Executive Summary KOF Economic Forecast, Spring 2019

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This is a summary of the 2019 spring forecast for Switzerland, released by the KOF Swiss Economic Institute at ETH Zurich on 27 March 2019, with a forecast horizon up to the end of 2020. 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.

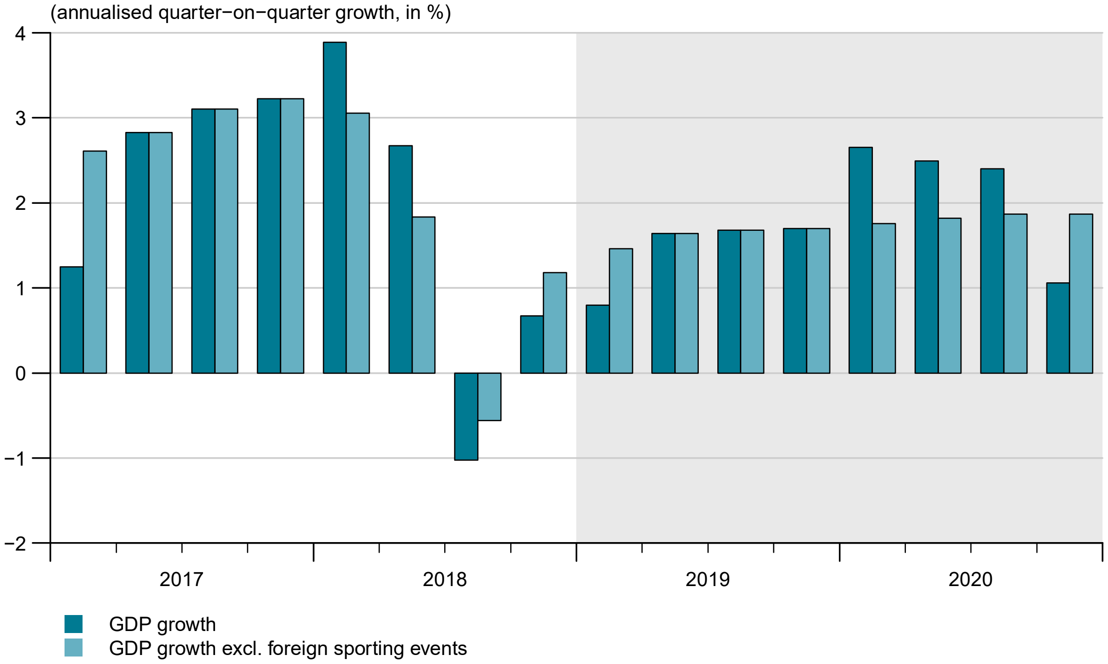
The global environment

The international macroeconomic environment for the Swiss economy has deteriorated further during the past months. We expect relatively weak economic growth in the euro area for the first half of 2019. Additionally, we expect the slowdown of the Chinese economy to continue, with negative feedback effects on other Asian economies. Furthermore, economic growth in the United States will normalise as the strong stimulus from the recent tax reforms gradually peters out. However, growth in the first quarter of 2019 will likely be dampened by the latest government shutdown.

The Swiss economy

Our forecast for Swiss GDP growth is 2.6 per cent this year, 1.6 per cent for 2019 and 2.1 per cent for 2020 − after moderate headline GDP growth of 1.6 per cent in 2017. The quarter-on-quarter figures reveal that the Swiss economy has passed its peak in the growth cycle which, according to the provisional Swiss GDP data, was during the first quarter of 2018. The same statistics recently delivered a surprise, showing that third-quarter GDP growth was negative. Whilst this does not stand in complete contrast to the broader picture from the international economy or the current indicators for Switzerland, we consider this sharp decline in growth to be an outlier. Our forecast suggests that we will see a rebound in the fourth quarter; after that, growth rates will weaken somewhat, before returning to around potential. The underlying annualised quarter-on-quarter GDP growth rates are shown in the figure below.

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



GDP growth rates should recover somewhat in 2019 compared with the second half of 2018. However, the annual average output gap will turn negative again. Overall GDP growth this year will achieve an annual average of around 1.0 per cent. For 2020 this increase is likely to be 2.1 per cent. Adjusted for major sporting events, the output gap will be negative in both years.

The Swiss labour market delivered a strong performance in 2018. The seasonally adjusted unemployment rate – as defined by the International Labour Organization (ILO) – declined from 4.9 per cent at the beginning of the year to 4.3 per cent in the fourth quarter. Similarly, the number of full-time-equivalent jobs grew by 1.8 per cent relative to 2017. However, both job and employment growth slowed in the second half of 2018. Moreover, several leading indicators of the Swiss labour market have passed their peaks and fallen in recent months. While our nowcasting models predict that job growth will remain relatively strong in the first quarter of 2019, we expect it to slow in the second half of 2019. Year on year, we expect the growth in full-time-equivalent jobs to be below average (0.7 per cent). This is not sufficient to reduce unemployment further. We thus predict that seasonally adjusted unemployment under the ILO definition will remain at the current rate of 4.2 per cent throughout 2019 and 2020. The unemployment rate as defined by SECO, which only counts the registered unemployed, will amount to 2.4 per cent in the current year and 2.5 per cent in 2020. According to the Swiss wage index, nominal wages will increase by 0.9 per cent in 2019. Given an expected inflation rate of 0.5 per cent, growth in real wages remains weak.

Real private consumption rose by 1.0 per cent in 2018 after 1.1 per cent in 2017. Low real wage growth will continue to act as a drag on consumer spending in 2019, causing private consumption to increase by an even more modest 0.8 per cent. Per-capita consumption expenditures will stagnate in 2019. Real incomes should rise more sharply in 2020. In addition, population growth will increase, so consumer spending will make a greater contribution to growth in 2020 than this year.

Machinery and equipment investment declined in the second half of 2018. In the near future this investment will grow at rates below the historical average. This can be attributed to weak international demand for products from Switzerland and the deteriorating profitability of businesses in the second half of 2018. By the end of 2019 exports will slowly regain momentum and the profit situation will improve. Machinery and equipment investment should therefore accelerate again and return to a steady growth path.

Growth in construction investment slowed in 2018 and experienced a particularly weak fourth quarter. The slowdown in the economic environment and the build-up of overcapacities – which are becoming apparent, for example, in the form of rising vacancy rates – are dampening construction investment in the residential segment during the forecast period. On the other hand, non-residential construction is on the path to recovery, driven by investment by pharmaceutical and biotech companies as well as investment in the healthcare sector. This will partially compensate for weaker residential construction. In addition, infrastructure investment (roads and railways) is building momentum after the launch of two infrastructure funds. The outlook for civil engineering companies is brightening, according to the KOF Business Tendency Survey of the construction sector.

The slowdown in the world economy curbed Swiss foreign trade in the last quarter of 2018. On an annualised basis, total exports (excluding valuables) expanded by 12 per cent in that quarter, whilst imports were 1.9 per cent lower compared with the previous quarter. Economically less sensitive pharmaceutical products provided the biggest growth stimulus to exports, while exports of machinery and electronics, watches and metalwork remained subdued. Trade in services continued to be sluggish. International demand for Swiss products is expected to remain weak in the first quarter of 2019 but will slowly regain momentum in the second half of this year. Political risks relating to international trade disputes and Brexit constitute downside risks to the export forecast. Overall, foreign trade will adversely affect GDP growth in the first half of 2019. The annual growth contribution of the external balance will be virtually zero this year and positive next year.

In February, the Swiss government again reported a large fiscal surplus for the previous year. For 2018 it amounted to 0.4 per cent of GDP and was ten times the figure in the original budget. Taken together with the surpluses of the cantons, municipalities and the social security funds, the surplus achieved by the general government may approach 1 per cent of GDP. We expect to see a similar surplus this year, whereas it will be somewhat lower next year if the planned tax reform is approved by the plebiscite in mid-May. This tax reform is being supplemented by additional measures for the public old-age pension scheme. The tax reform itself may deliver a fiscal stimulus to the economy, whilst the further pension funding to be provided by employers and employees constitutes a negative stimulus. The additional measures taken by the Swiss government to support the public pension system will not change the fiscal stance . Overall, the reform will deliver a modest fiscal stimulus in 2020.

The European Central Bank (ECB) has yet again postponed a return to positive key interest rates. Since we do not expect the Swiss National Bank to raise its interest rates before the ECB, short-term rates in Switzerland are likely to remain at their current rock-bottom levels for another year. With inflation expected to remain very low and the output gap turning negative again, there is no need for more restrictive monetary policy. Nevertheless, negative interest rates – especially if they persist for an extended period – also involve risks in terms of capital allocation. The greater risk in our view, however, is that the Swiss franc might appreciate in the event of a premature normalisation of monetary policy.

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