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Immigration lower despite economic recovery

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Editorial

Dear readers

The exit from lockdown has enabled the economy in Switzerland and elsewhere to bounce back quickly, as households have once again been able to spend their money – including the funds saved during lockdown. The basis for Switzerland's recovery was laid in the form of the targeted monetary and fiscal policy measures taken at the start of the crisis – specifically the expanded opportunity to claim short-time working compensation and the state-backed COVID-19 loans granted by the banks.

Our forecasts are assuming that while the economic recovery will persist over the next few quarters, its tempo will weaken, above all due to a still frail labor market. Economic activity will also be held back by the stubborn presence of the pandemic. That said, we are not expecting either Switzerland or any of its key trading partners to have to resort to far-reaching lockdown measures once again.

Should this moderately optimistic forecast prove correct, the question now is how to bring an end to the various emergency measures taken on the economic policy front. Any negative side-effects and misplaced incentives caused by these measures need to be corrected, yet without simultaneously stalling the process of economic recovery. For example, short-time working harbors the risk that employees will be dissuaded from looking for new jobs, or that uncompetitive companies will be indirectly subsidized. The COVID-19 loans in turn increase the risk of companies becoming excessively leveraged, which over the course of time could potentially lead to bankruptcies. Up until now, the debate in connection with the coronavirus measures appears to us to be overly focused on government debt, with too little attention being paid to preserving and strengthening the financial health of the private sector, and to the risk of throttling growth opportunities in the future.

The Swiss people will shortly vote on an exit of another kind at the ballot box. In the discussion over the free movement of persons too, the crux of the matter is the extent to which immigration into Switzerland should be governed by interventionist measures or market forces. The current system, in which the state corrects any negative side-effects of purely market-driven immigration with so-called "flanking measures", appears to us to be much better than the alternative, namely state-decreed border closures of the kind the country experienced during the COVID-19 crisis, or a modified version of the same, i.e. quotas determined by the state. As our Focus article (p. 12) shows, a gradual slowdown in net immigration over the next year or two appears likely even under the current regime.

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Road back to normality remains long – despite the intermediate sprint

The unprecedented economic slump in the first half of 2020 is now being followed by a rapid recovery. The further progress of which is likely to be rather sluggish, however. The development of gross domestic product is thus resembling a "lopsided V".

Historically huge GDP slump in H1 2020

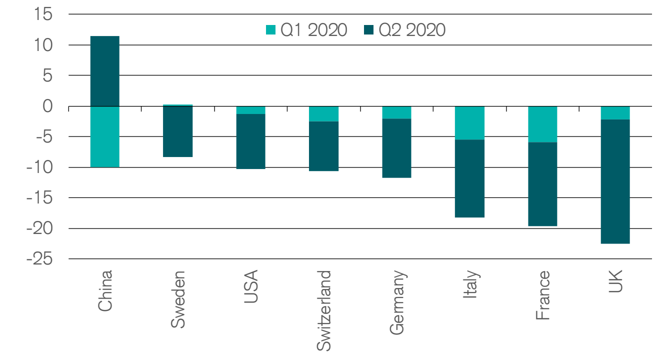
In the second quarter of 2020, Swiss gross domestic product (GDP) collapsed in an unprecedented fashion: GDP slumped by 8.2% compared to the first quarter, the sharpest decline since quarterly figures were first recorded by the State Secretariat for Economic Affairs (SECO) back in 1980. What's more, this slump was more than four times as severe as the one experienced during the financial crisis of 2008/2009. Even in the first quarter of the year, GDP declined by what was at that point a record-high 2.5%. The resulting collapse in Swiss GDP in the first half of 2020 was comparable to that recorded by the US and Germany, but nothing like as great as that recorded in Italy, France, and the UK (cf. Fig. 1). In Sweden, by contrast, the negative development was less pronounced.

Mobility restrictions as key driver of slump

The second quarter marks the nadir of the COVID-19 crisis because it encompasses the majority of the days in which draconian measures are in place to contain the virus. There is a high correlation generally between the rigor of such measures (as measured by the University of Oxford's "Stringency Index") and the development of GDP (cf. Fig. 2). In particular, the initiated lockdown measures dramatically curtailed the mobility of consumers and workers alike. According to our calculations, around a third of all goods and services were unavailable – or only obtainable with difficulty – for Swiss consumers during the lockdown period. However, the measures decreed to contain the spread of the pandemic were probably economically necessary, as they changed the behavior of people to the "correct" extent. Indeed, a detailed study conducted by Nobel Prize-winning economist Michael Spence, which was based on comprehensive global data, arrives at the conclusion that it was not the rigor of the measures *per se* but the decline in mobility that was originally responsible for the decline in economic output[1]. However, mobility can actually decrease more strongly than expected when initiated measures are "too weak", specifically if consumers are unsettled by high infection rates and fatality figures. Moreover, Spence argues that it is crucial both from an epidemiological and from an economic perspective that measures are taken decisively, and above all implemented swiftly.

Fig. 1: GDP decline in an international comparison

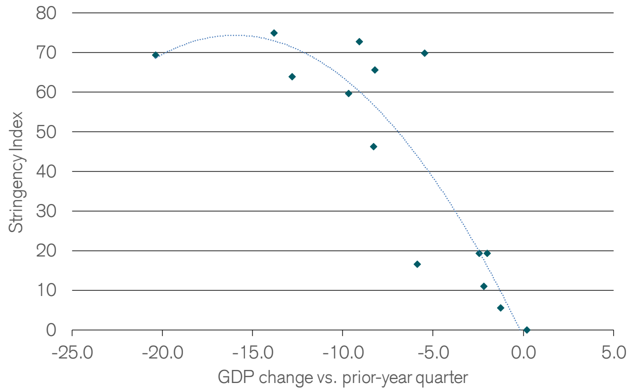
Real GDP, quarter-on-quarter change in %



Source: Datastream, Credit Suisse

Fig. 2: Restrictions go hand in hand with slump in GDP

Stringency Index of University of Oxford and change in GDP (Q1 and Q2 2020)



Source: Datastream, Credit Suisse

[1] "Five lessons from tracking the global pandemic economy", Michael Spence and Long Chen at www.vox.org

Switzerland fared relatively well

According to statistics compiled by Apple, the decline of mobility in Switzerland was comparable to that in Germany, but much less marked than in Italy, Spain, or France. Only in Sweden the mobility of the population was greater. The moderate nature of the lockdown strategy in Switzerland – building sites and manufacturing businesses were not shut across the board, for example – and its tangible impact on containing the virus are thus also two key reasons why the decline in Swiss GDP was relatively low. Another positive aspect was the fact that measures to contain the negative consequences of the lockdown were implemented swiftly and efficiently. The impact of the compensation for short-time working and the COVID-19 loans was felt within days of being announced. Moreover, Switzerland has a relatively advantageous industry sector breakdown, with a high proportion of value creation coming from pharma, chemicals, and other sectors (including commodities trading, banking, and insurance) that were not directly affected by the restrictions.

The economy is rebounding, ...

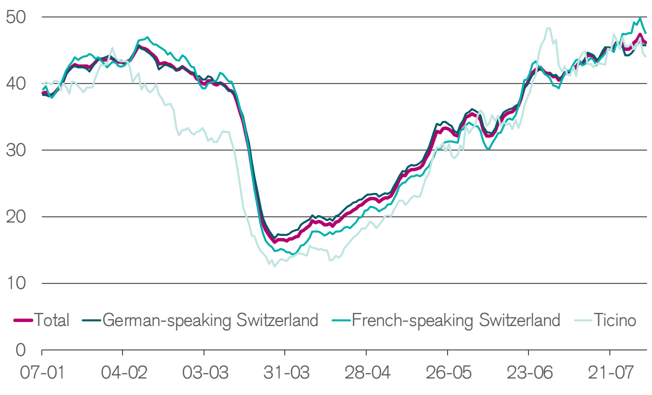
With the repeal of the majority of COVID-19 measures and the perception of a low risk of infection, mobility in Switzerland has normalized. When measured in terms of cellphone movements, the level of mobility is now even higher than before the pandemic – although the summer weather probably explains some of this increase (cf. Fig. 3). The economy is recovering as a direct result: The Swiss Purchasing Managers Index (PMI) for the services sector and its equivalent for the manufacturing industry have now both risen above the growth threshold, thus far pointing to a V-shaped recovery (cf. Fig. 4). Retail sales in July were almost 10% above their pre-crisis levels, with the increase most apparent in the "household", "leisure", and "garden" areas (whereas "clothing and shoes" remained clearly in negative territory). Prompt data released by SIX Group relating to bank card payments indicates that the positive momentum of consumer spending remained high in August.

... not least thanks to catch-up purchases

The current resurgence of consumer spending has also been fueled by the significant savings accumulated by the majority of households during the lockdown period, amounting to some CHF 8.0 billion in total. According to our estimates, around two-thirds of savings from this period of restricted supply (i.e. around CHF 5.5 bn) are likely to be spent in the following months. Furthermore, when borders were closed there were considerably fewer purchases made by the Swiss abroad, which has provided an estimated additional demand of CHF 2 billion[2]. Declining prices and the desire to make up for lost time provided additional spending incentives.

Fig. 3: Swiss mobility higher than before the crisis

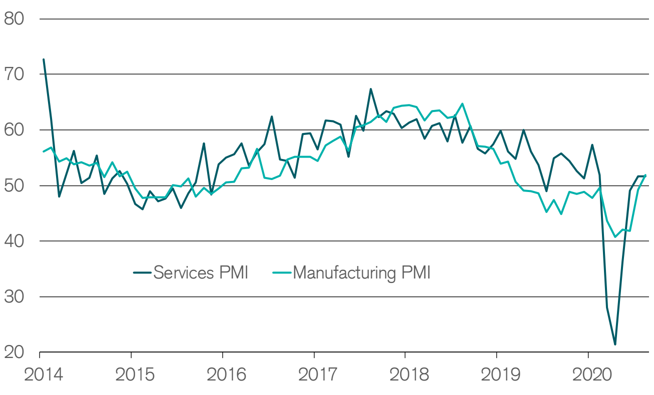
Mobility: Average daily distance traveled, 7-day average



Source: intervista AG, Credit Suisse

Fig. 4: Purchasing managers indices (PMIs) indicate growth

PMI > 50 = growth



Source: procure.ch, Credit Suisse

[2] Swiss Economics Alert: Shopping tourism in 2019 amounted to approx. CHF 8 billion

Recovery likely to lose momentum

However, the post-lockdown catch-up effects are increasingly waning, which means the recovery in consumer spending is also likely to lose momentum over the coming months. Generally speaking, the key driver of private consumption is the labor market situation. Immigration, for example, which on average accounts for more than a quarter of all growth in consumer spending, is closely linked (and is likely to remain so) to the demand for labor thanks to the Free Movement of Persons Agreement. Furthermore, perception of job security has a strong influence on consumer sentiment, and there is also at least a theoretical correlation between the development of employment and the development of wages.

Rising unemployment rate weighs on sentiment

However, the labor market situation can be expected to remain difficult until well into next year. Despite short-time working, the unemployment rate will probably rise over the next few months. In specific terms, we are anticipating a rise from the current level of 3.4% to around 4.0% by mid-2021 (2020 average: 3.2%; 2021: 3.9%). It is traditionally the case that a rise of this nature will slow consumer spending growth even if it does not halt it altogether. As explained in detail in our Focus article on page 12, net migration can be expected to decline further in the meantime. This should likewise have the effect of restricting growth in consumer spending over the coming year.

Slump in corporate profitability makes any significant rise in wages improbable

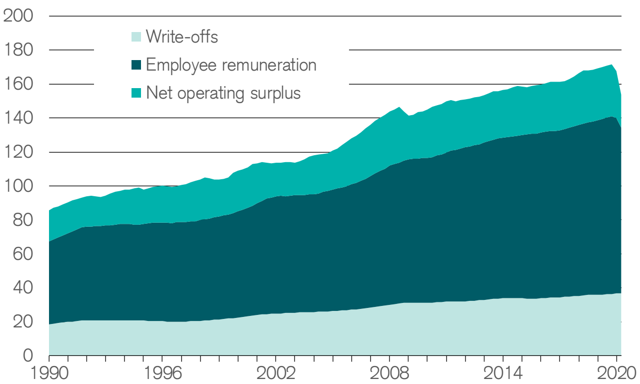
Up until now, companies have absorbed the lion's share of the collapse in GDP themselves. For example, Figure 5 makes it clear that the proportion of GDP accounted for by corporate earnings has declined much more strongly than the level of employee remuneration: The slump compared to Q4 2019 when measured against net operating surpluses amounted to 37%, compared to a decline of just 7% when measured against employee compensation. Furthermore, the decline in employee remuneration has been at least partly offset by transfers such as compensation for short-time working. It is to be expected that companies will primarily be focusing on improving their profitability over the coming months. As a consequence, over the coming year we can expect to see significant restraint in new recruitment, a rise in unemployment as already mentioned, and only marginal wage increases. Accordingly, we are expecting nominal wages to essentially tread water in 2021 (+0.1%). Given that the level of prices is not set to fall any further (2021 inflation: +0.3%; following –0.7% in 2020), the purchasing power of Swiss wages will actually decline slightly next year. As an additional factor, consumer spending growth is likely to be further hampered for as long as the coronavirus continues to preoccupy the economy. Although we are not expecting another comprehensive lockdown, particularly as progress is likely to be made on the medical side, there is every reason to expect renewed restrictions at a regional level at various times.

Investment climate remains subdued

In view of the difficult corporate earnings situation, the investment climate can be expected to remain subdued for a while longer too. That said, the demand for investment in equipment and machinery should at least pick up slightly thanks to the recovery in the manufacturing economy. This much is at any rate suggested by the historic correlation between the volume of investment and the level of the Purchasing Managers Index (PMI) for manufacturing (cf. Fig. 6). Up until now, investment in the pharmaceutical and chemical industry as well as in IT infrastructure has mitigated the collapse in investment volume observed elsewhere.

Fig. 5: Net operating surplus nosedives

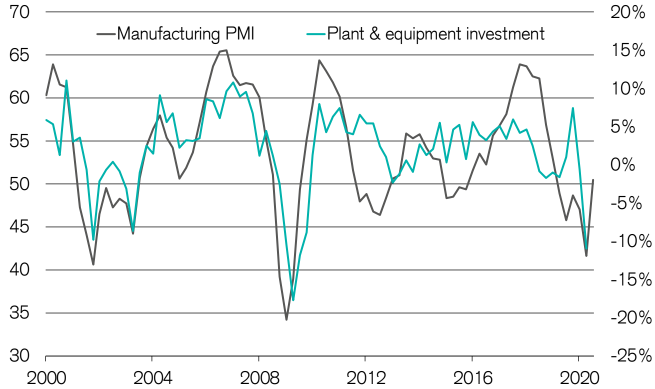
Income side of GDP, in CHF bn per quarter



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

Fig. 6: Recovery in manufacturing PMI sparks hope for recovery in investment

PMI > 50 = growth; investment in plant & equipment vs. previous year, real



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

Construction investment declining

Construction investment likewise declined in the first half of 2020, despite low interest rates and building sites being for the most part open. Here it was the general uncertainty that had a negative impact, and the potential for recovery is likely to remain limited for now given rising vacancy rates in the rental apartment segment.

Export industry turns the corner

The slump in goods exports has up until now also been kept in check by the high weighting of the pharmaceutical and chemicals sector (50% of exports) and its low short-term correlation with economic development. There are many reasons to believe that this sector will remain a reliable prop of foreign trade development in the future too. In the meantime, cyclical sectors such as the watchmaking industry and the mechanical engineering, electrical and metal-working industry (MEM industry) have turned a corner. We are assuming that the recovery here will persist. Last but not least, export development has been significantly affected by the stringency of the coronavirus measures taken in export destinations, respectively through restrictions to mobility (cf. Fig. 7). Accordingly, the easing of lockdowns abroad will impact positively on demand for Swiss products, albeit with a certain time lag. However, the road back to normality is likely to be a particularly long one in international trade, given that transport capacities and intercontinental mobility are likely to remain restricted for a good while yet.

GDP recovery resembles "lopsided V"

The recovery from the historic collapse in the first semester is currently unfolding at an extremely rapid pace, particularly in the sectors of the economy that are driven by domestic consumer spending. However, the progress of the recovery going forward is likely to be fairly sluggish. Accordingly, the development of GDP over the years 2020 and 2021 is likely to resemble a lopsided "V". We are therefore sticking by our predictions for this year, which are optimistic in comparison with other institutions, namely that GDP will decline by 4.0%, or less than most other economies. In addition, we continue to expect the recovery in 2021 to prove insufficiently strong to restore GDP to its pre-crisis levels by the end of that year (2021 forecast: +3.5%).

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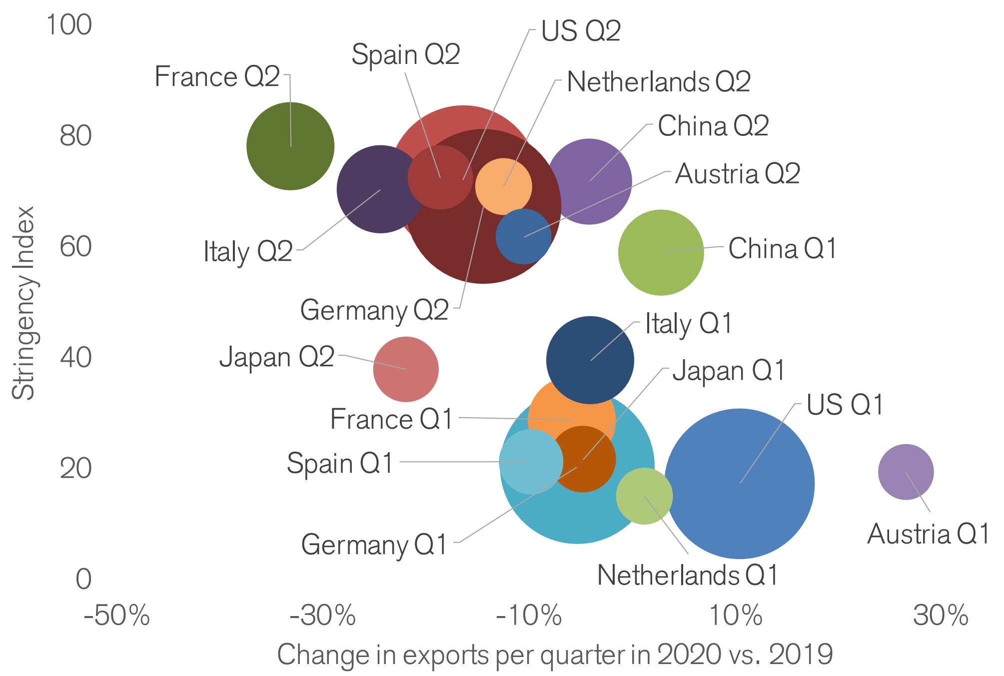
Fig. 7: Exports scarred by harshness of COVID-19 measures taken in export destinations
Size of circles: proportion of total exports 2019



Source: Swiss Federal Customs Administration, Datastream, Credit Suisse

Inflation

Just like in other industrialized nations, the core rate of inflation (i.e. consumer price inflation excluding prices of crude oil products and food) initially fell in Switzerland too as a result of the COVID-19 pandemic – among other things, because retailers initially had to work through their inventories after reopening their stores. But price momentum has normalized since July. Inflation can be expected to generally remain low for a while longer, however, as the level of capacity utilization in the economy is too low for any significant price rises. For Switzerland, we continue to expect an average inflation rate of –0.7% in 2020 and 0.3% in 2021.

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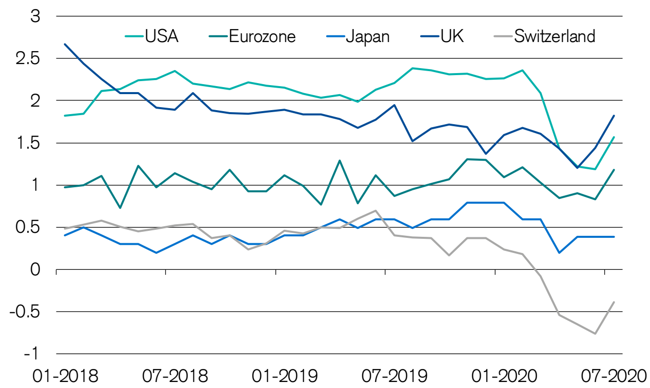
Core rates of inflation have risen recently
Core rate of inflation, in % (YoY change)



Source: Datastream, Credit Suisse

Labor market

In mid-2020 there were 31,000 fewer jobs in Switzerland than the year before (–0.6%), although just under 70% of this figure related to part-time jobs. When expressed in full-time equivalents (FTEs), employment declined by 0.2%. The sectors most heavily affected by this headcount reduction were the hotels & catering and temporary employment sectors. Employment declined in manufacturing too, whereas in healthcare, social care, and teaching there were more people employed than a year ago. The outlook remains gloomy, as the number of advertised jobs has declined noticeably (Q2 2020: –27% YoY). Overall, we are expecting a decline in employment (in FTEs) of 0.5% on average in 2020.

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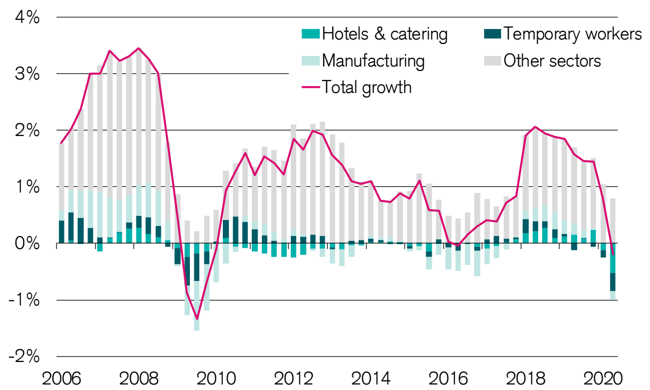
Employment declines, particularly in hotels & catering
Employment (full-time equivalents): YoY growth in %; growth contributions



Source: Swiss Federal Statistical Office, Credit Suisse; last data point: Q2 2020

Immigration

For 2020, we are expecting net migration of the permanent residential population to work out at around 50,000 persons. One of the reasons why this decline is not expected to be greater is the likelihood of fewer persons leaving Switzerland than usual during the COVID-19 crisis. Overall, the number of foreign citizens leaving Switzerland in the second quarter of 2020 was 20% down on the prior-year period, and the number of Swiss leaving their own country can also be expected to have declined. Finding a job abroad and relocating there were made much more difficult by the pandemic. At the same time, short-time working and social security benefits provided a fairly secure environment in Switzerland.

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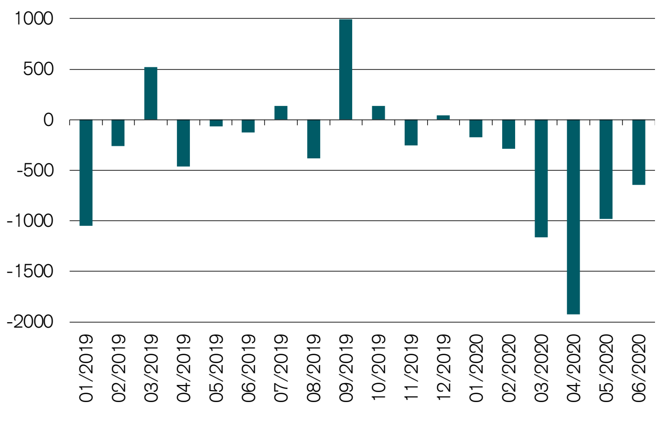
Much less emigration from Switzerland in H1 2020
Emigration of permanent foreign residential population, YoY change, number of persons



Source: State Secretariat for Migration, Credit Suisse

Pharmaceutical industry

Following an extraordinarily strong first quarter, which was above all attributable to stockpiling, pharma exports did not develop quite so dynamically in the second quarter. Customers were presumably able to draw on their bloated reserves. That said, pharma exports nonetheless remained stable at a high level – a development that we believe is set to continue over the next three to six months. At times, the pharma sector accounted for almost 50% of total Swiss exports in the second quarter. Despite a recovery in other industries, this figure is unlikely for the time being to fall back to the level recorded at the end of 2019 (around 40%).

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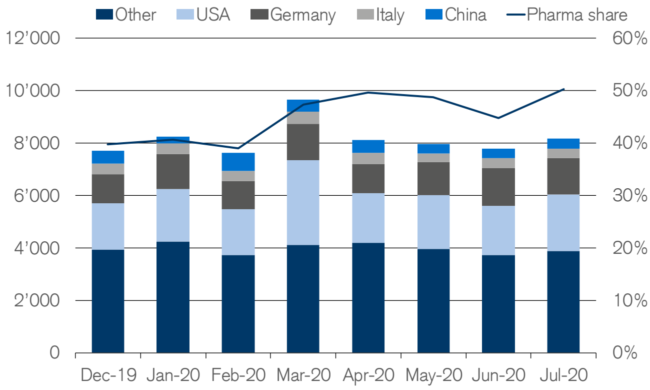
Pharma's share of total exports flirts with 50% mark

Pharma: Exports in CHF mn by country, seasonally adjusted (LHS), and proportion of total exports



Source: Swiss Federal Customs Administration, Credit Suisse

Engineering, electrical, and metal industry (MEM)

Exports of the engineering, electrical, and metal (MEM) industries in April actually slumped below the levels recorded during the financial crisis. The situation then improved slightly in May and June, which can be attributed to the lockdown easing measures initiated in Switzerland's neighboring countries. Whereas MEM exports to China have hovered around the levels recorded at the end of 2019, their development in the US going forward remains uncertain. Although MEM exports to this country picked up again somewhat in June, an increase in the Covid-19 infection rate and the more draconian containment measures taken in a number of states provide grounds for pessimism.

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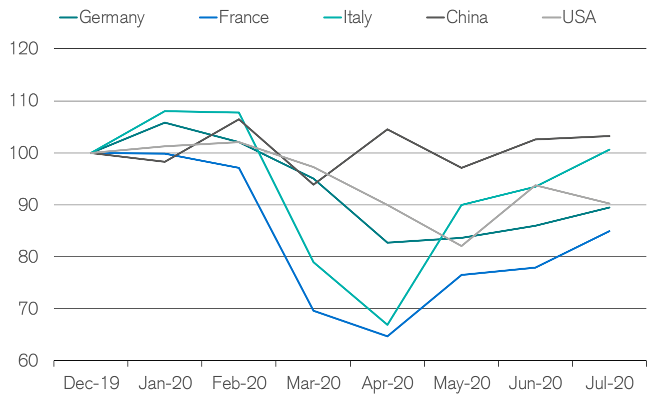
Easing of lockdown in Europe reflected in MEM exports

Development of MEM exports by country, indexed (Dec 2019 = 100) and seasonally adjusted.



Source: Swiss Federal Customs Administration, Credit Suisse

Watch industry

Watch exports slumped spectacularly in April, falling from almost CHF 1.5 billion in March to just CHF 427 million. Although a recovery manifested itself in May and June, exports are still a long way off their pre-pandemic levels. Of the major export markets, China exhibited the strongest recovery. The situation in Hong Kong remains difficult due to political uncertainties, while in the US the magnitude of the anticipated fiscal stimulus package to support households will play a key role in the development of Swiss watch exports going forward.

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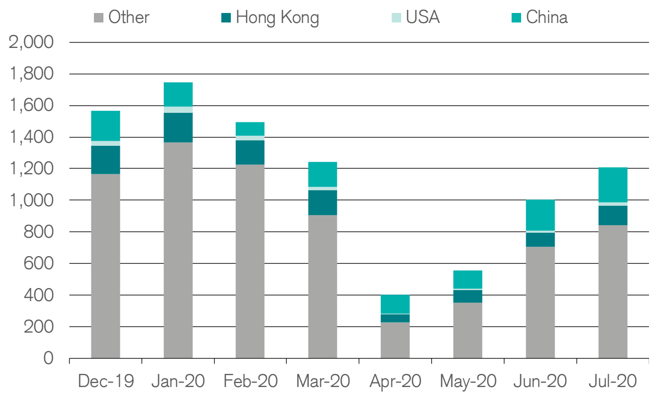
Watch industry puts April nadir behind it for time being

Watch exports in CHF mn by country, seasonally adjusted



Source: Swiss Federal Customs Administration, Credit Suisse

Retail trade

Nominal sales of the food and non-food segments exhibited contrasting tendencies during the coronavirus crisis. From May onward, non-food sales were supported above all by strong demand from the leisure and DIY/gardening/automotive accessories areas. By contrast, the situation for clothing and shoe retailers remains bleak, and their prospects are unlikely to change in the foreseeable future. In the food sector, the return of shopping tourism will prove an obstacle to any sharp rises in sales figures.

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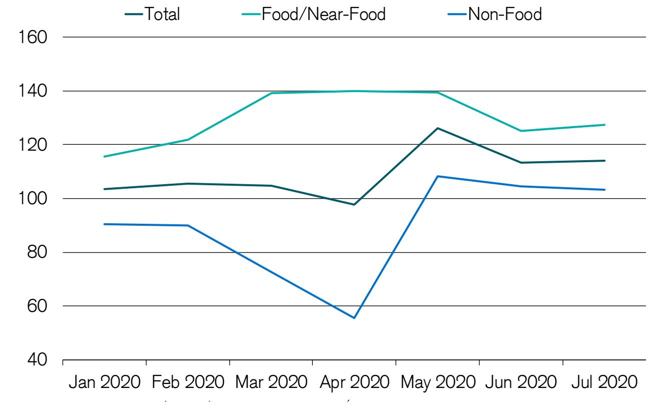
Food: evidence of the return of shopping tourism

Nominal retail sales, indexed (Jan. 2012 = 100) and seasonally adjusted



Source: GfK, Credit Suisse

Tourism

In the tourism sector too, not all protagonists have suffered to the same extent in the face of COVID-19. So far, the decline in overnight stays has been more pronounced in the urban centers and suburban municipalities than in tourist regions. This is above all attributable to the higher proportion of Swiss guests visiting tourism-dependent municipalities (2019: 52%) compared to urban areas (2019: 36%). Coronavirus has had the effect of boosting domestic tourism. We expect this will help cushion the decline in overnight stays in tourist areas over the summer months. By contrast, a recovery in the numbers of foreign tourists visiting Switzerland is likely to be some way off.

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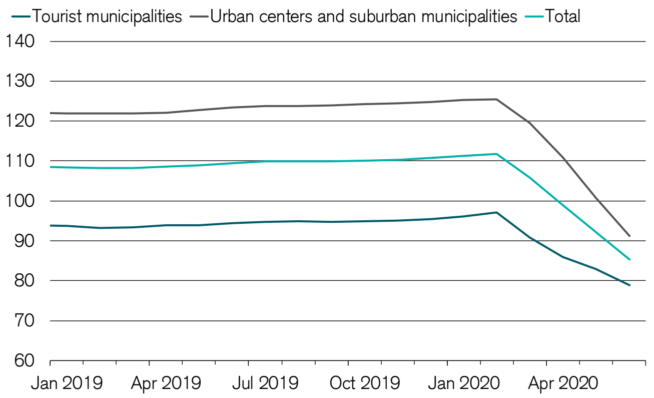
Domestic tourism supports tourist regions

Overnight stays by municipality type, indexed (Jan. 2010 = 100), moving 12-month average



Source: Swiss Federal Statistical Office, Credit Suisse

Information technology (IT)

In the IT sector, business conditions improved somewhat in the second quarter following a very poor start. The balance between companies who view their business situation as positive and those that view it as negative has now increased to 24% (previous quarter: 7%). This improvement is corroborated by the more robust PMI figures being recorded in manufacturing and services, two of the key sales areas for the IT sector. Given the current backdrop, sentiment is likely to brighten further, albeit with rather less dynamism.

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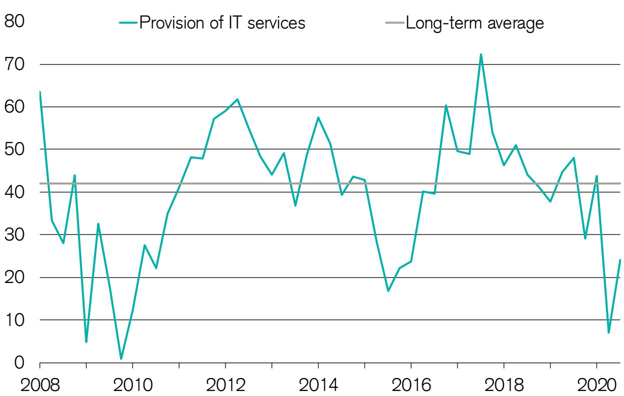
IT sector comes close to nadir recorded during financial crisis

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



Source: Swiss Economic Institute of the ETH Zurich , Credit Suisse

COVID-19 slows immigration beyond lockdown

Thanks to high immigration in the first quarter and a decline in the number of people emigrating, net migration to Switzerland should decline only slightly in 2020, despite the coronavirus crisis. However, net migration is likely to weaken further in 2021, despite the expected economic recovery.

Travel restrictions as part of coronavirus measures

Just like in other countries, COVID-19 led to far-reaching restrictions in public life in Switzerland. On March 16, 2020, the Federal Council declared an extraordinary situation as per the Epidemics Act. As a consequence, not only were schools, shops, and restaurants temporarily closed, but travel into Switzerland was also heavily restricted. Borders were partially closed from March 25 to June 8, 2020. Switzerland's neighboring countries likewise sealed themselves off almost entirely.

High immigration at start of year

The coronavirus crisis exploded at a time when net immigration into Switzerland had started to rise again after two years of stagnation (cf. Fig. 1). Net immigration of the permanent foreign residential population in the first quarter of 2020 was 30% up on the previous year's equivalent. The main reasons for this increase are likely to have been robust employment growth over the two previous years and the removal of the safeguard clause in respect of Romania and Bulgaria.

Halving of net immigration in Q2 2020

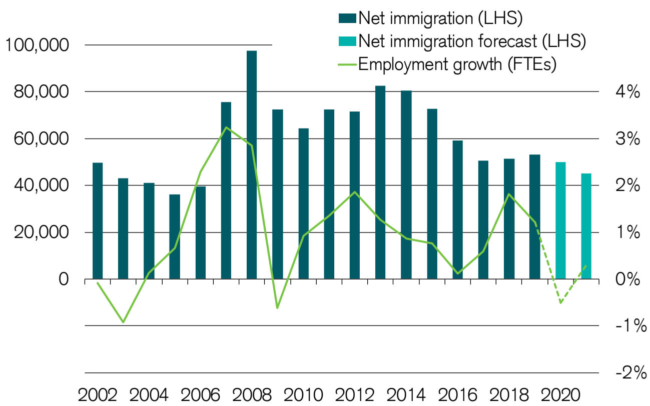
However, the travel restrictions then clearly fed through into immigration figures in April and May 2020 (cf. Fig. 2). Overall, net migration (excluding register corrections) declined by 25% in the second quarter of 2020 compared to the prior-year period. If transfers between the temporary and permanent residential population ("changes of status") are excluded and only the actual migration movements across the Swiss border are observed, the decline amounted to as much as 50% (balance of effective immigration). This is despite a countermovement becoming apparent in June and net migration once again rising. However, this is likely to have been a catch-up effect involving relocations to Switzerland that had originally been planned prior to the onset of the pandemic, rather than a change in the underlying trend.

Emigration also down

However, the decline in net migration in the second quarter cannot be attributed to a decline in the number of immigrants alone. It was also the case that many fewer people left Switzerland than normal. Finding a job abroad, looking for accommodation, and actually relocating were all made much more difficult by the pandemic. For those in danger of losing their jobs in Switzerland, short-time working and social security benefits continued to promise a certain degree of security and stability. Overall, the number of foreign nationals turning their back on Switzerland in the second quarter of 2020 was some 20% down on the prior-year period.

Fig. 1: Declining trend in immigration

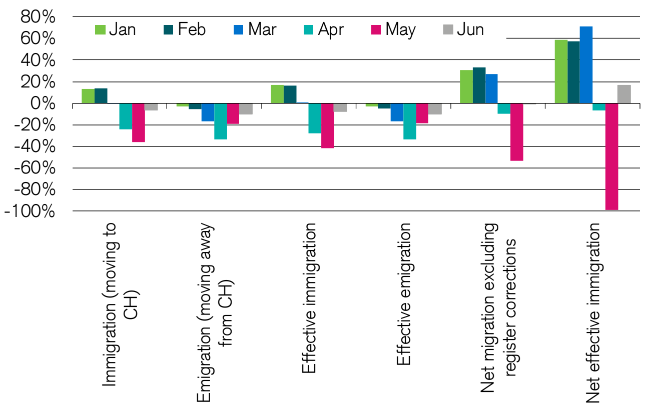
Net immigration: permanent residential population, including CH citizens, excluding register corrections (LHS) and employment growth (full-time equivalents)



Source: State Secretariat for Migration, Swiss Federal Statistical Office, Credit Suisse; last data point: 06/2020

Fig. 2: COVID-19 weighs on net migration in Q2 2020

Migration movements of permanent foreign residential population; 2020 change compared to same month in prior year



Source: State Secretariat for Migration, Credit Suisse; last data point: 06/2020

Borders closed – with some exemptions

The fact that any immigration took place at all in April and May 2020 is explained by the exemption rules: In particular, workers from the European Union (EU) whose activity related to the supply of essential goods and services (e.g. healthcare, food, IT infrastructure) retained their right of entry. This can be seen in the structure of immigrants: The proportion of immigrating workers rose in the second quarter in sectors such as IT, healthcare, and agriculture. By contrast, the proportion of immigrants working in sectors directly affected by the lockdown – such as hotels & catering and teaching – declined (cf. Fig. 3).

Travel restrictions initially only partly lifted

As well as immigration for work purposes, the immigration of families to join immigrant workers was also limited at times. Moreover, travel restrictions continue to apply for a number of non-EU countries. These primarily apply to short stays of less than 90 days – be it for a vacation, short training courses, medical treatment, or non-urgent business meetings. By contrast, the restrictions imposed on the entry of workers from non-EU countries were finally lifted on July 6. However, the return of restrictive measures cannot be ruled out, and will depend on the further development of the pandemic.

Recession likely to slow immigration even further

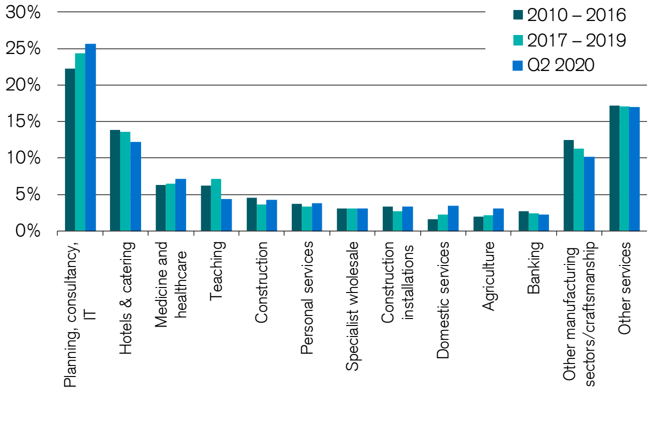
In parallel to the phased lifting of restrictions on entry into Switzerland, the economy will once again become the key driver of immigration. Despite clear indications of recovery, it is likely that the pandemic will weigh on growth both in Europe and worldwide in the medium term. For Switzerland, we are anticipating an overall decline in gross domestic product of 4.0% in 2020 (cf. Fig. 4). Thanks to the relatively benign development of the pandemic so far, together with government support measures in the form of short-time working compensation and loans to affected companies, the recession should prove less severe in Switzerland than in the Eurozone, where the economy is likely to shrink by up to 8.0% this year. However, Swiss demand for foreign labor can be expected to remain low for the time being, given that we are expecting a 0.5% decline in employment in 2020 (cf. Fig. 1). In 2021 too, employment is likely to only barely recover (+0.3%), while unemployment is likely to rise further to 3.9%, which would be its highest level for 15 years. The slow recovery of the labor market should therefore impede any rapid resurgence in immigration.

Forecast for 2020: positive migration balance of 50,000

Overall, we are expecting net migration of the permanent residential population to amount to around 50,000 in 2020 (previous year: 53,000, cf. Fig. 1). There are three reasons why this decline will not be more accentuated, despite the coronavirus crisis: First, as explained above, immigration was still extremely strong in the first quarter. Second, the pandemic led not only to a decline in immigration, but also to a reduction in the number of people leaving Switzerland. The number of Swiss moving abroad is also likely to have declined sharply. Third, a proportion of the effective decline in the number of immigrants only feeds through into the immigration figures of the permanent foreign residential population with a certain time lag.

Fig. 3: Immigration during coronavirus crisis focused in sectors relating to the basic supply of goods and services

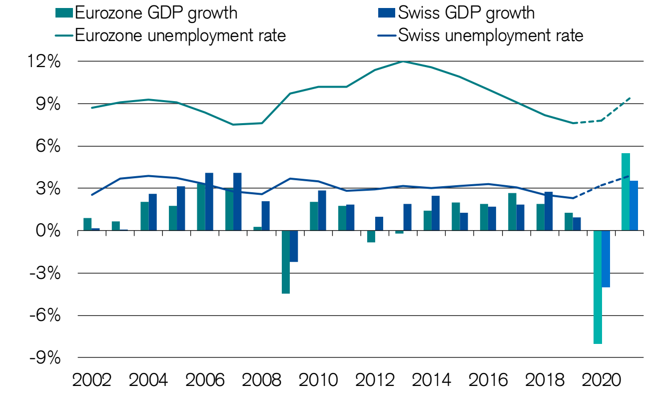
Immigration of workers (permanent foreign residential population): breakdown by sector



Source: State Secretariat for Migration, Credit Suisse; last data point: 06/2020

Fig. 4: Slump in economic output likely to be lower in Switzerland than elsewhere in Europe

Economy and labor market in Switzerland and Eurozone; 2020/2021: forecasts



Source: State Secretariat for Economic Affairs, Organisation for Economic Cooperation and Development (OECD), Credit Suisse; last data point: 06/2020

Slump in number of short-term residents …

According to the definition applied by the State Secretariat for Migration, the non-permanent residential population and persons seeking asylum do not form part of the permanent residential population – which means they are not included in the above forecast of net migration for 2020. The non-permanent residential population comprises persons who reside less than a year in Switzerland and hold a short-term resident's permit. For COVID-19-related reasons, the number of short-term residents has declined even more dramatically than the permanent foreign residential population. Overall, the former's net migration balance over the last 12 months amounted to -11,400 (cf. Fig. 5). However, a proportion of these immigrants (typically around a quarter) will end up staying in Switzerland in the longer term, and will receive the corresponding resident's permit after a certain period of time. In other words, these immigrants undergo a change of status and switch from the non-permanent to the permanent residential population. The latest decline in the number of short-term residents will therefore feed through into the numbers of the permanent residential population after a delay of a few quarters.

… and in number of asylum seekers

Furthermore, the statistics on foreigners in Switzerland only capture recognized refugees, but not persons seeking asylum or temporarily admitted persons. The number of asylum seekers, which had already been in decline since the European refugee crisis of 2015/2016, has reached a new low as a result of the COVID-19 pandemic. Indeed, in the second quarter of 2020 the equivalent figure was some 60% below that of the prior-year period. Accordingly, the number of persons undergoing the asylum-seeking process is also declining (cf. Fig. 5). This decline can likewise be expected to feed through into the immigration figures (foreigner statistics) with a few quarters' delay.

Forecast for 2021: net positive migration of 45,000

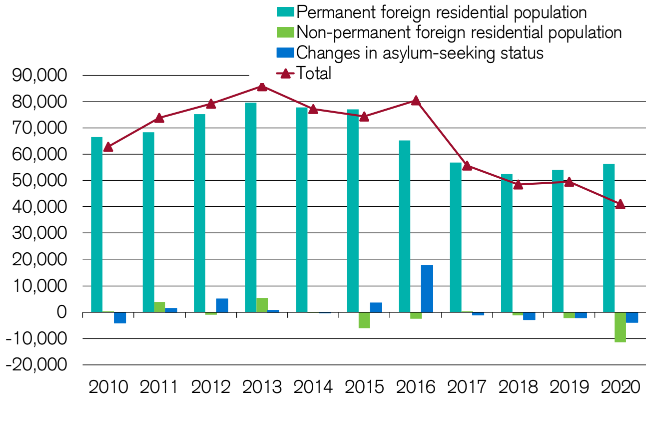
Some of the direct repercussions of the COVID-19 pandemic will therefore not become apparent in the "official" immigration numbers until after a certain time lag. Nonetheless, the economic consequences are likely to already be evident – such as in the form of lower demand in the real estate market. As an additional factor, even in the event of a favorable development of the pandemic, the labor market is likely to recover from the crisis only very sluggishly. Accordingly, for 2021 we are anticipating a further decline in net immigration to a level of around 45,000 persons. This would bring net migration below the 50,000 mark for the first time since the introduction of the free movement of persons in 2007.

Trend reversal dependent on labor market recovery

In summary, it may be concluded that immigration into Switzerland has been heavily dependent on the development of the Swiss economy and demand for labor on the part of companies based here, even after the introduction of the free movement of persons. This is also clear from the fact that the structure of immigrants in gainful employment has increasingly shifted away from the second sector of the economy and into high-growth services sectors such as consultancy, IT, teaching, and healthcare (cf. Fig. 3). The development of immigration beyond 2021 will depend on the further development of the pandemic and the nature of the economic recovery. In the event of a prolonged recession with a continued rise in unemployment, a much sharper decline in immigration cannot be ruled out. On the other hand, until labor markets elsewhere in Europe recover, the number of foreign workers in Switzerland returning to their home countries is also likely to be subdued, thereby limiting the decline of net migration.

Fig. 5: Effective decline in immigration stronger than implied by permanent residential population

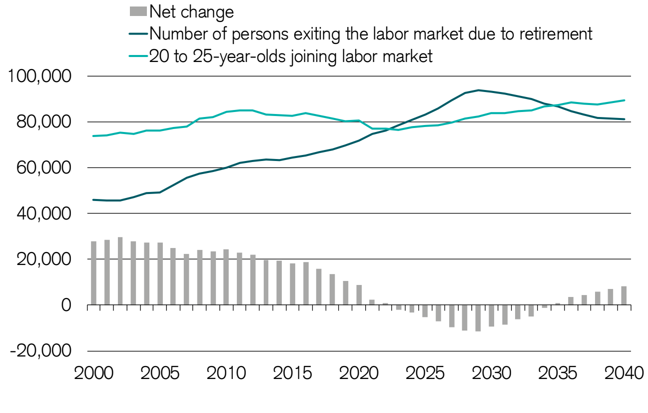
Overall picture of net immigration in foreigner and asylum-seekers area, 12-month totals as per month of June



Source: State Secretariat for Migration, Credit Suisse; last data point: 06/2020

Fig. 6: Baby boomer generation leaves gap in labor market

Number of persons joining/exiting the Swiss labor market for demographic reasons



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

Immigrants replace baby boomers

Net immigration is also affected by the demographically-related decline in employment activity. The rolling wave of retirement on the part of the high birth-rate cohorts of the baby boomer generation will leave a major gap in the labor market. At the end of the 2020s, a net total of up to 10,000 persons is likely to exit the labor market every year (cf. Fig. 6). These workers are at least partly likely to be replaced by workers recruited abroad.

No great resurgence likely from today's standpoint

As a consequence, a temporary resurgence in immigration to a level of 60,000 or even more is conceivable over the coming years. A new phase of domestic economic dynamism, coupled with economic problems in one of Switzerland's three neighboring countries, or another refugee crisis would likewise see immigration experience a temporary rise. However, in the event of an economic recovery in keeping with potential growth, we believe the most likely scenario for the coming years is average net migration of just over 50,000 persons.

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Review: development of immigration since introduction of free movement of persons

Surge in immigration has receded

Switzerland has been a country of immigration for decades. With the introduction of the free movement of persons as per the bilateral agreements between Switzerland and the EU, the country became even more attractive as a potential destination for working European migrants. From 2007, the year of entry into force of the full free movement of persons with the old countries of the EU (EU-17), a sudden spike in net immigration was apparent (cf. Fig. 1). The very next year, net migration peaked at more than 97,000. Despite the phased expansion of the free movement of persons to the new member states of the EU (EU-8, EU-2), this peak was not scaled again over the following years. Indeed, a persistent decline set in after 2013. From 2017 onward, Switzerland's net migration rate came to settle at the much lower level of just over 50,000. These figures include the net migration of the Swiss population itself. Ever since 2002, a net average of around 5,800 Swiss have left the country each year – be it to study, work, or retire elsewhere.

Key drivers: economic developments at home and abroad

Even since the introduction of the free movement of persons, immigration has continued to be largely determined by economic factors. When the economy flourishes, new jobs are created, the demand for labor subsequently exceeds domestic supply in certain sectors, and additional foreign workers are recruited. By contrast, against a backdrop of weak employment development, such as in the aftermath of the financial crisis or during the period 2014-2016, a direct decline in immigration can be observed (cf. Fig. 1). In addition, the EU – whose economy struggled with the consequences of the 2008 financial crisis for a prolonged period – was able to reduce its high unemployment rate steadily from 2014 onward, whereas the Swiss manufacturing industry was weakened during this period by the strength of the franc (cf. Fig. 4). The recovery was particularly impressive in Portugal, where the unemployment rate declined dramatically between 2013 and 2019. As a result, Switzerland has recently recorded a high net emigration of Portuguese, who constitute the third-largest group of foreigners in Switzerland after Italians and Germans. The number of emigrants accounted for a significant proportion of the decline in net migration in the years after 2014. Between 2013 and 2018 their number rose by 14% – while the number of immigrants declined by 10% over the same period.

Clustering in urban agglomerations and French-speaking Switzerland

Factors that have prevented an even greater decline in immigration include the European refugee crisis in the mid-2010s, and more recently the removal of the safeguard clause in respect of Bulgaria and Romania (EU-2) from mid-2019. Within Switzerland, the most popular target destinations for immigrants are the urban agglomerations and the cantons of French-speaking and Italian-speaking Switzerland. Particularly worthy of emphasis here is the Lake Geneva region, much of which has seen high employment growth in recent years. However, in a number of cantons outside of German-speaking Switzerland, particularly Vaud, Neuchâtel, Fribourg, and Valais, the rate of immigration has fallen particularly strongly over the last few years. And the Italian-speaking Canton Ticino has even recorded negative net migration over the last 12 months.

First assessment of the COVID-19 loan scheme

To support companies confronted with a sudden halt in cash flow, banks offered cheap loans guaranteed by the Swiss government until 31 July. Corporates borrowed CHF 17 bn and defaults have been very limited so far.

Companies have borrowed CHF 17 bn under the COVID-19 loan scheme …

In late March 2020, the Swiss authorities launched the COVID-19 bridging credit scheme in collaboration with banks. Until 31 July, banks offered loans to Swiss corporates of up to CHF 500,000, guaranteed by the government under this scheme for up to 5 years at 0% (at least for the first year). According to SECO, companies borrowed an estimated CHF 14 bn under this program (see Fig. 1). In addition, a second facility (the so-called COVID-19-Credit-Plus) allowed corporates to borrow more than CHF 500,000 (up to CHF 20 million) at a slightly higher interest rate. The Confederation guaranteed 85% of the amount of these loans. Under this second facility, companies borrowed an additional CHF 3 bn.

We estimate the utilization rate of the COVID-19 loans to be around 60% …

The aim of these loans was to bridge liquidity shortfalls in corporates due to the lockdown of the economy. However, corporates were not permitted to use the loans for new investments. As the media first reported, it appears that many corporates borrowed as a precautionary measure. To estimate the utilization of the loans, we used data from the Swiss National Bank (SNB). Banks can indeed refinance the loans at the SNB (i.e. borrow liquidity from the SNB) through the so-called COVID-19 refinancing facility. To borrow from the SNB, banks have to provide the credit claims as collateral. However, credit lines that have not been drawn cannot be used as collateral. Hence, in comparing the total amount of COVID-19 loans and the refinancing of the banks at the SNB, we obtained a rough estimate of the utilization of the loans by corporates. As banks have borrowed CHF 10 bn from the SNB (see Fig. 2), it suggests a utilization rate of approximately 60% for the COVID-19 loans.

At 0.1%, the default rate has remained very low so far …

For the government, the financial risk is anticipated to be much smaller than initially thought. The government was indeed willing to guarantee up to CHF 40 bn in loans, more than twice the amount that was actually lent. Moreover, the government has provisioned CHF 1 bn for credit defaults this year. While credit defaults will most likely continue to increase, as it is still early days, losses so far have only reached CHF 18.9 million as of September 9, representing a default rate of less than 0.1%.

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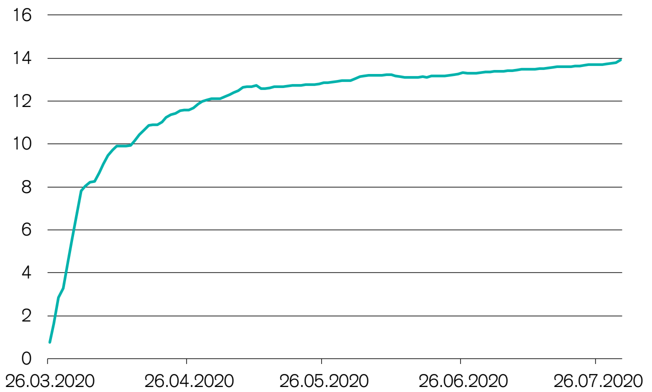
Fig. 1: Corporates borrowed CHF 14 bn in COVID-19 loans

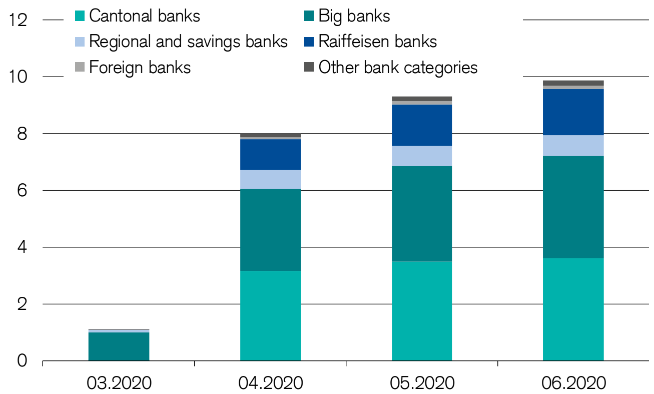
Estimated cumulated loan volume, in CHF bn. COVID-19 credit plus are excluded.



Source: SECO, Credit Suisse

Fig. 2: Refinancing of COVID-19 loans at the SNB

Amounts due by banks to the SNB (excluding repos), in CHF bn



Source: SNB, Credit Suisse

USD loans to banks

During the height of the COVID-19 crisis, demand for USD liquidity rose sharply across the globe. In Switzerland, the SNB reactivated its swap line with the US Federal Reserve (Fed), which allows the SNB to temporarily exchange CHF against USD with the Fed and lend the USD to the Swiss banking system. Demand among Swiss banks for USD liquidity from the SNB surged in March and April 2020, before slowing down as USD borrowing costs normalized globally. Since August, banks have not borrowed any more USD from the SNB, and the SNB announced it would scale back its USD auctions.

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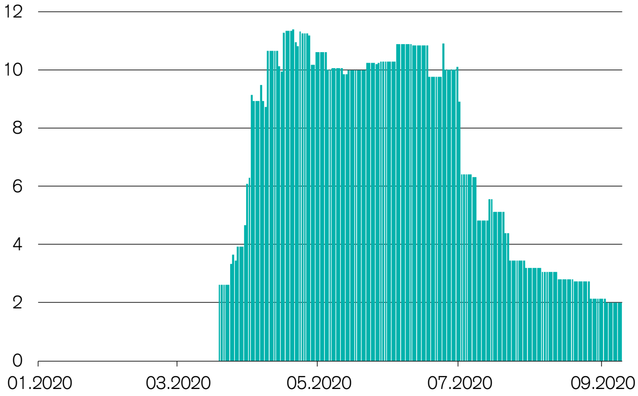
Demand for USD liquidity has dropped

Outstanding USD loans to banks (USD repos), in USD bn



Source: SNB, Credit Suisse

Foreign currency interventions

We estimate that, since the beginning of the year, the SNB has purchased around CHF 91 bn in foreign currencies to dampen appreciation pressures on the CHF. With these pressures gradually abating over the summer, the SNB reduced its intervention volume. Foreign currency purchases will likely remain the main tool of the SNB to address bouts of appreciation of the CHF in the near future. On the other hand, we believe that the SNB will refrain from lowering its policy rate deeper into negative territory for the time being.

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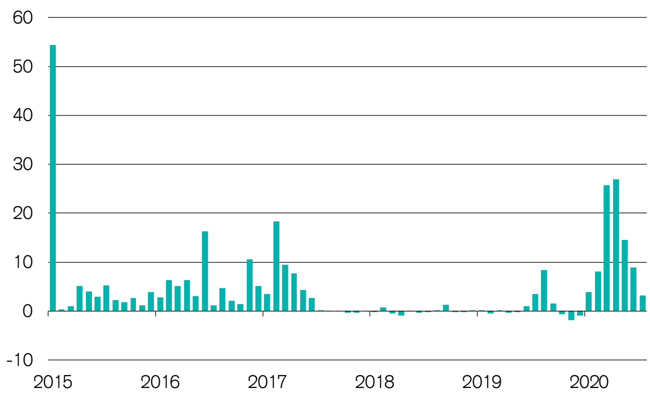
Foreign currency purchases have slowed down

Estimated foreign currency purchases by the SNB, in CHF bn



Source: SNB, Credit Suisse

SNB profits

After reporting a loss of CHF 38.2 bn in Q1 2020 due to the sharp drop in financial asset prices and the appreciation of the CHF — which lowered the book value of its foreign currency reserves — the SNB's portfolio quickly recovered in Q2 2020; financial markets rebounded rapidly and the CHF weakened. In Q2 2020, the SNB reported a profit of CHF 39 bn. While most of the profit came from gains on its foreign currency reserves, the SNB also earned CHF 4.3 bn from its gold reserves, as gold prices rose almost 10% in CHF in Q2 2020.

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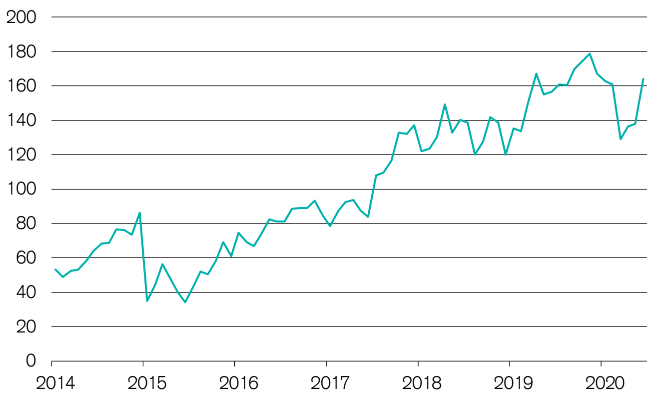
The SNB quickly recovered from its Q1 2020 loss

SNB equity capital, in CHF bn



Source: SNB, Credit Suisse

Owner-occupied housing

Confidence in the market appears to have returned following the easing of the lockdown. However, a complete return to the levels of demand recorded prior to the onset of Covid-19 is not expected until next year at the earliest. That said, price developments have so far been unaffected by the pandemic. The low supply of owner-occupied housing (little new construction activity, low vacancy rates) and the very low mortgage rate environment have led to further price increases in recent months. Indeed, the prices of single-family homes and condominiums were 3.3% and 1.9% higher respectively in the second quarter compared to the prior-year quarter.

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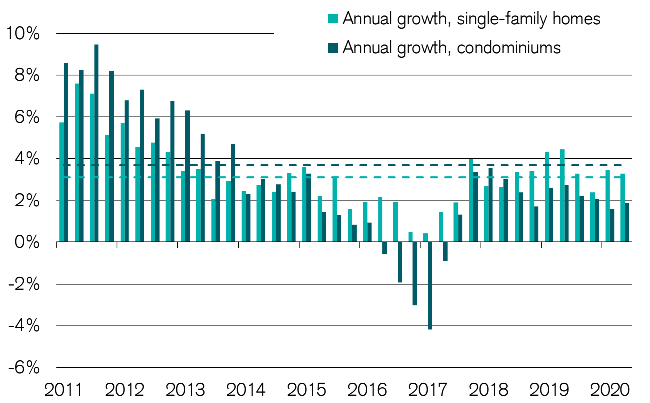
Residential property price growth still positive

Annual growth rates by segment



Source: Wüest Partner; last data point: Q2 2020

Rental apartments

The Covid-19 crisis has also given rise to short-term uncertainty among project developers. According to submitted planning applications, 18% fewer rental apartments were planned in the second quarter of 2020 than in the prior-year quarter. This figure is likely to be exaggerated, however, as a number of French-speaking cantons and Ticino did not report data on planning applications during the lockdown, or did so only partially. Applications then recovered as early as June (+14% year-on-year). The number of approved rental apartments has risen again recently, and is actually 8% higher over the last 12 months than for the prior-year period.

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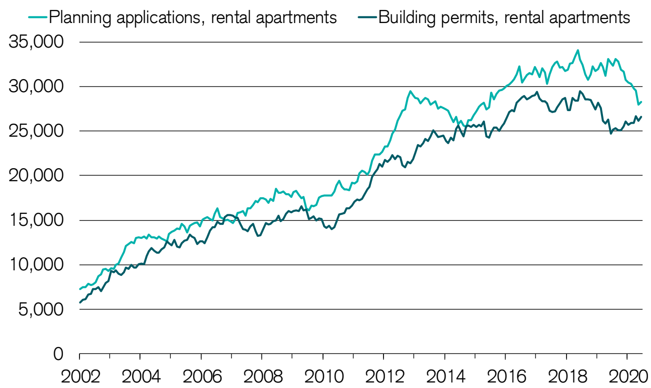
Rental apartment construction still barely affected by coronavirus crisis

Planning applications and building permits, moving 12-month average, in number of apartments



Source: Baublatt, Credit Suisse; last data point: 06/2020

Office property

In the office world, the Covid-19 pandemic has triggered a major shift toward working from home. As a result, many companies have discovered significant cost-cutting potential, which is why we are likely to see a rising trend of allowing employees to spend more time working from home, thereby reducing the need for office space. This effect could act as a long-term drag on demand for office premises. Yet at the same time, there is no evidence so far of any reticence on the part of office property developers. Quite the opposite: In recent months, both building permits and planning applications have exhibited a renewed rise following the low figures recorded in 2019. The volume of planning applications submitted over the last 12 months is 14% higher than for the prior-year period.

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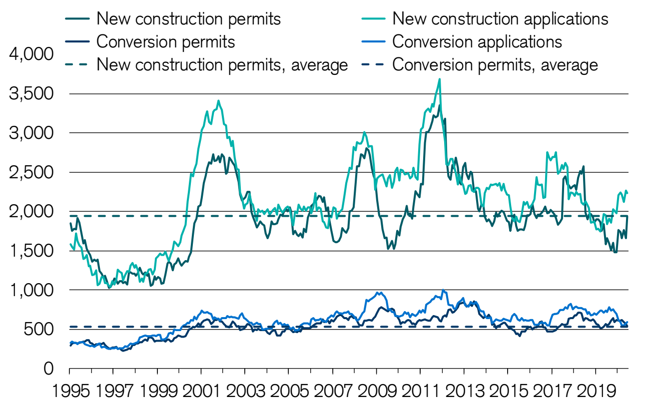
Projected office market activity on the rise again since January

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



Source: Baublatt, Credit Suisse; last data point: 06/2020

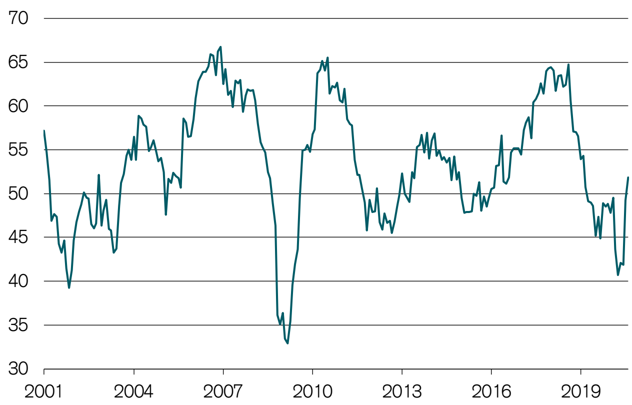
Credit Suisse Leading Indicators

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



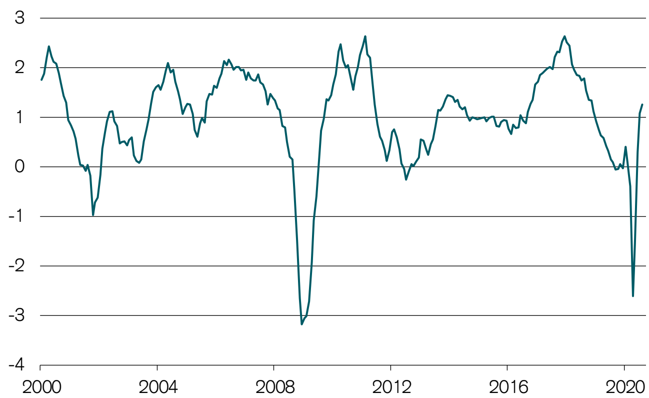
Source: procure.ch, Credit Suisse

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



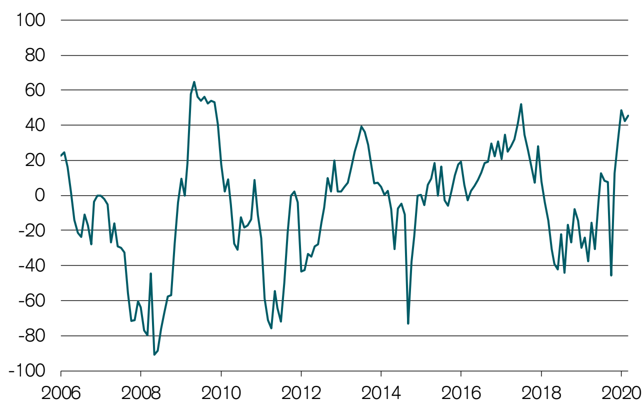
Source: PMIPremium, Credit Suisse

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



Source: CFA Society Switzerland, Credit Suisse

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

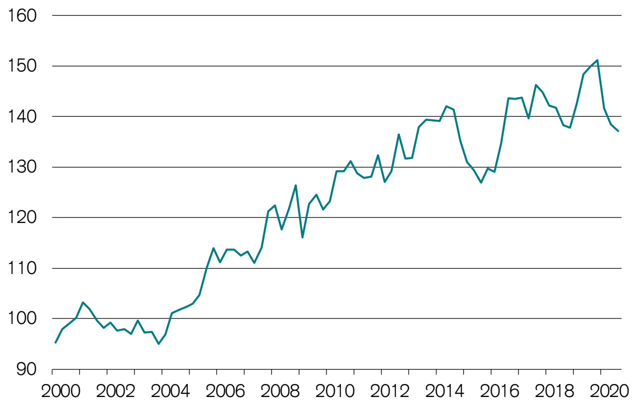
Credit Suisse Leading Indicators

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



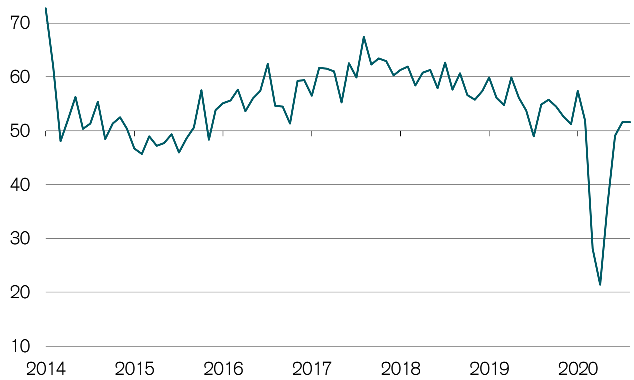
Source: Swiss Contractor's Association, Credit Suisse

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

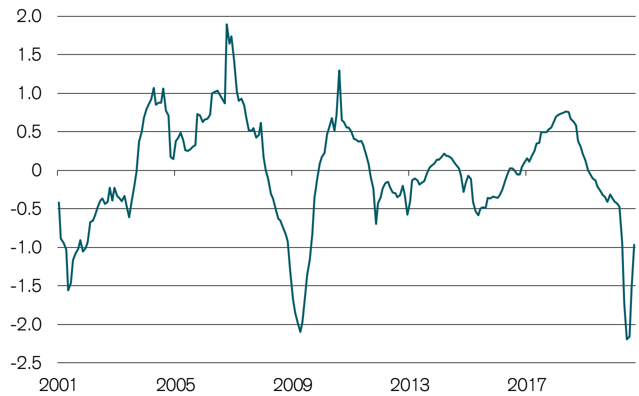


Source: procure.ch, Credit Suisse

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

	2020	2020	2020P	2020P	2021P	2021P	2021P	2021P	2020P	2021P
	Quarter 1	Quarter 2	Quarter 3	Quarter 4	Quarter 1	Quarter 2	Quarter 3	Quarter 4		
GDP (YoY, in %)	-0.7	-9.3	-4.1	-1.9	0.6	9.8	3.5	0.7	-4.0	3.5
Consumer spending	-3.8	-12.5	-0.5	8.0	1.7	1.7	1.7	1.7	-2.1	1.7
Government expenditure	2.4	2.5	3.5	3.5	3.0	3.0	3.0	3.0	3.0	3.0
Gross capital investment	0.2	-7.8	-2.8	-2.2	2.1	1.7	1.8	1.8	-3.2	1.9
Construction investment	1.9	-2.7	-3.0	-3.0	1.5	1.5	1.5	1.5	-1.8	1.5
Investment in plant and equipment	-0.6	-11.0	-2.7	-2.0	2.0	2.0	2.0	2.0	-4.0	2.0
Exports (goods and services)	0.0	-15.7	-5.5	-4.7	7.0	7.0	7.0	7.0	-6.5	7.0
Imports (goods and services)	0.0	-17.2	-3.3	-3.3	4.0	4.0	4.0	4.0	-6.0	4.0
Inflation (in %)	-0.1	-1.3	-0.9	-0.6	-0.4	0.4	0.6	0.5	-0.7	0.3
Unemployment (in %)	2.7	3.2	3.4	3.6	3.9	4.0	3.9	3.8	3.2	3.9
Employment growth FTEs (YoY, in %)	0.8	-0.2	-1.0	-1.5	-1.0	0.5	0.7	0.9	-0.5	0.3
Net immigration (in thousands)									50.000	45.000
Nominal wage growth (YoY, in %)									0.5	0.1

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

Forecasts for the World Economy

	Forecasts				Structure		Significance for Switzerland	
Forecasts	GDP YoY, in %		Inflation YoY, in %		Population In million	GDP In USD billion	Share of exports In %	Share of imports In %
	2020	2021	2020	2021	2018	2018	2018	2018
World	-4.1	3.9	1.8	2.3	7.593	84.930	100	100
US	-5.5	3.4	1.1	1.9	327	20.580	16.3	6.2
Euro zone	-8.0	5.5	0.5	0.9	342	13.639	44.3	61.7
Germany	-6.6	3.8	0.9	1.1	83	3.951	18.8	27.1
France	-10.1	6.5	0.4	0.7	65	2.780	6.5	8.0
Italy	-10.6	5.6	-0.1	0.7	60	2.076	6.2	9.3
UK	-10.5	6.4	0.9	1.3	66	2.829	4.0	3.8
Japan	-4.9	1.5	-0.3	0.3	126	4.972	3.3	1.7
China	3.3	5.6	2.7	2.6	1.395	13.368	5.2	7.1

Source: Datastream, International Monetary Fund, Credit Suisse

Interest Rates and Monetary Policy Data

	Current	3-month	12-month		07/2020	06/2020	07/2019
SNB target range (in %)	-0.75	-0.75	-0.75	M0 money supply (CHF bn)	703.7	684.0	556.8
10-year government bond yields (in %)	-0.46	-0.2	-0.2	M1 money supply (%, YoY)	4.7	4.4	4.7
				M2 money supply (%, YoY)	2.4	2.1	3.4
				M3 money supply (%, YoY)	3.8	3.1	3.3
				Foreign currency reserves (CHF bn)	847.0	851.1	767.9

Source: Datastream, Bloomberg, Credit Suisse

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