

Jean-Pierre Roth: Economic activity and monetary policy in Switzerland

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, 12 December 2003.

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The National Bank has decided to leave the target range for the three-month Libor rate unchanged at 0.0%-0.75%. For the time being, the three-month Libor is to be kept around 0.25%. In the past two years, we reacted to the decline in economic activity and the upward trend of the Swiss franc by considerably relaxing our monetary policy. Now the signs of an economic recovery in Switzerland are intensifying. The upswing is not yet assured, though. At the same time, the inflation potential is small. For this reason, we are adhering to our expansionary monetary policy and are keeping down the attractiveness of Swiss franc investments. We estimate that the economy will grow by slightly over 1.5% in 2004, while a moderate decline in economic activity is expected for the current year. If monetary policy remains unchanged, average annual inflation is likely to amount to 0.4% in the coming year, to 1.0% in 2005 and to 2.3% in 2006. We are of the opinion that price stability can be maintained by tightening monetary policy at a later point in time.

In the following, I shall first focus on economic activity in Switzerland and our new inflation forecast. This will be followed by a discussion of monetary policy. Finally, I shall elaborate on the new National Bank Law.

Economic activity

In Switzerland, a turnaround in economic development emerged in the third quarter of 2003. Real GDP exceeded the previous quarter's level for the first time since the third quarter 2002. Nevertheless, it still fell short of its year-earlier level. The Swiss economy recovered largely in line with our expectations as communicated in our September assessment of the situation. The recovery is attributable to the pickup in global economic activity, low interest rates and generally more favourable exchange rate conditions. This benefited primarily exports, which rose markedly in the third quarter. Equipment investment, too, picked up slightly following a long phase of decline. Private and government consumption continued to have a stabilising effect.

The economic situation in Switzerland should improve further in the next few months. We are expecting exports to continue developing favourably, coupled with a robust increase in equipment investment. In this way, the economic upswing in Switzerland will become increasingly broad-based and strengthened. In the course of 2004, unemployment should also fall, leading to a pickup in private consumption. On average, a moderate decline in economic activity will be recorded in the current year, while for 2004, as already stated, we expect the economy to grow by slightly over 1.5%. This will, however, not yet suffice to close the production gap. Production capacities will therefore still not be fully utilised in the coming year.

Even though the overall prospects have clearly improved, the situation in a number of industries remains difficult. There is still a risk that the economic upswing in our country may be short-lived. A delay in the global economic recovery in the next few quarters, an unfavourable development in the financial markets or growing geopolitical tensions could jeopardise the economic pickup in Switzerland. Overall, however, the cyclical risks today are significantly more balanced than even a few months ago. It can thus not be ruled out that the recovery will set in faster than we expect.

Inflation forecast

I shall now turn to the latest development in inflation and our new inflation forecast. Annual inflation (inflation rate compared with previous year) measured by the national consumer price index has shown extremely stable development for some time. In August, it rose by 0.2 percentage points to 0.5%, where it remained until November. This stability is attributable to the evenly spread price increases for domestic goods. Inflation on imported goods has been distinctly more volatile in the wake of fluctuating oil prices. The core inflation rate calculated by the National Bank currently amounts to 0.6%.

The graph shows our inflation forecast of September 2003 (the dash-dotted green curve in the graph) as well as the new forecast of December 2003 (dashed red curve). The assumptions on which the new forecast rests differ in various respects from those in September. For one thing, growth in the United States will be markedly higher in the current year than anticipated three months ago. With the present fiscal stimulus no longer a factor, however, economic growth is likely to slow down distinctly again next year but should remain robust. We still anticipate an upswing in the EU in the coming year. It is probable, however, that it will take slightly longer to close the output gap than we assumed as recently as September. Inflationary pressure from abroad will thus remain moderate although inflation in other countries will not recede as markedly either in the coming year as we expected three months ago. Furthermore, we anticipate a decline in the price of oil to approximately USD 25 per barrel in the course of 2004.

On the assumption that the three-month Libor rate will remain stable at 0.25% during the next three years, inflation should average 0.4% in 2004, 1.0% in 2005 and 2.3% in 2006. The inflation trend according to the new forecast will exceed the September forecast until mid-2005. Until the end of 2004, inflation is likely to remain fairly stable at around 0.5% and to fluctuate only slightly due to basis effects. The new forecast shows that the threat of negative inflation rates has diminished. This is the result of an improvement in the global economy and of the less marked decline in inflation abroad, as also of the weaker Swiss franc vis-à-vis the euro. As from the beginning of 2005, inflation will show a rising trend due to the expansionary monetary policy we took as an assumption. In mid-2005, it will reach 1%, in mid-2006 2% and near the end of 2006 a rate of 3%. This increase is a little flatter than forecast in September. It rests on the notion that in the next few years the output gap will narrow somewhat more slowly than predicted in September due to the productivity gains the upswing is expected to bring.

From mid-2006 onwards, forecast inflation will no longer lie within the range that the National Bank equates with price stability. It must, however, be noted that, as always, our forecast is based on an unchanged three-month Libor rate, i.e. on the assumption that monetary policy will remain as expansive as now during the next three years. It is also important to understand that the uncertainty of the forecast increases with the length of the forecasting horizon.

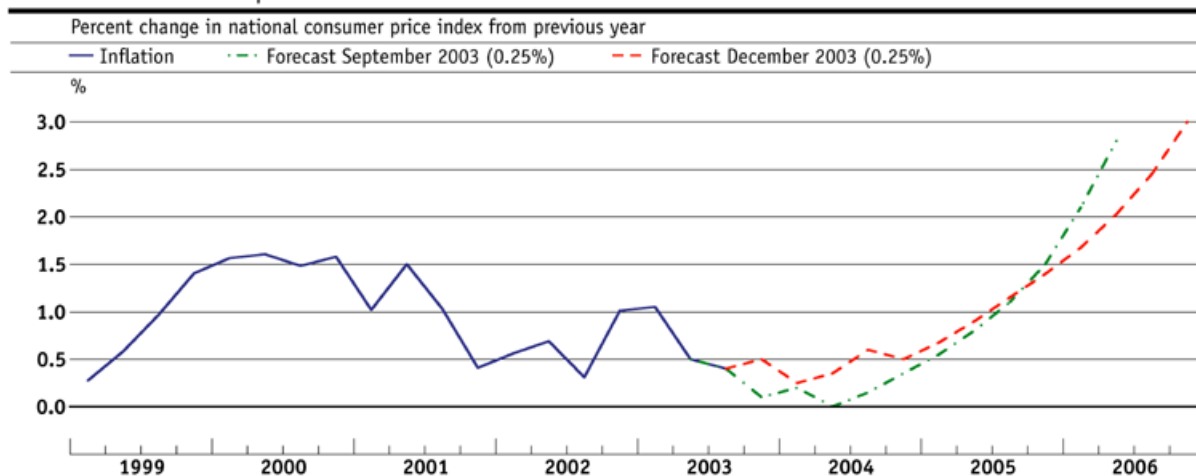
Continuation of expansionary monetary policy

In the past two years, we have changed over to a strongly expansionary monetary policy. In so doing, we have reacted rapidly and unequivocally to the deterioration in the economic situation and the upward pressure on the Swiss franc. The favourable development of inflation provided us with the necessary leeway for the interest rate cuts we implemented. Between March and July, the Swiss franc weakened considerably vis-à-vis the euro, and the economy is gradually beginning to gain momentum again.

The expansionary monetary policy was accompanied by growing monetary aggregates. The strong increase in the money stocks, does not, however, present a significant risk for price stability at the present time. For one thing, credit creation by the banks is continuing to be slow-moving. For another, the growth of the money stocks is considerably influenced by portfolio shifts, which are likely to be reversed once economic activity accelerates and interest rates begin to rise. We shall, however, continue to keep a careful eye on this development.

As already stated, there are still certain risks that the economic development will not be sustained. The upswing in Switzerland should not be jeopardised by a premature changeover to a more restrictive monetary policy. We shall therefore continue our expansionary monetary policy and in this way further bolster the economic recovery. We are convinced that we shall have sufficient time to keep inflation within the bounds of price stability by tightening monetary policy at a later point in time. Should a possible marked appreciation of the Swiss franc vis-à-vis the euro threaten to cause an undesirable tightening of monetary conditions, we would again take decisive action.

Inflation forecast of September 2003 with Libor at 0.25% and of December 2003 with Libor at 0.25%



Inflation Forecast December 2003 with Libor at 0.25%	2003	2004	2005	2006
Annual average inflation in %	0.6	0.4	1.0	2.3

 [Inflation forecast of December 2003](#)

New National Bank Law in the making

On 3 October, the two Federal Chambers passed the new National Bank Law. We are very happy with the course of the parliamentary debate: only minor amendments were made to the draft of the Federal Council. The deadline for a referendum is 22 January 2004. If no referendum is sought, we assume that the Federal Council will put the new Law into force on 30 April 2004, i.e. the date of our Annual General Meeting.

The new Law will modernise the legal framework of the National Bank. It lays down the mandate of the Swiss National Bank in detail, guarantees the SNB independence in its decision-making, regulates its accountability vis-à-vis the Federal Council and Parliament and strengthens the supervisory powers of the Bank Council. The latter will no longer consist of 40 members as at present; it will comprise only 11 members, six of whom are elected by the Federal Council and five by the SNB's Annual General Meeting. The new Bank Council will be constituted on the day of our Annual General Meeting.

The new Law extends the National Bank's room for manoeuvre on the operational level. Until now, the Law laid down exactly what assets the SNB was permitted to invest in and what securities were eligible as collateral in Lombard business. In future, the National Bank will be responsible for making these decisions itself. At the time when the new Law enters into force, we shall publish two directives. One will spell out the technical preconditions for our monetary operations; the other will set out how we shall use our extended investment policy scope. My colleague, Philipp Hildebrand, in his address will present our first ideas on this subject.

The new Law vests specific responsibilities in the SNB with respect to the oversight of payment and securities settlement systems. Up to now, our oversight of the SIC interbank payment system was based on a contractual relationship. As from next year, our responsibilities in this domain will be based on the Law and will extend to the oversight of all major payment and settlement systems. My colleague, Niklaus Blattner, will discuss this subject in more detail in his remarks.

The new Law also provides that the SNB shall issue implementing regulations in the area of minimum reserves, statistics and the oversight of payment and settlement systems. The draft of an ordinance has already been submitted to the interested parties for consultation. In the field of minimum reserves and statistics we intend in principle to take up the provisions already existing in the Federal Law on Banks and Savings Banks and the Federal Law on Investment Funds. As regards the oversight of

payment and settlement systems, we are advancing into totally new territory, where for the time being only the main principles have been defined. This implies pioneering work in the implementation.