

Jean-Pierre Roth: Inflation and economic activity – are we at a crossroads?

Summary of a lunchtime discussion by Mr Jean-Pierre Roth, Chairman of the Governing Board of the Swiss National Bank and Chairman of the Board of Directors of the Bank for International Settlements, at the “Geneva Financial Center” organisation, Geneva, 28 August 2006.

The complete speech can be found in French on the Swiss National Bank’s website (www.snb.ch).

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While the world economy is experiencing exceptionally vigorous expansion and inflationary pressure is contained, there is still a certain amount of uncertainty. Will the economy turn down again and inflation accelerate?

The Swiss National Bank is not working with a scenario of imminent weakness in the global economy, even if the rate of growth slows somewhat. Certainly, the US economy appears to be heading for a soft landing, and economic activity in Europe is also likely to increase less rapidly in the second half of the year. On the price front, the recent surge in inflation in the consumer price index was largely attributable to the cost of goods and services directly linked to energy prices, while core inflation remained at a relatively low level. Given the slowdown in global spending and the normalisation of monetary conditions, inflationary pressures are likely to remain restrained.

This assessment also applies to Switzerland. The vitality of the manufacturing, financial and construction sectors, which have fuelled economic growth in our country over the past few quarters, is likely to diminish, particularly in view of the expected slowdown in global demand. Growth in Swiss GDP will probably amount to a little over 2.5% in 2006 (this is a cautious forecast), falling back slightly in 2007 yet remaining in the vicinity of 2%. Consumer prices rose 1.4% in July, marginally above our figure for core inflation, which at 1.2% is the highest since April 2002. However, these rates are well below the level of 2% that we consider the upper limit for price stability. For 2006 as a whole, we expect the average rate of inflation to remain below 1.5%, and this is unlikely to change much in 2007.

With respect to monetary policy, the healthy economic outlook in both the world and domestic economies, together with the high level of capacity utilisation in manufacturing, require us to further pursue normalisation of the target range for the three-month Libor. This is particularly necessary in view of the significant relaxation in global monetary conditions – due to the depreciation of the Swiss franc against the euro – that has occurred since our last monetary policy assessment in mid-June.