ETH zürich KOF

Press Release

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KOF Economic Forecast, Winter 2016/2017: Slow Recovery in Uncertain Times

Growth dynamics in the Swiss economy remain weak. Private consumption is restrained and the export industry is not regaining its former strength. In 2017, GDP is expected to rise by a modest 1.6%, accompanied by a mediocre employment trend. However, with immigration on the decline, the unemployment rate according to SECO will remain more or less stable at 3.3%. Inflation will turn slightly positive again.

International environment

In the 3rd quarter 2016, the global economy put in a burst of speed. Thanks to a favourable trade balance, the USA expanded at an above-average rate compared to the previous quarters, although non-recurring effects played a substantial role in this development. The European economy continued to recover slowly. Thanks to fiscal stimulation, China managed to largely maintain its growth dynamics. KOF is expecting slightly weaker global dynamics in the 4th quarter 2016. While lower growth contributions are anticipated from the main global regions, the crisis states Brazil and Russia are the only countries expected to continue their gradual recovery. In the subsequent quarters, global economic dynamics are likely to pick up slightly.

Donald Trump's election as US President is affecting the global economic outlook – primarily by increasing forecast uncertainty. At present, it is unclear to what extent Trump will, or wants to, implement his election promises of fiscal impetus through infrastructure programmes and tax cuts as well as increased protectionism. Although KOF cannot forecast the political action that will be taken in the USA, we are taking account of the new situation by imputing certain fiscal measures. Nevertheless, any direct increase in US import demand resulting from such fiscal measures will be small. In contrast, it is likely that the exchange rate level will have certain effects on the global economy: Fiscal impetus will increase price pressure in the USA from 2018 onwards and the FED will allow interest rates to rise slightly faster than previously assumed. On top of this, KOF assumes that the protectionist leanings of the new US government will have a restraining effect on international trade integration. KOF does, however, not expect an impact on global trade before the medium or longer-term. These aspects notwithstanding, global trade is likely to grow at a relatively slow pace in the forecast period.

Italy currently presents a downside risk for the European economy. In the case of another election, and consequently a referendum on euro area membership as promised by the opposition, uncertainty among investors would rise considerably. If it came to this, the extreme scenario of a banking and public debt crisis could not be excluded.

Swiss economy

Economic activity in Switzerland slowly returned to normal in 2016. While production increased, prices continued to decline until the end of the year due to the 2015 Swiss franc revaluation and the lower oil price. The significant appreciation also emphasised the need for productivity increases, which resulted in a stagnation in the employment of labour that started at the beginning of 2015. In this period, wage rises were weak although the average purchasing power of wages still rose in consequence of the falling prices.

Deflation phase coming to an end

Due to the latest rise in the crude oil price, the period of declining prices is generally coming to an end. Nevertheless, KOF believes that consumer prices will remain low in the short term (2016: -0.4%, 2017: 0.3%), allowing the Swiss National Bank (SNB) to continue its loose monetary policy. With the Swiss franc gaining slightly against the euro in the last few months, KOF has revised its previous technical assumption for the euro from 1.10 to 1.08 and is leaving the exchange rate at this level over the entire forecast period.

Weak investments
Despite ample liquidity, fixed investment in Switzerland is on the weak side and is expected to remain so for the time being. Investment in rail vehicles and aircraft, which also played a domineering role in preceding KOF forecasts, remains the mainstay. Little impetus is expected from the construction industry (2017: 0.9%). Building activities are already at a high level and the increase in transport infrastructure investments is not likely to manifest itself before 2018. Residential construction has reached an unsustainable level, with the increase in housing stocks substantially exceeding the increase in the number of households. Consequently, KOF does not expect any notable growth in the field of residential construction.

Structural change continues
After gaining both in terms of employment and value added throughout the weak franc period in comparison to the rest of the economy, the relevance of the manufacturing sector has been declining since the financial crisis. At present the manufacturing industry accounts for approx. 18% of value added. According to the latest KOF forecast, this share will contract further, with only the pharmaceutical sector remaining in a position to gain further weight. Both the hotel and restaurant industry and the industrial sector are affected by the high exchange rate and are likely to record further losses. Forced structural change is expected to continue and will result in an increase in business and personal services. Growth in the financial services sector will be below average and the construction industry will also lose significance.

Given this consistently difficult environment for the manufacturing sector, KOF expects the trend in goods exports to be on the flat side in the coming quarters, while service exports are likely to rise. All in all, the current forecast anticipates a 2.2% increase in exports in 2017 and 3% growth in 2018. In terms of imports, KOF expects faster growth with imports focussing predominantly on intermediate inputs.

Slower immigration
The conversion into law of the constitutional article on immigration curbs approved in 2014 appears to be following the soft approach. Nevertheless, weaker economic activity and the need for productivity increases are likely to result in lower economic immigration in the coming years than in the past. KOF therefore expects a moderate rise in employment (in full-time equivalents: 0.4% in 2017 and 2018) and no notable change in the unemployment rate. The rate according to the International Labour Organization (ILO) is expected to average 4.6% in 2017, the rate according to the State Secretariat of Economic Affairs (SECO) 3.3%. With a weak wage trend predicted, growth in private consumption will be limited (2017: 0.9%).

No end to low-interest phase in sight
Owing to the weak price trend and revaluation pressure, KOF does not anticipate any change in short-term interest rates in the forecast period, which will thus remain substantially below zero. However, long-term interest is expected to turn positive again in the near future and continue rising at a very slow pace. At the end of 2018, we expect a 0.25% return on 10-year Swiss government bonds.

Given this background, KOF projects a Swiss GDP growth rate of 1.6% in 2017 and 1.9% in 2018.

Find more information about the KOF Forecast on our website:
https://www.kof.ethz.ch/en/forecasts-and-indicators/forecasts/kof-economic-forecast.html →

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