

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

Summary report for the attention of the Governing Board of the Swiss National Bank for its quarterly assessment of March 2009

The SNB's delegates for regional economic relations are constantly in touch with a large number of enterprises from the different industries and economic sectors. Their reports, which contain the subjective evaluations of these companies, are an important additional source of information for assessing the economic situation. On the following pages, the most important results of the talks held from December 2008 to February 2009 on the current and future economic situation are summarised.

Summary

Most of the 170 or so representatives of various economic sectors and industries interviewed by the SNB's delegates for regional economic relations between December 2008 and February 2009 reported a clear and rapid worsening of the economic environment. Whereas, in summer 2008, the majority of companies had still regarded business activity as good to very good, the situation changed dramatically in September and October. Since then, the slowdown in business activity has become considerably more pronounced.

The impact of the economic downturn varied according to the companies' area of activity and market position. Exports, especially of capital goods, have been particularly hard hit. Companies with a domestic and consumer goods focus have

not come under so much pressure, although representatives of this industry are expecting activity to weaken over the coming months.

Companies have reacted to the economic downturn by tightening their cost management. The measures taken are far-reaching and also include the review of investment plans. While, in general, companies are retaining strategically important investments, they are dispensing with any others that are not deemed strictly necessary. A rapidly growing number of firms are either preparing to introduce short-time working or have already done so. January and February also saw a marked rise in redundancies.

There is a high degree of uncertainty about the magnitude and duration of the crisis, with all the delegates expecting a difficult year to come.

1 Production

Manufacturing

The machinery industry is one of those hardest hit by the crisis, with companies rating the current crisis as much sharper, more pronounced and more globalised than the recession of 2002/03. Back then, the fall in orders had been more gradual. Moreover, there had been regional variation, which is not the case in the current crisis. Manufacturers of textile machinery and suppliers to the automotive industry suffered a particularly sharp fall in orders. Developments have been less dramatic for manufacturers of capital goods for the energy technology and supply industry, and for producers of medical technology. Nevertheless, they too are now starting to feel the effects of the crisis. The same is true of watchmaking, which had experienced a veritable boom in recent years.

Apart from the machinery industry, there was also a slowdown in business activity for producers of metals, plastics, chemicals (excluding agrochemicals), textiles and clothing. On the other hand, those industries that are traditionally resistant to cyclical fluctuation, such as food and pharmaceuticals, fared relatively well.

The fall in orders is partly a reflection of inventory flows: a number of delegates reported that their customers had cut inventories aggressively, which had weighed heavily on new orders. It is therefore hoped that, over the coming quarters, new orders will move more in line with production or sales.

Services

To date, the impact of the economic downturn on retail trade has been muted. Many respondents were pleasantly surprised by the Christmas sales figures. Following a record year in 2007, most of them had expected an appreciable decline. The year 2009 also started well, although results varied depending on the product range. Food sales performed well. Sales of winter sports articles also exceeded expectations. However, sales of consumer durables (electronics, furniture) were down considerably. Car sales, as well as demand for luxury goods, also suffered. A number of respondents attributed this to the negative wealth effects resulting from the financial market crisis.

In the main, representatives of the hospitality and tourism industry were satisfied with activity in 2008. Although figures for overnight stays were

mostly lower compared with the excellent numbers for 2007, the decline was only small. However, in the past few months the effects of the weakening economy have become increasingly evident, above all in towns and cities. There has been a sharp drop in business travel and spending behaviour has generally become more cautious – a development exacerbated by the strength of the Swiss franc. This decline has been partly offset by a good winter season for the ski resorts, which benefited from very good snow conditions. For the summer season, expectations are muted. However, no one is projecting a sharp decline.

Other branches of the service industry are feeling the effects of the crisis more keenly. The picture in the IT industry is still mixed. On the other hand, representatives of the transport and logistics industry reported a slump in international business, with an attendant sharp fall in freight tariffs. The media segment also suffered a severe decline. Receipts from advertising fell markedly, and affected all areas (job, property and commercial advertising).

At the banks, commission income was hardest hit, owing to falling share prices and lower transaction numbers. Banking industry representatives reported that investors were predominantly seeking security and liquidity. The collapse of Lehman Brothers, the Madoff scandal and the closure of numerous hedge funds had undermined customer confidence. Structured products (which were associated with high commission income) were no longer attracting any custom. The banks also reported that they had not changed their lending policies. Margins had shrunk, partly as a result of stiff competition in the mortgage market, and partly due to the difficulty in investing liquidity profitably. Most respondents from the non-bank sector confirmed that lending policies were largely unchanged. However, they said that business performance was now being more closely monitored. Moreover, it was more difficult to borrow large amounts – especially for exports. This was compounded by the fact that competition played only a limited role in this area, as smaller banks were generally not prepared to fill the gap left by either of the two big banks. In addition, many customers feared that lending conditions could become more unfavourable if the recession were to become entrenched.

Respondents from the insurance industry reported a marked fall in demand for life insurance products. In the area of mandatory occupational pension schemes, the technical interest rate continued to be difficult to achieve. Many pension funds with insufficient coverage ratios were therefore seeking a comprehensive insurance solution.

Construction and real estate

The majority of delegates from the construction industry described the level of outstanding orders as satisfactory. The weakening economy has so far not had any dramatic effect, and delegates do not expect a sharp decline over the next few quarters. This is probably due to the stimulus programmes launched by the federal government and a number of cantons, which are heavily slanted towards infrastructure projects.

Residential construction has remained robust, and respondents continue to expect healthy growth, since the low level of interest rates should support demand. Moreover, the weakness of the stock market means that residential property ownership is once again becoming attractive for many investors. There was also continuing strong demand for maintenance and renovation work, which mainly benefited the finishing industry. Commercial and industrial construction activity, however, was considerably weaker. A number of delegates reported that firms had put investment projects on hold. In the civil engineering industry, the orders situation continues to display regional variation, and in some areas is dominated by large-scale projects.

The majority of respondents from the real estate sector reported a levelling-off of prices. Real estate prices did not rise excessively during the upward phase of the economic cycle, which means that Switzerland has not experienced a real estate bubble. The delegates were thus not expecting a sharp correction.

2 Labour market

Personnel costs represent the largest element of expenditure for most companies. Thus, the effects of the crisis have increasingly been felt on the labour market over the past few months. Initially, companies did not renew temporary contracts and instructed employees to draw down their overtime balances. In addition, in the past few weeks many companies have introduced short-time

working. This is, however, expensive for employers, hence the growing number of redundancies. This has predominantly affected less qualified workers.

At present, short-time working is generally being chosen over redundancies, because companies do not wish to lose qualified staff whom they have only just gone to the trouble of recruiting. Moreover, given the volatility of business, they want to be prepared in the event of a recovery, even if it turns out to be only temporary.

3 Prices, margins and earnings situation

With the downturn in the economy, competitive pressures remained high or even intensified. The leeway for price increases has thus narrowed markedly. However, competition does not manifest itself solely through prices. For instance, respondents from the hospitality industry reported that they planned to leave prices unchanged, and instead offer supplementary services.

The onset of the crisis saw a further escalation of the price war that has been waged in the retail industry for a number of years. Among the major retailers, at the beginning of the year Coop signalled a new round in the price war by announcing that it was cutting prices on 600 brand-name products. Other major retailers responded with targeted price adjustments to their product ranges. Attention is now turning to the arrival on the market of a new large retailer: Lidl.

Margins have also come under pressure in the manufacturing industry, as many firms are faced with growing capacity surpluses. Some relief has been provided in recent months by declining commodity prices. However, the appreciation of the Swiss franc against the euro and the pound sterling, as well as the uncertainty reflected in the high exchange rate volatility, have weighed heavily. This will now be compounded by the pay increases agreed last autumn, which some respondents now consider, with the benefit of hindsight, to be too high, given the fact that inflation is declining. Exchange rate volatility and fuel price rises also continue to be areas of concern for a number of companies.