

# The economic situation from the vantage point of the delegates for regional economic relations

Summary report to the attention of the Governing Board of the Swiss National Bank for its quarterly assessment of December 2005

The Swiss National Bank's delegates for regional economic relations are constantly in touch with a large number of enterprises from the different industries and economic sectors. Their reports, which contain the subjective evaluations of these companies, are an important additional source of information for assessing the economic situation. The main results of the talks held between September and November 2005 on the current and future economic situation are summarised in this section.

## Summary

The talks held with around 140 companies and industry associations between September and November 2005 yielded a more favourable picture than in the preceding period. The economic upswing seems to have gained momentum and is gradually spreading to the domestic economy. Representatives of the export, financial services and construction sectors were once again extremely upbeat. By contrast, the retail sector remains more cautious about the situation. The tough price competition was stressed in almost all talks.

Overall, investment increased and there was no more talk of a freeze on capital spending. However, tough competition meant the focus was still on modernisation and rationalisation. Nevertheless, investment to increase capacity also picked up. The majority of those interviewed took an optimistic view of 2006. In many cases, this confidence was based on comfortably full order books that will ensure good capacity utilisation well into the new year.

# 1 Production

## Manufacturing

The industrial companies surveyed were upbeat about business trends. They have achieved and in many cases exceeded the – often ambitious – sales targets set for 2005. High capacity utilisation has lengthened lead times. Asia (China), Central and Eastern Europe and the US remain particularly dynamic markets. By contrast, companies are less positive about business with other parts of Europe, although the situation does not seem to have deteriorated further.

Once again, the fastest growing industries included the chemical and pharmaceutical industries, medical technology, biotechnology, electrical and electronic engineering and watchmaking. Business prospects also seem to be brightening in other areas that have so far lagged behind the general upturn, especially general mechanical engineering and vehicle construction. Other areas such as the textile and apparel industry continued to contend with difficult conditions but even these industries were relatively optimistic about 2006.

## Services

The retail sector remained guarded about business trends, but there were isolated indications of a slight improvement. It was felt, however, that consumers were still cautious and price-conscious. Pressure to cut prices was especially prevalent in the wholesale sector. Although sales are surging in the newly created low-price segments, this is taking business away from other segments. Overall, therefore, sales are making little headway. Smaller, speciality businesses targeting the upper price bracket posted very good sales trends, partly thanks to the rebound in the tourist trade.

Despite bad weather and floods in late August, most representatives of the hotel industry felt that the summer season had been satisfactory to good. In many cases, good bookings in the autumn made up for loss of turnover in the summer, at least to some extent. City tourism increased substantially, due not least to rising numbers of visitors from Asia. By contrast, the catering industry still has to contend with tough competition and customer restraint, so it is far more pessimistic about the situation. Both private and corporate clients are still tending to economise, but financial services customers are returning to somewhat more generous spending patterns.

Corporate services – e.g. transportation, telecommunications, logistics and consultancy – registered an upturn in business. The advertising industry also picked up, mainly thanks to lavish advertisements placed by the real estate industry. In fact, advertising as a whole seems to be moving out of recession.

Banks again reported good trends. Mortgages and asset management are still the main sales drivers in this industry. Opinions are divided about trends on the mortgage market, with assessments showing strong regional differences. Some of those interviewed – including representatives of construction and real estate – pointed to local signs of overheating and a clear rise in the risk-tolerance of banks, while others were convinced that the risks were under control.

## Construction

Companies focusing on residential construction continued to rate the outlook as very good and saw little indication that the market would weaken in the near future. Order volumes look set to remain high for the time being and could even increase in some areas. Nonetheless, there was a general awareness that the sharp rise in residential building activity is likely to be followed by leaner times. Construction companies have not really expanded capacity in recent years, so utilisation rates should remain good even if demand tails off. Most of those interviewed in commercial and industrial construction saw little growth in business other than in the retail segment, while opinion on civil engineering remained pessimistic.

## 2 Labour market

Overall, recruitment remained subdued. Many companies only increased staff numbers on a temporary basis. The retail sector is continuing to reduce its headcount. Talks with representatives of a wide range of industries highlighted the substantial shortage of skilled employees, especially those with technical and commercial skills.

## 3 Prices, margins and earnings situation

Although business has picked up, high pressure on prices and margins has remained a dominant topic. In general, higher costs resulting from the rise in energy and raw material prices could not be passed on to customers, leading to a massive drop in revenues in some areas such as transportation (especially air transport). Often companies have endeavoured to offset the reduction in margins by cutting back in other areas. Many suppliers – especially in the food sector – are feeling the impact of the pressure on retail prices. In response to this trend, there was a clear consensus among both industrial and service companies about the need to raise productivity, cut costs and adopt innovative policies to gain access to lucrative lines of business. A few companies had been able to raise prices thanks to buoyant demand for their products, and an increasing number saw scope to increase prices in the coming year.