

# KOF Economic Forecast, June 2018

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**Publication date:**

2018-06

**Permanent link:**

<https://doi.org/10.3929/ethz-b-000411139>

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## Executive Summary

Embargo: 9am, 15 June 2018

**This is a summary of the 2018 summer forecast for Switzerland, released by the KOF Swiss Economic Institute at ETH Zurich on 15 June 2018, with a forecast horizon up to the end of 2019. It first focuses on recent economic developments abroad, which constitute the most important conditioning factors for the Swiss economy, and then presents the main forecast results for Switzerland.**

### **The global environment**

Global production at the beginning of 2018 expanded significantly less vigorously than in 2017. Firstly, output flattened as expected after having peaked last year. And secondly, the international economy was constrained by one-off effects, such as negative public consumption in Germany owing to the lengthy formation of a government. Global economic momentum is likely to increase somewhat in this and the coming quarters. The US tax reforms are expected to provide stimulus. However, given the slow increase in excess capacity utilisation and the gradually less expansionary monetary policy, the strong momentum of 2017 will not be regained. In the second quarter of 2018, KOF expects economic activity to remain somewhat subdued in the euro area. The oil price continued its upward trend in spring 2018. A resulting increase in energy prices is likely to push up global inflation in the short term. KOF forecasts that inflation in the euro area will rise to around 2 per cent in the coming months. The simmering trade conflict between the US and the EU is fuelling uncertainty. Any escalation may have negative effects on international trade and investment. Further forecasting risks arise from recent political developments in Italy. Any resurgence of the euro crisis would pose a significant downside risk to global economic activity, and especially to the European economy.

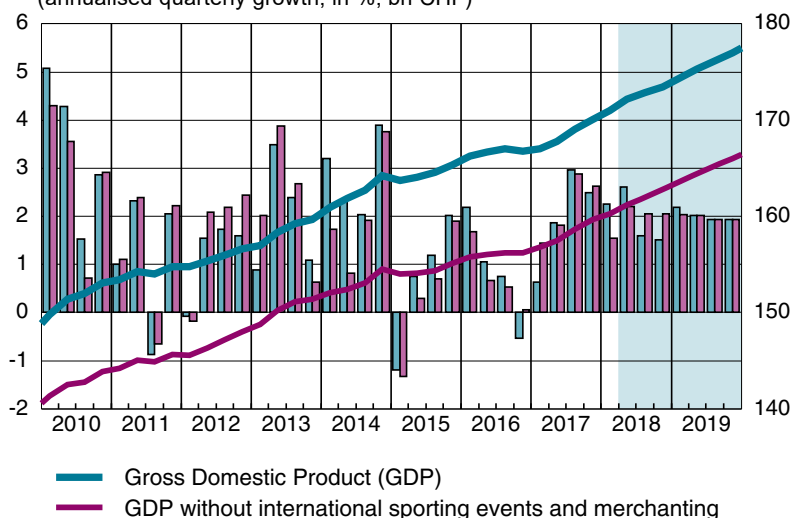
### **The Swiss economy**

Our forecast for Swiss GDP growth is 2.3 per cent this year and 1.9 per cent for 2019, after sluggish headline GDP growth of 1.1 per cent in 2017. The quarter-on-quarter figures confirm that the Swiss economy is at its peak growth. Although growth rates will weaken somewhat, the economy remains in an upswing.

Notice, however, that official Swiss GDP growth has in recent times been only of limited help in determining the Swiss business cycle; the former is distorted by sizeable (sporting) events, which at best may be loosely related to the performance of the remaining economy. In addition, international commodity trading (merchanting), for which the business and tax environment has made Switzerland a preferred location, has long since been identified as contributing significantly, but erratically, to Swiss value added. After obtaining the information needed to complement the official 'headline' GDP data, we estimate a 'core' GDP series that excludes both types of activities. Being less erratic, the resulting graph confirms the main message from headline GDP.

## Impact of International Sporting Events and Merchandising

(annualised quarterly growth, in %; bn CHF)



The employment figures from the first quarter of the year show that the upturn in the Swiss economy has reached the labour market as well. With seasonally adjusted annualised quarterly growth of nearly 4 per cent, full-time equivalent (FTE) employment exceeded even optimistic economic forecasts. In addition, employment growth was broadly based, including the watch industry, mechanical engineering, the hospitality industry and knowledge-intensive service sectors whose employment growth was generally weak in the preceding quarters. According to the data of the Swiss Federal Statistical Office, FTE employment increased even more because workers have, in contrast to previous years, increased their level of employment, i.e. have been working more full time instead of part time. This suggests good utilisation of production capacities.

Private consumption is by far the largest Swiss demand component. We expect consumer spending for the current year to increase by 1.2 per cent. In line with our labour market forecast, next year's growth is likely to accelerate to 1.4 per cent.

Given Switzerland's debt brake and its established culture of conservative budgeting, pro-cyclical growth impetus from public spending is not to be expected this year or next. As a result, real government consumption is expected to grow 0.9 per cent this year – below the long-term average but in line with the average since the financial crisis. In 2019, government consumption growth is expected to slow to 0.9 per cent in real terms.

Over the last two years, equipment investment has shown robust momentum. The cyclical increase in investment activity will weaken in the next two quarters and hit a low at the turn of the year. Investment activity should pick up again over the course of 2019. Growth in equipment investment will be lower over the coming years. Investment is being positively influenced by rising demand, whilst the quarterly pattern continues to be characterised by one-off factors (e.g. long-term acquisitions of aircraft and trains).

Construction investment will grow by 1.1 per cent this year. We do not expect a significant increase for 2019, given the saturation of the housing market. With activity in civil engineering and non-residential construction comparatively robust, next year's growth in total construction is forecast to be 1.2 per cent.

The Swiss export industry continues to expand thanks to the encouraging economic situation abroad and growing international investment momentum. Compared with the second half of 2017, however, this momentum slowed slightly in the first quarter. Commodity exports rose at an annualised rate of 3.2 per cent. Growth continued to be broadly based. In particular, the increase in exports of industrial machinery, precision instruments, watches and metals continued. Service exports rose 3.7 per cent in the first quarter thanks to higher licensing and patent revenues. Despite rising tourist numbers, tourism exports grew weakly. Robust export growth is expected for the remainder of the year. Given the gradually declining momentum of the global economy, export growth will slow down in the medium term. In addition, the risks to the export economy have increased in the light of the trade dispute between the US and the EU. Although US protective tariffs on steel and aluminium have so far had a negligible effect on Swiss exports to the US, Switzerland would be seriously affected if the EU took protective measures or if the dispute spread to other sectors such as the automotive industry.

The strongest upside risk we see in this forecast is the expectation-driven part of private investment. The generally benign economic outlook could result in higher investment than forecast here, especially if the current deterioration in confidence indicators turns out to be temporary. On the other hand, business investment may also be impacted by downward revisions of demand expectations or by uncertainty shocks. Potential triggers of negative reactions and thus downside risks to our forecast currently exist, above all, in the political sphere. Any slowdown in international trade due to further intensified protectionism would hit Switzerland. Geopolitical uncertainties, for example in the Middle East or the South China Sea, could also have an impact on the performance of the real economy, particularly via financial markets. The recent political developments in Italy are a further forecast risk. Any resurgence of the euro crisis would pose a significant downside risk to global economic activity, and especially to the European economy.

The full version of the KOF Economic Forecast can be found in KOF Analysen, 2018, Nr. 2, Sommer (in German):

[www.kof.ethz.ch/en/publications/kof-analysen](http://www.kof.ethz.ch/en/publications/kof-analysen) →

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