

Press Release

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KOF Autumn Forecast 2015: Price Declines Cushion Collapse – Depreciation Improves Prospects

In contrast to many economic observers fear, the Swiss economy recorded a slight increase in real production in the second quarter 2015. Prices, however, came under pressure and are likely to plunge this year given the current margins. KOF expects Switzerland's real GDP to expand by 0.9% this year and 1.4% next year. Unemployment will rise slightly and prices will continue to decline. Globally, emerging markets will be catching up more slowly with the industrial countries than before.

Global economic environment

At present, the global economy looks rather like it did in 2013 when the Fed's announcement of its intention to taper the stimulus programme resulted in turmoil on the financial markets. At the time, the prospect of higher yields in the USA led to a massive outflow of capital from the emerging markets, which had a negative impact on financing conditions. With capital investments and the cross-border exchange of goods suffering, production as a whole was ultimately affected. On top of this, emerging market currencies devalued significantly, causing some of the central banks to raise interest rates. This, in turn, placed a further strain on investment activities. At present, the situation looks remarkably similar.

This is, however, not exclusively due to the Fed or its first increase in federal funds rate in close to ten years which is expected this year. Home-grown problems in the emerging markets and structural changes are equally responsible. Both Brazil and Russia have slid into a deep recession this year and the GDP growth rate in China is tumbling. In addition, the weak performances of China, Brazil and Russia will affect a number of economies in Central and East Asia as well as Latin America.

The continuous recovery of the euro area makes for better news. Helpful factors consist of further quantitative easing, less restrictive fiscal policies, the euro's depreciation against the dollar and the low oil price. Following its dip in the first quarter 2015, the US economy is regaining ground. Growth rates in the coming months are expected to exceed the potential rate of approx. 2.25%.

Development in Switzerland

While KOF had expected the strong Swiss franc appreciation to pull the Swiss economy into a brief technical recession, new official figures published by the State Secretariat for Economic Affairs (SECO) paint a more positive picture. Once again, the Swiss economy has proved to be more flexible and robust than anticipated after the "Swiss franc shock". There is, however, a price to pay for flexibility: With many producers lowering their selling prices, margins have slumped. In the first six months of 2015, the price level in the domestic production industry declined by a significant 0.9% compared to the previous year.

This cave-in mostly affects goods destined for exports. If adjusted for price, the export goods figure actually increased in the second quarter while the nominal volume went down compared to the previous quarter. Another noticeable development was the decline in real goods imports in the second quarter. The pressure on profit margins, which went hand in hand with the substantial drops in prices, is likely to have had a particularly negative impact on the engineering and metal industry. The slight decline of the Swiss franc at the beginning of the second half of the year may, however, give the domestic economy a bit more breathing space. Throughout the forecast period, margins are expected to stabilise and may even perk up slightly.

In terms of GDP, KOF expects an average growth rate of 0.9% (June: 0.4%) for the current year. Given Switzerland's population growth of 1.1%, per capita GDP will thus record a slight decline (-0.2%). A robust development is anticipated in 2016, resulting in a GDP growth rate of 1.4% (June: 1.3%). Stable domestic consumption and positive impulses from the global economy will promote growth. Although this year, private consumption looks somewhat less dynamic (1.2%), consumer spending is likely to recover in 2016 and record a real increase of 1.7%. In terms of exports, KOF expects a 1.1% rise this year, going up to 4.4% next year. Total imports are predicted to expand by 1.6% in 2015 and as much as 6% in 2016.

Slight increase in unemployment

The unemployment rate is currently going up slightly, which is partially due to rising youth unemployment. In the second quarter, the seasonally-adjusted rate of registered unemployment increased by around 0.1 percentage points on the previous quarter. KOF anticipates an average unemployment rate of 3.3% this year, followed by 3.6% in 2016. Unemployment as defined by the International Labour Organisation (ILO) will also rise, from 4.3% to 4.4%. The outlook for the labour market is thus similar to the last forecast.

All in all, the capital investment development was rather weak. For the current year, KOF expects a stagnation in construction investments, followed by a 0.7% increase in 2016. The outlook for equipment investments indicates moderate growth (2015: 2.7%). In 2016, they are expected to rise by 3.6% with growth dominated by one-time effects, namely the purchase of new aircrafts and new rolling stock.

Anticipated exchange rate development

Now that the Greek debt crisis appears to be over, the Swiss franc-euro exchange rate has stabilised. Despite the turbulent development of the Asian financial markets, the Swiss franc has depreciated in the second half of the year. Its previous role as a safe haven appears to have receded into the background compared to spring. KOF forecasts a euro-swiss franc exchange rate of 1.10 which is expected to persist throughout the forecast period. The inflation rate will firmly remain in the negative zone. This year, prices are expected to decline by 1.1%, the lowest annual figure since the turn of the century. Average annual prices will continue to drop in 2016 (-0.2%).

Box: Declining Prices

Both consumer prices and domestic production prices have been on the slide since 2011. Consumer prices are dominated by the development in import prices, especially energy sources. This development usually transfers to prices in the domestic manufacturing industry via cost reductions. When consumer prices decline or rise more slowly, wage agreements turn out lower. The same applies when company profits go down. Rationalisation investments also contribute towards cost cutting and result in price reductions under competitive conditions.

In the case of a sudden exchange rate movement, such as the one we experienced at the start of the year, the order of the adjustments is reversed in some industries: Due to the competitive situation, prices were lowered first. Cost cutting measures, some of which are still in progress, followed subsequently. In effect, temporary extensions of working hours without wage increases are equivalent to wage reductions, and the imminent negotiations are likely to result in wages less generous than expected if the minimum exchange rate for the Swiss franc against the euro had been maintained. On top of this, increased procurement of intermediary inputs from abroad is likely to lead to further cost savings; surprisingly, however, imports of intermediary inputs have so far been declining.

Find the tables of the latest KOF Forecast on our website:

<http://www.kof.ethz.ch/en/forecasts/economic-forecasts/>

You can find further contributions regarding the latest KOF Forecast on 2 October in the newsletter "KOF Bulletin"

<http://www.kof.ethz.ch/en/publications/kof-bulletin/>

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Forecast Tables

(per cent changes from previous year, unless otherwise indicated)

Table 1:
World Economy

	2013		2014		2015		2016		2017
	Oct. 2015	Oct. 2015	June 2015	Oct. 2015	June 2015	Oct. 2015	June 2015	Oct. 2015	
Real gross domestic product (GDP)									
OECD Total	1.2	1.8	1.8	2.0	1.7	2.0	2.1	1.9	
European Union (EU-27)	0.2	1.4	1.3	1.8	1.6	1.8	1.9	1.9	
USA	1.5	2.4	2.4	2.4	1.9	2.7	2.6	2.4	
Japan	1.6	-0.1	-0.1	0.7	0.9	0.7	1.2	0.2	
Oil price (\$ per barrel)	108.8	98.9	98.9	54.2	62.0	50.6	66.3	51.6	

Table 2:
Switzerland: Real Gross Domestic Product by Type of Expenditure

at previous year's prices	2013		2014		2015		2016		2017
	Oct. 2015	Oct. 2015	June 2015	Oct. 2015	June 2015	Oct. 2015	June 2015	Oct. 2015	
Private consumption	2.2	1.3	1.3	1.2	1.9	1.7	1.8	1.5	
Public consumption	1.3	1.3	1.4	1.8	1.9	1.0	1.2	0.7	
Gross fixed capital formation	1.2	2.1	1.5	1.6	0.3	2.5	1.6	0.1	
Construction	3.1	3.3	0.9	0.0	-1.1	0.7	-0.6	-0.1	
Machinery and equipment	0.0	1.3	2.0	2.7	1.2	3.6	2.9	0.3	
Exports of goods (1) and services	0.0	4.2	3.8	1.1	1.5	4.4	2.8	4.8	
Goods (1), (2)	-1.0	4.0	4.0	-0.8	-0.5	5.2	3.2	6.1	
Services	4.7	2.4	10.5	1.5	11.2	4.3	0.1	3.4	
Imports of goods (1) and services	1.3	2.8	1.8	1.6	1.2	6.0	2.0	4.2	
Goods (1)	0.7	1.7	1.5	-2.0	3.0	6.9	3.8	4.4	
Services	2.9	5.1	1.5	9.0	0.8	4.2	4.8	4.0	
Change in stocks (3)	1.0	0.2	-0.1	-0.3	-0.3	-0.8	-0.4	0.2	
Gross Domestic Product (GDP)	1.8	1.9	-0.5	0.9	-0.2	1.4	0.3	1.8	

(1) without valuables (i.e. exports and imports of precious metals incl. non-monetary gold and stones, gems as well as objects of art and antiquities)

(2) without merchanting

(3) Percentage contribution to GDP-growth

Table 3:

Switzerland: Other Macroeconomic Indicators

	2013		2014		2015		2016		2017
	Oct. 2015	Oct. 2015	June 2015	Oct. 2015	June 2015	Oct. 2015	June 2015	Oct. 2015	
Real effective exchange rate (CHF)	-2.0	0.6	0.6	6.9	8.2	-4.9	-2.2	-2.3	
3-month Libor CHF (1)	0.0	0.0	0.0	-0.7	-0.8	-0.7	-0.8	-0.5	
Yield of 10 years federal bonds (1)	0.9	0.7	0.7	0.0	0.0	0.3	0.0	0.7	
Consumer prices	-0.2	0.0	0.0	-1.1	-1.1	-0.2	-0.3	0.3	
Full-time equivalent employment	1.3	0.8	0.8	0.9	0.5	0.4	0.0	0.5	
Unemployment rate ILO (2)	4.4	4.5	4.5	4.3	4.4	4.4	4.8	4.5	
Unemployment rate SECO (3)	3.2	3.2	3.2	3.3	3.3	3.6	3.6	3.7	

(1) Level

(2) Unemployed as percentage of labour force according to the International Labour Organization, ILO

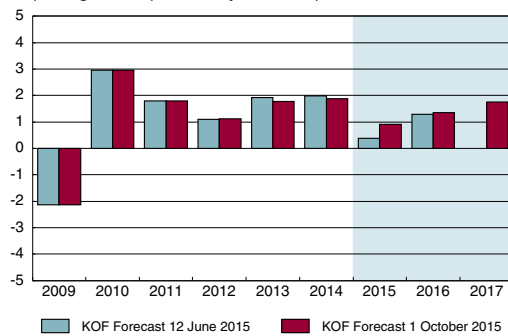
(3) Unemployed as percentage of labour force according to census of 2010

Graphs

Graph 1

Switzerland: Real GDP with Forecast

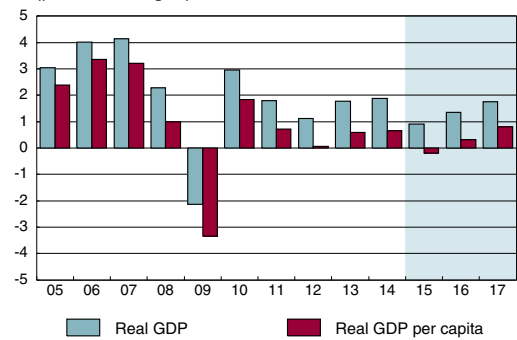
(change over previous year, in %)



Graph 2

Real GDP and GDP per Capita

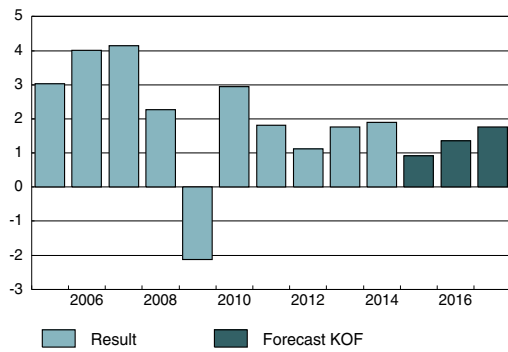
(percent changes)



Graph 3

Switzerland: Real GDP

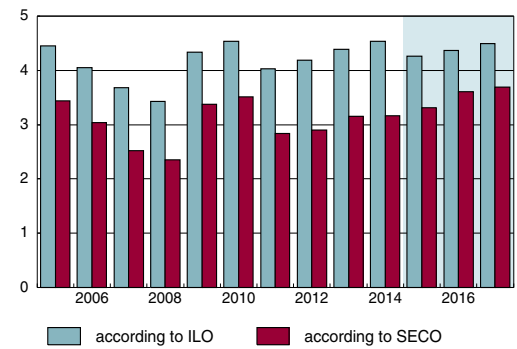
(percentage changes)



Graph 4

Switzerland: Unemployment Rate

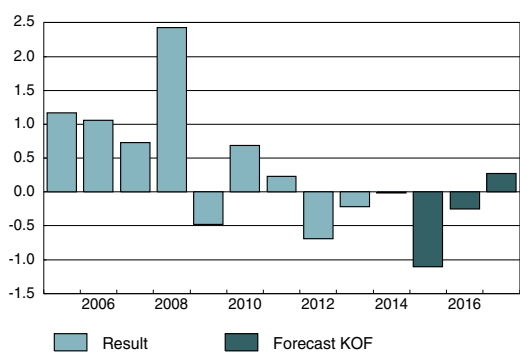
(per cent)



Graph 5

Switzerland: Consumer Prices

(percentage changes)



Graph 6

EU/USA: Real GDP

(percentage changes)

