Executive Summary of KOF's Economic Forecast for spring 2021

25 March 2021

This is a summary of the 2021 spring forecast for Switzerland, released by the KOF Swiss Economic Institute at ETH Zurich on 25 March 2021, with a forecast horizon up to the end of 2022.

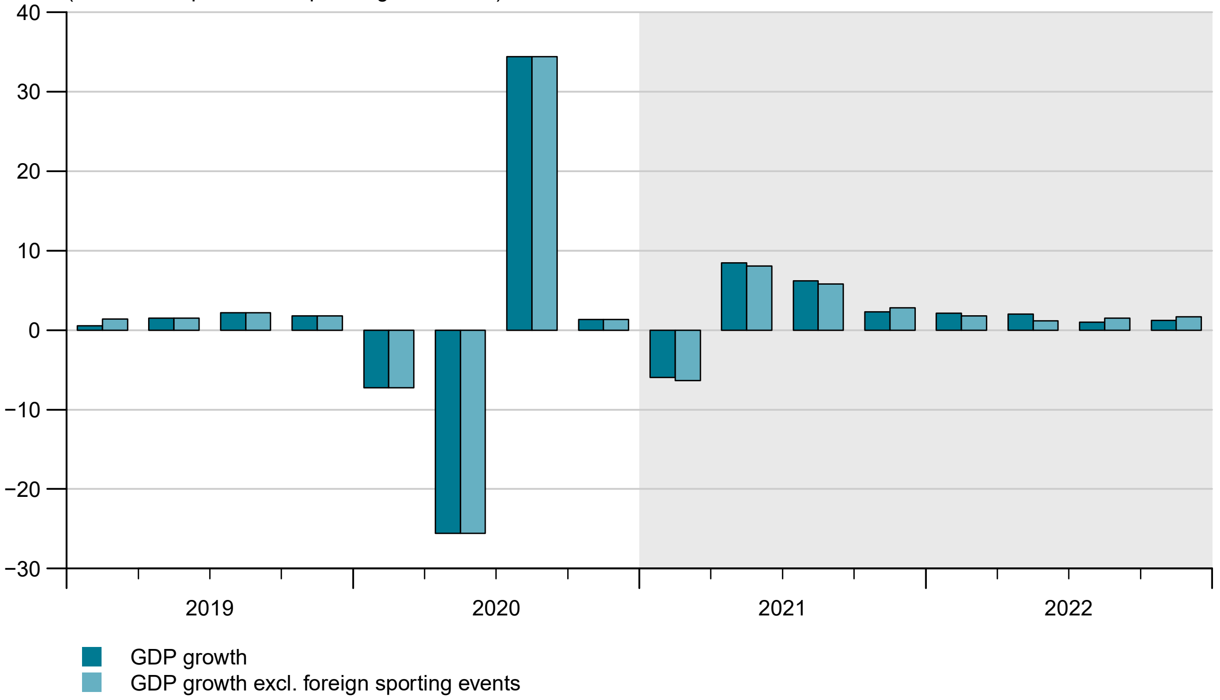
2020 will go down in history as a year of extremes. The COVID-19 pandemic caused an unprecedented slump in the global economy in the first half of 2020, followed by a strong rebound in the third quarter. However, a resurgence in case numbers in the autumn and renewed containment measures halted any further recovery, especially in Europe. The restrictions imposed in many places did not have as strong an impact on the economy as had been the case during the first wave. Nevertheless, coronavirus will continue to set the tone for the economy this year. Having witnessed growth in the fourth quarter of 2020, KOF expects to see a slight downturn in the global economy from a Swiss perspective in the first quarter of 2021. Whereas the stimulus to global gross domestic product (GDP) coming from East Asia and the United States predominated in the fourth quarter, KOF assumes in its baseline scenario that negative growth in the euro area will be the decisive factor in the first quarter. From the second quarter onwards the vaccination campaigns that have been launched in many countries should lead to a reduction in restrictions and – assisted by fiscal stimulus packages – initiate a global economic recovery. In its baseline scenario KOF reckons that global GDP will return to its pre-crisis level in the second half of 2021. There is still a great deal of uncertainty about the further course of the pandemic, which is having an impact on the latest economic forecasts. KOF has therefore presented various scenarios for both the international and Swiss economies.

The second wave of coronavirus halted any further economic recovery in Switzerland at the end of 2020. According to Switzerland's State Secretariat for Economic Affairs (SECO), GDP growth weakened from a non-annualised 7.6 per cent in the third quarter of 2020 to 0.3 per cent in the fourth quarter. The performance of the Swiss economy varied widely from sector to sector. According to SECO, trade grew slightly in the fourth quarter of 2020. In its winter forecast KOF continued to expect negative growth. There was also an increase in gross value added in parts of industry as well as in finance and insurance. Interestingly, the growth stimulus to industry this time came not from the chemical and pharmaceutical industries – which, as expected, contracted in the second half of 2020 – but from the remaining areas of industry, such as energy and water supply. In contrast to these sectors of the economy, the industries hit hard by non-pharmaceutical measures suffered losses once again. The hospitality sector in particular was massively affected by the restrictions imposed on opening hours and the numbers of customers permitted.

After Switzerland's case numbers had stagnated at a high level at the beginning of the year, the country's Federal Council decided on 13 January to extend and tighten the restrictions introduced in December. The reasons given included the further spread of new and more infectious virus variants. Among the most economically relevant measures introduced on 18 January was the closure of non-essential shops. The closure of restaurants, cultural establishments, sports and recreational facilities introduced at the end of December was extended for another five weeks. Since 1 March, shops, museums, zoos and sports facilities have been allowed to reopen under certain conditions as part of an initial, cautious steps towards relaxation. The Federal Council has stated that, in order to be able to ease restrictions further, the guidelines for four criteria must be met. At the time of the forecast (on 19 March), three of the four criteria revealed values above the benchmark set by the Federal Council. KOF's baseline scenario assumes that the restrictions will be eased in several small stages from mid-April so that the non-pharmaceutical interventions are at the summer 2020 level in mid-June. It is assumed that, although the number of cases will increase, there will be no capacity overload of the health care system and therefore no further containment measures will be required.

The restrictions imposed at the end of December and tightened in January did not leave the economy unscathed. KOF's baseline scenario forecasts that GDP will decline in the first quarter. In addition to retail and transport, the hospitality sector is likely to be hit particularly hard again. However, industrial companies are proving more resilient to the non-pharmaceutical measures and will even be able to increase their output in the first quarter. KOF expects the overall economy to recover from the second quarter onwards. This should also boost the labour market and increase employment. KOF expects GDP to grow by 3.0 per cent this year. It is thus revising upwards its forecast update from February 2021 by 0.9 percentage points. This forecast revision is partly based on the fact that the Swiss and international economies proved to be more resilient than expected in the fourth quarter of 2020. KOF has also adopted a much more positive assessment of the global economy. In addition, the February forecast update was still assuming that the agreed non-pharmaceutical interventions would not be eased before the end of March, which proved to be overly pessimistic. The strongest growth stimulus will come from industry, the public sector and consumer-related services, whereas the retail, communication, transport and hospitality sectors will hardly contribute to GDP growth at all in 2021. KOF expects GDP to rise by 2.8 per cent next year, which represents a downward revision of 0.8 percentage points. The baseline scenario predicts that Swiss GDP will return to its pre-crisis level as early as mid-2021.

Real GDP with Forecast
(annualised quarter−on−quarter growth, in %)



As with the performance of gross value added, the impact of the COVID-19 pandemic on the labour market has been mixed. In the fourth quarter of 2020 there was a massive year-on-year fall in employment in hotels and restaurants as well as other business services. However, this decline was virtually offset by strong employment growth in government-related sectors over the same period. Overall, total employment at the end of 2020 was thus only slightly lower year on year, which is disproportionate to the decline in GDP over the same period. However, the labour market has been hit much harder than the aggregate employment figures suggest. Supported by short-time working, many companies have been able to reduce their volume of work without having to announce lay-offs. Consequently, the reduction in actual working hours has been at least as large as the decline in gross value added. Many workers have therefore been affected by the COVID-19 crisis in the form of a massive reduction in their working hours. Because they account for a large proportion of the sectors with enormous employment losses, younger workers have suffered particularly from the consequences of the pandemic. KOF expects to see a modest decline in total employment in the first quarter of the current year. Catch-up effects are not expected to materialise until the second quarter owing to the easing of restrictions, which should appear in the employment figures from the second half of the year onwards. Nevertheless, uncertainty about how the pandemic will evolve up to the end of 2021 is preventing companies from creating significant numbers of jobs. KOF expects to see moderate employment growth in 2022.

Government consumption supporting the economy; foreign trade also gaining momentum

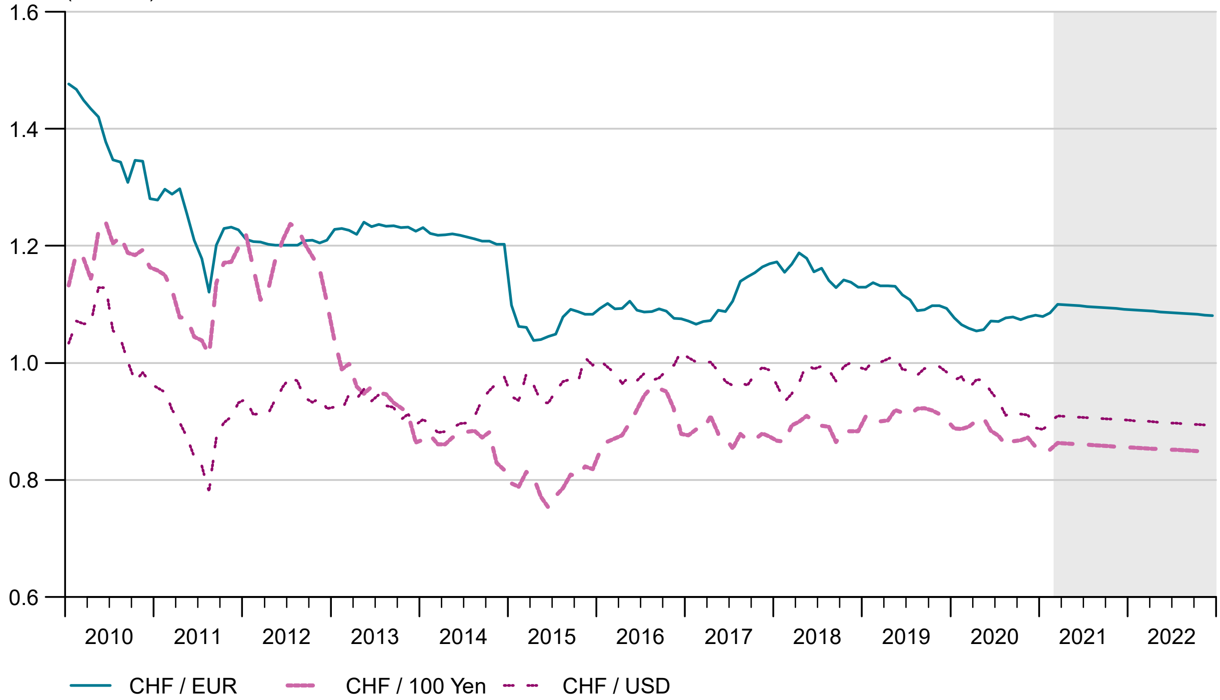
The pandemic also impacted on aspects of consumption last year. After falling sharply in the spring of 2020, private consumption staged an unprecedented recovery in the third quarter. At the end of the year, however, it was slowed by the second wave of infections. Private consumption remains in a weakened state at the beginning of this year. Only from the second quarter onwards will consumption start to pick up again, exceeding its pre-crisis levels by the end of 2021. Government consumption supported the economy last year and will remain high this year too owing to its additional pandemic-related spending, thus making a positive contribution to growth. Next year, however, government consumption is expected to decline again. After experiencing sharp, pandemic-related volatility last year, equipment investment is likely to receive a boost again in the current year. Although the restrictions and uncertainty about how the pandemic will evolve in the first half of the current year are still hampering firms' investment activity, investment in equipment is likely to grow again from the second half of the year onwards. This moderate increase will continue next year. Foreign trade also had a turbulent 2020. After falling sharply in the second quarter, the international trade in goods gained considerable momentum in the third quarter and had returned to its pre-crisis levels by the end of 2020. Swiss exporters should benefit from the international economic upswing this year and next. KOF therefore expects Swiss foreign trade in goods to grow robustly again. In services trade, on the other hand, there was no real recovery last year. Tourism and transport services in particular struggled severely with the restrictions on passenger transport introduced to combat the pandemic. Over the course of this year, however, services exports – supported by a global economic upturn – will recover and continue to grow next year as well.

In 2020 the public finances were significantly impacted by the extraordinary expenditure required to support the economy. In addition, there was a slump in revenues owing to the weakness of the economy. This resulted in a general government fiscal deficit equivalent to about 2.3 per cent of GDP. The degree of fiscal expansion is expected to remain high this year. Given the recent exceptional expenditure by the Swiss government and the lower revenue from income and profit tax, a high general government fiscal deficit is again expected. In addition, KOF expects that the federal government's nationwide vaccination and testing strategy will lead to a further increase in government consumption. The debt-to-GDP ratio according to the Maastricht criteria is expected to rise to just over 30 per cent this year, which is roughly equivalent to the level of debt ten years ago. Compared with other countries, however, Switzerland is still in a very good position. According to estimates by the European Commission, the level of debt in Switzerland's neighbouring countries is currently at least twice as high.

Inflation remains low during the forecasting period

After consumer price inflation has remained in negative territory since February of last year, it will turn positive over the coming months. In the first few months of this year inflation was again higher than in previous months, which is largely due to the lower decline in import prices compared with last year. In recent months the prices of petroleum products have risen again on the global market towards pre-crisis levels. This will cause the rate of inflation to return to positive territory over the coming months. For the time being, the prices of tourist goods will remain under pressure and will not recover significantly until the second half of the year. Overall, underutilised capacities and slow nominal wage growth will continue to keep inflation low. KOF's inflation forecast has been revised upwards owing to the higher oil price, the slightly weaker Swiss franc exchange rate and a slightly better assessment of the economic situation. KOF expects to see average inflation of 0.3 per cent this year and 0.4 per cent next year.

Exchange rates, with forecasts
(nominal)



Alternative scenarios for the economy

Due to the great uncertainty regarding the course of the pandemic and political decisions, the KOF describes three further alternative scenarios in addition to the basic scenario. The scenarios assume less favourable and more positive developments of the pandemic. The effects of international downside risks on the Swiss economy are analysed separately from possible domestic developments of the pandemic and policy decisions.

For the international downside scenario, fiscal multipliers that are lower than in the baseline scenario pose a downside risk. This could lead to a situation where the fiscal stimulus already decided does not sufficiently reach the economy. As a result, the recovery on the labour market would be weaker than assumed. The resulting hysteresis would in turn influence short- and medium-term economic development via feedback effects. In the international negative scenario, KOF therefore expects global GDP to stagnate in the first half of 2021. From the third quarter onwards, a recovery will set in, but this will be very sluggish due to the hysteresis effects mentioned above. As a result, global GDP is not expected to return to its pre-crisis level until the end of 2022. A less favourable course of the international economy will also have an impact on the Swiss economy. It is expected that export-oriented industry in particular will be hit particularly hard. Compared to the baseline scenario, the international hysteresis effects leave a longer-lasting mark on the Swiss economy. However, the trade, transport and hospitality sectors as well as the state and consumer-related services are hardly affected. For this year, KOF expects GDP growth of 2.4 per cent in this negative scenario. This results in a loss of value added of CHF 4.2 billion compared to the baseline scenario. In the next year, GDP growth is likely to remain below the assumed growth of the baseline scenario, which will lead to additional costs of CHF 7.4 billion.

In the Swiss alternative scenarios, the focus is on pandemic events within Switzerland. It is assumed that the course of the international environment will be similar to that of the baseline scenario. For the Swiss positive scenario, the non-pharmaceutical measures are already reduced to the level of summer 2020 in mid-April. It is assumed that the infection figures will increase, but that further containment measures will not be necessary. Faster vaccination coverage than assumed in the baseline scenario could be one reason for this. The sectors that benefit most from the easing are arts, entertainment and recreation, transport and storage, and the hospitality industry. Especially in the second quarter, the Swiss economy is growing more strongly as a result than in the baseline scenario. For the current year, KOF expects GDP growth of 3.1 per cent in this positive scenario, which corresponds to a gain in value added of CHF 0.9 billion. For 2022, GDP growth of 2.7 per cent is expected.

In the Swiss negative scenario, the incidence of infections rises so sharply compared to the baseline scenario that, without renewed measures, the health system will be overburdened. This can be attributed to a combination of rapid relaxations and a rapid spread of the more infectious viral mutations. It is assumed that the relaxations enforced from mid-April will be withdrawn for six weeks from June. Subsequently, the containment measures can be relaxed comparatively quickly due to the progress of vaccination in this scenario. The repeated increase in restrictions leads to losses in value added, particularly in the hotel and restaurant industry, in the arts, entertainment and recreation sector and in transport, which amount to CHF 2.2 billion compared to the baseline scenario. For the Swiss economy, this means an annual growth rate of 2.7 per cent for 2021. Assuming that no lasting economic damage occurs despite the renewed interventions through support measures, GDP growth in the coming year should be 3.1 per cent.

Forecasting risks

The performance of the economy going forward will be strongly influenced by the progress of the COVID-19 pandemic, which is the greatest source of risk for the forecast. Some of these risks are described in the pandemic scenarios mentioned above. However, there are other risks that have not been quantified in these scenarios. In addition to the scenarios described above, renewed restrictions could cause many companies' financial cushion to be depleted in the coming months. This would lead to a wave of bankruptcies, which could have short- and medium-term effects on the economy. A new virus variant that is even more contagious than the viruses known in the past poses a further risk. Such a variant could require even more restrictive measures than before and have greater adverse effects on the economy. But there are also upside risks. Firstly, vaccine production and distribution could be more efficient than expected. This would allow more people to be vaccinated more quickly, which would enable restrictions to be eased sooner and could lead to higher GDP growth. And, secondly, the surge in consumption resulting from the exploitation of pent-up purchasing power could be stronger than expected and thus stimulate the economy more effectively.

Further information on the KOF Economic Forecast can be found here:
https://www.kof.ethz.ch/en/forecasts-and-indicators/forecasts/kof-economic-forecast.html →