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Economy at a high

The Swiss economy is growing, companies are generating enormous profits and unemployment is falling. But what of the future for the economy? Will the upswing continue? We put these questions to Daniel Kalt, an economist at UBS.

SWISS REVIEW: *From an economic point of view, 2006 seems to have been a very good year. Is this a fair assumption?*

DANIEL KALT: 2006 will indeed go down in the annals of economic history as an unusually good year. The Swiss economy not only topped various league tables in terms of competitiveness, it also ranked highest in terms of growth, at 3 percent. That means Switzerland even outpaced its larger neighbours in the euro zone.

What were the main reasons for this positive economic development?

Capital investment in equipment has become one of the biggest driving forces for growth, increasing by a striking 8.9 percent over the previous year. This investment activity was supported by three factors: Capacity utilisation levels are far above the long-term average, companies are making high and healthy profits, and orders have risen sharply. What's more, investment should remain at a high level for some time. We expect investment in equipment to increase by 9.2 percent for the year as a whole. That would make it the strongest growth since 1998.

How has economic growth affected the labour market?

The labour market reacted positively too. The numbers of people either out of work or working short-time are falling, and the number



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of unfilled posts has increased significantly. The average level of unemployment for the year will decrease to 3.3 percent in 2006 and probably be as low as 3.0 percent this year.

That will presumably also affect consumer spending, won't it?

Greater job security does indeed have a positive effect on consumer confidence. Given the growing optimism among Swiss households and good employment prospects, the upward trend in private consumer spending could increase even further. This had risen by 1.9 percent over the previous year by late 2006.

Will this development continue to the same extent in 2007?

In the second quarter of 2006, the gross domestic product (GDP) rose by 3.2 percent compared to last year. That's the highest rate in six years. However, economic growth now appears to have reached its culmination point. We therefore expect a gradual slowdown in the coming quarters.

What's your economic forecast for the coming year?

A few clouds have already appeared on the economic horizon. In the US, the world's

most important economic powerhouse, the real estate market has already weakened significantly, and this is bound to have a greater and greater effect on consumer growth. Domestic factors in Europe are also contributing to the slowdown. Alongside higher interest rates, restrictive fiscal policies in particular – such as the increase in value-added tax in Germany – could also weigh heavily on economic growth. In view of the global cooling of the economy, GDP growth in Switzerland will also slow down noticeably this year.

What does this mean for Swiss exports?

Because of the less optimistic outlook for the global economy, we assume that Swiss exports will be significantly lower this year. We also expect a gradual cooling in residential construction.

And what are your predictions with regard to consumer spending?

Spending by private households will continue to develop positively. This will be supported by the ongoing improvements on the labour market, wage increases and a probable slight reduction in annual average oil prices. These factors have a lasting effect on private consumption. Overall, we expect real GDP growth to fall by 1.5 percent in 2007.

How great is the threat of inflation?

We expect inflation rates to continue to remain very moderate across the entire forecast period. Whereas rising oil prices boosted inflation last year, they are likely to contribute slightly less to overall inflation. By contrast, higher interest rates should make housing costs a little more expensive. On the whole, most prices will remain under pressure, especially in the pharmaceutical and retail sectors. In 2007, we expect inflation to fall from 1.2 percent (2006) to 0.9 percent.

And how will interest rates develop?

Against the backdrop of a weaker economy and moderate inflation, we believe that the Swiss National Bank will take a time-out on interest rates, having raised the key interest rate at the end of 2006.

THE INTERVIEW WAS CONDUCTED BY HEINZ ECKERT.

GROSS DOMESTIC PRODUCT (GDP)

■ Gross domestic product (GDP) measures the total value of production in the year by all companies located in a particular country. GDP can be calculated by adding together all the expenditure for which these companies are responsible (end-use consumption by households, the state and social insurance, investment, and the difference between exports and imports of goods and services).