Thomas Jordan: Review of the Swiss economy and global economic outlook

Introductory remarks by Mr Thomas Jordan, Chairman of the Governing Board of the Swiss National Bank, at the Media News Conference of the Swiss National Bank, Berne, 13 December 2012.

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The Swiss National Bank (SNB) is leaving the minimum exchange rate of CHF 1.20 per euro unchanged. The Swiss franc is still high. An appreciation of the Swiss franc would compromise price stability and would have serious consequences for the Swiss economy. Consequently, the SNB will continue to enforce the minimum exchange rate with the utmost determination. It is prepared to buy foreign currency in unlimited quantities for this purpose. In addition, the SNB is leaving the target range for the three-month Libor at 0.0–0.25%. If necessary, it stands ready to take further measures at any time.

Essentially, the SNB's conditional inflation forecast is unchanged from its September forecast. In the short term, price movements will again be subdued by a somewhat weaker economy in the euro area. In addition, the impact which past appreciation of the Swiss franc is having on the price level is rather stronger than had originally been expected. From mid-2013 onwards, the path of the new conditional inflation forecast is almost identical to that of September. The forecast is based on an unchanged three-month Libor of 0.0% over the next three years. Given this assumption, the Swiss franc weakens over the forecast period. Nevertheless, forecast inflation remains low for the next few years. For 2012, the inflation rate will amount to –0.7%. For 2013, we expect inflation of –0.1% and for 2014, 0.4%. In the foreseeable future, therefore, there is no risk of inflation in Switzerland.

The third quarter of 2012 saw weak growth and a decline in trading activity worldwide. Although growth in the US economy and some of the emerging economies picked up, a mild recession persisted in the euro area. In Switzerland, real GDP in the third quarter increased again following a temporary downturn. For the fourth quarter, however, we expect significant weakening in growth. Consequently, economic growth in Switzerland for the year 2012 is likely to remain unchanged at around 1.0%. For 2013, we expect growth of 1.0–1.5%.

The downside risks for the Swiss economy remain considerable. Although the measures announced by the European Central Bank (ECB) have significantly reduced the probability of extreme developments in the monetary union, there is still substantial uncertainty in connection with the management of the debt crisis in the euro area. It also remains to be seen how far the upcoming budget consolidation in the US will hamper growth. This question is weighing on the sentiment in the financial markets and the real economy. Moreover, momentum in the Swiss residential mortgage and real estate markets remains strong, and has led to a further increase in risks for financial stability.

Global economic outlook

I would now like to outline the outlook for the global economy and Switzerland in more detail. Then I will look at monetary and financial conditions and the SNB's monetary policy.

In the third quarter of 2012, global economic growth remained weak, while the volume of international foreign trade actually declined. A mild recession persisted in the euro area, and Japan recorded strongly negative growth figures. In the US, growth was supported by private consumption as well as the improvement in residential construction investment. The situation varied in the emerging economies. In some countries, there was scarcely any improvement in economic momentum, while in others – such as China – a supportive economic policy led to some consolidation.

We still expect that the global economy as a whole will gradually recover. However, we have adjusted our forecast for 2013 slightly down from the last monetary policy assessment. This revision mainly affects the short-term outlook for the euro area. We expect that the euro area will only emerge from the recession during the course of 2013. In the US, the moderate recovery is likely to continue, partly as a result of the favourable developments in residential construction. In the emerging economies, growth should continue to gain momentum.

The downside risks for the global economy remain high. The crisis in the euro area continues to weigh on the economic outlook. In September, the ECB initiated a new securities purchasing programme, Outright Monetary Transactions. Although this announcement substantially reduced the probability of extreme events and led to an easing in the financial and credit markets, the economic situation in the monetary union remains vulnerable and the level of uncertainty is still considerable. A further source of uncertainty are the upcoming fiscal decisions in the US.

Swiss economic outlook

In Switzerland, real GDP in the third quarter increased again following a downturn, due to a temporary recovery in exports. For the fourth quarter, however, we again expect significant weakening in growth. Consequently, economic growth for this year is likely to come to around 1.0%, as forecast to date.

For 2013, we expect growth of 1.0–1.5%. While the gradual revival in the global economy is having a supportive effect, the strength of the Swiss franc will hold back export momentum and corporate investment expenditure. Domestic demand is also likely to be restrained over the next few quarters. In view of the modest pace of growth, production capacity in Switzerland will probably remain underutilised in 2013. The rate of unemployment is likely to rise further.

Given the fragility of global conditions, the downside risks also remain high for Switzerland.

Monetary and financial conditions

I will now turn to monetary and financial conditions, which are almost unchanged as compared to the situation in summer 2012. Interest rates in the Swiss franc money market continue to fluctuate around zero. Since mid-June, the three-month Libor has fallen from some 9 basis points to only 1 basis point. Interest rates in the repo market are predominantly negative. In addition, the yield on ten-year Confederation bonds attained a new historical low. This shows that the demand for safe investments remains high.

Over the past few months, as before, movements in the Swiss franc mainly reflected the changing risk assessment of market participants. Following the ECB’s announcement in early September that it would purchase unlimited quantities of bonds of crisis-hit euro area countries under certain conditions, the upward pressure on the Swiss franc lessened.

The M1, M2 and M3 monetary aggregates, which measure the amount of money held by households and companies, have increased substantially over the past few months. For this reason, some fear that we are heading for high rates of inflation. However, this is not the case. The inflation forecast for Switzerland continues to be low. At present, the inflation rate is still in negative territory. Inflationary pressure remains minimal because of the strong Swiss franc and the relatively unfavourable global growth outlook. Moreover, the underutilisation of production capacities in Switzerland is restraining the inflation outlook. Surveys on inflation expectations show that households and companies continue to assume that prices will remain stable, also in the medium term.

Given the current low interest environment worldwide, enforcement of the minimum exchange rate is necessary to ensure suitable monetary conditions in Switzerland. Global uncertainty will persist for the foreseeable future and drive demand for secure investments.

As a result the exchange rate situation will remain fragile, despite the calmer environment that has come about as a result of the measures taken by the ECB.

However, the very low interest rates around the world are also associated with risks. The longer a low interest rate phase persists, the greater the potential danger of speculative price developments and misallocations. Investors searching for yields could place increasing amounts in real estate, and this can lead, in particular, to a rise in real estate prices and thus, to a distorted pattern of incentives.

Momentum in the domestic residential mortgage and real estate markets remains exceptionally strong. Mortgage lending continues to grow briskly compared to the economy as a whole. In addition, real estate prices, already at a high level, continued to rise. As a result, risks for financial stability increased further. My colleague, Jean-Pierre Danthine, will give you an assessment of the situation in the financial sector from the point of view of the SNB.

Monetary and investment policy

The minimum exchange rate provides us with new challenges for our monetary policy but also for our investment policy. I would therefore like to close with a few words on our foreign currency investments. As you know, in the months May to August, in particular, we had to purchase large quantities of foreign currency in order to enforce the minimum exchange rate. Consequently, the SNB’s foreign currency investments have significantly increased. Also, we cannot exclude the possibility that we will have to intervene substantially again.

From the beginning we made it clear that enforcement of the minimum exchange rate was associated with risks. We are endeavouring to reduce the balance sheet risks through suitable diversification of our foreign currency investment. However, the exchange rate risk on the foreign exchange reserves is based on monetary policy considerations and the SNB is therefore obliged to bear it. My colleague, Fritz Zurbrügg, will talk about the management of the foreign exchange reserves in his remarks.

Through its monetary policy, the SNB serves as a buffer for the Swiss economy and cushions the effect of severe shocks. Because it has a long-term focus, it is in a position to carry substantial risks. This means we can react flexibly in exceptional situations in order to fulfil our mandate, which is to ensure price stability while taking due account of economic developments.