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Press release

Monetary policy assessment of 16 March 2006

National Bank raises the target range for the three-month Libor by 0.25 percentage points to 0.75–1.75%

The Swiss National Bank (SNB) is raising the target range for the three-month Libor with immediate effect by 0.25 percentage points to 0.75–1.75%. It intends to hold the rate in the middle of the target range for the time being.

Economic development is in line with expectations. It has gained further momentum and is becoming increasingly broad-based. The National Bank still expects GDP to expand by a little more than 2% in 2006. At the moment, inflation is largely determined by the price of oil. It should remain moderate and subside somewhat in the course of 2006. The SNB forecasts average annual inflation of 1%.

By raising the target range, the National Bank is adjusting its monetary policy stance to economic activity. Despite the interest rate lift, monetary policy remains expansionary and supports the upswing. The SNB's action ensures, however, that the inflation outlook remains favourable. On the assumption that the three-month Libor will remain unchanged at 1.25%, annual inflation is projected to reach 1.1% in 2007 and 2.0% in 2008. Provided that the economy continues to perform as expected, the National Bank will further pursue the gradual adjustment of its monetary policy. If the Swiss franc were to appreciate rapidly, the SNB would respond appropriately.

International environment

The National Bank's inflation forecasts are embedded in a scenario for the global economy, which – according to the SNB's assessment – represents the most likely development. Given that global economic assumptions have altered only slightly overall since the December forecast, expectations for a robust global economy remain intact.

The lower-than-anticipated GDP growth in the US for the fourth quarter of 2005 is mainly due to temporary factors. GDP expansion for 2006 is projected to accelerate again to over 3%. There are signs that economic activity in the euro area is above the December predictions. The National Bank projects economic growth of approximately 2.5% for 2006.

The assumed euro/dollar exchange rate was almost the same as in the December 2005 forecast. The price of oil has been fluctuating at a high level since the middle of last year. The oil price expectations were adjusted slightly upwards compared with the previous assessment in December.

Price of oil and competitive pressure

On the assumption that the price of oil will remain stable, annual inflation will subside in the course of 2006. New global suppliers and stronger competitive pressure in the retail trade continue to hold back price rises. However, such changes in relative prices can only influence the price trend temporarily.

Economic outlook

Economic activity was in line with the SNB's expectations. The National Bank anticipates economic growth of a little over 2.0% for Switzerland this year, which corresponds to the December forecast. The economy has gained further momentum and is becoming increasingly broad-based. The labour market is showing signs of improvement. Owing to the favourable sales trend in all the major markets, exports should rise again in 2006, albeit at a slower rate than previously. This will continue to have a positive effect on the domestic economy. Higher utilisation of technical production capacity is likely to strengthen investment activity and boost demand for equipment goods. The conditions for a stimulation of employment and private consumption are thus fulfilled. Given its currently high level, only construction investment is likely to decline somewhat this year.

In view of the robust economic situation, the National Bank expects production capacity to reach a normal level of utilisation in the course of the year. The utilisation rate will continue to vary between companies. However, we are approaching the time when higher aggregate demand will have an effect on prices rather than on economic activity, as more companies are increasingly making full use of their production capacity.

Monetary development

The monetary aggregates react rapidly and sensitively to the SNB's interest rate decisions. Alone the expectations of a change in the three-month Libor influence the interest rates on longer-term investments, thus resulting in a new assessment of the opportunity costs of holding money. Accordingly, the monetary aggregates grew at a slower pace following the two interest rate decisions of June and September 2004. This pattern was confirmed after the interest rate hike of December 2005. The money overhang, which had been built up due to the strongly expansionary monetary policy in the past, did not grow any more as a result of the last three interest rate decisions.

Growth in lending has stabilised at a relatively high level. Mortgage loans continue to increase by over 5% year-on-year. As the other loans remained steady, aggregate lending grew more slowly than mortgage loans. The SNB will continue to keep a close eye on developments in the real estate market.

Inflation outlook and reasons behind the monetary policy decision

The Libor target range was lifted by 0.25 percentage points at the last assessment. The inflation forecast, which was based on a Libor of 1.0%, pointed to an increase in inflation in the longer term. Given this situation, the SNB announced that it would further adjust its monetary policy should the economy continue to recover. Economic activity was as anticipated, and the inflation outlook was also confirmed at the new assessment. The further 25-bp increase in the target range is intended to counteract an overutilisation of production capacity and an excessive liquidity supply.

Inflation forecast following the monetary policy decision

The National Bank uses the inflation forecast to summarise its assessment of the inflation outlook and to communicate the future need for action in monetary policy. The new inflation forecast (dashed red line) extends from the first quarter of 2006 to the fourth quarter of 2008 and is based on the assumption of a constant three-month Libor of 1.25%, as against a Libor of 1.0% used for the December forecast (dash-dotted green line).

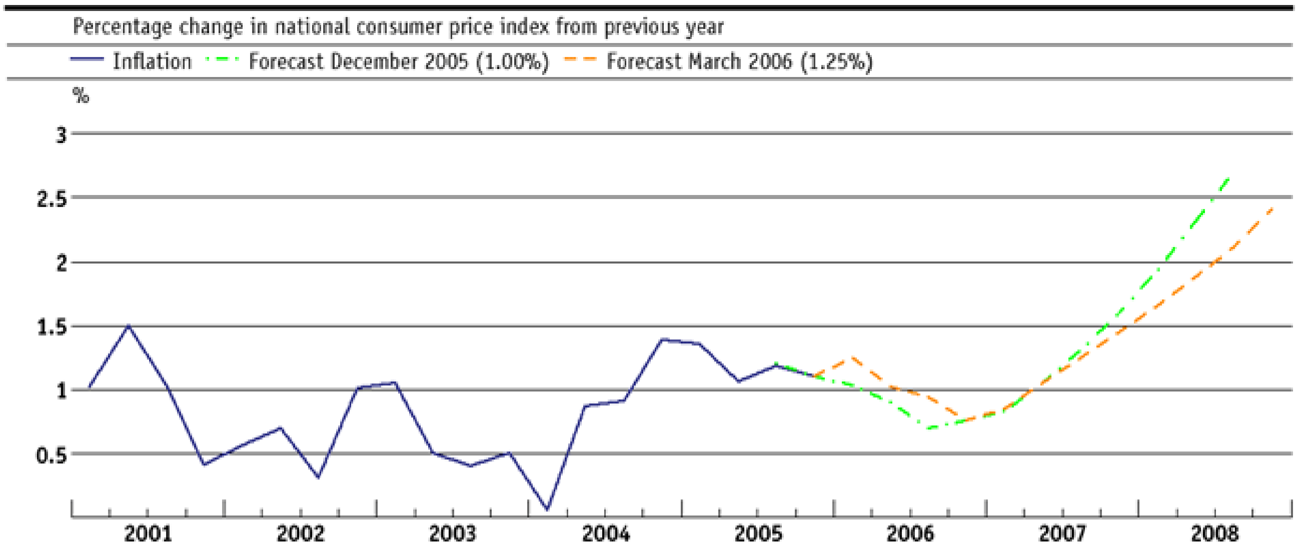
Despite the higher interest rate, the new forecast exceeds that of December 2005 until the end of the year. The reasons for this development are two-fold. First, the upward revision of the oil price assumption results in a temporary rise in inflationary pressure. Second, there are signs of a moderate increase in prices of imported goods. As of the beginning of 2007, the new forecast lies below the previous one. This reflects the dampening effect of today's interest rate decision on future inflation.

Inflation is projected to remain low, averaging 1.0% in 2006 and 1.1% in 2007. It is evident from the inflation dynamics, however, that a three-month Libor of 1.25% is still not sufficient to guarantee price stability in the longer term.

Continuation of previous monetary policy

With today's decision to increase the three-month Libor by 0.25 percentage points, the National Bank is adhering to its previous monetary policy course. It continues to make use of the leeway available to it to bolster the economy without endangering price stability in the longer term. Provided that the economy continues to perform as expected, the National Bank will further pursue the gradual adjustment of its monetary policy. Should the Swiss franc appreciate rapidly, the SNB will respond appropriately.

Inflation forecast of December 2005 with Libor at 1.00% and of March 2006 with Libor at 1.25%



Observed inflation March 2006

	2002				2003				2004				2005			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Inflation	0.56	0.69	0.31	1.01	1.05	0.50	0.40	0.50	0.06	0.87	0.91	1.38	1.35	1.06	1.18	1.10

Inflation forecast of December 2005 with Libor at 1.00% and of March 2006 with Libor at 1.25%

	2005				2006				2007				2008			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Forecast December 2005, Libor at 1.00%				1.10	1.03	0.90	0.70	0.75	0.83	1.05	1.30	1.60	1.93	2.30	2.70	
Forecast March 2006, Libor at 1.25%					1.25	1.01	0.94	0.76	0.85	1.05	1.24	1.45	1.65	1.88	2.11	2.40

Inflation forecast of March 2006

Swiss National Bank