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Recent Economic Developments in Switzerland
December 1965-May 1966

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Summary

Some slight strengthening of expansionary pressures in the Swiss economy seems to have occurred during the period under review but the general trend is still toward a levelling off in the over-all growth rate.[1/] New permits for residential construction issued in the first quarter (1966) were higher than in any quarter since January-March 1964, when there was a spurt in the demand for permits in anticipation of the controls the government later clamped on building. Public spending is exerting an expansionary influence not only in the form of rapidly mounting subsidy payments but through sharply increased Federal investment outlays. Federal investment expenditures alone will increase at a minimum 14 per cent from last year's appropriations, and local governments are continuing to boost outlays in an effort to catch up on public services which have lagged recently. Consumer demand is also still robust although somewhat more moderate than earlier in the boom. Retail sales in the first quarter increased at about the same rate as during the first quarter of 1965. However, investment demand has been hard hit by the shortage of labor.

1/ For the previous review of Swiss economic developments see "Economic Developments in Switzerland, June-November 1965," dated December 3, 1965.

The effectiveness of the government's anti-inflationary measures is also being blunted by increasing foreign demand, which is taking up much of the slack created by reduced domestic demand. Shipments abroad (on a seasonally adjusted basis) in the first quarter increased from the fourth quarter 1965 at an annual rate of around 12 to 13 per cent. Foreign purchases of watches, machinery and equipment--both electrical and non-electrical--and certain chemicals and pharmaceuticals were especially strong.

Continuation of monetary restraint measures, higher interest rates and further reduction in the number of foreign workers should moderate the expansion of internal demand this year although recently increased buoyancy indicates a levelling off rather than any over-all reduction. In fact, the virtual halt in the expansion of the labor force seems to have more effectively discouraged businessmen from new investment in plant and other capacity-expanding expenditures than the governmental embargo on non-essential building. The volume of new construction undertaken by commercial and industrial enterprises in 1965 was actually below the previous year's level and is continuing to stagnate again this year. By far the major share of new investment is going into spending on new equipment to help increase output with existing plant capacity and labor force. This has relieved conditions in the construction industry and made additional resources available for residential building where a shortage continues.

In some sectors of the economy demand seems to be pushing against supply ceilings, and there is not very much cushion available in the economy as a whole against unforeseeable pressures. However, in certain selected areas there are signs of an easing demand for labor. The reduction in the foreign labor contingent has been greater in some industries than was required by law. There is a general tendency toward a shorter work week and less overtime, although recently the amount of overtime worked in some industries has stabilized at a high level. Also, in certain consumer goods industries like textiles there are indications of declining employment.

Prices and wages accelerated their upward trend in the period under review. The consumer price index rose over 1 per cent in each the fourth and first quarters and at the end of March it was 5.4 per cent above the year-earlier level. Much of the most recent pressure on retail prices has come from higher food prices, sharp upward adjustments in the price of oil and rates for electricity and higher labor costs which have raised the prices of services. Wholesale prices also rose sharply in the six months from the end of September 1965. After over a year of stability, the wholesale price index registered quarter-to-quarter gains of 1 per cent in the fourth quarter of 1965 and almost 2 per cent in the first quarter. Higher raw material prices abroad and higher prices on food and agricultural items at home were to blame. In addition, higher wage costs were reflected in increased prices for certain processed items at the wholesale level.

The annual survey of wages and salaries conducted last October (the results were only recently made available) showed that wage rates for hourly workers had increased 7.5 per cent over the year-earlier level and that salaried employees had realized a 6.9 per cent gain. In each case, the increase was only very slightly below that in 1964.

Monetary conditions remain moderately tight: the authorities maintained their restrictions on bank credit, the inflow of foreign funds and the flotations of new securities. Swiss money market conditions have tightened throughout the spring as higher rates in the Euro-currency market drew funds away from the domestic market. Also, foreign demand for short-term bank loans increased as credit availability tightened abroad. From its post-year-end low point of 3.81 per cent at the end of February, the Zurich three-month deposit rate climbed to 4.12 per cent by the end of May, its highest level since World War I.

In the long-term capital market, signs of strain began to build up about February. Although the volume of new bond issues has remained strictly limited, an increasing number have not been fully sold upon offer, and underwriting commercial banks have from time to time had to acquire them to clear the market. There is evidence that funds are being increasingly attracted to the high-yielding international issues. Although intervention by the Swiss National Bank in the secondary market has kept yields just below 4 per cent until recently, many observers believe that it is only a matter of time until the authorities will have to allow the rate to move up in line with increasing rates in foreign markets.

In the foreign exchange market, the Swiss franc edged lower from January through April, reflecting primarily a larger than usual outflow of funds into foreign financial markets. But it has been back at its ceiling against the U.S. dollar since mid-April. Swiss National Bank reserves of gold and foreign exchange declined $454 million in the January-April period, somewhat more than the usual seasonal pattern, but in May gained $80 million.

Due to continuing fine export performance, Switzerland's foreign trade deficit in the first four months of this year was down to $192 million (on a seasonally adjusted basis), compared with $235 million in the last four months of 1965. Exports increased at an annual rate of between 12 and 13 per cent while imports held virtually stable.

Economic activity intensifies during winter months

The general trend in the Swiss economy is still toward moderation of excessive demand pressures. However, during the period under review, there was a slight increase in both foreign and domestic demand pressures and intensification of economic activity.

Growing export demand continued to blunt the effect of the government's anti-inflationary measures. Shipments to foreign purchasers (on a seasonally-adjusted basis) in the first quarter increased at an annual rate of between 12 and 13 per cent from fourth quarter 1965. Foreign purchases of watches, machinery and equipment, certain chemicals and pharmaceuticals were particularly strong.

Next to export demand, public demand continues to be the most expansive part of the internal demand picture in Switzerland. During January-March 1966, Federal expenditures increased over 28 per cent from the same quarter of 1965. During the year as a whole, Federal Government expenditures are expected to increase between 15 and 20 per cent from 1965. A strong increase in spending at the cantonal and city government level is also underway.

A greater demand for housing is evident in the larger number of residential building permits that are being issued. In the first quarter of this year, more permits for residential construction were issued than in any quarter since the first quarter of 1964, when builders rushed to obtain permits in anticipation of the expected restrictions that were eventually placed on construction activity.

On the other hand, investment demand has been hard hit by the shortage of labor. In 1965 new commercial and industrial construction was actually below the previous year's level, and indications are that it is continuing to stagnate. The reduction of the foreign labor contingent in the country has led businessmen to eliminate most of their investment plans that require any additional labor. By far the major share of new investment is going into new equipment in an attempt to increase output with existing plant capacity. This reduction in commercial and industrial building is expected to reduce the total output of the building industry about 4 per cent this year below the output in 1965.

Domestic consumption has also been more moderately buoyant. From January to March, year-to-year gains in retail sales averaged 6.3 per cent, compared with a 6.7 per cent gain in the same period of 1965. The final figures will very likely show that the gains in spring sales this year were equally as good as in 1965.

On the output side, increased demand has led to intensified activity although the growth rate of industrial production was lower than in previous years. In the second and third quarters, industrial output was practically equal to the year-earlier level but rose approximately 3 per cent in the fourth quarter of 1965 on a year-to-year basis. (See Table 1.) Although the data are not yet available for the first quarter of this year, industrial output is expected again to show some increase in its rate of upswing. However, most of the intensified activity has been concentrated in the watch and machinery industries, where output is responding almost entirely to foreign rather than domestic demand.

Table 1. Switzerland: Industrial Production
(1958=100)

	I	II	III	IV
1963	130	143	142	149
1964	139	152	147	155
1965	144	152	152	160

Source: Banque Nationale Suisse, Bulletin mensuel.

Prices accelerate upward trend

Although the government's disinflationary program has moderated the buoyancy in the Swiss economy, it has had very little effect on the sharply rising trend in prices. Both consumer and wholesale prices accelerated their upward trend during the winter and early spring months.

The consumer price index published by the Swiss National Bank posted a 1 per cent gain over previous quarters in each the fourth and the first quarters; at the end of April it was over 5 per cent above the year-earlier level. (See Table 2.) Part of this increased cost-of-living can be attributed to temporary or seasonal factors, such as the rise in food prices; between the end of September 1965 and the end of March this year, the food price index rose almost 4 per cent, mainly due to seasonal reduction in domestic supplies of food, reduced import supplies, and price increases granted by the government in order to subsidize domestic agriculture. During the same period, the prices of heating oil and electricity increased a little over 3.5 per cent. Prices of labor-intensive products such as clothing and services also registered large increases, reflecting the increased cost of labor. However, there has been some easing in the housing and apartment market so that pressures for higher rents are more moderate than they were six months ago.

Wholesale prices spurted sharply in the six months from the end of September 1965, after more than a year of relative stability. (See Table 2.) The recently revised wholesale price index published by the Swiss National Bank showed quarter-to-quarter gains of 1 per cent in

Table 2. Switzerland: Price Indices
(month or monthly average)

		Consumer Price Index (Aug. 1939=100)	Wholesale Price Index (1963=100) Total	Domestic	Foreign
1963					
	Year	202	100	100	100
1964					
	Year	208	102	102	102
1965					
	I	210.5	102.1	102.5	101.1
	II	213.3	102.3	102.5	101.8
	III	216.2	101.9	102.3	100.7
	IV	219.1	102.9	103.4	101.9
	Year	214.8	102.3	102.7	101.4
1966					
	I	221.8	104.7	105.1	103.7
	April	222.5	104.9	105.3	103.9

Source: Banque Nationale Suisse, Bulletin mensuel.

the fourth quarter 1965 and almost 2 per cent in the first quarter of this year. These increases were due equally to higher prices for both domestic and foreign commodities. At home the index for processed food products at the wholesale level increased over 5 per cent in the six months beginning with September 1965, and the prices of non-processed agricultural and raw material items increased only slightly less. Higher prices of nonferrous metals and oil products in foreign markets also contributed significantly to the higher wholesale price level in Switzerland.

Wages increase sharply in 1965; foreign labor force to be reduced further

The shortage of labor continues to be the most restrictive factor at work in the Swiss economy today. The government's recently announced intentions to pursue its policy of reducing the foreign labor contingent in the country will keep labor market conditions in Switzerland under unrelenting pressure although the slower growth rate in economic activity has been reflected in a reduced demand for labor. Registered job vacancies have been down significantly since September last year even though industrial activity intensified about that time. (See Table 3.) The amount of overtime authorized by cantonal authorities has also been reduced from year-earlier levels.

Table 3. Switzerland: Unemployment and Job Vacancies, 1964-66
(numbers)

End of Month	Registered Unemployed			Registered Job Vacancies		
	1964	1965	1966	1964	1965	1966
January	1,049	818	1,543	6,039	6,499	4,420
February	303	667	277	7,134	5,359	4,794
March	242	264	190	6,996	5,937	4,792
April	174	155	168	6,760	5,686	4,977
May	129	138		6,411	5,421	
June	139	140		6,207	5,477	
July	111	88		6,018	5,346	
August	130	117		6,133	5,161	
September	119	117		6,283	5,027	
October	196	166		5,954	4,773	
November	237	333		5,813	4,373	
December	631	583		5,685	3,935	

Source: Banque Nationale Suisse, Bulletin mensuel.

The annual survey of wages and salaries conducted by the government in October 1965 (the results of which have only recently been made available) shows year-to-year gains in wages and salaries almost equal to those that occurred in 1963 and 1964, when both of these categories registered the highest annual rises since wage controls were abolished in 1946. This survey showed that wage rates for hourly workers had increased 7.5 per cent from October 1964. Increases were highest in rates paid semi-skilled and unskilled laborers. Salary levels rose only slightly less at 6.9 per cent. The greatest increases were in salaries in the chemical and textile industries and in privately owned transportation enterprises. Because of continued tight conditions in the labor market, authorities expect wage and salary increases this year to about equal those in 1965.

On March 1 the Federal Council released new regulations requiring a 5 per cent reduction between then and the end of January 1967 in the foreign labor forces of all Swiss firms employing ten or more foreigners. This new reduction is scheduled to take place in two stages. Companies to which these regulations are applicable are required to reduce foreign workers by 3 per cent by the end of July and then by another 2 per cent by the end of January 1967. Thus, by February 1, 1967 the total foreign labor contingent of firms employing ten or more foreigners will have been reduced by 10 per cent of the level at which it was on March 1, 1965.

Along with the introduction of this additional reduction, some important changes were made in the regulations concerning foreign workers in the country. Border crossers who commute to Switzerland every day to their jobs will no longer be counted as a part of the "controlled" foreign labor force. Seasonal workers in hotels, restaurants and other establishments catering to the tourist trade also will not fall under the regulations. In addition, special quotas will be established for seasonal construction workers. Finally, perhaps the most important change is the lifting of the general ceiling on employment in manufacturing enterprises throughout the country. Producers will now be permitted to increase their over-all work forces by 4 per cent, provided that the increase comes from Swiss workers, foreigners permanently resident in the country or border crossers. This change will for the first time in two years permit real competition between producers for Swiss workers. While manufacturers have agreed among themselves to a code prohibiting non-ethical competition for labor, no doubt this will encourage more vigorous competition in the labor market.

The effect of these new measures will vary considerably from industry to industry and enterprise to enterprise. Labor intensive industries for which special arrangements have not been made, such as the textile industry, will still be pressed to rely even more heavily upon increased productivity to maintain the current level of output. The lifting of the general employment freeze will particularly affect the weaker firms within those industries most hard hit by the general labor scarcity. The exclusion of border crossers from the regulations, however, should afford much relief to firms that are located geographically close to the border, such as firms in Basel, Geneva and Ticino.

Financial conditions continue to tighten in response to conditions in foreign markets

Generally tighter conditions developed in all Swiss financial markets during the December-May period. In December the money market tightened in its usual year-end manner, and commercial banks withdrew a large volume of funds from abroad in order to meet their year-end liquidity needs. The usual period of easing occurred after the first of the year, but it was quite brief and market rates did not decline as much as usual. The three-month deposit rate at large Zurich banks, for example, dropped only slightly to 3.81 per cent in January from its year-end level of 4 per cent. (See Table 4.) By March it was back up to 4 per cent, and more recently competition in this market for funds has caused some banks reportedly to bid as high as 4.25 per cent for funds, 25 basis points above the heretofore effective 4 per cent ceiling voluntarily agreed upon by the large banks.

In December commercial banks repatriated from abroad a record volume of funds to meet their year-end liquidity needs. Most of these foreign currency assets--approximately $385 million--were exchanged for Swiss francs through 30-day swap facilities with the Swiss National Bank and had only minor effects on money and foreign exchange rates. Ample

Table 4. Switzerland: Selected Financial Indicators

	1965		1966				
	Sept. 24	Dec. 31	Jan. 28	Feb. 25	Mar. 25	Apr. 29	May 29
Interest rates							
3-month yields:							
Zurich banks a/	3.88	4.00	3.81	3.88	4.00	p/ 4.12	p/ 4.12
Euro-dollars b/	4.50	5.25	5.31	5.44	5.69	5.75	5.75
U.S. Treasury bills b/	3.94	4.45	4.53	4.66	4.46	4.61	4.61
Euro-Swiss francs	4.19	4.94	4.38	4.75	5.31	6.12	6.00
Deposit certificates (3 to 8 years)							
12 cantonal banks	4.36	4.36	4.36	4.36	4.36	4.36	p/ 4.36
5 large banks	4.39	4.39	4.39	4.39	4.39	4.39	p/ 4.39
Long-term government bonds	3.96	3.97	3.90	3.89	3.92	3.93	3.94
Stock prices (1958=100)	227.3	222.2	241.8	244.5	234.3	231.5	221.9
Exchange rates							
Spot francs (U.S. cents)	23.158	23.159	23.078	23.053	23.048	23.160	23.173
Forward premium (+) discount (-) on franc c/	+0.28	+0.30	+0.87	+0.66	+0.48	-0.23	-0.23

a/ Most frequently quoted rates of the five large Swiss banks in Zurich.
b/ Return in Swiss francs after cost of exchange cover.
c/ Per cent per annum.
p/ Preliminary figures.

domestic liquidity during January facilitated the reversal of these swaps, and there were no particular strains on the market as had been expected.

Throughout the first quarter, however, several factors were at work reducing domestic liquidity, and by the first of April they had begun to make an impact on the money market. First, the continuing demand for foreign currencies in the foreign exchange market resulted in a net loss of official reserves and consequently reduced reserves of the commercial banking system which the central bank offset very little. Second, the general tightening of credit availability in foreign markets and the continuing demand of U. S. firms for foreign credits in line with the American balance of payments program resulted in increased borrowing from these sources. Third, by March the domestic demand for bank credit, which is usual at this time of year, began to build-up.

At the end of March the Swiss National Bank began to add liquidity to the banking system. In April and May the net outflow of foreign exchange reversed itself as the commercial banks repatriated foreign currency assets and foreigners with loans outstanding at Swiss banks began to pay them off because of the sharp increase in rates changed. Some foreign borrowers were reportedly being charged between 7 and 8 per cent per annum for the three-month loans. These factors stabilized the market although interest rates are still at near-record levels.

Also, some minor interest rates were increased in January. Major Swiss commercial banks raised their private discount rates for first class commercial bills and acceptances by 1/2 percentage point to 3-1/2 per cent and increased the rate of interest paid on deposit books from 3-1/4 per cent to 3-1/2 per cent.

Capital market conditions very stringent; security issues quota reduced

In the market for long-term capital, signs of strain began to show up about mid-February. The first quarter quota for public domestic bond issues, which is set by a special new issues committee and approved by the central bank, was set at SF 720 million, roughly half of the total value of the applications reportedly made. But as the quarter wore on it became evident that because higher yields abroad were evidently diverting both foreign and domestic funds from the Swiss market, even this reduced supply of new issues was too destabilizing. By late February almost all new issues were being badly undersubscribed. In fact, the Federal Government refunding issue in late March was first sharply reduced and then fully placed only with considerable difficulty.

The new issues quota for the second quarter was reduced to SF 630 million, offering some temporary relief to the market. Most issues in April were successfully placed. But strain continued to build up and late that month the City of Geneva raised the coupon on its SF 25 million issue to 5 per cent, the first local government borrowing to take place above 4.75 per cent. Also, power company issues, which theretofore had carried 5 per cent coupons, moved up to 5.25 per cent at about the same time.

There was a great tendency in May for prices to drop sharply soon after the books were closed. Uncertainty continued to build up and investors increasingly began to hold off making purchases in anticipation of still lower prices. Although borrowers are now again raising their coupon rates, most market observers believe that strained conditions will continue to build up in the Swiss market until yields are allowed to go higher in line with foreign yields or the supply of issues to the market is sharply cut back by the authorities.

Foreign borrowing in the Swiss bond market amounted to SF 172 million during the first four months of the year, up from SF 140 million in the final quarter of 1965, when the authorities reopened the market to foreigners following its closure in the summer of 1965. The authorities have continued to allow foreign issues on the theory that they attract foreign funds almost exclusively and particularly foreign funds that would not be going into domestic Swiss issues. However, the recent failure of the Esso Standard (France) issue may be taken as an indication that the Swiss franc is no longer attracting foreign capital and prompt the authorities again to close the market to foreign borrowers.

In the secondary market the prices of non-government issues have been under pressure throughout the period. Yields on long-term Federal Government issues were stabilized, however, by the national bank at between 3.90 per cent and 3.95 per cent during most of the period. (See Table 4.) More recently they have been allowed to rise to 4 per cent.

After rebounding to a recent high in February, Swiss stock prices again retreated. The index published by the Swiss Bank Corporation rose to 250 in February from 220 in December but by late May had fallen back to the 220 level. (See Table 4.) Continued tightness in financial markets, rising interest rates and economic uncertainty were mostly to blame.

Swiss franc rate affected by capital movements; official reserves decrease

On the foreign exchange market the Swiss franc rate has been affected primarily by capital movements during the period under review. Following its usual seasonal pattern in January, the rate against the U. S. dollar retreated from its ceiling as banks returned funds abroad that had been repatriated to meet year-end liquidity needs. However, the demand for foreign currencies became protracted and the rate continued to fall through the month of March. Higher interest rates abroad on both short- and long-term investments attracted domestic funds and diverted foreign funds that usually flow into Swiss investments.

In mid-February the Swiss National Bank began intervening in the foreign exchange market to take some of the pressure off the rate. In the two months from February 7 to April 7 Swiss official reserves of gold and foreign exchange decreased $40 million.

Finally, by early April financial conditions had become so stringent in Switzerland that commercial banks began withdrawing funds from foreign exchange investments, thus reversing the flow of capital. This caused the Swiss franc rate to rebound sharply to its ceiling against the U. S. dollar.

In May acutely tighter liquidity conditions accelerated the repatriation of funds from abroad. Also, foreigners with outstanding bank loans in Switzerland made a concerted effort to repay these loans because of the excessive rates being charged. This increased the demand for Swiss francs and the Swiss National Bank made large support purchases of dollars in the market. Official international reserves rose $80 million for the month. (See Table 5.)

Table 5. Switzerland: Official Reserves
(end of month figures, million U.S. dollars)

	1965				1966		
	Mar.	June	Sept.	Dec.	Mar.	Apr.	May
Gold	2,703	2,790	2,656	3,042	2,652	2,648	2,631
Foreign Exchange	247	217	216	206	181	146	243
Total	2,950	3,007	2,872	3,248	2,833	2,794	2,874
Change	1/-170	+57	-17	+376	-415	-39	+80
Gold Ratio	92	93	92	94	94	95	92

1/ Changes in first quarter.
Source: Banque Nationale Suisse.

Foreign trade balance improves

Booming foreign demand for Swiss products and more moderate domestic demand for imports has reversed the deteriorating trend in the country's foreign trade balance. In the first four months of this year the seasonally adjusted trade deficit averaged $48 million per month, down from $59 million per month in the fourth quarter 1965. (See Table 6.)

Table 6. Switzerland: Foreign Trade
(Seasonally-adjusted monthly average or month, million U.S. dollars)

	1965				1966				
	I	II	III	IV	I	Jan.	Feb.	Mar.	Apr.
Imports, c.i.f.	299	301	308	318	318	296	333	326	311
Exports, f.o.b.	235	244	251	259	267	268	263	271	272
Deficit	-64	-57	-57	-59	-51	-28	-70	-55	-39

Source: OECD, Main Economic Indicators; Neue Zürcher Zeitung.

Exports registered their highest quarterly gain since 1960. The increase in the January-March period from the previous quarter was at a 12 to 13 per cent annual rate. Imports, on the other hand, showed no quarter-to-quarter gain. However, there are recent indications that imports of consumer goods -- both durables and nondurables -- are picking up a little more than seasonally. Furthermore, since Switzerland's major export industries depend rather heavily on imported raw materials, the accelerated expansion of Swiss exports is expected soon to begin to have feedback effects on imports.