Jean-Pierre Roth: Economic activity in Switzerland

Introductory remarks by Mr Jean-Pierre Roth, Chairman of the Governing Board of the Swiss National Bank, at the half-yearly media news conference, Berne, 16 June 2005.

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Ladies and Gentlemen

As we have just announced in our press release, the Swiss National Bank is leaving the target range for the three-month Libor rate unchanged at 0.25-1.25%. It intends to keep the rate in the middle of the target range at around 0.75% for the time being.

The fourth quarter of 2004 and the first quarter of 2005 saw a stagnation of economic activity in Switzerland, with the high price of oil as well as the depreciation of the dollar in the final quarter of 2004 acting as brakes. These factors also held back economic activity in Europe, as had been expected, thus further weakening the Swiss economy. Despite the sluggish development in the first quarter of 2005, the SNB still expects the economy to recover during the course of the year, with an increase in momentum in the second half. This notwithstanding, the pace of expansion for 2005 is likely to slow further. The SNB thus projects a growth rate of around 1%, as compared with 1.5% at the last assessment. Its expectations with regard to inflation in 2005 remain unchanged from the March assessment, so that average annual inflation for the year is likely to amount to 1%. On the assumption that the three-month Libor remains unchanged at 0.75%, annual inflation is forecast to stand at 0.5% in 2006 and reach 1.4% in 2007. Inflation prospects for the medium term now look more positive than they did at the March assessment. A correction to the expansionary monetary policy pursued by the SNB for a long time now will be necessary if the economic outlook improves. Should the Swiss franc appreciate rapidly, the Swiss National Bank will respond appropriately.

What were the most important factors that led to our decision to leave the three-month Libor rate unchanged? Before answering this question, I would like to briefly outline the situation we are facing. I will begin by presenting the economic environment, and then go on to describe the monetary situation.

As far as economic activity is concerned, we have revised our evaluation downwards since the last monetary policy assessment. In the final quarter of 2004, the Swiss economy slipped slightly, accompanying a rise in the price of oil and a decline in the dollar in the period from October to December. Both of these factors also had an unfavourable impact on the European economy.

Contrary to the expectations expressed at our last monetary policy assessment, economic activity in Switzerland remained restrained in the first quarter. Despite a slight increase in domestic demand, GDP stagnated compared with the previous quarter. This disappointing result was mainly attributable to export developments. Companies were faced with slack demand and consequently limited their volume of investment. This affected employment, and the resulting uncertain labour market situation had a dampening impact on private consumer spending which rose at a below-average rate. The real estate sector, by contrast, benefited from the continuation of favourable financing conditions.

Oil prices rose again at the beginning of the year, continuing to act as a brake on the world economy, and the situation remained particularly gloomy in Europe. Given these developments, it is most unlikely that the 1.5% growth for 2005 forecast in the last monetary policy assessment will be attained. However, signs of an improvement in the Swiss economy became evident in the first quarter of the year, with exports picking up in April and May. We expect this trend to be confirmed in the months to come, and now forecast real GDP growth of about 1% for the year 2005 as a whole. This delay in the recovery of the economy will have a dampening effect on price developments in the year 2006.

Now I would like to outline my assessment of monetary developments, which remain more or less unchanged with respect to the assessment presented in March. The three-month Libor rate has remained at a low level for a long time now: it has been below one percent for almost three years, since July 2002. Real rates of interest for three month maturities have been negative for two years.

Given the unusually low level of interest rates, the willingness to invest in liquid assets remains high and, according to our estimates, the money overhang persists. However, the moderate growth in the M3 monetary aggregate indicates that this situation has not changed since the last monetary policy assessment. Thus, the monetary analysis shows that we can continue pursuing our expansionary monetary policy for the time being, without incurring additional risks.

Since the first quarter of 2003, the year-on-year growth rate for mortgage loans has exceeded 5%. Mortgage loans to households slowed slightly at the end of 2004, but since then their rate of growth has accelerated to a level higher than that recorded in recent years. Mortgage loans to companies, which had declined over the past five years, have also risen again since the beginning of the year. Prices continue to increase in the real estate market, a development to which, in our view, the low mortgage rates have contributed. Well aware that our monetary policy is still expansionary, we are keeping a close eye on developments in the real estate sector.

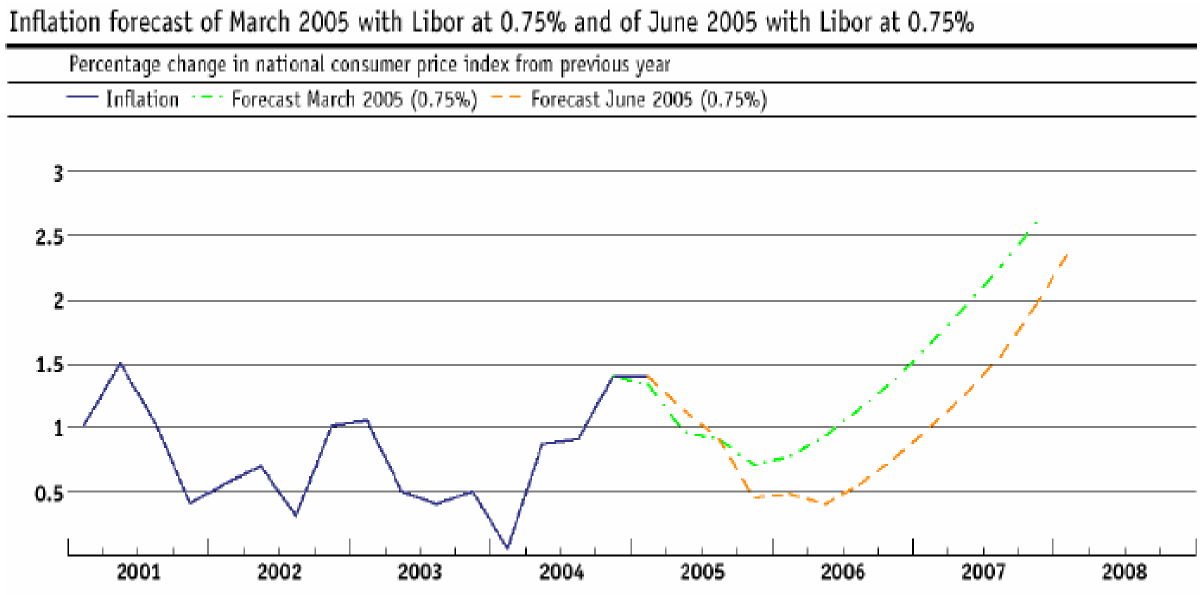
In view of the above-mentioned developments, we have decided to leave the target range for the three-month Libor rate unchanged at 0.25-1.25%. What were the most important factors that led to this decision? There were three of them. First of all, we needed to downgrade our expectations with respect to the development of the economy. However, there are no signs of any cyclical downturn and the economy continues to recover, even if this recovery is somewhat delayed and muted. Second, the lacklustre economic activity is being accompanied by an improvement in the medium-term outlook for inflation. This means that an increase in the Libor target range appears less urgent. Third, the level of uncertainty has risen. The economic outlook in Europe is more difficult to assess than it was in March. Although the price of oil declined in April and May, it rose again significantly in June, and high prices in the oil market could persist for some time to come. In addition, the decline in the level of long-term interest rates is not very consistent with a recovery in the economy.

I will now briefly outline our new forecast for inflation. The graph depicts the current and the previous forecasts. The dashed red curve represents the new forecast, which covers the period from the second quarter of 2005 to the first quarter of 2008. The dash-dotted green curve shows the forecast presented in the last monetary policy assessment. Both forecasts are based on the assumption of a three-month Libor rate of 0.75%.

The line representing the new inflation forecast begins slightly above the previous forecast, dropping significantly below it from next year onwards. The decline in inflation rates this year is due to a stabilisation in the price of oil. The lower level of inflation next year is attributable to weaker growth in economic activity. In 2007, inflation will rise rapidly because of the high level of utilisation of resources and the high level of liquidity. This means that, should the three-month Libor rate remain unchanged at 0.75%, inflation would reach 2.4% by the end of the forecasting horizon. This would be above the range which the SNB equates with price stability.

The forecast shows that the current level of interest rates cannot be maintained once the economic situation normalises. Since monetary policy has been expansionary for a long time now, there is a greater threat of inflation in the future. If the economic outlook continues to improve, it will be necessary to make adjustments to monetary policy.

With our decision to leave the three-month Libor unchanged, we are adhering to our previous monetary policy course for the time being. We continue to support the economy, using the leeway available to us. This policy should guarantee longer-term price stability. As mentioned before, the SNB will respond appropriately if the Swiss franc appreciates rapidly, and is keeping all its options open for this eventuality, as it has done in the past.



Observed inflation June 2005

	2002				2003				2004				2005			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Inflation	0.56	0.69	0.31	1.01	1.05	0.50	0.40	0.50	0.06	0.87	0.91	1.40	1.40			

Inflation forecast on March 2005 with Libor at 0.75% and of June 2005 with Libor at 0.75%

	2005				2006				2007				2008			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Forecast March 2005, Libor at 0.75%	1.33	0.96	0.91	0.70	0.76	0.93	1.14	1.36	1.65	1.94	2.25	2.60				
Forecast June 2005, Libor at 0.75%		1.13	0.91	0.45	0.48	0.40	0.55	0.75	1.00	1.25	1.55	1.95	2.40			

Inflation forecast of June 2005 (53 kb)