

Swiss National Bank Quarterly Bulletin

September 3/2012 Volume 30

Contents

4	Monetary policy report
30	Business cycle trends
36	Chronicle of monetary events

Monetary policy report

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

This report is based primarily on the data and information available as at 13 September 2012.

Monetary policy report

Contents

6	About this report
7	1 Monetary policy assessment of 13 September 2012
8	Monetary policy strategy at the SNB
9	2 Global economic environment
9	2.1 International financial and commodity markets
10	2.2 United States
11	2.3 Euro area
12	2.4 Japan
13	2.5 Emerging economies
14	3 Economic developments in Switzerland
14	3.1 Aggregate demand and output
16	Revision of Switzerland's system of national accounts in the summer of 2012
17	3.2 Labour market
18	3.3 Capacity utilisation
19	3.4 Outlook for the real economy
20	4 Prices and inflation expectations
20	4.1 Consumer prices
22	4.2 Producer and import prices
22	4.3 Real estate prices
23	4.4 Inflation expectations
24	5 Monetary developments
24	5.1 Summary of monetary policy since the last assessment
25	5.2 Money and capital market interest rates
26	5.3 Exchange rates
27	5.4 Stock markets
27	5.5 Monetary and credit aggregates

About this report

The Swiss National Bank (SNB) has a statutory mandate to pursue a monetary policy serving the interests of the country as a whole. It ensures price stability while taking due account of economic developments.

It is a particular concern of the SNB that its monetary policy be understood by a wider public. Moreover, it is obliged by law to inform regularly of its policy and to make its intentions known. This monetary policy report performs both of these tasks. It describes economic and monetary developments in Switzerland and explains the inflation forecast. It shows how the SNB views the economic situation and the implications for monetary policy it draws from this assessment.

Sections 2–5 of the present report were drawn up for the Governing Board's monetary policy assessment of September 2012. Section 1 ('Monetary policy decision of 13 September 2012') is an excerpt from the press release published following the assessment.

Unless otherwise stated, all rates of change from the previous period are based on seasonally adjusted data and are annualised.

1 Monetary policy assessment of 13 September 2012

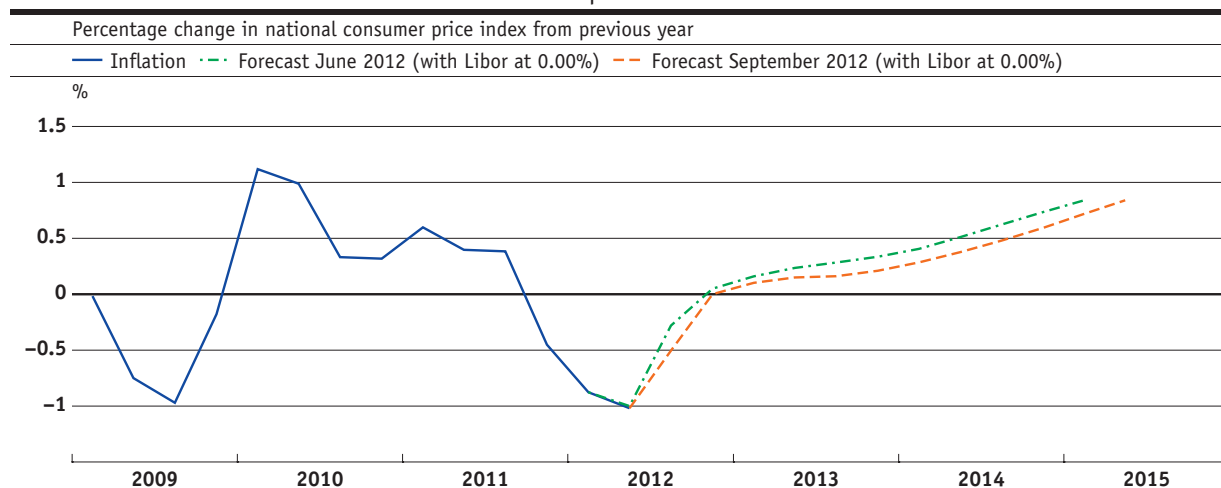
The Swiss National Bank (SNB) is leaving the minimum exchange rate unchanged at CHF 1.20 per euro, and will continue to enforce it with the utmost determination. It remains committed to buying foreign currency in unlimited quantities for this purpose. The Swiss franc is still high and is weighing on the Swiss economy. For this reason, the SNB will not permit an appreciation of the Swiss franc, given the serious impact this would have on both prices and economic performance in Switzerland. It is leaving the target range for the three-month Libor unchanged at 0.0–0.25%. If necessary, it stands ready to take further measures at any time.

Compared to the June forecast, the SNB's conditional inflation forecast has been adjusted downwards slightly. It is based on a three-month Libor of 0%. The further deterioration in the inflation outlook stems partly from the unfavourable prospects for the global economy and a more pronounced underutilisation of production capacity in Switzerland, and partly from the fact that a depreciation of the Swiss franc has failed to materialise as expected. The forecast continues to project that the Swiss franc will weaken over the forecast horizon. The SNB is expecting an inflation rate of –0.6% for 2012, 0.2% for 2013, and 0.4% for 2014. Consequently, there is no threat of inflation in Switzerland in the foreseeable future.

In the second quarter of 2012, economic growth weakened worldwide. Although the emerging economies continued to underpin the global expansion, their rates of growth were lower than expected. Economic performance in the US remained lacklustre. In the euro area, recessionary trends were accentuated and a number of peripheral economies registered strongly negative growth rates. The unfavourable international environment also weighed on the Swiss economy. In the second quarter, real GDP fell slightly and unemployment increased. As a result of the deterioration in the global economic outlook and the downward revision of GDP for earlier quarters, the SNB is now expecting growth of around 1% for Switzerland in 2012, as opposed to the 1.5% projected in the June forecast.

Downside risks to the Swiss economy will also stay high in the near term. The global economy remains vulnerable. Growth prospects are being dampened by the euro area crisis, on the one hand, and the uncertainty surrounding forthcoming fiscal policy decisions in the US, on the other. The situation on the financial markets is also fragile. In addition, the continuing strong momentum on Swiss residential mortgage and real estate markets poses risks for financial stability over the medium term.

Chart 1.1
Conditional inflation forecast of June 2012 and of September 2012



Source: SNB

Observed inflation in September 2012

Table 1.1

	2009				2010				2011				2012				2009	2010	2011	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
Inflation	0.0	-0.7	-1.0	-0.2	1.1	1.0	0.3	0.3	0.6	0.4	0.4	-0.5	-0.9	-1.0				-0.5	0.7	0.2

Conditional inflation forecast of June 2012 with Libor at 0.00% and of September 2012 with Libor at 0.00%

	2012				2013				2014				2015				2012	2013	2014	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
Forecast June 2012, Libor at 0.00%		-1.0	-0.3	0.1	0.2	0.2	0.3	0.3	0.4	0.5	0.6	0.7	0.8					-0.5	0.3	0.6
Forecast September 2012, Libor at 0.00%			-0.5	0.0	0.1	0.2	0.2	0.2	0.3	0.4	0.5	0.6	0.7	0.8				-0.6	0.2	0.4

Source: SNB

Monetary policy strategy at the SNB

The SNB has a statutory mandate to ensure price stability while taking due account of economic developments.

The SNB has specified the way in which it exercises this mandate in a three-part monetary policy strategy. First, it regards prices as stable when the national consumer price index (CPI) rises by less than 2% per annum. This allows it to take account of the fact that the CPI slightly overstates actual inflation. At the same time, it allows inflation to fluctuate somewhat with the economic

cycle. Second, the SNB summarises its assessment of the situation and of the need for monetary policy action in a quarterly inflation forecast. This forecast, which is based on the assumption of a constant short-term interest rate, shows how the SNB expects the CPI to move over the next three years. Third, the SNB sets its operational goal in the form of a target range for the three-month Swiss franc Libor. In addition, a minimum exchange rate against the euro is currently in place.

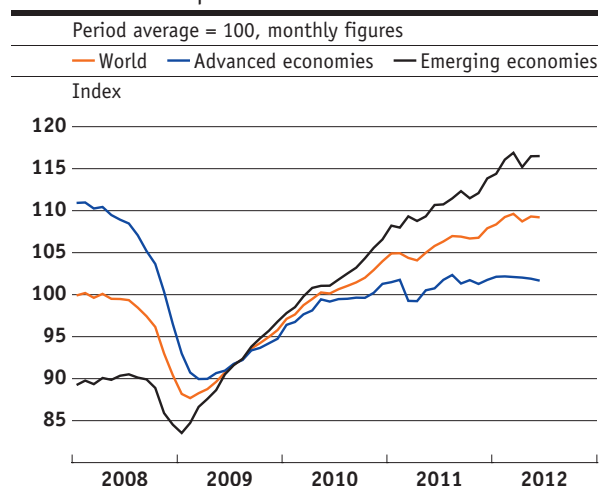
2 Global economic environment

In the second quarter of 2012, economic growth slowed worldwide, and while the emerging economies continued to support global expansion, their growth rates were lower than expected. In the advanced economies, growth more or less ground to a halt, with recessionary tendencies intensifying in the euro area. Southern member states of the euro area reported a substantial decline in their GDP, and Germany lost considerable momentum.

The slow pace of growth in the first half of 2012 highlights just how fragile the global economic recovery remains. The SNB now expects the recovery in the global economy to be slower than it projected in its last assessment. The growth outlook is principally being hampered by uncertainty surrounding the crisis in the euro area but also by imminent fiscal policy consolidation in many of the advanced economies. In the emerging economies, too, growth is likely to remain subdued given the slowdown in world trade. In these countries, there is some scope for a relaxation of monetary and fiscal policy.

The SNB forecasts continue to assume that Europe's financial and sovereign debt crisis will gradually ease; however, the risks overall remain very high.

Chart 2.1
Global industrial production



Sources: Netherlands Bureau for Economic Policy Analysis (CPB), Thomson Financial Datastream

2.1 International financial and commodity markets

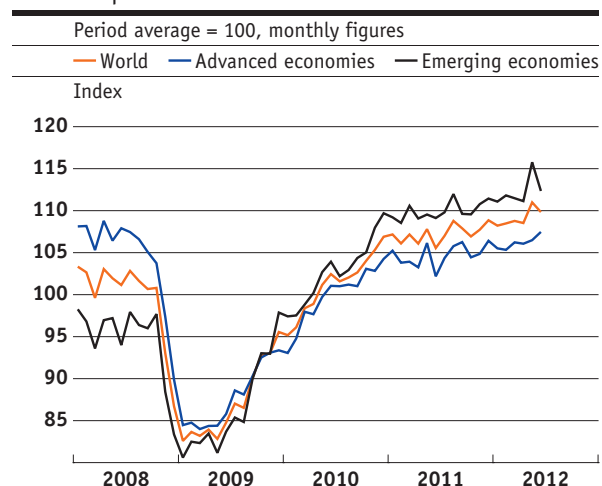
The international financial markets continue to be dominated by uncertainties emanating from Europe's financial and sovereign debt crisis. Nonetheless, the situation has improved somewhat since the SNB's last assessment in mid-June – in large part due to expectations of new monetary policy easing in the euro area and the US.

Yield spreads on the government bonds of certain euro area member states over German government bonds narrowed again slightly. Trading on the foreign exchange markets was also shaped by anticipated monetary policy developments. Both the US dollar and the euro lost value on a trade-weighted basis (cf. chart 2.4). The equity markets managed to recoup their second-quarter losses, and uncertainty, as measured by the VIX volatility index, fell to its lowest level since the beginning of the financial crisis in 2008 (cf. chart 2.3).

Having lost considerable ground in the spring, commodity prices hardened again slightly overall during the quarter (cf. chart 2.5). Drought and the prospect of poor harvests caused the price of agricultural commodities to soar and energy prices also rose again in response to geopolitical risks. The price of industrial metals, which are particularly sensitive to cyclical fluctuations, dipped marginally.

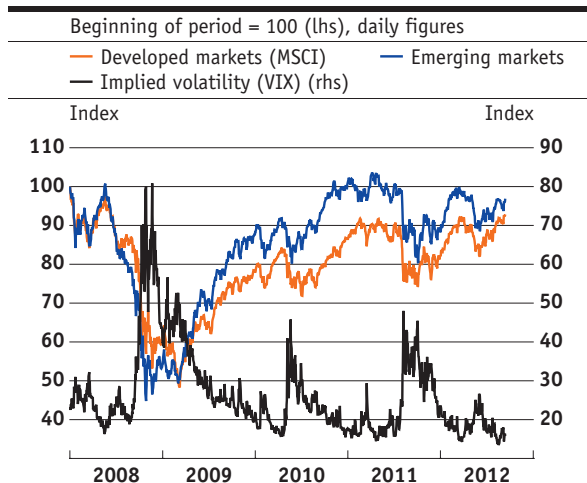
The SNB's forecasts are based on assumptions about the oil price and the USD/EUR exchange rate; over the forecast period it is assuming an oil price for Brent crude of USD 105 per barrel and an exchange rate of USD 1.22 to the euro.

Chart 2.2
Global exports



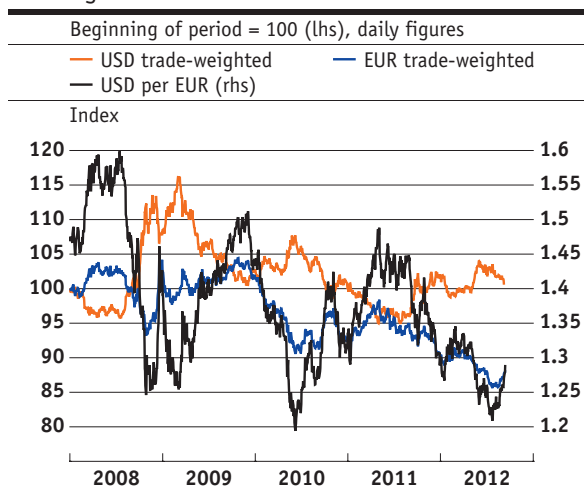
Sources: CPB, Thomson Financial Datastream

Chart 2.3
Stock markets



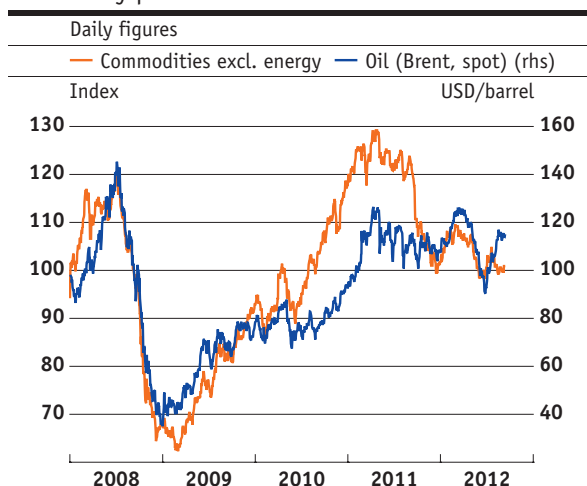
Sources: Reuters, Thomson Financial Datastream

Chart 2.4
Exchange rates



Sources: Reuters, Thomson Financial Datastream

Chart 2.5
Commodity prices



Sources: Reuters, Thomson Financial Datastream

2.2 United States

The recovery in the US remains weak. Second-quarter GDP grew by 1.7%, compared to 2.0% in the preceding period, driven by private domestic demand. Government demand, by contrast, continued to decline. Since the end of the recession at the beginning of 2009, annual GDP growth has averaged just 2.2%. This sluggish recovery explains why the US aggregate output gap remains large and unemployment is falling only slowly (cf. chart 2.9).

The SNB continues to project moderate growth for the coming quarters. The fall in real estate prices continues to put a strain on numerous households and is significantly inhibiting private consumption. Weak export demand and a trend towards a more restrictive fiscal policy are also likely to dampen confidence. There are nevertheless some positive developments in construction, which finally regained some momentum for the first time since the crisis, and house prices are also picking up again slowly. The SNB is projecting GDP growth of 2.3% for both 2012 and 2013; however, developments in the euro area and the unpredictable trajectory of US fiscal policy (fiscal cliff) continue to make forecasting exceptionally difficult.

Consumer price inflation declined in the wake of falling energy prices to 1.7% in August (cf. chart 2.10). Core inflation also decreased slightly to 1.9% (cf. chart 2.11). High unemployment and weak wage growth are likely to keep inflation pressure low in the medium term.

Monetary policy continued to be very expansionary. In June, the Federal Reserve stated its intention to sell another USD 267 billion of short-term government bonds and buy longer-term bonds for the same amount. Moreover, in September, it announced that it also intended to buy USD 40 billion in mortgage-backed securities of the state-run mortgage banks Fannie Mae and Freddy Mac each month. It would continue this programme – in a context of price stability – and possibly undertake additional asset purchases until there was a substantial improvement in the labour market. The aim of both programmes is that long-term interest rates should decline further, thereby supporting the recovery in the economy. The Fed left the reference interest rate at 0.0–0.25% (cf. chart 2.12). According to its September assessment, in view of the economic outlook, an exceptionally low reference rate will be required until mid-2015, at least.

2.3 Euro area

In the euro area, GDP contracted by 0.7% in the second quarter, having stagnated at the beginning of the year. Portugal, Greece, Spain and Italy remained mired in deep recession. At the end of June, Spain and Cyprus sought rescue funds from their partner countries. The weakness in southern Europe also increasingly affected the two biggest economies in the euro area: Germany's GDP growth slowed noticeably and France's GDP slipped for the first time since 2009. Investment activity in the euro area declined further due to ongoing uncertainty and low capacity utilisation. This uncertainty also weighed on consumer demand. However, exports still provided a positive stimulus. The unemployment rate rose further to 11.3% in July (cf. chart 2.9).

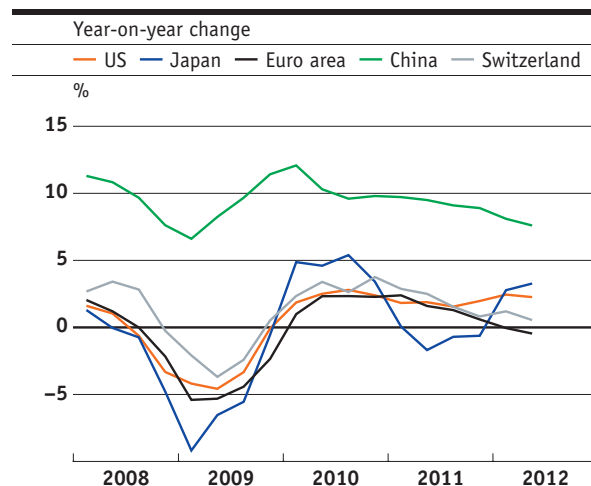
The financial and sovereign debt crisis continues to have a strong impact on economic activity in the euro area. Restrictive fiscal policies – with tougher consolidation programmes in Italy, Spain and France – as well as persistent uncertainty, continue to cloud the growth outlook. Confidence among companies and consumers deteriorated further in August and manufacturers' sales outlook for the coming months worsened. The SNB is continuing to project a slight decline in euro area GDP for 2012 and very modest growth for 2013.

Consumer price inflation has risen only negligibly in the euro area over recent months; it stood at 2.6% in August (cf. chart 2.10), having stagnated at 2.4% for the three preceding months. Core inflation also remained largely unchanged, at around 1.6% (cf. chart 2.11). Price rises for energy and agricultural products, as well as a VAT increase in Spain, should prevent inflation from falling in the coming months.

The European Central Bank (ECB) further relaxed its monetary policy. It lowered its main refinancing rate by 0.25 percentage points in July, taking it to 0.75% (cf. chart 2.12), and reduced its deposit rate to 0.0%. In addition, it broadened its eligibility criteria for collateral for refinancing operations. At the beginning of September, the ECB announced a new securities purchase programme. It stated that it was prepared to purchase short-term sovereign bonds of countries that put forward a formal application to the European Financial Stability Facility/European Stability Mechanism (EFSF/ESM), and that submitted to the strict and effective conditionality condition. No upper limit is foreseen for the purchases. The purchase programme aims at ensuring the proper transmission of the monetary policy stance to the real economy.

Chart 2.6

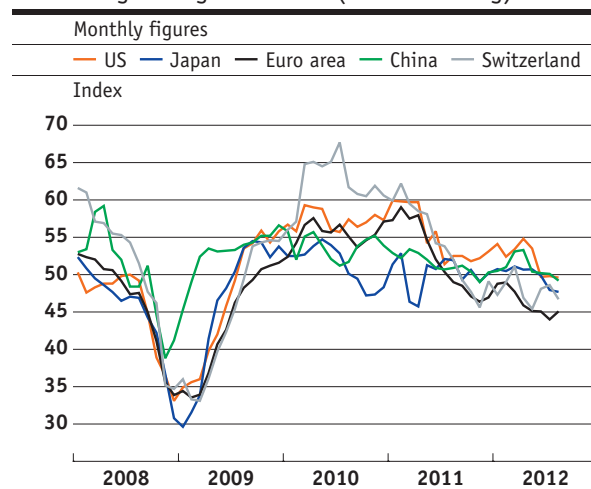
Real GDP



Sources: State Secretariat for Economic Affairs (SECO), Thomson Financial Datastream

Chart 2.7

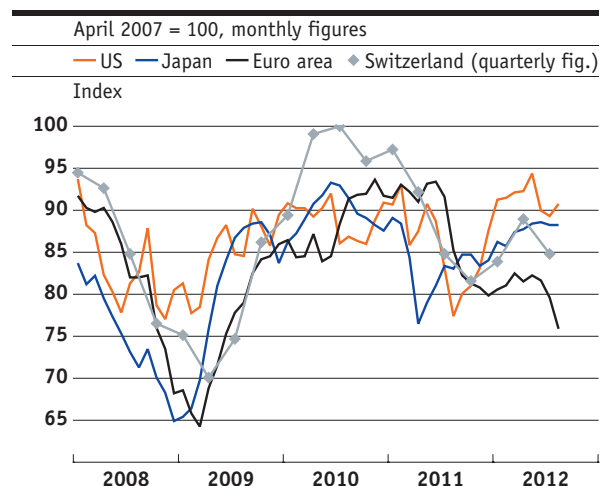
Purchasing managers' indices (manufacturing)



Source: Thomson Financial Datastream; copyright and database rights: Markit Economics Ltd 2009; all rights reserved

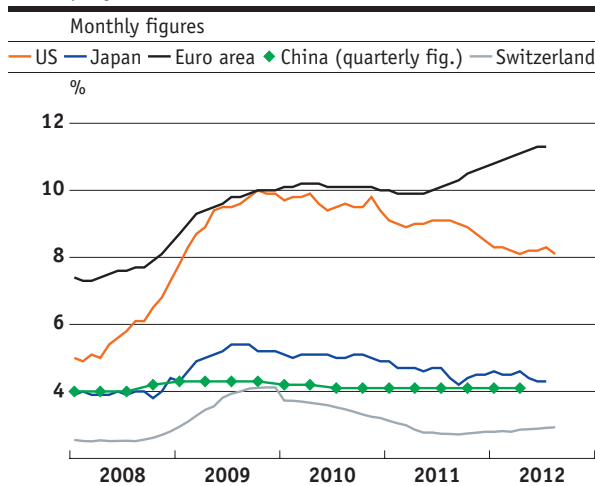
Chart 2.8

Consumer confidence index



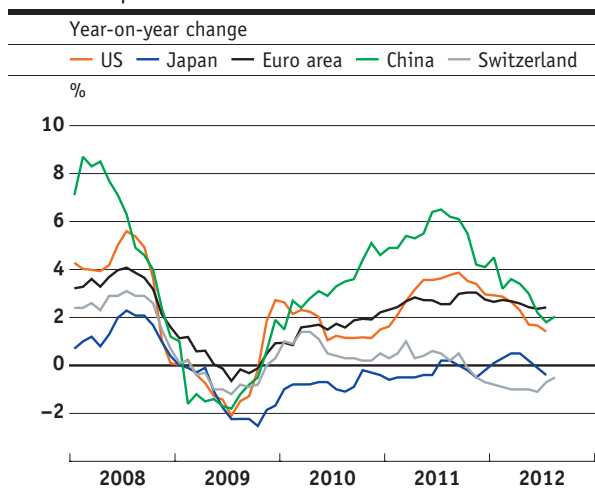
Sources: SECO, Thomson Financial Datastream

Chart 2.9
Unemployment rates



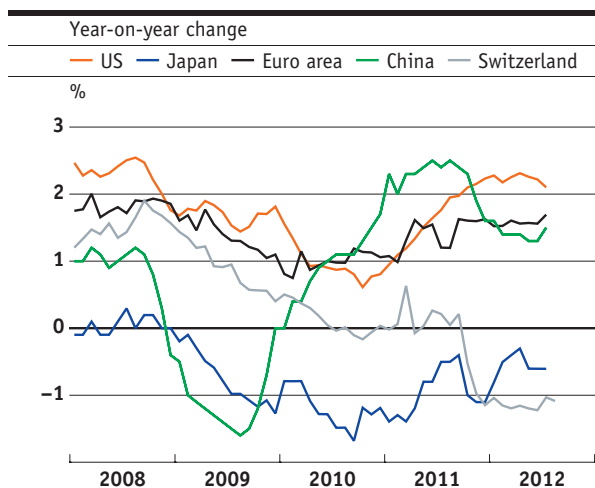
Sources: SECO, Thomson Financial Datastream

Chart 2.10
Consumer prices



Sources: Swiss Federal Statistical Office (SFSO), Thomson Financial Datastream

Chart 2.11
Core inflation rates



Sources: SFSO, Thomson Financial Datastream

At the EU summit at the end of June, a plan for a European banking union featuring a central regulator was adopted. The proposal by the European Commission foresees that the banking union will be phased in from 2013.

2.4 Japan

In Japan, the economic recovery continued at a moderate pace, with second-quarter GDP expanding by 0.7% compared to 5.3% in the preceding period. Growth thus remains below the levels achieved before the financial and economic crisis hit in 2008. Fiscal stimuli for private consumption, in place since the beginning of the year, as well as public investment in reconstruction, supported domestic demand. Exports likewise only increased moderately following the catch-up effect in the previous quarter.

The outlook for the second quarter is muted. The discontinuation of certain government subsidies is likely to inhibit consumer demand, and confidence among manufacturers has deteriorated in recent months due to flagging global demand and the high value of the yen. These factors are expected to limit investment. In August, as part of a medium-term consolidation of state budgets, the Japanese government decided to begin a phased VAT increase. The first rise, scheduled for April 2014, is expected to affect consumer spending, by causing some expenditure to be brought forward to the end of 2013. Overall, the SNB's growth forecast for Japan remains largely unchanged. It expects a GDP increase of 2.6% for 2012 and considerably weaker GDP growth for 2013.

In July, Japanese consumer prices were 0.4% lower than a year earlier (cf. chart 2.10), but higher energy prices are likely to push inflation up slightly in the coming months. Overall, though, price momentum is expected to remain very weak due to below-average capacity utilisation.

The Bank of Japan is maintaining its expansionary monetary policy. As announced, it has continually increased the volume of its securities purchases, confirming that the target volume for its securities programme to the end of June 2013 is JPY 70,000 billion (CHF 870 billion) and that its budget for purchasing Japanese government bonds – the largest asset class – remains JPY 29,000 billion. It left the call money rate unchanged at 0.0–0.1% (cf. chart 2.12).

2.5 Emerging economies

Modest demand from advanced economies and uncertainty regarding Europe's financial and sovereign debt crisis have continued to subdue momentum in the emerging economies. Some countries were further held back by legacy tightening measures. Overall, while private consumer demand continued to support economic activity, second-quarter GDP growth in most countries was well below potential.

The second quarter saw China's GDP up a moderate 7.6% on the previous year (cf. chart 2.6). The government relaxed its economic policy in selected areas and prioritised certain infrastructure projects in order to bolster economic activity. In India, the business climate continued to be encumbered by restrictive lending conditions and the slow pace of state reforms. Export activity in the newly industrialised Asian economies (NIEs) – South Korea, Taiwan, Hong Kong and Singapore – tapered off significantly. Growth in Brazil remained slack despite a comprehensive economic stimulus package, and economic activity in the other Latin American countries cooled in response to monetary policy tightening.

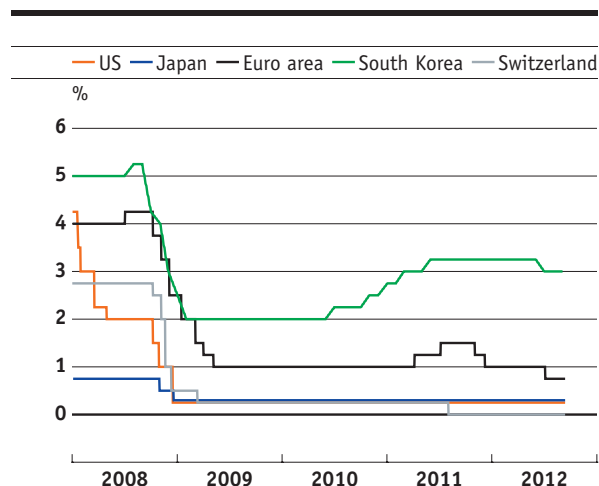
All in all, a modest recovery may be expected for the emerging economies in the second half of the year. In China, India and Brazil, consumer demand will remain a significant growth driver. Furthermore, China's monetary interventions and targeted invest-

ments in infrastructure and social housing should gradually gain traction. New state investment incentives in Brazil are also expected to give rise to stimuli. In many of the emerging economies there is scope for the use of monetary and fiscal policy measures if economic activity declines sharply.

Overall, consumer price inflation in the emerging economies has continued to decline. China's annual inflation rate fell year-on-year from a three-year high of 6.5% to 2.0% in August (cf. chart 2.10). In India, inflation fell from approximately 10% to 7.6% over the same period. In Brazil, however, consumer inflation rose marginally to 5.2%, as bad harvests drove up food prices. Inflation in food prices is expected to rise in many other countries in the months ahead; however, price pressure is likely to remain low on the demand side of the equation.

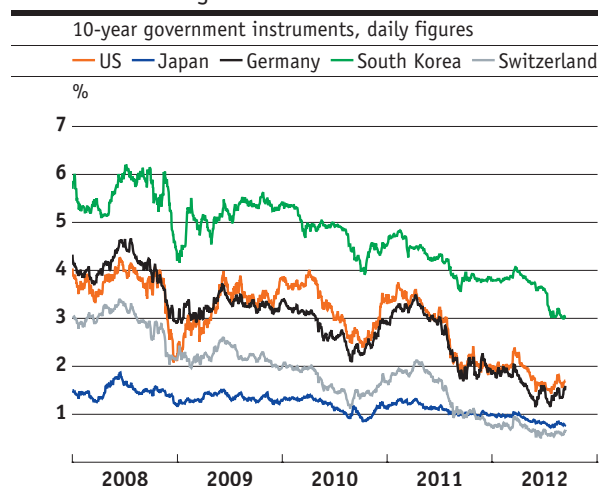
Central banks in the emerging economies have continued to relax monetary policy. In July, China's central bank reduced its key interest rate for lending and deposits for the second time in a month. Prior to this, it had lowered the minimum reserve requirements for banks on several occasions. The central bank has also permitted virtually no further appreciation of the Chinese currency on a trade-weighted basis since the beginning of the year. For the first time in three years, the Bank of Korea cut its key interest rate (cf. chart 2.12). Brazil's central bank further reduced its key interest rate to a historical low.

Chart 2.12
Official interest rates



Sources: SNB, Thomson Financial Datastream

Chart 2.13
International long-term interest rates



Sources: SNB, Thomson Financial Datastream

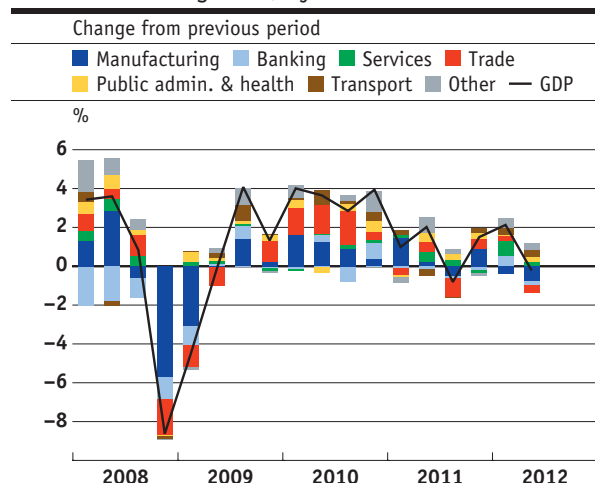
3 Economic developments in Switzerland

As expected, economic activity in Switzerland in the second quarter of 2012 was unable to maintain the robust GDP growth of the previous quarter. According to an initial estimate by the State Secretariat for Economic Affairs (SECO), GDP declined slightly (-0.2%). A lack of stimulus from abroad played a major role in this slowdown, for exports declined significantly. Imports remained almost constant, meaning that foreign trade contributed negatively to economic growth. Supported by robust growth in consumption and construction investments, however, domestic demand also provided a gleam of hope for the economy in the second quarter.

With immigration still robust, the potential for growth remained solid. The stagnation of GDP led to a further widening of the negative output gap for the whole economy. Because demand for labour remained muted, the number of unemployed persons rose slightly again in the summer.

For the second half of the year, the SNB expects moderate GDP growth. The demand for exports will probably remain subdued on account of the slow recovery of the world economy and the continuing high value of the Swiss franc. The declining volume of new orders, the high degree of insecurity and the pressure on profit margins are impacting negatively on corporate investment. The SNB now expects growth of around 1% for 2012. The new estimate reflects both the figures for GDP growth in the winter half-year, as revised by SECO/SFSO, and the unpromising international outlook.

Chart 3.1
Contributions to growth, by sector



Source: SECO

3.1 Aggregate demand and output

Slower growth in a large number of industries

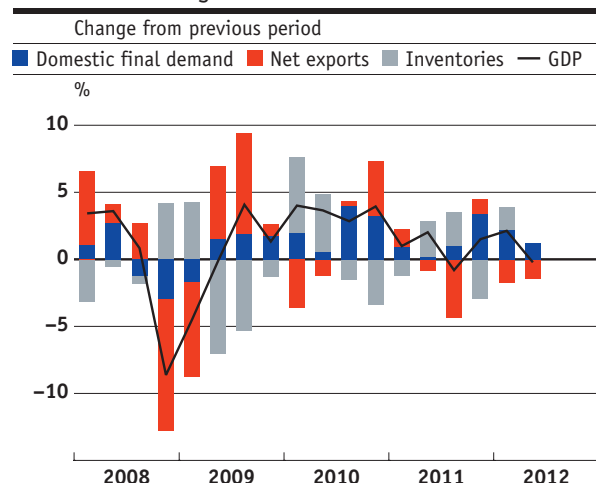
Robust GDP growth in the first quarter was followed by a decline in the second quarter by 0.2%, according to an initial estimate by SECO. This slowdown extended over several industries (cf. chart 3.1). The drop in value added in manufacturing and trade had a major dampening effect. Value added in the banking industry also dropped, following a temporary recovery in the previous quarter. Furthermore, after a prolonged period of growth, transport and communication services and business-related services all weakened. Construction, however, offered a positive stimulus, as did insurance and the energy industry.

Exports continue to stagnate

Net exports (excluding valuables) in the second quarter were negative once again (cf. chart 3.2). While exports declined by 3.0% compared to the previous quarter (cf. chart 3.3), imports remained almost unchanged at -0.1% (cf. chart 3.4). Overall, this resulted in a negative foreign trade contribution of 1.4 percentage points.

Goods exports declined again in the second quarter, with most export industries registering a decline. Exports of machinery continued their negative trend. Demand for chemicals and pharmaceuticals also fell, while exports of metals dropped sharply. Only exports of watches and vehicles continued their upwards trend in spite of the flagging global economy. Looking at individual markets, goods exports to Europe and the US decreased, whereas demand for Swiss goods increased in Asia.

Chart 3.2
Contributions to growth in demand



Source: SECO

Exports of services also fell in the second quarter. Lower commodity prices led to lower net revenues from merchandising, which in turn played a significant role in the decline. Income from cross-border banking transactions also decreased. However, income from tourism rose again, thanks to the major increase in overnight stays of foreign guests.

Imports stagnated in the second quarter, with goods and services developing in quite different directions. After a sharp rise in the previous quarter, goods imports were negative in the second quarter on account of weak demand for foreign capital goods. A rise in imports of services all but compensated for the decline in goods imports, with positive developments above all in the tourism, licenses and patent areas.

Robust domestic economy

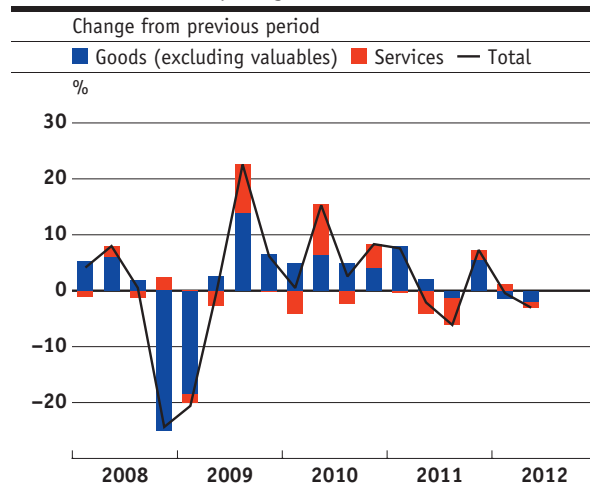
Domestic final demand rose less sharply in the second quarter than in the previous quarter (cf. chart 3.5 and table 3.1). Consumer spending and construction investment expanded, while equipment investment declined.

After private consumer spending had risen sharply in the winter half-year, it continued to grow moderately in the second quarter (1.3%). Especially when buying food, clothing and furniture, consumers showed more restraint. Consumer confidence also declined in July, when the economic outlook, in particular, was judged more pessimistically. Consumption will thus probably increase more moderately in the medium-term. However, it should receive further support from immigration.

After a downturn in the first quarter attributable to weather conditions, construction investment rose again in the second quarter. However, it remained below its level at the close of 2011. According to surveys carried out by the Swiss Federation of Master Builders, there was varied development in the different segments. Residential construction expanded strongly again, and commercial construction recovered further from its weakness of recent years. By contrast, civil engineering registered a certain loss of momentum.

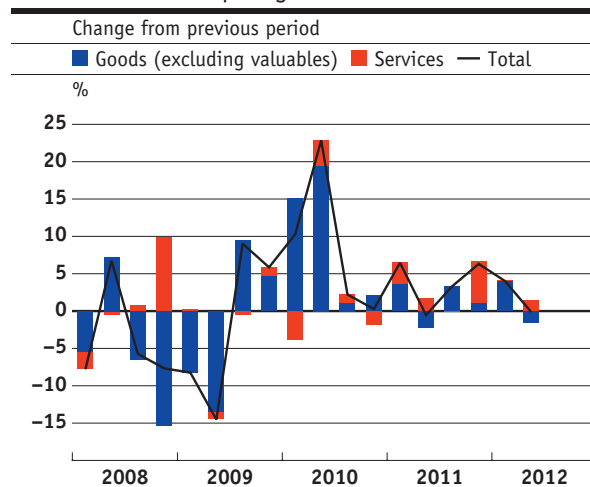
The drop in equipment investment reflects primarily lower investment in vehicles. Thus the strong rise observed in this segment in the previous quarter proved to be temporary. Developments in the other segments were mixed. Investment in machines stagnated, while investment in electronic goods and software increased.

Chart 3.3
Contributions to export growth



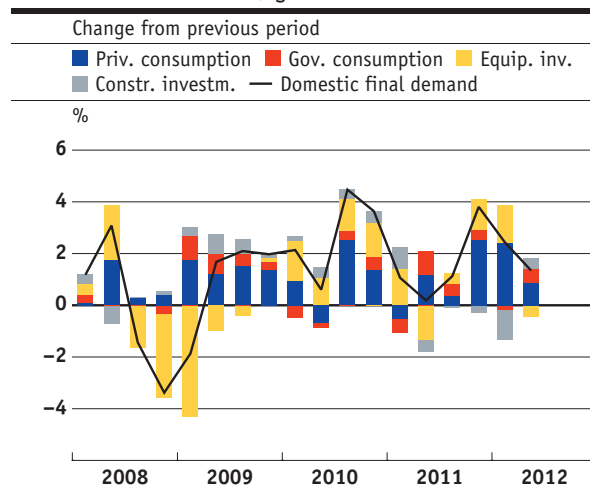
Source: SECO

Chart 3.4
Contributions to import growth



Source: SECO

Chart 3.5
Domestic final demand, growth contributions



Source: SECO

Real GDP and components
Growth rates on previous period, annualised

Table 3.1

	2008	2009	2010	2011	2010		2011				2012	
					Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Private consumption	1.2	1.8	1.6	1.2	3.8	2.1	-0.8	1.8	0.6	3.9	3.7	1.3
Government consumption	-2.5	3.3	0.7	2.0	3.0	4.2	-4.5	7.8	3.6	3.2	-1.5	4.1
Investment in fixed assets	0.7	-8.0	4.8	4.0	7.1	7.9	9.8	-7.8	1.4	3.9	0.9	-0.1
Construction	0.0	3.0	3.5	2.4	3.6	4.6	8.4	-4.3	-1.1	-2.9	-11.0	4.3
Equipment	1.1	-15.5	5.8	5.2	10.1	10.6	11.0	-10.6	3.4	9.7	11.7	-3.4
Domestic final demand	0.6	-0.4	2.2	1.9	4.5	3.6	1.1	0.2	1.1	3.8	2.4	1.3
Domestic demand	0.5	0.0	2.3	1.9	6.4	-0.1	-3.0	5.1	3.9	1.1	3.2	-0.7
Total exports	2.9	-7.7	7.8	3.8	0.2	7.8	10.0	-1.3	-3.6	0.1	-0.9	1.5
Goods ¹	2.1	-11.1	9.4	6.3	7.4	6.0	11.9	3.1	-1.8	8.0	-2.0	-2.8
Services	3.4	1.2	3.7	-1.4	-6.8	13.5	-1.1	-12.6	-15.2	5.7	3.6	-3.4
Aggregate demand	1.4	-2.9	4.3	2.6	4.1	2.8	1.7	2.7	1.0	0.7	1.8	0.1
Total imports	-0.3	-5.2	7.4	4.2	7.1	0.1	3.4	4.3	5.5	-1.1	0.9	0.8
Goods ¹	-1.0	-8.3	10.6	3.1	1.3	2.6	4.4	-2.8	4.1	1.3	4.9	-1.9
Services	0.6	9.0	-1.5	7.3	6.1	-9.4	16.1	9.5	0.3	29.7	0.8	7.3
GDP	2.2	-1.9	3.0	1.9	2.8	3.9	1.0	2.0	-0.8	1.5	2.1	-0.2

¹ Goods: excluding valuables (precious metals, precious stones and gems as well as works of art and antiques)
Source: SECO

Revision of Switzerland's system of national accounts in the summer of 2012

Within the framework of continuing quality improvement and the adjustment of the national accounts system to meet EU standards, a large-scale revision of Switzerland's system of national accounts was carried out in the summer of 2012. Besides introducing the new General Classification of Economic Activities (NOGA 2008), the Swiss Federal Statistical Office (SFSO) also brought up to date the statistics on which it is based. In order to improve comparability with other countries, the SFSO also revised its method for calculating investments. Based on this revision, the breakdown of GDP has changed both on the demand side and on the output side.

At the end of June, the SFSO published the revised annual figures for the national accounts for the period 1990–2010. According to the new esti-

mates, the level of the total nominal GDP series is higher (by 4.3% for the year 2010). Furthermore, real GDP growth in 2010 was revised from 2.7% to 3.0%. In late August, the SFSO published its first estimate for Switzerland's national accounts for 2011. According to this estimate, GDP growth in 2011 amounted to 1.9%.

The change in Switzerland's system of national accounts on an annual basis also resulted in a revision of SECO's estimates for quarterly data. The revision of the system of national accounts necessitated an adjustment of the quarterly models and the indicators used. SECO published its first quarterly estimate based on the new method on 4 September. Due to this new method, the estimated path of GDP growth in the second half of 2011 and the first quarter of 2012 is significantly lower.

3.2 Labour market

Rising unemployment

The labour market has softened further. Unemployment has again increased slightly in recent months. Between May and August, the number of people registered as unemployed with regional employment offices increased by just over 2,000 (seasonally adjusted). The unemployment rate remained unchanged at 2.9% (cf. chart 3.6). On a non-seasonally adjusted basis, the unemployment rate rose from 2.7 to 2.8 during this period.

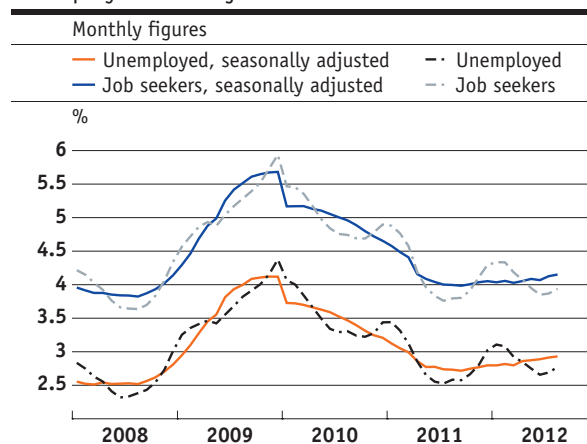
Since June, SECO has been calculating the unemployment rate using labour force figures from the Federal Population Census of 2010 (until now, the 2000 figures had been used). This has increased the officially registered labour force from 3,946,988 to 4,322,899. On the basis of this revision, the registered unemployment rate for the period since 2010 is around 0.3 percentage points lower than previously.

Short-time working remained practically unchanged at a low level in the second quarter (cf. chart 3.7).

Surprising growth in employment

According to the official employment statistics of the SFSO (JOBSTAT), the number of jobs rose again in the second quarter. Full-time and part-time employment each rose by 1.7%. Expressed as full-time equivalents, employment rose by 1.6% (cf. chart 3.8), suggesting a slight acceleration in employment growth. However, a high degree of uncertainty is attached to these figures. In the recent past, large discrepancies have been shown to exist between JOBSTAT and the Employment Statistics (ES) of the SFSO. In contrast to JOBSTAT, ES points to a clear slowdown in employment growth. ES figures, however, are as yet available only up to the first quarter. Most other employment market indicators (the number of jobs available, employment prospects) also point rather to a cooling-off on the employment market.

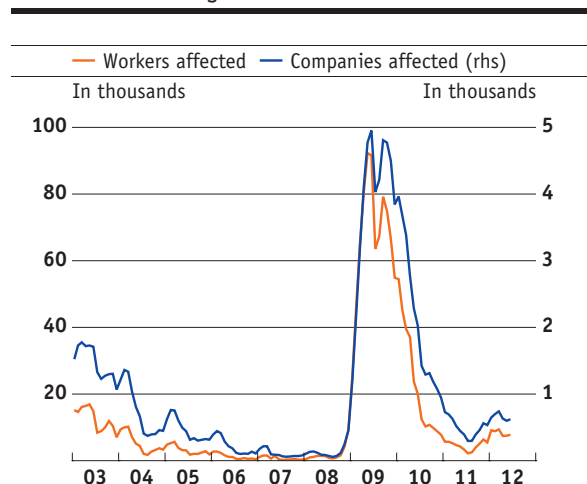
Chart 3.6
Unemployment and job seeker rates



Unemployed and job seekers registered with the regional employment offices, as a percentage of the labour force according to the 2000 census (labour force: 3,946,988 persons) to 2009, and according to the 2010 census (labour force: 4,322,899 persons) from 2010.

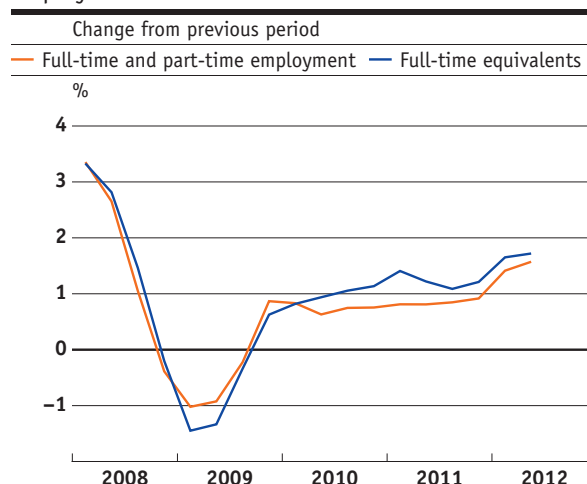
Source: SECO

Chart 3.7
Short-time working



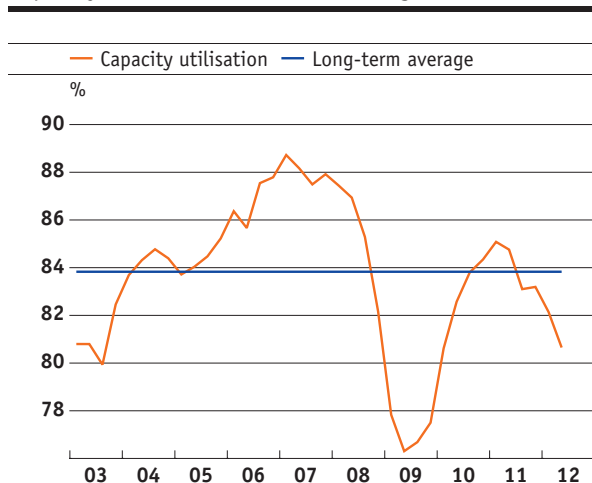
Source: SECO

Chart 3.8
Employment



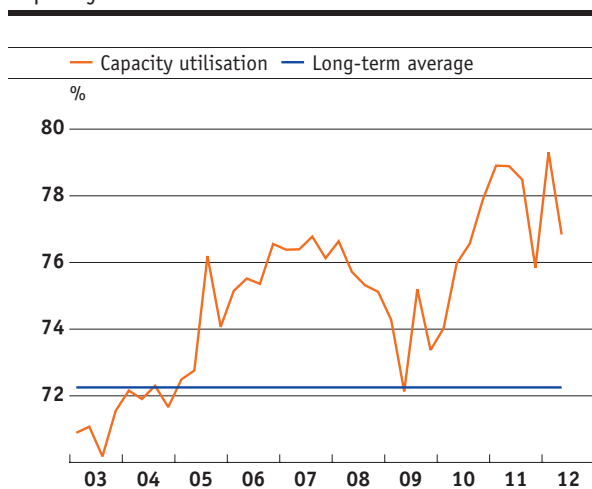
Source: SFSO, seasonal adjustment: SNB

Chart 3.9
Capacity utilisation in manufacturing



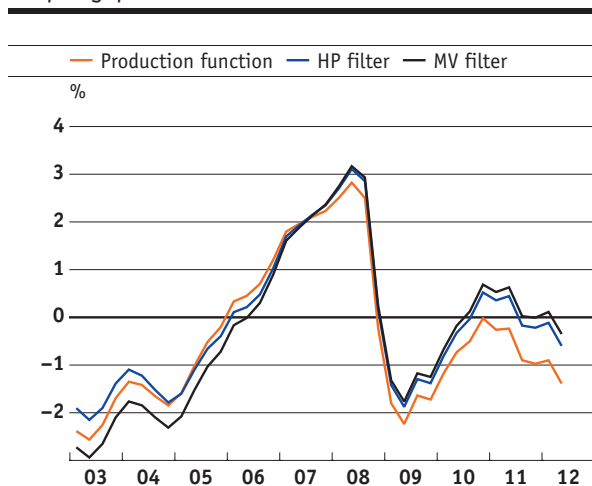
Source: KOF Swiss Economic Institute

Chart 3.10
Capacity utilisation in construction



Source: KOF Swiss Economic Institute

Chart 3.11
Output gap



Source: SNB

3.3 Capacity utilisation

Declining utilisation in manufacturing

Technical capacity utilisation in manufacturing declined significantly in the second quarter. According to the survey conducted by the KOF Swiss Economic Institute, it slipped to 80.7%, thereby remaining below its long-term average (cf. chart 3.9).

In the construction industry, however, utilisation remains very high. The level of machine utilisation declined slightly to 77.4% but nevertheless persisted at a very high level (cf. chart 3.10). Accordingly, many of the companies interviewed complained of bottlenecks in machine and equipment capacity, as well as labour shortages.

Among services companies, utilisation in the second quarter was at an average level overall. It declined further in the hospitality industry, however, which is probably attributable to the strength of the Swiss franc and to the weak state of economic activity in other countries.

Negative output gap

The output gap, which is defined as the percentage deviation of observed GDP from estimated aggregate potential output, shows how well the production factors in an economy are being utilised.

The negative output gap opened up further in the second quarter as a result of the slight decline in GDP growth. Estimated potential output based on the production function approach indicates that the output gap was -1.4% in the second quarter, compared with -0.9% in the first quarter (cf. chart 3.11). Estimates using other methods (Hodrick-Prescott filter and multivariate filter) suggest that the negative output gap is in fact smaller (-0.6% and -0.3%).

The different estimates reflect the various ways of calculating potential output. The production function approach takes the labour market situation and the stock of capital in the economy into account. Since potential labour levels, in particular, have increased steadily in recent years – primarily because of immigration – potential output and, hence, the output gap are larger when calculated with this method than with statistical filter methods.

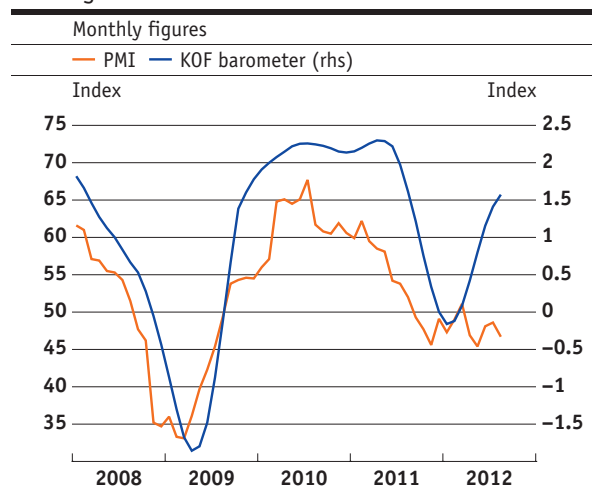
3.4 Outlook for the real economy

The short-term growth outlook for Switzerland remains subdued. Most leading indicators, with the exception of the KOF barometer, confirm this assessment. Despite a certain degree of stabilisation on the international financial markets, the situation in the euro area remains very tense. The introduction of the minimum exchange rate against the euro somewhat reduced the high value of the Swiss franc, but without clearer stimuli from abroad, the Swiss economy is likely to grow only slowly in the coming quarters.

The position of the manufacturing industry has not worsened further, though there is also no sign of any clear recovery. Domestic demand was hitherto dynamic, but is now tending towards a slight decline. Less favourable employment prospects and a more pessimistic mood among consumers will probably impact negatively on private consumer expenditure in the second half of the year. Construction activity, too, is likely to rise only modestly.

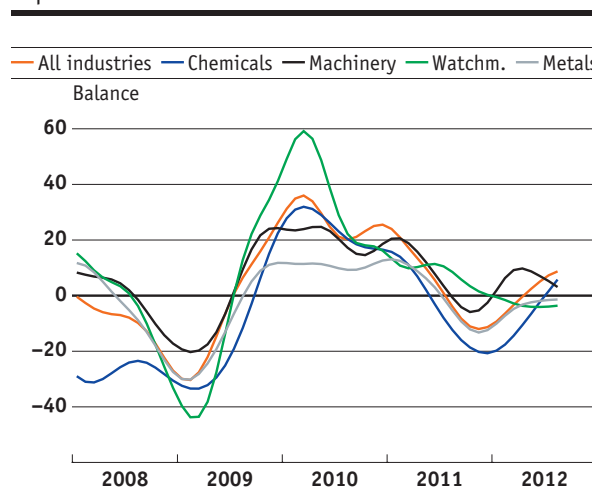
The SNB is expecting GDP growth to be below its potential for the second half of the year. According to the latest SECO estimates, growth in the past winter half-year was weaker than originally calculated. Moreover, the international outlook has worsened further. As a result, the SNB expects annual growth for 2012 of only around 1% (compared to a forecast of 1.5% in June). Unemployment is likely to rise again slightly and the output gap to stay negative for even longer. The economic outlook remains highly uncertain, since the fragile situation in the euro area is exposing the Swiss economy to considerable downside risks.

Chart 3.12
Leading indicators



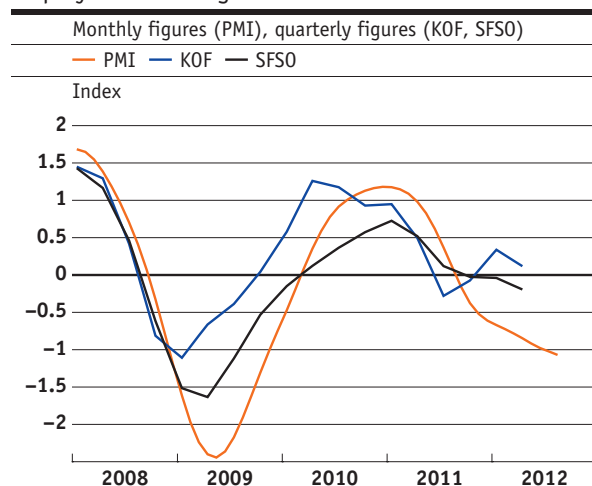
Sources: Credit Suisse, KOF Swiss Economic Institute

Chart 3.13
Expected new orders



Source: KOF Swiss Economic Institute

Chart 3.14
Employment leading indicators



Sources: Credit Suisse, KOF Swiss Economic Institute, SFSO

4 Prices and inflation expectations

The sharp price decline in 2011 is still having a considerable impact on the annual inflation rate, i.e. the rise of prices compared to the corresponding month in the previous year. The course of the price decline, however, reflects the minimum exchange rate against the euro set in September 2011, which put a halt to the deflationary trend first in supply prices (import and producer prices) and then in consumer prices.

No inflationary pressure is currently being exerted by import and producer prices on downstream consumer prices. The medium-term inflation expectations reported in surveys remain on a low level and are consistent with the SNB's definition of price stability.

4.1 Consumer prices

Lower negative annual inflation

Annual inflation, as measured by the national consumer price index (CPI), increased from -1.0% to -0.5% between May and August (cf. table 4.1). The negative annual inflation rate continues to be attributable to the price decline registered in the summer and autumn of 2011. Since May, prices have again gone down sequentially to a slight extent under the influence of seasonal sales, but net of seasonal factors they have, in fact, increased slightly.

Basis effects will continue to shape annual inflation over the coming months. However, last year's price decline is gradually disappearing from the twelve-month comparison, which will lead to a rise in the annual inflation rate.

National consumer price index and components
Year-on-year change in percent

Table 4.1

	2011	2011		2012		2012		
		Q3	Q4	Q1	Q2	June	July	August
Overall CPI	0.2	0.4	-0.5	-0.9	-1.0	-1.1	-0.7	-0.5
Domestic goods and services	0.6	0.7	0.3	0.0	0.0	0.0	0.1	0.0
Goods	-1.3	-1.1	-2.1	-2.3	-2.1	-2.3	-1.9	-2.0
Services	1.1	1.2	1.1	0.7	0.6	0.6	0.7	0.5
Private services excluding rents	0.8	0.9	0.9	0.7	0.6	0.6	0.7	0.6
Rents	1.3	1.3	1.2	0.8	0.7	0.7	0.7	0.5
Public services	1.8	1.8	1.4	0.6	0.3	0.3	0.3	0.3
Imported goods and services	-0.7	-0.4	-2.6	-3.4	-3.8	-3.9	-2.9	-1.6
Excluding oil products	-2.5	-1.8	-5.0	-5.2	-4.9	-4.8	-4.2	-4.1
Oil products	9.3	7.5	10.5	6.2	2.2	1.0	3.6	12.0

Sources: SFSO, SNB

Halted price decline in foreign goods

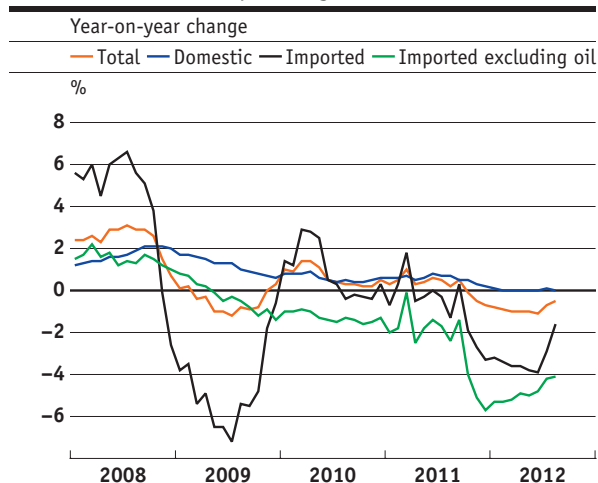
The minimum exchange rate against the euro has brought the sequential decline in prices for foreign goods to a halt. Disregarding the impact of seasonal sales, prices for foreign goods have hardly gone down any more since the beginning of the year. This is reflected in less negative inflation on a year-on-year basis (cf. chart 4.1). Prices for oil products, which were 12% above their year-back level in August, have also contributed to this development.

Annual inflation for domestic goods, too, remains in negative territory (cf. chart 4.2). Within one year, prices for domestic goods declined approximately to the same extent as those for foreign goods. Prices for services, by contrast, continued to rise in a year-on-year comparison. However, the increase in prices for rents and public services slowed down somewhat over the past few months.

Core inflation remains low

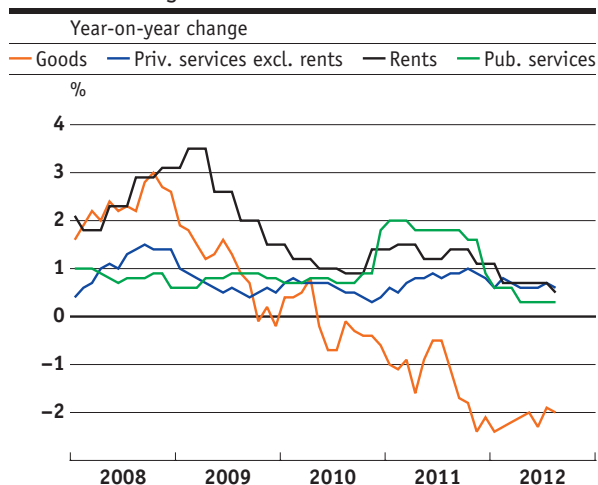
The core inflation rates depicted in chart 4.3 show the annual inflation trend stabilising on a low level. The Swiss Federal Statistical Office's core inflation rate (SFSO1) and the trimmed mean (TM15) calculated by the SNB were practically unchanged in August in comparison with the May figures. Only dynamic factor inflation (DFI) suggests a turning point.

Chart 4.1
CPI: domestic and imported goods and services



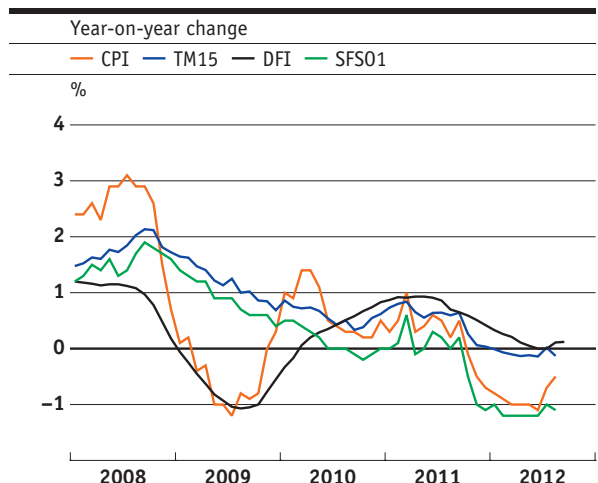
Sources: SFSO, SNB

Chart 4.2
CPI: domestic goods and services



Sources: SFSO, SNB

Chart 4.3
Core inflation rates



Sources: SFSO, SNB

4.2 Producer and import prices

Producer and import prices in August on year-back level

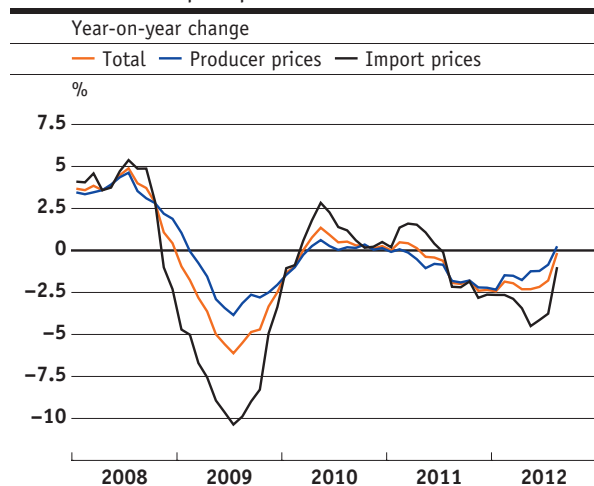
Between May and July, producer and import prices together declined, before rising again in August due to higher prices for oil products. Net of oil products, both producer and import prices remained practically unchanged compared to their May level.

Annual inflation in producer and import prices together advanced between May and August and amounted to -0.1% in August (cf. chart 4.4). The increase is due to the fact that last year's strong price decline is gradually disappearing from the twelve-month comparison (decreasing basis effect).

Since December 2010, the SFSO has also been collecting data in the manufacturing industry on the prices of goods for export. After a significant decline, these export prices have been on the rise since November 2011.

Producer and import price levels as a whole suggest that the minimum exchange rate against the euro has had a stabilising rather than inflationary impact in this category. In view of low inflation rates abroad, this is unlikely to change over the coming months. At present, supply prices are exerting no inflationary pressure on downstream consumer prices.

Chart 4.4
Producer and import prices



Source: SFSO

4.3 Real estate prices

Further increase in residential property prices

Most real estate price indices show a continuing rise in prices for single-family houses and owner-occupied apartments. According to Wüest & Partner, transaction prices again rose sharply in the second quarter (cf. chart 4.5). The transaction price indices published by Fahrländer Partner and IAZI also registered significant increases. Wüest & Partner's offer price indices based on newspaper and internet adverts, however, declined slightly in the second quarter.

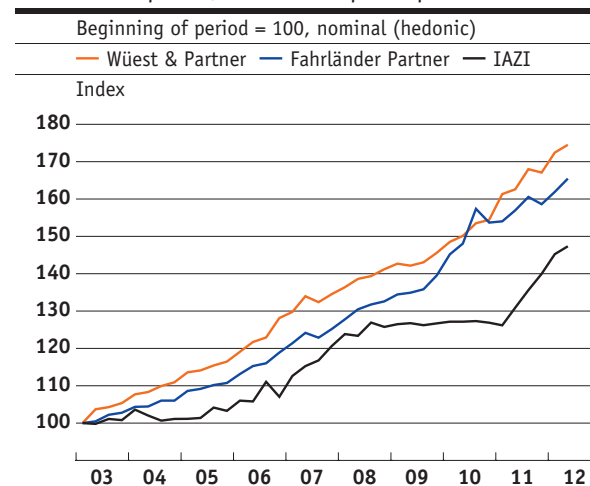
Growing discrepancy between rents for new and existing contracts

In the second quarter, rents for apartments offered on the market (offer rents) were again significantly higher than a year earlier (cf. chart 4.6). By contrast, rents under existing contracts changed only little over the year. Rents under existing contracts are legally bound to the reference interest rate, which was reduced to 2.25% as of 2 June 2012, putting further pressure on these rents.

Package of measures on mortgage financing

On 1 June 2012, given the risk of overheating on the residential property market, the Federal Council decided on a package of measures aimed at having a dampening effect on the rise in mortgage lending and real estate prices (cf. chapter 5.5 on monetary and credit aggregates).

Chart 4.5
Transaction prices, owner-occupied apartments



Sources: Fahrländer Partner, IAZI, Wüest & Partner

4.4 Inflation expectations

Inflation expectations remain low

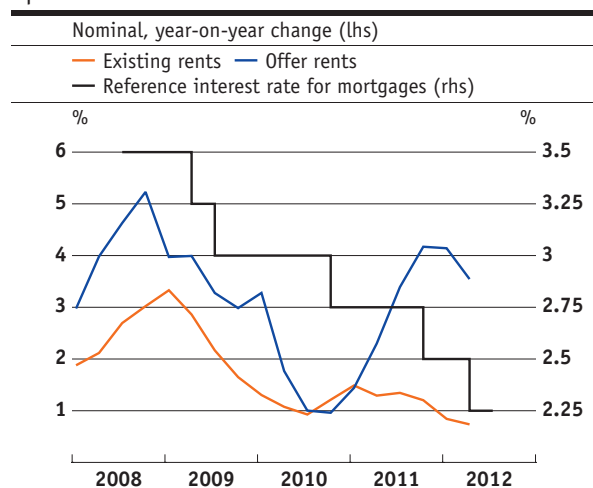
The results of surveys of households and experts on price and inflation trends are still indicating low inflation expectations.

SECO's latest survey of households, conducted in July, shows that expectations regarding price developments have hardly changed in comparison with the previous quarter. Of the households surveyed, 41% expect prices to remain unchanged over the coming 12 months, while 44% are counting on rising and 15% on sinking prices (cf. chart 4.7).

Moreover, the Credit Suisse ZEW Financial Market Report reveals that, at the beginning of August, nearly two-thirds of the analysts surveyed expect inflation rates to remain at their current low level for the next six months. Slightly fewer than 30% of the respondents anticipated higher inflation rates and the remainder lower ones. The proportion of respondents expecting lower inflation rates decreased significantly in August, after rising in June and July.

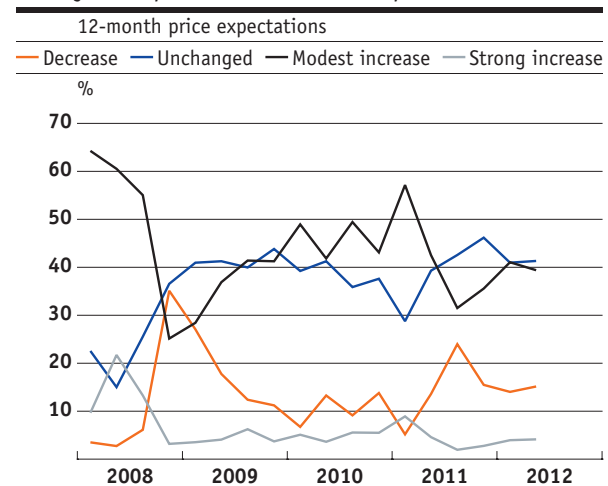
Information on quantitative inflation expectations can be found in the reports by the SNB delegates for regional economic relations and in a survey conducted by the audit and consulting company Deloitte. The talks with company representatives held by the SNB delegates in July and August indicate that companies expect the inflation rate to be 0.2% in six to twelve months, as in the previous quarter. In line with earlier surveys, the medium-term inflation expectations established by Deloitte are somewhat higher. In the second quarter, the CFOs and heads of finance from companies based in Switzerland who took part in this survey expected the inflation rate to be 1.3% (previous quarter: 1.5%) in two years. Medium-term inflation expectations therefore remain within a range that is consistent with the SNB's definition of price stability.

Chart 4.6
Apartment rents and reference interest rate



Sources: Federal Office for Housing (FOH), SFSO, Wüest & Partner

Chart 4.7
Survey on expected movements in prices



Sources: SECO, SNB

5 Monetary developments

Over the past few months, enforcement of the minimum exchange rate against the euro continued to impact strongly on the SNB's monetary policy. Against the euro, the Swiss franc persisted close to the minimum exchange rate of CHF 1.20 until the beginning of September, subsequently rising by one centime. Against the US dollar and other currencies, the Swiss franc weakened for a short time as much as the euro. Since interest rates remained more or less unchanged, this resulted in a slight easing in monetary conditions overall.

Foreign currency purchases for the enforcement of the minimum exchange rate led to an increase in bank sight deposits held at the SNB and, with them, the monetary base. The broad monetary aggregates also rose significantly. By contrast, the rate of credit growth declined, although it is still above the growth in nominal GDP.

5.1 Summary of monetary policy since the last assessment

Continuation of the monetary policy announced in September 2011

In the past few months, the SNB has continued to pursue the monetary policy which it announced in September 2011 and reiterated at subsequent assessments. On 6 September 2011, the SNB had set a minimum exchange rate of CHF 1.20 against the euro, after reducing the target range for the three-month Libor to 0.0–0.25% and greatly increasing liquidity in August.

Increase in sight deposits at the SNB

Enforcement of the minimum exchange rate has led to a rise in total sight deposits at the SNB in the period since the June assessment. In the week ending 7 September 2012 (final calendar week before the mid-September assessment), sight deposits totalled CHF 370.7 billion, compared to CHF 266.1 billion in the final calendar week before the mid-June assessment. This has taken sight deposits to a new record level. Between the assessments in mid-June and mid-September, they averaged CHF 341.6 billion. Of this amount, CHF 267.3 billion was accounted for by the sight deposits of domestic banks and CHF 74.3 billion by other sight deposits.

Extensive foreign exchange operations

Between the mid-June and mid-September assessments, the SNB carried out extensive foreign exchange transactions on the spot market. However, it did not conduct any foreign exchange swaps or repo transactions. Since the assessment in June, the outstanding SNB Bills, which at that time amounted to CHF 0.5 billion, have all fallen due.

High level of bank surplus reserves

Statutory minimum reserves averaged CHF 11.7 billion between 20 May 2012 and 19 August 2012, an increase of CHF 0.5 billion compared to the preceding period (20 February 2012 to 19 May 2012). On average, banks exceeded the requirement by around CHF 233.7 billion (previous period: CHF 153.7 billion). The average compliance level increased from 1,469% to 2,100%.

5.2 Money and capital market interest rates

Money market rates remain low

Since the last monetary policy assessment, money market interest rates have changed very little. The three-month Libor declined from 0.09% in mid-June to 0.05% in September (cf. chart 5.1). On both the unsecured money market and the repo market, trading volumes remained at a low level.

Long-term interest rates strongly affected by high demand for secure investments

The demand for secure investments, which is driven by the crisis in the euro area, is still a key factor affecting yield movements on government bonds. Yields on medium and long-term Confederation bonds have declined to new historic lows. Yields on ten-year Confederation bonds dropped just below 0.5% at times.

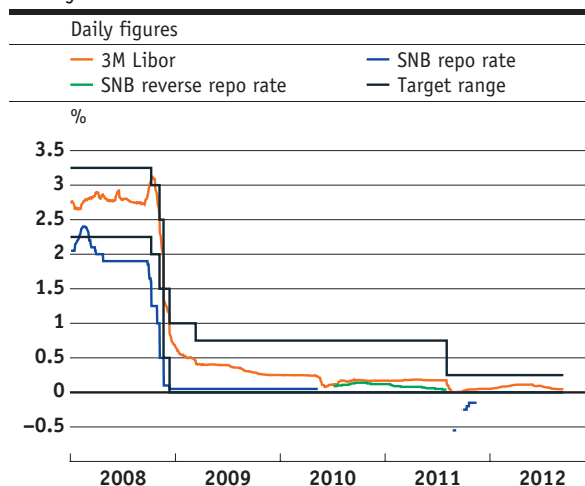
Yield curve changed very little

The path of the yield curve for Confederation bonds is slightly higher than at the time of the June assessment (cf. chart 5.2). The spread between the yield on ten-year Confederation bonds and the three-month Libor stood at around 0.6 percentage points in mid-September.

Real interest rates still low

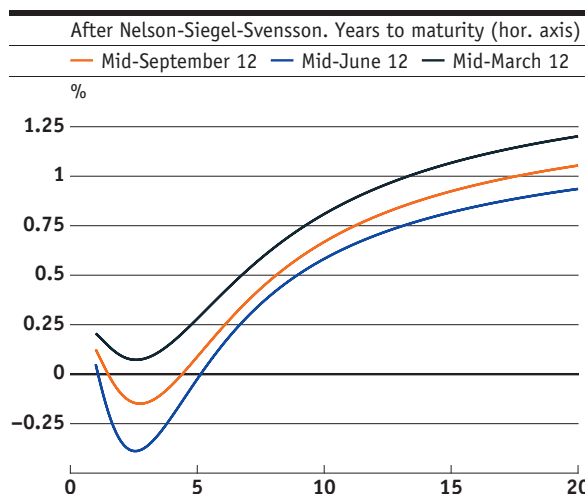
At around 0.1% (cf. chart 5.3), estimated ten-year real interest rates were virtually unchanged compared to the last monetary policy assessment. Real interest rates are calculated using both the ten-year yield on Confederation bonds and inflation expectations for the same time horizon, estimated with the aid of a vector autoregression model.

Chart 5.1
Money market rates



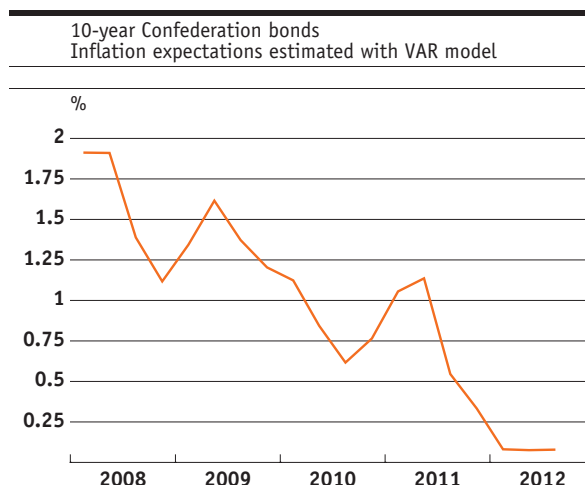
Sources: Bloomberg, Reuters, SNB

Chart 5.2
Term structure of Swiss Confederation bonds



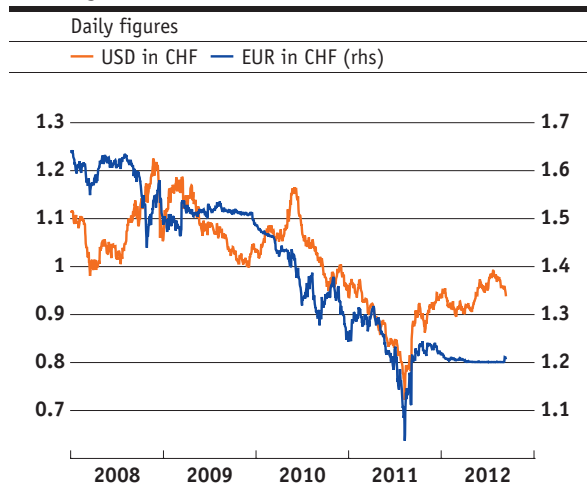
Source: SNB

Chart 5.3
Estimated real interest rate



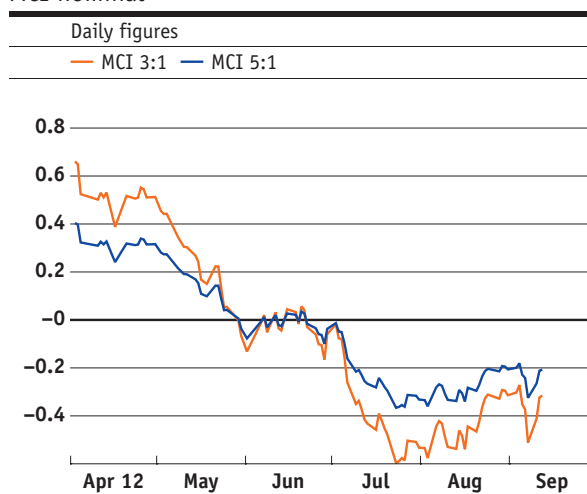
Source: SNB

Chart 5.4
Exchange rates



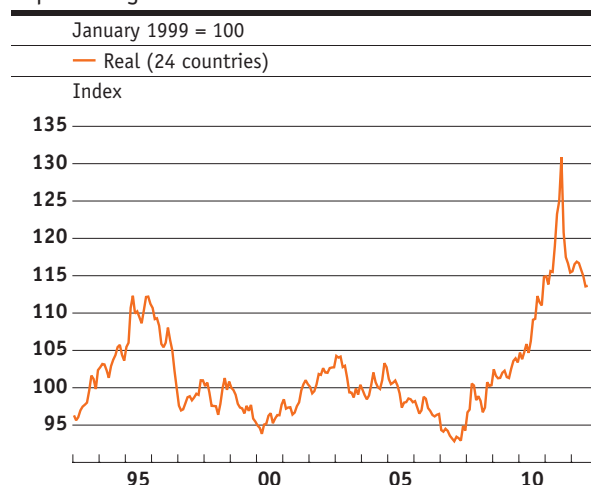
Source: SNB

Chart 5.5
MCI nominal



Source: SNB

Chart 5.6
Export-weighted external value of Swiss franc



Source: SNB

5.3 Exchange rates

Swiss franc rate against euro close to minimum exchange rate

Until the beginning of September, the exchange rate of the Swiss franc against the euro remained close to the minimum exchange rate of CHF 1.20. It then rose slightly to CHF 1.21. Against the US dollar, the Swiss franc weakened significantly for a short time alongside the euro. However, at the time of the monetary policy assessment in September it was trading slightly higher than three months previously against the US dollar, as was the euro (cf. chart 5.4).

Monetary conditions slightly eased

Since interest rates remained largely unchanged, the alterations in monetary conditions essentially express movements in exchange rates. The Monetary Conditions Index (MCI) illustrated in chart 5.5 combines changes in the three-month Libor with the nominal export-weighted external value of the Swiss franc. To take account of uncertainty regarding the relative impact of changes in interest rates and exchange rates, two different weightings are used for the MCI (3:1 and 5:1). The index is reset to zero at the time of the last monetary policy assessment. A negative value thus signifies a loosening of monetary conditions. The change recorded in the MCI between the June assessment and September corresponded to an interest rate reduction of 20 to 30 basis points.

Real external value of Swiss franc still at high level

The real export-weighted external value of the Swiss franc declined by 3% from March to August (cf. chart 5.6), reflecting both the nominal depreciation of the Swiss franc and the lower rate of inflation compared to Switzerland's most important trading partners. The real external value of the Swiss franc remains well above the long-term average. Thus, the Swiss franc is still high.

5.4 Stock markets

Higher share prices

Since June, Swiss share prices have risen in line with movements on international stock markets. In mid-September, the SMI – which encompasses the twenty largest share titles in the SPI – was 9% above the level at the beginning of the year and well above the low point for the year recorded at the start of June. Consequently, it has now returned to a level last seen before the downturn in summer 2011. Simultaneously with the rise in the SMI, the index of expected 30-day volatility for the SMI has dropped. Thus uncertainty on the equity market is assessed as being lower than the average for the past few years (cf. chart 5.7).

A breakdown of the SPI, with its approximately 230 share titles, shows that the rise in the index since mid-June has been mainly driven by manufacturing and pharmaceutical titles (cf. chart 5.8). Moreover, companies with large market capitalisations recorded bigger gains than medium-sized and smaller companies.

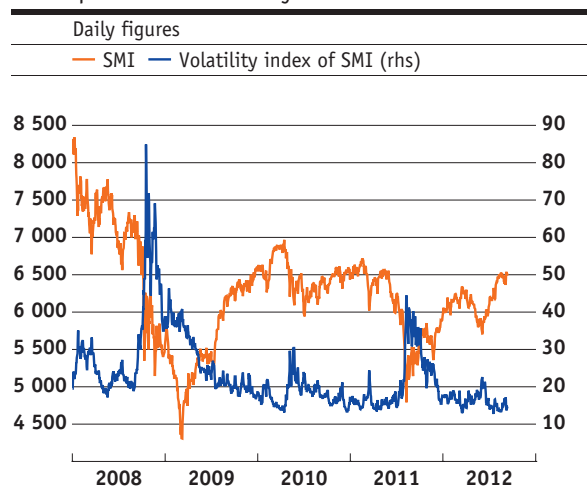
5.5 Monetary and credit aggregates

Sharp rise in monetary base

The monetary base, which comprises banknotes in circulation plus domestic banks' sight deposits with the SNB, rose from an average level of CHF 274 billion in June to CHF 338 billion in August (cf. chart 5.9). This growth reflected a strong increase in bank sight deposits at the SNB, which is largely attributable to foreign exchange operations carried out by the SNB to enforce the minimum exchange rate against the euro.

Chart 5.7

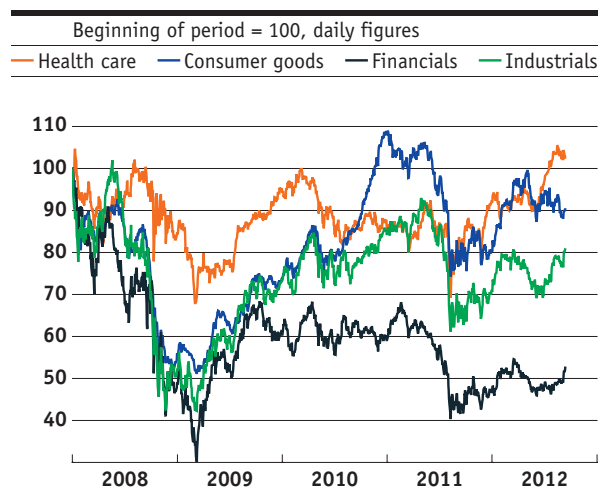
Share prices and volatility



Source: Thomson Financial Datastream

Chart 5.8

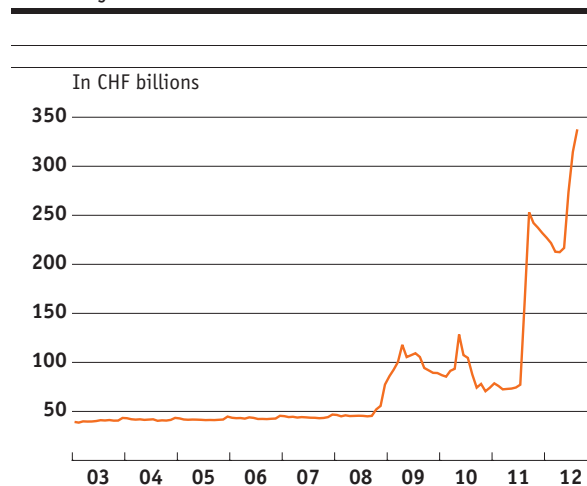
Selected SPI sectors



Source: Thomson Financial Datastream

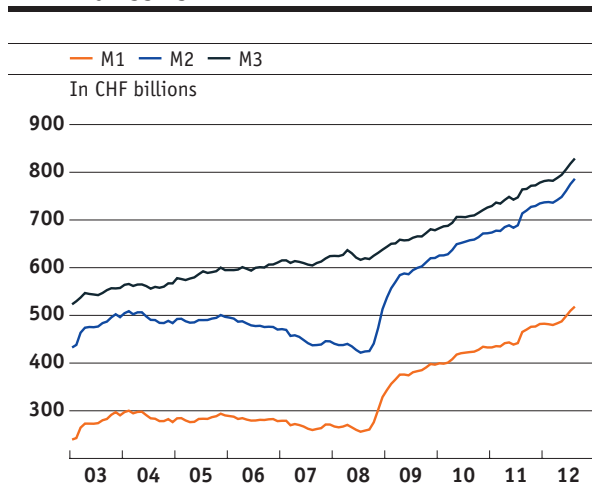
Chart 5.9

Monetary base



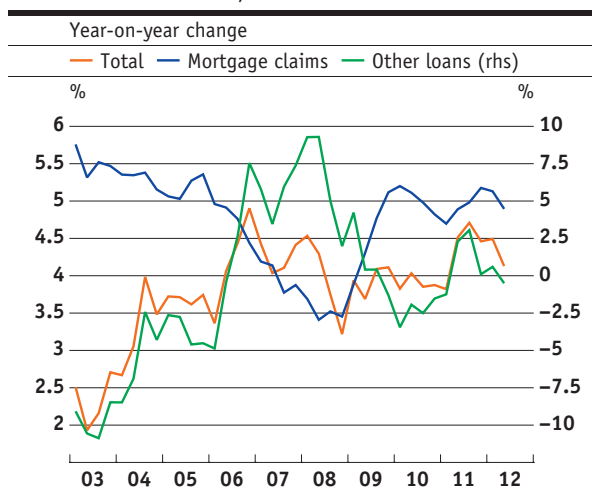
Source: SNB

Chart 5.10
Monetary aggregates



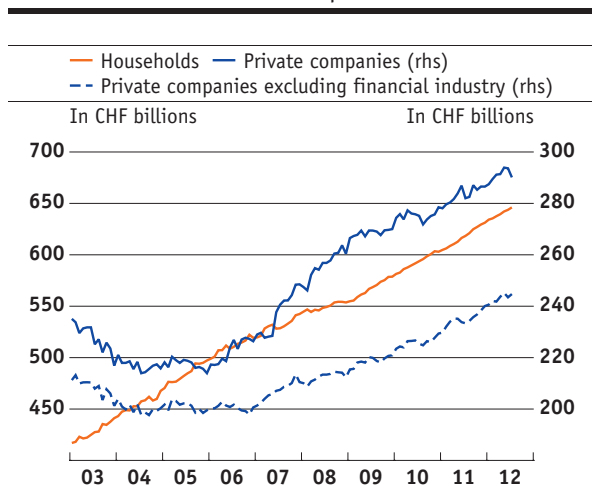
Source: SNB

Chart 5.11
Growth in bank loans, in Swiss francs



Source: SNB

Chart 5.12
Loans to households and companies



Source: SNB

Further increase in broad monetary aggregates

The broad monetary aggregates, which measure money holdings of households and companies (excluding banks), have also increased significantly since June (cf. chart 5.10). In August, M1 (notes and coin in circulation, sight deposits and transaction accounts) was CHF 53 billion or 11.4% above its year-back level. Of this amount, CHF 31 billion accrued solely in the period from May. In the same time period, M2 (M1 plus savings deposits) rose by 10.2% and M3 (M2 plus time deposits) was up by 8.5% (cf. table 5.1).

The most recent movements in the broad monetary aggregates recall the significant increase in August 2011. In both cases, the financial market uncertainties associated with the debt crisis in the euro area played a role. Overall however, the strong growth in the money supply mainly reflects the fact that, encouraged by the low level of interest, banks have been generating credit and creating deposits.

Lending growth slows a little

Lending continues to grow at a slower pace than the monetary aggregates. In the second quarter, bank lending was 3.9% above the year-back level. This means that the rate of growth was slightly below that of the previous quarter (cf. chart 5.11).

Both mortgage lending and other lending contributed to the decrease in lending growth (cf. table 5.1). In the case of mortgage claims, the growth decline affected mainly claims against private companies. By contrast, hardly any slowdown occurred in the growth in mortgage claims against households. As regards other lending, year-on-year growth of secured lending moved into negative territory. Consequently, in the second quarter, other lending – both secured and unsecured – was lower than in the corresponding year-back quarter.

A breakdown of bank lending by borrower category, as at June 2012, shows that lending to households increased by around CHF 27 billion or 4.4% over the year-back month (cf. chart 5.12). In the same period, lending to non-financial companies rose by CHF 9.7 billion or 4.1%. By contrast, lending to financial companies, which had more than doubled in the past few years, was down by CHF 2.9 billion, or 5.5%. Overall, therefore, no bottlenecks were identified in the supply of credit to the Swiss economy.

Monetary aggregates and bank loans
Year-on-year change in percent

Table 5.1

	2011		2012		2012			
		Q3	Q4	Q1	Q2	June	July	August
M1	8.6	8.5	10.8	10.8	11.0	13.6	15.3	11.4
M2	7.7	7.7	9.1	9.0	9.4	11.3	12.5	10.2
M3	6.9	7.2	7.4	6.7	7.0	8.5	9.5	8.5
Bank loans total^{1,3}	4.2	4.7	4.3	4.2	3.9	3.4	3.6	
Mortgage claims ^{1,3}	4.9	5.0	5.2	5.2	4.9	4.7	4.7	
Households ^{2,3}	4.5	4.5	4.8	5.1	5.0	4.9	4.9	
Private companies ^{2,3}	5.6	5.7	6.1	5.3	4.9	4.4	4.4	
Other loans ^{1,3}	0.7	3.1	0.4	-0.1	-1.1	-2.6	-2.0	
Secured ^{1,3}	4.3	4.4	1.6	1.8	-0.9	-3.2	1.8	
Unsecured ^{1,3}	-1.5	2.4	-0.4	-1.3	-1.2	-2.2	-4.5	

1 Monthly balance sheets

2 Credit volume statistics

3 Growth rates for the bank loans item and for its components include information provided by banks on changes in their classification practices. Consequently, they may deviate from growth rates published in the *Monthly Bulletin of Banking Statistics*.

Source: SNB

Package of measures on mortgage financing

On 1 June 2012, given the risk of overheating on the residential real estate market, the Federal Council decided on a package of measures in connection with mortgage financing, including the creation of a new instrument (countercyclical capital buffer) and higher capital requirements for mortgages. In addition, FINMA approved new Swiss Bankers Association guidelines on minimum capital requirements and amortisation as minimum supervisory standards. These measures aim to have a dampening effect on mortgage market momentum and real estate prices.

No activation of countercyclical capital buffer at present

Under the Capital Adequacy Ordinance, the SNB can make a proposal to the Federal Council for activation of the countercyclical capital buffer after consultation with FINMA, should the conditions for activation be fulfilled. On 27 August, the SNB announced that it would not put forward such a proposal for the time being. The decision was taken in the light of a number of indications of a possible slowdown in momentum on the mortgage and real estate markets as well as the package of measures announced on 1 June 2012. However, the SNB emphasised that the decision should not be interpreted as an all-clear.

Business cycle trends

SNB regional network

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

Third quarter of 2012

The Swiss National Bank's delegates for regional economic relations are constantly in touch with 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 July and August 2012 with 200 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.

Region	Delegate
Central Switzerland	Walter Näf
Eastern Switzerland	Jean-Pierre Jetzer
Geneva	Marco Föllmi
Italian-speaking Switzerland	Fabio Bossi
Mittelland	Martin Wyss
Northwestern Switzerland	Daniel Hanimann
Vaud-Valais	Aline Chabloz
Zurich	Markus Zimmerli

Summary

In the third quarter of 2012, economic activity remained largely unchanged from the previous quarter. However, in contrast to previous quarters, there was no further easing of margin problems; this is forcing companies to further optimise processes. In many places, therefore, a range of measures to cut costs and increase efficiency continue to be implemented.

The main source of concern about future developments continues to be the uncertainty surrounding the European debt crisis and – linked to this – further exchange rate developments, which in turn were a popular subject of discussion in the interviews.

There are still differences between industries. In construction, business activity registered another sharp increase. Manufacturing saw a marginal improvement, whereas business stagnated in the services sector. Demand for labour remained unchanged, overall, from the previous quarter.

The outlook for real growth in turnover remained cautiously optimistic in all industries. Capital expenditure and demand for staff are likely to remain unchanged or decline slightly. Average utilisation of technical production capacity and infrastructure is normal in manufacturing and in the services sector, and is still relatively high in construction.

1 Business activity

Manufacturing

In manufacturing, business activity has improved slightly. Real turnover was, overall, slightly above the previous quarter's and also the year-earlier quarter. The exchange rate problem continues to be dominant in most branches of industry. Additional measures taken by companies to increase efficiency and the continued focus on exchange rates in the SNB's policy have helped companies face this challenge effectively.

Machinery and vehicle manufacturing and the chemical and pharmaceutical industries all posted higher turnover than in the previous quarter. Turnover remained at the same level in the food and timber processing industries but was lower in the textile and clothing industries. The watchmaking industry and its suppliers reported that turnover growth had slowed from its previously very strong pace.

Demand from the emerging economies of Asia was again the main driver for the export industry, although the pace has slowed somewhat. Stimulus came from the US, Central and South America and the Arab countries. In Europe, demand originated mainly from Germany, Scandinavia and eastern Europe. Demand from France was weak and from southern Europe it was particularly slack or even non-existent.

Construction

In construction, real turnover was higher than in the previous quarter, though the pace of activity declined slightly. Developments were particularly buoyant in the finishing trade and preparatory constructing work, but turnover also rose in structural and civil engineering. Business momentum in residential construction barely slowed, while the situation in commercial and industrial construction remained rather subdued.

Real estate market risks were mentioned by a number of respondents, though the assessment of their importance continues to differ according to region and industry.

Services

In the services sector, real turnover remained largely unchanged overall, both quarter-on-quarter and year-on-year.

Good business momentum was reported by providers of facility management and maintenance services. IT companies working for small and medium-sized companies reported vigorous business. Auditors, legal and tax advisers and transport operators also recorded turnover growth. In contrast, trading business activity remained flat. Retailing continued to suffer as a result of cross-border shopping. The view that this phenomenon is set to continue for an extended period is increasing in the retail industry.

Considerable price pressure was also evident in the hotel and travel industries, leading to a drop in turnover in nominal terms year-on-year and stagnation compared with the previous quarter. Hotels in holiday regions expressed particular concern over the lack of European guests; however, strong demand from Asian tourists lent support to some areas. The catering industry recorded a decline in business activity. In banking, receipts from financial services were particularly sluggish – a result of considerable risk aversion on the part of clients.

2 Capacity utilisation

Overall, the utilisation of capacity and infrastructure was judged to be normal. The differences between the industries have grown, however.

Companies in the manufacturing industry rated their overall capacity utilisation as normal. It was high in the chemical and pharmaceutical industries and also for companies in the metal products and processing industries supplying the automotive industry, the medical technology field or companies with construction-related activities. In contrast, momentum in the watchmaking industry saw a definite slowdown; the companies surveyed judged capacity utilisation as being close to normal. Textile companies and the food industry continued to experience low or very low capacity utilisation. Finished product inventories are considered somewhat too high, particularly for the textile and machinery industries.

In construction, technical capacity utilisation remained consistently high, even more so in civil engineering than in structural engineering. Most of the surveyed companies expressed great satisfaction with capacity utilisation, with many order books full until the end of the year. The situation has allowed a number of companies to be selective with regard to the offers they submit and the orders they accept.

In the services sector, capacity utilisation was rated as normal overall. A relatively high level of capacity utilisation was recorded by IT companies, architectural firms and facility management, as in the previous quarter. Hotels and restaurants continued to see a low level of capacity utilisation, though the hotel industry in towns did profit from buoyant business tourism. The trend of reservations being made in lower categories of hotel due to cost considerations continued, however.

3 Demand for labour

As in the previous quarter, the demand for labour remained almost unchanged. The companies surveyed in the manufacturing industry continue to assess their staff numbers as being slightly too high. They continue to exercise restraint in their personnel policy, often do not replace employees when they leave and cover any increases in demand by taking on temporary staff or through overtime work. The trend of increased spontaneous applications from southern European countries continued, particularly in the border areas.

In construction, numbers of staff were generally considered appropriate, whereas in the previous quarter they had been considered to be too low. Specialists continue to be in short supply. Civil engineering firms are finding it easier than structural engineering firms to find personnel.

Staff numbers in the services sector were also adequate overall. Architectural practices, planning firms and auditors indicated that their recruitment needs were fairly high. Banking specialists are being sought selectively. The catering and hotel industries continue to be overstaffed.

The surveyed companies rate the recruitment of staff overall as being just as difficult and time-consuming as always. In many industries, the required personnel can only be found abroad. Staff availability remained tight in the plastics production and processing industry and, to some extent, in pharmaceuticals. Various companies in the machinery, electronics and metal (MEM) industries also had difficulty finding specialist staff. Insurance companies, transport operators and the hotel industry found it easier than normal to recruit staff.

4 Prices, margins and earnings situation

All sectors rated margins as weaker than normal. The trend observed in recent quarters towards an alleviation of this problem did not continue. Pressure to optimise costs and innovate thus continues unabated. At the same time, however, the results from previous optimisation measures are having an effect.

Many discussions reconfirmed that 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. A number of respondents indicated the severe impact which any further appreciation of the Swiss franc could have on their company or industry.

The manufacturing industry continued to suffer a great deal from the pressure on profit margins. Each industry is affected, though it is particularly pronounced in the textile industry, as well as in timber and plastic processing and the machinery industry. On average, companies expect purchase prices to remain unchanged in the coming months, but they anticipate that they will have to make further concessions in sale prices in Swiss francs. The development of the US dollar exchange rate led to margin improvements for some companies at least.

In construction, a trend towards below-average margins became apparent in structural engineering and the finishing trade, while civil engineering recorded almost normal margins. A trend towards the stabilisation of purchase prices and a simultaneous downward adjustment in construction prices suggest that the pressure on margins is set to continue.

The services sector presented an unchanged picture: Hotels and restaurants continued to suffer from unusually low margins, as did wholesaling. Representatives of the financial, transport and logistics industries rated their position in this respect as unfavourable. The companies surveyed in the services sector expect sale and purchase prices to remain unchanged.

5 Outlook

Uncertainty about future developments has hardly changed since the second quarter. In terms of global risks, uncertainty surrounding the European debt crisis was cited most frequently. There is a great deal of scepticism regarding further developments in southern Europe. The economic slowdown in northern Europe and other parts of the world is also contributing to this uncertainty.

Companies continue to be restrained with their employment and cautious with their domestic investment plans. However, as in the previous quarter, turnover expectations for the coming months remain positive in all industries, despite the potential dangers.

In manufacturing, representatives of all industries, apart from the textile industry and some metals and machinery companies, expect turnover to rise slightly over the next six months. The outlook in the watchmaking industry and its suppliers is slightly subdued.

In construction, seasonally adjusted turnover and capacity utilisation should increase slightly in the coming months. Some companies report that order books are already well filled or even very full well into next year. Many companies are also not expecting to see any significant slowdown in 2013, despite the adoption of the second homes initiative leading to uncertainty about construction activity in holiday regions over the medium term. However, no additional stimulus is to be expected as far as employment is concerned.

Overall, companies from the services sector are cautiously optimistic about the business trend in the next six months, as in the last quarter. All industries assume that turnover will be stable or rise slightly. Capacity utilisation and headcounts are likely to remain unchanged from their current levels. Not only facility management companies but also travel agencies and staff recruitment firms have relatively optimistic turnover expectations. Retail trade, passenger transport and transport operators are also more confident about the future than just a few months ago.

The continuing high level of uncertainty with regard to the future path of the economy is reflected in investment plans. All three sectors will see a slight decline in equipment investment in the coming twelve months compared with the past year, though individual companies are investing substantially with the intention of improving productivity at their Swiss locations. Planned investments in commercial and industrial construction are stagnating at present levels in all sectors.

Chronicle of monetary events

The chronicle summarises the most recent monetary events. For events dating further back, please refer to SNB press releases and the *Annual Report* at www.snb.ch.

September 2012

At its quarterly assessment of 13 September 2012, the SNB reaffirms that it will maintain the minimum exchange rate of CHF 1.20 per euro and will enforce it with the utmost determination. It remains prepared to buy foreign currency in unlimited quantities for this purpose. In the view of the SNB, the Swiss franc is still high and is weighing on the Swiss economy. The target range for the three-month Libor remains unchanged at 0.00–0.25%. If necessary, the SNB stands ready to take further measures at any time.

June 2012

On 25 June 2012, the SNB concludes a Swiss franc/zloty swap agreement with the National Bank of Poland. In the event of tensions in the Swiss franc interbank market, the facility enables the NBP to provide Swiss franc liquidity to banks in Poland.

At its quarterly assessment of 15 June 2012, the SNB reaffirms that it will maintain the minimum exchange rate of CHF 1.20 per euro and will enforce it with the utmost determination. It remains prepared to buy foreign currency in unlimited quantities for this purpose. Even at the current rate, it considers the Swiss franc to be still high. If necessary, the SNB stands ready to take further measures at any time. The target range for the three-month Libor will remain unchanged at 0.0–0.25%.

March 2012

At its quarterly assessment of 15 March 2012, the SNB reaffirms that it will continue to enforce the minimum exchange rate of CHF 1.20 per euro with the utmost determination and is prepared to buy foreign currency in unlimited quantities for this purpose. The target range for the three-month Libor will remain unchanged at 0.0–0.25%. The SNB will continue to maintain liquidity on the money market at an exceptionally high level. Even at the current rate, it considers the Swiss franc to be still high. The SNB stands ready to take further measures at any time if the economic outlook and the risk of deflation so require.

December 2011

At its quarterly assessment of 15 December 2012, the SNB reaffirms that it will continue to enforce the minimum exchange rate with the utmost determination and is prepared to buy foreign currency in unlimited quantities. It is leaving the target range for the Libor at 0.0–0.25%, and continues to aim for a three-month Libor close to zero. Even at the current rate, the SNB considers the Swiss franc to be still high and should continue to weaken over time. The SNB goes on to say that it will continue to maintain liquidity at exceptionally high levels, but has decided not to set a specific target level for sight deposits at present. The SNB stands ready to take further measures at any time if the economic outlook and the risk of deflation so require.

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