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 December 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 October and November 2009 on the current and future economic situation are summarised.

Summary

In the talks held by the SNB delegates for regional economic relations with around 180 representatives of various economic sectors and industries in October and November, the consensus was that the economy is gradually regaining momentum. Initial – and mostly still weak – signals of a trend reversal in parts of the export industry had already been recognisable in the previous round of talks. These were now confirmed and shown to be more pronounced. Moreover, the expectations expressed the last time were, for the most part, exceeded. Despite these positive developments, however, euphoria would be inappropriate. Unemployment is still on the rise and capacities in numerous sectors of the economy remain underutilised, in some cases massively so.

Most of the respondents anticipate another difficult year ahead. For the first time in a long while, a slight majority of the respondents expect an increase rather than a decrease in turnover. As far as staff numbers are concerned, however, most anticipate further cuts. Selling prices are also expected to tend downwards.

Weak demand remains the principal concern. Pressure on margins and earnings were also frequently mentioned. The weak dollar was brought up more often than before when the topic of exchange rates was raised. The banks' lending policy, by contrast, was less of a talking point. Obviously, the credit crunch that was widely feared would result from the financial crisis has not come to pass.

1 Production

Manufacturing

Compared to the talks in August, distinctly more representatives from the manufacturing sector now spoke of an upturn in demand. The main reasons mentioned were the partial rebuilding of inventories following their massive depletion and the economic stimulus packages implemented by governments in various countries. Demand from Asia, particularly China, developed dynamically, but Latin America, especially Brazil and Mexico, also warranted mention. Demand from the US and Europe, by contrast, remained weak. In the case of the US, one of the reasons was the weakness of the dollar, which rendered Swiss exports more expensive.

There are, in part, major differences from one manufacturing sector to another. Various companies from sectors that benefit early from a recovery, especially in the chemical and plastics industries, had already expressed confidence in August. They now confirmed the turnaround and spoke of a positive trend growth rate in October and November in terms of both output and turnover. Positive signals came from other industries, too, including the energy technology and supply industry and parts of the machinery industry. Although the overall picture has become brighter, the mood in many areas of manufacturing remained gloomy. Order volumes particularly in the machinery and watchmaking industries are, in certain cases, substantially below their year-earlier level. Despite capacity reductions, capacity utilisation reached a new low-water mark in numerous companies.

Respondents from the manufacturing industries are generally counting on a slow recovery. Companies benefiting late from an economic recovery, such as those operating in plant engineering, will probably achieve a turnaround only in 2010. Nor are representatives of other lines of manufacturing, for the most part, expecting to see production figures approach values reached before the recession any time soon. Various respondents, moreover, expressed doubts with regard to the durability of the latest revival in demand. On the one hand, the inventory cycle and the government stimulus programmes will come to an end in the foreseeable future. On the other, the revival of demand in numerous areas was deemed too weak to allow companies to take a long-term view, and plan and invest accordingly based on the secure knowledge of a coming economic upturn.

Services

Hotels and restaurants mostly reported figures exceeding the expectations that had been adjusted downwards after a restrained trend in early summer. Demand was still well below the year-earlier level, but by less than many had feared. In most regions, it was the Swiss clients who, to a certain extent, made up for the drop in the numbers of foreign visitors. Hotels catering for business travellers and providing venues for seminars and congresses generally registered low occupancy rates in spite of some encouraging signals. The same applied, in general, to upmarket hotels, whereas those in the middle class range benefited from clients' cost awareness and thus, in many cases, recorded only slight declines in revenue. Reservations for the coming winter season were still on a low level at the time of the survey, but respondents from the ski resorts did point out that guests nowadays tended to plan and book at short notice.

Most of the respondents from the retail sector spoke of stagnation, however with some significant differences from one line of business to another. The main reason was said to be the growing price awareness among consumers inducing them, in certain cases, to switch to providers and products of different price segments. Demand remained good especially for sports items and leisure activity goods in general, as well as in the food sector, which is resistant to cyclical fluctuation. By contrast, demand was down in the clothing, shoes, furniture and electronic devices sectors. Expectations for the Christmas season are subdued and retailers look ahead to 2010 with a certain unease. The principal fear is that the anticipated further rise in unemployment will have a negative impact on consumer confidence.

The information gained from talks with representatives of other service providers from the consumer and business segments – including IT, tourism and transportation – was mixed. Turnover was generally lower than a year before, albeit to highly varying degrees. Most surveyed companies from these segments, however, anticipate stagnating or slightly increasing sales over the coming months.

Already in August, respondents from the banking sector had been more upbeat than in spring, and the tenor of this survey was similar. Banks are benefiting especially from the positive stock market developments. In the lending business, private demand for mortgages remained strong, whereas demand for corporate loans slackened. Banking representatives almost unanimously spoke of extremely fierce competition in the lending business, which took its toll on margins. Expectations for the coming year are, for the most part, restrained. Banks are preparing for increasing loan defaults and have therefore raised their provisions. Bankers in asset management, too, expect uneasy times ahead.

Construction

The construction companies surveyed were mostly upbeat about the course of business. This is due especially to the order volume, which was largely deemed to be satisfactory. The weak trend in commercial and industrial construction continued despite certain encouraging signals, whereas the situation in residential construction and civil engineering remains good. Most respondents expect turnover to stay largely unchanged over the coming months. Overall, the construction industry continues to benefit from the low interest rates, the government stimulus packages for the economy, a migration balance that is positive – albeit to a lesser extent than the year before – and the willingness of many home owners to invest in environment protection and energy-saving measures.

2 Labour market

Most of the companies surveyed reacted to the recession by taking steps to save costs. From the start, natural turnover was used as a means to reduce staff. A large number of companies – predominantly in the manufacturing sector, less so in services – introduced short-time work. The number of lay-offs has risen since spring. Over the past two to three months, the situation has changed insofar as numerous firms that had resorted to short-time work retracted this measure or at least reduced its extent. The consensus in a large number of discussions was, however, that the turning point in the job market has not yet been reached. Most respondents consider the recovery to be fragile and are unlikely to employ more people in the foreseeable future. In addition, most of them plan to maintain their policy of using natural turnover to reduce their workforce. Many are also rethinking their strategy and trying to find the most appropriate medium-term production level. In some cases, this is likely to lead to resizing and thus a reduction in the number of employees.

3 Lending conditions

The credit crunch that was widely feared would result from the financial crisis has not materialised. During the talks held in October and November, respondents from the non-banking sectors again made hardly any mention of a shortage of credit. Banks are obviously being flexible in general and passing on the benefit of more favourable refinancing costs. However, risk premia for bank loans have apparently gone up in reaction to the worsening of key financial indicators.

Bank representatives have confirmed this impression. Risk premia are indeed being raised and, in particular, being related more closely to the situation of the company concerned. The banks surveyed consider the fact that corporate loans are barely growing or, in some cases, even receding to be an expression of the reduced corporate investment level. Based on the lower earnings recorded by numerous companies, banks also anticipate an increase in credit defaults in the coming year.

4 Prices, margins and earnings situation

Respondents from all industries pointed to the, in part, considerable pressure on margins and a deterioration in their earnings position. In general, the reason cited was the under-utilisation of capacities in their company and their industry in general. On the one hand, the decline in demand can lead to an increase in average production costs owing to large blocks of fixed costs. On the other, the global economy's excess capacity makes it difficult or even impossible for individual companies to factor higher costs into their prices. The number of respondents preparing for lower selling prices exceeds the number of those planning price increases. This holds true not only for manufacturing and construction, but also for the services sector. As a result, the tightening of margins is mostly expected to continue. The anticipation of smaller margins has added to companies' liquidity concerns and to their general sense of unease.

Companies reacted very swiftly to the decline in earnings by tightening cost management. The discussions with representatives of all industries revealed that firms were determined to keep the cost-cutting measures in place. However, they saw little scope for further cost savings without resorting to job cuts or pay reductions.

Asked about pay developments, most respondents mentioned changes in the bandwidth of 0–1%. With staff numbers declining, this should lead to a stagnation or even a slight decline in the nominal total wage bill. Some stated that their companies had actually considered pay cuts, but most had dismissed the idea because they feared the negative impact on morale.

On the subject of exchange rates, a majority of respondents from the export sector were satisfied with a Swiss franc exchange rate against the euro of just over 1.50. The current Swiss franc rates against the US dollar and the pound sterling were a greater reason for concern and were deemed by many to be too low.