasingly difficult to set such standards in view of the strong fluctuations in the banks' demand for sight deposits. In fixing a target range, the National Bank does not aim at pursuing an active interest rate policy and will continue to permit interest rate fluctuations to a certain extent.

#### **4. The European Central Bank and its monetary policy**

On 1 January 1999, the European Central Bank (ECB) took up its activity and assumed responsibility for formulating and implementing monetary policy for the entire European currency area. This paper discusses and assesses the general guidelines and principles based on which the ECB formulates its monetary policy. The article also deals with the critical discussion surrounding the ECB's monetary policy concept taking place between adherents of a strategy of inflation targeting and adherents of a strategy of monetary targeting. Finally, the study also investigates whether relevant insights may be gained from this discussion for monetary policy in general and therefore also for Swiss monetary policy.

#### **5. Chronicle of monetary events**

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##### **1. Monetary policy decisions for the 2nd quarter 2000**

On 23 March 2000, the Swiss National Bank decided to further tighten its monetary policy and to increase the target range for the three-month Libor rate from 1.75%–2.75% to 2.5%–3.5%. This step was taken in response to the growing inflationary dangers emanating from accelerating economic activity and the development of the exchange rate. The National Bank announced that it is aiming at the middle of the target range.

The National Bank had last increased the target range for the three-month Libor rate on 3 February, by a half percentage point to 1.75%–2.75%. Data released after this interest rate adjustment shows that the Swiss economy had gained enormous momentum in the second half of 1999. This unexpectedly strong acceleration in growth was accompanied by a distinct rise in employment and a further decline in unemployment. The vigorous growth is broadly based. On the domestic front, private consumption and notably construction demand picked up. The chief stimuli, however, emanated from exports, which benefited from the international economic upswing and the falling export-weighted exchange rate.

Leading indicators show that the growth of real gross domestic product of close to 2% forecast by the National Bank at the end of 1999 will be clearly surpassed in the current year. The industrial and construction sectors witnessed a marked expansion in both incoming orders and orders on hand. Consumer sentiment is excellent, and there are increasing signs of the labour market tightening. Moreover, inflationary stimuli from abroad are becoming discernible. On the one hand, the decline in the export-weighted exchange rate increases the price of imported goods and, on the other, production costs are rising in the wake of higher raw material prices.

Given the dynamic economic development and the continued weak trend of the Swiss franc vis-à-vis the dollar the inflationary risks have grown significantly. If the National Bank left the interest rates unchanged, inflation measured by consumer prices could climb to over 2% in the medium term. By raising the target range for the three-month Libor rate by 3/4 percentage points this danger is to be counteracted.

#### **5. Chronicle of monetary events**

##### **Increase in the target range for the three-month Libor rate**

On 3 February and on 23 March 2000, the National Bank increased the target range for the three-month Libor rate by 0.5 percentage points to 1.75%–2.75% and by 0.75 percentage points to 2.5%–3.5% respectively. The Bank thus reacted to growing inflationary threats.

##### **The Federal law on currency and payment instruments enters into force on 1 May 2000**

The Federal law on currency and payment instruments was passed by the federal parliament in the winter session of 1999 (cf. Quarterly Bulletin 4/1999, p. 81). After the period for instituting a referendum had expired unused on 20 April 2000, the Federal Council put the new law into force as per 1 May 2000.

The Federal law on currency and payment instruments implements the severance of the gold link of the Swiss franc on the statutory level. Simultaneously with the definitive removal of the SNB's obligation to redeem banknotes and of the gold parity of the Swiss franc from federal legislation, the Decrees of the Federal Council of 29 June 1954 concerning the legally fixed exchange rate of banknotes and the abolition of their redemption in gold, and of 9 May 1971 concerning the fixing of the gold parity of the Swiss franc were rescinded. The new federal law embodies the revised regulations concerning the characteristics of currency and the national money which are relevant for the public. It defines the Swiss currency unit, describes the legal payment instruments and the obligation of creditors to accept these instruments, replaces the coinage law in its entirety and incorporates the provisions relating to banknotes from the National Bank Law. Together with the Federal law on currency and payment instruments, the revised coinage ordinance was also put into effect.