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Recent Economic Developments in Switzerland,
December 1963-February 1964

17 pages

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Summary

Record imports in December and again in January underscored the extent to which boom conditions continued to strain the Swiss economy during the winter. Both consumer and wholesale prices ended the year up 4 per cent from the previous year, although the rise in wholesale prices reflected mostly higher prices for imports rather than for domestic goods. The labor market was also tighter in the fourth quarter than in 1962.

New stabilization powers. These adverse developments led the Swiss Government in late January to request from Parliament substantial new legal powers to broaden the scope and to tighten the effectiveness of current stabilization efforts. The new measures have two main objectives: to keep foreign funds off Swiss money and capital markets; and to establish more effective general credit controls over domestic business expansion and some special controls over the building sector.

To these ends, the Government has introduced draft legislation which will give the Banque Nationale Suisse (BNS) legal powers to do what they are already doing under the "voluntary" gentlemen's agreements with the banks and, for the first time, to extend these restrictions to all other financial institutions. For the first time, the BNS can also require a 100 per cent reserve on all newly received foreign funds not invested

1/ Earlier developments in the Swiss Economy are reviewed in "Recent Economic Developments in Switzerland, September-November 1963" dated November 27, 1963.

abroad by Swiss financial institutions. The authorities will also be granted new powers to limit credit (already in effect on a voluntary basis) and to set up a country-wide building licensing program. The measures established by the new legislation will be in effect for a period of two years. On February 24, the bills establishing the new authority were approved by the lower house; they are expected to be debated in the Council of States (the upper house) by mid-March.

<u>Background to new stabilization program.</u> In a major policy speech on January 20, Dr. Iklé (Director General of the Swiss National Bank) explained why the Swiss authorities had rejected revaluation of the Swiss franc at this time and had decided--instead--to strengthen the anti-inflationary program in a renewed direct attack on the causes of inflation. From 1945 to 1959, annual price rises in Switzerland had been kept within narrow limits of 1.2 to 1.3 per cent; but recently three factors have produced substantial excess demands on Swiss economic resources which have accelerated price advances in that country:

a. The 1960 upswing added heavier than normal export orders on a fully-employed Swiss economy and, in turn, stimulated heavier domestic investment;

b. Monetary crises in Europe since early 1959 have produced heavy inflows of funds (both foreign-owned and the return of Swiss funds) which have found their way into the domestic economy in sufficient volume to produce a total of investment far in excess of current savings;[1/] and

c. Recent reductions in the surpluses of the Federal budget have increased inflationary pressures: earlier budget surpluses had been substantial and the funds largely placed abroad as a sterilization measure.

He added that those who attribute "the Swiss boom . . . solely /to/ a price advantage vis-a-vis foreign countries," as in the German revaluation of the D-mark in 1961, are incorrect. Germany then had a current account surplus with direct inflationary repercussions, but Switzerland now has a current-account deficit and has gained reserves only through capital inflows. Should its export industry (already facing discriminatory Common Market tariffs) and tourist trade "be penalized" because foreign funds seek refuge in Switzerland, he asks. Revaluation, Dr. Iklé concludes, could undermine confidence in the Swiss franc as the current account deficit worsened and could result in "the most severe disturbances on the Swiss money and capital markets as foreign funds were withdrawn."

Recent advances in Swiss interest rates. Interest rates continued to advance during the winter months in the medium- and long-term financial markets. The yield on Federal Government long-term bonds has risen from 3.18 per cent last July to 3.41 per cent at the end of December and to 3.71

1/ A Swiss paper has calculated that since 1960 some SF 5.5 billion ($1.3 billion) of "foreign flight money" has "found its way into the Swiss money stream," with some 30 per cent held as deposits with the big commercial banks. Of total Swiss liabilities to foreigners of some SF 23.5 billion ($5.5 billion), the paper estimates the composition as follows (in billion of Swiss francs):

Short-term bank liabilities	9.5
Foreign participation in Swiss external loans	2.5
Swiss Securities held by foreigners	5.5
Foreign direct investments in Switzerland	2.0
Real estate and mortgage holdings	4.0
Total	23.5

(Source: Boersen-Zeitung, January 31, 1964.)

per cent on February 21. In the new issues market, the 4 per cent coupon on bonds gave way entirely to 4-1/4 and 4-1/2 per cent toward the end of February as new security offerings picked up in anticipation of new credit controls. Medium-term rates also rose: 3 to 8 year deposit certificates climbed from 3.63 per cent at end-December to 3.88 per cent on February 21. Only in the money market has liquidity been sufficient to allow a fall in rates. Easier short-term credit conditions reflected the expansion in liquidity based on capital imports, not on borrowings from the central bank.

The Swiss franc weakened in the foreign-exchange market soon after the new stabilization measures were announced in January. The spot franc declined from 23.174 U. S. cents on January 24 to 23.103 cents on February 28. There were reports in the financial press that funds were being diverted in some volume from Switzerland to Germany.

Anti-inflationary program passes lower house of Parliament

At year-end, all sectors of the Swiss economy were still running at capacity, as has been the case for the past four years, and continued business expansion was forecast for 1964 in spite of new official anti-inflationary measures. With imports and prices continuing to advance, the government, in a revolutionary step in post-war Swiss monetary policy, asked Parliament for legal powers to strengthen its stabilization effort. (The current stabilization program is built on two voluntary agreements, one on foreign funds and one on domestic credit, concluded between the BNS and the commercial banks.) Legislation embodying these proposals was approved by the lower house of Parliament on February 24 and has now gone to the Council of States (upper house) where it will be debated in mid-March. If it is approved, it will become law for two years unless rejected by a popular referendum that must be conducted within one year of Parliamentary approval.

The draft bills before Parliament provide the authorities with new powers in the fields of:

a. Foreign funds. The Federal Council will be empowered to:

1. extend to all financial institutions accepting foreign funds (not merely the banks) the requirement for a minimum period of notice for withdrawal of foreign accounts and the limitation on paying interest on them;
2. require a 100 per cent reserve against all foreign funds accepted since January 1, 1964 to the extent they are not invested abroad;
3. prohibit institutions accepting foreign funds from investing them in Swiss securities, real estate, and mortgages. (Foreign funds may continue to be invested in foreign bonds denominated in Swiss francs.)

b. Domestic credit. The Federal Council will be empowered to:

1. limit bank credit expansion to a certain percentage of 1961-1962 credit growth;
2. fix ceilings on credits and mortgage loans on real estate;
3. limit issue of certificates by investment funds which hold assets in real estate;
4. require that new stock and bond issues be announced in advance so that they may be "spaced out" by the authorities if necessary to prevent the capital market from being unduly burdened.

c. Construction. The Federal Council will establish a country-wide ceiling and individual cantonal ceilings on building and permit construction only upon the issuance of licenses (excepting buildings costing less than $57,937). Three categories of construction are planned:

1. High priority buildings such as hospitals, certain rural and industrial construction. No license will be required but these will be counted against the total volume of building to be authorized.
2. Buildings prohibited for one year such as theatres, museums, administrative buildings. After one year, these will be subject to license.
3. All other. License required.

The new powers to be granted the authorities in the fields of foreign funds and credit are only permissive. The Federal Council will continue to use the "voluntary" approach as much as possible. However, the new legislation will give general binding force to any agreement signed by a majority of those invited to accede to it, and such a binding agreement becomes a part of federal law, enforceable as such. Only if this approach fails is the government to invoke its additional powers.

Construction continues heavy

Building, the sector to which the government's anti-inflationary program is most sharply directed, continues to be the economy's most "overheated" sector, even though construction was slightly lower in 1963 than in 1962. In Switzerland's 65 principal cities and towns, completed dwellings were down about 15 per cent (from 23,672 to 20,169 units) in 1963, and the number of industrial projects authorized for construction was also slightly lower. However, the number of dwellings constructed in the fourth quarter 1963 rose from the third quarter more than they increased during the fourth quarter 1962 from its previous quarter.

Labor shortage remains acute

The Swiss labor market continues under severe strain. The seasonal increase in unemployed workers in both November and December was less than last year because the relatively mild weather permitted construction activity to continue longer into the winter than usual. (See Table 1.) Registered job vacancies were above their year-ago figure in each month, and in December the ratio of vacancies to unemployed was 6 to 1 compared with a 2-1/2 to 1 ratio in December 1962.

Table 1. Switzerland: Unemployment and Job Vacancies

End of Month	Registered Unemployed		Registered Job Vacancies	
	1962	1963	1962	1963
August	185	142	6,262	6,701
September	1o9	171	6,085	6,902
October	324	194	5,847	6,739
November	484	263	5,053	5,912
December	1,886	778	4,741	4,954

Source: Banque Nationale Suisse, Bulletin mensuel.

Because of the government's limitation on imported labor, Switzerland's very severe labor shortage can only be eased by bringing the boom under control. In March 1963 the authorities began to restrict foreign workers to enterprises in which the total labor force (Swiss and foreign) was less than the average number employed during or at the end of 1962. Thus, foreign labor cannot contribute to raising a firm's total employment above the 1962 figure; if total employment in a firm falls below this figure, however, foreign labor will be admitted, even to replace Swiss nationals. This flexibility in the foreign labor control program explains why foreign labor could rise 45,000 in 1963. Although this increase was less than half the 1962 increase, it still disturbs the government, and it had intended to include an absolute limit on the number of foreign workers in the country in its anti-inflationary program. However, the existing program was renewed for a few more months in order to ascertain whether other stabilization measures will decrease the demand for foreign labor. If they do not, the government does intend to place an absolute limit on non-Swiss workers in the country.

Prices and wages continue to rise

The disturbing increase in prices was one of the most important reasons for the government's recent anti-inflationary moves. The average monthly consumer price index for 1963 advanced 3.6 per cent over 1962, slightly less than in 1962, but wholesale prices rose by 4.1 per cent over their 1962 level, about one percentage point more than the previous year. (See Table 2.) Price pressures seemed to sharpen in the fourth quarter of 1963 as both consumer and wholesale prices rose more than in the comparable period of 1962. That these 1963 price increases were greater than those in the United States, Great Britain, Austria and Western Germany points up the severity of the problem confronting the Swiss authorities. It is important that prices be brought under control if Swiss exports are to remain competitive.

Table 2. Switzerland: Price Indices
(August 1939 = 100; month or monthly averages)

	Consumer Price Index	Wholesale Price Index		
		Total	Domestic	Foreign
1961	187	215	213	217
1962	195	222	224	220
1963	202	231	231	230
1962 I	192	219	219	219
II	194	222	222	221
III	196	223	226	218
IV	197	225	227	222
1963 I	199	230	231	228
II	201	231	231	231
III	202	228	227	229
IV	205	235	234	234
July	202	228	227	229
August	202	226	226	226
September	203	230	229	230
October	204	234	234	233
November	205	235	234	235
December	205	235	235	235
1964 January	205	234	233	236

Source: Banque Nationale Suisse, Bulletin mensuel.

Numerous wage and salary increases either took effect in the fourth quarter or were approved for early 1964. The entire construction industry was given a 6-7 per cent wage increase at the beginning of the year, and salaries and wages in the machinery and metals industry (Switzerland's most important in terms of employment and exports) went up by 4 per cent on February 1. Also, a 4 per cent wage increase for all federal workers (including Post, Telephone and Telegraph, and the Federal Railways) together with an augmentation of cost of living allowances is being considered by Parliament. It would be retroactive to January 1 and inject about $20 million annually into the economy.

Medium- and long-term interest rates under pressure

The demand for long-term financing springing from the "overheating" of the economy has continued strong. The easier credit market conditions anticipated for early 1964 by some observers of the Swiss scene (in particular, by the BNS) in November have not yet materialized, except in the money market.[1/]

The reaction to the credit restrictions proposed by the government placed heavy pressure on the long-term market throughout February. Only in the money-market has liquidity been ample. In spite of the reversal of the dollar/franc swaps between the BNS and the commercial banks in January, the money-market eased, and the 3-month deposit rate at the large Zurich banks

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1/ In a circular the BNS sent to the country's two banking associations last fall, it had anticipated additional liquidity in the Swiss markets in the near future and an easing of the pressure on long-term rates. It then expressed the belief that the large supply of U. S. dollars that had flowed into Switzerland in last-half 1963 was in part a repatriation of Swiss foreign investments and could well flow into the capital market after the first of the year. These funds do not appear to have flowed into the domestic capital market to any large extent.

See "Recent Economic Developments in Switzerland, September-November, 1963," pages 4 and 5.

dropped from 3.38 per cent at year-end to 2.94 per cent early in January and has remained there since. (See Table 3.)

Table 3. Switzerland: Selected Financial Indicators for Selected Dates, 1963-1964
(in per cent per annum or index)

	1963			1964	
	July 26	September 27	December 27	January 31	February 21
Interest rates					
3-month yields:					
Zurich banks a/	2.94	3.12	b/3.38	2.94	2.94
Euro-dollars c/	4.10	4.03	4.25	4.12	4.06
U.S. Treasury bills c/	3.16	3.28	3.50	3.48	3.51
Deposit certificates (3 to 8 years):					
12 cantonal banks	3.44	3.63	3.63	3.88	3.88
5 large banks	3.39	3.64	3.64	3.85	3.85
Long-term government bonds	3.18	3.26	d/3.41	3.56	3.71
Stock prices (1958 = 100)	255.7	266.4	b/253.1	249.5	249.1
Exchange rates					
Spot francs (U.S. cents)	23.15	23.18	23.18	23.16	23.11
Forward premium on franc e/	+0.02	+0.06	+0.09	+0.68	+0.81

a/ Most frequently quoted rates of the five large Swiss banks in Zurich.
b/ December 31 figures.
c/ Return in Swiss francs after cost of exchange cover.
d/ December 20 figure.
e/ Per cent per annum.

To combat continued scarcity of medium-term funds, some of the major banks raised to 4 per cent on January 1 the rate they pay on medium-term certificates of deposit (Kassenobligationen), a move the BNS would not allow them to make in November. Some of the smaller banks raised their 3-8 year certificate rate on February 1 from 4-1/8 to 4-1/4 per cent to attract funds, even though an increased volume of savings deposits is being converted into medium-term certificates.

The supply-demand balance that kept long-term yields steady through December, even with a volume of new issues that was above the seasonal level, gave way in January to a rise in long-term rates. An increased number of borrowers went to the market following the announcement of the government's proposed credit restrictions in late January, and the yield on Federal Government long-term bonds rose from 3.45 per cent on January 31 to 3.71 per cent by February 21. A Swiss power company recently issued a 15-year, 4-1/2 per cent, $11.6 million bond that was priced to yield 4.47 per cent, the highest effective yield to date. Only three months ago the same company raised funds with a 4.12 effective yield. No foreign borrowers were allowed into the market in February, and the 4 per cent coupon rate gave way entirely to 4-1/2 and 4-1/4 per cent toward the end of the month.

The stock market recovered from a nine-month low at mid-December only to retreat again after the New Year in face of the uncertainties surrounding the anti-inflationary program. After the program was announced in late January, the market went into an uninterrupted decline, dropping off 9 per cent by mid-February from the January high. It has continued uneven since.

1963 foreign trade deficit increases

Switzerland's foreign trade deficit rose $34 million over 1962 to $825 million in 1963, although exports grew at a slightly higher rate than imports. (See Table 4.) The rate of increase in manufactured imports was particularly high (8.1 per cent), presumably reflecting domestic price increases and the strong consumer demand.

During the fourth quarter, exports increased more than imports (and at a considerably higher rate than imports) to cut the average monthly

Table 4. Switzerland: Foreign Trade, 1962-1963
(seasonally adjusted, monthly average or month, in millions of U.S. dollars)

		Imports c.i.f.	Exports f.o.b.	Trade Balance
1962	I	252	180	-72
	II	246	185	-61
	III	254	187	-67
	IV	250	187	-63
1963	I	249	191	-58
	II	273	204	-69
	III	278	200	-78
	IV	280	210	-70
	May	279	207	-72
	June	265	208	-57
	July	285	197	-88
	August	271	199	-72
	September	278	202	-76
	October	282	209	-73
	November	273	218	-55
	December	285	202	-83
1964	January	1/293	1/208	1/-85
		Annual Totals		
1962		3,020	2,229	-791
1963		3,253	2,428	-825

1/ Preliminary figures subject to adjustment.

Source: OECD; *Neue Zürcher Zeitung*.

deficit (seasonally adjusted) to $70 million. (The third quarter average monthly deficit was $78 million.) This, however, was still $7 million above fourth quarter 1962. A surge of imports in December sent the trade deficit (seaonally adjusted) back up to an unusual high of $83 million, just below last July's all-time high. Preliminary figures indicate the deterioration carried over into January when the trade deficit was about 60 per cent above the year-ago figure.

Official reserves increase for the year

Indicating the magnitude of the surplus in Switzerland's balance of payments (the Swiss do not publish official balance of payments estimates), official Swiss reserves of gold and foreign exchange increased by 7 per cent ($202 million) from year-end 1962 to year-end 1963. (See Table 5.) December's $316 million increase and January's $301 million decrease in official reserves reflect the BNS's massive dollar buying and subsequent resale to assist the banks in their year-end liquidity needs. Most of the funds ($208 million) were acquired in dollar-franc swaps directly with the commercial banks, by-passing the foreign exchange market. To keep gold at its usual ratio of 91 to 93 per cent of total reserves, the BNS acquired from the Bank for International Settlements (BIS) $232 million of gold for dollars and resold it to the BIS on a short-term forward basis. Separately, the BNS bought from the BIS $50 million of gold for Swiss francs, which the BIS then swapped with the Federal Reserve Bank of New York, permitting the latter to retire obligations to the BNS. The reserval of all these swaps in January accounts for the loss of official reserves in that month.

Table 5. Switzerland: Official Reserves
(end of period figures, in millions of U. S. dollars)

Date		Gold	Foreign Exchange	Total	Change	% of Reserves Held in Gold
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
	III	2501	200	2701	- 7	93
	IV	2820	254	3074	+373	92
	October	2520	246	2766	+ 65	91
	November	2522	235	2758	- 8	
	December	2820	254	3074	+316	92
1964	January	2550	224	2773	-301	92
	February	2551	202	2753	- 20	93

Source: Banque Nationale Suisse.

Swiss franc softens in late January

Shortly after the announcement of the government's anti-inflationary moves on January 27, the Swiss franc exchange rate began to soften. (See Table 6.) In December and January it had been consistently strong, remaining just below the limit imposed on the dollar/franc rate by the BNS in the Swiss market. Although this retreat in the franc rate has been general against all major European currencies, it has been greatest against the German mark and the US dollar.

A combination of factors probably bears responsibility for the decline in the Swiss franc rate. Until the government announced its anti-boom program, there had been continuous rumor of a revaluation of the franc. When it became plain that the government intended to stem the "over-heating" in the economy without revaluation, speculation apparently shifted from the

Table 6. Foreign Exchange Rate for the Spot Swiss Franc
(in U.S. cents per Swiss franc)

Par Value	22.868
Lower Limit	22.472
Upper Limit 1/	23.178

Year	Month	Daily Average 2/	Week Ending		End of Week 3/
1963	January	23.120	December	6	23.173
	February	23.123		13	23.176
	March	23.102		20	23.176
	April	23.099		27	23.175
	May	23.127	January	3	23.173
	June	23.125		10	23.176
	July	23.129		17	23.176
	August	23.164		24	23.174
	September	23.171		31	23.164
	October	23.171	February	7	23.158
	November	23.166		14	23.124
	December	23.170		20	23.106
				28	23.103
1964	January	23.168			
	February	23.122			

1/ 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.
2/ Noon buying rate.
3/ Noon selling rates.

Source: Federal Reserve Board.

Swiss franc to the German mark. Observers also noted an increasing investment demand for marks, especially from Swiss-managed foreign funds, probably in response to the government's proposals to tighten up on the inflow of foreign funds.

The wide discount on the 3-month forward dollar against the Swiss franc that opened up early in the new year continued through February, indicating the continued strong demand for forward franc cover.