

# Business cycle trends

## SNB regional network

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

### Second 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 April and May 2012 with 235 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 remained robust in the second quarter of 2012. The problem of contracting margins has eased somewhat but was still the focus of attention for company efforts at optimisation. Many are therefore taking further action to reduce costs and raise efficiency. Companies appreciate the increased planning security resulting from the minimum exchange rate for the Swiss franc against the euro. The main worries about future developments relate to an increased number of unknown factors in connection with the consequences of the European debt crisis and – linked to this – further exchange rate developments.

There are still considerable differences between industries. Construction saw a strong rise in business activity following a decline in the previous quarter due to weather conditions. In manufacturing and the services sector, business stagnated. Demand for labour was also unchanged, overall, from the previous quarter.

The outlook for real growth in turnover remained moderately positive in all sectors. However, capital expenditure and demand for staff are likely to continue to stagnate. Average utilisation of technical production capacity and infrastructure is normal in manufacturing and the services sector and is still relatively high in construction. It is expected to increase slightly in the coming months in both construction and manufacturing.

# 1 Business activity

## **Manufacturing**

Business activity in manufacturing remained stable. Overall, real turnover remained unchanged compared with both the previous quarter and year-on-year. The exchange rate problem has continued to ease in many industries thanks to the measures taken by the SNB and companies themselves.

In the watchmaking, chemical, plastics and metal products industries, turnover was higher than in the previous quarter, while in the textile and machinery industries, it was unchanged. By contrast, lower turnover was reported by the clothing and food industries, in particular.

Demand from the emerging economies of Asia was again the main driver for the export sector, but momentum was once again lower than in the previous quarter. Stimulus also came from the US. In Europe, demand originated mainly from Germany, Scandinavia and Eastern Europe. Demand was particularly sluggish in Spain and Italy, and was also weaker in France.

## **Construction**

Following the relatively significant fall-off in business activity in the first quarter due to weather conditions, turnover picked up perceptibly in the second quarter. In many cases, the declines registered in the previous quarter were offset. Developments were particularly buoyant in civil engineering, but turnover also rose in structural engineering, the finishing trade and preparatory construction work. While residential construction continued to boom, the situation in commercial and industrial construction remained subdued.

Some respondents pointed to real estate market risk, which was referred to, in some cases – depending on the region – as ‘overheating’. The banks’ lending policy tends to be perceived as increasingly cautious.

## **Services**

In the services sector as a whole, real turnover was still slightly higher than in the previous quarter and the corresponding quarter of 2011.

Good business momentum was reported by the IT industry, architectural practices and engineering firms, insurance companies and the travel industry. Business activity in the banking industry stagnated, with developments in the various areas of business offsetting each other. The situation has stabilised in the retail and wholesale trade and the hotel industry. Real turnover in these areas of activity was virtually unchanged quarter-on-quarter. However, extensive price erosion exerted downward pressure on nominal turnover figures in the retail industry. At many hotels, large-scale special offers and price discounts were necessary to maintain capacity utilisation at a high level. The tourism industry in mountain regions is still complaining of a marked decline in the number of European visitors owing to exchange rates and weather conditions. However, in some regions this has been partially offset by increased demand from visitors from Asia and Russia, and from within Switzerland.

## 2 Capacity utilisation

Overall, utilisation of production capacity and infrastructure was judged to be normal. The previous wide variation between industries has decreased further. Finished product inventories are still considered somewhat too high, especially in the textile industry, but also in wholesaling (notably the car trade).

In manufacturing, capacity utilisation was rated as normal overall. It remained comparatively high in watchmaking and the related supply trade as well as in parts of the pharmaceutical industry. In the machinery and metal products and processing industries, the previous negative situation had improved somewhat. By contrast, capacity utilisation was very low at textile firms and in the food industry.

In construction, technical capacity utilisation was still relatively high, with capacity utilisation considerably higher in structural engineering than in civil engineering. The great majority of the companies that took part in the survey were very satisfied with their level of capacity utilisation. Some reported that they were unable to fully meet demand, owing mainly to staff shortages.

In the services sector, infrastructure utilisation was rated as normal overall. As in the previous quarter, a relatively high level of capacity utilisation was recorded by architectural practices and engineering firms, real estate companies and IT companies. Representatives from the financial industry, retailing and wholesaling reported normal levels of utilisation. Hotels and restaurants continued to report persistently low utilisation, although hotels in cities reported buoyant business tourism. There is also a trend to downgrade from higher to lower hotel categories or room categories.

## 3 Demand for labour

Overall, the demand for labour has remained practically unchanged. The manufacturing companies included in the survey still considered that their headcounts were slightly too high. Their handling of this situation remained unchanged: they continued to exercise restraint in their personnel policy, did not replace employees when they left and covered any seasonal increases in demand by taking on temporary staff or through overtime work. In border areas, especially in Ticino, there has been a sharp rise in the number of job-seekers from neighbouring countries.

In construction, the demand for labour increased slightly faster than in the previous quarter. A number of companies again said they were having considerable difficulties recruiting and retaining suitable personnel. Some specialised workers such as construction supervisors, foremen and machinery specialists are in very short supply. Alongside cost considerations, staff shortages were often given as the reason why more contracts were being awarded to foreign firms.

In the services sector, staff levels were generally considered appropriate. Architectural practices and engineering firms indicated that their recruitment needs were fairly high. The previously strong demand for personnel in the IT industry has dropped off somewhat. The hotel and catering industry was still overstaffed. In addition, a few banks 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 plastics production and processing industry and, to some extent, in pharmaceuticals. The situation was comparatively relaxed for companies in the food industry. In the services sector, recruitment was considered slightly easier than normal, especially at IT companies and banks.

Per capita labour costs increased slightly across all three sectors. In many industries, the market for specialists has dried out. This is particularly true for pharmaceuticals, watchmaking, civil engineering, as well as architectural practices and engineering firms, which therefore faced higher per capita labour costs. New collective agreements have also increased costs in the industries affected.

## 4 Prices, margins and earnings situation

Many companies are still confronted with the problem of low or below-average 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 or was less pronounced than in the previous quarter. The reasons given were the same as in the past: tougher competition, waning demand and the sustained strength of the Swiss franc. The pressure to cut costs therefore remains as high as ever. At the same time, however, margin-improvement measures in the past are increasingly having an impact, as is an easing of raw material prices.

There was further confirmation that the minimum exchange rate for the Swiss franc against the euro has brought welcome planning security for many companies and even prevented some from going out of business. However, some manufacturing companies and service providers still rate the current exchange rate as critical (and expressed a desire for a higher minimum exchange rate). It was felt that the situation would worsen if sales volume were to come under pressure as well as margins.

Manufacturing was still suffering badly from pressure on profit margins. All industries are affected, but the phenomenon was particularly pronounced in the textile and plastics processing industries. On average, companies do not expect purchase prices to decline much in the coming months, but they anticipate that they will have to make further concessions in selling prices in Swiss francs.

In construction, the phenomenon of below-average margins mainly affected structural engineering, whereas margins were close to normal in civil engineering and the finishing trade. Expected purchase and selling prices are both now assessed as being virtually stable.

In the services sector, hotels, restaurants and wholesaling continued to suffer from unusually low margins. Margins at transport and logistics companies and IT firms had deteriorated considerably compared with the assessment given in the previous quarter. Representatives of the financial industry rated their situation as fairly negative, but considerably less so than in previous quarters.

## 5 Outlook

The uncertainty about future developments has increased slightly again. Companies' domestic employment and investment plans remain cautious to restrained. Despite the potential risks, turnover expectations for the coming months remain positive in all sectors, as they were in the previous quarter.

In manufacturing, representatives of all industries, apart from some companies in the metals and machinery sector, expect turnover to rise slightly over the next six months. Accordingly, technical capacity utilisation in these industries should be somewhat higher, although there are no signs that this could have a positive effect on employment.

In construction, seasonally adjusted turnover and capacity utilisation should improve slightly in the coming months. Some companies report that orders books are well-filled or very full into next year. A slightly positive stimulus may also be expected in employment. The acceptance of a popular initiative that puts a ceiling on the proportion of second homes has led to some uncertainty about the medium-term outlook for construction.

In general, companies in the services sector are cautiously upbeat about the business trend in the next six months. All industries assume that turnover will be stable or rise slightly. Capacity utilisation and headcounts are likely to remain fairly stable at the present level. Architectural practices and engineering firms and companies in the travel industry report more optimistic turnover expectations. Representatives of the retail trade have recently been comparatively optimistic about their turnover prospects.

In terms of global risks, the unknown factors in connection with the European debt crisis were cited most frequently.

The unusually low margins are still demanding the full attention of the companies affected. Further price discounts are already in the pipeline at many companies and, together with the persistently tough competitive situation, could maintain the high pressure on margins. Low interest rates are often seen as an advantage, but the fact that this situation has lasted so long is giving rise to concern. In connection with the increased real estate market risk, banks are becoming noticeably more cautious about granting loans.

The slightly higher overall uncertainty with regard to the future path of the economy is reflected in investment plans: equipment investment in manufacturing and the services sector is likely to remain unchanged at current levels or only grow slightly, and could even recede somewhat in construction. Manufacturing is showing a slightly lower tendency to invest in construction, while services companies are planning a modest increase.