Swiss Economics

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2023 wage round: What should be expected?

Monitor Switzerland | Q3 2022

Consensus Economics
Forecast Accuracy Awards
Switzerland 2021

Editorial

Dear Reader

This edition of "Monitor Switzerland" takes a close look at the labor market, which is currently in outstanding shape: Never have more jobs been created in Switzerland than in the second quarter of 2022. The number of vacant positions also reached a record level, and the unemployment rate has hovered around 2.2% since the spring of this year, its lowest level in two decades.

A scarcity of labor is a positive for consumer sentiment: If workers perceive their jobs to be secure they are likely to be happy to spend money. For this reason, we continue to adopt a cautiously optimistic stance where Swiss economic development is concerned – despite the difficult global environment (you can find more on our forecast for the Swiss economy on page 6). However, a tight labor market is also one of the two main ingredients for a wage-price spiral, in which wage increases and price rises spur each other on; this is the point at which economists really start to worry about inflation. Once such a wage-price spiral has established itself, central banks can only break it by weakening demand for goods and services so severely that unemployment increases. For the economy and society as a whole, it is therefore better if no such inflationary spiral ever takes hold. Karl Otto Pöhl, the former President of the German Bundesbank, once came up with a pertinent comparison: "Inflation is like toothpaste. Once out of the tube, it's fiendishly difficult to get back in."

The rate of inflation has recently picked up in Switzerland too, reaching its highest level since the early 1990s in August. At 3.5%, however, it is significantly lower than in neighboring countries. Furthermore, according to our forecasts it should slip back into the comfort zone of below 2% over the course of next year, as long as our expectation proves right that global energy prices do not rise further. Unlike in other developed nations (particularly the US), inflation is largely "imported" into Switzerland, above all through higher oil and energy prices. As such, the stronger franc is also having an inflation-suppressing effect, as does the early interest rate hike by the Swiss National Bank (SNB) (you can find our monetary policy assessment on page 18). Moreover, in the focus article of this edition (page 12) we highlight several indicators that clearly suggest the risk of a wage-price spiral in Switzerland is generally low. While it is true that wages are rising faster than at any time over the last decade because of high inflation and a shortage of specialist labor, wage restraint appears to be something of a national characteristic. In general, employees are apparently prepared to forgo maximum potential wage increases in the short term in order to reduce the risk of losing their jobs, thereby securing long-term prosperity. This far-sightedness pays off for workers, as the proportion of economic output paid out in wages is extraordinarily high in Switzerland. In addition to wage increases, companies currently have other options at their disposal to preserve their appeal as employers in a tight labor market. For example, they are increasingly introducing more flexible working conditions, as our survey of Swiss companies shows.

We wish you an enjoyable read.

André Helfenstein
CEO Credit Suisse (Switzerland) Ltd

Claude Maurer
Chief Economist Switzerland

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Consumer spending supports growth

The healthy labor market situation is alleviating the negative effect of the energy crisis on Swiss households. However, manufacturers are starting to feel the effects of recession in the Eurozone. Swiss economic growth is therefore likely to slow from 2.5% in 2022 to 1.0% in 2023.

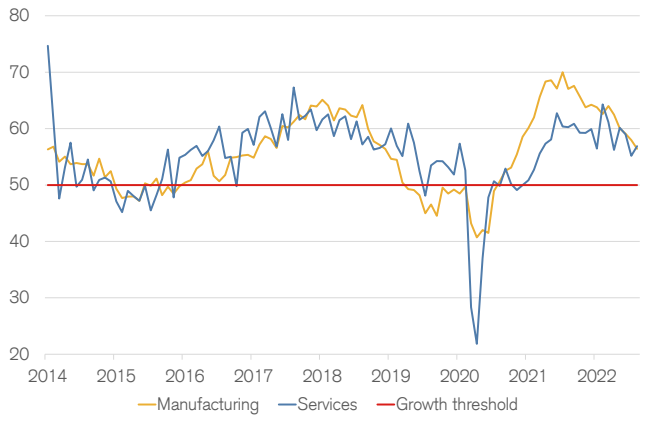
Lifting of COVID-19 measures provides tailwind

Gross domestic product (GDP) in Switzerland recorded a quarter-on-quarter rise of 0.3% in the second quarter of 2022. Although this represents a slowdown in growth momentum compared to the prior quarter (Q1 2022: +0.5%), the recovery is persisting despite the war in Ukraine and the sharp rise in energy prices. This dynamic development is above all attributable to the lifting of the measures to contain coronavirus back in April. Growth accordingly proved strongest in the hotels & catering sector, in transport, and in culture, entertainment, and recreation. By contrast, value creation declined in sectors such as chemicals/pharma and retail, which enjoyed a boom in business during the pandemic.

Consumer spending remains robust – not least due to immigration

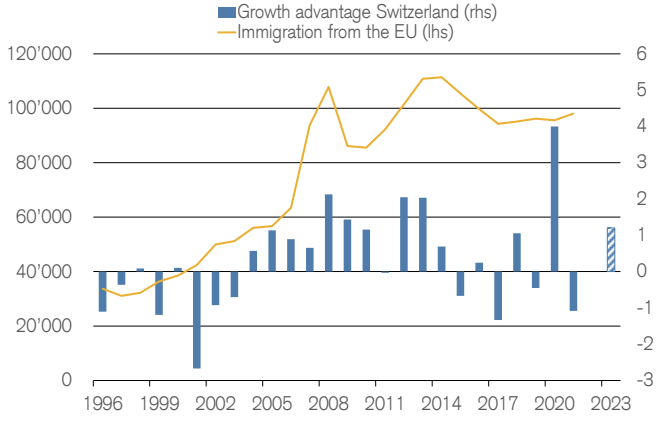
The positive momentum of consumer spending can be expected to continue in the coming months. The Purchasing Managers Index (PMI) for the services sector, which measures the development of consumer-oriented services, remains in the growth zone (Fig. 1). Thanks to full employment (cf. labor market box on page 8), the earnings situation of Swiss households remains healthy despite widespread economic concerns, and this is typically key to the spending mentality. Moreover, the rise in inflation has not reduced purchasing power in Switzerland that much overall. Thanks to high employment growth and the shift toward better-paid jobs, the total figure for wages paid in the first half of 2022 rose by 6.3%, well above the rate of inflation (2.5%). In addition, immigration has recently picked up again (cf. box on page 8). Immigration is an important driver of consumer spending – indeed, this phenomenon has on average accounted for significantly more than a quarter of all consumer spending growth in recent years. Given that immigration rises whenever economic growth is lower in Europe than in Switzerland (Fig. 2), it is only reasonable to assume that the trend of higher immigration figures will continue.

Fig 1: Leading indicators remain above growth threshold
Purchasing Managers Index (PMI)



Source: procure.ch, Credit Suisse. Last data point: August 2022

Fig 2: Immigration reacts to growth differences
Number of immigrants (lhs); growth difference between the European Union (EU) and Switzerland, in percentage points (rhs)



Source: Federal Statistical Office (FSO), Refinitiv Datastream, Credit Suisse.

High energy prices weigh on manufacturers

Switzerland is less vulnerable to the current energy crisis than its European neighbors. Natural gas is not used here to produce electricity. It is also less commonly used in industrial processes than in Germany, for example. However, Switzerland is not immune to price rises and the rationing of energy supply. In our forecast we assume that rationing can be avoided thanks to the initiated or planned measures of the public sector on the one hand and the agility of companies on the other. By contrast, in view of higher energy prices we believe that companies active in particularly energy-intensive sectors – such as the metal and chemical industries – will voluntarily cut off production as soon as operations cease to be profitable. However, as a proportion of the expected outages is likely to be covered by short-time working compensation, the negative effects of such disruptions should be limited for consumer spending as a whole.

Inflation not a serious drag on consumer spending

As things stand, the inflated wholesale market prices for oil, gas, and electricity are feeding through into Swiss household expenses only in reduced form thanks to price regulation, the strong franc, and the relatively low significance of energy in the typical household budget. Inflation is therefore much lower in Switzerland than elsewhere. At the same time, the risk of a wage-price spiral is low, as we explain in our focus article. Although we are forecasting inflation to persist above the level of 3.0% until the end of the year, we expect it to then gradually fall to levels commensurate with price stability (cf. box on inflation, page 8). According to our analysis of the price elasticities of consumer demand, the dampening effect of inflation on consumer spending is generally limited. On average, a rise in the inflation rate by one percentage point reduces consumer spending by just 0.11%-0.13% (depending on the estimation method). All in all, the positive momentum of consumption should persist into 2023. Government spending should likewise remain a prop of economic growth, as it should record an extraordinary rise due to one-off expenditure to prevent power shortages.

Export momentum suffering from recession in Europe

By contrast, the outlook for manufacturers has become much gloomier. Although the PMI for manufacturing (Fig. 1) in Switzerland still does not point to contraction (in contrast to its Eurozone counterpart), the expected recession in the Eurozone will also weigh on Swiss exports given that the EU is Switzerland's most important trade partner, accounting for some 50% of all exports. In particular, the mechanical engineering, electrical, and metalworking industry as well as the chemicals sector must brace themselves for lower export demand. In stark contrast, pharmaceutical exports exhibit little short-term elasticity towards changes in economic developments in the EU. According to our forecasts, the EUR/CHF currency pair is set to remain below parity. Thanks to the much lower rate of inflation in Switzerland, however, the export industry is coping with the current EUR/CHF exchange rate relatively well (see Fig. 3), as the lower cost increases alleviate the competitive pricing disadvantage.

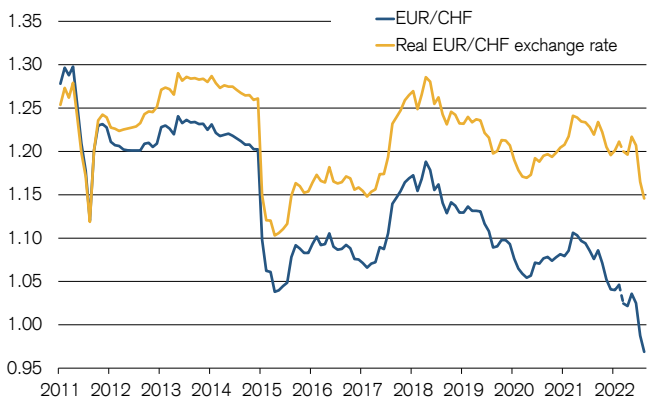
Gloomier growth prospects

Overall, we expect Switzerland to avoid sliding into a recession. That said, growth prospects for the coming year have gradually become gloomier here too (Fig. 4). Swiss gross domestic product should nonetheless rise by 1% in 2023, as long as an energy shortage can be avoided.

claude.maurer@credit-suisse.com

Fig 3: CHF not at record high against EUR after adjustment for purchasing power

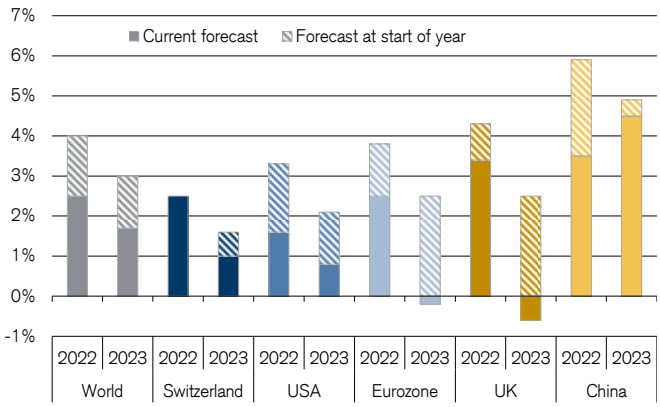
EUR/CHF exchange rate, real and nominal



Source: Refinitiv Datastream, Credit Suisse. Last data point: August 2022

Fig 4: Significant forecasts revisions in a number of countries

Change in Credit Suisse forecasts for real gross domestic product, worldwide



Source: Credit Suisse. As of September 6, 2022

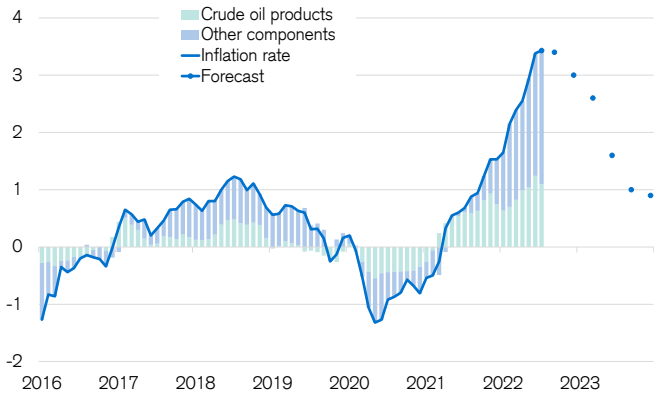
Inflation

Although the inflation rate is set to remain above the level of the last 15 years, we are expecting it to fall at the end of 2022 and the start of 2023. The impact of higher oil prices on inflation should gradually subside, while both gas and electricity prices could temporarily spike again. Meanwhile, there are increasing signs pointing to a waning of inflationary pressure on goods prices. Moreover, the economic slowdown is likely to make it more difficult for service providers to raise their prices. We are anticipating an inflation rate of 2.9% for this year and 1.5% for 2023.

maxime.botteron@credit-suisse.com

Inflationary pressure likely to subside

Contribution to inflation in percentage points; year-on-year inflation in %



Source: Refinitiv Datastream, Credit Suisse

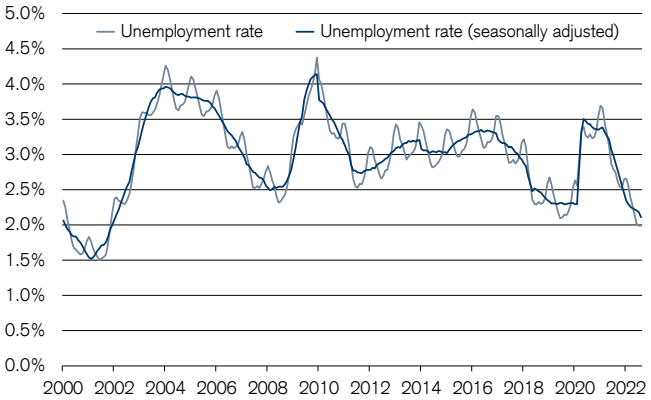
Labor market

Unemployment fell quickly last year from the peak recorded during the coronavirus crisis, but its downward trajectory has slowed since the spring of 2022. In August, the seasonally-adjusted unemployment rate stood at 2.1%, lower than at any point since the start of 2002. In view of the increase in economic uncertainties and the expected slowdown in the economy, the decline of unemployment will probably come to a halt as the year progresses. That said, we are not predicting any sharp rise from today's standpoint. We are expecting an average annual unemployment rate of 2.2% for 2022, and 2.3% for 2023.

emilie.gachet@credit-suisse.com

Unemployment rate at lowest level for more than two decades

Number of registered unemployed divided by size of working population



Source: State Secretariat for Economic Affairs (SECO), Credit Suisse
Last data point: August 2022

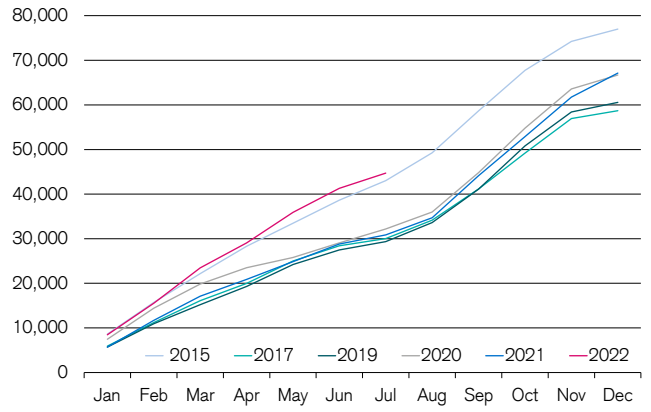
Immigration

A net total of 44'686 persons migrated to Switzerland in the first seven months of this year. This mid-year figure for migration is 44.8% higher than the prior-year equivalent. The change is almost exclusively attributable to the increased number of immigrants, which is up by 18.7%. The high numbers of refugees from Ukraine are not (yet) relevant for this metric, as they are not counted as part of the permanent foreign residential population. Instead, the strong influx of migrants mirrors the robustness of the Swiss economy in recent months. Since we are not forecasting a recession for Switzerland for next year – in contrast to the Eurozone – the inflow of migrants is likely to continue for the time being.

sara.carnazzi@credit-suisse.com

Immigration rises sharply in the first half of 2022

Net migration of permanent foreign residential population (excluding register corrections), cumulative values



Source: State Secretariat for Migration, Credit Suisse

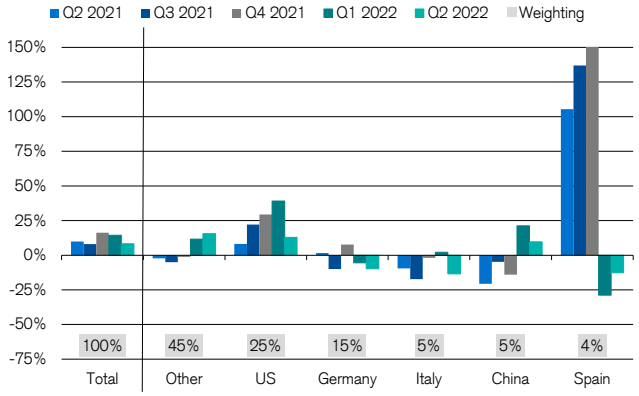
Pharmaceutical industry

In the second quarter of 2022, the exports of the pharma industry were slightly lower than those of the prior-year quarter (–1.6%). However, they were still above their pre-pandemic level (+8.2%). Pharma exports to the US and China increased, whereas exports to Germany, Italy, and in particular Spain declined due to normalization following the special effects of the pandemic. Over the next few months, pharma exports should remain at their current high levels, as they exhibit relatively little dependency on the fluctuations of exchange rates and economic development.

meret.muegeli@credit-suisse.com

Normalization above pre-pandemic level

Pharma exports compared to pre-pandemic level (same quarter as 2019), seasonally adjusted, and proportion of total pharma exports (2019)



Source: Swiss Federal Customs Administration, Credit Suisse

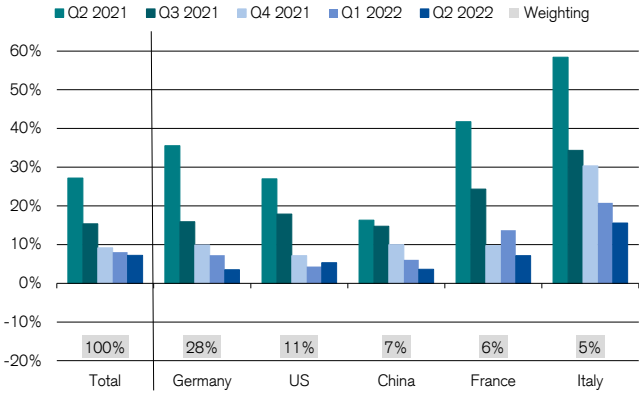
Mechanical engineering, electrical and metal industry (MEM)

The MEM industry recorded another increase in exports in the second quarter of 2022. However, the purchasing managers indices suggest that global sentiment in manufacturing is deteriorating, particularly in the Eurozone. This is weighing on the growth outlook of the Swiss MEM industry for the remainder of the year. By contrast, the industry is gaining support from exports to China, as the lifting of coronavirus lockdowns there is once again stimulating demand. That said, there are still uncertainties over Beijing's zero-tolerance policy toward COVID-19.

meret.muegeli@credit-suisse.com

MEM exports record further growth

MEM exports compared to prior-year quarter, seasonally adjusted, and share of total MEM exports



Source: Swiss Federal Customs Administration, Credit Suisse

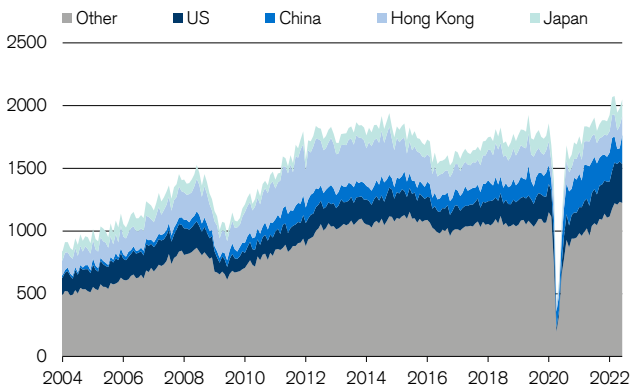
Watch industry

Swiss watch exports are continuing to rise, with sales reaching almost CHF 6 billion in the second quarter of 2022 (+8.1% year-on-year). The latest growth here is attributable to rising exports to the US and Europe. By contrast, exports to China and Hong Kong declined once again. However, the lifting of COVID-19 lockdowns in China and the associated brightening of consumer sentiment could trigger a certain amount of catch-up spending. On the other hand, any deterioration in consumer sentiment – particularly in the US – could undermine growth.

meret.muegeli@credit-suisse.com

Growth in watch exports to the US and Europe

Watch exports in CHF mn, by country, seasonally adjusted



Source: Swiss Federal Customs Administration, Credit Suisse

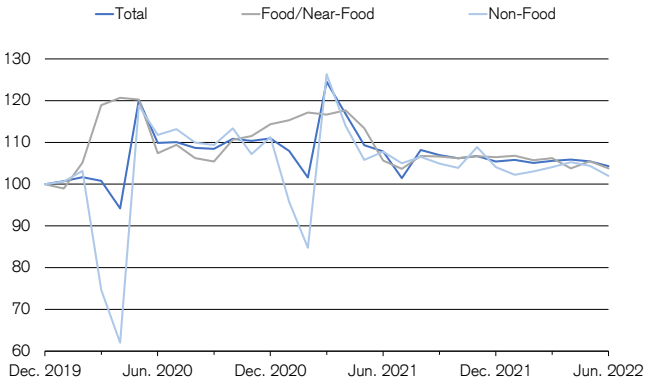
Retail trade

The sales of the retail trade underwent a process of normalization in the first half of 2022. The strong pandemic-related sales figures of last year have led to negative growth rates this year in both the food/near-food and non-food segments. Viewed on an absolute basis, however, sales remain above their pre-crisis level. The clothing/shoes area has enjoyed positive growth rates: This sector was particularly hard-hit at the start of the pandemic, and is still in the recovery process. Prices are continuing to rise, above all in the household & living and DIY/garden/auto accessories areas.

meret.muegeli@credit-suisse.com

Retail sales continue to normalize

Development of seasonally adjusted nominal retail sales, indexed, average 2019 =100



Source: GfK, Credit Suisse

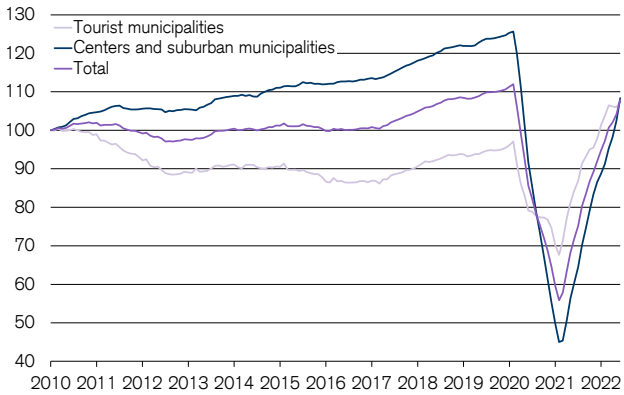
Tourism

The process of recovery in the tourism sector continues. This is clear from figures for overnight stays in the second quarter of 2022, which were even higher than their pre-pandemic levels. In pandemic-affected years it was domestic guests who propped up tourism, but foreign guests are now also choosing to holiday in Switzerland again in increasing numbers. The latter are contributing significantly to the recovery not just in tourist municipalities, but also particularly in urban centers and suburban municipalities. Although foreign guest numbers have yet to get back to their pre-crisis level, visitors from Europe and North America in particular are increasingly likely to be eying up Switzerland as a vacation destination over the coming months.

meret.muegeli@credit-suisse.com

Return of foreign tourists stimulates recovery

Overnight stays, indexed (January 2010 = 100), 12-month averages



Source: Federal Statistical Office, Credit Suisse

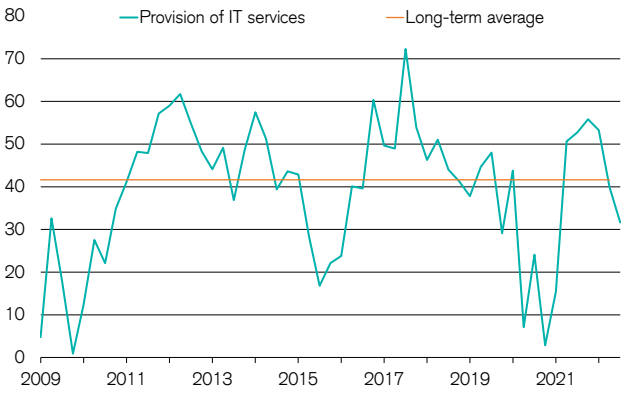
Information technology (IT)

Sentiment in the IT sector is losing some of its buoyancy, with survey figures now having fallen below their long-term averages. The balance between companies who view their business situation as positive and those that view it as negative stood at 32% at the start of the third quarter of 2022 (previous quarter: 40%). The weakening dynamism of production in the manufacturing sector, which is the key purchaser of IT services, has surely played a key role here. As we do not expect any short-term improvement in this regard, the deterioration in confidence in manufacturing is also likely to weigh on the IT sector going forward.

meret.muegeli@credit-suisse.com

Sentiment in IT sector below long-term average

Balance between companies who view their business situation as positive and those that view it as negative, in %, and long-term average



Source: Economic research unit of ETH Zurich (KOF), Credit Suisse

Labor shortage and inflation as wage drivers

Against a backdrop of a labor shortage and high inflation, wages in Switzerland are rising more strongly than at any point over the last decade. Quite a few companies have approved extraordinary wage adjustments in the current year. However, the potential for strong wage increases next year looks to be limited. Meanwhile, many companies are seeking to make working conditions more flexible in order to preserve their appeal as employers.

Robust Swiss labor market with widespread personnel shortages

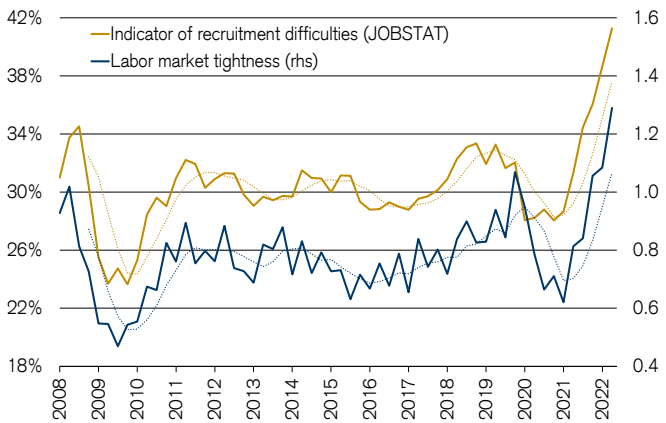
Despite rising economic uncertainties, the Swiss labor market has proved to be extremely robust so far this year. Ever since the spring, the seasonally adjusted unemployment rate has hovered at 2.2% or so, the lowest level for 20 years. In the first half of 2022, full-time equivalent employment was 3.1% above the prior-year level. At the same time, the number of vacant positions climbed into record territory. Given these developments, companies have found it much more difficult to recruit personnel. The labor market tightness – i.e. the relationship between number of vacancies and number of unemployed, which provides an indicator of how difficult employers find it to fill vacant positions – reached an unprecedented level in the second quarter (Fig. 1). What's more, in a special purchasing managers index (PMI) survey conducted by Credit Suisse together with procure.ch in July, 70% of companies indicated that they were having greater difficulty recruiting personnel now than before the coronavirus crisis. Moreover, according to figures released by the KOF Swiss Economic Institute, the problem of staff shortages is broadly distributed across all sectors (Fig. 2). Above all in the healthcare and social services, corporate services, and hotels & catering sectors, but also in the construction industry and the IT sector, a particularly large number of companies were reporting insufficient headcount in July 2022. The situation has also become much more problematic in the transport sector since the start of the year. In a mirror image of the dire recruitment problem faced by many companies, the degree of job security felt by Swiss consumers in July was higher than at any point since April 2011, despite a sharp deterioration in consumer sentiment generally.

Nominal wage growth in 2022 the highest for more than a decade

The latest data on wage developments in Switzerland also shows that nominal wages are now once again exhibiting a stronger upward trend after more than a decade of modest growth (Fig. 3). According to the quarterly estimates of the Federal Statistical Office (FSO), the Swiss Wage Index (SWI) rose by 2.0% in the first half-year of 2022 compared to the prior-year equivalent. The SWI essentially reflects wage development for unchanged activity. The wage recorded in

Fig 1: Labor market extremely tight from employer perspective

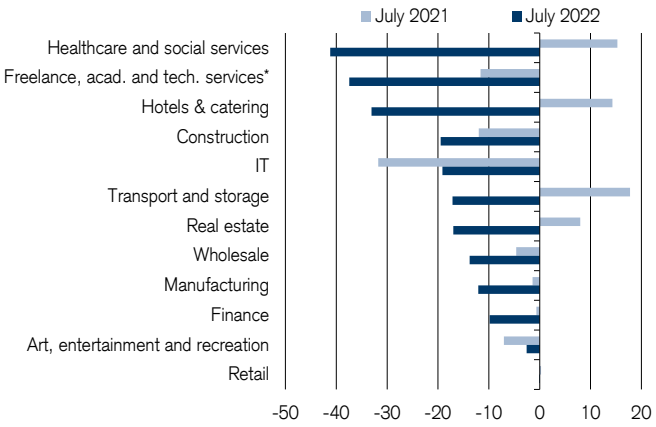
Labor market tightness: ratio of vacancies to unemployed; indicator of recruitment difficulties: proportion of surveyed companies unable to source qualified personnel or having difficulty doing so, in %



Source: Federal Statistical Office, Adecco Group Switzerland/University of Zurich, x28 AG, Credit Suisse. Last data point: Q2 2022

Fig 2: Many sectors confronted with personnel shortages

Balance between proportion of companies who view current staffing levels as too high (+) or too low (-), in percentage points, selected sectors



* Freelance, academic, and technical services
Source: KOF Swiss Economic Institute, Credit Suisse

the index corresponds to the standardized contractual gross wage for a full-time equivalent. It does not take into account irregular wage components such as special bonus payments. By contrast, the "employee compensation" statistic in the national accounts (ESA) is based on a different wage concept: This involves estimating the total wage amount actually paid to employees on the basis of data from the AHV Compensation Fund. On the one hand, the development of employee compensation depends on employment growth: In order to facilitate comparability, Figure 3 shows the development of wages adjusted by growth in full-time equivalent employees (FTEs). On the other hand, the ESA statistic – unlike the SWI – also captures variable wage components and labor market dynamism (e.g. switches to better-paid positions or to sectors with higher salaries, changes in the average level of education of the working population, etc.). In the first half-year of 2022, employee compensation per FTE was as much as 3.0% above the prior-year level, whereby this relatively strong growth is likely to have been driven, among other wage-increasing effects, by the decline in short-time working. Employees on short-time working are typically not paid their full wage, which is then reflected in a lower figure for employee compensation per FTE at the point of payment.

Wage growth modest compared to other countries

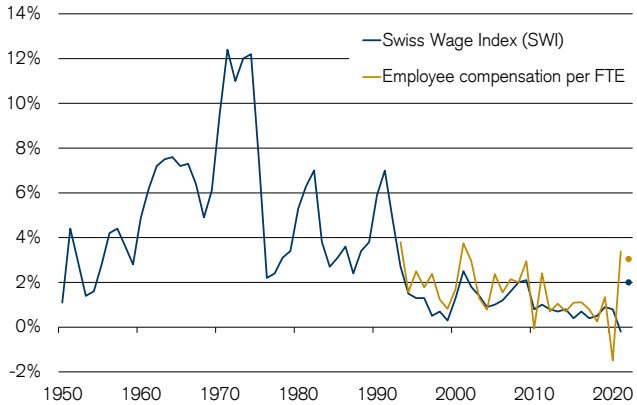
When current nominal wage growth in Switzerland is compared to the developments abroad, the former turns out to be relatively modest despite its recent sharp acceleration (Fig. 4). In the US in particular, wage growth has accelerated dramatically since mid-2021, working out at more than 7% year-on-year in June and July this year. In addition to significant differences in inflation rates – which were in excess of 8% in both the Eurozone and the US in July – and the ensuing pay demands to compensate for this development, certain other factors also play a part in this discrepancy. In contrast to the US, wages are adjusted relatively rarely in the Swiss labor market, and thanks to the widespread use of short-time working during COVID lockdowns – as an alternative to layoffs such as in the US – fewer new appointments were recorded during the recovery. New appointments are an obvious point at which wages are renegotiated. As the responses from the PMI survey confirm, wage negotiations for existing employment contracts in Swiss firms usually take place only once a year (in the case of 91% of industrial companies and 83% of service companies), typically in the fourth quarter. The wages are then adjusted with effect from the start of the following year or the following spring.

Wages have been adjusted outside of the typical annual cycle in many companies this year

Accordingly, nominal wage development this year has been heavily shaped by the situation in place when wage negotiations were held in the last few months of 2021. Back then, neither inflation nor the labor shortage was as pronounced as both these factors are today. However, according to our PMI survey, a good 15% of industrial companies and as many as one service company in five have planned or indeed already implemented extraordinary wage adjustments this year, i.e. wage adjustments outside of the typical annual cycle.

Fig 3: Nominal wages rising more strongly than trend of recent years

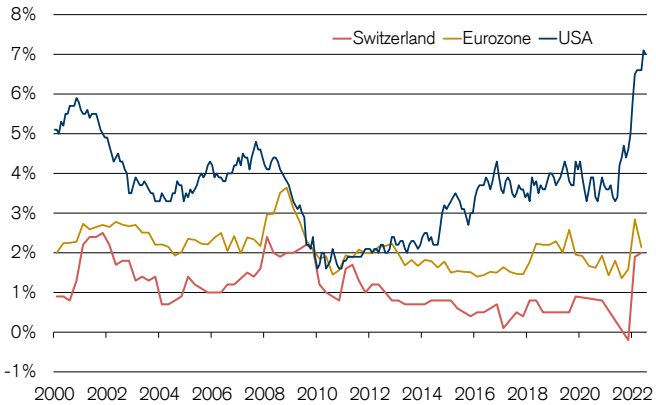
Year-on-year change in %, nominal; lines: annual data, dots: first half-year



Source: Federal Statistical Office (FSO), Wüest Partner, Credit Suisse. Last data point: 2021 and first half-year 2022

Fig 4: Nominal wages in the US rising at more than three times the Swiss rate

Nominal wages, year-on-year change in %; Switzerland: Swiss Wage Index (quarterly estimates), Eurozone: European Central Bank's Indicator of Negotiated Wages, USA: Altanta Fed's Wage Growth Tracker (weighted total, 3-month average)



Source: European Central Bank, Federal Reserve Bank of Atlanta, Federal Statistical Office, Credit Suisse. Last data point: Q2 2022 (Eurozone, Switzerland), July 2022 (USA)

Swiss labor market characterized by wage restraint generally

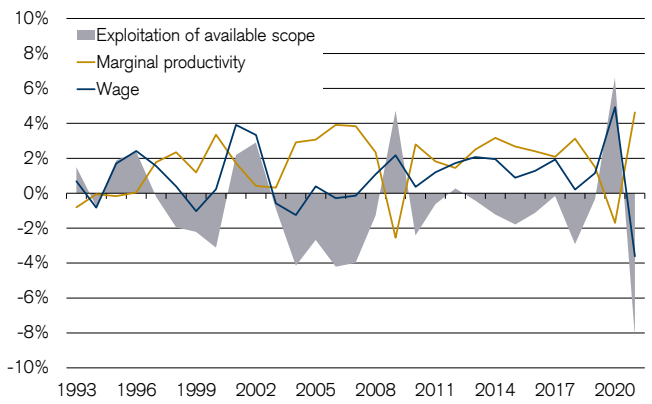
Moreover, relations between employees and employers (or employee and employer organizations) in Switzerland are typically characterized by a pronounced willingness to compromise. The concept of wage restraint appears to be systematically anchored here over the long term, i.e. the potential scope for negotiated wage increases ("margin of distribution") from the employee perspective tends not to be exploited to the full. In order to test this thesis, we have compared past real wage increases with the increase in the marginal productivity of labor. According to economic theory, these two variables should correlate if the production factors of labor and capital are optimally deployed. Our estimates of the extent to which wages have actually mirrored this (marginal) productivity since the 1993 wage round are illustrated in Figure 5. Here positive values indicate an excessive margin of distribution and negative values an underexploited margin. In most cases, it is clear from our calculations that the maximum possible potential has not been fully exploited. It might therefore be inferred that workers in Switzerland are generally prepared to renounce maximum wage increases in the short term in order to reduce the risk of unemployment and thereby contribute to long-term prosperity. Only in the recessions of the 1990s, following the collapse of the dot-com bubble in 2001, and during the financial crisis of 2009 was there any employment-restricting "overuse" of the margin of distribution, i.e. wages at that time were not falling sufficiently fast to maintain the level of employment. In the first coronavirus year of 2020 too, the margin of distribution was massively "overused" according to all measures, although this can be explained by the fact that the actual number of hours worked declined much more sharply than wages as a result of short-time working – and vice versa in 2021. Thanks to short-time working, there was no decline in employment in Switzerland despite the coronavirus crisis. This should therefore be isolated as a special period – albeit one that shows how the "insurance" of wage restraint helps at times of crisis (even if the costs of short-time working were largely borne by the state). However, it is difficult to predict whether this systematic wage restraint will persist even against a backdrop of greater scarcity of labor – which is precisely what Switzerland faces now.

No significant shift in labor market mobility evident so far

Furthermore, despite the sharp increase in recruitment difficulties experienced over the last few quarters, the situation in Switzerland cannot be compared with the situation in the US, where the pandemic led to an explosion of the voluntary quit rate from the end of 2020 onwards. This phenomenon, which intensifies personnel shortages and therefore the upward pressure on wages, has been dubbed the "Great Resignation". So far, no such wave of resignations has been evident in Swiss data. Although the employment rate of the working-age population (15 – 64-year-olds) did decline during coronavirus years, particularly among younger adults under 25, the last few quarters have revealed a stabilization or even a slight rise. The FSO statistics on labor market mobility also do not point to any major wave of resignations in Switzerland (Fig. 6). The so-called "gross rotation rate", which measures the proportion of job changes and departures due to voluntary/involuntary termination of employment activity over the last year, remained stable in 2021 after declining in the first coronavirus year of 2020, and stayed below the levels recorded in 2018/2019. Only the proportion of people switching jobs within the same company increased in both of the last two years. In 2021 this ratio worked out at 3.4%, higher than the average bandwidth of fluctuation recorded in the period 2010-2020. An initial analysis of the data of the Swiss Labor Force Survey (SLFS) for the first quarter of 2022 would appear to confirm this: The propor-

Fig 5: Theoretical scope for wage increases seldom fully exploited

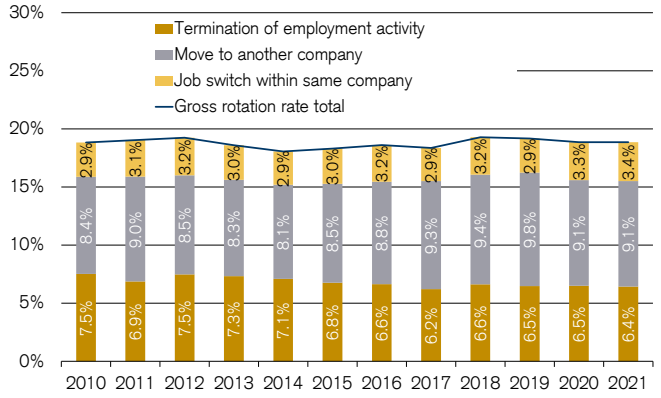
Marginal productivity of labor and wage index per hour, change in % (real)



Source: Federal Statistical Office, Credit Suisse. Last data point: 2021

Fig 6: No wave of resignations in Switzerland during pandemic

Job switches and departures as a result of termination of employment activity, in % of employees prior to departure, voluntary and involuntary causes



Source: Federal Statistical Office, Credit Suisse. Last data point: 2021

tion of surveyed individuals of working age who had changed jobs since the last interview (between three and nine months previously) rose only slightly compared to the first quarter of 2021, primarily as a result of changes of position within the same company. Furthermore, according to our calculations the proportion of employed persons switching to another sector between the first quarter of 2021 and the first quarter of 2022 actually declined compared to an earlier, similar analysis for the period dating from the end of 2019 to the end of 2020. However, it is interesting to note that, of the 10% or so employed persons who were looking for a new or second job in 2021, some 30% cited their current wage being too low as one of the main reasons for their search.

2023 wage round overshadowed by uncertain economic outlook

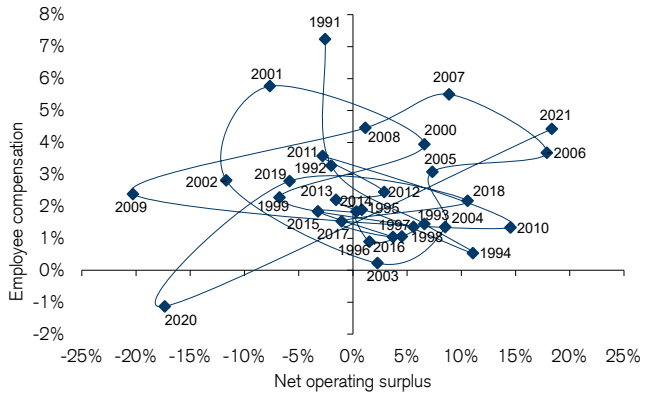
Many companies are just about to embark on negotiations for the 2023 wage round. The unions are coming into these negotiations with demands for a compensatory rise to preserve the purchasing power of employees in light of inflation along with an additional real wage increase. The range of general wage increases being called for is between 3% and 5%, depending on the sector. As explained above, the economic situation and outlook in the final quarter of 2022 will be key to the outcome of this wage round. The economic outlook has darkened recently. Although we are not anticipating a recession for Switzerland in 2023, a sharp growth slowdown looks highly likely. Inflation should continue to fall from its peak while remaining above pre-crisis levels (cf. "Economy" section on page 6). Where the labor market is concerned, we are anticipating a weakening in demand for workers given the economic slowdown and the subsiding post-pandemic catch-up effects, which should at least partly alleviate the acute problem of personnel shortages. Although we are not expecting any significant rise in unemployment, the unemployment rate is likely to have reached its lowest point. However, in view of demographic developments (and specifically the wave of baby-boomer retirements) the labor shortage in the Swiss labor market is likely to remain a key theme in the medium term.

Wage growth to be limited by companies' financial constraints

The wage increases actually achieved for 2023 will also depend on the financial freedom of maneuver open to companies. The results of the latest economic surveys of the KOF Swiss Economic Institute suggest that the profitability situation in key sectors of the economy – such as manufacturing, construction, trading, IT, corporate services, and healthcare – is currently weakening again following the sharp recovery from the troughs of the coronavirus crisis (the recovery saw profitability soar to above pre-crisis levels in some cases). This may put a limit on future wage growth. Two major exceptions to this trend are hotels & catering and transportation, both of which are continuing to benefit from the positive effects of the lifting of the coronavirus measures. In these sectors, no deterioration in the earnings situation was apparent up to July this year at least. Accordingly, we are expecting these sectors – which are faced with serious personnel shortages – to record the highest wage increases in 2023.

Fig 7: Wage growth during pandemic came at cost of corporate earnings

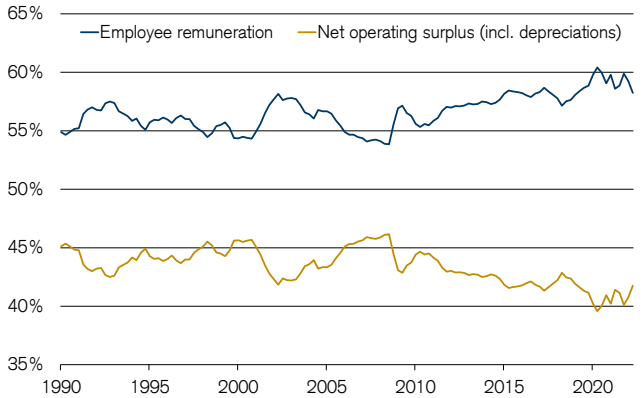
Year-on-year change in %



Source: State Secretariat for Economic Affairs (SECO), Credit Suisse. Last data point: 2021

Fig 8: Employee share of gross domestic product already high

Proportion of nominal gross domestic product (GDP), seasonally- and calendar-adjusted figures



Source: State Secretariat for Economic Affairs (SECO), Credit Suisse. Last data point: Q2 2022

Figure 7 shows how the total wage amount paid out to employees (as measured by the employee compensation statistic) and corporate earnings (as measured by the net operating surplus from the ESA) have developed over the last years. The leftward lurch in 2020 confirms the finding that the pandemic affected profitability first and foremost, with a counter-movement then being apparent in 2021, which continued in the first half of 2022. Overall, however, wages have risen at the cost of corporate earnings in the coronavirus years. Despite the decline in the last two quarters, the proportion of total gross domestic product accounted for by employee compensation stays very high in a long-term comparison (Fig. 8). Of the countries that make up the Organisation for Economic Co-operation and Development (OECD), Switzerland has one of the highest ratios here.

Forecast for nominal wage growth in 2023: 2.3%

On average, the industrial companies surveyed in our PMI survey in July 2022 are anticipating wage growth of around 2% for the coming year (Fig. 9). Expectations in the manufacturing sector extend up to 5%, although 16% of companies are expecting a zero increase. In the services sector the bandwidth is rather wider – here wage expectations range from 0 to 10%, with an average of 2.5%. 42% of service companies are anticipating wage growth of 3% or more. These wage increases anticipated by companies are on average lower than the current wage demands being put forward by unions. Our latest forecast of average nominal wage growth for 2023 (based on the SWI) stands at 2.3%, somewhat higher than company expectations. As a result of the likely decline of inflation to 1.5%, wages are also likely to rise in real terms in 2023. However, this will not suffice to fully compensate for the decline in real wages in 2021 and 2022.

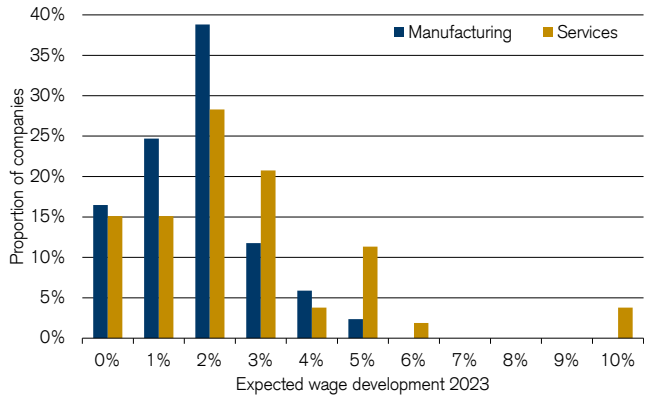
Many companies resorting to flexible working measures to remain attractive as employers

In order to remain attractive as an employer in an environment characterized by a shortage of specialist labor, in addition to wage increases companies also have the option of tweaking the fringe benefits or working conditions they offer. According to our PMI survey, Swiss companies appear to lean much more heavily towards the latter option (Fig. 10). 69% of manufacturing companies and 76% of service providers indicated that they had implemented flexible working models recently, such as home working options or more flexible working hours, with a further 9% planning to do so in both sectors. By contrast, expanding fringe benefits (e.g. by offering further training options) is not something that is being looked at to the same extent. Nonetheless, 34% of surveyed manufacturing companies and almost 40% of companies from the services sector do have such intentions or have already brought in such measures.

emilie.gachet@credit-suisse.com

Fig 9: Companies anticipate average wage growth of around 2% for next year

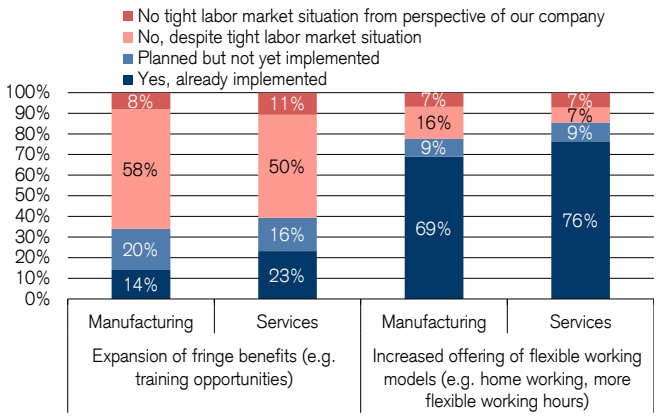
"What average wage change are you expecting for your workforce for 2023?", proportion of respondent companies in %, PMI survey of July 2022



Source: procure.ch, Credit Suisse

Fig 10: Expansion of fringe benefits less common than flexibilization of working conditions

"In view of the current tight labor market, has your company resorted to the following measures?", proportion of respondent companies in %, PMI survey of July 2022



Source: procure.ch, Credit Suisse

Moderately positive rates

As inflation remains elevated, we expect the Swiss National Bank (SNB) to raise its policy rate to 0.75% by the end of the year. For 2023, we expect inflation to gradually decline, allowing the SNB to maintain its policy rate at 0.75%.

The drivers of inflation should remain immune to monetary policy tightening

Inflation in Switzerland has accelerated to its fastest pace since 1993, as it reached 3.5% YoY in August. Consumer prices have increased due to a confluence of factors, including an energy crisis in Europe, global supply chain issues and labor shortages in some industries. For the SNB, this situation is a challenge. Indeed, monetary policy has no influence on most of these factors. Normally, a tightening of monetary policy through an increase in the policy rate aims to curb demand (i.e. private consumption and investment spending) to reduce the upward pressure on prices. This is supposed to work in an environment where the economy is close to overheating. However, there is currently no indication that elevated inflation is the result of an overheated Swiss economy. Is the tightening of monetary policy therefore futile?

No evidence of households bringing forward consumption expenditure

While raising the policy rate will probably not contribute much to lower inflation, leaving the monetary policy unchanged bears the risk of de-anchoring inflation expectations. If households were to believe that future prices would rise faster, they would bring forward their consumption expenditures, which would fuel demand and hence prices. For now, there is no indication of such behavior, as households are reluctant to make major purchases, according to the latest consumer survey by the Sate Secretariat for Economic Affairs. However, that could change, if the SNB were too slow to react to elevated inflation.

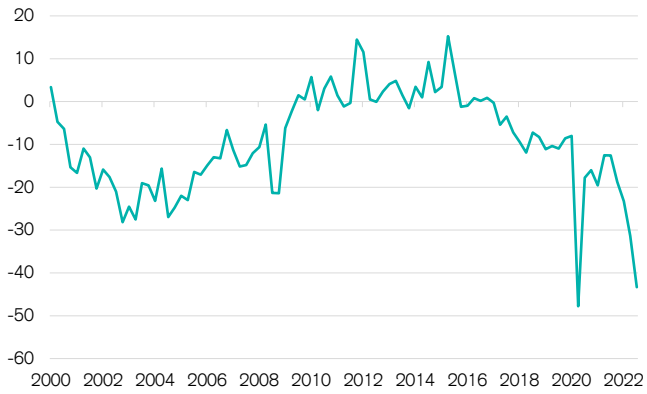
Policy rate increases prevent the Swiss franc to depreciate

Another reason for monetary policy tightening is the exchange rate. Central banks globally are raising their policy rates and if the SNB were the only one to keep it unchanged, the Swiss franc would quickly depreciate. As a weaker currency makes imports more expensive, such depreciation would raise inflation even more. Therefore, the SNB has no other choice than to continue to raise its policy rate, in our view. After a first increase to –0.25% in June, we expect the SNB to set its policy rate at 0.50% in September. In December, we forecast another rise of the policy rate to 0.75%. As we expect inflation to slow down in 2023, we believe that the SNB will then keep its policy rate unchanged at 0.75% next year.

maxime.botteron@credit-suisse.com

Now is not a good time for major purchases

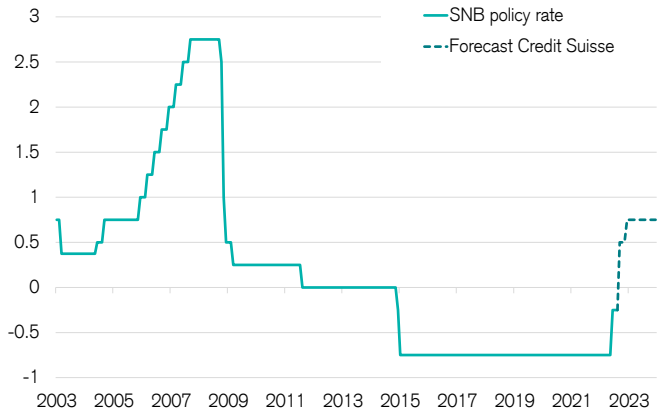
Moment to make major purchases, SECO consumer confidence survey, index



Source: SECO, Credit Suisse

The policy rate should reach 0.75% by year-end

In %



Source: SNB, Credit Suisse

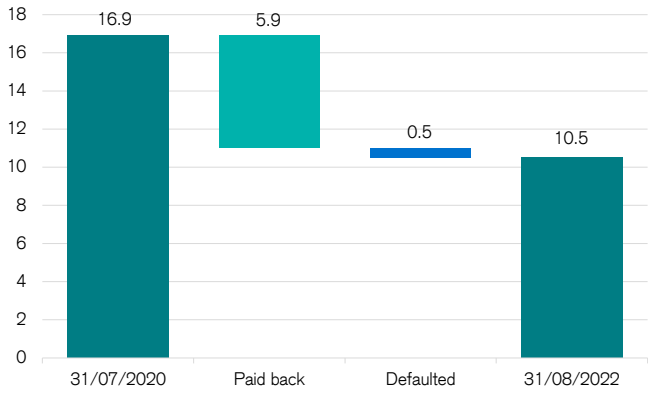
COVID-19 loans

After significant repayments in the second quarter of this year (around CHF 1 bn), COVID-19 loan repayments slowed in the third quarter. Since our last update (8 June 2022), the volume of paid-back credits rose by CHF 146 mn. Overall, CHF 5.9 bn have been paid back, representing approximately 35% of all COVID-19 loans. Defaults have also increased since our last update from CHF 431 mn to CHF 513 mn, while CHF 16.8 mn (+3.6 mn) could be recovered from previously defaulted loans. Outstanding COVID-19 loans have thus declined to CHF 10.5 bn.

maxime.botteron@credit-suisse.com

Repayments of COVID-19 loans have slowed

Outstanding COVID-19 loans, in CHF bn



Source: SECO, Credit Suisse

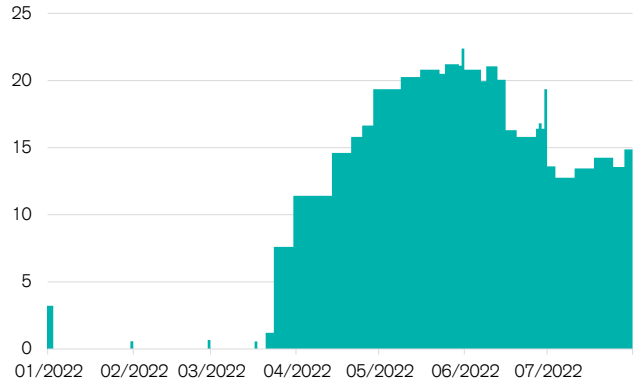
Liquidity-providing operations

Due to the generous exemptions from the negative interest rate, only a relatively small portion of banks' reserves at the SNB is subject to the negative rate. This situation has put upward pressure on SARON, an overnight money market rate, as banks, which are fully exempted from the negative rate, are incentivized to borrow liquidity at a negative rate and deposit it at 0% at the SNB. To prevent SARON from rising too much, the SNB has temporarily added liquidity through liquidity-providing repos. As soon as the policy rate will be positive (or at least at 0%), the SNB will most likely not need to add liquidity anymore.

maxime.botteron@credit-suisse.com

The SNB has provided billion of fresh liquidity to banks

Outstanding SNB liquidity-providing CHF repos, in CHF bn



Last data point: 31/07/2022. Source: SNB, Credit Suisse.

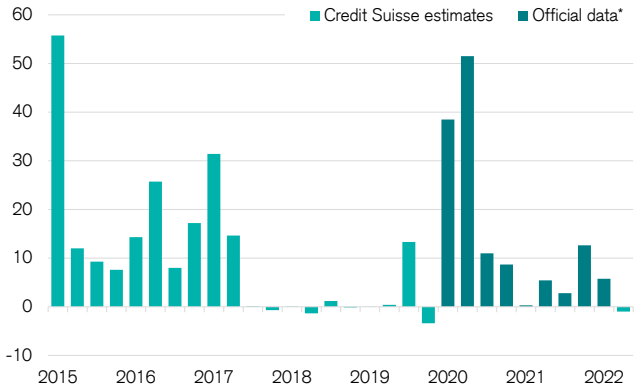
SNB foreign currency interventions

Following its June monetary policy assessment, the SNB announced that it would be "prepared to purchase foreign currency, if there were to be an excessive appreciation of the Swiss franc." The SNB however added, "if the Swiss franc were to weaken, [it] would also consider selling foreign currency." Since this announcement, the Swiss franc has appreciated, so that any sales of foreign currency are highly unlikely. Yet the appreciation of the Swiss franc has probably been insufficient so far to trigger fresh currency purchases.

maxime.botteron@credit-suisse.com

The SNB has halted its foreign currency purchases

Net foreign currency purchases by the SNB, in CHF bn



Last data point: Q2 2022. *Available from Q1 2020. Source: SNB, Credit Suisse.

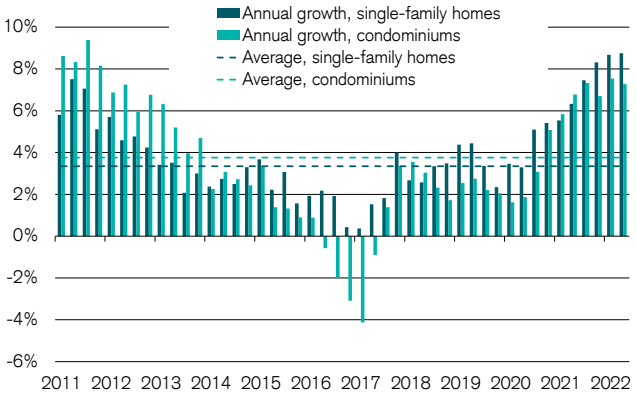
Owner-occupied housing

The strong rise in mortgage interest rates has led to lower demand for owner-occupied housing. However, demand still contrasts with insufficient supply, and newbuild activity continues to decline. The market therefore remains characterized by a demand overhang, thanks to which prices of condominiums and single-family homes posted year-on-year rises of 7.3% and 8.8% respectively in the second quarter. We are expecting price momentum to be much more modest over the next few quarters. But with a scarcity of supply propping up prices, we are not yet anticipating any price declines.

thomas.rieder@credit-suisse.com

Property price rises despite higher interest rates

Price development of medium segment; dotted lines: average 2000–2021



Source: Wüest Partner. Last data point: Q2 2022

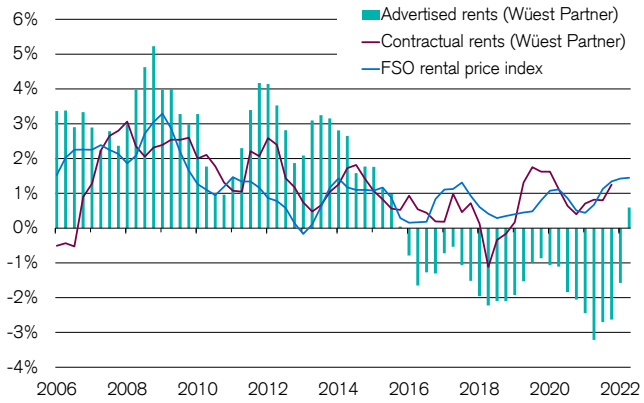
Rental apartments

All rental price indices are currently rising, as waning construction activity is coming up against high demand driven by the economy and immigration. Rents advertised on online property websites have also been rising since the second quarter of 2022, having previously exhibited a downward average trend for five whole years. By contrast, tenants with existing agreements are so far only feeling the inflationary pinch in the area of ancillary costs. However, from the end of 2023 they can expect to see a rise in the reference interest rate and a consequent rise in net rents of up to 3%. On top of this they should factor in up to 40% of accrued inflation, which can be passed on by landlords.

fabian.waltert@credit-suisse.com

Acceleration of rental price growth

Rental price indices in a year-on-year comparison



Source: Federal Statistical Office (FSO), Wüest Partner, Credit Suisse.
Last data point: Q2 2022

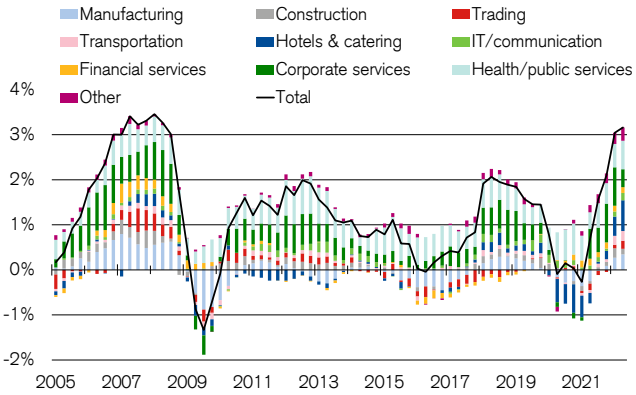
Office property

The typically strong correlation between the growth of office employment and demand for office space ceased to apply during the pandemic. Following the lifting of the coronavirus measures in February 2022 and the return of most workers to their traditional workplaces, many companies have abandoned their wait-and-see attitude, as reflected in a sharp increase in demand for space over the course of 2022. In addition to the pent-up demand for space, employment growth has also gained further momentum. Demand for office space has therefore been strong in 2022, although the darkening of the economic outlook is likely to undermine this buoyancy going forward.

kerstin.hansen@credit-suisse.com

Employment growth recovers impressively

Annual change in number of employed (full-time equivalents) in %



Source: Federal Statistical Office, Credit Suisse. Last data point: Q2 2022

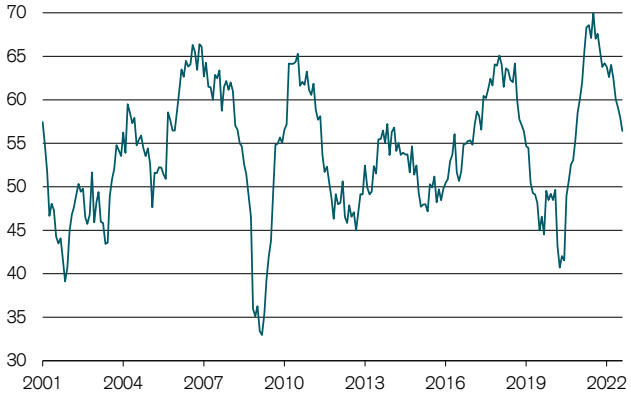
Credit Suisse Leading Indicators

Purchasing Managers' Index (PMI)

Purchasing managers stand at the beginning of the production process. The PMI uses this forward-looking feature to forecast the level of economic activity. The index is based on a monthly survey conducted by procure.ch, the industry body for purchasing and supply management. Purchasing managers respond to eight questions on output, backlog of orders, purchasing volumes, purchase price, delivery times, stocks of purchases, stocks of finished goods, and employment. They indicate whether activity levels are higher, the same, or lower than in the preceding month. The percentage share of responses stating "higher" and "no change" are used to calculate the sub-indices, though only half of the "no change" share of responses is included. The PMI lies between 0 and 100, with a figure of more than 50 indicating an expansion of activity compared with the previous month.

Industrial Activity

PMI index > 50 = growth



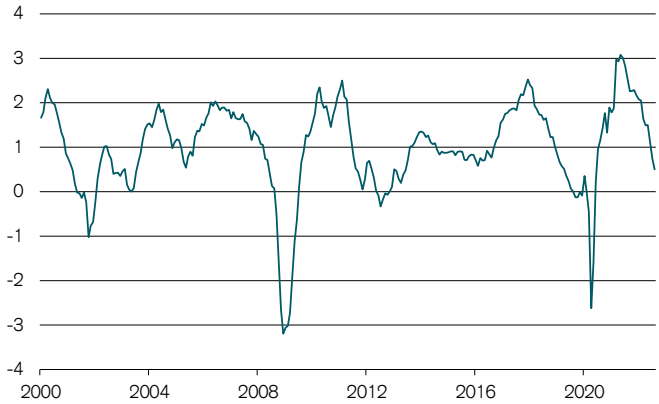
Source: procure.ch, Credit Suisse

Credit Suisse Export Barometer

The Credit Suisse Export Barometer takes as its basis the dependence of Swiss exports on foreign export markets. In constructing the export barometer, we have drawn together important leading industry indicators in Switzerland's 28 most important export markets. The values of these leading indicators are weighted on the basis of the share of exports that goes to each country. The export barometer consolidates this information to produce a single indicator. Since the values in question are standardized, the export barometer is calibrated in standard deviations. The zero line corresponds to the growth threshold. The long-term average growth of Swiss exports of approximately 5% is at 1.

Exports

In standard deviation, values > 0 = growth



Source: PMIPremium, Credit Suisse

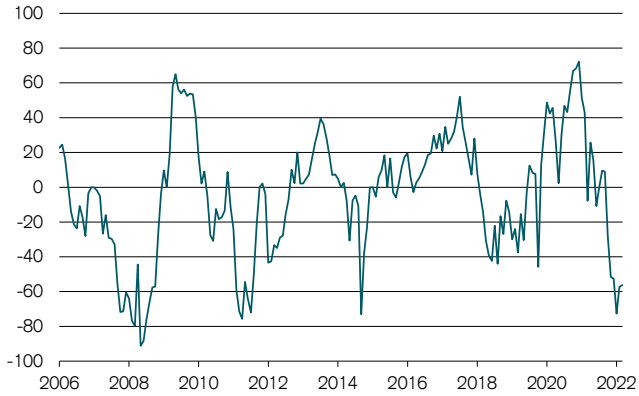
CS CFA Society Switzerland Index

Financial analysts have their finger on the pulse of the economy. Since 2017, we have been conducting a monthly survey of financial analysts jointly with CFA Society Switzerland under the heading Financial Market Test Switzerland[1]. Analysts are questioned not only about their assessment of the current and future economic situation as well as the rate of inflation but also about financial market issues such as equity market performance and interest rate forecasts. The CS CFA Society Switzerland Index represents the balance of expectations regarding the development of Swiss economic activity over the coming six months.

[1] Published as the Credit Suisse ZEW Index from 2006 until 2016

Economic Activity

Balance of expectations, values > 0 = growth



Source: CFA Society Switzerland, Credit Suisse

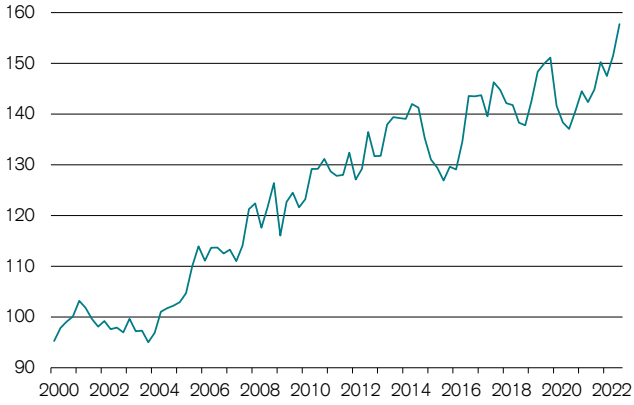
Credit Suisse Leading Indicators

Swiss Construction Index

The Swiss Construction Index is published once a quarter jointly by Credit Suisse and the Swiss Contractors' Association (SCA). It serves as a leading indicator for the state of Switzerland's construction sector by forecasting the volume of work in the core construction business in the coming quarter. The indicator is calculated by Credit Suisse and is based mainly on a quarterly survey conducted by the SCA among its members. Additional data is provided by the Swiss Federal Statistical Office and Baublatt. The Construction Index was launched in the first quarter of 1996.

Construction Industry Climate

1st quarter 1996 = 100



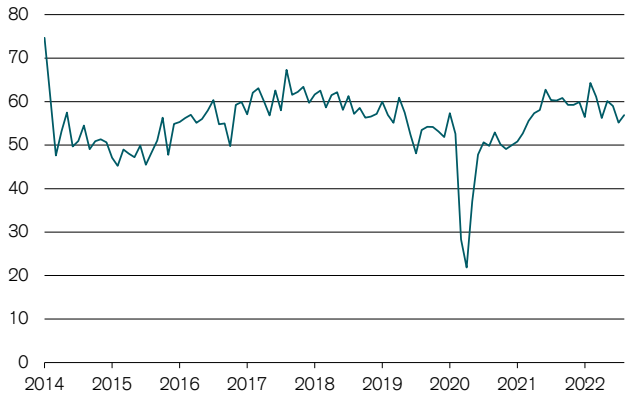
Source: Swiss Contractor's Association, Credit Suisse

PMI Services

Procure.ch, the professional association for purchasing and supply management and Credit Suisse launched a PMI for the services sector in 2014. The Services PMI is structured in exactly the same way as its industry counterpart. Values over 50.0 points mean expansion. It is based on a survey of purchasing managers from Swiss service providers. There are six subcomponents: type of business, new orders, order book, purchasing prices, sales prices and number of employees.

Activity in the services sector

PMI Services index > 50 = growth



Source: procure.ch, Credit Suisse

Forecasts and Indicators

Forecasts for the Swiss Economy

	2022	2022	2022P	2022P	2023P	2023P	2023P	2023P	2022P	2023P
	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Quarter 1	Quarter 2	Quarter 3	Quarter 4		
GDP (YoY, in %)	4.7	2.8	1.3	1.2	0.7	0.7	0.9	1.6	2.5	1.0
Consumer spending	7.0	4.4	2.5	2.5	1.4	1.4	1.4	1.4	4.0	1.4
Government expenditure	1.9	1.3	1.0	2.0	1.1	1.1	1.1	1.1	1.5	1.1
Gross capital investment	1.1	0.6	1.2	1.3	1.0	1.0	0.9	1.0	1.1	1.0
Construction investment	-3.4	-2.8	-1.2	0.0	-0.2	-0.2	-0.2	-0.2	-1.8	-0.2
Investment in plant and equipment	3.3	2.3	2.5	2.0	1.5	1.5	1.5	1.5	2.5	1.5
Exports (goods and services)	12.2	8.3	4.1	-5.0	3.0	3.0	3.0	3.0	4.5	3.0
Imports (goods and services)	8.7	7.1	2.7	0.0	2.5	2.5	2.5	2.5	4.5	2.5
Inflation (in %)	2.1	3.0	3.4	3.0	2.6	1.6	1.0	0.9	2.9	1.5
Unemployment (in %)	2.3	2.2	2.1	2.1	2.2	2.3	2.3	2.4	2.2	2.3
Employment growth FTEs (YoY, in %)	3.0	3.2	2.0	1.4	0.6	0.1	0.3	0.9	2.4	0.5
Net immigration									75,000	
Nominal wage growth (YoY, in %)									2.0	2.3

Source: Federal Statistics Office, State Secretariat for Economic Affairs SECO, Credit Suisse

Forecasts for the World Economy

	Forecasts				Structure		Significance for Switzerland	
Forecasts	**GDP** YoY, in %		**Inflation** YoY, in %		**Population** In million	**GDP** In USD billion	**Share of exports** In %	**Share of imports** In %
	2022	**2023**	**2022**	**2023**	**2021**	**2021**	**2021**	**2021**
World	2.5	1.7	7.4	4.6	7,764	96,293	100	100
US	1.6	0.8	8.1	4.2	332	22,998	18.1	6.0
Euro zone	2.5	-0.2	8.1	4.2	343	14,505	51.5	66.8
Germany	1.1	-0.6	8.1	4.4	83	4,226	17.0	27.4
France	2.1	0.1	6.0	3.7	65	2,935	5.7	7.6
Italy	3.0	-0.4	7.7	3.9	59	2,101	6.0	9.4
UK	3.5	-0.6	9.6	10.5	68	3,188	3.0	2.2
Japan	0.6	0.6	1.7	1.5	126	4,937	2.9	2.0
China	3.5	4.5	2.3	2.0	1,413	17,458	6.0	8.9

Source: Datastream, International Monetary Fund, Credit Suisse

Interest Rates and Monetary Policy Data

	Current	3-month	12-month		07/2022	06/2022	07/2021
SNB target range (in %)	-0.25	0.50	0.75	M0 money supply (CHF bn)	726.9	747.7	724.5
10-year government bond yields (in %)	0.9	0.9	1.2	M1 money supply (%, YoY)	2.1	3.0	6.5
				M2 money supply (%, YoY)	0.0	0.0	3.5
				M3 money supply (%, YoY)	-0.3	-0.2	3.3
				Foreign currency reserves (CHF bn)	869.9	884.4	945.9

Source: Datastream, Bloomberg, Credit Suisse

Impressum

Publisher: Credit Suisse AG, Investment Solutions & Sustainability

Nannette Hechler-Fayd'herbe
Head of Global Economics & Research
+41 44 333 17 06
nannette.hechler-fayd'herbe@credit-suisse.com

Authors

Maxime Botteron

Sara Carnazzi Weber

Franziska Fischer

Emilie Gachet

Claude Maurer

Meret Mügeli

Thomas Rieder

Fabian Waltert

Contribution

Maciej Zolotenki

Editorial deadline

8 September 2022

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