

Half-yearly Media News Conference, Geneva, 15 June 2000

Introductory remarks by Hans Meyer, Chairman of the Governing Board of the Swiss National Bank

In view of its mandate and the current and foreseeable economic environment, the Swiss National Bank has decided to tighten its monetary policy once more. Effective immediately, it has therefore raised the target range for the three-month Libor rate by 50 basis points to 3.0% - 4.0%.

The economic recovery, which got under way in the second half-year of 1999, has continued at a more rapid and solid pace in the current year than originally expected. We expect real gross domestic product to grow by approximately 3% for the whole year. As is known, we anticipated a rise in the order of only 2% last autumn.

The inflation forecast we published at the end of 1999 projected the following inflation rates for the years 2000-2002: 1.5%, 1.7%, and 1.8%. Already at the beginning of the year, however, there were signs that the economy would pick up more markedly than originally expected. We therefore tightened the monetary reins sooner and more forcefully than we had planned at the time. First, we allowed the three-month Libor rate to climb to the upper part of the target range of 1.25% - 2.25%. After that, we increased the target range by 50 basis points to 1.75% - 2.75% at the beginning of February. Finally, toward the end of March, we concluded that a further tightening was indicated. Therefore, the target range was raised by yet another 75 basis points to 2.5% - 3.5%. If we had left the three-month Libor rate at the level as of the beginning of January 2000, inflation would have clearly surpassed the 2% mark before the end of the year (graph 1).

In the first quarter of the current year, the Swiss economy grew by just over 3% in real terms. We can expect a rise in the same order in the second quarter. This vigorous development is broad based. Exports increased by around 10% year-on-year. Both the favourable economic development in the neighbouring countries and monetary conditions contributed to this trend. The situation on the domestic market is characterised by construction spending accelerating significantly, strong demand for capital goods, and continued brisk consumer spending.

The development on the labour market has been favourable as well, and today we virtually have full employment in Switzerland. Staff shortages are on the increase, notably among better-qualified workers. Such signs of strain, just as the surge in the utilisation of available capacity, suggest that the production potential of our economy is largely exhausted at the present time.

As already mentioned, the prospects for the future economic development are good. Both in Switzerland and abroad, the leading forecasting institutes have adjusted their forecasts upward for the current year. In the coming year, the international economy is likely to lose some of its momentum. Switzerland is expected to witness a similar development. Exports will be affected and - as a result of interest rate increases since the start of the year - also investment. Private consumption, by contrast, will probably remain brisk.

In reviewing the inflation forecast, we have come to the conclusion that in the given circumstances the steps taken to tighten monetary policy so far may not have been adequate for ensuring price stability in the medium term. If the three-month Libor rate were left at the current level of around 3%, an inflation rate of more than 2% would have to be expected in the coming years. Today's increase in the target range is therefore necessary. Since the current expansion of our economy outstrips its production potential, a rise in inflation to a rate of more than 2% in the year ahead will be practically unavoidable in spite of the steps taken to tighten monetary policy. According to our inflation forecast, this rise is likely to be a temporary phenomenon only. As graph 2 illustrates, inflation should again drop below 2% in the next few years. A tighter monetary policy should dampen growth with the usual time lag. The development of the monetary aggregates communicates a similar message.

The inflation forecast for the next three years is based on a three-month Libor rate of 3.5%. It shows the anticipated course of inflation should the economy both in Switzerland and abroad develop in line with our expectations. As always, the future course of the economy cannot really be predicted. For this reason, economic development must be closely followed and any necessary monetary policy consequences must be drawn.

It is still too soon to make an in-depth assessment of the modifications in the monetary policy concept introduced at the beginning of the year. It can, however, be stated today already that by and large the reactions were positive. A cause for satisfaction were the improved transparency and the fact that decision-making is purposely broadly based

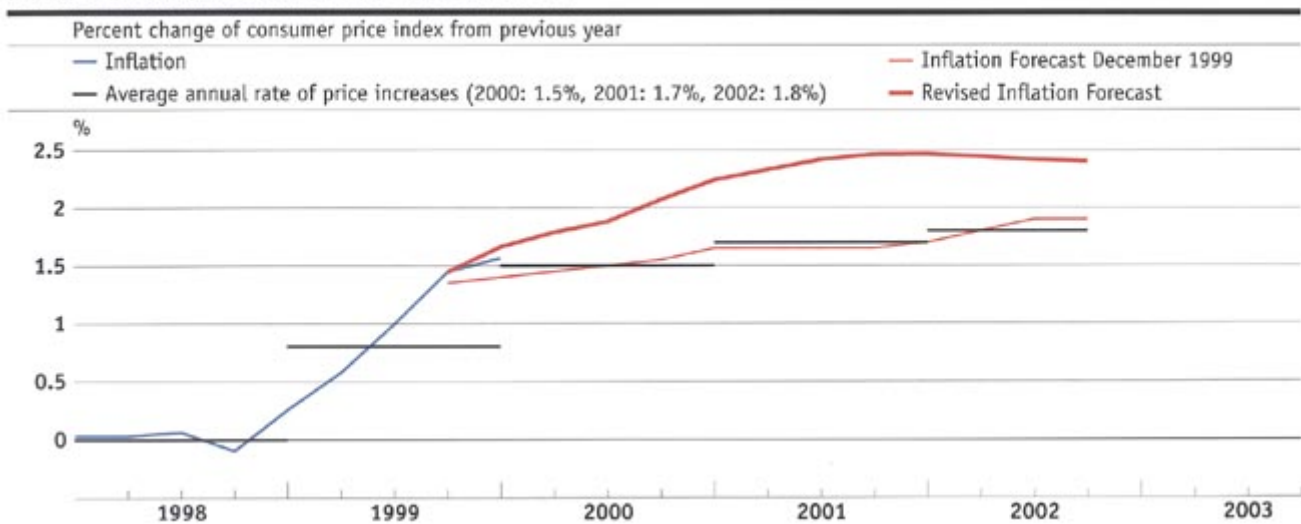
on all relevant indicators. In the operational field, the three-month Libor rate has proved to be a useful target variable. The experience gained so far, however, has already shown that we have not found the perfect solution. The transition from the decision-making process to the actual decision itself of necessity remains a discretionary act. Moreover, any assessment of the situation continues to be fraught with uncertainty, and the overall economic interconnection of effects is still not completely transparent.

To summarise, first of all, the gratifying aspects of the present development must be pointed out once more. In all probability, we shall achieve remarkable growth accompanied by full employment and price stability this year. The other side of the coin is the risk - which tends to increase - for overall economic stability. From today's vantage point, our monetary policy course should enable us to maintain price stability in the medium term.

From a somewhat broader perspective, it must be pointed out that there is a danger of the positive development obscuring the view for the continued need to improve the institutional framework for the economy in a socially acceptable manner.

Graph 1

Revised Inflation Forecast with Libor at 1.75%



Graph 2

Inflation Forecast with Libor at 3.5%

