The economic situation from the vantage point of the delegates for regional economic relations

Summary report for the attention of the Governing Board of the Swiss National Bank for its quarterly assessment of September 2009

The SNB's delegates for regional economic relations are constantly in touch with a large number of enterprises from the different industries and economic sectors. Their reports, which contain the subjective evaluations of these companies, are an important additional source of information for assessing the economic situation. On the following pages, the most important results of the talks held in July and August 2009 on the current and future economic situation are summarised.

Summary

In the talks held by the SNB delegates for regional economic relations in July and August, most of the 160 or so representatives of various economic sectors and industries said the pace of economic decline was easing. This was most obvious in industries that hold an early position in the economic cycle. Assessment of the outlook also improved, although in many cases respondents conceded that the situation remained vulnerable. Outstanding orders and production are still below the year-back level, and quite substantially so in some areas.

In the past few months, differences between export-based companies and those with a domestic market focus have become less pronounced. In principle, export-based companies are still much more strongly affected by the crisis than domestically-focused companies. However, an increasing number of respondents are mentioning firmer foreign demand and favourable indications, particularly from Asia. By contrast, the domestic economy – which had held up well for a long time – has been increasingly affected by the crisis. Construction has remained relatively robust. Sentiment has improved in the banking industry.

Complaints about bank financing conditions and the exchange rate remain rare. Clearly, financing conditions have not worsened very much more than is normally the case in a cyclical downturn in which companies' production and earnings come under pressure. Nevertheless, there are widespread concerns that interest rates could rise again next year and that the Swiss franc might regain strength.

1 Production

Manufacturing

The assessment of the new orders situation by respondents in the manufacturing industry varied considerably. However, the number of positive evaluations was substantially greater than in previous months. We can therefore assume that the average level of new orders for all companies is likely to have stabilised. In many cases, however, outstanding orders and production have fallen further, although the decline appears to have slowed considerably.

Variation between the different industries remains considerable. In machinery, business has deteriorated further and expectations for the near future remain negative. By contrast, the mood has changed recently in the chemicals industry, which – like machinery – was affected by the crisis at an early stage. The food and pharmaceuticals industries are still holding up well. In geographical terms, Asia and South America appear to have been the main source of positive momentum in the past few months, since their demand for infrastructure projects is still strong. By contrast, most respondents describe demand from the US and western Europe as weak.

Most company representatives are cautious in their evaluation of the outlook. Although a bottoming out of the cycle was often mentioned, many company representatives were assuming that the recovery would not begin until 2010, and even then would be tentative. Some respondents drew attention to the fact that the good news primarily related to industries that were benefiting indirectly from government support packages in other countries and that, consequently, the risk of a short-lived recovery was considerable. Other representatives noted the worldwide development of large capacities in manufacturing over the past few years and stated their expectation that this overcapacity was likely to cause financial difficulty for many companies, and that a wave of consolidations with works closures and mergers was likely. They concluded that a continuation of the low level of investment could be expected in the medium term.

Services

The situation in retailing is better than in manufacturing, but since spring the crisis has been perceptible in this area too. Industry representatives often spoke of consumers substituting cheaper articles for expensive ones. Variations between the different segments remain considerable. In general, the food segment is holding up better than the non-food segment. Within the non-food segment, demand for clothing, furniture and consumer electronics has suffered most. Most respondents in retailing (and also from other consumer-related areas) were expecting a further deterioration in consumer confidence. In general, they based this on the expected rise in unemployment.

Respondents from the hospitality industry expressed similar views. Expenditure per guest has declined perceptibly. Numbers of guests are also falling, although in most important tourism regions they are still at the level of 2006 and 2007 – which at the time were considered to be good years. The drop in numbers is greater for guests from abroad than it is for Swiss guests. Some businesses have even managed to compensate the drop in the number of foreign guests by attracting more Swiss guests; usually, however, this has necessitated special deals and corresponding loss of margin. Other types of accommodation and same-day travel from Switzerland and neighbouring areas across the border continue to hold up well. As was the case three months ago, the biggest losses have been recorded in business travel and in conferences and seminars. In these areas, the cost-saving efforts of companies are making a clear impact.

Other business-related services have also suffered a decline. In most areas, business remains slow. This is as true for consulting and market research as it is for advertising. Since July, however, the situation has improved in transportation, with the largest Swiss providers reducing their capacity. A number of software providers also spoke of continuing robust demand for IT solutions.

In the banking industry – in particular in asset management – the mood has improved in recent months due to the worldwide revival of the financial markets. Corporate results were better than expected, and investor risk appetite again appears to have increased somewhat. The solution of the tax dispute with the US also caused a certain amount of relief. In general, demand for mortgage loans has remained high, while demand for commercial loans has continued to suffer as a result of the recession. Despite a rise in credit volume, income from interest rate business is still under pressure. However, a healthy stock exchange has stimulated commission business, which has given rise to higher income in this area.

Construction and real estate

As was the case three months ago, representatives of the construction industry reported that business had been good. Although construction volume has slipped slightly in seasonally adjusted terms, the levels of new orders and outstanding orders have remained satisfactory. Since the level of outstanding orders has remained high, respondents are expecting a high level of construction activity again in the second half of the year.

Residential construction and civil engineering are making particularly strong contributions to the good business results in the construction industry.

By contrast, commercial and industrial construction is struggling, since numerous projects have been frozen or abandoned. Residential construction is supported by the low mortgage rates and demographic developments. Moreover, the finishing industry is benefitting from government promotion of energy-saving measures.

This construction cycle has been supported, in general, by the fact that the current recession was not preceded by overheating of the real estate market, as has so often been the case in the past. Most respondents from the real estate industry assessed the current price level as appropriate. Only in the case of commercial and industrial properties and expensive residential properties in locations that could not be described as truly first-class did they see the need for (further) price correction.

2 Labour market

In the past few months, the labour market has deteriorated steadily. Companies reacted to receding demand first, by introducing short-time working, next, by placing an embargo on new recruitment and then, by taking advantage of natural fluctuation in employment. Finally, over the past few months, there has been a rise in the number of redundancies.

The talks with industry representatives confirmed the impression gained three months ago that further lay-offs were to be expected. It is likely that short-term working, which is being used extensively, will increasingly give way to unemployment. Although companies are still trying to retain well-trained staff, many respondents spoke of increased pressure to further reduce employee numbers as simple cost reduction measures had been exhausted and the pressure to step up efficiency was increasing.

However, variation between industries and between companies within the same industry is considerable. Once again, some respondents mentioned the difficulties in recruiting specialists. Moreover, there are even a number of companies in the manufacturing industry that have ceased short-term working over the past few weeks and are now back up to full production.

3 Lending conditions

As in past discussion rounds, respondents from the banking industry stressed the fact that, in the vast majority of cases, access to credit and lending conditions were unchanged, and that the rate of growth in credit volume had fallen off because demand had weakened. In addition, they pointed out that many of the remaining investment projects were being funded by the companies themselves.

Representatives of other industries basically confirmed this picture. In almost all cases, financing conditions were described as essentially unchanged. However, many respondents expected a tightening in the near future because of the deterioration in key data. Furthermore, there was frequent mention of the fact that large loans have become harder to obtain. General worries with regard to future interest rate developments were aired in several discussions. On various occasions, concern was expressed that central banks would not be able to reabsorb the massive expansion of liquidity supplied to banks in good time without disruption.

4 Prices, margins and earnings situation

Most respondents noted that prices had remained unchanged or had fallen slightly, although there were substantial variations between the different industries. Weak demand and tough competitive pressure are forcing down sale prices. Monetary conditions as well as commodity prices and transportation costs are providing some relief. Commodity prices and transportation costs have risen in the past few months, but they are still lower than a year ago.

Margins have dropped due to overcapacity, strong competition and the shift in demand to cheaper products. In some discussions, respondents spoke of substantial worldwide overcapacity affecting most manufacturing industries. Given expected growth, utilisation of this capacity would only increase slowly. They concluded that the outlook for earnings and margins therefore remained gloomy.

Various company representatives mentioned that, in addition to their own earnings position, those of their suppliers and customers had also become more important. Generally speaking, they were paying particular attention to the areas of liquidity management and enforcement of payment arrangements.

The exchange rate gave little cause for discussion. Representatives of the export industry welcomed the foreign currency sales announced by the SNB in March, which are aimed at preventing a further appreciation in the Swiss franc against the euro. They said this had substantially reduced uncertainty with respect to movements in the exchange rate. However, some respondents expressed the concern that the Swiss franc might become stronger again next year.