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Workforces sought

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Editorial

Dear Readers

As well as the regular brief reports on the economy, real estate, industry, monetary policy and the like, the focus of this issue of Monitor Switzerland is placed on the labor market, which is also currently doing very well: According to the Swiss Federal Statistical Office, the number of employees rose by 1.6% year on year in the first quarter of 2018. It now amounts to almost five million, thereby reaching its highest level since the financial crisis.

Although the number of employees is growing, there simply seems to be "not enough" of them, as companies from many segments are bemoaning an increasing lack of labor in general and of skilled labor in particular. The number of vacancies has risen by more than 17% on the previous year. There are theoretically four options for rectifying this shortfall. Firstly, employees could work longer hours. However, implementing this would be difficult. After the franc shock, many employees were prepared to fill the gaps as they feared for their jobs. They are obviously less willing to do this as the economy booms, even though they would earn more money. There are also provisions under labor law preventing an increase in working hours. Moreover, long-term data show that additional work is an unlikely trend above all in view of the fall in working hours with increasing prosperity. The average weekly working hours in Switzerland back in 1950 amounted to 50 hours compared with just under 42 today. Meanwhile, annual leave entitlement has risen from two to five weeks. A glance at the working lifetime also gives little cause for optimism: The trend toward early retirements remains unbroken. All this confirms the fundamental microeconomic insight that most people prefer free time ("idleness") to work as long as they can afford this.

The second option would be to mobilize 'dormant' workforces. Our focus article examines where these could be found but nevertheless concludes that this potential is probably also more limited than the raw data suggest. In order to mobilize the two larger groups of this 'hidden reserve', namely pensioners and young women, significant but probably not very feasible changes to work incentives as well as a rethink in the recruitment policy of companies would be needed. Not working is generally also a conscious choice among these groups. The third option – attracting more labor from abroad again – is likewise barely feasible any more as an increasing shortage of skilled labor is also emerging in the European Union and wages are rising. Furthermore, relocation from other regions remains impeded by the restrictive immigration provisions.

A fourth option would be to replace the lack of manpower with machines. Corporate investments are indeed rising sharply at present, not least due to the labor shortage. However, substituting labor with capital is also a very gradual process even in the age of digitalization. This incidentally also means that the fears of massive job losses as a result of advances in technology are likely to be greatly exaggerated – not least because various new job profiles are being created in their wake.

Bottom line: The acute shortage of labor in Switzerland is primarily the consequence of a strong cyclical economy and in the longer term results from a high level of prosperity enabling many citizens to afford more free time. Above all in the summer we wish you lots of this!

Thomas Gottstein
CEO Swiss Universal Bank

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Contents

Economy

Capacities are being expanded

The Swiss economy is undergoing a 'mini-boom' Economic growth in 2018 is set to be above average at 2.2%. Investments are being made and staff hired in response to the capacity bottlenecks.

Growth statement in Q1 2018 statistically distorted upwards

The Swiss economy once again recorded above-average growth in the first quarter of 2018. Real gross domestic product (GDP) increased by 0.6% on the previous quarter. This suggests that Swiss GDP growth was not significantly curbed by the economic slowdown in the Eurozone and US at the start of the year. However, it is estimated that almost a quarter of the growth recorded in the first quarter is attributable to a temporary boost due to international sporting events such as the Winter Olympics. A large number of international sports federations such as the International Olympic Committee and the Fédération Internationale de Football Association (FIFA) are headquartered in Switzerland and their revenues are allocated to Swiss GDP despite the fact that their activities take place outside the country.

Good prospects for the export economy

The outlook for the Swiss export economy remains positive. The growth rate of the global economy should accelerate again after having been curbed on both sides of the Atlantic in the first quarter among other things due to the unusually cold weather. Households in Europe and the US are set to display lively consumption thanks to rising wages and an improved labor market situation, and companies are investing again thanks to the solid demand and ongoing advantageous financing conditions despite all political uncertainties. Economic growth in the US and Europe as well as in most emerging markets should therefore be above average in the second half of 2018. We accordingly expect exports from Switzerland to increase by 4% in 2018.

Lively workforce expansion...

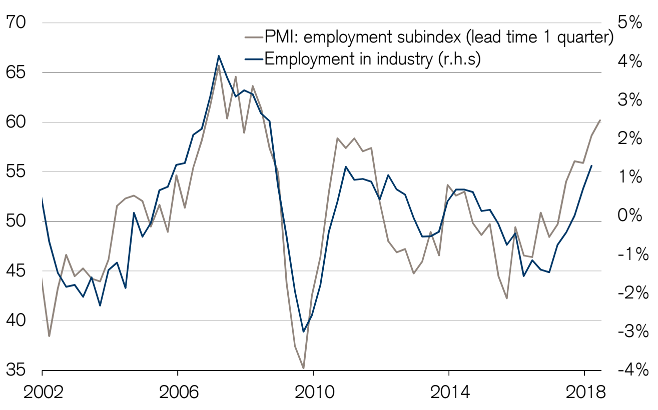
The sound industrial economy in Switzerland is exerting a positive impact on the labor market. In the first quarter the strongest growth of employment in industry for ten years was recorded, and the latest survey results of the purchasing managers' (PMI) survey point toward a further acceleration of employment growth (see Figure). A glance at the further subindices of the PMI survey also reveals clear signs of bottlenecks (see Figure). For example, purchase prices are rising and it has seldom taken longer than today for ordered goods to arrive. This high capacity utilization should further stimulate investment activity and increase workforce requirements.

...and increased profits again

On top of this, corporate profits rose anew in the first quarter of 2018. Although the share of profits in GDP remains low when compared historically, thereby pointing toward a continued challenging margin situation, the improvement in the profit situation is clearly visible. Corporate profits have already exceeded the level of 2010 again (see Figure). They are a significant cata-

Employment growth set to continue

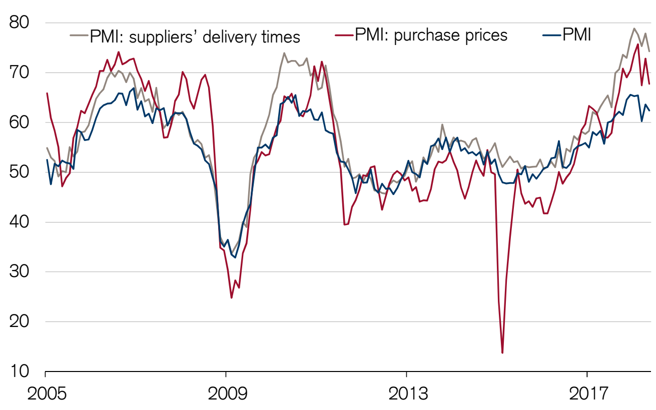
PMI employment subindex; YoY employment in industry



Source: Swiss Federal Statistical Office, procure.ch, Credit Suisse

Signs of capacity bottlenecks

Index, growth threshold = 50



Source: procure.ch, Credit Suisse

lyst for capital expenditure. Their increase accordingly reinforces our view that investments in machines and equipment will this year be above average (forecast for investments in equipment: +4%).

Builders set to respond to overproduction

Meanwhile, the growth of construction investments should slow down further in 2018 (forecast for construction investments: +1.4%). Although the backlog of orders remains high in all segments of the construction industry, the increasing vacancies due to years of overproduction of new rental apartments and to some extent also of commercial properties are likely gradually to cause builders to take their foot off the accelerator.

Solid but not very dynamic consumption growth

While private consumption is also set to increase solidly this year, the growth rate is likely to be comparatively subdued. Although consumer sentiment is improving thanks to a fall in the unemployment rate, one of the key drivers of consumption growth in recent years – immigration – is slowing down. The latter is being reduced above all by the improvement in the labor market situation in most European countries. We forecast an increase in private consumption of 1.4% for 2018, which is slightly below average.

Mini-boom set to end in 2019

According to our forecast, the Swiss economy will altogether grow by 2.2% in 2018, which is significantly up on the previous three years. The upturn is broadly based, with all indicators in the green (above-average) zone (see Figure). However, GDP growth is already expected to slow down again somewhat in 2019 (forecast: +1.7%). Following immigration, the construction industry as a second important growth driver of the Swiss economy is ultimately also set to lose strength in 2019. The positive effects of the dynamic recovery of the labor market are unlikely to be able to offset the loss of momentum, particularly since the growth momentum from abroad could also be lower than this year.

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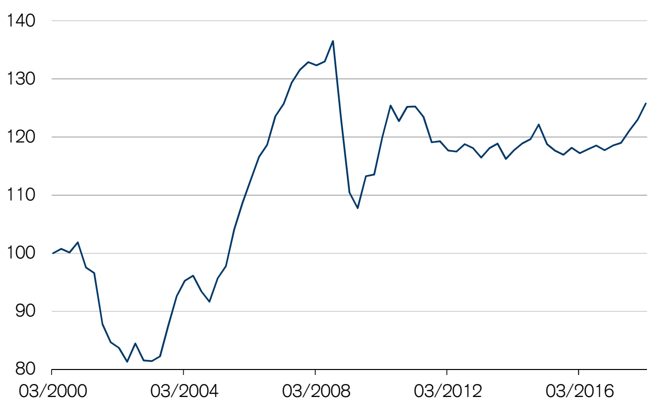
Profits have overcome the strong franc

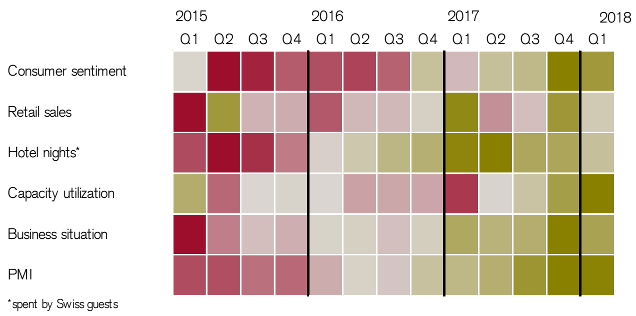
Index (net surplus), Q1 2000 = 100



Source: State Secretariat for Economic Affairs (SECO), Credit Suisse

All indicators in the green zone

Heatmap; green = above average, red = below average



Source: Datastream, GfK, Credit Suisse; *by Swiss guests

Swiss Economy I Monitor

Labor market

Around 4,500 fewer people were registered with the regional employment centers (RECs) in April 2018, and the unemployment rate fell from 2.9% in March to 2.7% in April. However, some of this sharp decrease is attributable to technical adjustments at the RECs. The current labor market conditions are more or less comparable with those in mid-2008: Back then, shortly before the financial crisis, unemployment fell to a temporary low of 2.5%. In view of the many positive leading indicators, the labor market situation should improve further in the course of the year.

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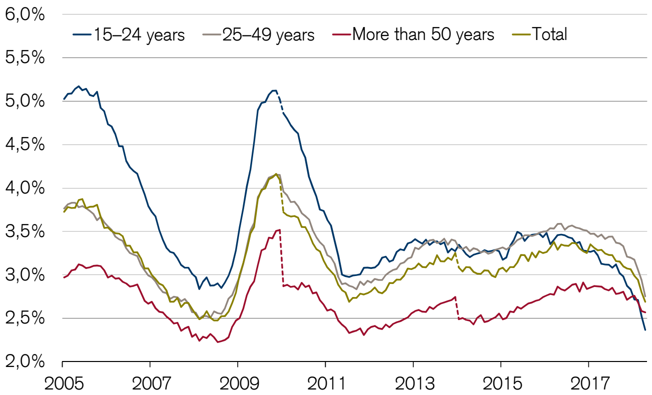
Fewer unemployed in all age groups

Unemployment rate by age group and overall, seasonally-adjusted, in %



Source: State Secretariat for Economic Affairs (SECO), Credit Suisse, dotted line = structural break

Inflation

The inflation rate so far this year has somewhat exceeded our forecasts, above all due to higher oil prices. We are therefore slightly revising our forecast for 2018 upwards from 0.5% to 0.8%. Nevertheless, the inflation risks in Switzerland remain low. Structural factors are curbing price increases. For example, the rising supply of rental accommodation is limiting increases in apartment rents, and the prices for healthcare services are continuing to fall as the political pressure to lower healthcare costs is not set to decrease. We confirm our inflation forecast for 2019 of 0.7%.

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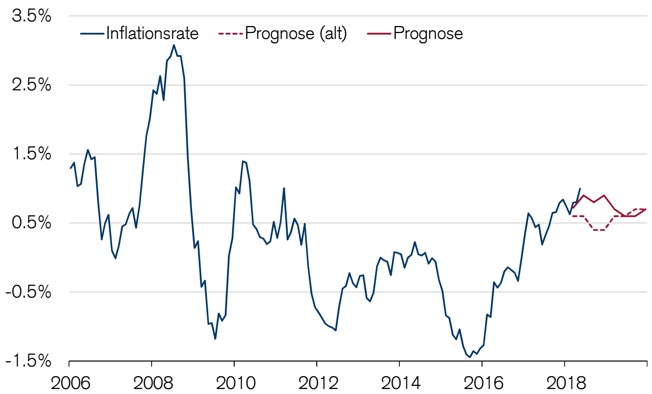
Moderate upward revision of forecast

Year-on-year in %



Source: Datastream, Credit Suisse

Immigration

As part of implementation of the mass immigration initiative, employers are required from 1 July 2018 to report to the regional employment centers vacancies in professions with nationwide unemployment of at least 8%. This threshold will be reduced to 5% from 2020. Construction and the hotel and catering industry are among the sectors most greatly affected by the job reporting requirement and that have until now also relied strongly on migrant workers. Companies in these sectors now have to grant domestic job seekers a time advantage on the labor market.

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Construction and hotel and catering industry affected by compulsory job reporting requirement

Immigration of usual foreign resident population by sector, 2017

Source: State Secretariat for Migration, Credit Suisse

Labor market focus

The hidden reserves are set to remain “hidden”

In view of the aging population, decreasing immigration and increasing shortage of skilled labor, there is a need to make better use of the existing workforce potential. There is potential lying dormant among the unemployed, the underemployed and the less well-known “hidden reserves”. However, their mobilization is set to remain challenging.

The working population is stagnating and calling for better utilization of the workforce potential.

The Swiss working population is stagnating and getting older: If the current trends continue, the ratio of workers to the overall population will fall by 2040 from over 54% to just under 49% and around one in five workers will be aged over 55. While the automation of activities that today are still carried out by the workforce could partially offset the growth-impeding effects of the stagnating working population, at the same time digitalization will significantly alter the job profiles of many professions and could even increase the need for skilled labor in certain sectors. In view of the shortage of skilled labor already existing today in some sectors (see Figure) and the slowdown in the influx of foreign labor, it is necessary to improve the utilization of the existing domestic workforce potential. But where could these additional workers come from?

One in five 15 to 74-year-olds seeking work or more work

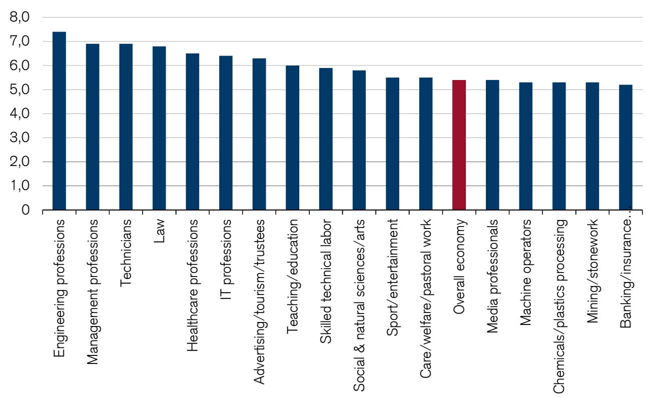
If we view the population within a generously defined working age of 15 to 74, there was an untapped workforce potential throughout Switzerland in 2016 of around 837,000 persons. This is equivalent to 13.2% of the usual resident population and primarily comprises unemployed and underemployed persons and the so-called hidden reserve (see Figure and table). Initial figures for 2017 suggest a stable situation on the same scale.

High workforce potential in Western Switzerland and Ticino

The potential offered by the untapped workforce varies significantly from canton to canton (see map). In the cantons of Geneva, Glarus, Vaud, Neuchâtel and Ticino over 16% of the resident population aged between 15 and 74 is underemployed, unemployed or belongs to the hidden reserve. In the cantons of Appenzell Innerrhoden, Obwalden and Zug their share lies below 9%. The composition of this potential also varies slightly: A somewhat greater share of the potential in the major regions of Lake Geneva and Ticino consists of unemployed persons and the hidden reserve, while in Central Switzerland and Zurich underemployed persons account for a somewhat higher share.

Shortage of skilled labor above all in engineering, management and technical professions

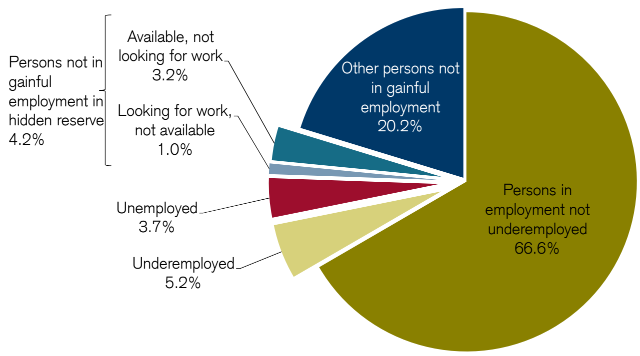
Overall index of shortage of skilled labor: The higher the figure, the more the indicators altogether point toward shortages. Only professions with a higher shortage are shown.



Source: State Secretariat for Economic Affairs, Credit Suisse

Potential of untapped workforces is only partially captured by the unemployment rate

Structure of usual resident population (15 – 74 years old) by detailed labor market status, 2016, in %



Source: Swiss Federal Statistical Office (Swiss Labor Force Survey, SLFS), Credit Suisse

Four main groups with latent potential
Usual resident population (15 – 74 years old) by detailed labor market status

Groups	Definition	No. of persons
Unemployed	Unemployed according to criteria of the International Labour Organization: actively seeking work and able to start a new job within two weeks	238,000
Hidden reserve: seeking work, not available	Seeking work but not available in the short term (within two weeks) to take up employment	64,000
Hidden reserve: available, not seeking work	Not currently seeking work but would in principle like to work and would also be available for this	203,000
Underemployed	Part-time workers who would like to increase their workload	332,000
		Total 837,000

Source: Swiss Federal Statistical Office (Swiss Labor Force Survey, SLFS), Credit Suisse

Unemployment already low

There is unlikely to be any great additional workforce potential lying dormant among the unemployed. On a European comparison, the Swiss labor market is relatively flexible and offers sufficient incentives to take up employment. The unemployment rate is currently at a very low level, especially in view of the fact that a large part of this is residual unemployment. This form of unemployment prevails independently from the economy and time of year because the characteristics profiles of the job seekers do not match the vacancies (structural unemployment) or the search for a suitable new job lasts a certain amount of time (frictional unemployment).

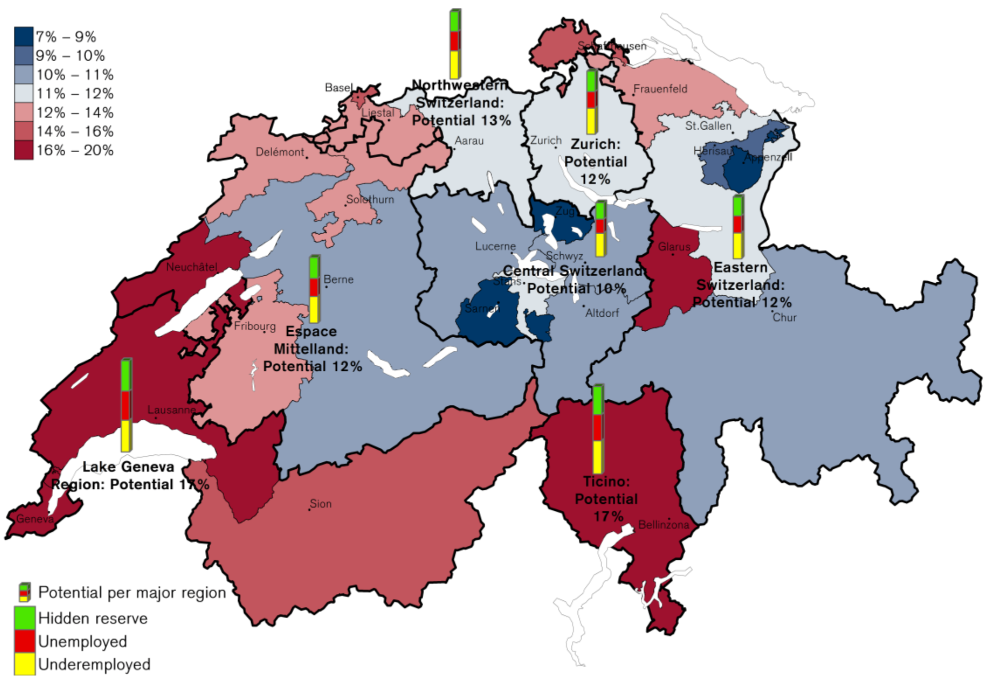
Certain amount of potential among underemployed workers

Almost 20% of part-time workers said that they would like to work more. Above-average numbers of women, 48 to 58-year-olds and persons educated to secondary levels I and II are underemployed (see Figure). The primary reason for this is that these groups more frequently work part-time. If additional manpower is required in a company, it makes sense to increase the workload of the underemployed; however, there appears to be a mismatch in these cases between work supply and demand so that the potential here is likewise set to be limited.

Hidden reserve: temporarily not available for work …

The potential of persons not currently participating in the labor market but expressing an interest in gainful employment appears more promising. This hidden reserve is said to have greater proximity to the labor market than other persons not in gainful employment who do not harbor any desire to work. Over 60% of the significantly smaller part of the hidden reserve (persons seeking work but not available) in terms of numbers consists of 15 to 25-year-olds, many of whom

Untapped workforce potential in the Lake Geneva Region and Ticino is significantly greater than in Central Switzerland
Potential of untapped workforces (hidden reserve + unemployed + underemployed) as share of usual resident population (15 to 74-year-olds) per canton; bars: composition of this potential per major region, 2016



Source: Swiss Federal Statistical Office (Swiss Labor Force Survey, SLFS), Credit Suisse are still in education or training and will subsequently enter the labor market. By contrast, personal, family and health reasons are above all decisive for the current non-availability of older members of this group.

… or available but not seeking work – notably older workers …

Mobilization of the second group of the hidden reserve that is not actively seeking work but would fundamentally like to have a job appears particularly promising at first glance. A considerable share of this is made up of older workers: While 16% fall into the category of 59 to 65-year-olds, a further 24% have already reached statutory retirement age. A total of around 80,000 older workers (over 58 years of age) claim to be interested in getting a job. These senior citizens willing to work are generally well educated (55% and 30% respectively hold a qualification at secondary level II or tertiary level) but the vast majority (76%) are no longer actively seeking work due to their retirement. Health reasons are the decisive factor for a further 7%. However, among both the 59 to 65-year-olds and the 48 to 58-year-olds, almost one in eleven also believes that there is no opportunity for a further job on the labor market (see Figure): Eighty percent of a total of around 6,400 ‘disillusioned’ workers who nevertheless remain interested in employment fall into these age categories.

… and women

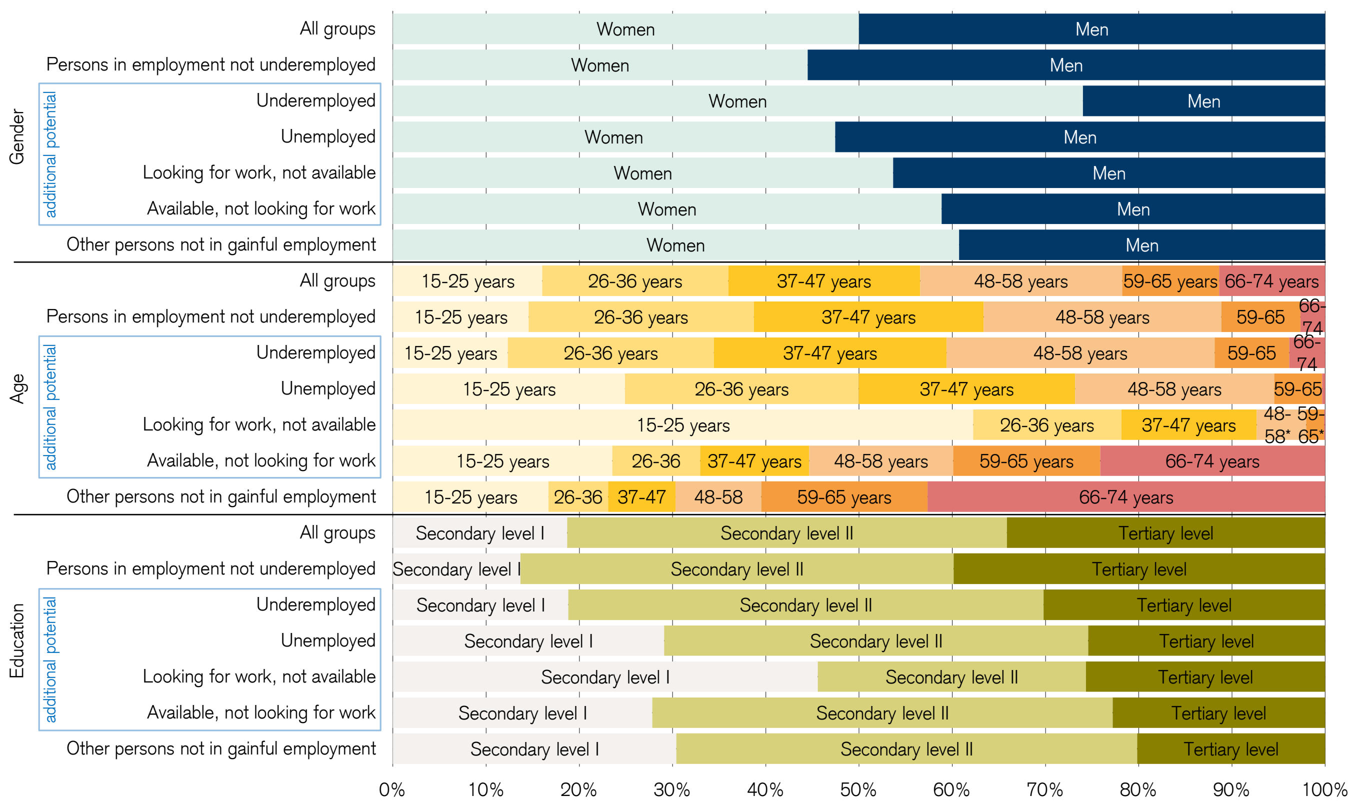
A further group is overrepresented among persons available but not seeking work: Almost 60% of them are women. Above all family commitments are the decisive factor here for not actively seeking employment. This reason is cited in 40% of cases among 26 to 58-year-olds, followed by health (24%) and personal reasons (27%). Family commitments play a secondary role for men (3%). Health reasons (43%), other personal commitments (36%) and education/training (12%) are decisive here.

Forgoing of employment activity or part-time work due to family commitments is widespread

Family commitments are also decisive in 44% of cases for non-participation in the labor market among the other persons aged between 26 and 58 who are not in gainful employment, namely those not expressing any interest in employment. Among women with children aged under 15, the share of these other persons not in gainful employment is significantly higher at 17% than among those without children (9%) and the share of the hidden reserve doubles to 4%. An even

Potential among well-educated workers, especially among women

Usual resident population (15 – 74 years old), by employment status and various features, in %, 2016



Source: Swiss Federal Statistical Office (Swiss Labor Force Survey, SLFS), Credit Suisse

* These results are to be interpreted with caution owing to the low sample size.

greater share of women retires completely from the workforce among households where the youngest child is aged under seven. Nevertheless, the participation rate of mothers in Switzerland is altogether high: Almost four out of five mothers continue to work, although the substantial majority with a reduced level of employment. However, one in four part-time employees also reduces their workload due to excessively expensive or unsuitable childcare facilities. Improvements in the reconciliation of work and family life and tax incentives for couples with two incomes could contribute to bringing about a higher participation of persons with children.

Combat shortage of skilled labor with labor market reserves? Yes but …

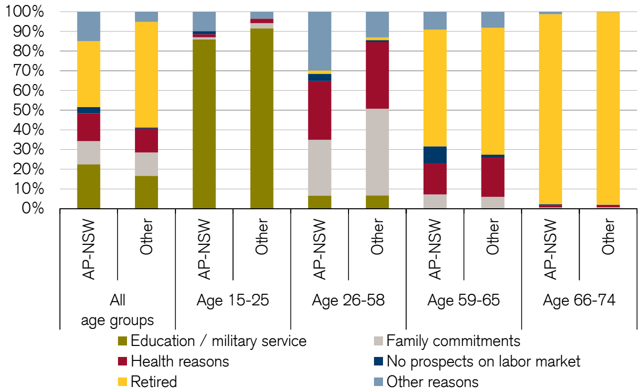
It was pointed out at the beginning of this article that the shortage of skilled labor was particularly marked in the engineering, management, technical, legal, IT and healthcare professions. There is also untapped workforce potential in these areas in Switzerland (see Figure). For example, 14,000 persons are available in the technical and IT professions who belong to the hidden reserve – only slightly fewer than the number of unemployed in this job category. There is also a significant hidden reserve in the production occupations in industry and commerce. Furthermore, many part-time employees in all occupational groups are interested in increasing their workload. A glance at the statistics reveals considerable potential for the mobilization of additional manpower, particularly among older workers and women who would like to work but for various reasons do not do so. However, the statistics also show that the size of these groups has remained relatively stable over the years. Why is it not possible to integrate these persons into the labor market?

… the demand for older workforces is limited …

Compared internationally, the labor participation of older persons in Switzerland is high and has been increased in the last 20 years. Older people are also less frequently affected by unemployment than younger workers. However, once they do actually become unemployed, they have significantly more difficulties finding a new job and the likelihood of becoming affected by long-term unemployment is significantly greater for those aged over 50. Particularly problematic are the generally higher wage level and social insurance costs incurred for older staff. Moreover, their level of education tends to be lower than that of younger generations and is not always documented with a formal diploma. According to the 2017 SME Study of Credit Suisse[1], so far only just under one in four small and medium-sized enterprises (SMEs) have been opting for employment beyond statutory retirement age as a means of securing their skilled labor requirements. These almost exclusively comprise SMEs that are already today expecting a high additional labor requirement due to retirements. A rethink has not yet really taken place among companies.

Family and health decisive factors for not seeking employment among 26 to 58-year-olds

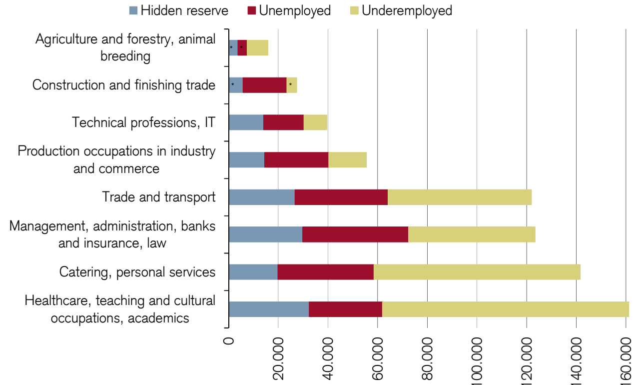
Reason why person (15 – 74 years old) not seeking work, "available persons, not seeking work" (AP-NSW) and "other persons not in gainful employment", 2016



Source: Swiss Federal Statistical Office (Swiss Labor Force Survey, SLFS), Credit Suisse

Untapped potential also in sectors with high shortages of skilled labor

Potential of untapped workforces (15 – 74 years old) by job category, no. of persons, 2016



Source: Swiss Federal Statistical Office (Swiss Labor Force Survey, SLFS), Credit Suisse

* These results are to be interpreted with caution owing to the low sample size.

[1] See: *Success factors for Swiss SMEs in 2017: strategies for combating the shortage of skilled labor*, Credit Suisse, August 2017

… and there are certain question marks on the supply side

As well as a limited demand for older workers, it is also questionable with regard to the supply side whether the labor participation of senior citizens can be significantly increased in the medium term. Based on the data analyzed for this article, 17% of all 66 to 74-year-olds are employed and further 7% express an interest in remaining in work beyond retirement age. A considerable share of pensioners therefore appear to be enjoying their well-earned retirement and only offering their services to the workforce if the work is attractive in terms of both content and remuneration. The so-called reservation wage is therefore likely to be relatively high for this segment. Furthermore, many senior citizens remain active, with around one in five engaging in voluntary work after retirement, for example. An obvious option for making greater use of the potential of older workers would be to raise the statutory retirement age. However, as the discussion before and after the failed 2020 Pension Reform has illustrated, this measure appears set to remain taboo for some time to come.

Reconciliation of work and family life remains a challenge

Enhancing the integration of women is also only progressing slowly. Measures for balancing family life and work better help to attract the untapped potential from the (hidden) reserve. Certain residual fiscal disincentives for two-income households, the marriage penalty and the supply of nursery places and day schools that in many places remains underdeveloped and is frequently expensive pose obstacles to the utilization of the additional workforce potential. An improvement of the underlying structural conditions could also promote the (re-) assumption of employment by the more significant group in terms of numbers comprising other persons not in gainful employment who are not currently interested in a job. The urgency of the problem – not least in view of the acceptance of the mass immigration initiative – has also led to a series of measures within the framework of the so-called qualified workers initiative of the Federal Council. However, if economic policy measures continue only to be implemented hesitantly, the hidden reserve is likely largely to remain “hidden” for the foreseeable future.

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Monetary policy

Troublesome profits

Retained profits on the Swiss National Bank's (SNB) foreign currency reserves are adding to the size of its balance sheet. Were monetary policy easing again to be warranted, a very large balance sheet could limit policy options.

Profits on foreign currency reserves inflating the SNB's balance sheet...

In March 2018, the SNB's foreign currency reserves topped CHF 770 billion. Most of these reserves were accumulated during the past ten years of foreign exchange interventions which were intended to prevent the CHF from appreciating too much. With substantial parts of these reserves invested in bonds and equities, interest, dividends and capital gains generated more than CHF 70 billion in SNB profits between 2008 and 2017. While a (small) share of these profits has been distributed to the public sector, by far the largest part has essentially been accumulated in the form of retained earnings in the SNB's balance sheet, thereby contributing to its expansion. We have used our long-term forecasts for financial asset returns to simulate how the SNB's reserves could develop over the next five years. Assuming that there are no sales or additional purchases of foreign currencies, the central tendency suggests that the foreign currency reserves should grow to almost CHF 900 billion by the end of 2022 (see fig.). This would correspond to an annual compounded rate of return of 3.9%.

...and could limit its policy options if monetary policy easing were to be warranted

After the removal of the minimum exchange rate for EUR/CHF, the SNB argued that "a [continued] expansion of the balance sheet [c]ould have severely impaired the SNB's ability to conduct monetary policy in [the] future," as it "would have made further monetary policy measures substantially harder" to implement. In other words, the SNB was worried that it would not be able to ease monetary policy in an effective way as required if its balance sheet were to become too large. Admittedly, and unlike purchases of foreign currencies, an expansion of the SNB's balance sheet resulting from accumulated profits is irrelevant for monetary policy because these get booked as own capital rather than as base money. However, a constantly growing balance sheet could nonetheless cause discomfort for the SNB. If economic conditions were to warrant monetary policy easing, the SNB may again need to purchase substantial amounts of foreign currencies which would further add to an already very bloated balance sheet. If market participants were then to question the willingness of the SNB to further inflate its balance sheet due to concerns raised on this issue back in 2015, purchases of foreign currencies could be less effective in weakening the CHF. Meanwhile, a good return on foreign currency reserves could be a boon for the public sector. Under an optimistic scenario in which the SNB was able to sell its foreign currency reserves over time without triggering appreciation pressure on the CHF, exceptional profit distributions substantially larger than the current annual CHF 1 to 2 billion would be conceivable.

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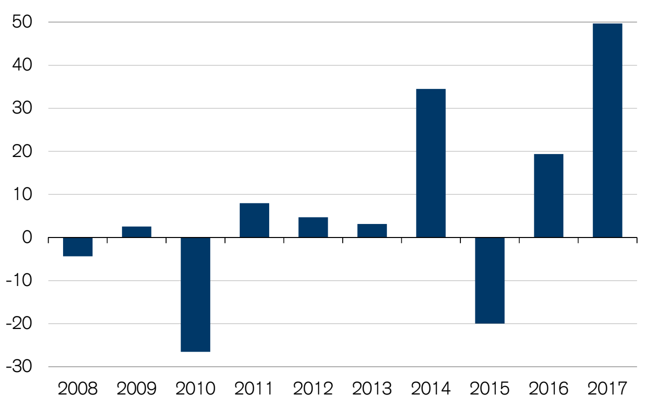
Profits on foreign currency reserves

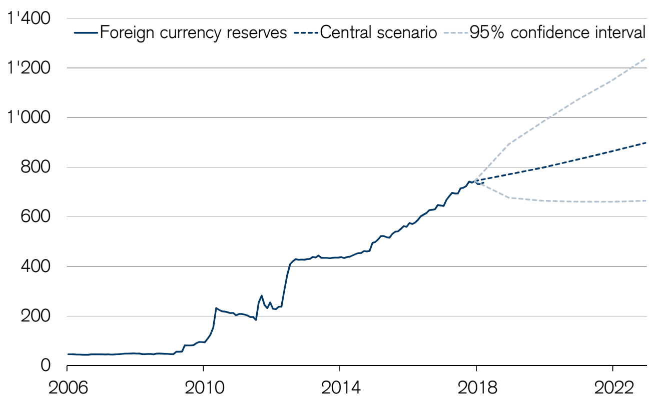
Annual earnings on the SNB's foreign currency reserves, in CHF (bn)



Source: Swiss National Bank, Credit Suisse

Foreign currency reserves could yield around 4% p.a.

Foreign currency reserves, incl. projection for the next 5 years, in CHF (bn)



Source: Swiss National Bank, Credit Suisse

Monetary policy I Monitor

Policy rate

Most economic indicators in Switzerland are pointing to "normal" or slightly "overheated" economic conditions. However, the SNB has made it clear that it is not yet comfortable with the valuation of the CHF. Moreover, and despite solid economic growth, inflation is unlikely to accelerate in the near future as structural factors are dampening price increases. In this context, we expect the SNB not to raise the deposit rate from currently its current –0.75% to –0.50% until Q1 2019. A second rate increase could then follow in Q3 2019. Market expectations derived from financial instruments have been pricing in fewer rate hikes so far.

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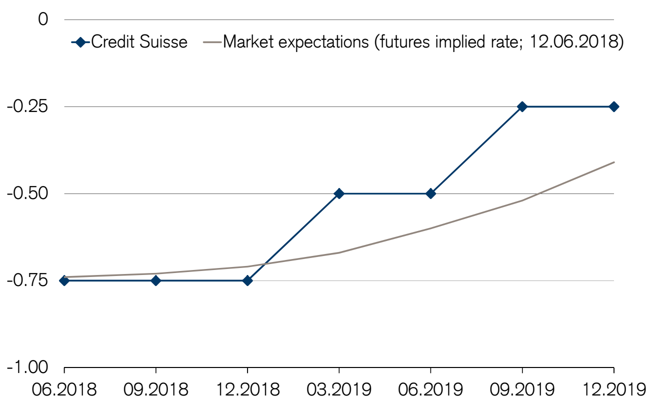
SNB likely to raise its policy rate in 2019

SNB deposit rate, in %, Credit Suisse forecast and market expectations



Source: Bloomberg, Credit Suisse

Mortgage rates

Immediately after the introduction of the negative interest rate by the SNB, banks widened their margins on mortgages to compensate for higher costs for hedging the interest rate risk. Meanwhile, margins on longer term mortgages have dropped very close to levels that prevailed before the introduction of the negative rate. This trend may reflect intensified competition, in particular from pension funds, which are keen to offer long-term mortgages. For shorter term mortgages, the decline of the margins has been more gradual. However, the demand for shorter term mortgages is much lower.

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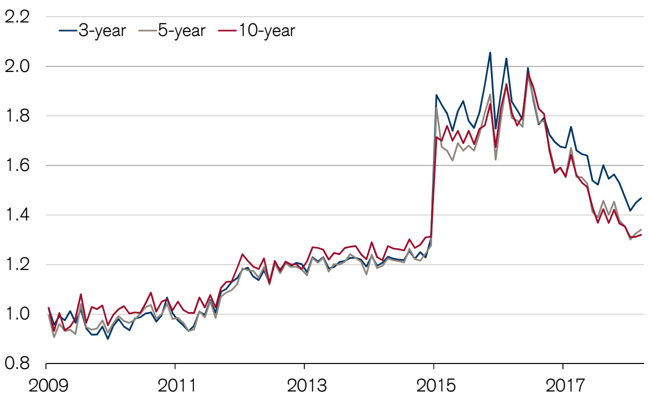
Margins on mortgage credits have compressed

Approximated banks' margins on mortgage credits, in percentage points



Source: Datastream, Eikon Reuters, Credit Suisse

Foreign currency reserves

Although the SNB essentially halted its foreign exchange interventions last summer, its foreign currency reserves have since then displayed substantial fluctuations. Alongside outright purchases (or sales) of foreign currencies, two other factors exert an impact on reserves. Firstly, any change in the value of the SNB's foreign assets, be this due to exchange rate movements or changes in stock and bond prices, will affect the value of foreign currency reserves. Secondly, the SNB lends and borrows securities from outside parties (via repo and reverse repo transactions), thereby increasing or reducing the volume of reserves.

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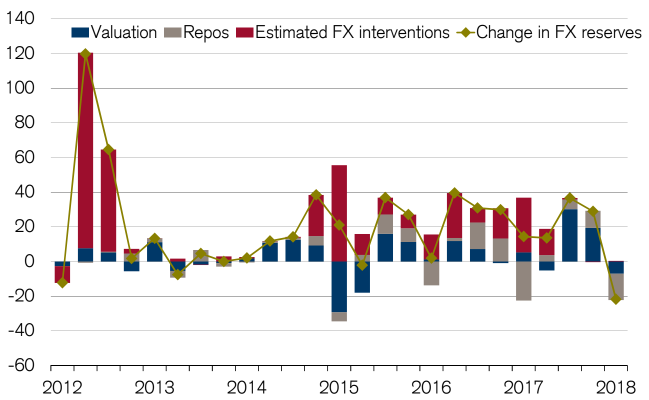
Factors impacting foreign currency reserves

Change in the SNB's foreign currency reserves, in CHF (bn)



Source: Swiss National Bank, Credit Suisse

Economic policy

US punitive tariffs on metals can be coped with

The US is a relatively small sales market for the Swiss metal industry. The punitive tariffs on US imports of aluminum and steel can therefore be coped with. However, regulatory initiatives for pharmaceuticals would have more serious consequences.

Trade war "light"

Despite the aggressive trade policy rhetoric on the part of the US, as expected no global trade war appears to be breaking out. For example, the punitive tariffs on US imports of steel (25%) and aluminum (10%) are not currently being applied toward China. On the other hand, temporary exemptions for the EU have already been suspended again.

Few Swiss imports of aluminum and steel to the US

The punitive tariffs have applied to our exporters already since their initial announcement in March 2018. While these protectionist measures can prove dramatic for individual companies in the metal industry, they are barely set to have any consequences for the Swiss economy as a whole. Swiss aluminum and steel exports accounted for just 2.2% of all goods exports in value terms in 2017 (see Figure). Exports to the US comprised 4.2% of these. By comparison, around 85% of all Swiss aluminum and steel exports are sold in the European Union (EU). Were the EU (contrary to our expectations) to introduce similar trade restrictions, the Swiss export economy would thus be hit significantly harder.

Regulatory initiatives in the pharmaceuticals sector with more serious consequences

By contrast, the pharmaceuticals sector as the Achilles' heel of the Swiss export economy is responsible for more than a third of Swiss exports, with 20% of pharmaceutical products delivered to the US. The US is a lucrative market for pharmaceutical companies as the prices for medical products there are less strongly regulated than in many other countries. If the US were to adopt protectionist measures regarding pharmaceutical imports from Switzerland, this would probably have considerably worse consequences. According to a position paper of the US President's Council of Economic Advisors, the US is very much aware of this issue. However, there have so far been no specific proposals for combating the international price differences for pharmaceuticals.

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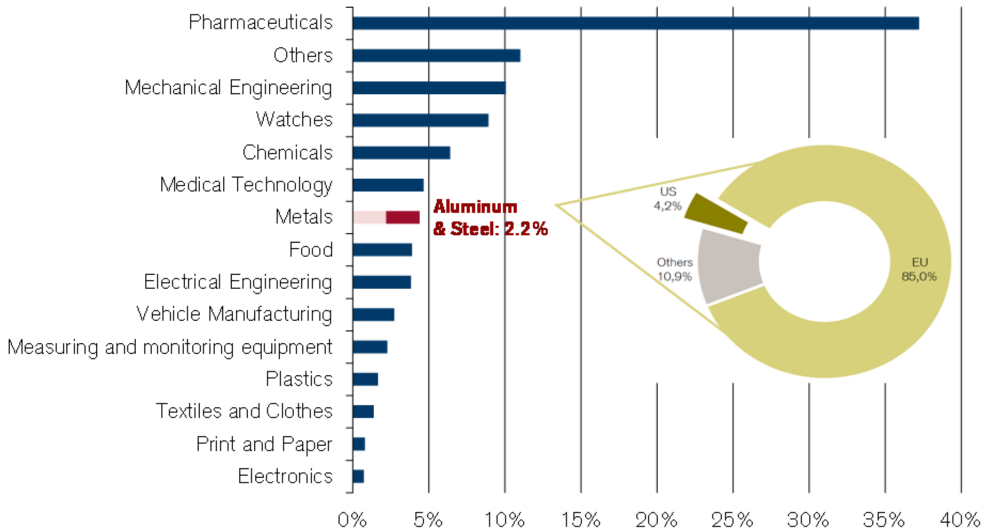
Few steel and aluminum exports to the US

Swiss total exports by sector and Swiss aluminum and steel exports by destination, 2017, in %.



Source: Swiss Customs Administration, Credit Suisse

Investments

Technology in the service of mankind and investors

Technology is now perceived as a threat that could permanently make the human workforce redundant. However, it also offers significant advantages for mankind and a large number of investment opportunities for investors.

The five Credit Suisse supertrends offer long-term investment opportunities

New technologies and extended areas of application of existing technologies will also remain a core issue in the future. We have therefore defined "technology in the service of mankind" as one of five supertrends. We expect these supertrend issues to play a dominant role in the years to come and to open up attractive investment opportunities.

Technology is not just a risk but also an opportunity

Cutting-edge technology is currently being increasingly perceived as a threat: Robots, algorithms and programs have a reputation of destroying jobs and rendering human beings redundant. However, we should not forget that technology and innovation also have their good sides: They increase productivity and facilitate better products and services. Digitalization, for instance, has on the one hand certainly triggered major upheaval in areas such as media, the retail trade and publishing and heralded the end of many companies and business models. However, it has also expanded to sectors such as automobiles, finance and healthcare where it has yielded greater customer benefits. At the same time, digitalization serves as the basis for new business ideas and its creative potential is at least as large as its powers of upheaval. While jobs may therefore by all means disappear because repetitive, manual activities are replaced by machines, by the same token new and challenging jobs in creative areas are also set to be created. The shortage of labor (see page 8) could therefore even intensify further in certain activities.

Online platforms are among the major winners ...

We have no doubt that digitalization will also shape our lives in the future. It is for this reason that the so-called digitizers offering sales growth as well as rising operating margins due to economies of scale and increased efficiency are set to be among the major winners of the years to come. Providers of online platforms in particular should continue to benefit to a high degree. Furthermore, online advertising agencies and companies creating new ecosystems on the basis of the Internet of Things and cloud computing are also set to count among the winners in the long term.

... as are companies in the area of data security and handling

However, digitalization undoubtedly also has its negative aspects, with data theft in particular posing a major risk. It is for this reason that we consider cyber security to be one of the most stable areas with regard to IT expenditure. Moreover, the exponential increase in the flood of data that is automatically stored could lead to rising costs. This could facilitate the development of a fast-growing business segment for companies focusing on services for the qualification, administration and cleansing of data repositories.

Not only IT companies set to benefit

Digitalization also offers interesting opportunities for companies outside the IT sector. The necessity to promote innovation and enhance operational efficiency will boost long-term trends such as big data, the Internet of Things and the virtual world. Technologies such as virtual reality (VR), augmented reality (AR) and robotics offer outstanding opportunities in this respect.

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Real Estate I Monitor

Owner-occupied housing

While the prices for owner-occupied housing stagnated in the first quarter of 2018, compared with the prior-year quarter they display a solid increase of 3%. However, the regained price momentum remains below the average price growth since 2000. The price rise is greatest in the Zurich area and in the catchment areas of Lucerne, Basel, Berne and Lausanne. Thanks to the good economic situation, the prevailing low interest rates and a decline in new construction activity, we also expect price growth in the coming quarters. However, this should be somewhat lower than in the recent past.

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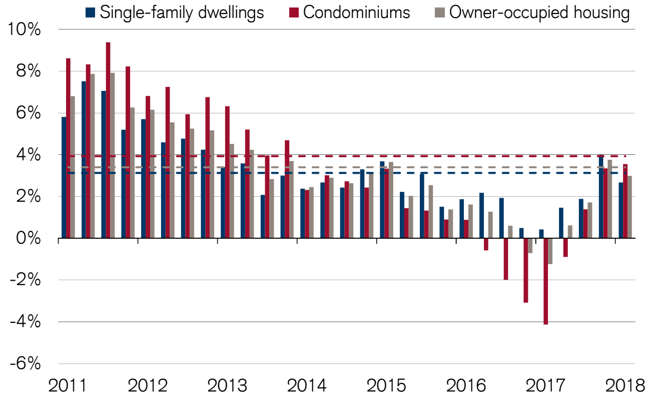
Property prices with solid growth

Annual growth rates; dotted lines: 2000 – 2017 average p.a.



Source: Wüest Partner, Credit Suisse

Rental apartments

A slight fall in figures for planning applications and building permits over the past year seemed to indicate that the boom in rental apartment construction would also not last forever. However, the planning applications received in the first quarter of 2018 show that there is still no sign of an abandonment of residential investment properties by investors. The number of rental apartments planned in the last 12 months is now 2,000 residential units up on that of the prior-year period again. Around 33,700 apartments have been planned over the past 12 months – a new high.

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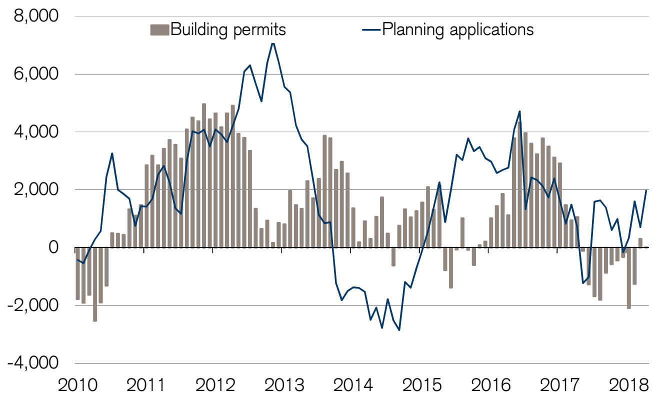
Planning activity increasing further

YoY building permits and planning applications*, number of residential units



* YoY change in moving 12-month total

Source: Baublatt, Credit Suisse

Retail property

Despite improved consumer sentiment, the situation in the retail trade remains extremely challenging. The far-reaching structural changes due to the development of e-commerce are weighing down on the margins of bricks and mortar retailers and reducing the demand for retail property. The plight of the retail property market is causing investors to be cautious. Since the end of 2018, the planning activity of new retail properties has been well below its long-term average. Owing to continuing problems on this market, we do not expect any new momentum for construction activity in this sector for the time being.

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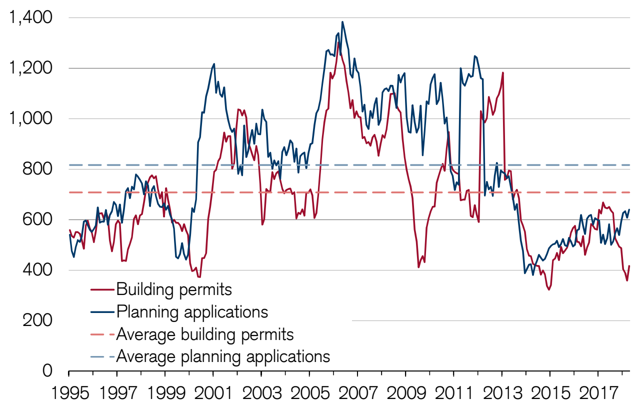
Planning activity remains slack

Construction sum in CHF mn., new construction/extension, moving 12-month total



Source: Baublatt, Credit Suisse

Sectors I Monitor

Chemical and pharmaceutical industry

The year-on-year exports of the chemical industry increased by 5% in the first quarter of 2018 and those of the pharmaceutical industry by almost 2%. As before, a majority of companies in both industries considers the business situation to be good or satisfactory. The companies surveyed by the KOF Swiss Economic Institute are also largely optimistic regarding the months to come, particularly in the chemical industry which is set to continue to benefit more from the currently dynamic economic climate than the acyclic pharmaceutical sector.

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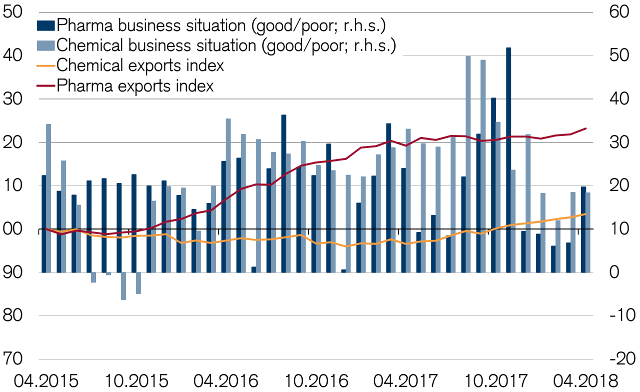
Chemical exports still in growth mode

Exports: moving 12-month average, index: April 2015 = 100;
business situation: share of companies surveyed, balances in percentage points



Source: Swiss Customs Administration, KOF Swiss Economic Institute, Credit Suisse

Engineering, electrical and metal industry (MEM)

The MEM industry continued to benefit in the first quarter of 2018 from the robust global economic performance and the weaker franc but has lost some momentum. Year-on-year exports in the first for months of 2018 grew by around 11%, down from 10% in the final quarter of 2017. The majority of companies continues to rate the business situation as satisfactory or good and has optimistic expectations for the months to come. In view of the ongoing positive global economic situation, we share this optimism.

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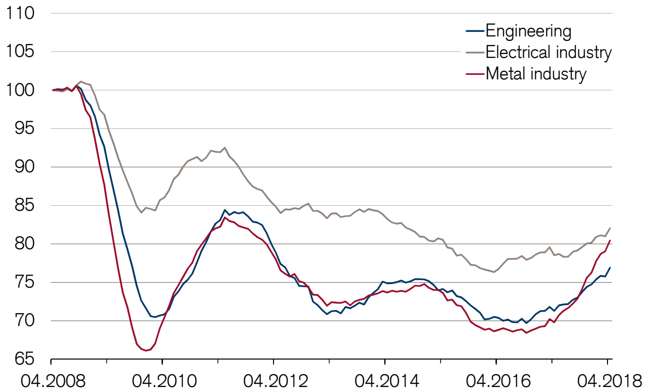
Robust dynamics in MEM exports

Exports: moving 12-month average, index: April 2008 = 100



Source: Swiss Customs Administration, Credit Suisse

Watch industry

The watch industry significantly increased its exports in the first quarter of 2018 (+10% YoY). Unlike the preceding quarter, positive momentum came not just from the Asian main sales markets (China, Hong Kong, Japan), but also from the US and some European countries. Although exports in the lower price segment continued to fall, the decline has slowed down. Altogether the outlook is positive. The KOF business tendency survey shows that companies are more optimistic about the future development of the business situation than at any time since mid-2011.

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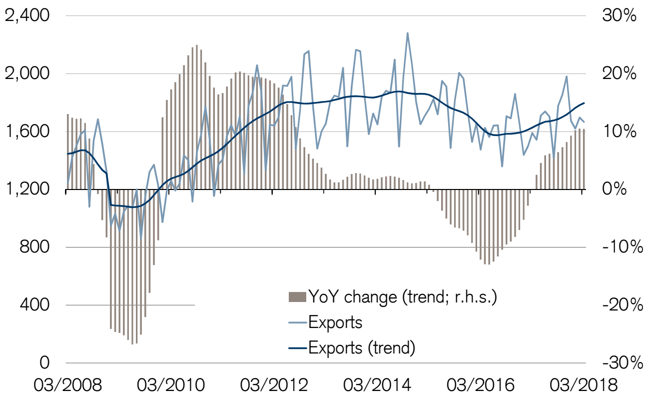
Growth in the watch industry remains dynamic

Exports (monthly figures) in CHF mn., YoY change, in % (trend)



Source: Swiss Customs Administration, Credit Suisse

Retail trade

Thanks also to the robust labor market, consumer sentiment remains good. However, the retail trade barely benefited from this in the first quarter of 2018. Nominal retail sales practically stagnated (+0.1% YoY). Retailers in the non-food segment even sustained sharp sales losses (–1.9%), while the food segment grew strongly for the second quarter in succession (+1.4%). We expect the retail trade also to lag behind the Swiss economy in 2018 owing to structural problems in the non-food sector (keyword: e-commerce).

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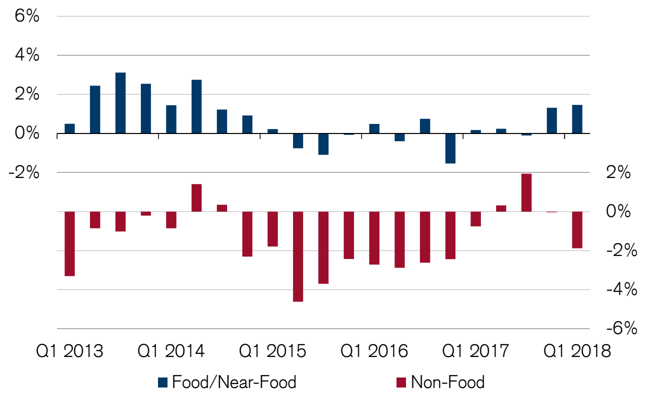
Food pulling away from non-food

Nominal retail sales, YoY growth in %



Source: GfK, Credit Suisse

Tourism

Thanks to perfect weather and currency conditions, the winter season already got off to a promising start in 2017. With a 4.8% increase in the number of overnight stays (January to March 2018, YoY), Swiss hoteliers closed the winter season on successful note. With 6.9% more first entries throughout the entire winter season, the ailing cable car sector also recorded its best result in recent years. However, in order to achieve a sustainable recovery, the Alpine destinations also need to win back Swiss guests in the warm season who in the past few years have increasingly spent their summer vacation abroad.

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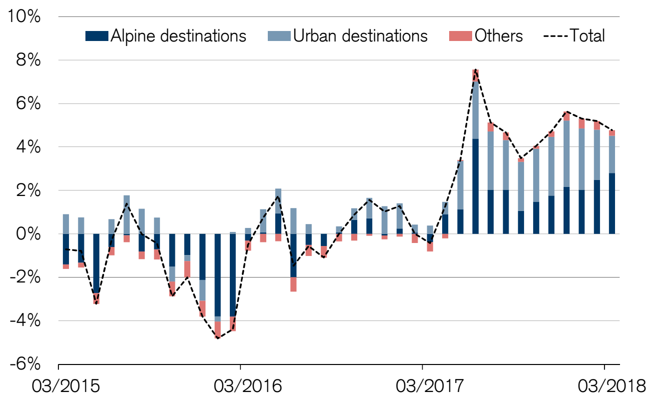
Good winter season

Overnight stays, moving three-month average, YoY growth in %



Source: Swiss Federal Statistical Office, Credit Suisse

Information technology (IT)

The course of business in the IT sector has improved further. The Swico ICT Index that summarizes the current quarter expectations of Swiss IT companies regarding the development of sales, order intake and margins once again rose in the second quarter of 2018 and reached its highest level in seven years. The prevailing trend toward digitalization should also generate strong demand for IT services in 2018. The good business situation in important customer segments (such as industry) is likewise benefiting the IT sector.

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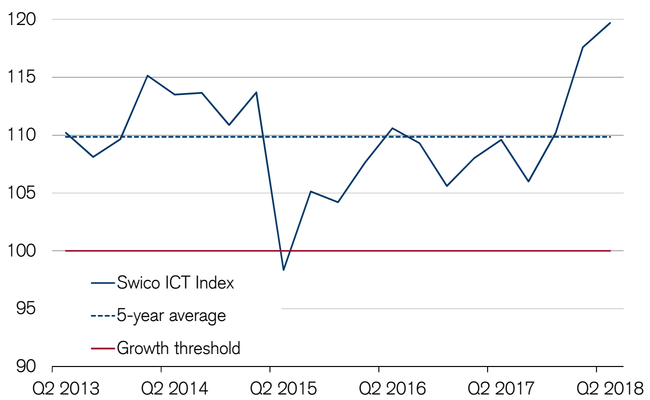
IT companies are very confident

Sentiment index: > 100 = improvement, < 100 = deterioration on previous quarter



Source: Swico, Credit Suisse

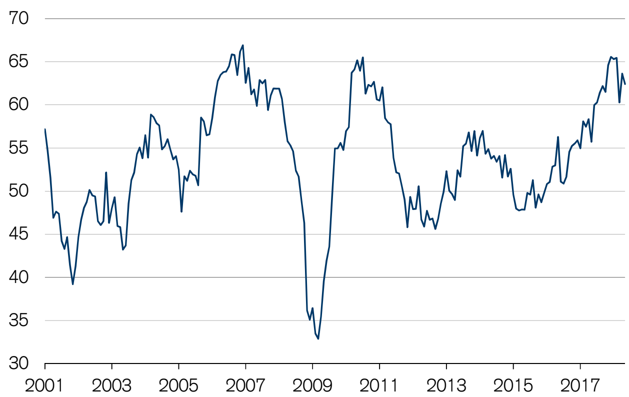
Credit Suisse Leading Indicators

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



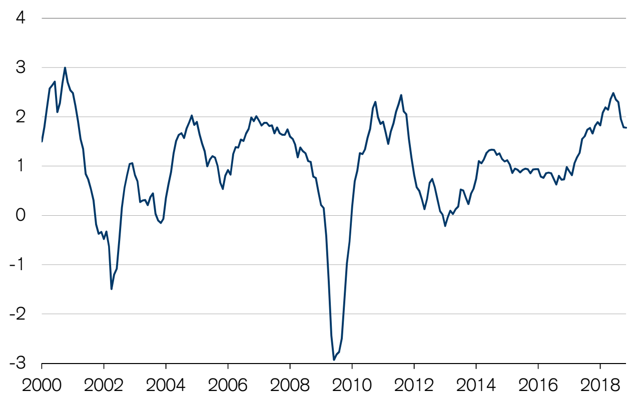
Source: procure.ch, Credit Suisse

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



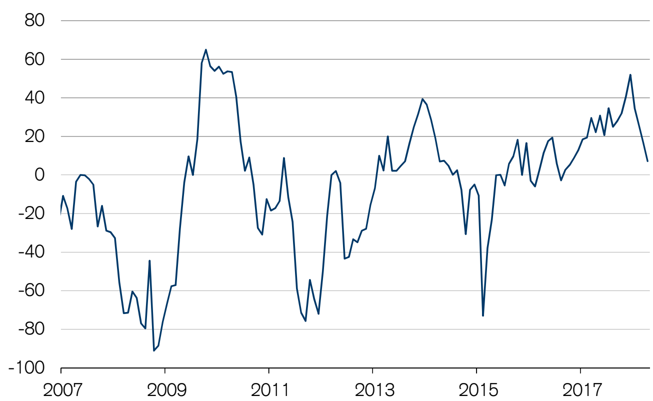
Source: PMIPremium, Credit Suisse

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.

Economic Activity

Balance of expectations, values > 0 = growth



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

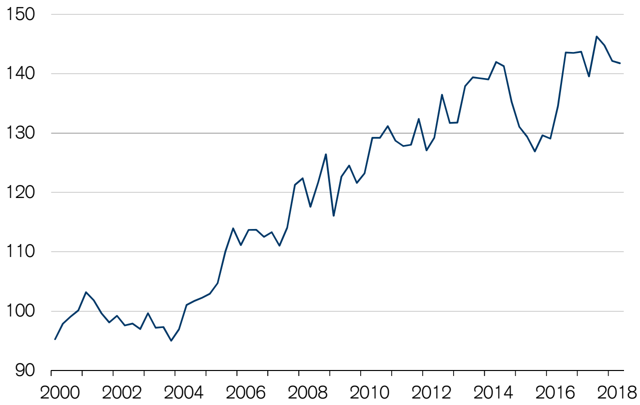
Source: CFA Society Switzerland, Credit Suisse

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



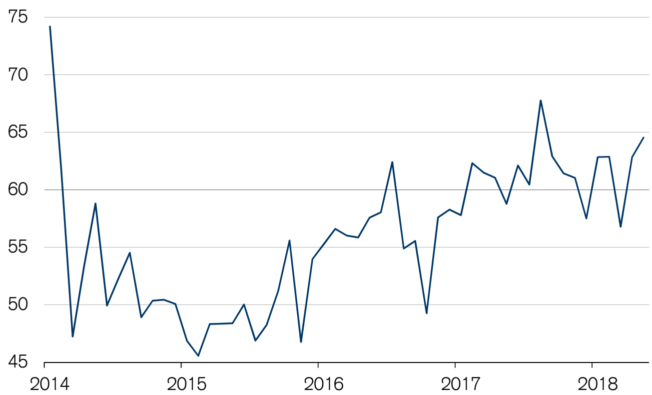
Source: Swiss Contractor's Association, Credit Suisse

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

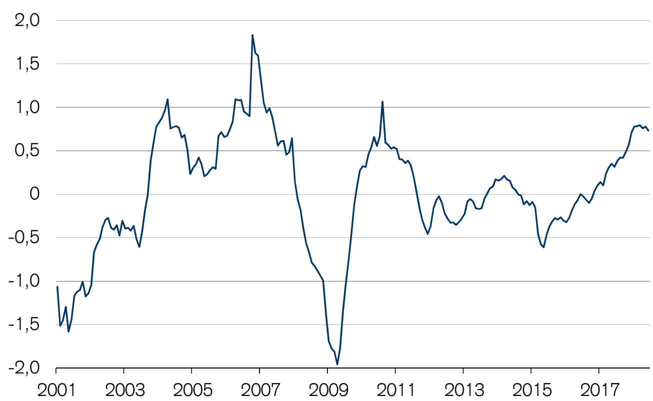


Source: procure.ch, Credit Suisse

Macro Momentum Indicator

The Credit Suisse Macro Momentum Indicator (MMI) condenses the current performance of key Swiss economic data to a single figure. Data from economic surveys, consumption, the labor market, lending and the export economy are used to calculate a standardized momentum that is then weighted with the applicable correlation to GDP development. Values above (below) zero point toward an acceleration (slowdown) of the Swiss economy in the last three months compared with the past six months.

Economic Activity



Source: Datastream, Credit Suisse

Forecasts and Indicators

Forecasts for the Swiss Economy

	2018 Q1	2018P Q2	2018P Q3	2018P Q4	2019P Q1	2019P Q2	2019 Q3	2019P Q4	2018P	2019P
GDP (YoY, in %)	2.2	2.4	2.2	2.0	1.8	1.7	1.7	1.8	2.2	1.7
Consumer spending	1.0	1.3	1.5	1.6	1.4	1.4	1.4	1.4	1.4	1.4
Government expenditure	0.7	1.0	1.0	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Gross capital investment	3.5	2.4	2.5	4.0	2.3	2.1	2.1	2.1	3.1	2.1
Construction investment	1.6	1.4	1.4	1.4	0.4	0.4	0.4	0.4	1.4	0.4
Investment in plant and equipment	4.6	3.0	3.0	5.5	3.0	3.0	3.0	3.0	4.0	3.0
Exports (goods and services)	1.7	4.5	4.5	5.2	3.5	3.5	3.5	3.5	4.0	3.5
Imports (goods and services)	5.9	3.0	2.6	2.5	3.0	3.0	3.0	3.0	3.5	3.0
Inflation (in %)	0.7	0.9	0.8	0.9	0.7	0.6	0.6	0.7	0.8	0.7
Unemployment (in %)	2.9	2.6	2.4	2.3	2.3	2.3	2.2	2.2	2.6	2.3
Employment growth FTEs (YoY, in %)	1.7	1.7	1.7	1.5	1.2	1.2	1.2	1.2	1.5	1.2
Net immigration (in thousands)									50	50
Nominal wage growth (YoY, in %)									0.7	1.0
Current account balance (in % of GDP)									6.8	7.2
General Government budget surplus (in % of GDP)									0.0	
Public debt (in % of GDP)									40.9	.

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

Forecasts for the World Economy

Forecasts	Forecasts: GDP YoY, in %		Inflation YoY, in %		Structure: Population In million	GDP In USD billion	Significance for Switzerland: Share of exports In %	Share of imports In %
	2018	2019	2018	2019	2016	2017	2017	2017
World	3.4	3.2	2.6	2.4	7,444	79,865	100	100
US	2.8	2.4	2.5	2.1	324	19,391	15.3	6.8
Euro zone	2.5	2.2	1.7	1.7	340	12,607	44.1	63.4
Germany	2.5	2.3	1.7	1.9	82	3 685	18.9	28.2
France	2.0	1.7	2.0	1.2	65	2 584	6.4	7.9
Italy	1.7	1.6	1.2	1.6	61	1,938	6.2	9.7
UK	1.4	1.7	2.5	2.2	66	2,625	5.2	3.3
Japan	1.3	1.0	0.7	0.8	127	4,872	3.3	1.9
China	6.5	6.2	2.5	2.0	1,383	12,015	5.2	7.0

Source: Datastream, International Monetary Fund, Credit Suisse

Interest Rates and Monetary Policy Data

	Current	3-month	12-month		Current	Prev. mth.	Prev. year
3-month Libor (in %)	–0.73	–0.8 to –0.6	–0.6 to –0.4	M0 money supply (CHF bn)	548.0	545.9	555.8
SNB target range (in %)	–1.25 to -0.25	–1.25 to -0.25	–1.00 to 0.00	M1 money supply (%, YoY)	6.9	7.1	5.6
10-year government bond yields (in %)	0.06	0.1– 0.3	0.3 – 0.5	M2 money supply (%, YoY)	3.6	3.9	3.6
				M3 money supply (%, YoY)	3.3	3.3	3.2
				Foreign currency reserves (CHF bn)	787.4	768.4	730.1

Source: Datastream, Bloomberg, Credit Suisse

Risk warning

Every investment involves risk, especially with regard to fluctuations in value and return. If an investment is denominated in a currency other than your base currency, changes in the rate of exchange may have an adverse effect on value, price or income.

For a discussion of the risks of investing in the securities mentioned in this report, please refer to the following Internet link:
https://research.credit-suisse.com/riskdisclosure

This report may include information on investments that involve special risks. You should seek the advice of your independent financial advisor prior to taking any investment decisions based on this report or for any necessary explanation of its contents. Further information is also available in the information brochure "Special Risks in Securities Trading" available from the Swiss Bankers Association.

Past performance is not an indicator of future performance. Performance can be affected by commissions, fees or other charges as well as exchange rate fluctuations.

Financial market risks

Historical returns and financial market scenarios are no guarantee of future performance. The price and value of investments mentioned and any income that might accrue could fall or rise or fluctuate. Past performance is not a guide to future performance. If an investment is denominated in a currency other than your base currency, changes in the rate of exchange may have an adverse effect on value, price or income. You should consult with such advisor(s) as you consider necessary to assist you in making these determinations.

Investments may have no public market or only a restricted secondary market. Where a secondary market exists, it is not possible to predict the price at which investments will trade in the market or whether such market will be liquid or illiquid.

Emerging markets

Where this report relates to emerging markets, you should be aware that there are uncertainties and risks associated with investments and transactions in various types of investments of, or related or linked to, issuers and obligors incorporated, based or principally engaged in business in emerging markets countries. Investments related to emerging markets countries may be considered speculative, and their prices will be much more volatile than those in the more developed countries of the world. Investments in emerging markets investments should be made only by sophisticated investors or experienced professionals who have independent knowledge of the relevant markets, are able to consider and weigh the various risks presented by such investments, and have the financial resources necessary to bear the substantial risk of loss of investment in such investments. It is your responsibility to manage the risks which arise as a result of investing in emerging markets investments and the allocation of assets in your portfolio. You should seek advice from your own advisers with regard to the various risks and factors to be considered when investing in an emerging markets investment.

Alternative investments

Hedge funds are not subject to the numerous investor protection regulations that apply to regulated authorized collective investments and hedge fund managers are largely unregulated. Hedge funds are not limited to any particular investment discipline or trading strategy, and seek to profit in all kinds of markets by using leverage, derivatives, and complex speculative investment strategies that may increase the risk of investment loss.

Commodity transactions carry a high degree of risk and may not be suitable for many private investors. The extent of loss due to market movements can be substantial or even result in a total loss.

Investors in real estate are exposed to liquidity, foreign currency and other risks, including cyclical risk, rental and local market risk as well as environmental risk, and changes to the legal situation.

Interest rate and credit risks

The retention of value of a bond is dependent on the creditworthiness of the Issuer and/or Guarantor (as applicable), which may change over the term of the bond. In the event of default by the Issuer and/or Guarantor of the bond, the bond or any income derived from it is not guaranteed and you may get back none of, or less than, what was originally invested.

Investment Strategy Department

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