KOF Economic Forecast, March 2018

Executive Summary

Zurich, 28 March 2018

This is a summary of the 2018 spring forecast for Switzerland, released by the KOF Swiss Economic Institute at ETH Zurich on 28 March 2018, with a forecast horizon up to the end of 2019. It first focuses on recent economic trends abroad, which constitute the most important conditioning factors for the Swiss economy, and then presents the main forecast results for Switzerland.

The global environment

The global economy can look back on a successful 2017, even if the present global upswing weakened slightly towards the end of 2017 after an exceptionally strong performance in the summer half-year. In line with the sharp upturn in the global economy, world trade increased by 4.5% last year after five weak years with average growth rates of 2%. Prices for energy and raw materials recovered in the course of the year without having a considerable impact on consumer prices. Globally, however, the underlying price pressures – measured in terms of core inflation, excluding energy and food prices – increased only moderately last year.

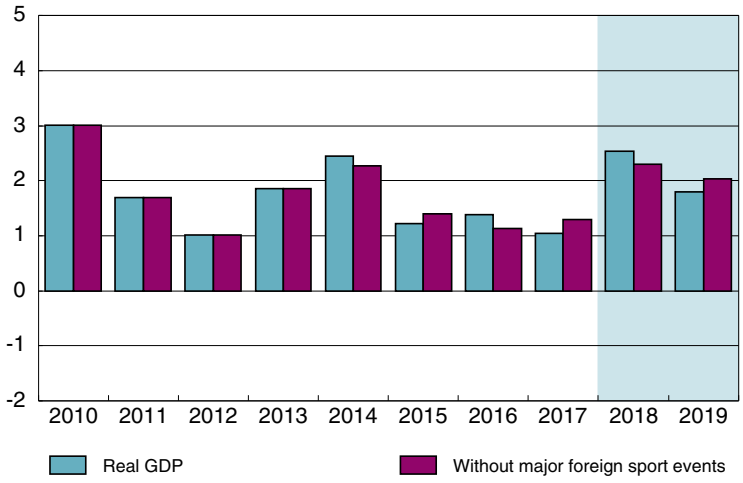
In the current year the Federal Reserve (Fed) is expected to raise interest rates by about the same amount as last year. The European Central Bank (ECB) kept interest rates low last year. In April 2017 it began to gradually normalise its monetary policy by reducing the net volume of its bond purchases, although the first policy rate increase is not likely to occur before 2019.

The strong performance of the global economy will slowly decline over the forecast period. In the developed economies, which so far have been the driving force behind the upswing, most output gaps were probably closed last year.

The Swiss economy

Our forecast for Swiss GDP growth is 2.5% this year and 1.8% for 2019 after a seemingly sluggish 1.0% in 2017. The quarter-on-quarter figures reveal that the Swiss economy is presently at its peak growth. Although growth rates will weaken somewhat, the economy remains in an upswing. Notice, however, that the development of Swiss GDP growth is only of limited help in determining the Swiss business cycle; the former is distorted by sizeable (sporting) events, which are at best loosely related to the performance of the remaining economy. In this respect, international commodity trading, for which the business and tax environment has made Switzerland a preferred headquarters location, is long known to contribute significantly, but erratically, to Swiss value added. While it appears easy to come up with ad-hoc explanations for past trends, forecasting this activity is virtually impossible. On top of this, Swiss national accounting recently started to reveal the effects of large spectator sporting events, such as international soccer competitions and the Olympic Games, which occur quadrennially and only in even years. As far as we can infer from the official statistics, we are mainly dealing here with the income accruing to entities domiciled in Switzerland resulting from the sale of TV rights. Just as for commodity trading, the revenues thus generated, and correctly captured in GDP, have only a marginal impact on the rest of the Swiss economy. In contrast to commodity trading, the timing of these sporting events is known. We are thus able to compute a 'Core GDP' series, which excludes these events. This is shown in the following graph.

Impact of Large International Sport Events
(percent changes)



The Swiss labour market is doing well. We expect employment to grow significantly, which will increase immigration this year. Total labour income will thus increase by 2.2%. Self-employed and capital income will also contribute to the increase in income. Despite positive inflation, real disposable income will rise by 2.0% this year. Employment growth is likely to slow down next year. At the same time, profits and capital income are likely to grow less significantly. Growth in real disposable income will be lower than in the previous year and amount to 1.5%. According to our forecast, full-time equivalent employment as well as the number of persons employed will rise by 1.4% this year and by around 1% in 2019, thereby reducing unemployment. Measured according to the International Labour Organization (ILO) definition, the unemployment rate will fall from 4.8% last year to 4.6% this year. Private consumption, by far the largest demand component, grew by 1.2% in 2017, with the second half of the year showing slightly stronger momentum. For the current year we expect consumer spending to increase by 1.6%. The Swiss consumer sentiment index rose significantly in January. Hotel overnight stays by Swiss residents were more than 5% higher in January than a year before. Registrations of new passenger cars also exceeded last year's levels in the first two months. In addition, the unusually long flu epidemic with corresponding health costs and the exceptionally cold weather in February are likely to have increased private spending in the first quarter. In line with our labour market forecast, consumer spending is likely to lose some of its momentum in 2019, growing at a below-average rate of 1.4%.

Given Switzerland's debt brake and its established culture of conservative budgeting, growth impetus from public spending is rare, and we do not expect this to change this year or next.

Business investment in machinery and equipment will maintain the robust momentum of recent quarters. The depreciation of the Swiss franc in 2017 is enabling exporting companies to see some recovery in their profit margins. This might gradually reduce their incentive to invest in labour-saving technology, leading to lower growth for 2019.

Construction investment increased by 1.9% in 2017 and will continue to grow solidly this year. By 2019, rising interest rates will start dampening construction investment activity. Investment in infrastructure and industrial/commercial building projects is driving the construction sector. Slowly rising interest rates and vacancy rates as well as weakening demand on the back of lower net immigration are dampening housing construction. Residential construction is thus predicted to perform modestly over the forecast horizon. In non-residential construction,

the improved economic environment is giving companies more scope for investment in commercial and office buildings as well as production facilities. This is being supported by several ongoing large-scale projects. During the forecast period, infrastructure investment is boosting civil engineering. The outlook for new construction of pumped-storage power plants, however, remains subdued. Hydropower has become less profitable owing to the low price of electricity.

The recent depreciation of the Swiss franc has enabled the profitability of export-led companies to recover. While export-driven companies are reporting a significant improvement in earnings, the outlook for domestically focused companies is more subdued; these are directly affected neither by the exchange rate nor by the expanding international economy. After having gone through a considerable contraction phase in the aftermath of the last global financial crisis, the earnings of financial companies are faring well again. Overall, Switzerland's total business gross operating surpluses will increase by a staggering 3.7% in 2018. For 2019 we expect a further increase of 2.5%. Wages will rise in 2018 but by less than productivity, which implies a reduction in unit labour costs. For 2019 we forecast that unit labour costs will increase again.

The main risks for the Swiss economy lie in potential international disruptions. Increased protectionism would act as a drag on the strongly export-led Swiss economy. Negative trends as a result of Brexit or renewed problems in the euro area could adversely affect the Swiss economy through weaker demand or unfavourable exchange-rate movements.

One possible pleasant surprise is the potentially stronger-than-expected investment cycle in Europe. The current upswing here is already being driven by robust investment activity. If investment picks up more strongly than expected, the internationally oriented Swiss economy would benefit.

The full version of the KOF Economic Forecast can be found in KOF Analysen, 2018, Nr. 1, Frühjahr (in German):
www.kof.ethz.ch/en/publications/kof-analysen →

Find more information about the KOF Economic Forecast on our website:
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