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Recent Economic Developments in Switzerland,
March-May 1964

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Summary

The economic pace continued to be rapid in Switzerland during March-May: a high level of construction activity created the most critical first-quarter labor shortage of the boom, and a sharp growth in imports produced an all-time high trade deficit in the first quarter. Prices, however, eased, apparently for seasonal reasons. Swollen credit demands, no doubt in anticipation of new financial regulations, produced an avalanche of new bond issues and drove interest rates up across the board. The Swiss franc recovered to its ceiling against the dollar on the strength of repatriated funds attracted by the tight money conditions.

The regulations established pursuant to the special legislation of early March give the authorities more control over the economy than they have before had in peace-time.1/ The direct controls on new building are now in effect, and the controls on foreign fund inflows are now law for <u>all</u> handlers of foreign money and enforceable by severe penalties. Legal credit ceilings were put in effect on May 1 and, for the first time in Swiss history, the law now requires that domestic capital issues must be authorized by a newly created capital issues committee. Reports that no new foreign bond issues will be allowed until fall suggests that the authorities expect that it will take time before the controls produce results.

Anticipating the new controls, borrowers drew heavily on Swiss credit facilities during March-May, and some interest rates advanced to their highest levels in years. An unusually large supply of new issues depressed yields on outstanding bonds, with yields on long-term governments reaching almost 4 per cent by late May. Institutional switching from mortgages to the higher yielding bonds

1/ See "Recent Economic Developments in Switzerland, December 1963-February 1964," dated March 10, 1964, pages 4-6.

kept mortgage funds particularly scarce as banks, short on longer term funds, were reluctant to grant mortgages even at higher rates. Rates were raised, both on the medium-term deposit certificates (Kassenobligationen) and 3-month bank deposits, but banks were still forced to convert large amounts of foreign exchange holdings into Swiss francs to meet liquidity needs.

This conversion of the banks' foreign holdings into francs and the repatriation of funds from Germany in response to the proposed withholding tax on bond income there pushed the Swiss franc back to its dollar ceiling by late April. The Banque Nationale Suisse (BNS) was forced to support the dollar, as a result, and foreign exchange holdings increased $88 million from the end of February in spite of the $250 million all-time high trade deficit of the first quarter.

New anti-inflationary measures put into effect

Economic activity in Switzerland continued to run at capacity levels during the March-May period. In an effort to restrain the expansion in demand, the authorities began to make use of the new powers granted them under the anti-inflationary laws passed by Parliament on March 13.[2] Several new regulations aimed at controlling the main sources of inflationary pressures were put into effect:

a. Construction. The program for licensing all new buildings and limiting total new construction in each canton to a ceiling fixed by the federal authorities went into effect on March 17, putting into effect practically all the powers of the new legislation.

b. Control of foreign funds. The new controls on foreign funds became effective for banking institutions on March 31 and

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2/ See "Recent Economic Developments in Switzerland, December 1963-February 1964" dated March 10, 1964, pages 4-6.

were extended to all handlers of foreign money effective May 1. Interest may now be paid on foreign-owned term deposits made after June 30, 1960 (which was formerly prohibited), but not on any deposits made after January 1 this year, except for central bank deposits and savings deposits of SF 20,000 or less. Financial institutions are required to balance their foreign accounts on the tenth of each month and to pay any net gain from the previous month into a frozen BNS account. They may sell Swiss securities to foreigners only to the amount of purchases from foreigners during the same month, and may not undertake any new investments in domestic assets for foreign accounts.

c. Control of capital issues. Government control of domestic capital issues (never before permitted in Switzerland) became effective May 1. All new issues of SF 5 million or more must now be authorized by a newly created capital issues commission which will program the total permissible value of new issues on a quarterly basis.

d. Domestic credit controls. Effective May 1, a new system of credit ceilings was put into law, replacing the old "gentlemen's agreement" on bank credit. The rate of credit extension for individual banks in 1964 may not exceed 78 per cent of their 1960 or 1961 rate, whichever is greater.

These laws give the Swiss authorities greater control over the economy than they have had before in peace-time and presumably could control the 4-year old boom if allowed to continue long enough. However, pressures are already being brought to bear to make the controls very temporary; it is claimed that they hamper the effectiveness of market forces and place undue administrative burdens on the financial sector of the economy. And, no doubt, certain loopholes will become apparent and reduce the program's effectiveness. For example, note is already taken of the cantonal exception allowed on all buildings worth less than $58,000.

Most acute winter labor shortage in four years

The mild winter weather reinforced the already high rate of economic activity, particularly in the construction sector, and helped to produce the most severe first-quarter labor shortage in the four years of the current boom. (See Table 1.) However, in spite of this labor stringency, the Government again tightened controls on foreign workers in March, even though the number of non-seasonal foreign workers subject to controls had declined by 2,000 between August 1963 and February 1964. In the agricultural sector though, where labor shortages are most critical, foreign recruitment is being stepped up: so far this year 1,800 farm laborers have been brought in from Spain, 1,000 from Yugoslavia and 200 from Tunisia. There are plans for further arrivals in the summer.

Table 1. Switzerland: Unemployment and Job Vacancies

End of Month	Registered Unemployed			Registered Job Vacancies		
	1962	1963	1964	1962	1963	1964
January	2,022	4,896	1,049	5,563	5,044	6,039
February	882	2,174	303	6,161	5,571	7,134
March	377	454	242	6,474	6,210	6,996
August	185	142		6,262	6,701	
September	199	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.

Price and wage increases moderate

Despite the strains on resources, wage and price pressures eased somewhat during the early part of 1964. The relative stability of prices during the first quarter, however, was largely due to seasonal price declines. Consumer prices were stable during February and March, mainly because lower food prices offset increases in other categories. Wholesale prices, and particularly those for domestic goods, moved slightly lower in each month of the first quarter. (See Table 2.)

During the March-May period, there was a lull in the upward movement of wage rates; however, one major increase occurred when Parliament approved a 4 per cent raise in federal wages in March. With wages poised to follow should further price increases occur, the price and wage situations are undoubtedly tied closely together at the moment.

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 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
October	204	234	234	233
November	205	235	234	235
December	205	235	235	235
1964 I	206	234	232	236
January	205	234	233	236
February	206	234	232	236
March	206	233	231	235

Source: Banque Nationale Suisse, Bulletin mensuel.

<u>Credit demands heavy in anticipation of new controls</u>

Anticipating the introduction of the new regulations, borrowers drew heavily on Swiss credit facilities during the three months under review, and <u>all</u> interest rates advanced, some to their highest levels in years. (See Table 3.) The rush to issue new bonds and increased demands for new mortgage credit kept the long-term securities markets under continuous pressure. Moreover, the supply of short-term funds was reduced by the new "leak-proof" regulation on foreign fund inflows.

Hard pressed for funds, the commercial banks reduced foreign holdings and increased 3-month deposit and trade paper discount rates to new recent highs. Zurich banks raised the 3-month deposit rate to 3.38 per cent in April (see Table 3) and put up the 5-year-old commercial paper discount rate of 2 per cent by 1/2 percentage point. Euro-Swiss franc rates moved up from 3.12 per cent on January 31 to 4.12 per cent on May 15, however, and many industrial accounts found it more profitable to place their Swiss franc deposits directly with foreign banks. This drew down domestic bank liquidity, as did unseasonally large increases in note circulation, and forced sharp borrowing at the BNS at times.

Scarcity of medium-term funds again led the large Zurich banks to put up their medium-term deposit certificate (Kassenobligationen) rate in April from 4 to 4-1/4 per cent. (The rate was increased to 4 per cent only in January.) However, a continued shortage of funds from deposit certificates of 5-year or longer maturity has made many banks reluctant to grant new mortgages, even at higher rates. The mortgage market has been tightened further by institutional switching from mortgages to bonds to take advantage of higher yields.

Table 3. Switzerland: Selected Financial Indicators

	1963	1964			
	September 27	January 31	March 27	April 24	May 15
Interest rates					
3-month yields:					
Zurich banks[a/]	3.12	2.94	3.19	3.38	3.38
Euro-dollars[b/]	4.03	3.44	3.82	4.51	4.16
U.S. Treasury bills[b/]	3.28	2.80	3.09	3.75	3.36
Euro-Swiss francs	3.81	3.12	3.62	4.12	4.12
Deposit certificates (3 to 8 years):					
12 cantonal banks	3.63	3.88	3.88	3.90	4.17
5 large banks	3.64	3.85	3.85	3.85	4.12
Long-term government bonds	3.26	3.56	3.90	3.85	[c/]3.90
Stock prices (1958=100)	266.4	249.5	246.2	238.7	235.4
Exchange rates					
Spot francs (U.S. cents)	23.18	23.16	23.11	23.18	23.17
Forward premium (+) discount (-) on franc[d/]	+0.06	+0.68	+0.43	-0.32	+0.09

a/ Most frequently quoted rates of the five large Swiss banks in Zurich.
b/ Return in Swiss francs after cost of exchange cover.
c/ May 8 figure.
d/ Per cent per annum.

The current avalanche of new issues is the factor most responsible for the stringency in Swiss financial markets, aside from the cut-off of foreign funds. New issues during the first quarter of 1964 totaled $236 million, about $78 million above the rate for a year ago and $40 million above that for the fourth quarter of 1963, when the current new issue boom began to gain momentum. (See Table 4.) The heavy offerings of new bonds have caused a steady increase in yields on outstanding issues. The yeild on long-term federal bonds rose from 3.56 per cent on January 31 to 3.90 per cent by mid-May, and a larger than usual number of apparently good new issues have recently been unsuccessful; this experience suggests the need for further adjustment of the terms on new bonds to current market conditions. (See Table 3.) In April yields steadied as funds, repatriated from Germany on announcement of a withholding tax there on income from foreign-held bonds, went into the Swiss bond market.

Since foreign funds have now been closed out of the market, interest rates are expected to continue to rise until the stabilization measures can cut back the demand for capital to equal the supply of domestic savings. In fact, Swiss authorities are counting on higher rates to increase domestic savings, but interest rates are expected to rise more slowly than at present. Reports that after the pending Badische Anilin (German chemical firm) issue no new foreign bonds will be allowed on the Swiss market until fall may indicate official views that it will take some time for the stabilization program to achieve results.

Table 4. Switzerland: New Capital Market Issues
(monthly average, millions U.S. dollars)

	1962				1963				1964	
	I	II	III	IV	I	II	III	IV	I	Apr.
Swiss borrowers[1]										
Bonds	24.5	26.8	16.6	18.8	38.2	32.3	36.0	55.5	66.9	40[2]
Stocks	15.6	21.7	5.3	6.9	14.5	10.0	3.6	12.5	11.9	[3]
Total	40.1	48.5	21.9	25.7	52.7	42.3	39.6	68.0	78.8	
Foreign borrowers[1]										
Bonds	20.2	13.2	7.0	10.5	9.3	18.1	4.3	13.9	7.6	0
Total[1]	60.3	61.7	28.9	36.2	62.0	60.4	43.9	81.9	86.4	
Foreign borrowing as % of total	33.5	21.4	24.2	29.0	15.0	30.0	9.8	17.0	8.8	0

1/ Amounts are gross.
2/ Preliminary figure.
3/ Not available.
Source: Banque Nationale Suisse, Bulletin mensuel.

Swiss stocks, already at low yields, lost lustre with the coming of the anti-inflationary program. Foreign support, too, was lost with the controls on foreign fund inflows, and prices fell about 5 per cent from March to May on reduced volume. (See Table 5.) On May 22, the industrial index was 234 compared with 266 last September.

Table 5. Switzerland: Industrial Share Index
(1958=100)

1963					
September	27	266.4	March	13	245.8
December	30	253.1		27	246.2
1964			April	10	242.5
January	3	256.1		24	238.7
	17	250.8	May	8	234.5
	31	249.5		22	234.5
February	14	242.7	June	1	224.4
	28	245.8			

Source: Swiss Bank Corporation.

Foreign trade deficit increases

Continuing growth of imports helped to ease demand pressures within Switzerland in the period under review but the growing foreign trade deficit is causing official concern. The first quarter trade deficit was $252 million (seasonally adjusted), an all-time high: it was $42 million above the previous quarter's deficit and $78 million above the year-ago amount. However, part of the heavier deficit was due to the delivery of six commercial aircraft early in 1964. (See Table 6.)

Since the beginning of the current period of economic expansion in 1960, Swiss import expansion has increasingly outpaced the growth in exports, even in the face of earlier restrictive action. The authorities now feel that the recent measures should achieve better balance in the trade account. However, the future of exports is closely tied to the success of current attempts to reduce world-wide tariffs. Since negotiations for granting Switzerland a special status with the Common Market countries have yielded no results, the government is counting heavily on a general reduction in tariff rates within the framework of GATT to preserve its trade position with the EEC.

Table 6. Switzerland: Foreign Trade
(seasonally adjusted monthly average or month, in millions U.S. dollars)

	1963				1964			
	I	II	III	IV	I	Jan.	Feb.	Mar.
Imports, c.i.f.	249	273	278	280	296	292	301	294
Exports, f.o.b.	191	204	200	210	212	207	215	215
Trade Balance	-58	-69	-78	-70	-84	-85	-86	-79

Source: OECD, Main Economic Indicators; Nene Zurcher Zeitung.

Official reserves rise

In spite of the recent large trade deficits, Swiss official reserves have continued to accumulate. BNS gold and foreign exchange holdings rose $63 million from end-February to mid-May, mostly from the transfer of foreign exchange holdings from the Swiss private banks to the central bank due to tight money conditions. (See Table 7.) Gold losses in March and April were caused by the reversal of year-end gold/franc swaps with the BIS; on the other hand, the large foreign exchange accruals in late April and early May reflect the BNS dollar support operations in the foreign exchange market.

Table 7. Switzerland: Official Reserves
(end-of-month figures, million U.S. dollars)

	1963				1964				
	Mar.	June	Sept.	Dec.	Jan.	Feb.	March	April	May 15
Gold	2,461	2,530	2,501	2,820	2,550	2,551	2,543	2,525	2,526
Foreign Exchange	177	178	200	254	224	202	201	280	290
Total	2,638	2,708	2,701	3,074	2,774	2,753	2,744	2,805	2,816
Change	-234	+70	-7	+373	-300	-21	-9	+61	+11
Gold Ratio	93	93	93	92	92	93	93	90	90

Source: Banque Nationale Suisse.

Swiss franc traded again at ceiling

Repatriation of funds from Germany (in response to the proposed withholding tax on foreign-held bond income) and the conversion of commercial bank foreign holdings into francs in the exchange market (in response to tight domestic money market conditions) gave the Swiss franc renewed strength in April. By the end of the month, the spot rate had returned to the former ceiling of 23.178 U. S. cents per franc. (See Table 8.) Offerings of U. S. dollars were so heavy in late April and early May that the BNS intervened to acquire about $36 million.

Thus, temporary factors are responsible for the recent recovery of the Swiss franc. For the future, the franc's outlook (aside from the times when refuge funds come into the country) may well depend on the reaction of Swiss interests with money abroad to the effects of the anti-inflationary program. A further tightening of credit conditions or rise in interest rates might produce further large-scale repatriation of Swiss funds.

Table 8. Switzerland: Spot Rates for the Swiss Franc[1/]
(U.S. cents per Swiss franc)

Par Value - 22.868; Lower Limit - 22.472; Upper Limit - 23.178[2/]

1963	Dec.	6	23.173	Feb.	7	23.158	Apr.	3	23.113
		13	23.176		14	23.124		10	23.128
		20	23.176		20	23.106		17	23.160
		27	23.175		28	23.103		24	23.178
1964	Jan.	3	23.173	Mar.	6	23.105	May	1	23.176
		10	23.176		13	23.129		8	23.175
		17	23.176		20	23.111		15	23.170
		24	23.174		27	23.109		22	23.175
		31	23.164					29	23.176

1/ Selling rates in the New York market.
2/ 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