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KOF Economic Forecast (summer 2023): Strong employment despite faltering economy

The Swiss economy is currently stable. However, the subdued performance of the global economy is also making economic activity in Switzerland more sluggish. The labour market, on the other hand, is in very good shape. Private consumption is also boosting economic activity. Gross domestic product (GDP) adjusted for sporting events will increase by 1.2 per cent this year and by 1.7 per cent next year.

Economic outlook remains virtually unchanged

Last year, global output only grew at a below-average rate owing to supply chain problems, the energy price spike and uncertainty in the wake of the war in Ukraine. Global output then surged at the beginning of this year, driven by the abandonment of China's zero-COVID policy and by the decline in energy prices. Global economic growth is likely to weaken in the second half of the year in the face of high inflation and tougher financial conditions. This will also have an impact on the performance of the Swiss economy, which is currently proving to be robust and stable despite facing a number of global challenges. KOF expects value added in Switzerland to grow more slowly over the coming quarters owing to the subdued nature of the global economy.

Switzerland's foreign trade remains unaffected by these developments for the time being. Swiss goods exports staged a strong recovery at the beginning of 2023, driven in particular by the pharmaceutical industry, but should achieve lower growth rates over the further course of the year. Services exports have been performing slightly erratically for some time now, especially in the case of licensing and patenting services. However, they should perform well overall in 2023 and increase by 3.8 per cent, especially in tourism exports. As the growth rate in imports is likely to be similar to that in exports, Switzerland's balance-of-trade surplus will continue over the forecasting period.

KOF is forecasting that Switzerland's real GDP will grow by 0.9 per cent in 2023 (by 1.2 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). Back in the spring, KOF had forecast growth of 0.8 per cent for 2023 (1.1 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 modified its economic outlook for Switzerland only modestly compared with its spring forecast and has revised its GDP forecast very slightly upwards to reflect the latest data. GDP per capita will flatline or even decline a little in 2023, while a modest increase is expected in 2024.

Strong employment growth

The labour market, on the other hand, is in very good shape. Employment has grown more than expected in recent quarters. The first quarter of 2023 also saw considerable job growth across a broad range of sectors. This increase in employment, only a small proportion of which was supplied by the domestic labour force, caused net immigration to grow significantly. Although some leading indicators for the labour market suggest that this job growth is levelling off, it is not expected to end immediately. However, the pace of job creation is likely to slow. Full-time-equivalent employment growth is not expected to approach its longer-term average (1 per cent) until 2024.

High immigration levels and the slowdown in employment growth will cause unemployment to stagnate at a low level over the coming months. According to the International Labour Organization (ILO), the annual average for 2023 and 2024 will be 4.2 per cent. The rate of registered unemployment – as defined by Switzerland’s State Secretariat for Economic Affairs (SECO) – will rise slightly during the forecasting period but will remain at historically low levels (2023: 1.8 per cent, 2024: 2 per cent).

Consumer behaviour has returned to normal

Employment growth in Switzerland and the resulting immigration are boosting domestic demand. Consumer spending will therefore be a key driver of economic growth despite high but declining inflation rates. Households’ consumption behaviour has largely returned to normal, so pandemic-related pend-up demand is slowly weakening. KOF expects real private consumption to increase by 2 per cent in 2023, with the first quarter likely to be stronger than the remaining three quarters. Higher growth in private consumption will be prevented by persistent inflation (2023: 2.2 per cent), which will reduce real disposable incomes by 0.3 per cent this year.

Inflation lower than expected

At 2.2 per cent, the annual inflation rate in May was at its lowest level since March 2022. The main reason for the fall in annual inflation was the normalisation of energy and fuel prices. In addition, inflation in domestic services was less dramatic than expected despite rising electricity prices at the beginning of the year. Moreover, KOF’s latest Business Tendency Surveys reveal that the proportion of companies intending to raise their prices over the next three months is declining after having hit historic highs around the beginning of the year. Overall, KOF now expects average annual inflation to be only 2.2 per cent this year (compared with 2.6 per cent in its spring forecast) and to remain unchanged at 1.5 per cent next year.

The recent rise in the mortgage reference interest rate will mean that many existing rents will be increased significantly in the coming autumn. Since residential rents currently account for a weighting of over 19 per cent in the Swiss national consumer price index (CPI), this increase will contribute significantly to inflation up to the end of the forecasting period, especially as the SNB’s tightening of monetary policy is likely to push up the reference interest rate further. KOF’s forecast assumes that about half of the inflation seen in 2024 will be caused by rent increases.

Very little real wage growth during the forecasting period

Currently available data indicate that real wages will grow only modestly or not at all over the forecasting period. The figures on productivity trends also suggest that real wage growth will remain low, as value added per hour worked has not increased since 2020.

Residential construction recovering

After several years of steady decline there are signs that the construction sector is slowly starting to recover. This trend is mainly being driven by residential construction investment. Higher population growth will put further pressure on output during the forecasting period. We expect total construction investment to recover gradually over the forecasting period.

Swiss companies’ investment activity surged at the beginning of this year despite rising interest rates, high energy costs and geopolitical uncertainty. Leading indicators suggest that this encouraging trend will continue in the near future. KOF therefore expects to see solid growth in equipment investment this year, which should continue – albeit perhaps at a slightly slower pace – in 2024.

The full report on KOF’s economic forecast is available here (in German):
https://kof.ethz.ch/content/dam/ethz/special-interest/dual/kof-dam/documents/Medienmitteilungen/Prognosen/2023/2023_2_Sommer_gesamtbericht_KA.pdf →

Figures and further information on KOF’s economic forecast are available here:
https://kof.ethz.ch/prognosen-indikatoren/prognosen/kof-konjunkturprognosen.html

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