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Swiss Economics

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Fears of recession exaggerated

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Editorial

Dear Readers

We hope you have enjoyed a restful summer, be it underneath a colored umbrella on the beaches of the Mediterranean, in your hiking boots on flower-strewn Alpine meadows, or perhaps somewhere else far away from the hustle and bustle of everyday life. Nonetheless, the considerable political turbulence around the world right now is unlikely to have escaped you entirely. A brief list would include an escalation of the Sino-US trade war, demonstrations in Hong Kong, government crisis in Italy, Brexit, and – in Switzerland – plenty of squabbling over the so-called framework agreement with the European Union (EU), as well as the withdrawal of recognition of Switzerland's stock market equivalence by the EU. In addition, if you happened to glance at the economic data, you will perhaps have seen the swift decline in purchasing manager indices (PMIs) in manufacturing, which in the case of Switzerland's northern neighbor have recently reached recessionary levels. Finally, if you paid any attention to the financial markets, you will have seen that the yields on 10-year Swiss government bonds have reached new historic negative levels – another warning of economic slowdown.

Although we too have had to downgrade our forecasts for Switzerland and numerous other countries, a full-blown recession still appears to us to be an unlikely scenario. Recessions are typically caused by violent shocks, be it sharp rises in interest rates or commodity prices, or a credit crunch triggered by financial imbalances. No such shock is currently apparent. Even the magnitude of tariffs that Washington and Beijing are imposing on one another is very limited when viewed relative to the size of their respective economies. Moreover, the survey of small and medium-sized companies (SMEs) that we published recently reveals that Swiss SMEs are suffering from ramped-up protectionism only to a limited degree. All in all, the idea that a recession can primarily be triggered by waves of tweets from the White House appears to us to be rather far-fetched. Last but not least, there are even signs in the financial markets that the current mood of pessimism might be exaggerated. It would therefore not surprise us if the stock market highs posted by the Swiss Market Index (and many other equity indices) back in the early summer were once again surpassed this fall.

But pessimism is not restricted to economic developments: Longer-term developments also provide recurring fuel for worrying debates. One important such theme is addressed by our Focus section in this issue – the upcoming wave of retirement on the part of the so-called baby boomers. Our analysis here not only contains general estimates, but also highlights which sectors of the Swiss economy will be affected by this development, and to what degree. Although shortages of skilled labor are likely to intensify in certain industries, it is often forgotten in pessimistic discussions of this issue that such shortages are also essentially the consequence of strong demand – i.e. robust growth in the purchasing power of the population – and that new technologies capable of eliminating these shortages represent additional opportunities for many companies.
On which note, we wish you interesting reading and a fruitful autumnal season.

Thomas Gottstein
CEO Swiss Universal Bank

Oliver Adler
Chief Economist

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Global environment

Europe

The numerous trade conflicts and the weakening of global economic growth weighed on the European economy in the second quarter of 2019. Countries such as Germany, Sweden, and the UK actually experienced a decline in their economic output, while Italy stagnated. And the prospects for the second half of the year look mixed. That said, the combination of a still robust labor market situation, persistently strong consumer spending, assistance on the monetary policy side from the European Central Bank (ECB), and the weak euro should limit the magnitude of the economic slowdown.

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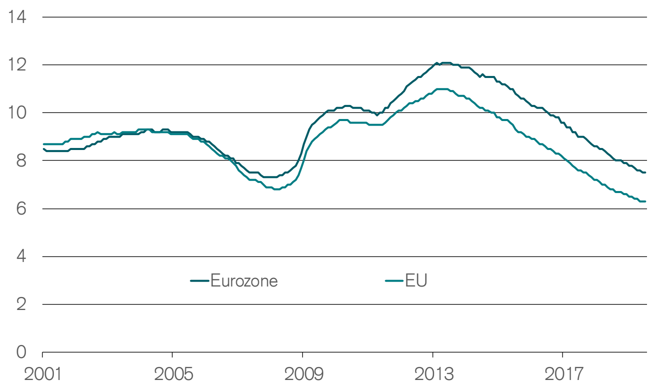
Unemployment rates still low

Unemployment rates, seasonally adjusted, in %



Source: Datastream, Credit Suisse

USA

Unlike most other large economies, the US economy remains in relatively robust shape. While a slowdown has been evident in the manufacturing economy stateside too, there are virtually no signs so far that weak manufacturing activity is spreading to the labor market and (by extension) to the key driver of economic growth, consumer spending. Moreover, the US central bank (Fed) has now cut its key rate, and further rate cuts can be expected to follow, which should have a positive impact on economic growth.

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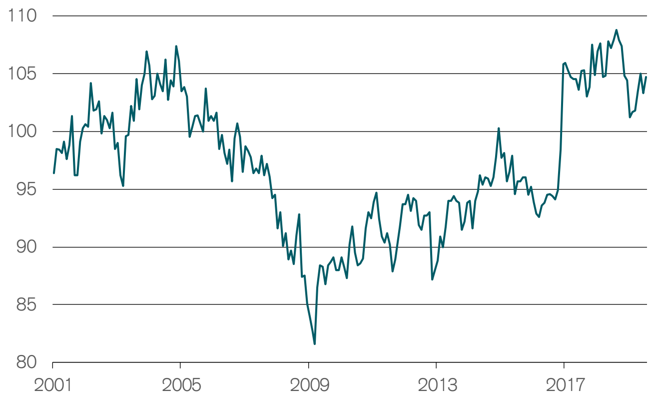
Small and medium-sized enterprises (SMEs) still very optimistic

NFIB Small Business Sentiment Index



Source: Datastream, Credit Suisse

China

A combination of the trade war with the US and the general cooling of the economy saw growth in China decline to just 6.2% in the second quarter of 2019. In other words, China is now growing at its slowest rate for several decades, even failing to match the growth figures recorded during the global recession of 2009. The measures taken by the Chinese authorities, such as an easing of credit conditions and the devaluation of the currency, should have the effect of supporting manufacturers as well as stimulating domestic spending and the construction economy. This should partly offset any further loss in economic momentum.

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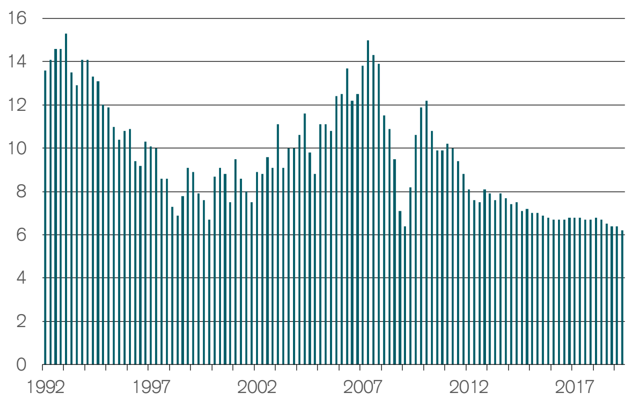
Growth slows again

Year-on-year growth in real domestic product, in %



Source: Datastream, Credit Suisse

Consumer spending supports growth

Swiss economic growth has weakened significantly compared to last year, and the outlook has deteriorated for the majority of manufacturers in particular. However, there is no evidence that Switzerland is sliding into a genuine recession.

Growth weaker in Q2 2019

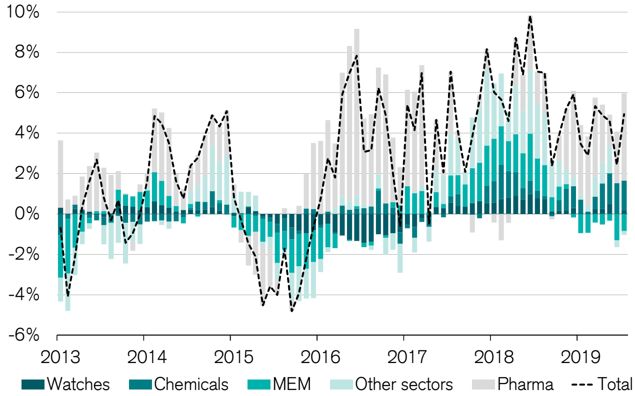
In the second quarter of 2019, the Swiss economy recorded a 0.3% increase in growth compared to the prior-year quarter. However, this rise was much weaker than in the equivalent quarter of 2018, with gross domestic product (GDP) being only marginally higher than its level a year earlier. The outlook appears similarly mediocre, particularly for the majority of manufacturers: The purchasing managers index (PMI) for the manufacturing sector, which we produce together with procure.ch, has been below the threshold indicating growth for almost six months now. At the same time, our Export Barometer indicates that the industrial economies of the countries to which Switzerland exports its goods are now weaker than at any time in the last seven years. Furthermore, the Swiss franc has recently appreciated against the euro.

Consumer goods exports continue to benefit from robust growth in global consumer spending

For example, export volumes in the machinery, electrical engineering, and metalworking industries (MEM industries) have been declining for almost a year now. Exports of watches are stagnating, although an additional factor is likely to be weighing temporarily on demand here, namely political turbulence in key sales market Hong Kong. By contrast, the exports of the pharmaceutical industry have been exhibiting an almost uninterrupted rise (cf. Fig. below left). Generally speaking, the high proportion of Swiss exports accounted for by consumer goods is something of a trump card at the moment: Two-thirds of Swiss export volumes comprise goods that are benefiting from consistently robust global consumer spending growth (cf. Fig. below right). In order for Swiss export volumes to slump, therefore, consumer sentiment would have to deteriorate markedly at a global level – which is not a scenario we currently envisage (cf. "Global environment", page 5). That said, we are also not expecting to see a significant acceleration in export growth at the moment, given the difficult situation faced by exporters of capital goods. As an additional factor, we are also not expecting any growth stimuli to come from the equipment investment side, given that moderate demand for exports typically goes hand-in-hand with moderate levels of corporate investment.

Pharma industry proving key prop for export growth

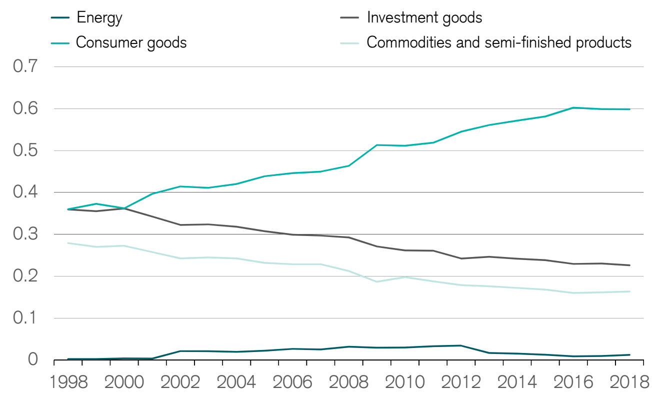
Year-on-year growth, moving 3-month average



Source: Swiss Federal Customs Administration, Credit Suisse

Consumer goods account for rising share of export volumes

Share of goods exports



Source: Swiss Federal Customs Administration, Credit Suisse
From 2002: includes electricity, returned goods and contract processing
From 2012: includes gold and silver bars, as well as coins

Domestic consumer spending benefits from healthy labor market situation

The picture is brighter when it comes to domestic consumer spending. Although the Consumer Sentiment Index shown below left is likewise "red" and therefore below-average, the questions that were answered negatively were above all those relating to respondents' previous or expected financial situations. The pessimism evident in respect of the previous situation is probably attributable to the equity market weakness evident at the year-end (which has now clearly been overcome), while pessimism regarding the future financial situation is likely to relate to the further decline in the level of interest rates. This is at least suggested by the strong correlation of respondents' answers with financial market developments. However, experience shows that the confidence expressed by the Swiss in their own job security is a much greater determinant of consumer spending decisions than the development of financial markets. And when it comes to the labor market and future economic developments, our consumer survey continues to paint a picture of moderate optimism.

Even manufacturers are not yet reducing headcount

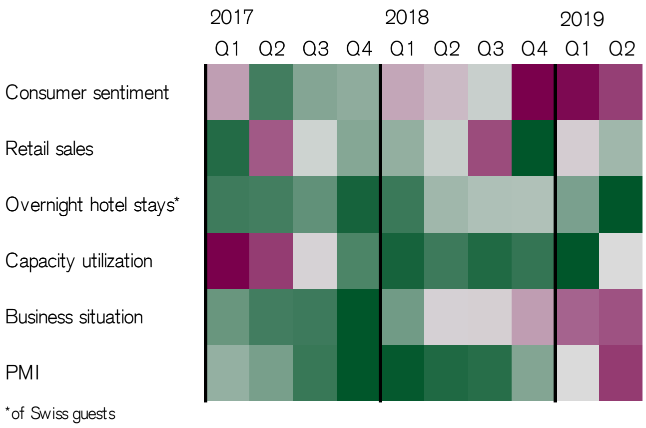
In actual fact, the labor market situation is comparatively robust right now. The unemployment rate is lower than at any point in the last ten years, while employment growth has only recently shown slight signs of weakening (cf. "Labor market", page 9). Even the MEM industry, which faces a severe cyclical challenge, appears to have reduced only its supply of temporary labor. On the other hand, the "Employer" sub-component of the PMI manufacturing survey has recently slid below the growth threshold for the first time since 2017 (with the exception of March 2019), albeit only very slightly. Although one should not read too much into a single negative monthly figure, it does fuel fears of a potentially longer-lasting and more widely proliferating reduction in headcount, which could in turn impact negatively on consumer sentiment.

Threat of contagion via the labor market is low

The analysis of the correlations illustrated in the Figure below right makes it possible to estimate the risk of the weakness in manufacturing spreading to the overall economy and the labor market. This indicates that the PMI for the manufacturing sector is clearly a strong leading indicator, as its correlation with GDP around six months earlier is relatively high (the darker the green, the greater the correlation). However, more in-depth analysis reveals that a wider recession for the Swiss economy is only indicated by the manufacturing PMI falling below the level of 44.9 points, rather than this indicator simply dipping below the PMI growth threshold of 50 points. Quite clearly, a significant decline in industrial activity is required to push GDP growth into negative territory. It is also apparent from this illustration that weak export development typically leads to an immediate slowdown in GDP growth, while weaker investment can clearly also be the consequence of weaker GDP growth. Employment in turn tends to lag behind or simultaneously mirror the development of the economy, as would be theoretically expected. Accordingly, even if employment in the manufacturing sector were to decline more sharply than expected, there would be no reason to subsequently expect a general deterioration of the Swiss economy.

The Swiss consumer keeps spending

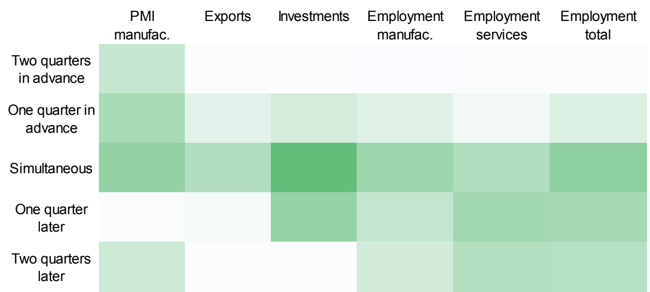
Heatmap; green = above-average, red = below-average



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

Labor market development follows gross domestic product

Timing of correlation with gross domestic product. The darker the green, the stronger the correlation



Source: Datastream, Credit Suisse

Consumer spending and construction investment support growth, ...

Another key reason why consumer spending is set to rise further in 2019 and 2020 according to our forecasts is the healthy state of the Swiss labor market. It should also not be forgotten that even the renewed rise in healthcare expenditure and the further slight increase in expenditure in the "living" area (above all rental costs and mortgage interest payments) should contribute to growth in consumer spending, as should robust purchasing power (thanks to low inflation) and persistently high immigration rates – essentially a guarantor of population growth. That said, our forecasts indicate that the increase in consumer spending is set to be relatively modest both this year and next year, namely around 1% in each case. On the other hand, construction investment can be expected to grow more strongly in 2020 (+1.2%), following a year in which the construction economy experienced a short-term slowdown (+0.6%). Specifically, order books remain very healthy despite fewer construction approvals and oversupply in some regions, as record-low interest rates continue to fuel investment in building projects.

... making a genuine recession an unlikely scenario

A full-blown recession extending to the services sector too is therefore a rather unlikely scenario, despite the weakness evident in numerous areas of manufacturing. As long as the global economy does not deteriorate further – a scenario we view as unlikely given the healthy parameters for consumer spending in almost all regions of the world – Swiss GDP is likely to grow by slightly more than 1% both this year and next (2019: 1.1%, 2020: 1.4%*****). Apart from anything else, it is perfectly conceivable that both the inventory cycle and the Sino-US trade dispute, both of which have contributed to the global weakness in manufacturing, will prove less of a drag in the second half of 2019 and in 2020, which would also be conducive to a stabilization or even a slight acceleration of economic momentum.

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***** In 2020, international sporting events such as the Olympic Games and the European Football Championships will stimulate Swiss GDP growth by a good 0.3 percentage points. This is because numerous international sporting associations – such as the International Olympic Committee (IOC) and the *Union of European Football Associations* (UEFA) – are headquartered in Switzerland and their revenues are assigned to Swiss GDP, even though the corresponding activities take place abroad. No international sporting event of this magnitude took place in 2019.

Economy Monitor

Inflation

The inflation rate is currently rather lower than expected, which is primarily attributable to the decline in oil prices. In addition, any appreciation of the franc typically makes the prices of imported goods cheaper. Although import prices (excluding oil products) have actually risen somewhat in recent months, the rise has only been modest, and has been limited to price increases for household goods and in particular furniture. Switzerland's inflation rate can be expected to remain moderately positive by the year-end (we are anticipating an annual average of 0.5%) and next year (forecast also 0.5%).

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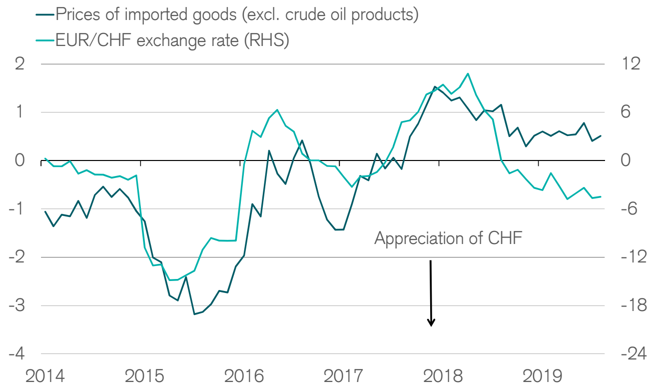
Import prices rise despite stronger franc

Year-on-year change in %



Source: Datastream, Swiss National Bank, Credit Suisse

Labor market

The weakness of demand in the export sector has barely affected the labor market so far. Although employment growth did lose some of its momentum in the second quarter of the year with a rise of 1.2% (year-on-year), it nonetheless remained strong. There are few signs of any sharp slowdown on the horizon. The number of open job vacancies is at a record level according to our survey. In particular, many companies in the services sector are planning to expand headcount by an above-average degree over the next few months. In manufacturing, by contrast, an increasing number of firms are looking to reduce headcount.

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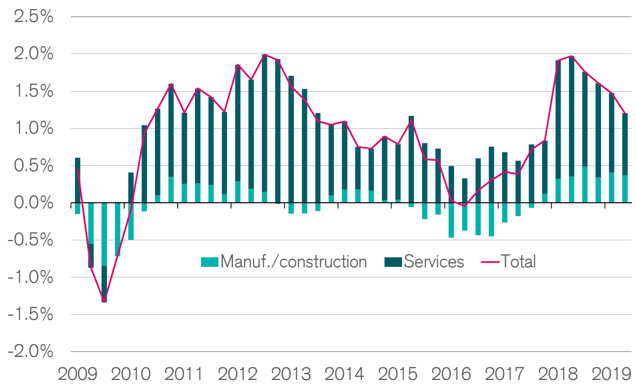
Employment growth slowing at a high level

Employment in full-time equivalents, YoY growth in % and growth contributions



Source: Swiss Federal Statistical Office, Credit Suisse

Immigration

Net immigration into Switzerland declined somewhat in the second quarter of 2019. For the first semester, however, there was an increase of 1.1% compared to the prior-year period. The slowdown in net immigration was particularly apparent from the EU-8 states, from Africa, and recently also from Italy. In addition, net immigration from Portugal remained negative. By contrast, there was a sharp increase in immigration from Romania and Bulgaria, which is attributable to the expiration back in May of the safeguard clause restricting immigration. For 2019, we continue to expect a positive net immigration figure of 55,000 persons (Swiss and foreigners).

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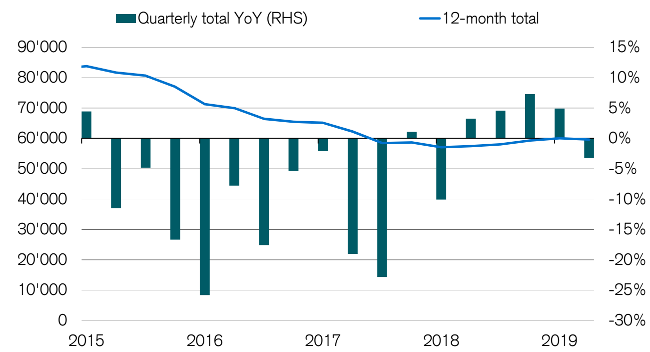
Immigration records slight year-on-year rise in H1

Net immigration of resident population (Swiss and foreigners, excluding registry corrections); quarterly total compared to previous year and 12-month total



Source: State Secretariat for Migration, Credit Suisse

Pharmaceutical industry

Swiss pharmaceutical exports have continued to develop dynamically, which is above all attributable to an increase in pharmaceutical exports to Germany and the USA. At 7.1%, overall growth compared to the previous year's quarter may have been slightly lower than at the start of this year and the end of 2018, but Swiss exporters are nonetheless continuing to benefit from positive stimuli from the pharma industry, particularly as this sector has been relatively unaffected by the weakening of the global economy.

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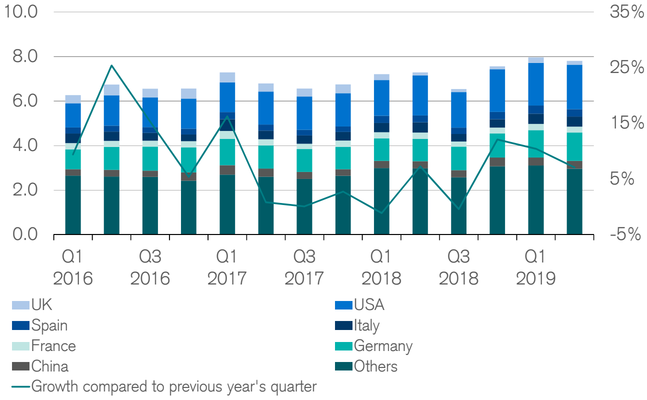
Pharma exports continue to grow dynamically

Exports per quarter in CHF bn (left-hand scale), growth compared to previous year's quarter (right-hand scale)



Source: Swiss Federal Customs Administration, Credit Suisse

Engineering, electrical and metal industry (MEM)

The trend of slowing demand from Europe has continued to weigh on the MEM sector. Compared to the previous year's quarter, exports from this sector declined by almost 7%. In addition to exports to Europe, exports to Hong Kong and China also declined. In the second quarter of 2019, only growth in exports to the US proved positive. In addition to economic weakness in Europe, the persistent uncertainties in connection with the trade war and Brexit are continuing to make life difficult for Swiss MEM exporters.

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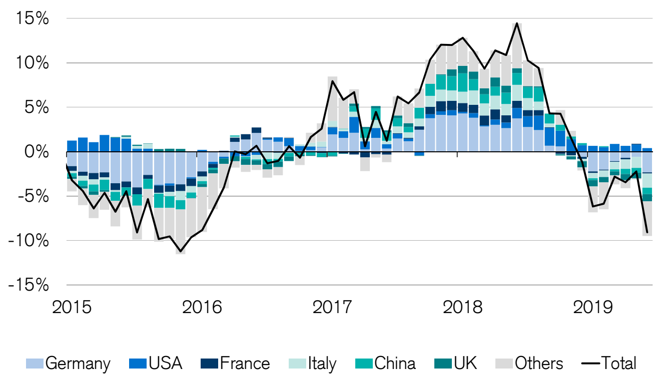
Accelerated decline in MEM exports

Exports: growth contribution by region, moving 3-month average



Source: Swiss Federal Customs Administration, Credit Suisse

Watch industry

Following a dynamic start to the current year, growth in watch exports virtually ground to a halt in the second quarter (+0.17% compared to previous year's quarter). A particularly striking development here was the slump in exports to Hong Kong in June 2019. The political turmoil in this key export market for the watch industry is likely to be at least partly responsible for this decline. Domestic tourists, who typically travel to Hong Kong from mainland China to purchase Swiss watches, largely stayed away in June. As it is not clear whether any improvement in the situation is in the offing, the pressure on Swiss watch exports could persist.

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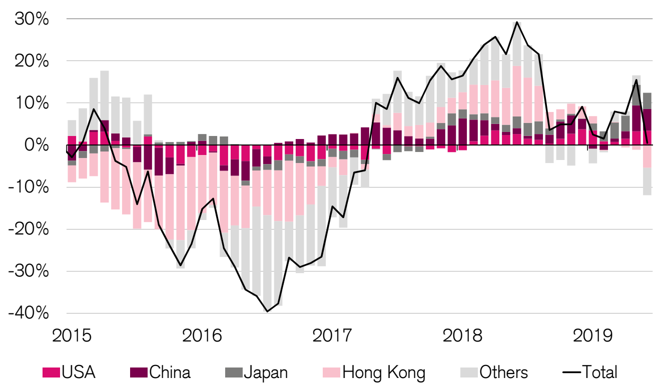
Turbulence in Hong Kong weighs on watch exports

Exports: growth contribution by region, moving 3-month average



Source: Swiss Federal Customs Administration, Credit Suisse

Retail

After a subdued start to 2019, nominal retail sales stabilized in the second quarter, recording a slight increase on the previous year's quarter (+0.13%). Sectors contributing to this positive development include food, personal care and health, domestic electronics and leisure. The Business Situation Indicator produced by the KOF economic research unit of the ETH Zurich likewise confirms that the majority of retailers are currently taking a positive view of their situation. Favorable developments in the Swiss labor market and positive population growth can be expected to continue to support Swiss retail sales for the time being.

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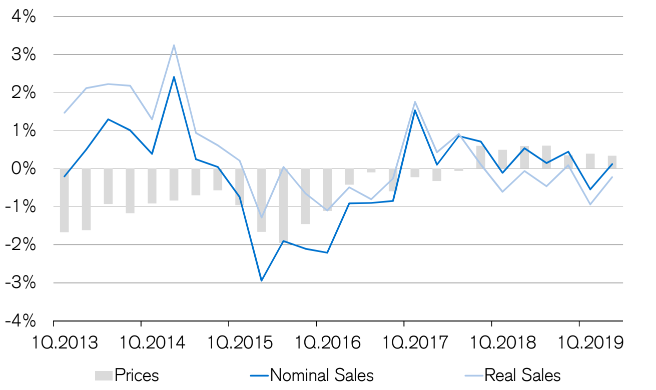
Swiss consumers hardly euphoric

Retail prices, nominal and real retail sales, change compared to previous year's quarter



Source: GfK, Credit Suisse

Tourism

After the Swiss tourist sector recorded a relatively sharp decline in overnight stays of guests from Europe in the first quarter of 2019, the situation then improved in the second quarter. Overall, there was a rise of just over 4% in overnight stays compared to the previous year's quarter. European guests made a key contribution to this positive development, spending more time in Switzerland in the second quarter of 2019 than they did in the prior-year quarter. However, a continuation of this trend looks doubtful given the slowdown in the European economy.

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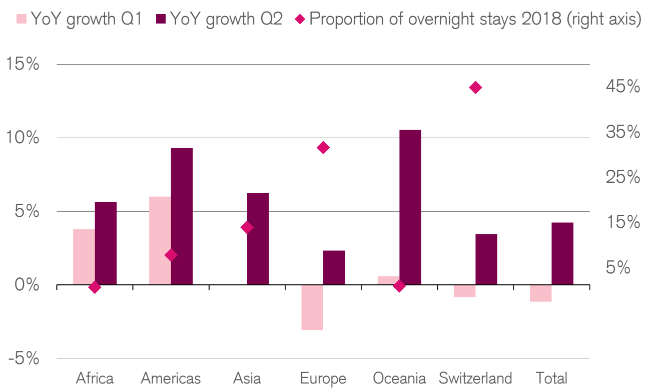
More overnight stays of Swiss guests

Overnight stays by guest origin: 2019 growth compared to previous year's quarter and proportion of total



Source: Swiss Federal Statistical Office, Credit Suisse

Information technology (IT)

Business conditions in the IT sector improved once again in the second quarter of 2019, and continue to be assessed by a majority of surveyed IT service providers as "good" or at least "satisfactory". This reflects the positive sentiment that continues to prevail in Swiss domestic sectors according to the KOF Business Situation Indicator. That said, the deteriorating situation in key customer sectors (e.g. the MEM industry) is likely to make itself felt in the IT sector sooner or later.

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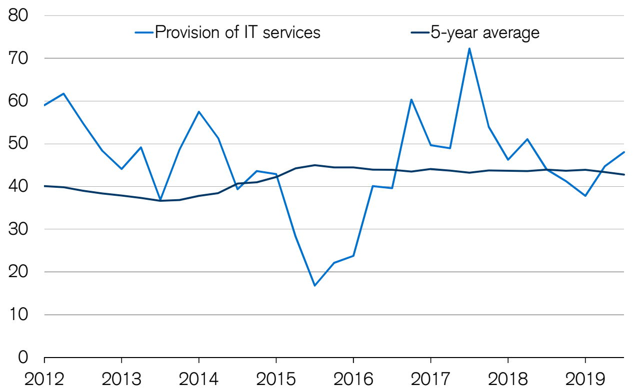
Improvement in business situation of IT service providers

Business conditions; share of surveyed IT service providers, balance in percentage points; quarterly



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

Retirement wave rolls on

The baby-boom generations are retiring. Over the next ten years, the Swiss labor market will be strongly affected by this wave of retirement, particularly as more economically active persons will be leaving the world of work than entering it.

Baby boomers: an influential generation

When making their predictions, demographers are assisted by one factor in particular: Demographic phenomena are characterized by a certain degree of "inertia", i.e. the events of the past recur from year to year, thereby influencing future population development in a fairly predictable way. A striking development that has left its mark on the age pyramid for more than half a century is the baby-boom phenomenon. Due to the extent of this phenomenon, these generations have become a key element in economic and social developments of the last few decades. And now they are retiring.

Who precisely are the baby boomers?

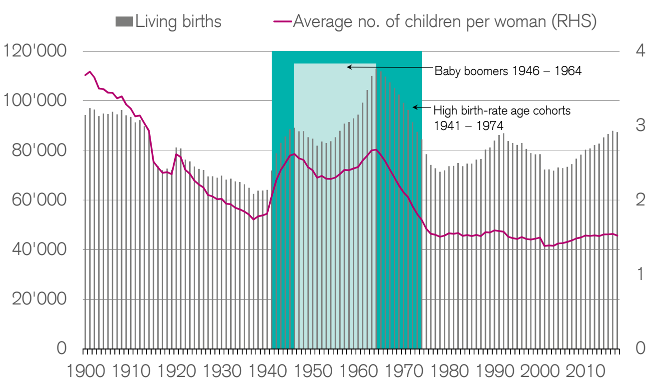
According to the most common definition, the baby boomers comprise the generations born between the end of the Second World War and the middle of the 1960s. In Switzerland, birth rates rose in two waves: An initial surge occurred in the 1940s, before a second – and more powerful – wave appeared in the mid-1950s before then peaking in the mid-1960s. In Switzerland, baby boomers are strictly considered to be the age cohorts born between 1946 and 1964, although when viewed in historical terms particularly high birth rates were recorded over a rather longer period, namely 1941-1974. A similar pattern can also be discerned in the case of countries like France and the US, where the baby-boom phase essentially kicked in immediately after the war. By contrast, due to the consequences of the Second World War, this phenomenon only began in Germany in the mid-1950s, lasting until the end of the 1960s.

110,000 or more newborns a year in the post-war years

During the baby-boom era, the average number of children born per woman rose to as much as 2.7, far higher than in either the previous era or the era that followed. In each of these years, anywhere between 80,000 and more than 110,000 children were born in Switzerland (see Fig.). These were the years of the economic miracle: A booming economy and the upbeat mood following the bleak wartime years were conducive to starting families, as a large number of children was not only desired but also financially affordable. Birth rates then declined sharply in the mid-1960s, and not just as a result of new methods of contraception that triggered the so-called "pill gap", but also due to the greater individualization of society, a development that made alternative life patterns more desirable. At the end of the 1970s, birth-rate figures stabilized at a low level, and have languished at around 1.5 children per woman ever since. In other words, birth rates are well below the level of 2.1, which is the figure required to replace parent generations and maintain a constant population (not taking into account net migration).

The birth rate miracle of the post-war era

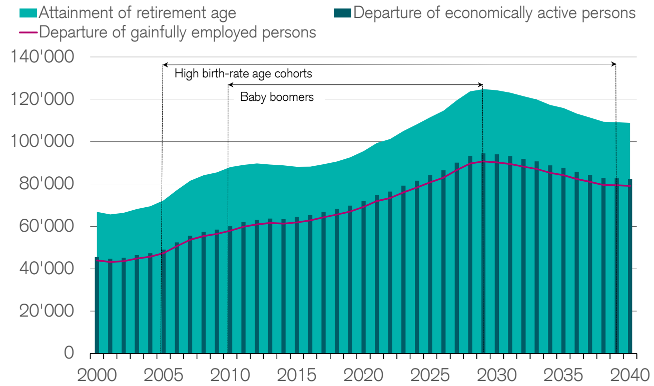
Live births and total fertility rate, expressed in number of children per woman



Source: Swiss Federal Statistical Office, Credit Suisse

Baby-boomer retirement wave rolls on

Number of people reaching the official retirement age (64/65)



Source: Swiss Federal Statistical Office, Credit Suisse

Baby boomers now retiring

The baby boomers of the post-war era are now retiring. In other words, demographic aging is now entering the decisive phase. The combination of significant age cohorts with rising life expectancy on the one hand, and successor cohorts of much lesser size (due to lower birth rates) on the other, is giving rise to clearly discernible imbalances of an ever-increasing nature. Particularly affected by this development is the pension system, where an increasing number of pensioners contrasts with a continuously declining number of financial contributors. To compound matters, benefits have to be paid out for a longer period of time. But the labor market will also have to face the repercussions of this wave of retirement on the part of more numerous age cohorts.

Some 1.1 million Swiss will reach retirement age over the next ten years...

The transition of the baby-boom generations from the world of work to retirement began back in 2010. If we take the more broad-based group of high birth-rate age cohorts as our point of reference, this phenomenon actually dates back to 2005. So far, an average of between 70,000 and 90,000 persons each year have reached the statutory retirement age of 64 years for women and 65 years for men (see Fig. on previous page). However, the second – and stronger – wave of retirements is yet to come, as an inverse mirror image of birth-rate developments in the post-war era. Over the next few years, the number of new pensioners will rise successively to well over 100,000 per year, before peaking at just under 125,000 in 2029. Over the next ten years, a total of some 1.1 million Swiss will reach retirement age. The number of new pensioners each year will rise to more than 100,000 before the entire baby-boomer generation has reached retirement age by around 2040.

…and more than 800,000 economically active persons will be leaving the labor market

However, not all of these new pensioners are active in the labor market prior to retirement. When it comes to implications for the labor market, analysis of the economically active population (which also encompasses the unemployed) as well as gainfully employed persons makes it possible to arrive at a more precise prediction. If we restrict ourselves to the active population, some 833,000 economically active persons and just under 800,000 gainfully employed persons will be withdrawing from the labor force over the next ten years. This estimate is based on the assumption that the labor participation rate will remain close to its current level in the future, and that the net immigration rate will remain at around 45,000 persons annually. In addition, it is assumed that the age cohorts in question will retire at the statutory pension age of 64/65. However, the available data on the transition to retirement shows that a not insignificant proportion of new pensioners will take early retirement. In 2017, for example, no less than 48.9% of men and 43.5% of women drew their first pension before their statutory retirement date. Once this aspect is factored into calculations, a proportion of the estimated impending retirement wave is brought forward in temporal terms.

Labor market: more departures than entries

When the number of retirements is set against the cohorts of 20-year-olds joining the labor market for the first time, it quickly becomes clear that the number of departures will soon outstrip the number of entries (see Fig.). By as early as 2021, the number of economically active persons retiring will surpass the number of young adults entering the labor market, a discrepancy that will become even more pronounced over the following years. At the peak of the baby-boomer retirement wave in 2029, some 18,500 more economically active persons will withdraw from the labor market than can be replaced by the younger generation.

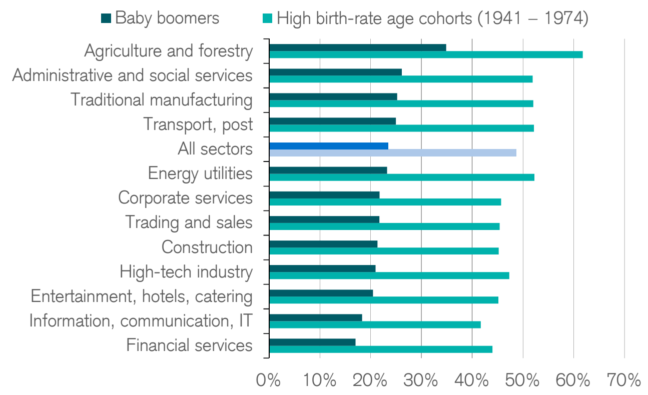
Departures from labor market will soon no longer be offset

Number of economically active persons

Source: Swiss Federal Statistical Office, Credit Suisse

Not all sectors equally dependent on baby boomers

Proportion of gainfully employed persons from 15 years of age in %, 2018



Source: Swiss Labour Force Survey (SLFS), Credit Suisse

Dependency on baby boomers varies according to sector

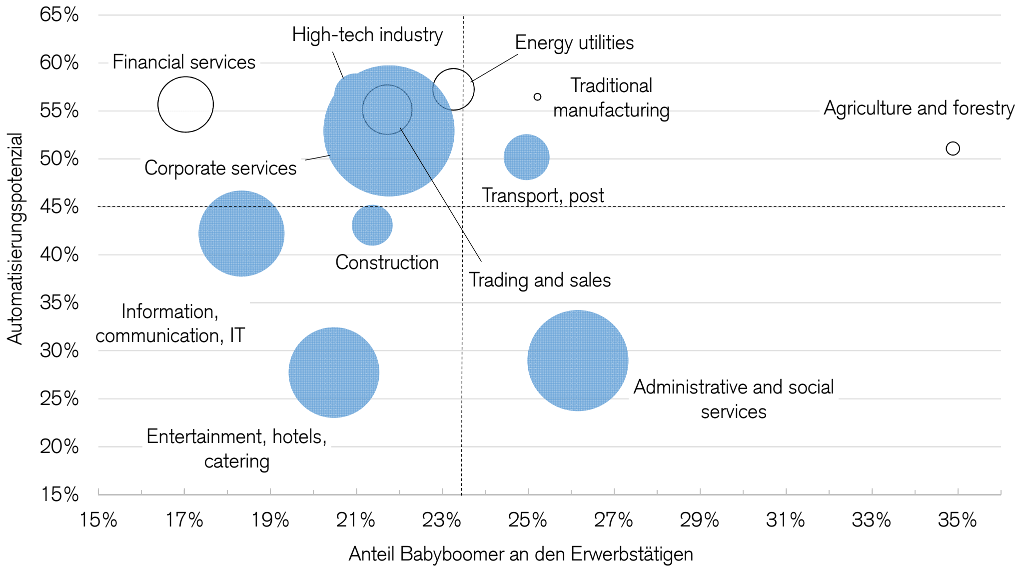
Not all industries are equally affected by the rolling wave of retirements. The reliance on the baby-boomer generations and high birth-rate cohorts up to the mid-1970s varies from sector to sector, in some cases markedly so. The sector most dominated by these age cohorts is agriculture and forestry, in which just under 35% of the workforce is made up of baby boomers, and as many as 61.8% of the high birth-rate age cohorts (see Fig. on previous page). Disproportionately high representation is also evident in administrative and social services (incl. healthcare), in traditional manufacturing, and in the transport industry. In these sectors, one in every four gainfully employed persons comes from the baby-boomer generation, and one in every two from the high birth-rate age cohorts. At the other end of the spectrum can be found the financial services and the information/communication/IT sectors. Here the younger overall average age means that baby boomers account for just 17% and 18.3% of the workforce respectively.

Where is the shortage of specialist labor likely to be particularly acute?

For the sectors of economic activity that are already suffering from a shortage of skilled labor, the baby-boomer retirement wave represents an additional problem that compounds the likelihood of personnel scarcity. The acuteness of the situation rises in keeping with the degree of dependency upon these generations, the growth dynamism of the sector in question, and the leeway available to offset any shortage of personnel through efficiency increases and automation. A quarter of all small and medium-sized enterprises (SMEs) in Switzerland are already looking to use digitalization and automation as specific tools to counter personnel shortages[1]. However, not all sectors can exploit this opportunity to the same extent. As is clear from the figure below, the potential for automation is well below average in the areas of administrative and social services on the one hand, and entertainment, hotels and catering on the other[2]. Whereas the latter can rely on younger workers, the former will be disproportionately affected by the retirement wave of the baby boomer generations – all the more so as this industry is currently experiencing disproportionately high employment growth. In particular, this is likely to be problematic for the healthcare sector, which has strong growth prospects – not least due to demographic development. By contrast, sectors such as high-tech industry and corporate services are better placed to handle the baby-boomer retirement wave. As well as the dependency of these sectors on workers from the high birth-rate generations being less pronounced, the potential to exploit the advantages of automation is disproportionately high. However, whether or not the latter will suffice to avert a shortage of skilled labor depends on the extent to

New technologies to tackle personnel shortages

Baby boomers as proportion of gainfully employed persons aged 15 and over in %, 2018; proportion of automatable activities in %, 2016; circle diameter: employment growth 2016 – 2018 (colored circles = positive growth); dotted axis crosshairs: average figures for economy as a whole



Source: Swiss Labour Force Survey (SLFS), Credit Suisse

[1] Credit Suisse, "Swiss SMEs: Strategies to Counteract the Shortage of Skilled Labor", 2017

[2] Our estimate of automation potential in individual sectors is based on the assumption that activities can be substituted by automated processes, above all in professions involving a high proportion of routine activity, both manual and analytical. The key drivers of this potential are technologies that are already available (cf. Dengler/Matthes (2018), "Substituierbarkeitspotenziale von Berufen: Wenige Berufsbilder halten mit der Digitalisierung Schritt" [DE only: translates as "*Substitution potential of occupations: few professions are keeping pace with digitization*").

which automation will itself lead to an additional requirement for skilled labor, namely for the implementation and controlling of computer processes, machines, and robots.

Retaining baby boomers in the labor market

In order to reduce the gap created by the retirement of baby boomers, companies essentially also have the option of employing these workers beyond the statutory retirement age. However, in reality only a minority of Swiss companies pursue this strategy, with just one in four Swiss SMEs currently doing so according to our survey[3]. That said, companies already facing significant potential staffing shortfalls as a result of retirements are making a greater effort to retain older employees than the average company surveyed. On the other hand, a number of question marks remain on the supply side, in particular whether the participation rate of older employees can be increased to any noteworthy degree. As things stand, 14.9% of men and 8.6% of women remain actively employed beyond the statutory retirement age; at the beginning of the 1990s the equivalent figures stood at 20% and 11.2% respectively. According to our analysis of the hidden reserves in the Swiss labor market, only 7% of Swiss aged between 66 and 74 are interested in working beyond the statutory retirement age[4]. It therefore appears that the incentive structure is not really conducive to greater exploitation of the working potential of older employees, either on the demand side or on the supply side. Whether or not the bridging pension for older employees planned by the Federal Council is the right answer to impending developments in the Swiss labor market is highly questionable.

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[3] Credit Suisse, Swiss SMEs: Strategies to Counteract the Shortage of Skilled Labor, 2017
[4] Credit Suisse, The hidden reserves are set to remain “hidden”, Monitor Switzerland, Q2 2018

Inflation and population aging

Recent academic studies have examined the link between inflation and demographics in an attempt to explain low inflation rates in developed markets. However, these investigations lead to contradictory results.

A high dependency ratio could fuel inflation…

Changes in the age structure of a population affect the ratio of consumers to the labor force. A high dependency ratio (i.e. the ratio of the young and elderly to the working age population) implies more consumers relative to people producing goods and services. The resulting production "shortage" could generate inflation pressure. Conversely, a low dependency ratio where more people produce goods and services relative to consumers could be disinflationary.

…which would imply that an aging population will lift inflation…

Economists at the Bank for International Settlements (BIS)[5] have examined how different age cohorts impact inflation. They found that younger and older cohorts are generally inflationary, while working age cohorts are disinflationary. The figure on the left shows the estimated impact of demographics on inflation for Switzerland, which we derived from the BIS results and our own demographic forecasts. Due to the aging population, Switzerland's dependency ratio has started increasing again, and is expected to continue to rise. Since most major economies are expected to go through a similar trend (see figure to the right), the results of the empirical analysis suggest that inflation is set to rise globally in coming decades.

…unless the opposite is true…

However, other analyses[6] have demonstrated the opposite impact, i.e. have linked faster growth in the working-age population to higher inflation. And these findings can also be explained by theory. The so-called secular stagnation hypothesis assumes that population aging has raised savings globally, thus depressing real interest rates. Monetary policy easing, which should lift inflation, is thus more difficult as interest rates cannot be cut significantly below zero. So, are aging populations inflationary or deflationary? Given contradictory empirical results and theories, it is hard to reach a convincing conclusion. In any case, we note that both theories mentioned above, which link an aging population with either higher or lower inflation, assume that companies adapt production capacity very gradually - even slower than demographic trends - which seems unlikely to us. We would therefore be cautious in linking an aging population to any long-term inflation trend.

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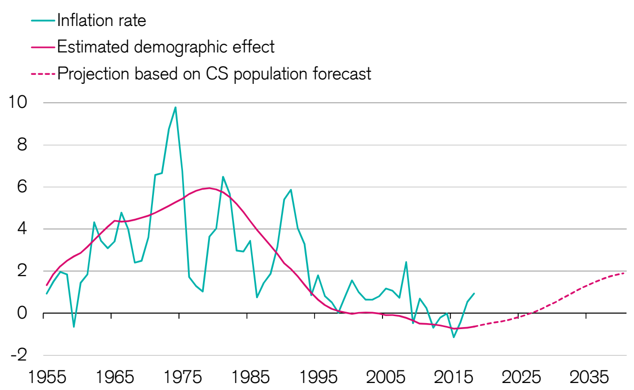
Will demographic trends boost Swiss inflation?

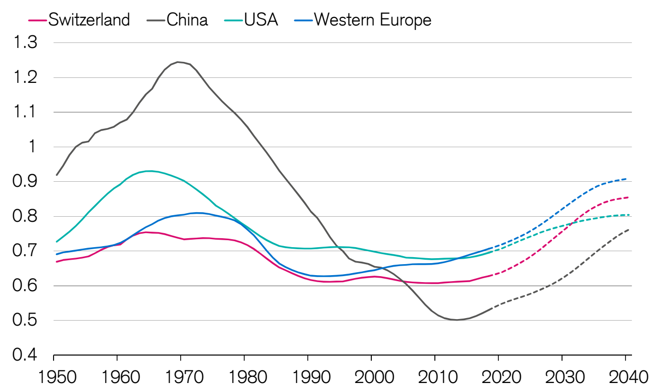
Inflation rate, in %



Source: Datastream, Credit Suisse

Population aging will raise the dependency ratio

Dependency ratio



Source: United Nations World Population Prospects, Credit Suisse

[5] Juselius, M. and Takats, E. (2015). Can demography affect inflation and monetary policy? BIS Working Papers No. 485.

[6] E.g. Bobeica, E. et al. (2017). Demographics and inflation. ECB Working Paper Series No. 2006.

Banknotes in circulation

Most banknotes in circulation continued to grow at a very slow rate in June 2019, while CHF 1000 bills in circulation dropped by almost 4% YoY. Any lowering of the policy rate by the Swiss National Bank (SNB) deeper into negative territory will likely prompt commercial banks to pass on the negative rate to more client deposits. This, in turn, will likely spur demand for banknotes. However, any increase in demand for banknotes following an interest rate cut by the SNB would likely be temporary, thus giving the SNB further leeway to cut rates if necessary.

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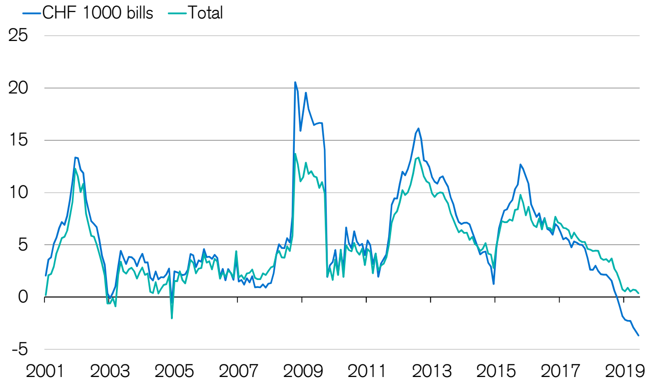
CHF 1000 bills in circulation have declined

Banknotes in circulation, growth rate, in % YoY



Source: Swiss National Bank, Credit Suisse

Foreign currency reserves

At the end of June, the SNB held CHF 780 bn in foreign currency reserves. Around 40% were invested in EUR denominated assets. Since mid-July, the SNB has again purchased foreign currencies after the CHF appreciated against the EUR. While the appreciation of the CHF will lower the value of the EUR assets, a rally in government bonds held by the SNB should partially compensate for any loss due to exchange rate fluctuations. A loss is also likely on the SNB's equity holdings in Q3 2019.

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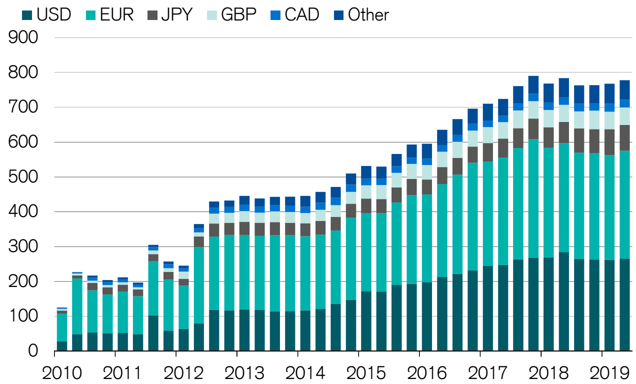
Around 40% of the SNB's currency reserves are in EUR

Foreign currency reserves of the SNB, in CHF bn



Source: Swiss National Bank, Credit Suisse

Mortgages to corporates

Since Q4 2018, growth in mortgages to corporates has accelerated in Switzerland. Financial service companies, as well as a broad category of services that include real estate activities, made the biggest contribution to this growth. This acceleration, coupled with rising prices for residential investment properties are likely the triggers for increased scrutiny of the residential investment property segment by the SNB and the Swiss Financial Market Supervisory Authority. The Swiss Bankers Association has proposed measures including a lower loan-to-value ratio to address potential risks for financial market stability stemming from these developments.

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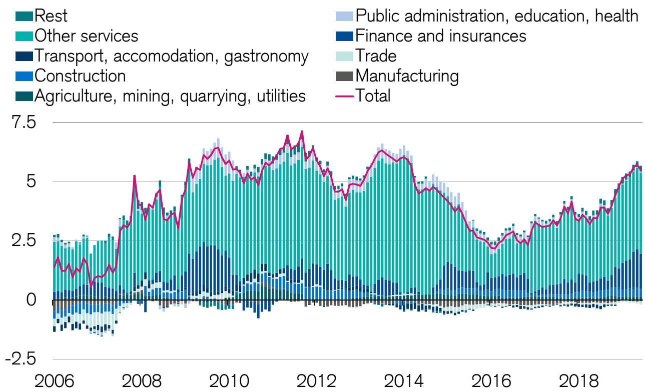
Acceleration in mortgages to corporates

Growth rate, in % YoY



Source: Swiss National Bank, Credit Suisse

Owner-occupied housing

In the area of owner-occupied housing, price growth remained impressive thanks to very low interest rates and a low level of construction activity. In the second quarter of 2019, condominium prices rose by 2.7% compared to the previous year's quarter. As in previous quarters, the rise in prices for single-family dwellings (4.4%) was significantly higher. The reasons why real estate prices have not risen significantly more strongly are likely to include the already high level of prices, which require buyers to provide additional equity, and the regulatory guidelines relating to credit lending. The drag on demand exercised by the latter continues to be tangible.

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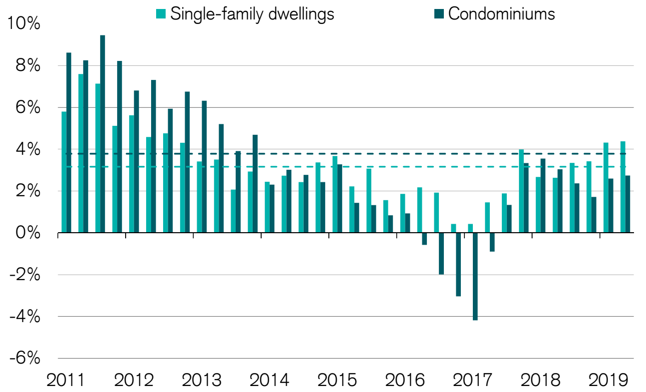
Unbroken price dynamism in owner-occupied housing

Annual growth rates; dotted lines: average 2000 – 2018



Source: Wüest Partner, Credit Suisse; last data point: Q2 2019

Rental apartments

According to the real estate consultancy company IAZI, transaction prices for residential investment properties with both residential and mixed use have risen by 80% since 2002. However, rents have failed to keep pace with this development: The rental price component of the Swiss consumer price index (LIK) has risen by just 22% over the same period. Indeed, the rents of advertised apartments have actually declined slightly over the last three years. Accordingly, real estate investors have been facing a decline in cash flow yields. These yields remain attractive in the today's negative interest-rate environment, however. In addition, investors have benefited from sharp rises in asset values in recent years.

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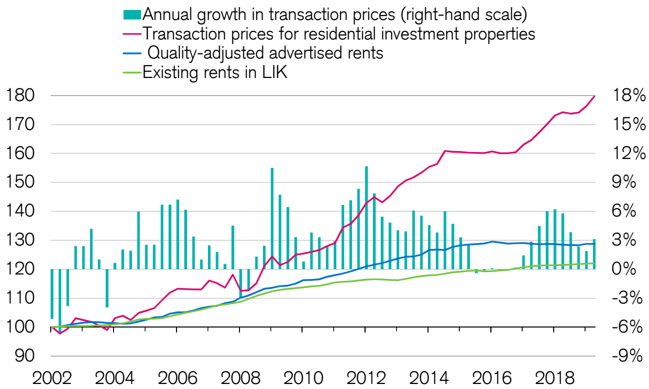
Huge gulf in development of purchase prices and rents

Residential investment properties: development of transaction prices and rents, Index: Q1 2002 = 100



Source: IAZI, Homegate, Swiss Federal Statistical Office, Credit Suisse; last data point: Q2 2019

Office property

Construction activity in the office space market has declined noticeably. Total newbuild permits over the last 12 months encompassed a construction volume of CHF 1,675 mn, which is 14% below the corresponding long-term average (CHF 1,953 mn). This is the lowest level recorded since 2009, and reflects the more circumspect stance of investors, which is in turn attributable to high vacancy rates in outer and peripheral business districts. By contrast, there was a significant recovery in the market for centrally located office space, which is now deriving additional support from the decline in construction activity.

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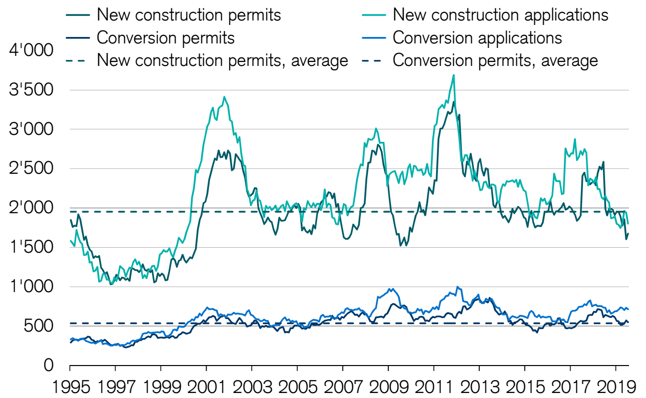
Decline in construction activity in office space market

Building permits and planning applications, moving 12-month total, in CHF mn



Source: Baublatt, Credit Suisse; last data point: July, 2019

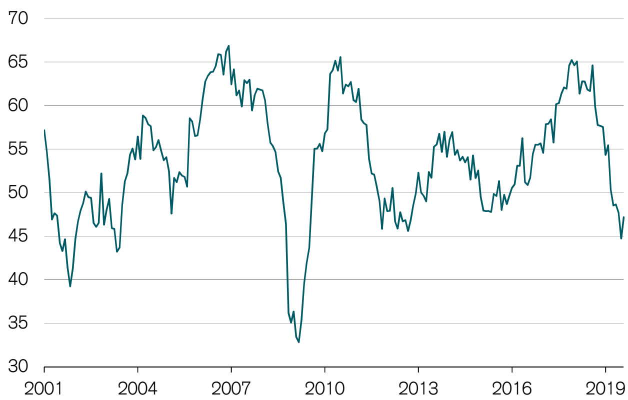
Credit Suisse Leading Indicators

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



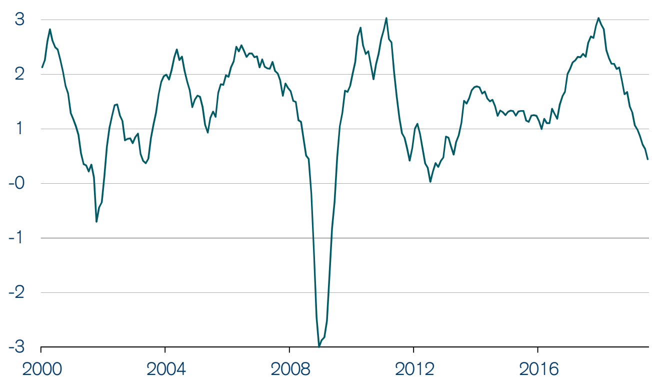
Source: procure.ch, Credit Suisse

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

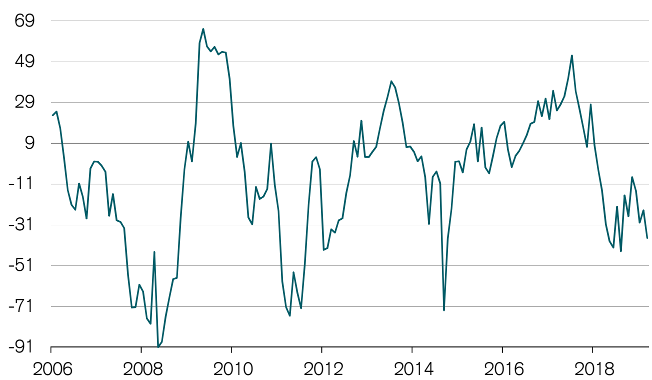
CS CFA Society Switzerland Index

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

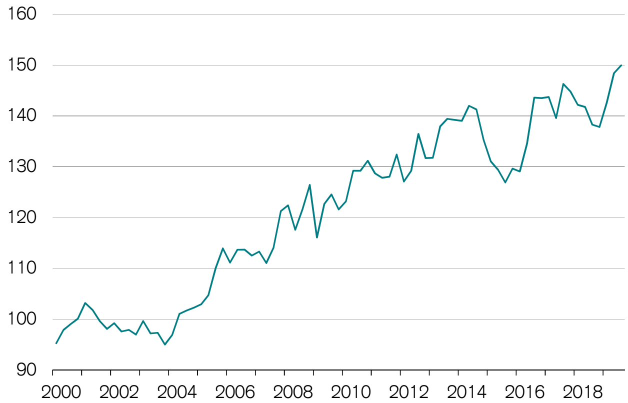
Credit Suisse Leading Indicators

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



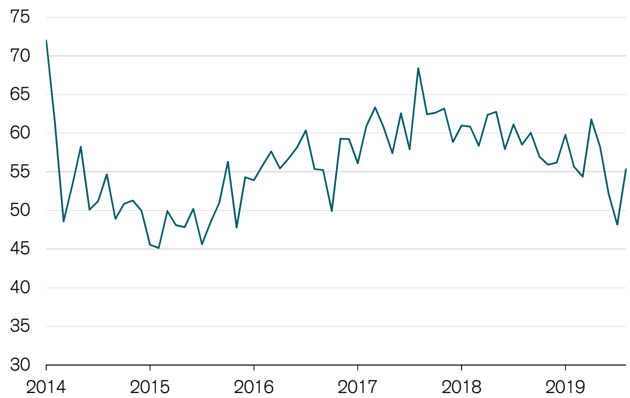
Source: Swiss Contractor's Association, Credit Suisse

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

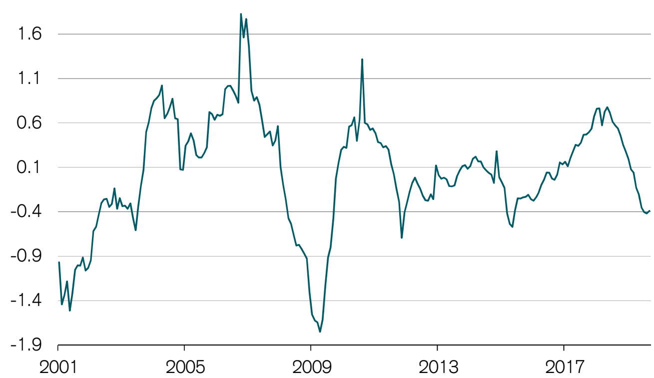


Source: procure.ch, Credit Suisse

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

	2019P Q1	2019 Q2	2019P Q3	2019P Q4	2020P Q1	2020P Q2	2020P Q3	2020P Q4	2020P	2020P
GDP (YoY, in %)	1.0	0.2	1.1	1.7	1.6	1.6	1.3	1.2	1.1	1.4
Consumer spending	0.6	0.9	1.2	1.2	1.3	1.3	1.3	1.3	1.0	1.3
Government expenditure	0.9	1.0	1.0	0.9	1.0	1.0	1.0	1.0	1.0	1.0
Gross capital investment	-0.5	-0.9	1.7	2.0	1.3	1.1	1.1	1.1	0.6	1.1
Construction investment	1.4	0.2	0.2	0.9	1.2	1.2	1.2	1.2	0.6	1.2
Investment in plant and equipment	-1.5	-1.6	2.5	2.5	1.0	1.0	1.0	1.0	0.5	1.0
Exports (goods and services)	2.7	2.3	2.5	0.4	2.5	2.5	2.5	2.5	2.0	2.5
Imports (goods and services)	-0.9	-1.7	3.2	3.5	2.0	2.0	2.0	2.0	1.0	2.0
Inflation (in %)	0.6	0.6	0.3	0.3	0.5	0.3	0.5	0.6	0.5	0.5
Unemployment (in %)	2.3	2.3	2.3	2.3	2.3	2.4	2.4	2.5	2.3	2.4
Employment growth FTEs (YoY, in %)	1.5	1.2	1.0	0.9	0.9	0.9	0.8	0.8	1.2	0.9
Net immigration (in thousands)									55	55
Nominal wage growth (YoY, in %)									0.7	0.7
Public debt (in % of GDP)									6.9	7.2

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 %
	2019	2020	2019	2020	2018	2018	2018	2018
World	2.7	2.7	2.6	2.5	7'530	84'740	100	100
US	2.3	2.1	1.9	2.0	327	20'494	16.3	6.2
Euro zone	1.1	1.4	1.2	1.2	341	13'669	44.3	61.7
Germany	0.5	0.9	1.5	1.6	83	4'000	18.8	27.1
France	1.2	1.4	1.3	1.5	65	2'775	6.5	8.0
Italy	0.1	0.7	0.8	1.1	60	2'072	6.2	9.3
UK	1.2	1.3	1.9	2.1	66	2'829	4.0	3.8
Japan	0.8	0.5	0.6	0.2	126	4'972	3.3	1.7
China	6.2	6.0	2.5	2.2	1'395	13'407	5.2	7.1

Source: Datastream, International Monetary Fund, Credit Suisse

Interest Rates and Monetary Policy Data

	Current	3-month	12-month		Current	Prev. mth.	Prev. year
SNB target range (in %)	–0.75	–0.75	–0.75	M0 money supply (CHF bn)	562.7	568.4	548.0
10-year government bond yields (in %)	–0.92	–1.0	–0.9	M1 money supply (%, YoY)	5.1	5.2	6.9
				M2 money supply (%, YoY)	3.6	3.6	3.7
				M3 money supply (%, YoY)	3.5	3.6	3.3
				Foreign currency reserves (CHF bn)	788.0	767.7	787.4

Source: Datastream, Bloomberg, Credit Suisse

Important Information

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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 document, please refer to the following Internet link:
https://investment.credit-suisse.com/gr/riskdisclosure/

This document 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 document 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 reliable indicators 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 document 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, including the loss of the entire investment, and may not be suitable for many private investors. The performance of such investments depends on unpredictable factors such as natural catastrophes, climate influences, hauling capacities, political unrest, seasonal fluctuations and strong influences of rolling-forward, particularly in futures and indices.

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.

Private Equity
Private Equity (hereafter "PE") means private equity capital investment in companies that are not traded publicly (i.e. are not listed on a stock exchange), they are complex, usually illiquid and long-lasting. Investments in a PE fund generally involve a significant degree of financial and/or business risk. Investments in private equity funds are not principal-protected nor guaranteed. Investors will be required to meet capital calls of investments over an extended period of time. Failure to do so may traditionally result in the forfeiture of a portion or the entirety of the capital account, forego any future income or gains on investments made prior to such default and among other things, lose any rights to participate in future investments or forced to sell their investments at a very low price, much lower than secondary market valuations. Companies or funds may be highly leveraged and therefore may be more sensitive to adverse business and/or financial developments or economic factors. Such investments may face intense competition, changing business or economic conditions or other developments that may adversely affect their performance.

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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