

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

Summary report for the attention of the Governing Board of the Swiss National Bank for its quarterly assessment of March 2008

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. On the following pages, the most important results of the talks held from December 2007 to February 2008 on the current and future economic situation are summarised.

Summary

Most of the 170 or so representatives of various economic sectors and industries interviewed by the SNB delegates for regional economic relations between December and February reported good business activity. The industrial sector and consumer-related industries such as retail and tourism performed particularly well. By contrast, respondents from the banking sector, who have been considerably affected by the stock market slump, gave a more cautious assessment.

The prevailing outlook for the next few quarters is optimistic. Given the high level of capacity utilisation, the current year should again see some significant investment. In contrast to the autumn 2007 round of talks, however, financial market turbulence and the uncertainty this is causing put a dampener on sentiment, thus nipping any euphoria more or less in the bud. Nevertheless, both banks and companies refuted any suggestion of a tightening in lending conditions. On the other hand, rising prices for energy, industrial raw materials and agricultural products, coupled with the weak dollar, proved to be a major burden. Recruitment of personnel also continues to pose a problem.

1 Production

Manufacturing

After what was, for the most part, a very successful 2007, the majority of manufacturing companies got off to a good start in 2008 and were generally able to reach or even exceed their targets. However, sales growth targets for 2008 are mainly lower than the figures from the previous year. Outstanding orders remained at a very high level and, in many cases, are set to extend through the first half of the year. The EU, eastern Europe (Russia) and Asia (China) continued to be the most important drivers of demand. Nevertheless, a number of companies reported a sharp decline in demand from the US. This was especially the case for suppliers to the US automobile and construction industry, although companies in other sectors have not (yet) experienced much of a slowdown. Markets are broad-based in geographic terms, meaning that higher sales in other regions frequently helped to offset US losses. Utilisation of technical capacity and staffing levels remained very high in most sectors, thus again resulting in production delays and extended delivery periods. Procurement of raw materials is still a problem, although the situation does seem to have eased somewhat.

The healthy economic climate extended across almost all industries. High levels of investment worldwide in the relatively non-cyclical areas of electricity and transport had an especially stimulating effect, as did increased efforts to consume energy and raw materials more efficiently. However, a large number of respondents expected order intake to level off during the course of the year, even though clear indicators pointing in this direction are still few and far between. In many cases, respondents saw this as part of a process of the economy 'returning to normal' – which, in view of the continued signs of overheating, was something to be welcomed.

Services

Representatives from consumer-related service sectors again expressed a great deal of satisfaction at the way business has performed. After what was by and large a gratifying Christmas season, retailers reported good sales results for January and February and continued free-spending on the part of consumers. This applies both to wholesalers and to smaller retailers. Nevertheless, some respondents offered a somewhat more circumspect

outlook for the rest of 2008 and reduced their sales targets accordingly. Car dealers are currently one such retail group with this mindset. Up to now, signs of a drop in expectations have been particularly evident in the medium price bracket, but less so in the high-price and luxury segments. Retailers in Switzerland's border regions continued to benefit from the exchange rate-induced decline in cross-border shopping by Swiss residents.

Respondents from the various tourism sectors also painted a positive picture. The winter season generated record results in some areas, thanks to favourable snow and weather conditions and a considerable willingness to spend on the part of tourists. Most respondents were optimistic as regards future prospects. The numbers of both domestic holidaymakers and tourists from the EU, Asia and eastern Europe are extremely encouraging, so that the drop in visitors from the US has probably been compensated. Swiss cities also benefited from the continuing strong demand relating to business events and conferences. Having said this, some parts of the banking sector were reporting cancellations.

The outlook among representatives from the company-related services segment was more mixed. Whereas respondents from the IT industry were upbeat, transport and logistics companies reported a drop in cross-border transactions. Higher transportation costs are also having a tempering effect. A number of management consultants, whose clients include banks, have also expressed misgivings.

Given the financial market turbulence and weak stock market, banks were less optimistic as regards the business climate than they were a few months ago. This rather more downbeat view was especially noticeable among service providers operating mainly in the wealth management segment, whose clients' custody account assets have contracted. Customers are also less inclined to perform banking transactions. Consequently, many of the respondents surveyed expected a decline in commission income compared to the prior-year level. The lending business continued to perform well, though margins remain under pressure. In view of the slowdown in the residential construction sector, banks are expecting a deceleration in mortgage volume growth. Corporate lending remained robust, with banks continuing to take a favourable view of their clients' financial circumstances. They rejected any suggestion that they had tightened their lend-

ing conditions, and this was confirmed in discussions with business representatives. However, there is some trepidation among a number of companies at the prospect of having to renew their respective loans.

Construction and real estate

Construction industry representatives were again encouraged by economic conditions, despite most reporting a downturn in new residential building. In many cases, a high order backlog guarantees continued activity well into 2008. Commercial and industrial construction and, to a certain extent, major public building projects are helping to provide positive impetus. The verdict was also positive among respondents from the construction-related industries, which are benefiting greatly from a high level of renovation activity and improvements in energy technology. Opinions are still divided on the outlook for the real estate market. Price increases – most notably in the top price bracket – seem to be subsiding in some regions. This is attributable to an increase in the availability of residential property and to heightened price sensitivity, mainly on the part of potential buyers from abroad. In other regions, strong demand and rising real estate prices continue to be norm.

2 Labour market

While a number of respondents have indicated their intention to further expand their workforce this year, the demand for additional labour seems less urgent compared to the previous year. Temporary employment is being used increasingly as a means of covering personnel requirements. The recruitment of qualified staff is still proving to be a difficult and cost-intensive process – a problem which applies to the labour markets both in Switzerland and abroad. Fluctuation rates also remained at a high level. The wage increases implemented by most respondents were more substantial than in the prior-year period. Almost all companies reported a rise in wage pressure – a situation which only gave cause for concern in exceptional cases, however.

3 Prices, margins and earnings situation

Rising prices for energy, raw materials and agricultural products were a considerable worry. Scope for price adjustments in the industrial sector has increased during the economic upswing of the past few years. However, fierce price competition continues to dominate many areas, and this often prevents the full cost of inflation from being passed on to customers. Companies are therefore continually seeking to increase productivity in order to maintain margins. At the beginning of the year, wholesalers upped the prices of numerous basic foodstuffs such as bread, flour and milk products, thereby passing on at least some of the higher procurement costs for corn and milk. Customers apparently accepted these price hikes without complaint. Nevertheless, in view of the consistently tough competition, representatives from the retail sector are still envisaging downward pressure on prices.

As a result of the weak dollar, many exporters are seeing their margins shrink drastically. Price increases in the US currency only tend to work in exceptional situations, and companies that charge in Swiss francs are often forced to make price concessions. In some parts of the Asian dollar area, invoicing in euros is being increasingly encouraged. In contrast, exporters expressed continued satisfaction with the euro exchange rate. Although the euro, which was still strong, pushed up the price of numerous goods from the EU area, the consumer goods sector in particular was able to pass on the cost of these hikes.