

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 2010

The SNB's delegates for regional economic relations are constantly in touch with a large number of enterprises from different industries and economic sectors. Their reports, which contain subjective evaluations of these companies, are an important additional source of information for assessing the economic situation. The following pages contain a summary of the most important results of the talks held in January and February 2010 with some 220 company representatives on the current and future economic situation.

Summary

The economy continued to recover in the first quarter of 2010. The uptrend in manufacturing was significantly broader than had been the case just a few months earlier. Most industries showed a modest increase in demand and real turnover. This led to a reduction in short-time work, which until that point had been widely implemented. However, because many manufacturers were recovering from a severe low level, under-utilisation of production capacity in some branches remained substantial. As in previous quarters, the situation in the construction and finishing industries was favourable. At the beginning of the year, the level of construction activity ranged from satisfactory to high, and that stable to trending slightly upwards. The continuation of a moderately upward trend was also evident in the services sector.

Expectations for the coming six months are cautiously optimistic. All the companies surveyed continue to believe that in the short term, the recovery is likely to be moderate and somewhat fragile. At the international level, the successful combating of the banking crisis and the recovery of the financial markets have resulted in a more positive mood. However, there is a residual crisis-related uncertainty, especially with regard to the sustainability of the recovery. Many are concerned by the financial state of the world's governments and the effects this could have on foreign exchange markets as well as on the propensity to consume and invest.

In general, the earnings situation of companies is most likely to be improved by a rise in the volume of sales, with few companies expecting increased profit margins.

1 Developments in the first quarter of 2010

Manufacturing

The manufacturing industry had shown a noticeable revival in demand in the fourth quarter of 2009. This upward trend continued into the first months of 2010, although in a weaker form. The recovery also began to take hold in industry sectors which until then had been contending with stagnating or declining business activity. Compared to the fourth quarter of 2009, manufacturing exhibited a broadly based increase in turnover. In many cases, this turnover, however, remained lower than in the previous year. Outstanding orders rose, but incoming orders were characterised by an unusually high level of volatility.

The inventory adjustment process is largely complete: the level of stock of finished products was described by almost all companies surveyed as appropriate. Consequently, a further rise in demand should be immediately reflected in an increase in production. An exception is the watchmaking industry, where stocks are still above the desired level.

Looking at individual sectors, the recovery has taken hold recently in the metal and machinery industry in particular, although the level of growth varies considerably from one firm to another. The situation in the chemical industry, which produces preliminary products needed by the manufacturing sector, also brightened in the first quarter of 2010. In the food and pharmaceutical sectors, the positive trend of the previous period continued. Only in the textile and clothing industries did turnover persist at a very low level.

The increase in demand in the second half of 2009 was driven primarily by emerging markets. At the beginning of 2010, incoming orders originated from all markets. While demand from the Far East continued to play a supportive role, orders from traditional markets (US, euro area and Switzerland) increased. However, in the euro area particularly, the strength of demand varied substantially from one country to another, as well as over time.

Construction

In the construction sector, first-quarter turnover as well as outstanding orders were significantly higher than in the previous year. In comparison to the fourth quarter of 2009, the tendency is towards a continued upward trend, although with less momentum, with adverse weather perhaps playing a role. Growth was stimulated once again by the housing market and civil engineering, while development in commercial and industrial construction was weak. The companies surveyed foresee a stable to mildly increasing level of business activity in the coming months.

Services

In the services sector, turnover was roughly equal to that of the first quarter of 2009. A positive trend was observed in the period between the fourth quarter of 2009 and the first quarter of 2010. This growth was driven by the following sectors: retail, transport, travel agencies, banking and especially IT service provision for businesses. Clear signs of recovery were shown by companies active in business travel, seminars and congresses – companies which, prior to this, had been experiencing low levels of activity. In contrast, tourist-oriented hotels and restaurants reported a renewed decrease in turnover, especially in the high-price segment. This was caused mainly by the continued decline in the numbers of foreign guests. The logistics sector also reported a downturn.

On the strength of a marked recovery in the second half of 2009, turnover in the banking sector at the beginning of 2010 was roughly equal to that of the previous year. However, upward momentum slowed in comparison to the fourth quarter of 2009. Credit volume – especially mortgage loans – continued to rise, although interest rate margins remained very narrow. Positive growth was also recorded in the areas of trading and foreign trade financing.

2 Capacity utilisation

Technical capacity utilisation in the first quarter of 2010 differed considerably from one economic sector and industry to the next. In the manufacturing industry, technical capacity in general was still significantly under-utilised, although there were considerable differences from one company to another. In the metal, textile and clothing industries, as well as in the automotive parts industry, under-utilisation remained especially pronounced. Production capacity in the machine and electronics industries was slightly less under-utilised. On the other end of the scale, the food, pharmaceutical and plastics industries reported their utilisation as ranging from normal to high.

In the construction industry, the rate of utilisation remained mostly very satisfactory. The finishing industry in particular exhibited good utilisation. In most cases, work orders ensure that capacity is fully utilised for several months. An exception is that of firms in commercial construction, where capacity utilisation is slightly less than satisfactory.

The services sector also showed widespread under-utilisation. This was particularly evident in the wholesale, travel and logistics industries. In transport, banking and insurance as well as in hotels and restaurants, the level of utilisation was insufficient. In retail, those most affected were specialised providers of consumer durables (household furnishings, electronics, exclusive apparel). There were, however, also cases of larger department stores and diversified shopping centres having to contend with excess capacity.

3 Demand for labour

In the manufacturing industry, the increase in production resulted in an increased deployment of labour. This had the effect of reducing the workforce overhang, which until then had been considerable. Several of the companies surveyed ended short-time work at the beginning of the year. In some cases, overtime had already been recorded,

and there was talk among certain companies of the need to employ temporary workers. Despite this improvement, a quarter of the industrial businesses surveyed described their headcounts as being too high or much too high. For the time being, even firms with good utilisation are very wary of taking on new permanent employees. On balance, business activity in the manufacturing industry is likely to exhibit a slight decline over the next six months. A rise in production should be achieved by a return to increased labour productivity.

In the construction sector, the level of business activity was regarded on the whole as being adequate. Based on current business expectations, firms anticipate that employment will remain the same. In this as in other sectors, companies faced with the prospect of rising orders in the short term are making plans to take on temporary workers where necessary.

Employment in the services sector is also roughly at a desirable level. The only areas expected to yield new jobs in the coming months are IT service provision, business consultancy, and parts of banking and insurance.

There were selected instances of companies in different industries looking to take on specialists. Many companies surveyed indicated that the recession had not led to any meaningful easing in the employment market for this skill segment. Although less skilled personnel are relatively easy to recruit at the moment, specialised experts (chemists, laboratory assistants, technicians, civil engineers, financial experts, CEOs) remain difficult to find. One view repeatedly encountered was that employees were loath to risk changing employers given the current job market.

4 Lending conditions

In sum, given the state of the economy, the overwhelming majority of companies surveyed regarded the banks' lending policies as normal. There were also a few isolated reports from the manufacturing, the hotel and restaurant and the transport industries of restrictive and risk-averse

lending conditions. Construction companies' views of the banks' lending policies, by contrast, ranged from unproblematic to generous. This was explained by favourable current market conditions and an encouraging economic outlook. The banks surveyed view the weak development of corporate lending as a consequence of a lack of demand, for which they give two reasons: the generally modest level of capital expenditure, and the high degree of liquidity in many companies.

5 Prices, margins and earnings situation

The overwhelming majority of companies surveyed believe that the only way to improve earning situations in the short-term is by increasing the volume of sales.

In the manufacturing industry, the recession has led to a considerable reduction in profit margins. At the beginning of 2010, margins have on average remained significantly weaker than usual. The main reasons given for this were sluggish demand as well as tougher competition due to excessive capacity worldwide. The export industry suffered a further blow due to appreciation in the exchange rate, since prices in local currencies – especially in the euro area – could not be raised accordingly. It is likely that in the short term, profit margins will remain under pressure. On the one hand, a slight increase in purchase prices is expected, in particular in commodities. On the other, few firms are planning to raise their sales prices. In general, the expectation is that sales prices will either stagnate or decline further.

In the construction industry, the margins were generally considered normal. In residential construction and civil engineering, competition remains strong. Higher margins therefore appear difficult to implement, despite a lengthy expansionary phase and a good level of capacity utilisation. By contrast, in commercial construction, unsatisfactory margins are being attributed to relatively weak demand. Several of the companies surveyed are planning to introduce small price increases on a selective basis. These, however, are likely to do no more than partly compensate the anticipated rise in purchase prices.

Banks, travel agencies, logistics companies as well as tourist-oriented hotels and restaurants all see themselves faced with noticeably below-average

profit margins. The insurance and consultancy industries assessed their margins as being slightly narrower than usual. Margins in both the wholesale and the retail trade were viewed as normal. Here the environment remains in a state of flux: all companies surveyed spoke of an unstoppable medium-term trend towards lower selling prices. By applying the Cassis de Dijon principle and using more efficient selling strategies, companies should stand to profit in future from lower purchase prices. These measures alone, however, are unlikely to suffice. To maintain margins, all providers are looking at ways of optimising their processes and increasing their productivity.

6 Outlook

Expectations for the coming six months are cautiously optimistic. They point to the continuation of the moderate economic recovery currently underway. In the manufacturing industry, most companies surveyed foresee a modest increase in turnover. Capacity utilisation is expected to recover to a limited extent only. Companies plan to secure the upturn in output by again cutting back short-time work and by increasing labour productivity.

In the construction industry proper, firms expect that turnover will stagnate, while the finishing industry predicts a slight increase in turnover. Capacity utilisation in both industries is likely to remain roughly the same.

Expectations in the services sector vary. Retailers are cautious – firms surveyed anticipate stagnating turnover as a result of modest pay increase figures, the rise in health insurance premiums as well as perceived unemployment. Hotels and restaurants anticipate a comparable scenario. Decidedly more upbeat is the mood among banks and insurance companies, IT service providers, business consultants, personnel consultants and recruitment firms, travel agencies and conference organisers. Companies surveyed in these industries expect an acceleration in growth in the next six months. Nonetheless, on average the services sector expects only a small rise in capacity utilisation.

The caution in these expectations is putting a damper on companies' investment plans, with the prevailing view being that equipment and building investment will increase only marginally.