Jean-Pierre Roth: Global and Swiss economic outlook

Introductory remarks by Mr Jean-Pierre Roth, Chairman of the Governing Board of the Swiss National Bank, at the end-of-year media news conference, Zurich, 10 December 2009.

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By and large, our assessment of the economic and monetary situation is the same as in September 2009, with economic and financial developments running according to expectations. Risks remain significant, and for this reason we are maintaining our expansionary monetary policy.

Global economic outlook

Before I address the outlook for the Swiss economy, allow me to briefly examine economic developments at the international level, since they affect the outlook for Switzerland.

Signs of a recovery in global economic activity gathered strength during the second half of 2009. The ongoing normalisation of conditions on the interbank and financial markets, together with the monetary and fiscal stimuli, supported a recovery in production, especially in the manufacturing industry.

However, the legacy of the crisis still weighs heavily. The economic rebound of the past few months is largely the result of public sector intervention, and is not yet anchored firmly enough. Except in emerging Asia, the rebound has only partly redressed the losses sustained in 2008 and early 2009. Capacity utilisation rates are still generally low, and access to bank lending remains difficult in some countries. Moreover, both the labour market situation and the need to restore savings levels are weighing on household consumer spending. Therefore, we still hold the view that the return to global equilibrium will be slower and more uncertain than is usually the case at the end of a recession.

Swiss economic outlook

The Swiss economy is also on the road to recovery: Swiss GDP growth turned positive in the third quarter. However, value added continued to contract in the manufacturing industry. Overall, demand for labour is still falling and unemployment numbers are on the rise.

We are projecting a moderate recovery for 2010. Private consumption growth will be held back by weak household income growth. Exports will benefit from a gradual return to strength of external demand. This should allow manufacturing production to recover, albeit unevenly across the different segments. In particular, new orders in the equipment goods segment will probably continue to suffer from the excess capacity at the international level. In Switzerland, too, the increase in manufacturing production will not be enough to allow excess production capacity to be reabsorbed. Consequently, equipment investment is unlikely to see any improvement for several quarters, and there could be a fall in the number of manufacturing jobs. In the construction industry, on the other hand, where the degree of resource utilisation is more than satisfactory, demand should stabilise.

For 2010 as a whole, the SNB expects real GDP growth of between 0.5% and 1%, following a decline of around 1.5% in 2009.

Changes in monetary and financial conditions

Overall, monetary conditions are a reflection of our expansionary policy, especially with respect to interest rates and the monetary aggregates.

The Libor is currently at the level targeted since March this year, i.e. 25 basis points, a level which can be regarded as a floor. The fact that it was impossible to bring the rate down any lower than this led us, in March, to introduce other instruments in order to make our monetary policy as expansionary as the circumstances demanded.

Monetary conditions have become more expansionary via the interest rate channel in particular. Indeed, credit premia on the capital markets have declined steadily since the beginning of the year. As yields on Confederation bonds have remained low, other long-term yields have also trended downwards. It has thus become cheaper for companies to raise funds by borrowing on the capital market. In addition, our figures show that financing in the form of bank loans has also become more attractive following the decline in the Libor. In real terms – i.e. after factoring in expected inflation – interest rates are even lower.

The Swiss franc has appreciated slightly in trade-weighted terms, as a result of the recent weakening of the dollar. However, it has remained stable against the euro, which shows that the monetary policy followed since March has been effective. An appreciation of the Swiss franc against the euro would run counter to the relaxation in monetary conditions brought about through the interest rate channel. This is why the SNB will continue to act decisively to prevent any excessive appreciation of the Swiss franc against the euro.

An assessment of monetary conditions can be misleading if it is based on prices, which, like currently the libor, have reached a bound. For this reason, an assessment based on quantities – money and credit – is particularly important in the current circumstances.

The monetary base has increased substantially since October 2008, when the financial crisis entered a new phase following the collapse of Lehman Brothers. We supplied the interbank market with sufficient liquidity to meet burgeoning demand in a climate of uncertainty, in order to prevent any increase in money market rates. Since then, precautionary base money demand has declined and we have reabsorbed liquidity accordingly. The monetary base has thus fallen by 28% compared to the peak recorded in April 2009. The level of sight deposits is, however, still almost ten times higher than before the crisis. There is thus a risk of excessive money creation once confidence is restored.

Monetary conditions should not be judged in terms of banking sector liquidity, but rather on the basis of the liquidity available to households and firms – i.e. the monetary aggregates. M3 growth, which had been modest for a long time, has accelerated. In October, it reached an annual rate of 7.7%. M1 and M2 have shown strong growth. The significance of these growth rates is limited because the uncertainty linked to the crisis reinforced the general public's preference for liquidity, and because interest rates are at extremely low levels. It is therefore useful to analyse the transmission of monetary stimuli through the lending channel as well.

Mortgage loans provide a particularly good reflection of the effects of monetary policy. Why? Essentially, mortgage loans are used to finance real estate projects. But the yields on these investments, which are by their very nature long-term, are heavily dependent on the level of interest rates. This relationship has been confirmed once again: no sooner did we cut interest rates than the growth rate of mortgage loans began to increase more strongly. Having hit a low of 3.2% in November 2008, the growth rate then began to accelerate steadily, reaching 5.1% in October 2009. In the same month, other lending in Swiss francs declined at a rate of –0.3%, which is normal during a period of weak economic activity. All in all, lending to households and firms, both large and small, has continued to grow over the past few months, as the growth in mortgage lending has largely offset the drop in other lending.

According to the latest SNB bank lending survey, the phase of tightening lending conditions could be coming to an end. The share of banks reporting a further slight tightening of conditions for corporate lending has fallen considerably, from 40% at the time of the previous quarterly survey to 3% for this quarter. Households appear to be benefiting from a similar trend, as no banks have announced a tightening of their lending conditions for households, whereas in the previous quarter 50% of banks reported a further slight tightening of lending conditions for non-mortgage loans and 20% for mortgage loans to households.

The survey also suggests that demand for loans has stabilised. The share of banks experiencing increased household demand for mortgages has fallen from 40% at the beginning of this year to 10%.

The situation in Switzerland is thus very different to that observed in other economies. Not only is there no credit crunch, but we have also witnessed a substantial increase in the volume of mortgages. There are also signs of a relaxation in lending conditions for mortgage loans. We would like to sound a note of caution, both to banks and to firms and households, as regards the risks inherent in a relaxation of discipline in real estate financing.

Inflation outlook

Monetary policy influences the medium and long-term inflation outlook. By contrast, it has very little effect on short-term developments. The past two years have been a perfect illustration of this. Inflation peaked at 3.1% in July 2008, before plummeting to –1.2% in July this year. This reflects extreme movements in oil prices, which reached USD 145 a barrel in July 2008, only to fall to USD 35 in December of the same year. The temporary nature of fluctuations in inflation was correctly anticipated, as evidenced in our previous inflation forecasts. Since it takes time for the impact of monetary policy to feed through, it would have been futile to attempt to counter these movements.

The path of inflation in the near term will be largely dictated by recent movements in oil prices and the associated base effects. Inflation will already return to positive figures from the end of this year. This is mainly due to the base effect linked to the USD 35 low reached by oil prices in December 2008. Inflation will tend to decline thereafter, despite the recovery in growth. In fact, economic activity will remain subdued and will return only gradually to normal. Inflation will nevertheless remain positive throughout 2010. Assuming that our monetary policy remains unchanged, our new forecast shows that inflation will begin to increase again from the beginning of 2011, to reach 2% in the first half of 2012. Our expansionary monetary policy cannot be maintained indefinitely without incurring inflation risks.

Considerable uncertainty remains attached to this inflation forecast. Global economic developments could be less favourable than I described in the first section of my remarks. The financial crisis could reappear.

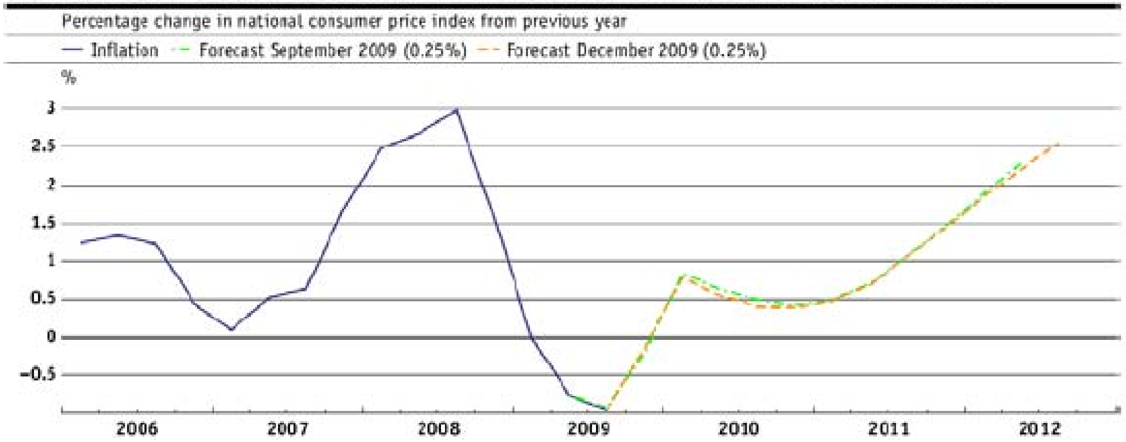
Monetary policy decision

The inflation outlook has not changed since the September assessment. It confirms that the expansionary monetary policy cannot be maintained for the next three years because price stability will be compromised in the long term. However, a swift correction in monetary policy would be precipitate since the inflation outlook is still associated with downside risks. If these risks materialised, we could again be faced with the threat of deflation. The uncertainties relate to the global economy and to the level of recovery within the financial industry. These factors have persuaded the SNB to opt for a cautious stance, and it is leaving its monetary policy course unchanged for the time being.

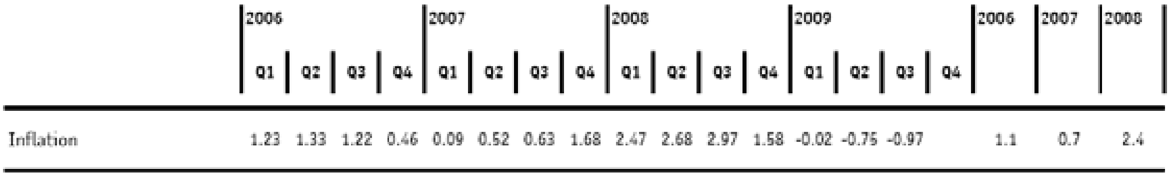
Strengthening the SNB’s equity capital

On 4 December, the SNB Bank Council decided to strengthen the SNB’s equity capital by doubling the allocation to provisions over the next five years. This decision was prompted by the growth in market and credit risks in the SNB’s balance sheet (creation of the SNB StabFund and the increase in currency reserves). Given the high level of the distribution reserve and results expected for 2009, this decision should not pose problems in terms of the distribution of profits, in the amount of CHF 2.5 billion annually, up to the end of the period agreed with the Confederation and the cantons (2017). My colleague Thomas Jordan will address these aspects in more detail in his own introductory remarks.

Inflation forecast of September 2009 with Libor at 0.25% and of December 2009 with Libor at 0.25%

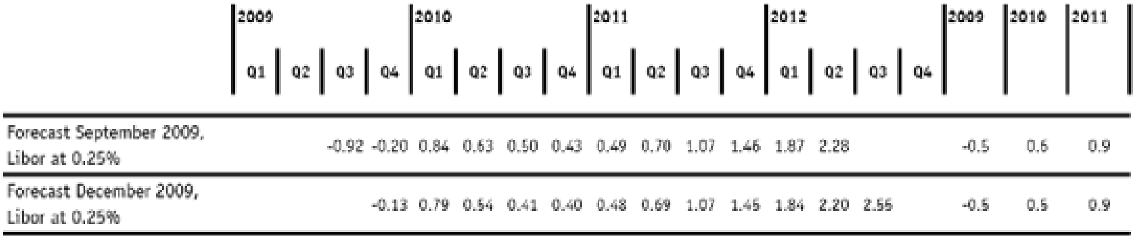


Observed inflation December 2009



	2006				2007				2008				2009				2006	2007	2008
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Inflation	1.23	1.33	1.22	0.46	0.09	0.52	0.63	1.68	2.47	2.68	2.97	1.58	-0.02	-0.75	-0.97		1.1	0.7	2.4

Inflation forecast of September 2009 with Libor at 0.25% and of December 2009 with Libor at 0.25%



	2009				2010				2011				2012				2009	2010	2011
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4			
Forecast September 2009, Libor at 0.25%			-0.92	-0.20	0.84	0.63	0.50	0.43	0.49	0.70	1.07	1.46	1.87	2.28			-0.5	0.6	0.9
Forecast December 2009, Libor at 0.25%				-0.13	0.79	0.54	0.41	0.40	0.48	0.69	1.07	1.45	1.84	2.20	2.56		-0.5	0.5	0.9