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Recent Economic Developments in Switzerland,  
April - August 1963

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Recent Economic Developments in Switzerland--April to August 1963

Summary

Credit conditions tightened and interest rates rose in Swiss financial markets during the period April to August. The banks had increasing difficulties in satisfying a growing demand for longer-term credit because Swiss National Bank regulations kept the interest rate on deposit certificates--a traditional important source of medium-term bank funds--at a level investors considered unattractive. Bond yields rose from 3.10 per cent in May to 3.22 per cent at the end of August. In August, the Swiss National Bank gave the banks permission to raise their rates on deposit certificates by 1/4 of 1 per cent to 3.75 per cent; but this permission was tied to the stipulation that the banks would not raise their interest charges on old mortgages for one year.

Swiss economic activity continued at a high level, in almost every area seasonally higher than in the first quarter. There were further signs, however, that the peak of the boom had passed.<sup>1/</sup> Consumer demand continued to be the chief expansionary force but retail sales in the second quarter grew at only half the rate of last year. Also, business investment expanded more slowly than in the peak boom period. Finally, new orders for industry--especially orders for capital goods--slacked off and completions of new industrial building projects rose only 2 per cent above completions a year ago.

The labor market remained tight. In July registered job vacancies increased and the labor market appeared quite as tight as earlier. Wages advanced considerably and prices continued to rise at approximately the same rate as in the

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<sup>1/</sup> Earlier evidence of a slowing down in the boom was discussed in "Economic Developments in Switzerland: January-May 1963" (July 2, 1963).

recent past.

In view of the prospect of easing economic conditions, the Swiss authorities took no additional measures to restrict economic expansion.

In mid-July, after announcement of U. S. measures to reduce its payments deficit and the U. S. decision to make a technical drawing from the IMF, the Swiss franc rose sharply in the foreign exchange market. The exemption of Canadian securities from the proposed interest equalization tax and the disclosure of the large second-quarter U. S. payments deficit increased the nervousness of the foreign exchange market in August and the rate for the Swiss franc rose steadily to a level just below its ceiling of 23.175 cents at the end of August.

#### Domestic credit conditions tighten

Credit conditions tightened in Swiss financial markets during the second quarter, as the banks found that increasing demand for longer-term credits for the financing of exports, building construction and the replenishing of inventories exceeded funds available for medium-term lending. Short-term funds, available in abundance from foreign capital inflows, could not (under Swiss banking practice) be used to satisfy the demand for longer-term credit.

Traditionally, the Swiss banks have relied for long-term funds on the issue of deposit certificates (Kassenobligation) with an average maturity of five years. Of late, however, investors have considerably reduced purchases of these certificates because the 3-1/2 per cent yield on such paper was considered unattractive. The Swiss National Bank was reluctant to allow the big commercial banks to increase the interest rate on these instruments because such an action would lead to an increase in mortgage rates and, thereby, to higher costs and prices. Banks were consequently forced to seek funds elsewhere; it was for this reason the Union Bank of Switzerland, one of the five large commercial banks, floated a SF 100 million

loan at 3-3/4 per cent on the Swiss bond market in July.

Finally, in August, the Swiss National Bank gave the banks permission to raise their interest rates on deposit certificates by one-fourth of a per cent to 3.75 per cent on the condition that the banks agree not to raise the interest charges on old mortgages for one year.

There is some question as to how effective the increased interest rate will be in enabling the banks to raise longer-term funds. The small (cantonal and local) banks as well as mortgage banks have been offering deposit certificates at 3.75 per cent for several months, and they report difficulties in marketing them even at the higher rate of interest. There is also the possibility that the small banks will now again raise the rate on their certificates because they traditionally pay 1/4 of 1 per cent more than do the large banks. In any case, it is widely assumed in financial circles that this represents the first step in a general rise in Swiss interest rates.

#### Pace of business expansion slowing down

There was further evidence in the second quarter that the Swiss boom had passed its peak and that economic activity, while at a high level, was advancing less rapidly. A seasonal upswing caused activity in most branches of the economy to register considerable gains over the rather depressed first quarter results, especially in building construction and related trades and in foreign trade. However, in many cases the year-to-year rate of increase was below that registered in previous quarters.

Consumer demand continued to be the chief expansionary force in the Swiss economy. Retail sales in the second quarter were 7 per cent higher than one year ago, and the lively increase in imports during the second quarter was very much a response to, and an indication of, continued strong consumer demand. On a year-to-year basis the rate of increase in retail sales declined gradually during the past year from 14 per cent in the second quarter of 1962 to only half that in the same quarter this year.

Exports increased markedly during the second quarter as deliveries were made on the large backlog of foreign orders. However, new foreign orders have shown a tendency to decline slightly. Furthermore, the Commission for Business Cycle Studies stated recently that a somewhat more cautious investment attitude appeared to have developed among Swiss businessmen, reflecting their less favorable expectations about European business prospects. Generally speaking, industrial investment is currently expanding more slowly than it did in the peak boom period. The placement of new orders with industry--especially the capital goods industries--has slackened off.

Second-quarter completions of industrial building projects were 2 per cent higher than a year earlier, as compared with a 6 per cent year-to-year rise in the 1962 second quarter. The completion of new residential dwellings in the second quarter was seasonally higher than in the first quarter. But from January to July 1963, only 11,321 new housing units were completed, as compared with 12,525 in the corresponding period of last year. Newly issued construction permits also were lower.

A moderating effect was exerted on the economy by the continuing decline in tourist trade attributed to lingering doubts generated by the Zermatt typhoid discovery. Swiss business travel also was reduced.

In view of the lessened pressures, the Swiss authorities took no new restrictive measures during the period under review. The "hot money" agreement in August between the Swiss National Bank and the commercial banks was renewed but its conditions were made slightly more moderate in that the annual charge of 1 per cent on foreign funds deposited in Switzerland for less than 6 months was rescinded. As before, however, the banks undertook to pay no interest on new foreign deposits of Swiss francs, and to abstain from purchasing Swiss securities, real estate, or mortgages for foreign account. In nearly all instances, also, foreign deposits remain subject to 3 months' withdrawal notice.

#### Tightness of labor market heightened by seasonal upswing

The Swiss labor market has continued to be very tight. Employers sought additional labor as economic activity increased seasonally in the second quarter, and

in July the number of registered job vacancies rose sharply. Prior to July there were some signs of a slight easing of the labor situation: since the second quarter of 1962, the number of employers registering a lack of skilled labor had decreased a little in each quarter. But this situation may have been reversed in July as labor demands were intensified. (See Table 1.) The number of new foreign workers declined slightly in the first half of 1963 from the same period last year. (See Table 2.) However, this probably reflects more the quotas imposed in March upon the importation of additional foreign workers as well as the effects of the severe winter, than a slackening of economic activity.

The continued tightness of the Swiss labor market gave added strength to the upward movement of wage rates in industry and construction, which rose faster in the second quarter this year than they had in the same quarter of 1962. (See Table 3.) The most important wage increases were won by workers in the watch, metal and machinery, wool, and clothing industries. The Zurich plasterers' strike, which was regarded as a test case for the 40-hour work week, was settled in July after a duration of more than 2 months. The compromise settlement provided an increase in the minimum hourly wage with an additional raise to become effective on January 1, 1964. Employers and employees agreed to accept arbitration by the Cantonal Mediation Office on the question of a reduction in the work week.

#### Prices continue to rise

There was further upward pressure on prices during the second quarter. The consumer price index rose 1 per cent, the same rate as during the previous quarter, to a level of 3.6 per cent above the second quarter of 1962, largely because of an increase in the average level of rents at the end of May and of increased prices for fuel and heating materials. (See Table 4.)

There was virtually no change in the wholesale price index from the first to the second quarter. Wholesale prices of domestically-produced goods dropped noticeably in June--only partly due to seasonal factors--but prices of imported products increased. The average level of the wholesale price index in the second quarter was 3.6 per cent higher than a year ago.

Table 1. Switzerland: Labor Market Conditions  
(seasonally adjusted, calendar months, in thousands)

	<u>Unemployment</u>	<u>Registered Job Vacancies</u>
1962 April	0.5	5.9
May	0.5	5.9
June	0.5	6.0
July	0.6	6.5
1963 January	1.3	5.1
February	1.2	5.2
March	0.6	5.4
April	0.5	5.6
May	0.5	5.9
June	0.5	6.1
July	0.5	6.7

Source: OECD

Table 2. Switzerland: Foreign Workers Granted First Visas  
(in thousands)

	<u>1962</u> <u>2. Quarter</u>	<u>1963</u> <u>2. Quarter</u>	<u>Absolute</u> <u>Change</u>
Seasonal workers	84.5	92.1	+7.6
Non-seasonal workers	48.3	42.0	-6.3
Border workers	11.6	12.7	+1.1
Total 2. Quarter	144.4	146.8	+2.4
Total 1. Quarter	138.3	125.9	-12.4
Total Jan.-June <u>1/</u>	282.6	272.7	-9.9

1/ Totals may not add because of rounding.

Source: Mitteilung No. 161 der Kommission für Konjunkturbeobachtung.

Table 3. Switzerland: Wage Rates in Industry and Construction

		<u>Percentage change over the previous quarter</u>	<u>IV 1960 = 100</u>
1961	I	+1.4	101.4
	II	+0.9	102.3
	III	+0.9	103.2
	IV	+1.4	104.6
1962	I	+2.6	107.3
	II	+1.0	108.4
	III	+1.1	109.6
	IV	+0.7	110.4
1963	I	+2.8	113.5
	II	+1.4	115.1

Source: Mitteilung No. 161 der Kommission für Konjunkturbeobachtung.

Table 4. Switzerland: Price Indices  
(August 1939 = 100; month or monthly averages)

		<u>Consumer Price Index</u>	<u>Wholesale Price Index</u>		
			<u>Total</u>	<u>Domestic</u>	<u>Foreign</u>
1961		187	215	213	217
1962	I	192	219	219	219
	II	194	222	222	221
	III	196	223	226	218
	IV	197	225	227	222
1963	January	198	230	230	229
	February	199	229	231	227
	March	199	230	231	229
	April	200	231	231	230
	May	201	233	233	232
	June	201	230	229	232

Source: Swiss National Bank Monatsbericht.



Foreign trade deficit increases as trade expands rapidly

In contrast to the results of the first quarter, both imports and exports (seasonally-adjusted) exhibited a lively upward tendency in the second quarter. Because imports expanded at a faster rate (10 per cent) over the previous quarter than did exports (8 per cent), the Swiss trade deficit widened from \$55 million in the first quarter to \$66 million in the second on a seasonally adjusted basis. (See Table 5.)

The growth of imports can be attributed to the upward trend of consumption in Switzerland and to milder weather. Particularly large increases occurred in imports of raw materials, especially fuels, heating materials, sugar, paper and pulp as merchants replenished stocks which had been depleted in the first quarter by both heavy consumption and transportation difficulties caused by the harsh winter.

The pick-up in exports reflected the large backlog of foreign orders on the books of Swiss industry. Almost all Swiss export industries reported gains for the second quarter, the greatest gains being made by the machinery, watch, and textile industries.

International reserves affected by special transactions in second quarter; considerable gain in August

International reserves of the Swiss National Bank were affected in June and July by the execution and reversal of three-way swaps among the BIS, the Swiss National Bank and the large Swiss commercial banks totalling about \$80 million; these swaps enabled the banks to indulge in their usual mid-year "window-dressing" without putting undue pressure on the U. S. dollar in the foreign exchange market.<sup>1/</sup> After adjustment for the swap transactions, there was an apparent reserve loss of \$6 million between the end of May and the end of July. (See Table 6.)

Reserves rose \$25 million in August: gold holdings increased \$7 million and foreign exchange holdings \$18 million. The rise in foreign exchange holdings reflects the central bank's intervention on the foreign exchange market in support of the dollar, especially during the first half of August. In addition, during

<sup>1/</sup> See "Recent Economic Developments in Switzerland, January-May, 1963," dated July 2, 1963.

Table 5. Swiss Foreign Trade: 1962 - July 1963  
(seasonally adjusted, monthly average or month, in millions of U.S. dollars)

	<u>Imports c.i.f.</u>	<u>Exports f.o.b.</u>	<u>Trade balance</u>
1962 I	250	181	-69
II	244	186	-58
III	256	186	-70
IV	251	187	-64
1963 I	247	192	-55
II	271	205	-66
January	240	186	-54
February	243	194	-49
March	260	197	-63
April	273	197	-76
May	281	208	-73
June	259	212	-47
July	291	195	-96

Source: OECD.

Table 6. Switzerland: Official Reserves  
(end of period figures, in millions of U.S. dollars)

<u>Date</u>	<u>Gold</u>	<u>Foreign Exchange</u>	<u>Total</u>	<u>Change</u>	<u>% of Reserves held in Gold</u>
1962 I	2444	164	2608	-151	94%
II	2409	297	2705	+ 97	89%
III	2453	176	2629	- 76	93%
IV	2667	205	2872	+243	93%
1963 I	2461	177	2638	-234	93%
II	2530	178	2708	+ 70	93%
April	2453	179	2632	- 6	--
May	2453	177	2630	- 2	93%
June	2530	178	2708	+ 78	93%
July	2444	180	2624	- 84	93%
August	2451	198	2649	+ 25	93%

Source: International Financial Statistics; Swiss National Bank.

August the BNS swapped francs for dollars with Swiss commercial banks in order to provide banks with more liquid funds in domestic currency. These operations also have added to the BNS's foreign exchange holdings in August.

Exchange rate nears ceiling as dollar comes under selling pressure

Early in July, the Swiss franc was in moderate demand on foreign exchange markets and the rate remained around 23.120 U. S. cents in the first two weeks of the month. (See Table 7.) But, in the third week of July, the rate jumped to 23.134 cents as the demand for Swiss francs strengthened in nervous reaction to President Kennedy's announcement of the proposed measures to combat the U. S. payments deficit. Uncertainty in foreign exchange circles as to the effects of the proposed interest equalization tax set off the initial movement out of dollars into francs, and nervousness increased with the announcement that Canadian securities would be exempt from the tax. The rate for the franc rose to 23.147 cents by the end of July.

The tightness of the Swiss money market and the difficulties of the banks in meeting domestic franc requirements also served to keep the U. S. dollar under pressure. Toward the end of July, the Swiss National Bank freed \$35 million equivalent of commercial bank balances which had been blocked since March 1961, and there was a temporary easing of the exchange rate.

But the dollar quotation on the franc climbed further during August. In the first week of August the BNS entered into dollar-franc swaps with commercial banks, thereby allowing the banks to bolster their franc position without selling dollar assets. The main source of pressure, however, reportedly came from a movement out of dollars into Swiss francs by non-Europeans. The dollar continued to weaken against the franc during the rest of August and the franc stood close to

Table 7. Foreign Exchange Rate for the Swiss Franc <sup>1/</sup>  
(in U.S. cents per Swiss franc)

	Par Value	22.868		
	Lower Limit	22.472		
	Upper Limit <sup>2/</sup>	23.175		
<u>Month</u>	<u>Monthly Average</u>	<u>Week Ending</u>	<u>End of Week</u>	
1962	October	23.139	July 5	23.120
	November	23.170	12	23.117
	December	23.167	19	23.134
			26	23.147
1963	January	23.120	August 2	23.158
	February	23.123	9	23.165
	March	23.102	16	23.168
	April	23.099	23	23.170
	May	23.127	30	23.170
	June	23.125	September 6	23.171
	July	23.129		
	August	23.164		

<sup>1/</sup> Noon buying rate.

<sup>2/</sup> Recent upper limit imposed by the BNS in the Swiss market; however, the Swiss authorities are not committed to hold the rate below 23.283.

Source: Federal Reserve Board.

Table 8. Switzerland: Balance of Payments on Current Account  
(in millions of SF)

<u>Years</u>	<u>Imports</u>	<u>Exports</u>	<u>Trade Balance</u>	<u>Tourism</u>	<u>Investment Income</u>	<u>Other Items</u>	<u>Balance on Current Account</u>
1955	6401	5622	- 779	580	515	346	662
1956	7597	6203	-1394	635	580	304	125
1957	8447	6714	-1733	735	580	223	-195
1958	7335	6649	- 686	770	555	321	960
1959	8268	7274	- 994	845	605	302	758
1960	9648	8131	-1517	940	680	306	409
1961	11644	8822	-2822	1080	710	118	-914
1962	12986	9580	-3406	1210	785	-52	-1463

Source: Mitteilung No. 160 der Kommission für Konjunkturbeobachtung.

the ceiling of 23.175 cents at the end of the month. The announcement of the unexpectedly large second quarter U.S. balance of payments deficit probably strengthened speculative sentiment against the dollar. The dollar exchange rate did not improve in the first week of September.

Current account balance of payments deficit larger in 1962

The Swiss current account deficit rose to SF 1,463 million (\$340 million) in 1962 from SF 914 million (\$213 million) in 1961. (See Table 8.) The deficit in the trade account widened in absolute terms, even though it rose proportionately less than the year before as imports grew more slowly and exports maintained practically the same rate of growth as they had in 1961. Net receipts increased from tourism, returns on Swiss investment abroad, payments to international organizations in Switzerland, and exports of electricity and licenses. However these gains were more than offset by an increase in the amount of foreign workers' pay remitted abroad and by increased imports of electric power.