Thomas Jordan: Global economic outlook and economic developments in Switzerland

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, 12 December 2013.

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Ladies and gentlemen

Welcome to the Swiss National Bank's news conference. I would like to begin today by explaining the SNB's monetary policy decision before moving on to present our assessment of the economic situation and monetary conditions. My colleague, Jean-Pierre Danthine, will then talk to you about developments in connection with financial stability and banknotes. Finally, my colleague, Fritz Zurbrügg, will look at the current situation on the financial markets, as well as at the management of our currency reserves and interest rate benchmark reforms. As always, we will conclude with a question and answer session.

I will now start with our monetary policy decision.

As you will have no doubt expected, the SNB is maintaining its minimum exchange rate of CHF 1.20 per euro. The Swiss franc is still high. With the three-month Libor already practically at zero, the minimum exchange rate continues to be the right tool for ensuring appropriate monetary conditions in Switzerland. If the Swiss franc were to appreciate, this would have significant consequences for the Swiss economy. On the one hand, an appreciation would lead to a further decline in import prices and a renewed threat of deflation. In this regard, we should bear in mind that inflation in the last two years has been predominantly negative. On the other hand, with an ongoing unfavourable international environment and a strong Swiss franc, the situation for our economy remains challenging.

Should it become necessary, we will therefore enforce the minimum exchange rate by buying foreign currency in unlimited quantities. And, if required, we will also take further measures. In addition, we are leaving the target range for the three-month Libor at 0.0–0.25%.

The SNB bases its monetary policy decision on a conditional inflation forecast, which assumes an unchanged three-month Libor of 0.0% over the next three years. You will find the relevant chart in your media kit. Compared to September, our forecast has been adjusted downwards slightly. Reasons for this are the unexpectedly low rates of inflation for October and November, which serve as a lower departure point for the forecast, as well as the decline in inflation in the euro area and the slight fall in the oil price, which both help to dampen the inflation outlook. For 2013, we still anticipate inflation of –0.2%. For 2014 and 2015, the inflation forecast is down in each case by 0.1 percentage points and is now at 0.2% and 0.6% respectively. Consequently, no inflation risks can be identified for Switzerland in the foreseeable future.

Global economic outlook

The SNB's inflation forecast is embedded in a global economic scenario. I would therefore like to begin with our assessment of the global economy.

Global economic recovery continued as expected in recent months, with the main drivers being the US, the UK and China. In the euro area, by contrast, growth lacked momentum and inflation slowed considerably more than expected. In many emerging economies, too, economic activity was rather sluggish.

The outlook for the global economy has not changed significantly since the September monetary policy assessment. Our forecasts suggest that growth will pick up gradually in the coming quarters. Further recovery is likely to be underpinned by a number of factors, including stable international financial markets, a less restrictive fiscal policy and a very expansionary monetary policy in the major advanced economies. Europe, however, will continue to experience below-average growth, with banks' restrained lending policies and ongoing uncertainty hampering investment activity. In addition, the high level of unemployment in this region will also hold back private consumption.

Uncertainty about the continued recovery of the global economy remains high overall. In many advanced economies, room for manoeuvre in economic policy is being constrained by the fact that interest rates are already very low and government indebtedness is high, making the global economy especially prone to shocks. We expect that the euro area will overcome the crisis in the medium term. However, the forthcoming assessment of banks' balance sheets could cause some ripples. Furthermore, exiting from unconventional monetary policy measures is as yet uncharted territory. Spikes on international financial markets therefore cannot be ruled out during the process of normalising monetary policy in the major currency areas.

Swiss economic outlook

I will now look at economic developments in Switzerland.

The economy continued to develop favourably in the third quarter. Annualised real GDP was up by slightly more than 2%. Unlike the previous quarter, goods exports grew substantially. Domestic demand, however, lost some momentum. On the output side, manufacturing in particular recorded positive growth, having previously fallen for three successive quarters. Construction continues to be an important growth driver.

Owing to this positive growth, utilisation of production capacity picked up. Nevertheless, it remained at a relatively low level in manufacturing. Employment increased slightly and the seasonally adjusted unemployment rate has not risen further since summer. Overall, the output gap remains negative.

The indicators already available suggest that growth will weaken temporarily in the fourth quarter. Following the sharp increase in the third quarter, goods exports and industrial output, in particular, are likely to advance at a slower pace. In the coming year, with the gradual improvement in the global economy, GDP should once again grow more strongly. We continue to expect growth of 1.5–2.0% for 2013. For 2014, we expect a growth rate of around 2.0%.

However, given the vulnerable economic situation abroad, downside risks still prevail for Switzerland.

Monetary and financial conditions

I will now turn to monetary and financial conditions.

Last summer, sparked by the debate about a possible reduction in the US Federal Reserve's bond purchase programme, long-term interest rates rose across the globe. Switzerland was no exception. The most recent interest rate reduction by the European Central Bank (ECB), by contrast, had little effect on Switzerland. One possible reason for this is that money market rates in the euro area were already at a very low level before the ECB's decision and did not fall any further.

Since October 2011, inflation rates in Switzerland have been predominantly negative. The introduction of the minimum exchange rate in September 2011 prevented a more severe deflationary trend, however. Lower price levels in Switzerland reflect, on the one hand, the impact of the past appreciation of the Swiss franc on import goods prices. On the other hand, price developments show clearly that domestic companies are lowering their costs so as to improve their price competitiveness. More than two years after the introduction of the minimum exchange rate, both effects have weakened considerably; this is also reflected in the current path of inflation. At the same time, inflation abroad is receding, especially in the euro area. The inflation differential between Switzerland and the euro area has thus decreased significantly.

Inflation differentials play an important role in the valuation of the Swiss franc. This decreased inflation differential means that the real effective exchange rate will hardly change from now on and will remain considerably above its long-term average. Unless there is a substantial nominal depreciation, the current high value of the Swiss franc will therefore continue.

Growth in the M1, M2 and M3 monetary aggregates has been perceptibly weaker since summer; this is primarily attributable to the rise in long-term interest rates. Liquidity held by households and companies has nevertheless remained high. In the past, a sustained high level of liquidity generally pointed to inflation risks. As a result of the financial crisis, however, this correlation cannot currently be made. Thus, in recent years, the inflation rate has remained exceptionally low despite a high level of liquidity.

At present, there are no signs of a rise in inflation in Switzerland. Our inflation forecast shows no risk of inflation whatsoever. In addition, surveys on inflation expectations reveal values that are consistent with our definition of price stability. This applies not only to short-term inflation expectations, but also to long-term horizons of up to ten years. Furthermore, production capacity in Switzerland is still underutilised, which also makes a rapid rise in inflation unlikely.

SNB monetary policy

In conclusion, I would like to look at the SNB’s monetary policy.

Overall economic conditions have hardly changed since summer. Consequently, monetary policy remains a challenge for the SNB. Up to now, our economy has performed relatively well, considering the difficult international environment. And we have not had to enforce the minimum exchange rate with foreign currency purchases since September 2012. Financial markets expect short-term interest rates to stay very low worldwide for some time to come. Furthermore, developments in the global economy are likely to remain uncertain. In this environment, the minimum exchange rate continues to be essential in ensuring appropriate monetary conditions in Switzerland. The guiding principle for our decisions is the SNB’s mandate to ensure price stability while taking due account of the development of the economy.

The financial crisis also showed us, however, that price stability alone is not sufficient to ensure that the financial sector remains stable. In this connection, the situation on mortgage and real estate markets – which are showing considerable momentum – has been cause for concern for quite some time now. Also, mortgage lending is still growing faster than GDP, with the result that aggregate debt is increasing further. The countercyclical capital buffer is a new tool with which the resilience of banks can be strengthened and imbalances on mortgage and real estate markets can be addressed. My colleague, Jean-Pierre Danthine, will now give you our assessment of the risks for financial stability.

Ladies and gentlemen, thank you for your attention.