

Press Release

Zurich, 28 January 2015

New KOF Forecast: Removal of the Euro-franc Floor Shocks Swiss Economy

The KOF has updated its December 2014 forecast in view of the "franc shock". It is expecting a slump in economic performance in the first six months of 2015. Unemployment is expected to rise, with prices falling further.

On 15 January 2015, the Swiss National Bank (SNB) unexpectedly removed the euro-franc minimum exchange rate, which had applied since 2011. This led to an increase in the value of the franc, which has since then remained at almost parity with the euro. Due to the new economic circumstances, the KOF has recalculated its December 2014 model-based forecast for the business cycle, assuming a new exchange rate of 1 Fr./Euro (rather than 1.20 Fr./Euro) until the end of 2016. It also takes account of the fact that the price of oil has fallen by more than was assumed in the December forecast (to 50 dollars per barrel rather than 70 dollars). As a result of these two changes to the framework conditions, the Swiss economy is expected to experience a short recession in the summer semester of 2015. However, it must be stressed that significant shocks such as an abrupt increase in the value of the currency by 20% impair the forecasting power of business cycle models.

The direct effect on the Swiss business cycle of the increase in the value of the franc will be felt on the export market. Exports are expected to fall significantly over the first half of the current year. The fall in the price of oil will result in a significant fall in earnings from the international oil trade, which is largely administered from Switzerland ("transit trade"). However, this only applies to value creation at current prices and not real value creation. In actual fact, real value creation will fall because the stronger franc will make exports of goods more expensive whilst also making it more difficult to export tourist services. Overall, the KOF is expecting exports to fall by 1.4% during the current year.

Businesses will not respond immediately to reduced demand from abroad, but will rather produce initially for stock. However, it is expected that production will then be reined in from the 2nd quarter of 2015. The KOF is expecting a short recession in the summer semester, with gross domestic product (GDP) falling by 0.5% during 2015 as a whole.

The foreign trade shock will have a knock-on effect on the domestic economy. Due to falling prices and scope for “retail tourism”, private consumption should initially hold up well. However, investments in equipment will become increasingly restrained as the exchange rate adjustment has made Switzerland even less attractive as a manufacturing location, having already been hampered by doubts over progress in the bilateral approach. At the same time, construction investment will be depressed, although not as a result of the stronger franc, as the initial signs of this were already apparent last year.

The tense situation for businesses will result in lost tax revenue. The KOF thus expects that the public administration and other sectors financed predominantly out of public funds, such as health and education, which had been motors of job creation since the start of the financial crisis, will have progressively less demand for labour, whilst the private sector will also be shedding jobs. Accordingly, a fall of the full-time equivalent rate of employment of 0.3% is forecast for 2015, along with a further fall of 1.8% in 2016. The rate of registered unemployment will increase from 3.2% in 2014 to 3.4% in the current year and 4.1% next year. The unemployment rate measured according to the international definition (which takes account also of those without insurance) will be higher at 4.4% (2015) and 4.9% (2016). The deterioration in the employment situation will dampen the rate of wage growth, with overall income from employment expected to stagnate next year. Private households are expected to react to this increasingly by reining in consumption, despite falling prices. Inflation, measured according to the National Consumer Price Index, is expected to fall below zero with -1.5 and -0.4 for this year and next year respectively.

To summarise, the exchange rate shock will have the following effects on the Swiss economy: exports will fall in the short term, although may benefit from an improved international environment during the latter part of the forecasting period. Demand on the part of customers who continue to buy Swiss products in spite of the strong franc will pick up in time, albeit returning to a different level. On the other hand, the transfer of the shock to the domestic economy as a result of restrained investment and consumption, in parallel with falling employment levels, will weigh down the business cycle for the entire forecasting period through to the end of 2016. Thus, GDP is forecast to fall in the current year and to remain stagnant also in 2016.

www.kof.ethz.ch/media

Contact:

PD Dr. Jochen Hartwig
Phone: 044 632 73 31
hartwig@kof.ethz.ch

Anne Stücker
Phone: 044 632 40 61
abrahamsen@kof.ethz.ch

Forecast Tables

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

Table 1:
World Economy

	2013		2014		2015		2016	
	Jan. 2015	Dec. 2014	Jan. 2015	Dec. 2014	Jan. 2015	Dec. 2014	Jan. 2015	Dec. 2014
Real gross domestic product (GDP)								
OECD Total	1.4	1.4	1.8	1.8	2.0	2.0	2.1	2.1
European Union (EU-27)	0.0	0.0	1.3	1.3	1.3	1.3	1.8	1.8
USA	2.2	2.2	2.3	2.3	3.1	3.1	2.7	2.7
Japan	1.6	1.6	0.2	0.2	1.0	1.0	1.4	1.4
Oil price (\$ per barrel)	108.8	108.8	98.9	99.9	50.4	70.5	51.4	71.9

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

at previous year's prices	2013		2014		2015		2016	
	Jan. 2015	Dec. 2014	Jan. 2015	Dec. 2014	Jan. 2015	Dec. 2014	Jan. 2015	Dec. 2014
Private consumption	2.2	2.2	1.1	1.1	1.3	2.1	0.2	1.7
Public consumption	1.4	1.4	1.5	1.5	1.7	1.7	1.3	1.3
Gross fixed capital formation	1.7	1.7	0.9	0.9	-0.6	1.0	-1.9	3.3
Construction	1.2	1.2	1.3	1.3	-1.4	-0.6	-0.3	1.6
Machinery and equipment	2.0	2.0	0.6	0.7	0.0	2.0	-3.0	4.3
Exports of goods (1) and services	0.0	0.0	3.2	3.4	-1.4	5.0	2.8	4.8
Goods (1), (2)	-1.0	-1.0	4.6	4.6	-	5.0	-	5.7
Services	4.7	4.7	2.6	2.6	-	4.2	-	4.0
Imports of goods (1) and services	1.4	1.4	1.7	1.7	1.5	3.3	2.9	4.8
Goods (1)	0.7	0.7	2.0	2.0	-	3.7	-	4.8
Services	3.1	3.1	0.9	0.9	-	2.4	-	4.8
Change in stocks (3)	1.2	1.2	0.6	0.5	0.3	-0.8	0.2	-0.4
Gross Domestic Product (GDP)	1.9	1.9	2.0	1.9	-0.5	1.9	0.0	2.1

(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 merchenting

(3) Percentage contribution to GDP-growth

© KOF, ETH Zürich

Table 3:
Switzerland: Other Macroeconomic Indicators

	2013		2014		2015		2016	
	42005	Dec. 2014	42005	Dec. 2014	42005	Dec. 2014	42005	Dec. 2014
Real effective exchange rate (CHF)	-1.6	-1.6	0.4	0.4	15.5	-2.0	-2.7	-2.2
3-month Libor CHF (1)	0.0	0.0	0.0	0.0	-	0.0	-	0.0
Yield of 10 years federal bonds (1)	0.9	0.9	0.7	0.7	-	0.5	-	0.5
Consumer prices	-0.2	-0.2	0.0	0.0	-1.5	-0.1	-0.4	0.5
Full-time equivalent employment	1.3	1.3	0.8	0.8	-0.3	0.9	-1.8	1.1
Unemployment rate ILO (2)	4.4	4.4	4.6	4.6	4.4	4.1	4.9	4.2
Unemployment rate SECO (3)	3.2	3.2	3.2	3.2	3.4	3.1	4.1	3.1

(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

© KOF, ETH Zürich