

# Business cycle trends

## SNB regional network

Report for the attention of the Governing Board of the Swiss National Bank for its quarterly assessment of March 2012

### First quarter of 2012

The Swiss National Bank's delegates for regional economic relations are constantly in touch with a large number of companies from the different economic sectors and industries. Their reports, which contain 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 2012 with 243 representatives of various industries on the current and future situation of their companies and the economy in general. The selection of companies is made according to a model that reflects Switzerland's industrial structure. The reference parameter is GDP excluding agriculture and public services. The companies selected differ from one quarter to the next.

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## Summary

The economic situation stabilised in the first quarter of 2012. Uncertainty about future developments has decreased slightly. Margins remained a focus of attention, but the exchange rate situation was no longer given the same prominence as in the previous quarter. The minimum exchange rate for the Swiss franc against the euro has made it easier for many companies to plan ahead and has mitigated the hectic element of these companies' business activities. The global economy remains fragile but this did not depress confidence to the same extent as in the previous quarter.

There are, however, still considerable differences between sectors. In construction, business activity was below the dynamic level seen in preceding quarters, as a result of weather conditions. In the manufacturing industry and the services sector, business stagnated. Overall, demand for labour was also unchanged from the previous quarter.

The outlook for real growth in turnover has brightened slightly in all sectors. However, capital expenditure and demand for staff are likely to stagnate. Average technical capacity utilisation is normal to high in all three sectors and is likely to remain stable in the coming months.

The main worries about future developments focus on uncertainty relating to the consequences of the European debt crisis, the risk of a slowdown in the global economy, and further exchange rate developments. Substantial portions of the economy are experiencing persistently heavy pressure on their margins. In many places, therefore, a range of measures are being implemented to cut costs further.

# 1 Business activity

## Manufacturing

In manufacturing, business activity has stabilised. Consequently, the marked loss of momentum registered in the previous quarter did not continue. Overall, real turnover remained unchanged compared with both the previous quarter and the same quarter of the previous year. In a number of sectors, the exchange rate situation remained a dominant issue, although it was less prominent than in the previous quarter.

The situation varied from one industry to another. In the chemical, pharmaceutical, plastics and watchmaking industries, turnover was higher than in the previous quarter. By contrast, a downward trend was registered by the metals processing industry, in particular.

Demand from the emerging economies of Asia was again the main driver for the export sector, though slightly less so than in the previous quarter. Stimulus also came from North America and Brazil. In Europe, demand mainly came from Germany, Scandinavia and Eastern Europe. Within the euro area, a clear gap became evident between the countries bordering the Mediterranean (excluding France), where demand dropped significantly in some cases, and the other member states.

## Construction

The construction industry saw another relatively significant fall-off in momentum, in many cases due to weather conditions. Turnover declined slightly compared with the previous quarter. Developments were especially negative in civil engineering; a slight drop in turnover was registered from both preparatory construction work and the finishing trade. While residential construction continued to boom, the situation in commercial and industrial construction remained subdued.

Once again, a number of respondents expressed misgivings about real estate market risk, while others regarded the risk as non-existent. They pointed in particular to the generally more cautious lending policies adopted by the banks.

## Services

In the services sector, real turnover remained around the same level as in the previous quarter but improved slightly year-on-year.

Good business momentum was registered by architectural and engineering firms, the travel industry and banks, with the latter reporting a continuation of the slightly positive trend that had asserted itself in the previous quarter, due in particular to lending business. The previous quarter's negative trend at transport operators and logistics companies was no longer in evidence.

Business activity in wholesaling declined again but the situation in retailing eased somewhat, with turnover remaining virtually unchanged from the previous quarter. Cross-border shopping remained a serious problem for many companies. A stabilisation was registered in the hotel industry, which had previously suffered from declining turnover. However, in many cases extensive promotional campaigns and price discounts were needed to achieve this. The tourist trade in mountain regions saw a pronounced decrease in guests from Germany and the Netherlands due to exchange rate factors. In some cases, the shortfall has been offset by increased demand from visitors from Asia, Russia and Brazil, as well as from within Switzerland. In the area of seminars and company events, hotels are noticing that companies are paring down their costs.

## 2 Capacity utilisation

Overall, capacity utilisation was judged to be normal. The previous wide variation between the sectors has decreased. Finished product inventories are still considered somewhat too high.

In manufacturing, capacity utilisation is rated as normal, whereas in the previous quarter it was still considered to be relatively high. It remained very high among producers of electrical appliances and relatively high in the watchmaking industry and the related supply trade. Utilisation of production capacity was very low among textile companies, while in the machinery and metal processing industries it was relatively low.

In construction, technical capacity utilisation was rated as relatively high, although not quite as high as in the previous quarter. Most of the companies that took part in the survey were very satisfied with their level of utilisation. Some companies were unable to meet demand in full.

In the services sector, capacity utilisation was rated as normal overall, as in the preceding quarters. A relatively high level of capacity utilisation was recorded by architectural and engineering firms, real estate companies and IT companies. Representatives from the financial industry reported a normal level of capacity utilisation. Retailers and the hotel industry reported persistently low utilisation, although hotels in cities, in particular, reported buoyant business tourism.

## 3 Demand for labour

Overall, the demand for labour has remained virtually unchanged. In manufacturing, it declined further compared with the previous quarter. The companies included in the survey still considered that their headcounts were slightly too high and continued to exercise great restraint in staffing policy. On the whole, they were not replacing employees when they left, and any seasonal increases in demand were met by taking on temporary staff or through overtime work. The benefits of free movement of labour were often mentioned.

In construction, the demand for labour increased only slightly. The majority of respondent companies rated the size of the current workforce as being in line with demand. The difficulties experienced in recruiting suitable personnel have not intensified further. Some companies reported that the situation had eased slightly. Specialised staff are still highly sought-after, however, and some companies cited the shortage of staff as a constraint.

In the services sector, staff levels were generally considered appropriate. High staff requirements were reported by IT companies, architectural and engineering firms and telecommunications companies. The hotel industry was still overstaffed. In addition, some staff recruitment agencies reported that headcounts were on the high side.

Overall, recruiting was considered to be as difficult and time-consuming as usual. Staff availability was very tight in the electrical appliance industry. In construction, it was mainly civil engineering firms that complained of a dearth of specialists. Architectural and engineering firms, real estate companies and travel agencies also reported difficulties in recruiting staff.

Per capita labour costs increased considerably across all three sectors compared with the previous quarter. In many industries, the market for specialists has dried out, leading to cost pressure in some instances. The new collective agreements for the hospitality industry, which took effect on 1 January 2012, also increased per capita labour costs. Architectural and planning firms, staff recruitment agencies and freight forwarders also faced higher per capita labour costs.

## 4 Prices, margins and earnings situation

Many companies are still facing the problem of low or unsatisfactory profitability, accompanied by relatively high capacity utilisation. In all sectors of the economy margins were judged to be lower than usual, although this view was held by fewer respondents than in the previous quarter. Tougher competition, flagging demand and the sustained strength of the Swiss franc were given as the main reasons for the contraction of margins. Pressure to optimise costs is continuing.

The minimum exchange rate for the Swiss franc against the euro brought welcome planning security for many companies and even prevented some from going out of business. However, some manufacturing companies and service providers still regard the current exchange rate level as critical. It was felt that the situation would worsen if sales volumes were to come under pressure as well as margins.

Of the 243 companies surveyed, 121 said their margins were lower than usual. However, across all three sectors the vast majority of these firms have positive or very positive margins. Only a very low proportion of companies reported zero or negative margins.

At the 121 companies where margins are lower than usual, the majority (nearly 60%) said they were responding with efforts to raise productivity. Although around a quarter of these 121 companies reduced the size of their workforce in Switzerland and about 10% relocated some production to other countries, only one-third said that these measures had been taken principally in response to the exchange rate. Moreover, similar measures had been decided on by companies that reported margins to be within the usual range or above it. In particular, 10% of companies in this group also reported that they were relocating some production to other countries. Such action is mainly being taken by companies that already have a foreign presence. Companies considering such action showed higher demand for specialists with experience of building up sales organisations and production plants in the Far East. Other widespread measures include hiring freezes, investment freezes and increased working hours without any increase in pay.

With regard to the change in the margin situation in recent months, 50 of the 243 companies surveyed reported that their margins had decreased. They cited price discounts in Swiss francs and lower sales volumes as the main reasons for this.

The manufacturing industry is still suffering most from pressure on profit margins. All industries are affected, but the phenomenon has been particularly pronounced in the textile industry. On the one hand, most companies expect to see a slight reduction in purchase prices in the coming months; on the other hand they anticipate a need to make further concessions in selling prices in Swiss francs.

In construction, below-average margins were more common in structural engineering than in civil engineering or the finishing trade. Low interest rates have made it far easier for new construction firms to enter the market, leading to further pressure on margins. Forecasts show that both purchase and selling prices are expected to decline.

Within the services sector, wholesaling, retailing and the hotel industry still reported low margins. Staff recruitment agencies have now joined their ranks. Representatives of the financial industry, who have been complaining about tight margins for some time, also gave a relatively negative assessment of the situation. By contrast, IT and telecommunications companies and travel agencies rated their margins as being normal to above average.

## 5 Outlook

The uncertainty about future developments is still in evidence, but has lessened somewhat. Companies' employment and investment plans in Switzerland remain cautious to restrained. Turnover expectations for the coming months have increased in all sectors compared to the previous quarter.

In manufacturing, companies in all industries apart from machinery expect turnover to rise slightly over the next six months. Accordingly, technical capacity utilisation should be slightly higher in these industries. By contrast, there are no signs of a positive effect on employment.

In construction, seasonally adjusted turnover and capacity utilisation should increase slightly in the coming months. Many companies report that their order books for this year are already either well-filled or very full. This could also stimulate employment to some extent.

In general, companies in the services sector are cautiously optimistic about the business trend in the next six months. Most industries in this sector expect to see a slight rise in turnover. Capacity utilisation and headcounts are likely to remain largely unchanged from their current levels. Representatives of real estate firms, the IT industry and transport operators are very optimistic about their turnover prospects, while commercial banks and insurers are relatively confident. Retailers and the hotel industry expect that turnover will be flat and that capacity utilisation in the months ahead will remain at the present relatively low level.

With regard to global risks, the uncertainty stemming from the European debt crisis and the slowdown in the global economy were the most frequently cited factors.

The unusually low margins remain a source of concern for the companies affected. Further price discounts are considered inevitable by many respondents and, together with the persistently tough competitive situation, will keep up the high pressure on margins. A few respondents expressed unease about the persistently low interest rates and the associated risks in the real estate segment. There were also, however, reports of banks exercising slightly greater caution in lending.

The slightly lower overall uncertainty with regard to the future path of the economy is reflected in investment plans: equipment investment in all three sectors is likely to at least remain unchanged at current levels. This represents a marginal improvement over the previous quarter, when expectations were negative. In the manufacturing industry in particular and to a lesser extent in the services sector, there are plans to boost capital expenditure slightly, especially in the area of equipment investment. Manufacturing companies are still showing a greater willingness to invest abroad rather than in Switzerland. This applies particularly to companies already operating abroad.