ETH zürich KOF

Executive summary of KOF’s economic forecast for spring 2023

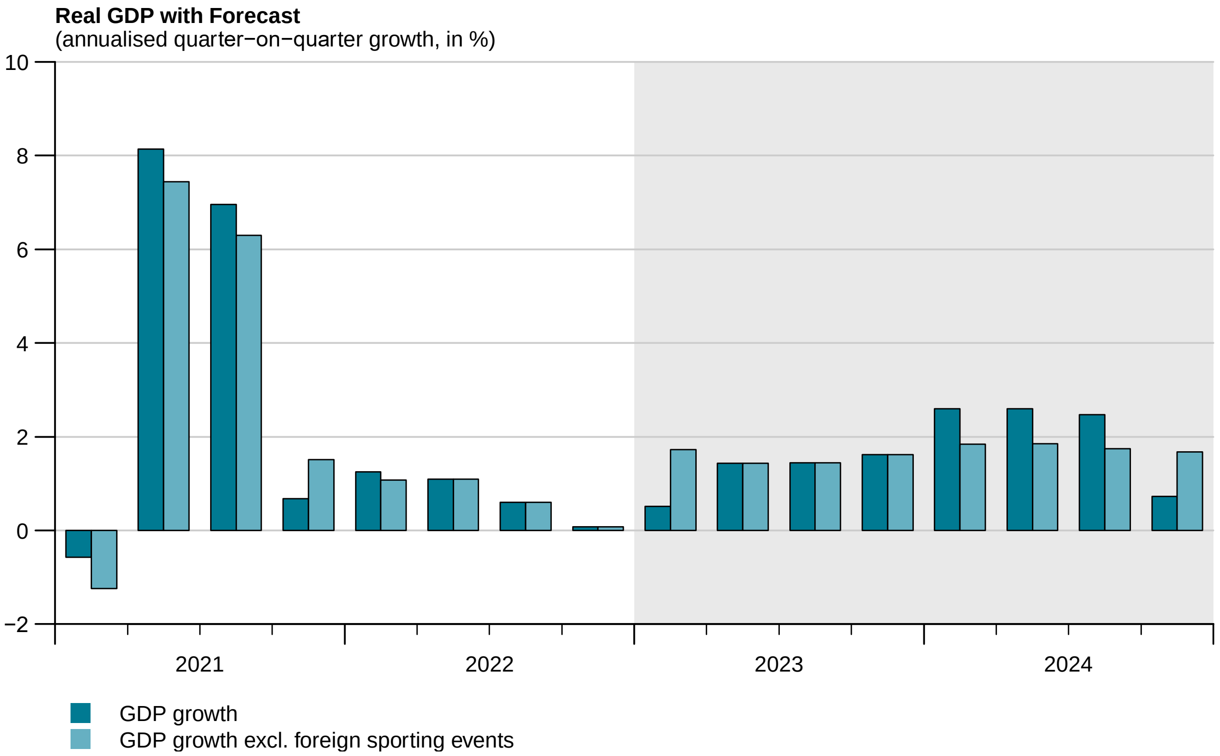
21 March 2023

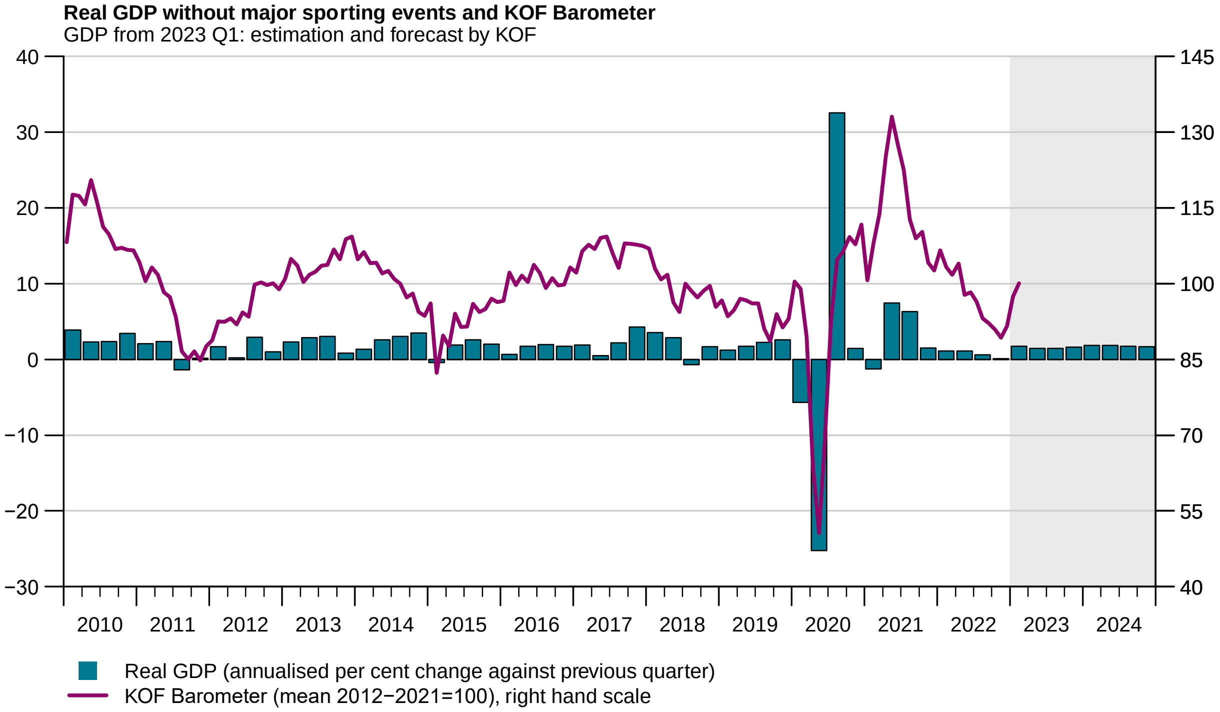
This is the 2023 spring forecast of the KOF Swiss Economic Institute at ETH Zurich, released on 21 March 2023, with a forecast horizon up to the end of 2024.

MILD WINTER CALMING FEARS OF RECESSION

The global economy had exceeded expectations at the end of 2022, with the US economy in particular performing much better than expected and helping to stabilise the world economy. Thanks to the mild winter and government intervention, the global economy will be less severely affected by the anticipated energy crisis in the current year than was previously feared. These positive developments will also have an impact on the Swiss economy which, however, is characterised by a high degree of resilience, which means that it has already been less seriously affected by a potential energy crisis. Consequently, any mitigation of this crisis is likely to have a smaller positive impact on the economy. In addition, inflation should be somewhat stronger than expected this year (and next) and thus weigh on real wage growth.

According to KOF’s forecast, real gross domestic product (GDP) in Switzerland is expected to rise by 0.8 per cent in 2023 (by 1.1 per cent excluding major international sporting events) and by 2.1 per cent in 2024 (by 1.7 per cent excluding major international sporting events). In its winter forecast, KOF expected growth of 0.7 per cent for 2023 (1.0 per cent excluding major international sporting events) and 2.1 per cent for 2024 (1.7 per cent excluding major international sporting events). KOF has thus only slightly amended its economic outlook for Switzerland compared with its winter forecast and has revised its GDP forecast slightly upwards, as the slowdown in the first half of the year is now less pronounced.





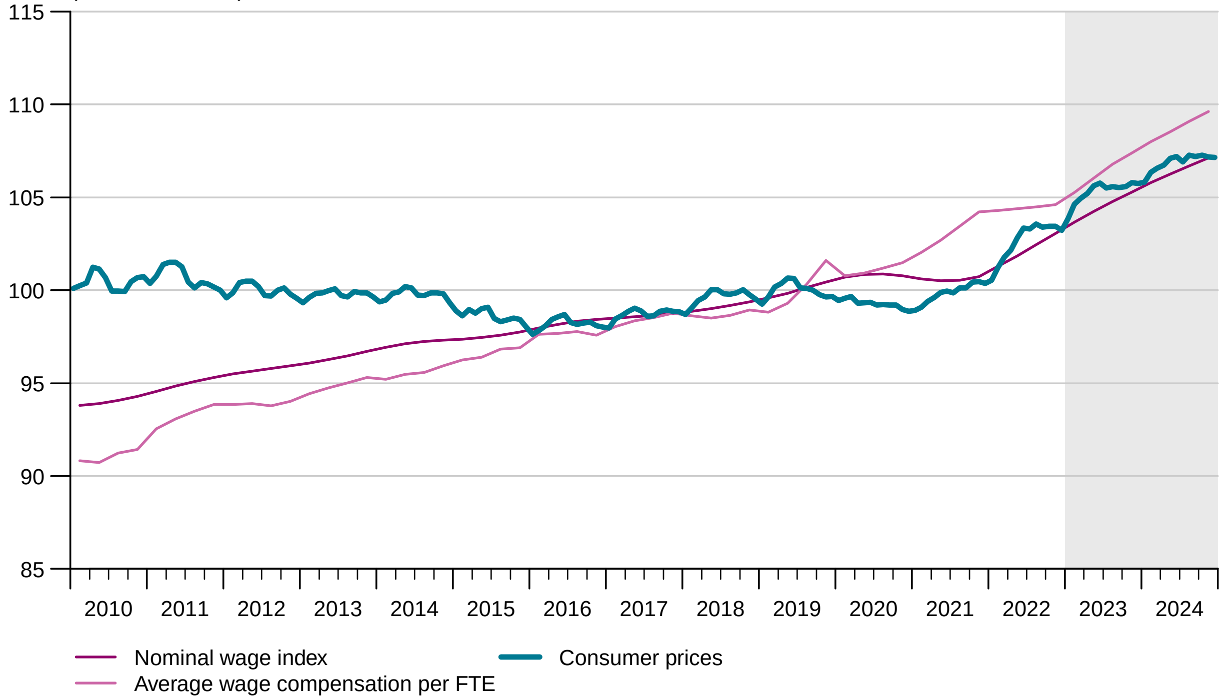
Global economy: optimistic despite challenges

Global output achieved only below-average growth in 2022 owing to supply-chain problems, the energy price spike and uncertainty resulting from the war in Ukraine. KOF expects to see a recovery in Europe this year, which many economic indicators are already suggesting. However, the energy crisis and monetary tightening are still having a dampening effect on the economic performance of some European countries. GDP growth in the US is likely to slow during the first half of 2023 as growth in private consumption is set to weaken. By contrast, KOF expects consumption in China to rebound sharply in the first half of 2023, which should also have a positive impact on the global economy. According to KOF's estimates, Swiss-export-weighted world GDP is likely to rise by 1.4 per cent in the current year. KOF is forecasting growth of 2.1 per cent for 2024, which represents a considerable upward revision compared with its winter forecast, in which it had only predicted increases of 0.5 per cent for 2023 and 1.9 per cent for 2024. The improvement in the international environment in the first half of 2023 will have a direct impact on Swiss goods exports, which are being revised upwards for both this year and next year.

Successful Swiss labour market

Last year was an exceptionally good one for the Swiss labour market. Almost all key labour market indicators reached or exceeded historic highs, while the unemployment rate fell to an all-time low. The Swiss labour market also performed better in the fourth quarter of 2022 than had been forecast. Compared with the previous quarter, employment measured in terms of full-time equivalents rose by 0.6 per cent, thereby exceeding expectations (winter forecast: 0.3 per cent). Although employment grew in almost all sectors, those that had been hit particularly hard by the measures imposed during the COVID-19 crisis stood out. These include the hospitality industry and the arts and recreation sector. It is expected that employment will continue to rise this year. The leading indicators for the labour market, such as the KOF Employment Indicator, remain at a high level. In addition, the Swiss Job Tracker shows that the number of vacancies also points to employment growth. KOF continues to expect total employment to grow in 2024, albeit at a slightly lower rate than in previous years. The unemployment rate as defined by Switzerland's State Secretariat for Economic Affairs (SECO) should continue to fall during the current year to 1.9 per cent on average before rising slightly to 2.2 per cent in 2024. The International Labour Organization's (ILO) unemployment rate, which is suitable for international comparisons, will remain consistently higher and is expected to average 4.1 per cent in 2023 and 4.2 per cent next year.

Wage and price development with forecast
(index, 2019=100)



Signs of recovery in the construction sector

After several years of steady decline there are signs of a gradual recovery in the construction sector. This is indicated, among other things, by KOF's latest economic surveys, which show that a large proportion of construction companies rate their current business situation as good. In addition, many firms expect their business to improve in the first half of 2023. At the same time, however, there is growing concern among companies that labour shortages could hamper further growth. Construction investment this year is likely to have bottomed out but will still probably shrink slightly compared with last year. KOF expects to see moderate growth in total investment in the construction sector from next year onwards. Residential construction investment – accounting for about 50 per cent of the total – will play a major role in this growth. Real-terms investment in the residential construction sector has also been declining steadily since it peaked in 2017, whereas it had grown strongly in previous years. The resulting shortages have exacerbated the situation in the housing market: an increasing lack of supply is coinciding with higher demand caused by changing housing preferences. This is particularly evident in the declining vacancy rates and soaring real-estate prices. KOF reckons that residential construction investment will continue to fall this year before hitting its low. KOF expects to see strong growth in residential construction investment in 2024. However, this growth will probably not be enough to ease the housing shortage. Projected population growth should continue to put pressure on the demand side.

Inflation curbing private consumption

Private consumption recorded strong growth in 2022. This was largely due to the catch-up effects arising from the COVID-19 pandemic and the growth in employment and disposable incomes. However, this recovery was hampered by high inflation and the resulting decline in real wages. While sales of many product groups had regained their pre-pandemic levels by the second quarter of 2022, there were still some that did not fully recover. The product groups of transport and hospitality were particularly affected, where spending in the fourth quarter of 2022 was still well below its level in the fourth quarter of 2019. KOF expects annual growth in real private consumption in 2023 to be in line with the average for recent years. Owing to forecast inflation levels, however, real spending is expected to grow at a lower rate than nominal spending, which will increase at a similar rate as before the pandemic. Real private consumption growth is expected to be below average in 2024. The main reasons for this are the expiry of pandemic-related catch-up effects and the inflation-related loss of purchasing power.

Chemicals and pharmaceuticals buoying the manufacturing sector

The manufacturing sector delivered a weak performance on the production side in 2022 owing to the global economic slowdown. In contrast, the hospitality sector achieved a spectacular recovery in value added with historically high growth rates. Despite this sharp rebound, however, the hospitality industry has not yet regained its pre-pandemic levels. Moreover, construction experienced a very weak 2022 with a sharp decline in value added. The value added in financial and insurance services fell steadily in 2022, albeit from a very high level. Gross value added in the retail sector returned to normal in 2022 from the unusually high levels that had prevailed during the COVID-19 pandemic, especially in the food sector. Manufacturing is expected to grow on the back of the chemicals and pharmaceuticals sub-sectors over the coming quarters while the rest of the sector will tend to flatline. Gross value added in construction is expected to rise over the forecasting period. Financial and insurance service providers will also increase their value added this year and next year. Although the retail sector is benefiting from strong private consumption, it will receive less stimulus in the next two years. The hospitality industry will benefit from the continued return of foreign guests from overseas markets in the first half of the year. In turn, demand from domestic guests will also partially return to normal. Once the catch-up effects arising from the COVID-19 pandemic expire in the second half of the year, no further significant increases in value added can be expected.

Investment in equipment remains robust

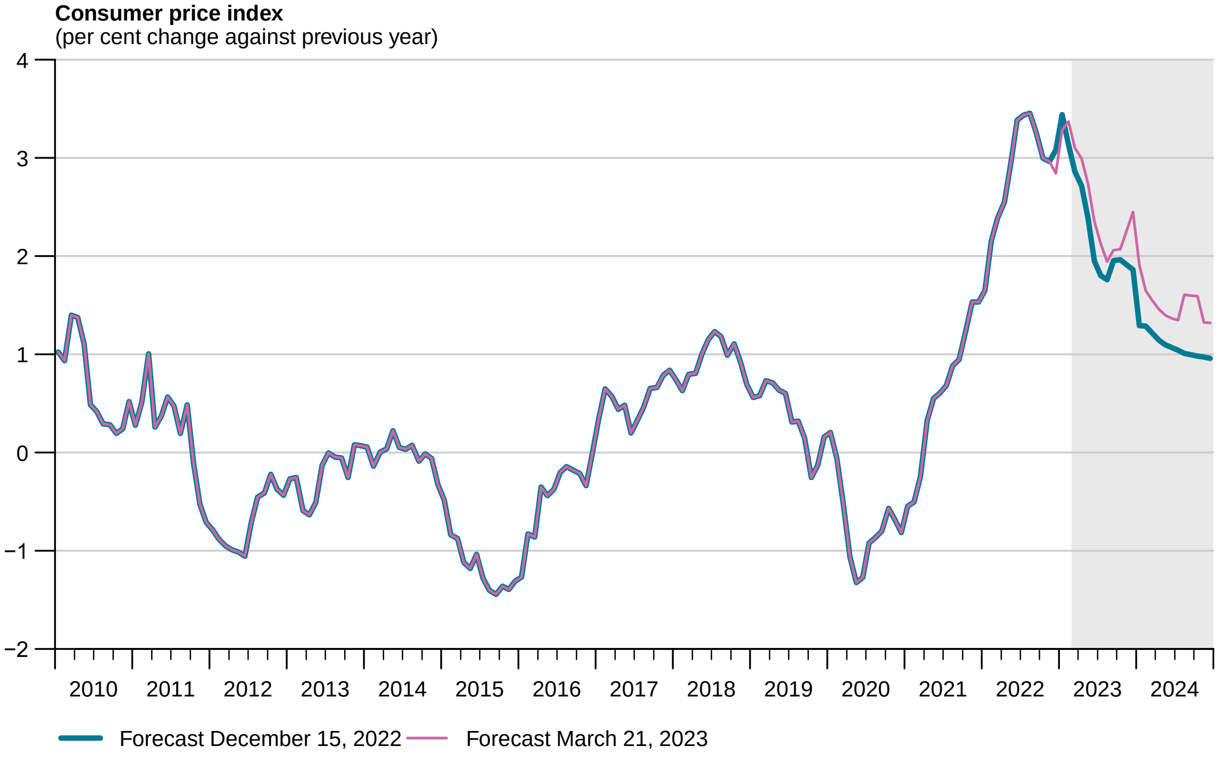
The latest data on the investment behaviour of Swiss companies show a surprisingly robust trend in capital spending on equipment in the fourth quarter of 2022. Investment also increased year on year for 2022 as a whole despite challenging conditions such as rising interest rates, higher energy costs and geopolitical uncertainty. Weak earnings in industry as well as heightened uncertainty are causing equipment investment to flatline in the first half of 2023. KOF expects the investment climate to brighten in 2024. Various indicators point to this trend, such as the improving earnings situation in almost all sectors and a slight increase in demand for credit.

Normalisation of public consumption

The pandemic situation had largely returned to normal by the end of 2022, which is reflected in the level of government consumption. The first half of 2022 saw a decline in public consumption. Nevertheless, the federal budget ended 2022 with a deficit. This is mainly due to lower revenues and persistently high exceptional pandemic-related expenditure. The level of withholding tax revenue in particular contributed to these lower overall revenues. Given the current environment of rising interest rates and prices, taxpayers now have a greater incentive to assert their claims for a withholding tax refund. KOF expects to see a further reduction in government consumption this year. Growth in public consumption is forecast to stagnate in 2024.

Inflation higher than expected

Inflation turned out slightly higher than expected in the first quarter of this year. This was mainly due to stronger-than-expected price increases in services, with the prices of air travel and package tours in particular rising significantly. This year the rate of inflation should fall initially owing to the expiry of base effects in energy prices before rebounding in the fourth quarter, when the impact of the rise in the mortgage reference rate will be reflected in the measurement of inflation. This increase, coupled with continued high demand in the face of tight supply, will ensure that rents rise well above average over the forecasting period.



Overall, KOF expects to see average annual inflation of 2.6 per cent this year and 1.5 per cent next year. This is a significant upward revision compared with its winter forecast. The main reason is stronger-than-expected service inflation. In addition, KOF is now predicting an earlier rise in the mortgage reference rate. As inflation is still not within the range that the Swiss National Bank (SNB) equates with price stability, KOF expects the SNB to raise its key interest rate in several stages over the course of this year from its current level of 1 per cent to 2 per cent and to leave it there until the end of the forecasting period. In addition, the SNB will ensure that the Swiss franc does not depreciate too much so that it can continue to contain imported inflation.

The output gap, which is important for longer-term equilibrium considerations, is likely to be just under 0.4 per cent during the forecasting period 2023 to 2024, which is only half as large as it was in 2022. The inflationary pressures resulting from overutilisation of domestic resources have therefore already eased.

Downside risks shifting

The bankruptcy of the Silicon Valley Bank has caused considerable uncertainty among investors, sent numerous bank shares plummeting worldwide and led to the takeover of Credit Suisse by UBS. If the crisis deepens further and spills over to other banks and countries, this will pose a considerable downside risk. Other downside risks include a renewed intensification of the real-estate crisis in China and a further escalation of geopolitical tensions related to the war in Ukraine. On the other hand there are also upside risks, as the reduction of supply-chain problems could boost the economy more than expected. Furthermore, the risk of renewed production shutdowns and port closures in China affecting international supply chains has fallen dramatically. In addition, there is a possibility that the current geopolitical conflicts will de-escalate and no longer concern economic actors, which would increase the propensity to invest and consume.

Further information on KOF's economic forecast is available here:
https://www.kof.ethz.ch/en/forecasts-and-indicators/forecasts/kof-economic-forecast.html