

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

Second quarter of 2010

Summary report for the attention of the Governing Board of the Swiss National Bank for its quarterly assessment of June 2010

The SNB's delegates for regional economic relations are constantly in touch with a large number of enterprises from different industries and economic sectors. Their reports, which contain subjective evaluations of these companies, are an important additional source of information for assessing the economic situation. The following pages contain a summary of the most important results of the talks held in April and May 2010 with some 230 company representatives on the current and future economic situation.

Summary

The favourable economic trend continued in the second quarter. Compared to the previous year, it was the recovery in manufacturing that was most evident. But in a quarter-on-quarter comparison too, manufacturing generated the strongest sales momentum. However, broad-based growth was also apparent in the construction industry and in the services sector, and the demand for labour gradually picked up. Companies are nonetheless still very reluctant to expand their workforces.

As a result of the stronger demand, industry representatives are looking to the immediate future with confidence. Expectations for the next few months point to positive turnover growth in all three economic sectors. The under-utilisation of production capacity in the Swiss economy is therefore likely to decrease further.

Apart from the favourable development of business activity, however, increasing concerns were also expressed about the complex economic situation. The state of public finances around the world and the impact this situation could have on

financial and foreign exchange markets, as well as on aggregate demand in the affected countries, are creating considerable uncertainty. In the view of a number of representatives, the extremely expansionary monetary policy being pursued around the world carries inflation risks and is sparking fears of sudden interest hikes. In the manufacturing industry, in particular, volatile commodity prices and indeed the availability of commodities generally is a source of concern. There are considerable discrepancies in the reactions of the industry representatives with regard to the weakening of the euro. This phenomenon is a problem for the hotel industry and for companies which generate the majority of their sales in the euro area, or which are exposed to strong competitive pressure from imports. In many cases, the negative effects of the depreciation of the euro can be cushioned by natural hedging strategies and a diversified client structure. The improved competitive strength of the euro area may also feed through into greater order volumes in Switzerland. In some industries the weakening of the euro is seen as beneficial, as it will lead to lower purchase prices.

1 Business activity

Manufacturing

The economic situation in the manufacturing industry saw further improvement in the second quarter. Turnover increased strongly and reached a significantly higher level overall than in the previous year. The positive turnover development was broad-based, with only a few companies posting turnover figures below last year's level. Although starting from very different levels, the textile and clothing industry, chemical industry, pharmaceutical industry, watchmaking industry and metals industry have all recovered with an unusual degree of strength within the course of the year.

Domestic demand was in important growth support. Demand from emerging markets in Asia, but also in South America, remained exceptionally vigorous. The euro area also made a significant contribution to demand.

Technical capacity utilisation increased further as a result, and demand for labour picked up. This in turn led to a further reduction in short-time work.

Stocks of finished products have been sharply scaled down over the last few months. In the second quarter, stock levels were regarded as adequate in all sectors. Future demand stimuli are therefore likely to result in a rise in production.

Construction

Starting from a very good level, upward momentum in construction continued, albeit at a slower pace. In a year-on-year comparison, industry representatives recorded a clear increase in turnover, although the turnover rise was limited when compared to the previous quarter. Growth stimuli have primarily been emanating from the residential and finishing areas, as well as civil engineering. A number of industry representatives expressed their concern over the real estate market risks that result from the low interest rate policy.

Services

Turnover in the services sector rose significantly between the first and second quarter of 2010. As a result, they clearly surpassed the previous year's level. The positive development was more broadly based than in the first quarter. Posting a very strong quarter-on-quarter increase in turnover, wholesale generated the strongest momen-

tum. Robust turnover growth was also observed in the retail trade, the hospitality industry and in IT. The financial industry saw the weakest growth, with a number of banks and insurers experiencing slight declines in business volumes.

2 Capacity utilisation

As in previous quarters, the degree of technical capacity utilisation in manufacturing differed greatly from industry to industry, as well as from company to company. On average, it remained below the level viewed by companies as normal, despite further clear recovery. Particularly striking was the under-utilisation of capacity in the mechanical engineering industry. However, the phenomenon also remained pronounced in the chemical, watchmaking, clothing, textiles and precision instruments industries, despite the favourable development of business activity in these sectors in recent months. The metals sector showed a very mixed picture. Capacity utilisation was at a normal level in the food industry, while it was assessed as normal to high in the pharmaceutical industry.

The construction sector saw a slowing of growth from the high level it had already attained. On average, technical capacity utilisation in this sector was considerably above the normal full employment level in the second quarter, too. Companies currently experiencing an unsatisfactory level of capacity utilisation were very much the exception.

In the services sector a certain degree of under-utilisation of capacity persisted, although this was less marked than at the beginning of the year. Despite strong sales growth, capacity utilisation in wholesale and in certain areas of the hotel industry was clearly unsatisfactory. This phenomenon was also evident in the corporate consulting and recruitment areas, in banks, and in clothing and shoe retail.

3 Demand for labour

Some redundancies are still occurring in certain parts of the manufacturing industry. In general, however, the recovery in business activity has gone hand in hand with an increase in demand for labour. This has not led to an increase in employment, however. Instead, existing short-time work measures have been withdrawn and previous labour productivity losses made good. Overall, workforce levels appeared to be in line with company requirements. The pharmaceutical industry is the only one in which a certain shortage of labour supply was evident.

In the construction sector too, the great majority of companies expressed themselves happy with the current level of employment, although in the finishing area there were occasional reports of a labour supply shortage, and people were often being recruited on a temporary basis to fill gaps.

In the services sector, the employment level was considered generally adequate to slightly inadequate. A need to hire additional staff was mainly expressed in the wholesale and transport areas.

In general, the difficulty of recruiting new staff was assessed as lower than usual. Exceptions in this respect were the construction sector and the chemical and pharmaceutical industry, with highly qualified staff in the laboratory, development, and management areas being particularly difficult to source.

Per capita labour costs in most sectors were comparatively stable, with the exception of the food, chemical, and the pharmaceutical industries. In these areas there was a noticeable year-on-year increase in real wages. Wages were also trending slightly upwards in the construction sector and the services sector, particularly in the IT industry, transport, and trade.

4 Prices, margins and earnings situation

The higher production and turnover volumes improved profit margins, as fixed costs were more fully absorbed. However, margins in the manufacturing industry were viewed as significantly weaker than was customary, as had already been the case at the beginning of the year. Margins are expected to remain under pressure in the short term. On the

one hand, companies are expecting an increase in purchase prices as stronger global demand leads to higher commodity prices (including cotton, oil and oil-related products, chemicals and metals), although the appreciation of the Swiss franc is likely to dampen this phenomenon to a certain extent. On the other hand, sale prices are expected to remain stable, on the whole. A number of companies from various sectors will try to push through price increases, but this will be dependent on specific company-related and market factors.

Anticipated increases in cement and steel prices are likely to lead to a deterioration of profit margins in the construction sector, as an increase in sale prices is only envisaged in a few cases. The depreciation of the euro is leading to stronger competition with foreign providers.

On average, representatives from the services sector considered the level of their profit margins as normal to slightly unsatisfactory. The overall result was negatively influenced by the clearly unsatisfactory interest rate margins of banks – with competition in the mortgage lending business being particularly fierce – and by the wholesale sector.

5 Outlook

The improvement in sentiment in the manufacturing industry, which has been evident since the fourth quarter of 2009, has continued. The majority of companies are anticipating a rise in turnover and higher capacity utilisation. The employment outlook for the next six months has also improved, and a slight rise in employment is now anticipated. In the January/February interviews, industry representatives were anticipating no change in employment levels. A return to increased labour productivity remained a widespread goal.

Companies remain optimistic in the construction industry, and are anticipating a further slight increase in turnover. In the residential and finishing areas, companies are anticipating a stabilisation of capacity utilisation at the current high level. A number of companies in the civil engineering sector are expecting a rise in capacity utilisation. No industry representatives are anticipating a decline in capacity utilisation. Employment is likely to remain stable.

In the services sector, expectations of business activity over the next six months have improved. Particularly optimistic appraisals of sales prospects were evident in wholesale and retail, in automotive sales, and in the IT sector. Consequently, representatives from the services sector anticipated a further increase in capacity utilisation and a slight rise in employment.

However, considerable uncertainties persist regarding the prospects for the European economy, potential exchange rate movements, and the future interest rate situation. Investment plans were therefore still rather on the cautious side, just as in the first quarter of 2010. Both equipment and construction investment are likely to rise only very slightly over the next 12 months.