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# Business cycle trends

SNB regional network

Report for the attention of the Governing Board of the Swiss National Bank for its quarterly assessment of September 2014

## **Third quarter of 2014**

The Swiss National Bank's delegates for regional economic development are constantly in touch with companies from different areas of the economy. This report is based on discussions conducted in July and August 2014 with 175 managers and entrepreneurs on the current and future situation of their companies and the economy in general. The selection of companies differs from one quarter to the next. It reflects the industrial structure of the Swiss economy, based on the breakdown of GDP (excluding agriculture and public services).

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Eastern Switzerland  
Geneva  
Italian-speaking Switzerland  
Mittelland  
Northwestern Switzerland  
Vaud-Valais  
Zurich

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## SUMMARY

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According to this survey, growth in the Swiss economy was slacker in the third quarter of 2014. Domestic demand in particular had a dampening effect. Exports continued to see moderate growth. Pressure on margins increased slightly, generally remaining somewhat lower than the levels considered by respondents to be normal, above all in the manufacturing sector.

Despite increased uncertainty over geopolitical risks and a number of imponderable political developments in Switzerland, the outlook for real turnover growth in the coming months is still guardedly optimistic. However, this confidence seems to have waned somewhat since the beginning of the year. By and large, companies remain very cautious with regard to their recruitment and investment plans.

## BUSINESS ACTIVITY

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### **Manufacturing: Momentum flattening out**

The manufacturing industry experienced a decrease in business momentum compared with the previous quarter. About 40% of the companies surveyed reported a quarter-on-quarter rise in real turnover, as against almost 50% in the previous quarter.

Business activity was flat in the machinery and plastics industries. Among the sectors that reported continuing healthy business activity were food producers, the chemical and pharmaceutical industries, as well as manufacturers of electrical equipment and precision instruments.

Domestic demand weakened slightly. Different regions were cited as export drivers, depending on the industry: the US, the BRIC countries, as well as Asia and Oceania are among the markets with encouraging levels of growth. Demand from Europe, notably Germany and the UK, remains sound, but is still down slightly quarter-on-quarter. Spain is increasingly providing impetus, too. Broken down by industry, there is sustained strong demand from automakers and the medtech sector.

### **Construction: Slowdown**

The construction sector witnessed a slowdown in momentum. Structural engineering work, in particular residential construction, continued to enjoy fairly robust turnover growth; civil engineering and the finishing trade trended flat.

### **Services: Stability**

Services sector turnover was roughly at the level of the previous quarter. While a third of the companies surveyed achieved a quarter-on-quarter increase in turnover, 45% reported that turnover had stagnated.

Banks, IT companies, the travel industry and some sectors of the hotel trade registered comparatively dynamic business activity. The favourable development reported by hoteliers was attributable largely to city hotels. Business tourism provided considerable impetus. While traveller numbers from the US and the Arab countries were high, this favourable development also reflects the fact that business activity was especially weak in the preceding quarter.

Among the sectors reporting quarter-on-quarter decreases in turnover were, most notably, transport companies, retailers and restaurants. Weather conditions had a very negative impact on mountain tourism. Numerous retailers continued to address the far-reaching impact of the structural change resulting from the growing proportion of online purchases, which is making consumers noticeably more price-sensitive. Individual respondents referred to a renewed increase in cross-border shopping as a consequence of relaxed import rules.

## CAPACITY UTILISATION

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Overall, production capacity was reported as being slightly underutilised, although there are still differences from one industry to another.

Companies in almost all areas of the manufacturing industry rated overall capacity utilisation as somewhat lower than normal on the whole. Existing production capacity thus contains considerable reserves to respond to any hikes in demand. Respondents from the chemical and precision instrument industries described production capacity as slightly overutilised.

In the construction industry, utilisation of technical capacity was generally above-average, due mainly to rather high capacity utilisation in the structural and civil engineering sectors. Order books are still well filled.

In the services sector, infrastructure (i.e. primarily office and retail space as well as transport capacity) was reported to be slightly underutilised overall. Low capacity utilisation levels were reported above all by transport companies, restaurants, advertising agencies and retailers. Bad weather had an adverse impact on the numbers of day trippers using mountain railways. By contrast, wholesalers, architectural offices and engineering firms stated that utilisation was on the high side. Utilisation levels were normal in the financial sector.

## DEMAND FOR LABOUR

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### **Demand for staff remains steady**

Overall, the companies surveyed reported that staff numbers were in line with requirements. This indicates that demand for labour is stable, but at the same time signals a more cautious attitude – given that demand had been slightly higher in the previous quarter. There are still quite considerable differences between the various industries in their assessment of how appropriate staffing levels are. No indications were given of changes to personnel policy.

The manufacturing companies surveyed rated their staff numbers as being in line with requirements. Only the precision instrument, pharmaceutical and metal processing industries stated that their headcounts were somewhat too low.

Within the construction sector, only individual businesses in the finishing trade indicated that they were understaffed. Headcounts in both structural and civil engineering are considered appropriate, with peaks covered by temporary staff. Within the services sector, IT companies reported that staff levels were too low. The retail sector is marginally overstaffed.

The process of recruiting staff was generally rated as somewhat more challenging and time-consuming than usual, although this was mainly due to a slightly more

acute lack of specialists, the most sought-after of which include engineers, chemists, construction site managers and well-qualified craftspeople. Many companies continued to report that the level of spontaneous job applications was still high to very high, above all in the regions close to the border. What is more, the proportion of suitable applicants is very low and the time and effort taken up by the selection process is increasing. Individual respondents stated that the catchment area for cross-border commuters had become even larger. Nevertheless, viable candidates for certain categories of jobs can no longer be found in the areas bordering Switzerland either.

## PRICES, MARGINS AND EARNINGS SITUATION

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### **Margins slightly weaker**

Margins overall were reported as being somewhat lower than usual, with approximately 45% of companies surveyed arriving at this assessment. 35% of companies reported that margins were within the normal range.

Profit margins were rated as lower than usual in almost all areas of manufacturing. This is particularly true for the metalworking, machinery and plastics industries as well as for manufacturers of electrical equipment and precision instruments. Businesses surveyed in the chemical and pharmaceutical industries reported margins to be normal. In the coming months, manufacturing companies expect purchase prices to remain stable, while sales prices will slightly decline.

In the construction industry, the companies surveyed reported margins to be generally normal. While margins in the finishing trade improved somewhat, those in civil engineering were slightly below-average. Stable building raw material prices and a decrease in construction prices are expected in the coming months.

Companies in the services sector still rated margins as lower than usual overall. The following sectors in particular saw themselves facing low margins: the transport and car trades, the IT sector, banks and architectural offices. In addition to the persistently low interest rates, bank representatives frequently cited the cost of implementing regulatory requirements as the main cause. The interest rate margin rose slightly nonetheless. Margins in the retail sector were reported as being normal.

The topic of exchange rates was generally addressed somewhat more frequently by respondents. Companies from all three sectors of the economy continue to be appreciative of the current stable exchange rate against the euro. However, respondents exposed to the Japanese yen and other currencies are concerned about the depreciation of these currencies.

## OUTLOOK

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### **Cautious optimism persists**

Although a slight increase in uncertainty is currently evident, companies remain confident about the business outlook for the coming months. Levels of optimism have, however, become visibly weaker since the beginning of the year. In all sectors – with the exception of the hotel trade – respondents expect a moderate rise in turnover in the next six months. By contrast, the construction industry is gradually readying itself for a slowdown in building activity.

Survey participants envisage a marginal increase in headcounts over this time horizon, in particular in the manufacturing sector, i.e. the chemical, pharmaceutical, metalworking and precision instrument industries. Investment plans remain muted too, with capital spending and construction investment expected to increase only slightly in the coming twelve months.

Prime concerns among respondents continue to include potential changes to operating conditions in Switzerland – as a consequence of numerous political initiatives and developments – and the increasingly complex regulatory and bureaucratic environment. Increasing geopolitical risks are likewise a cause of somewhat greater uncertainty.

### **MASS IMMIGRATION INITIATIVE: IMPACT AND COMPANY REACTIONS**

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As in the preceding quarter, as part of the company survey for the third quarter of 2014, the SNB delegates for regional economic relations addressed in detail the acceptance of the mass immigration initiative (MII). They examined the respondents' assessments of the implications of the MII for their own companies, but also for the Swiss economy as a whole.

The responses suggested that acceptance of the MII has resulted in a tangible increase in uncertainty among companies, with 43% of the companies surveyed reporting slightly (27%) or significantly (16%) higher uncertainty. Compared to the second quarter, uncertainty is assessed as having risen somewhat. By contrast, 57% of respondents reported that the acceptance of the MII made no difference to the level of uncertainty.

Since the manner in which the initiative will be implemented is still not clear, the vast majority of companies had not yet decided to take either staffing or investment measures.

Respondents expecting a negative impact on their companies were most concerned about greater difficulties in recruitment, followed by a decrease in immigration numbers lowering their customer base. Other significant factors were concerns about higher wage costs, more difficult market access, and the EU imposing wider export restrictions.

Looking to the medium and long term, a little more than half of respondents expected acceptance of the MII to have negative economic consequences for their companies, and approximately 70% thought it would have negative implications for the Swiss economy as a whole.

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