Thomas Jordan: Swiss National Bank's assessment of the economic situation

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, 19 June 2014.

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Ladies and gentlemen

Welcome to the Swiss National Bank's six-monthly news conference. As usual, I will begin by explaining the monetary policy decision and outlining our assessment of the economic situation. Afterwards, Jean-Pierre Danthine will present our latest *Financial Stability Report*, before Fritz Zurbrügg comments on current developments in the financial markets. Following our introductory remarks, we will be pleased to answer any questions you might have.

Monetary policy decision

I will begin with the monetary policy decision.

The SNB is maintaining its minimum exchange rate of CHF 1.20 per euro. The target range for the three-month Libor will remain unchanged at 0.0–0.25%. The Swiss franc is still high. We will therefore continue to enforce the minimum exchange rate with the utmost determination. If necessary, we are prepared to buy foreign currency in unlimited quantities for this purpose. With interest rates close to zero, the minimum exchange rate is the right tool to avoid an undesirable tightening of monetary conditions. This applies especially if the upward pressure on the Swiss franc were to intensify once again. And, if required, we are also willing to take further measures.

Our new conditional inflation forecast shows that inflationary pressure has receded once more in the medium term. The inflation forecast for the coming quarters is slightly higher than in March. This is because the departure point for the forecast has moved upwards, as inflation was somewhat higher in May than expected. However, from mid-2015 onwards, inflation will be lower than forecast in the previous quarter. The reason for this is that the global economic outlook has deteriorated slightly. Another factor is the unexpectedly weak inflation in the euro area. At 0.1%, the inflation forecast for the current year is 0.1 percentage points higher than in March. For 2015 and 2016, the new forecast – of 0.3% for 2015 and 0.9% for 2016 – is 0.1 percentage points lower, in each case, than at the previous monetary policy assessment.

It is important to bear in mind that our forecast is conditional. It is based on the assumption that the three-month Libor remains at 0.0% over the next three years and the Swiss franc weakens over the forecast horizon. In our forecast, therefore, we assume that the SNB will pursue a very expansionary monetary policy. Even under such assumptions, there are still no signs of any inflation risks for Switzerland in the foreseeable future.

Global economic outlook

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

The global recovery remains hesitant overall. Last quarter registered weaker growth than we had anticipated at our March monetary policy assessment. World trade also declined, after having exhibited strong growth in the last few months of 2013, which had raised hopes of a sustained economic recovery.

In the US, GDP declined in the first quarter. However, we consider this to be a transitory phenomenon which can be largely put down to an exceptional cold snap experienced this winter. Growth in the euro area was weak and varied greatly from one country to another. While economic activity continued to pick up in Germany, renewed stagnation in France and Italy gave rise to disappointment.

We continue to expect the global economy to firm in the coming quarters. However, the global economic recovery will remain very subdued by historical standards. Compared to the last monetary policy assessment, we now anticipate somewhat slower growth, in both advanced and emerging economies.

It is entirely possible, however, that global economic growth will be weaker than we have assumed. The euro area continues to face significant challenges. These include the consolidation of public sector finances as well as the implementation of institutional reforms and reforms to promote growth. In addition, various emerging economies are suffering from structural problems. Should the current geopolitical conflicts worsen, this would also hold back activity in the international economy. Since the major currency areas are in different phases of the monetary policy cycle, there is also a danger of greater volatility in the financial and foreign exchange markets. All this generates a high level of uncertainty with regard to future developments in the global economy.

Swiss economic outlook

I will now look at economic developments in Switzerland.

As expected, growth in Switzerland picked up somewhat in the first quarter, after having been relatively weak in the previous quarter. The rebound was mainly attributable to the upturn in business activity in manufacturing and the banking sector. On the demand side, exports of goods – which had still been declining in the previous quarter – and construction investment were the main growth drivers.

Nevertheless, the capacity of the Swiss economy is still not fully utilised overall. Technical capacity utilisation in manufacturing remains considerably below its long-term average. Although employment was up in the first quarter, the unemployment rate remained unchanged.

We expect the moderate recovery to continue in the coming quarters. For 2014, we anticipate that the growth rate will remain at around 2.0%. As we continue to see gradual improvement in the international environment, export demand is likely to rise. Over time, this should encourage corporate investment and stimulate demand for labour. The level of residential construction orders remains high. On the whole, however, we expect a considerable slowdown in the growth momentum of residential construction investment.

In addition to global risks, the Swiss economy also faces uncertainty at home. In the past few weeks, the SNB's delegates for regional economic relations asked companies to assess the impact of the popular initiative on curbing mass immigration on their business activity. The results suggest a tangible level of uncertainty about economic conditions. Most companies have not taken any specific measures, however.

Monetary and financial conditions

I will now turn to monetary and financial conditions.

After about two years of negative inflation, consumer price inflation has been practically zero for some months now. This very restrained development is also reflected in inflation expectations. The majority of market participants expect inflation to remain unchanged in the short term. Over a longer horizon of more than two years, the relevant surveys show that the expected rate of inflation is approximately 1.0%. These results are consistent with our assessment of the inflation outlook.

Geopolitical risks and mixed economic data in the major economies led to stronger demand for secure investments. This was reflected in falling yields on long-term government bonds. My colleague, Fritz Zurbrügg, will talk to you about developments in the financial markets in more detail. Mortgage rates also declined again, thereby further bolstering demand for mortgage loans.

However, the slowdown of momentum in mortgage lending, which has been observed for some time now, continued. This is a step in the right direction. Nevertheless, imbalances remain. It is therefore still too early for an all-clear.

Given the high level of liquidity, money market rates remained at a low level. Even prior to the introduction of negative interest rates by the European Central Bank (ECB), Swiss franc Libor futures slipped well into negative territory. We are closely monitoring the impact of the recent interest rate reductions in the euro area on Switzerland. Should there be a need for action, the SNB will take the necessary measures.

The export-weighted real external value of the Swiss franc remains well above its long-term average. Since the introduction of the minimum exchange rate, it has changed only slightly. Thus, the Swiss franc is still high. The slight inflation differential during the past quarters meant that the real adjustment of the Swiss franc against the euro has come to a virtual standstill. In this environment, the minimum exchange rate remains essential for guaranteeing appropriate monetary conditions.

SNB monetary policy

To conclude, I would like to mention a number of challenges which the SNB will be facing in the near future.

Overall, the environment remains extremely challenging for both the Swiss economy and our monetary policy. With its high level of international integration, Switzerland is strongly affected by global developments, especially those in neighbouring countries. The ECB's measures to support economic development in the euro area are also likely to have a favourable impact on the Swiss economy in the medium term. Nevertheless, given the low interest rates in Europe and the rest of the world as well as the strong Swiss franc, the SNB's monetary policy environment will remain highly complex. We will continue to take all action necessary to fulfil our mandate of ensuring price stability, while taking due account of economic developments.

The financial crisis has shown that balanced economic developments require more than just price stability; financial stability is also of key importance. The SNB's annual *Financial Stability Report* is a contribution towards this. In the report, we draw attention to developments which might present a risk for financial stability. In this respect, we are still concerned about imbalances on the mortgage and real estate markets. The financial crisis showed what serious effects the problems in the financial sector can have on the overall economy. It is precisely in the current environment of globally low interest rates that the danger of imbalances on the financial markets is particularly high. With our report, we would like to urge participants in these markets to exercise caution. In addition, recent developments in the area of legal risks demonstrate once again the importance of strongly capitalised Swiss banks. My colleague, Jean-Pierre Danthine, will now present the most important conclusions from our *Financial Stability Report*.

Ladies and gentlemen, thank you for your attention. It is now my pleasure to give the floor to Jean-Pierre Danthine.