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Short-Term Economic Analyses

Scenarios for the Swiss economy

SECO, Short-Term Economic Analyses

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Negative scenarios to complement economic forecast

The novel coronavirus and the health measures introduced in the middle of March to protect the public have presented both the Swiss economy and society as a whole with an **exceptional situation**. This means any **forecasting** involves an exceptional degree of **uncertainty**. For one thing, the extent of the economic slump since March is hard to estimate as only little 'hard' economic data is available so far. Also, the course the economy will take depends on the epidemiological situation and any accompanying health and economic policy measures adopted.

However, the latest data and analyses indicate that the health measures introduced in Switzerland and abroad are likely to have a much stronger impact on the real economy than assumed in the March economic forecast. To reflect the significant degree of uncertainty that exists, SECO complements the economic forecast of March with two negative scenarios. These do not replace the economic forecast. However, they illustrate possible short-run effects on the business cycle as well as expected long-run effects of:

- A significantly worse **slump** affecting the international and Swiss economy in the first half of 2020. For one thing, the public health measures in Switzerland that are considerably restricting economic activity (referred to hereafter as the 'shutdown') could be extended. Also, latest data indicate that their impact on the real economy could turn out to be clearly greater than assumed in the March economic forecast.

- Additional, significant **economic second-round effects** such as high numbers of lay-offs and corporate bankruptcies that would make economic recovery harder. This would give rise to other major risks, such as a threat to financial stability.

March forecast from the Federal Government's Expert Group[1]

In its March forecast, the Federal Government's Expert Group expected the global economy and the Swiss economy to experience a **recession** in the first half of 2020. Losses amounted to slightly more than 10% of valued added (across the whole economy) during the weeks of the shutdown. It was assumed that the shutdown would be largely lifted by the end of April. Under these conditions, GDP should shrink by 1.5% during 2020, and unemployment might rise to 2.8% (Figure 1, Figure 2, Table 1).

These figures were based on the assumption that the economy avoids any second round effects and makes a **fast recovery** from the restrictive measures. However, despite certain catch-up effects, the GDP level forecast as recently as December is not reached during the forecast period. By the end of 2021, **GDP losses** compared with the forecast from December 2019 amount to more than **30 billion francs** (nominal) in total.

[1] See the press release from 19 March 2020 at www.seco.admin.ch/economic-forecasts .

Negative scenario 1: 'V recession'

Both in Switzerland and abroad, the shutdown continues for longer and has a greater impact on the real economy than was assumed in the Expert Group forecast. In Switzerland, the shutdown is completely over around the end of May. **Production losses** during the shutdown period amount to around 25% of value added (across the whole economy); industry in particular is more badly affected than predicted in the March forecast from the Expert Group, due to acute delivery and sales problems, as are business services and also trade and construction. The **slump** in GDP in the first half of the year is therefore massive and applies to all demand components.

This results in a reduction in GDP for 2020 as a whole of around 7%. Unemployment is up to around 4%, and there are more insolvencies. Again thanks to economic measures, particularly a widespread use of short-time work, compensation for loss of earnings and provision of liquidity to businesses, second round effects such as mass lay-offs or high numbers of corporate bankruptcies or defaults on loans are avoided, however. Nonetheless, the increased indebtedness of companies is likely to have a significant negative effect on their future ability to invest and innovate.

In the second half of 2020, the economy starts to experience a rapid recovery ('V-recession'). For 2021, this means growth of around +8%. As compared with the December forecast, the **loss in GDP** up to the end of 2021 still amounts to around **90 billion francs** (nominal). The negative impact on production potential is somewhat greater over the medium term than in the March economic forecast.

Economic losses would be even bigger if the domestic shutdown were to have a greater impact on value added than assumed. If value added were to slump by 30% instead of 25% during the shutdown, this would mean GDP growth of only -8% or so for 2020.

Negative scenario 2: 'L-recession'

The longer the shutdown lasts in Switzerland but also in major trading partner countries, the more likely it is that economic second-round effects such as waves of lay-offs and insolvencies will occur. This is illustrated by Negative scenario 2.

Both abroad and in Switzerland, the economic slump in the first half of 2020 is similar to that in Negative scenario 1. In addition, though, the **recovery is only sluggish**. The domestic shutdown only eases gradually from June on, to prevent a further outbreak of the virus. This means the prospects of recovery for various service sectors are significantly restricted. GDP for 2020 declines by around -10%. There are **second round effects:** waves of lay-offs, corporate bankruptcies or defaults on loans are accumulating. As a result, production only starts to pick up again during 2021, with GDP growth for 2021 amounting to just 3% or so. This scenario does not envisage a financial crisis where major banks might be expected to have funding problems and the capital market might be frozen. However, financial stability is increasingly jeopardised and other major risks arise, for example in the real estate market.

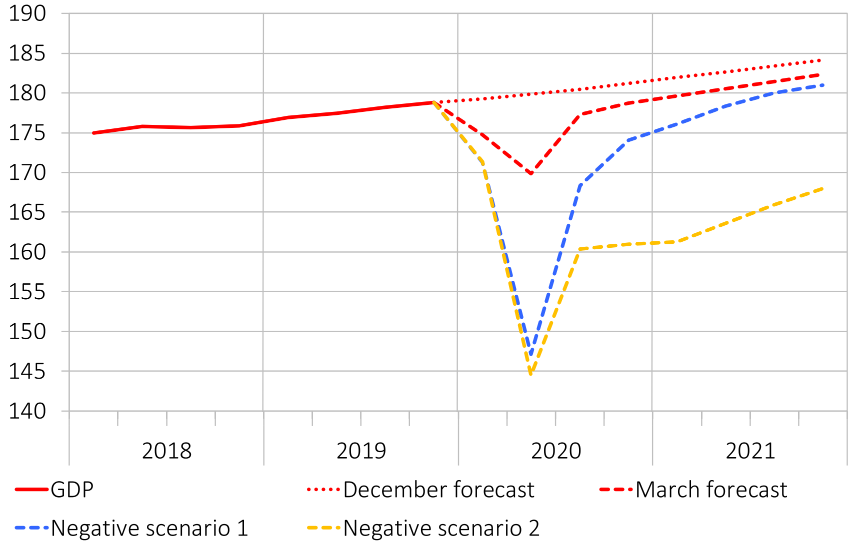
On the demand side, **consumption** is particularly badly hit on account of the extended measures and the significantly greater increase in unemployment (202: 4,5%; 2021: 6%); following a massive slump in 2020, only a tentative recovery would be expected in 2021. Unemployment could peak at values close to 7%. The facility of short-time work likely prevents an even stronger increase. **Investment in equipment** is declining over both years due to a growing number of insolvencies and the slow recovery. **Exports** too only recover slowly following the slump. In addition, many firms are also confronted with a widespread shortage of imported inputs.

Companies' ability to innovate and invest is severely affected. The **production potential** in this scenario would therefore also probably be much lower over the medium term, and possibly also over the long term, than in the March forecast. This implies a very significant and permanent reduction in prosperity. Compared with the December forecast, the **loss in GDP** (nominal) amounts to around **170 billion francs.**

The charts show quarterly figures for the different scenarios. They illustrate possible developments, but are not explicit forecasts. Slightly different quarterly figures would therefore also be conceivable with the scenarios described.

Figure 1: GDP

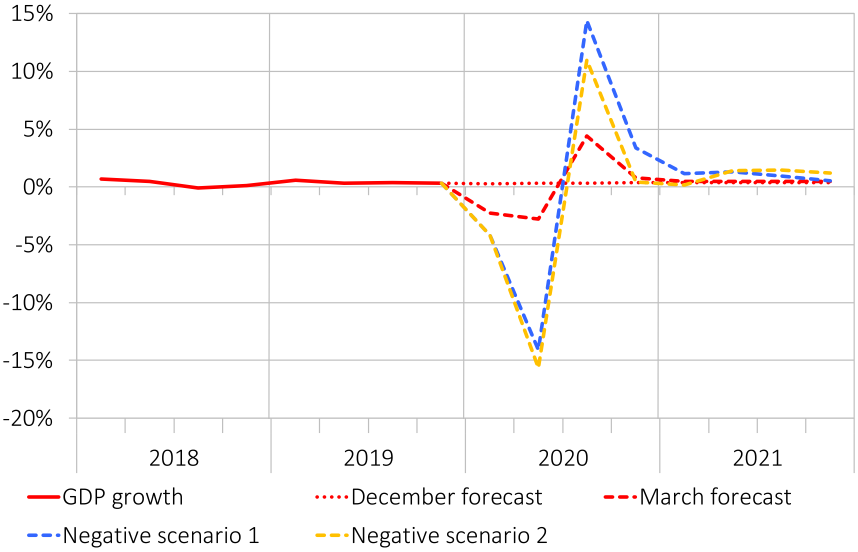
In billion Swiss Francs, real, sport event adjusted



Sources: SECO, Federal Government's Expert Group

Figure 2: GDP growth

Real, sport event adjusted, quarter on quarter



Sources: SECO, Federal Government's Expert Group

Table 1: March forecast and scenarios

			March forecast		Negative scenario 1		Negative scenario 2	
	2018	2019	2020	2021	2020	2021	2020	2021
GDP growth in % *	2,3	1,4	-1,5	3,3	-7,1	8,3	-10,4	3,4
Unemployment rate in %	2,5	2,3	2,8	3,0	4,0	3,7	4,5	6,0
Value added lost**	–	–	24	10	65	24	88	83

* real, sport event adjusted

** nominal, in billion CHF, in comparison to the December 2019 forecast

sources: FSO, SECO, Federal Government's Expert Group