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ECONOMY AND RESEARCH

KOF INDICATORS

KOF Swiss Economic Institute

EDITORIAL

Dear readers,

The Swiss economy followed a positive trend in 2017 even if, at first glance, the GDP growth figures do not seem to support this statement. At the beginning of last year, the economic situation was much weaker than towards the end, and the initially sluggish growth was not fully compensated by stronger results in the second six months. On top of this, income generated from big international sports events organised by sports umbrella organisations domiciled in Switzerland (Olympic Games Football World Championship) are now being posted under Swiss production. This led to a marked increase in value creation in 2016. The lack of any events of this scale in 2017 has pushed down the 2017 growth rate to the same degree. This year, KOF expects relatively high growth rates and a positive economic trend, not least due to the global upswing, which also benefits Switzerland, as described in the second article. The third contribution investigates the effects of short-time work. A current KOF study shows that the Swiss short-time work programme effectively prevented dismissals in the period from 2009 and 2015. The resultant savings in unemployment benefits most likely covered the direct costs of the short-time work compensation payments.

I hope you enjoy your read,

David Iselin

ECONOMY AND RESEARCH

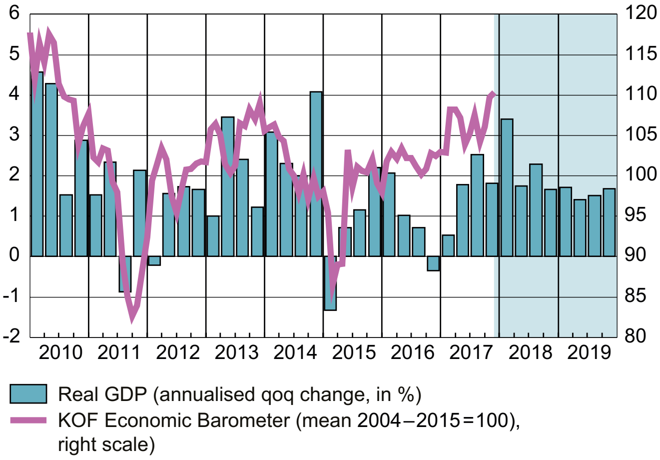
Upswing has Arrived, Sports Events Dominate the Cyclical Trend

The significant upturn in the global economy is also stimulating the Swiss economy. Foreign trade is benefitting from this situation. Investments in plant and equipment are also picking up. GDP is expected to expand by 2.3% in 2018 and by 1.7% in 2019. The labour market situation is improving as employment figures are going up and the unemployment rate is declining. These are the results of the current KOF Economic Forecast.

At present, the global economy is enjoying a significant upswing, which is likely to continue for the foreseeable future. In keeping with this trend, the available indicators of the state of the Swiss economy are almost exclusively positive. Leading, coincident and lagging confidence indicators have all gradually perked up (see G 1). On top of this, the quantitative data on exports and the quarterly estimates by the State Secretariat for Economic Affairs (SECO) are predominantly positive. However, it is mostly SECO's latest upward revisions of the official value creation data that resulted in an adjustment of our projected GDP growth rate for the current year from 0.8% to 1%.

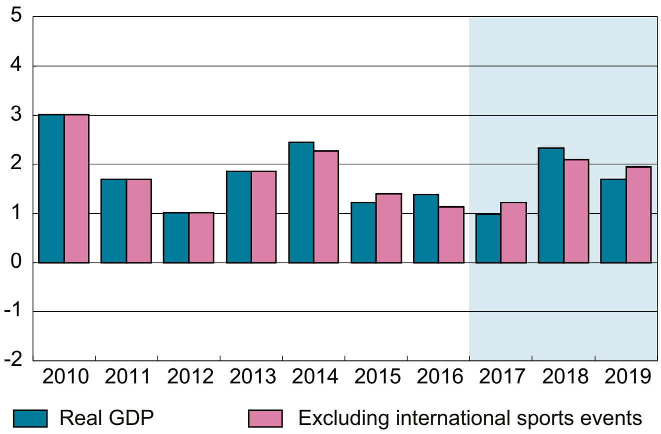
G 1: Real GDP and KOF Economic Barometer

(GDP as of 4th quarter 2017: KOF estimate/forecast)



International sports events boost Swiss GDP
The average annual GDP growth rate of 1% for 2017 is extremely low in historical comparison and therefore difficult to reconcile with the above-mentioned indicators. This circumstance can be explained with the quarterly GDP trend: At the beginning of the year, the economic situation was substantially weaker than towards the end of the year, and the initially sluggish growth was not fully compensated by stronger results in the second six months. On top of this, income generated from big international sports events organised by sports umbrella organisations domiciled in Switzerland have been posted under Swiss production since 2017 – an accounting adjustment that affects statistics as of the year 2014 (see G 2). In 2016, these events led to a marked increase in value creation of just under 0.3 percentage points. The lack of any events of this scale in 2017 has pushed down the statistical growth rate for 2017 to the same degree.

G 2: Effect of Major International Sports Events
(year-on-year change, in %)



The international sports events associated with the biggest income take place every four years, but not in the same year. Due to this rhythm, big international sports events occur in all even years, while odd years only host smaller events. As a consequence, the GDP growth rate in 2018 will be higher than suggested by the anticipated development of the other sectors. In 2019, GDP growth rates are once again expected to be lower. We have included this cycle in our forecast and expect GDP growth rates of 2.3% in 2018 and 1.7% in the following year.

GDP trend does not fully reflect the cyclical trend
As regards the observation and analysis of the cyclical trend, with income from big sports events now being posted with an effect on GDP, the GDP trend is even less coincident with the economic trend than before. It has been clear for a while now that the profits generated from merchanting have a substantial impact on the Swiss GDP trend, without having any of the effects on the labour market or prices that usually arise in conventional value creation through production and services. In the same way, changes in inventories, which are reported together with statistical differences between production and end use of the produced goods, also often elude any clear interpretation. Since big sports events may be considered as similarly isolated from the rest of the Swiss economy as merchanting, economic analysis must increasingly disregard the effect of such activities and events to arrive at a sensible interpretation of labour market and price trends. For instance, in the period from 2015 to 2017, the economic trend following the CHF revaluation shock at the beginning of 2015 is significantly more plausible if analysis excludes the big sports events, with 2017 being the year of economic recovery, than the GDP series with the noticeable peak of growth rates in 2016.

Positive labour market trend

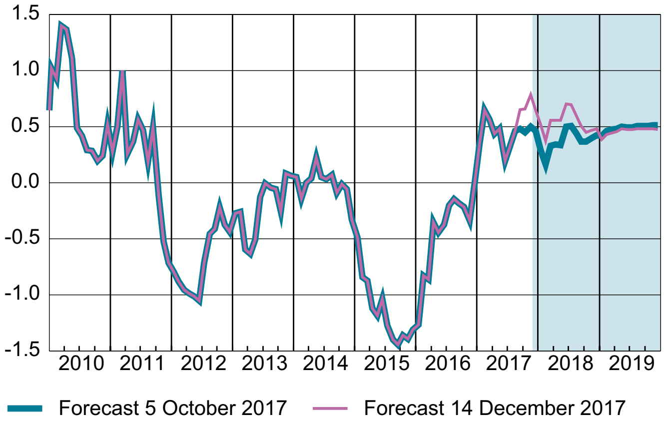
The current upswing is slowly filtering through to the labour market. Fulltime equivalent employment is back on the rise after a virtual stagnation in the period between the suspension of the minimum exchange rate at the beginning of 2015 and mid-2017. The rate of unemployed registered with the employment office has been declining since the beginning of the year and is now back at the level recorded at the beginning of 2015. In the forecast period, we expect a further rise in employment numbers and a successive decline in the unemployment rate until the beginning of 2019 – from just over 3% today to 2.9% for registered unemployment and from 4.7% to 4.5% for unemployment according to the internationally comparable definition.

Our forecast anticipates no change in the CHF/EUR exchange rate of just under 1.17 until the end of 2019. This exchange rate is particularly advantageous for the Swiss export industry, which includes numerous sectors whose margins and sales suffered considerable losses in 2015 and 2016. Retailers are also benefitting from the exchange rate trend as cross-border shopping is becoming less attractive.

Interest rate adjustment in sight

According to our forecast, the negative interest phase will slowly come to an end. We expect a rise in long-term interest rates as early as 2018, and a potential slow rise in short-term interest rates, which are currently still negative, in 2019. During the forecast period, we do not anticipate an active reduction of the Swiss National Bank's (SNB) exceptionally high balance sheet total which arose from past currency purchases. Even at the present exchange rate, the rise in prices will remain small; only a strong devaluation or a significant rise in crude oil prices could result in inflation rates beyond the SNB's comfort zone and hence in restrictive monetary measures (see G 3).

G 3: Consumer Prices
(year-on-year change, in %)



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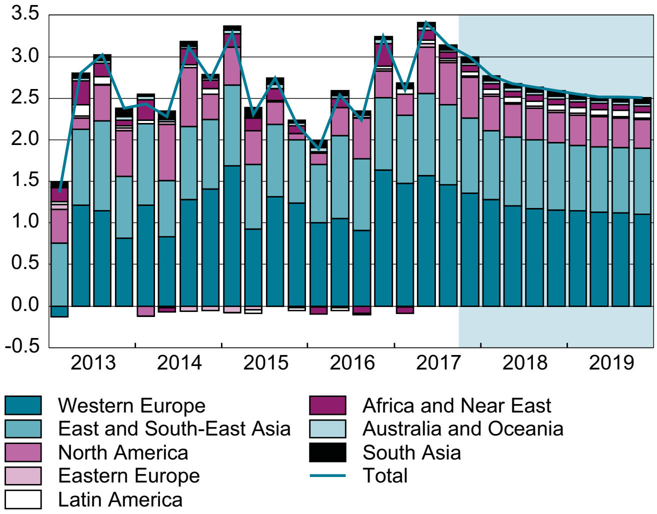
You can find more information about the KOF Economic Forecast at:
www.kof.ethz.ch/en/forecasts-and-indicators/forecasts/kof-economic-forecast/ →

Global Economy Booms

The world economy is on a positive path. For the time being, the global economic upswing is likely to continue until it will gradually slow down once China phases out its fiscal stimulus programme. The financial system has become more robust and the risk of a new financial crisis is limited.

The substantial upswing of the global economy continued in the third quarter 2017. Supported by a robust trend in private consumption and a significant increase in investments, the developed economies contributed substantially to global economic growth. Thanks to the positive economic situation, production gaps in the Eurozone and the USA should be almost, or entirely, closed by now. High growth contributions were also made by East and South-East Asia. While the boom continued in China due to fiscal stimulation measures, economic expansion slowed down slightly in Japan. The upswing in Latin America was held back by the sluggish economic recovery in Brazil and the impact of the devastating earthquakes in Mexico. Following India's reforms of its cash and VAT systems, the Indian economy is slowly regaining its footing (see G 4).

G 4: Growth Contributions of Various Country Aggregates
(in %, weighted by Swiss export share)

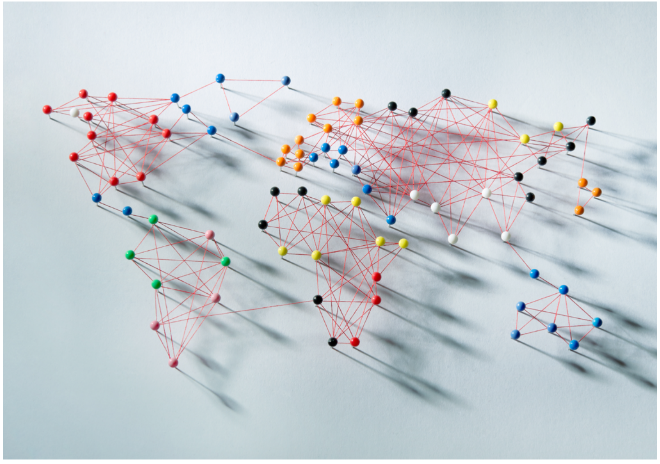


The current monetary divergence between the main economic regions continues. While the Japanese Central Bank persists with its expansive policy, the Fed has embarked on the path of monetary normalisation. For the present, the European Central Bank (ECB) intends to reduce its bond purchases by half at the beginning of 2018 and is likely to implement its first interest rate adjustment in 2019.

Past economic crises have shown that overly rapid rises in interest levels can lead to frequent defaults and hence to substantial distortions on the financial markets. The low interest rate environment of the past few years has encouraged private borrowing. On top of this, investors searching for higher returns have gone for more risky investments. In some western European and U.S. stock markets, for instance, there are significant overvaluations in historical comparison. The returns on highly speculative bonds are also extremely low at present.

Risk of a further financial crisis has declined

The gradual flattening of the interest rate curve in the USA indicates that the financial markets are slightly agitated. In the past, flat interest rate curves have been reliable indicators of an imminent economic slowdown. However, the amount of investments at risk of default is now significantly



The dots are connected again

smaller than in the run-up to the last financial crisis in 2007. With the financial system having become much more resilient, the likelihood of fresh crises arising on the financial market has declined and their potential effects are likely to be limited. Furthermore, after the experience of the big recession and the euro crisis, central banks are more willing to swiftly intervene and support the system in the case of fiscal distortions.

The global upswing is likely to continue for the time being until it will gradually slow down once China phases out its fiscal stimulus programme. In the forecast period, increasing over-utilisation of production factors in the developed economies will go hand in hand with a slowdown in economic growth in Europe and North America. This forecast is supported by the results of the current 'World Economic Survey' published by the ifo Institute for Economic Research. Assessments of the current situation in the developed economies are still at a high level, while expectations of the business situation in six months' time have declined to some degree. Developing and emerging markets currently view their situation negatively, but have a (more) optimistic outlook for the future. Both the upturn in global trade and the recovery of commodity prices should support the upswing in the emerging markets.

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Does Short-Time Work Prevent Dismissals?

Short-time work schemes are intended to prevent unemployment during recessions. So far, very few studies have provided evidence of the desired effect. A current KOF study now shows that the Swiss short-time work programme in the years 2009 to 2015 effectively prevented lay-offs. The savings in unemployment benefits are likely to have covered the direct expenses associated with short-time work compensation payments.

During the global financial and economic crisis from 2007 to 2009, many industrialised countries suffered a severe slump in economic performance. Short-time work programmes were among the popular measures intended to stave off imminent mass unemployment. In 2009 alone, Switzerland spent CHF 1.1 billion on short-time work compensation payments. Short-time work schemes are suitable for companies facing a temporary decline in demand for their goods and services. The scheme allows them to introduce a temporary reduction of working hours. The employees concerned receive compensation for the lost income from the unemployment insurance fund.

The principal aim of short-time work programmes is the prevention of lay-offs and hence unemployment. However, the effectiveness of such programmes is in doubt. There is a risk that the programmes merely postpone dismissals instead of preventing them. On top of this, there is a risk that short-time work compensation may be used for jobs that would have been preserved even without government support. Most research studies have come to sobering conclusions regarding the effectiveness of short-time work – especially earlier studies on short-time work schemes in Switzerland.

Short-time work significantly reduces lay-offs

In a new KOF study, Daniel Kopp und Michael Siegenthaler investigated whether the Swiss short-timework programme prevented unemployment in the years 2009 to 2015. To analyse this question, the authors linked the data of all Swiss companies that had applied for short-time work compensation in the years 2009 to 2014 with the unemployment insurance data of the Swiss State Secretariat for Economic Affairs (SECO) and the employment statistics of the Swiss Federal Statistical Office (FSO).

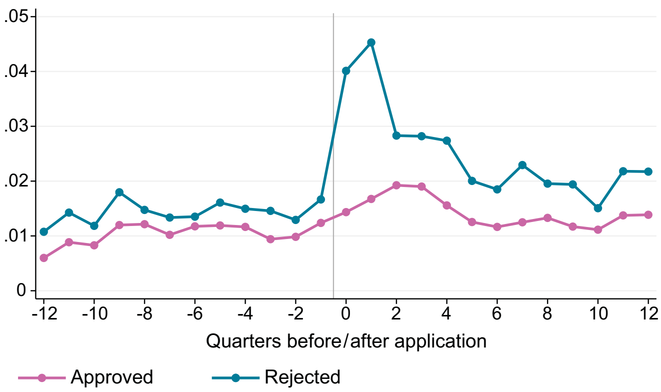
Short-time work helps in the long-run

The authors' analysis clearly shows that short-time work in the years 2009 to 2015 contributed to the prevention of dismissals. This central result is reflected in Graph 5. It shows the number of individuals laid off in a specific quarter who subsequently registered as unemployed with the regional employment offices. This number is expressed as a percentage of total employment at the former employer. According to the graph, enterprises whose short-time work application was rejected laid off over 4% of their staff in each of the subsequent two quarters, while the equivalent percentage in the quarters before the application was around 1%. Companies whose applications were approved showed a much smaller increase in dismissals (from 1% to approx. 2%).

The study has yielded two further interesting results. Firstly, companies that received a rejection laid off more employees, even two to three years after the application, than companies whose application was approved. This suggests that short-time work not only postpones dismissals but effectively prevents them in the long run. Secondly, the trend in the frequency of dismissals was similar for both groups in the three years before they applied for the short-time work programme, indicating that the two groups are comparable.

The above descriptive results are supported by the authors' statistical analyses. According to their estimates, in the three years following a company's application, short-time work reduces the number of dismissals by at least 10% of the original employment level. Some estimates even indicate that the impact is twice as high. In this context, short-time work predominantly safeguards the jobs of employees with mandatory school leaving certificates or vocational qualifications.

G 5: Dismissals of Employees as a Percentage of Total Employment in the Quarters Before and After the Short-Time Work Application



Unemployment insurance fund (appears to be) unaffected

Based on their estimates, the authors also concluded that short-time work led to savings in unemployment benefits of CHF 108,000 to 200,000 per short-time work case. This represents a significant financial benefit for the unemployment insurance fund. In fact, these savings could be sufficient to cover the entire costs arising to the fund due to short-time work, i.e. short-time work compensation payments.

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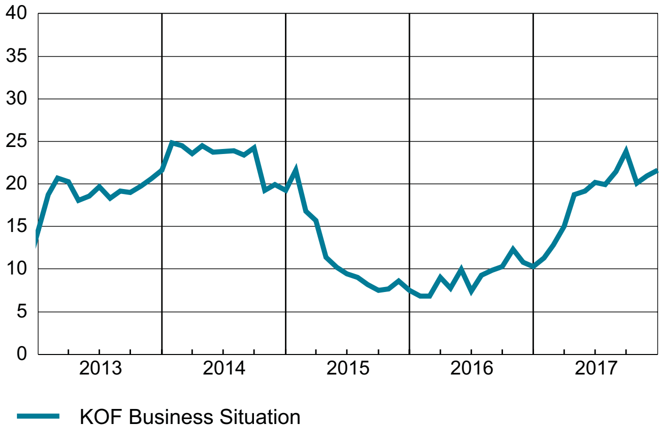
KOF INDICATORS

KOF Business Situation Indicator Ends Year on a Rise

In December 2017, the KOF Business Situation Indicator for the Swiss private economy went up slightly. Compared to the beginning of the year, the business situation of Swiss companies has improved substantially. The Swiss economy is ending the year in a healthy state.

Compared to the beginning of 2017, all sectors covered by the monthly surveys improved their situation. The manufacturing industry gained a lot of ground, although the current situation is no longer quite as positive as in November (see G 6). Both the retail and the financial/insurance sectors reported a better situation compared to the beginning of the year, with both sectors also improving over the preceding month. There has been a slight improvement in the business situation in both the construction and the project engineering sector, although they have followed different trends since the last month. While the business situation improved in the project engineering sector, the indicator for the construction sector declined. Wholesale, hotel and catering and the other service providers were last surveyed in October. At the time, wholesale and hotel and catering had reported an improvement in their business situation. The indicator for the other service providers dropped slightly.

G 6: KOF Business Situation Indicator
(balance, seasonally adjusted)



T 1: KOF Business Situation for Switzerland (seasonally adjusted balances)

	Dec 16	Jan 17	Feb 17	Mar 17	Apr 17	May 17	Jun 17	Jul 17	Aug 17	Sep 17	Oct 17	Nov 17	Dec 17
Private sector (overall)	10.3	11.3	12.8	15.0	18.8	19.2	20.2	19.9	21.5	23.8	20.1	20.9	21.6
Manufacturing	-8.1	-9.1	-7.0	-4.8	-1.5	-1.1	3.6	3.9	6.6	9.9	10.8	13.5	12.6
Construction	25.1	28.3	28.1	31.6	31.6	29.4	32.9	32.6	31.7	31.3	30.9	32.0	31.3
Project engineering	46.4	47.4	47.3	49.1	50.3	47.1	46.5	46.3	46.7	47.2	49.4	49.0	50.3
Retail trade	-9.8	-8.1	-10.3	-6.9	-3.2	-11.1	-0.6	-2.0	-1.2	2.7	1.4	0.5	4.3
Wholesale trade	-	0.1	-	-	9.8	-	-	15.5	-	-	19.5	-	-
Financial services	17.8	22.9	32.0	33.1	32.2	37.8	37.3	30.0	33.8	36.6	30.8	32.8	37.7
Hotel and catering	-	-16.2	-	-	-14.4	-	-	-1.9	-	-	-0.1	-	-
Other services	-	27.1	-	-	33.0	-	-	32.6	-	-	24.7	-	-

Answers to the question: We assess our business situation as good/satisfactory/bad. The balance is the percentage of 'good' answers minus the percentage of 'bad' answers.

From a regional perspective, the business situation trend presented a very diverse picture. While the business situation improved in the Zurich Region, Eastern Switzerland and the Lake Geneva Region, it changed very little in Espace Mittelland and Ticino. In contrast, the business situation deteriorated slightly in Central Switzerland and North-West Switzerland. From an annual perspective, the business situation thus improved in all of the FSO regions with the exception of Central Switzerland where the indicator ended the year on a less positive note (see T 1).

Explanation of graphs

Graph G 6 presents the KOF business situation across all sectors covered by the survey. The business situation in sectors which are surveyed on a quarterly basis is kept constant during the intervening months.

Graph G 7 presents the business situation in the main regions according to the Federal Statistics Office (FSO). The regions are coloured according to business situation. The arrows in the regions indicate the change in the business situation compared to the previous month. An upward-pointing arrow, for instance, indicates that the situation has improved over the previous month.

The KOF business situation is based on over 4,500 reports by Swiss companies. Every month, businesses are surveyed in the following sectors: industry, retail trade, construction and project engineering as well as financial and insurance services. Businesses in the hotel and catering sector, wholesalers and the other service providers are surveyed in the first month of every quarter. Among other questions, the businesses are asked to assess their current business situation. They may rate their situation as 'good', 'satisfactory' or 'bad'. The balance of the current business situation is the percentage difference between the 'good' and 'bad' responses.

G 7: KOF Business Situation in the Private Sector

The angle of the arrows reflects the change in the business situation compared to the previous month

Source: KOF

Net balances

- 55 to 100
- 30 to under 55
- 16.5 to under 30
- 9 to under 16.5
- 5 to under 9
- -5 to under 5
- -9 to under -5
- -16.5 to under -9
- -30 to under -16.5
- -55 to under -30
- -100 to under -55

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You can find more information about the KOF Business Tendency Surveys on our website:
www.kof.ethz.ch/en/surveys/business-tendency-surveys →

KOF Economic Barometer Rises Further

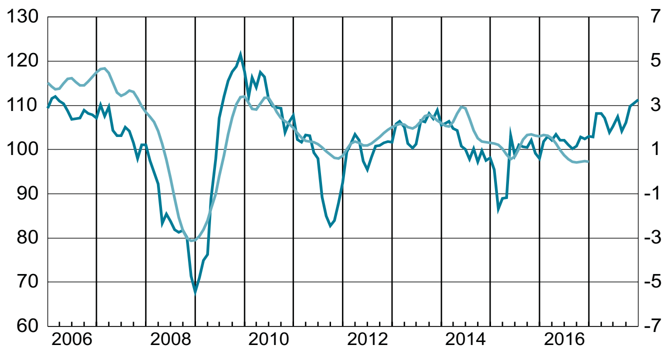
The KOF Economic Barometer continues its upward tendency in December. It has risen further by roughly one point to 111.3 points (after revised 110.4 points in November) (see G 8). The Barometer now stands at its highest reading since June 2010. The Swiss economy is in an upswing.

The high standing of the Barometer in December is driven mainly by the positive development of the indicators for the banking sector, after a less positive development in the last month. Further positive contributions come from the export sector and, to a smaller extent, from the indicators for manufacturing, consumption and accommodation, whereas the indicators for construction have slowed down the development a bit.

Within the manufacturing sector, the developments are mixed. The textile and wood processing industries show a clear upward trend. On the other hand, the prospects for the machinery and the electrical equipment industry have deteriorated clearly. The food industry also sees a negative trend, while the paper and the metal industries are developing more or less sideways. The project engineering firms show a more or less stable development in December.

In the goods producing sector (manufacturing and construction), the indicators for preliminary products move upwards. The orders and production slowed down in December, while the indicators for the general situation, the export demand, and the competitive and capacity development moved sideways.

G 8: Economic Barometer and Reference Series



KOF Economic Barometer (Index values; long-term average 2007–2016 = 100; left scale)
Month-on-month change of the Swiss business cycle (Reference series; SECO / KOF, right scale)

KOF Economic Barometer and reference time series: annual update

In September 2017, the scheduled annual update of the KOF Economic Barometer took place. The annual update involves the following steps: redefinition of the pool of indicators that enter the selection procedure, update of the reference time series, and renewed execution of the variable selection procedure. The updated reference series is the smoothed continuous growth rate of the Swiss Gross Domestic Product (GDP) according to the new System of National Accounts ESVG 2010, released in early September 2017, which takes into account the previous year's annual GDP data published by the Swiss Federal Statistical Office (FSO). As a result of the indicator variable selection procedure, the updated KOF Economic Barometer is now based on 273 indicators (instead of 272 as in the previous vintage), from a pool of almost 500 potential indicator series. They are combined using statistically determined weights.

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For detailed information on the KOF Economic Barometer, visit our website:
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