# Philipp Hildebrand: Global and Swiss economic outlook – overview for 2011/12

Introductory remarks by Mr Philipp Hildebrand, Chairman of the Governing Board of the Swiss National Bank, at the end-of-year media news conference, Berne, 15 December 2011.

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The Swiss National Bank (SNB) reaffirms its commitment to the minimum exchange rate of CHF 1.20 per euro. It will continue to enforce this minimum rate with the utmost determination. It is prepared to buy foreign currency in unlimited quantities. The target range for the Libor remains at 0.0–0.25%, and the SNB continues to aim for a three-month Libor close to zero. Even at the current rate, the Swiss franc is still high and should continue to weaken over time. The SNB stands ready to take further measures at any time if the economic outlook and the risk of deflation so require.

In the third quarter, the global economy picked up again slightly, thanks to positive stimuli from Japan, the US and China. Growth in Europe, however, remained weak and the economic outlook for the euro area deteriorated. In Switzerland, the pace of growth slowed considerably in the third quarter. The substantial appreciation of the Swiss franc over the summer is weighing heavily on the Swiss economy. For 2011 as a whole, real GDP growth of 1.5–2.0% can be expected. This is only because of the favourable economic development in the first half of the year. For 2012, the SNB is expecting economic growth in the order of 0.5%.

The international outlook continues to be highly uncertain. A further escalation of the European sovereign debt crisis cannot be ruled out. This would have grave consequences for the international financial system. Moreover, given our country's close relations with the euro area, Switzerland's economic prospects are highly dependent on how the crisis develops.

Compared to the previous quarter, the SNB's conditional inflation forecast has once again been adjusted downwards. In the short term, inflation will dip into negative territory sooner, owing to the effects of the earlier currency appreciation, which have been stronger than expected. In the longer term, the worsening of the growth outlook for the euro area is dampening inflation. The forecast for 2011 shows an inflation rate of 0.2%. For 2012, the SNB is expecting inflation of –0.3% and for 2013, of 0.4%. These forecasts are based on the assumption of a three-month Libor of 0% and a depreciating Swiss franc. In the foreseeable future, there is no risk of inflation in Switzerland. If foreign demand were to fall off more sharply than expected, downside risks to price stability would emerge.

## Global economic outlook

Following a very weak second quarter, the global economy picked up again slightly in the third quarter, benefiting from the resumption of production following the earthquake disaster in Japan. The decline in commodity prices during the third quarter also had a positive effect. In Japan, the US and China in particular, aggregate economic activity strengthened slightly. In the euro area, on the other hand, economic growth was weak.

The outlook for global growth is nevertheless subdued, and has, if anything, deteriorated since the last monetary policy assessment. The most recent US economic data have been somewhat better than expected, but the escalation of the European debt crisis has clouded the economic outlook for the euro area. Bond yields for fiscally weak states have risen markedly. The growing unease among market participants is also reflected in the increased volatility on the financial markets. Mounting borrowing costs and the high level of uncertainty are contributing to a marked worsening of the business climate in the euro area.

The SNB has adjusted its growth assumptions for the euro area over the next three years substantially downwards. For the rest of the world, on the other hand, our forecasts remain essentially unchanged. Uncertainty about the future outlook for the global economy remains extremely high. In particular, the European sovereign debt crisis poses grave risks for the international financial system and the real economy.

## Swiss economic outlook

In Switzerland, the pace of growth slowed considerably in the third quarter. According to preliminary estimates, annualised real GDP increased by only 0.9%. In particular, the substantial appreciation of the Swiss franc over the summer is weighing heavily on the Swiss economy. Exports fell sharply. At the same time, domestic final demand stagnated.

The economic slowdown was accompanied by a slight decrease in technical capacity utilisation. In manufacturing, it is now around the long-term average. In the construction industry, it has declined slightly, but remains at a very high level. Narrow profit margins and mounting concerns over the international outlook held companies' demand for labour in check.

The introduction of the minimum exchange rate has corrected the massive overvaluation of the Swiss franc and has given companies a sounder basis for their investment planning. This notwithstanding, the situation for a big part of the economy remains difficult. Waning global demand will continue to hold back export growth. Economic uncertainty, coupled with a difficult earnings situation for many companies, will curb corporate investment. Moreover, since October, the seasonally adjusted unemployment figure has risen again slightly. The deterioration in the labour market should constrain both consumer spending and investment in residential construction.

It is likely that the Swiss economy will stagnate in the fourth quarter. For 2011 as a whole, real GDP growth of 1.5–2.0% can be expected. This is only because of the favourable economic development in the first half of the year. For 2012, the SNB is expecting economic growth in the order of 0.5%.

## Monetary and financial conditions

In October and November, inflation turned negative, a development largely driven by the strong appreciation of the Swiss franc during the summer. Prices for a large number of tradable goods fell markedly. Following the introduction of the minimum exchange rate, the SNB is expecting temporarily negative inflation rates, but not a sustained decline in the general price level. Moreover, surveys also show that medium-term inflation expectations are still positive.

As a result of the substantial expansion of liquidity to combat the strength of the Swiss franc in August, some short-term interest rates turned negative. They have been close to zero since the previous monetary policy assessment. Long-term interest rates also declined further. The yield on ten-year Confederation bonds reached a new low. The expansionary effects of monetary policy are also evident in the growth of the money supply and in real interest rates, which have remained at a low level.

Since the introduction of the minimum exchange rate on 6 September 2011, the Swiss franc exchange rate to the euro has been above CHF 1.20. Compared to August, the Swiss franc has even depreciated more against the US dollar than against the euro. Nevertheless, even at the current exchange rate, the Swiss franc is still high.

In August, the SNB had substantially expanded Swiss franc liquidity, in order to weaken the heavily overvalued Swiss franc. Since then, banks' sight deposits with the SNB have been at historically high levels. The SNB will continue to maintain liquidity at exceptionally high levels, but has decided not to set a specific target level for sight deposits at present. My colleague Jean-Pierre Danthine will discuss the SNB's liquidity measures and their effects in more detail.

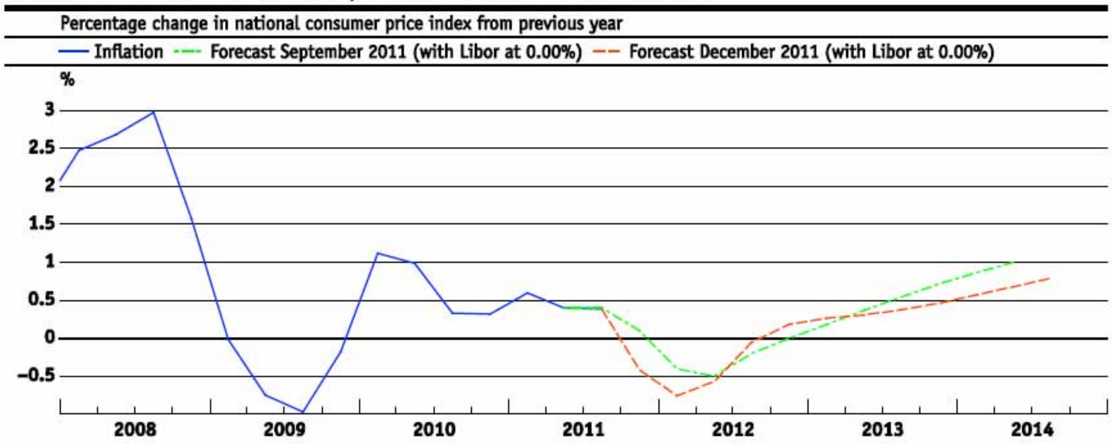
Both domestic mortgages and corporate lending in the real economy have continued to see robust growth. In the third quarter of 2011, lending standards and conditions for mortgages remained largely unchanged. By contrast, banks reported a slight tightening of lending standards and conditions for corporate loans – especially loans to large companies. Low interest rates continue to have a favourable effect on the demand for loans. In addition, the robust growth in real estate prices, particularly prices for owner-occupied apartments, continued unabated in the third quarter. In this context, the SNB welcomes the recent advances achieved in Switzerland with the introduction of macroprudential instruments. My colleague Thomas Jordan will report on developments in the area of financial stability and macroprudential policy.

## Chart of conditional inflation forecast

The (dashed) red curve on the chart represents the new conditional inflation forecast. It shows the future path of inflation, assuming that the three-month Libor remains unchanged at 0% over the next twelve quarters, and it covers the period from the fourth quarter of 2011 to the third quarter of 2014. For purposes of comparison, the (dash-dotted) green curve shows the conditional inflation forecast published in the previous quarter, which was also based on the assumption of a three-month Libor of 0%.

Until the second quarter of 2012, the SNB's new conditional inflation forecast is below the previous quarter's forecast. This is because the earlier Swiss franc appreciation impacted on prices more quickly than expected. From the third quarter of 2012, inflation rises above the previous forecast, because at this point the negative base effect of price declines since mid-2011 disappears. The muted course of inflation from the end of 2012 stems from the marked deterioration in the economic outlook for the euro area. Overall, despite the expansionary monetary policy, there are no signs of inflation risks over the forecast horizon.

## Conditional inflation forecast of September 2011 and of December 2011




## Observed inflation in December 2011

| | 2008 Q1 | 2008 Q2 | 2008 Q3 | 2008 Q4 | 2009 Q1 | 2009 Q2 | 2009 Q3 | 2009 Q4 | 2010 Q1 | 2010 Q2 | 2010 Q3 | 2010 Q4 | 2011 Q1 | 2011 Q2 | 2011 Q3 | 2011 Q4 | 2008 | 2009 | 2010 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Inflation | 2.5 | 2.7 | 3.0 | 1.6 | 0.0 | −0.7 | −1.0 | −0.2 | 1.1 | 1.0 | 0.3 | 0.3 | 0.6 | 0.4 | 0.4 | | 2.4 | −0.5 | 0.7 |

## Conditional inflation forecast of September 2011 with Libor at 0.00% and of December 2011 with Libor at 0.00%

| | 2011 Q1 | 2011 Q2 | 2011 Q3 | 2011 Q4 | 2012 Q1 | 2012 Q2 | 2012 Q3 | 2012 Q4 | 2013 Q1 | 2013 Q2 | 2013 Q3 | 2013 Q4 | 2014 Q1 | 2014 Q2 | 2014 Q3 | 2014 Q4 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Forecast September 2011, Libor at 0.00% | | | 0.4 | 0.1 | −0.4 | −0.5 | −0.2 | 0.0 | 0.2 | 0.4 | 0.5 | 0.7 | 0.9 | 1.0 | | | 0.4 | −0.3 | 0.5 |
| Forecast December 2011, Libor at 0.00% | | | | −0.4 | −0.8 | −0.6 | −0.1 | 0.2 | 0.3 | 0.3 | 0.4 | 0.5 | 0.6 | 0.7 | 0.8 | | 0.2 | −0.3 | 0.4 |