

Business cycle trends

SNB regional network

Summary report for the attention of the Governing Board of the Swiss National Bank for its quarterly assessment of March 2011

First quarter of 2011

The Swiss National Bank's delegates for regional economic relations are constantly in touch with a large number of enterprises from the different economic sectors and industries. Their reports, which contain subjective evaluations by these companies, are a valuable source of information for assessing the economic situation. The following pages contain a summary of the most important results of the talks held in January and February 2011 with 243 company representatives on the current and future situation of their companies and the economy in general. The selection of companies was made according to a model that reflects Switzerland's production structure. The companies selected differ from one quarter to the next. The reference parameter is GDP excluding agriculture and public services.

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Summary

The favourable economic trend continued in the first quarter. As in the previous quarters, the continued upward movement was most evident in manufacturing, despite a slight decline in momentum. The growth trend also continued in the services sector, although it weakened a little. Business activity in the construction industry stabilised at a high level. Overall, the demand for labour increased only marginally.

Respondents remain confident as regards developments in the near future. Expectations for coming months suggest continued growth in turnover in manufacturing, services and, to a lesser extent, construction. The manufacturing industry, in particular, is planning to increase investment. In all three sectors, technical production capacity utilisation in the Swiss economy is normal to good.

Despite the improvement in business activity, a number of concerns remain as regards the sustainability of the global economic recovery. Although uncertainties related to the state of government finances at international level have declined, the conflicts in North Africa have given rise to a new situation, whose risks are still difficult to appraise. In addition, some of the respondents fear that inflation risks and sudden interest rate hikes could result from the very expansionary monetary policies still being pursued around the world.

As was already the case in the fourth quarter of 2010, reactions to the appreciation of the Swiss franc vary considerably. Overall, however, the pressure on the economy has hardly changed at all (cf. 'Exchange rate survey: Effects of Swiss franc appreciation and company reactions', pp. 38–43).

1 Business activity

Manufacturing

In the first quarter of 2011, the economic situation for manufacturing improved, both quarter-on-quarter and year-on-year. However, growth was no longer as strong as in the fourth quarter of 2010. Turnover in real terms rose noticeably compared to the previous year, with only a few companies posting turnover figures that were still below last year's level. The improvement in watchmaking, metal processing, machinery and machine tools has been particularly pronounced within the past year. Favourable developments were also recorded in plastics, chemicals and pharmaceuticals and in the electronics and furniture industries.

Domestic demand held strong while demand from abroad also remained lively. Demand from the emerging economies of Asia was still exceptionally strong, while stimuli from the US strengthened and those from South America remained vigorous. Demand from Germany showed sustained momentum, as did that from France and Italy, albeit to a lesser degree. Various industries continued to benefit, directly or indirectly, from strong demand on the part of the European automotive industry.

Construction

Business momentum in the construction industry was maintained, at a slightly diminished level. Utilisation levels are good in both building construction and civil engineering, and resources are accordingly scarce. Current turnover is above last year's levels and those of the previous quarter, although momentum has declined somewhat. Residential construction is still the main driver of growth, although the finishing sector is also making a contribution. At present, the positive overall trend looks set to continue.

Once again, a number of respondents expressed their concern about increasing real estate market risks associated with the ongoing low interest rate policy and the strong demand for mortgages that it engenders. In some regions there is talk of 'unrealistic' or 'irrational' movements in the prices of land and real estate.

Services

In the services sector, turnover figures were good, exceeding the levels of both the previous year and the previous quarter. Assessments were almost unchanged by comparison with the fourth quarter of 2010. The greatest momentum was recorded by travel agencies, recruitment firms, insurance companies, banks, IT and hospitality, where turnover was well above that of the previous quarter. Architects, engineering and consulting firms, and wholesalers also recorded continued robust growth in turnover. However, retail business was very volatile. In border regions, in particular, the weakness of the euro is making itself felt in the form of a noticeable loss of custom to neighbouring countries. Overall, the momentum of business activity weakened somewhat for retailers, although lower turnover was often attributable to substantial price reductions rather than a drop in demand.

2 Capacity utilisation

Overall, the degree of capacity utilisation was judged to be not quite as high as in the fourth quarter of 2010. In manufacturing, construction and services, capacity utilisation exceeded the normal level by a smaller margin than it had in the previous quarter.

Manufacturing representatives continued to report good utilisation of technical capacity overall, although a number of companies mentioned a conflict between capacity and profitability which had even caused a few of them to turn down orders. Utilisation was on the high side in plastics manufacturing, watchmaking, chemicals and timber processing. Underutilisation was reported by some individual representatives in pharmaceuticals and textiles.

In construction, technical capacity utilisation remained at a high level, although it was markedly lower than that of the previous quarter. No companies reported unsatisfactory capacity utilisation. While, in the previous quarter, companies had still tended to expect a decline in utilisation, this quarter's survey showed that they were once again anticipating a slight increase in the months ahead.

In the services sector, capacity utilisation was normal, as in the previous quarter. The areas with the highest level of capacity utilisation, by far, were architects and engineering and consulting firms. Travel agents and software manufacturers also reported relatively high capacity utilisation. Trade reported normal capacity utilisation overall. Underutilisation was recorded by the hotel industry and by banks, whose representatives expressed dissatisfaction in connection with unfavourable business results achieved in asset management.

3 Demand for labour

In manufacturing, the further recovery in business activity continued to have a favourable impact on the demand for labour. Overall, representatives of manufacturing companies considered their staff levels to be on the low side, although these levels have been approaching requirements. However, a certain amount of caution as regards new recruitment was still evident. A shortage of labour was reported in electronics, watchmaking and chemicals. Personnel resources were also tight among timber processing firms. Individual companies from the textiles, metal manufacturing and processing industries reported that staff numbers were on the high side.

In the construction industry, too, the demand for labour continued to rise slightly. The majority of respondent companies were satisfied with their current staff numbers, although a number of them reported increasing difficulties filling vacant positions. In some instances, a lack of adequate personnel resulted in bottlenecks.

In the services sector, staff levels were generally considered appropriate to a little too low. Architects, engineering firms, planning offices, recruitment and IT firms all reported a need to recruit staff. The hotel industry was slightly over-staffed.

In general, difficulties in finding new staff have increased further. Compared to the previous quarter, recruitment has become more arduous and time-consuming in all sectors. This phenomenon was particularly pronounced in chemicals, electron-

ics, recruitment firms, architectural and engineering firms. Generally speaking, well qualified personnel still tended to be hard to find. Although the free movement of persons has had a beneficial effect overall, the labour market for certain job sectors appears to have dried up. Retailers did not have any significant recruitment problems.

Per capita labour costs showed a slight upward tendency in most business sectors. This mainly reflects pay rises agreed for this year. Compared to the previous quarter, wage pressure has increased, particularly in parts of the manufacturing industry but also in the services sector. Companies in machinery, watchmaking and pharmaceuticals, in particular, were faced with higher per capita costs. Wage pressure was also maintained in construction. In the services sector, increased labour costs were mainly reported by insurance companies, retailers, IT and recruitment firms.

4 Prices, margins and earnings situation

As in the previous quarters, profit margins in manufacturing were judged to be significantly tighter than usual. Although higher production and turnover volumes, per se, again helped to improve margins since fixed costs were more fully absorbed, this effect was unable to offset the general pressure on margins. Margins are likely to remain under pressure since companies expect purchase prices to continue rising, while it is unlikely that sale prices in Swiss francs can be increased to the same extent – partly due to intense competition and partly because of the exchange rate effect.

In construction, profit margins were judged to be close to normal. Compared to the previous quarter, the assessment of the situation has improved. Company representatives continued to expect further increases in commodity purchase prices. They considered it somewhat less likely than in the previous quarter that they would be able to charge higher sale prices. Competition with foreign providers in Switzerland has further intensified.

Overall, respondents in the services sector regarded their profit margins as largely normal.

Indeed, their assessment has improved over that of the previous quarter. As in the previous quarters, the overall result was negatively affected by banks' margins, which were clearly unsatisfactory. The reasons for these poor margins – apart from the low rate of interest – were the continued intense competition in mortgage lending as well as exchange rate movements which impaired asset management income. Representatives of recruitment firms, fiduciary companies, consultancy firms, transport companies and hotels also classified their profit margins as unsatisfactory. By contrast, travel agencies, IT firms and real estate management companies reported a relatively comfortable margin situation.

5 Impact of Swiss franc appreciation

As in the two previous quarters, the exchange rate situation was again raised with companies in the survey conducted in January and February 2011. When asked specifically about the impact of the appreciation of the Swiss franc on their business, 47% of the companies said they had experienced negative effects overall. This means that the situation remains unchanged from the assessment in the fourth quarter of 2010. A total of 37% of companies were unaffected by the appreciation, while 16% reported positive effects.

However, the effects varied considerably, depending on the production sector in question. Once again, manufacturing felt the most negative effects of the strength of the Swiss franc. These effects mainly took the form of greatly reduced profit margins and, to a lesser extent, a decline in sales volumes. By contrast, positive effects were mainly derived from lower import prices and, in some cases, lower investment costs.

In both the construction industry and the services sector, a majority of companies remained unaffected by the strength of the Swiss franc. However, its impact was perceptible in the tourism industry, in particular.

6 Outlook

The outlook for business activity, employment and investment remains favourable overall. Most company representatives are cautiously optimistic.

The great majority of manufacturing company representatives anticipate continuing growth in turnover and higher capacity utilisation in the coming six months. More staff recruitment is planned, but the pace of recruitment will be somewhat less forced than in the fourth quarter of 2010. With regard to the longer-term perspective, companies still have reservations about the sustainability of the current economic momentum, although their confidence has increased a little.

Companies in the construction industry remain largely optimistic, maintaining that a 'trend break' cannot be distinguished. They anticipate a further slight increase in turnover and capacity utilisation – in this respect, the positive assessment has actually risen slightly compared to the previous quarter. Companies are also planning a slight expansion in staff numbers. In the residential and finishing areas, companies are anticipating a stabilisation of capacity utilisation at the current high level.

In the services sector, expectations with regard to business activity over the next six months remain favourable. Compared to the previous quarter, assessments have trended upwards – this relates to expected turnover, capacity utilisation and recruitment plans alike. Representatives of IT, travel agencies and a number of hospitality businesses are particularly optimistic about their turnover prospects, but there is also confidence among bank, real estate and wholesaling representatives. By contrast, hotel operators in tourist regions express reservations.

The global risk factors that were most often mentioned in past quarters – uncertainty about the sustainability of the global recovery and risks in connection with the indebtedness of European countries and banks – have diminished somewhat. Risks emanating from the unrest in North Africa have now become the focus of attention. Quite a few industries are faced with sharp rises in the prices of commodities.

As regards further economic developments, overall uncertainty has declined. Business representatives are mainly concerned about the erosion of margins, staff shortages, a further appreciation in the Swiss franc and the sharp increases in the prices of some commodities. As in previous quarters, some respondents expressed unease about the continued low level of interest rates and the possible risk of inflation.

Investment plans continue to show an upward trend, particularly in manufacturing as well as, to a lesser extent, in the services sector. In manufacturing, the assessment in this respect has firmed up, compared to the fourth quarter, for both equipment investment and construction investment. In construction, the aim is to hold investment steady at the current level.

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