Industry gets back on its feet
For most industrial segments, second-quarter sales were lower than they were a year earlier; nonetheless, in many businesses the worst appears to be over. The construction industry picked up in recent months, while the recovery in retailing has run out of steam.

Chemicals and pharmaceuticals
Pharma flying high, chemicals return to growth

Mechanical engineering
Sales still trending south, but outlook is cautiously positive

Metals industry
Despite deceleration in sales decline, many firms still struggling

Food industry
Sales stuck in a decline

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The carnage continues

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A big boost for the main construction trade

Retailing and automotive trade
A sobering summer for retailing, but the automotive trade is moving closer to normal

Hotels and catering
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Sector overview

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The Swiss economy posted surprisingly strong growth in the second quarter of 2016: according to the State Secretariat for Economic Affairs (Seco), real gross domestic product (GDP) grew by 0.6% in April, May and June compared to the preceding quarter. The GDP component “inventories and statistical deviations” displayed particularly strong growth. However, changes in this component should not be overemphasized, since they are generally quite volatile and thus provide only limited insights into overall economic expansion. Government spending made a similarly positive contribution to growth in the second quarter. In contrast, private consumption – the most important component of demand – was flat compared to the previous quarter, and investments declined. Our view is that this is no time for euphoria. The high growth figure boosted second-quarter GDP 2.0% higher than the previous year’s rate. We have accordingly raised our GDP forecast for 2016 to 1.5%. Even at this level, economic growth will still be lower than it was before the franc shock.

As usual, the individual sectors made differing contributions to GDP growth. The healthcare and social services segment reported the highest year-on-year growth in nominal gross value added, as it already had in the previous quarter (cf. fig.). In terms of employment, too, the sector provides reliable support to growth (cf. fig.). The jump in value added in the energy sector is surprising given the current difficulties in the electricity business, particularly the low wholesale prices in Europe. The growth in the industrial component masks huge differences between individual businesses and varying company sizes, because the expansion stems almost exclusively from the chemicals/pharmaceuticals industry. Without the pharma sector, nominal Swiss exports of goods, which rose 4.7% year-on-year in the first eight months of 2016, would have been negative. In contrast to large companies, smaller industrial firms tend to assess the business climate as worse now than before abolishing the minimum exchange rate.

Aside from the chemical/pharmaceutical business, virtually all other industrial sectors reported lower sales in the first half of 2016 than in the first half of 2015. Although the food industry managed to raise exports thanks to the coffee segment, on the domestic front the sector is still plagued by shopping tourism and pressure from imports following the franc’s appreciation. Moreover, bad weather in the spring season weighed on sector sales. Sentiment among...
mechanical engineering companies brightened considerably even though sales are still lower in year-on-year comparison. The latest economic surveys suggest that order intake in mechanical engineering has risen in recent months, which will eventually work through to higher production and sales in the quarters ahead. The metals industry also seems to have overcome the worst effects of the franc shock. Nonetheless, pressure on prices and from imports remains high. Some metals suppliers are further affected by the difficult times in the watch industry, which is a key customer. Watchmakers are currently facing their worst phase since the financial crisis of 2009: In the year to date, watch exports have plummeted 10.9% compared to the year-earlier period. There are many reasons for the decline in demand, including the economic deceleration in China, competition from smart watches, and fears of terrorist attacks, which reduce global travel.

The construction business is recovering from its interim low in 2015. The construction index, which is based on data from the members of the Swiss Contractors' Association and published planning applications, climbed to a new record in the third quarter of 2016, predicting acceleration in the main construction trade (civil engineering and building construction). The finishing business, however, is lagging behind. The revival in building construction is largely a result of the negative-interest-rate environment and the related lack of decent investment opportunities. After a measure of easing in retailing early in the year, sales dropped off again in June and July, mainly due to weather factors. In the automotive trade, sales volumes continued the trend in recent months back to normal levels. Thanks to the stabilization in the EUR/CHF exchange rate, price erosion was minimized on new and used cars and spare parts. In hotels and catering, the adverse effect of the strong franc is gradually diminishing. Overnight stays by guests from the euro zone fell further in the May–July period compared to a year earlier, although the rate of decline was milder than that in 2015. However, the sector is hard hit by the decline in the number of Chinese guests.

The outlook for the rest of the year and next year remains cautiously positive. We expect the Swiss economy to grow at a similar rate in 2017 as in 2016 (GDP forecast 2017: 1.5%). Aside from exports, we do not expect acceleration in any of the GDP components. The forecast further reduction in immigration is likely to limit growth in consumption and demand for housing. Consumer confidence will probably remain subdued, but given the stabilizing employment market, should not erode further. Shopping tourism looks set to stay at a high level, but without increasing further, which explains our forecast of a slight recovery in retailing in 2017. The situation in the export business should continue to ease as the EUR/CHF exchange rate has stabilized, and the MEM industry in particular is positioned to benefit. Moreover, the global economy should provide some moderately positive demand stimulus.
2016 and 2017 forecasts for selected sectors of the Swiss economy
September 2016

<table>
<thead>
<tr>
<th>Production</th>
<th>Prices</th>
<th>Sales</th>
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<tbody>
<tr>
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<tr>
<td>Textiles and clothing</td>
<td>➠</td>
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<td>Paper</td>
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<td>Plastics</td>
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<td>Metals industry</td>
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<td>Mechanical engineering</td>
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<td>Electrical engineering</td>
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<td>Construction</td>
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<td>Automotive trade</td>
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<td>Wholesaling</td>
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<td>Retailing</td>
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<td>Hotels and catering</td>
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<td>Healthcare</td>
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Source: Credit Suisse

Explanation of symbols: ➔ > +5%; ➠ between +2% and +5%; ➔ between –2% and +2%; ➠ between –2% and –5%; ➠ < –5% year-on-year

**Origins of the cycle chart**

We use the cycle chart to determine the position of the various sectors in their own business cycles on the basis of the latest data and our own assessments. Since we only consider the relative positions of the sectors in their own cycle, a higher position for one sector as compared to another does not necessarily mean that the first sector is also showing higher growth. In textbook cases, sectors follow the cycles from left to right. However, the sectors often move through the cycles erratically due to exogenous shocks. The pace can also vary. Sectors in the dark blue and dark red groups exhibit relatively strong cyclical behavior. Sectors in the light and dark blue groups exhibit comparatively higher structural growth.
Chemicals and pharmaceuticals

Pharma flying high, chemicals return to growth

Of all the industries, the chemicals/pharmaceuticals sector reported the best performance by far over the last few months. High year-on-year increases in production, amounting to 10.4% in chemicals (including petroleum processors) and 8.6% in pharmaceuticals in the second quarter of 2016, suggest that demand is strong. Prices in both segments remained virtually unchanged. Due to severe price erosion in 2015, prices in the third quarter of 2016 were down 2.1% in chemicals and 3.7% in pharmaceuticals, well below the previous year’s figure. Producer prices were relatively stable and demand was solid in the pharma industry, resulting in sales growth of 3.6% year-on-year for the second quarter of 2016, while sales in the chemicals segment were 1.4% lower than in the previous year’s period. The sales trend for this sector, which is strongly linked with foreign markets, is also reflected in nominal exports of goods: Exports of chemical products are 5.0% higher year-to-date (January–August 2016) than in the year-earlier period. Exports of pharmaceutical products were particularly dynamic with growth of 16.4%. The highest increase was reported by exports to the USA (+28.5%). The upturn in the euro zone is expected to persist next year, and this will benefit the Swiss chemical industry since the region is a key sales market for its products. The pharma industry, less exposed to economic fluctuations, should benefit from structurally strong demand in Europe and, especially, the USA to continue driving robust growth.

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<thead>
<tr>
<th>Chemicals</th>
<th>Pharmaceuticals</th>
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<tr>
<td>2016</td>
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<tr>
<td>Production</td>
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<td>Sales</td>
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Mechanical engineering

Sales still trending south, but outlook is cautiously positive

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<th>2016</th>
<th>2017</th>
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<tr>
<td>Sales</td>
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<td>Production</td>
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Sales in mechanical engineering were lower in the second quarter of 2016 than in the same period of 2015. The decline of 4.0% year-on-year was worse than that of the preceding quarter (revised figure for the first quarter: –1.8% year-on-year). This is similarly reflected in the degree of production capacity utilization, which fell 2.6 percentage points to 85.3% from one quarter to the next. In the year to date (January–August), the sector’s overall exports have been 2.8% lower than a year earlier. Of the major segments, only manufacturers of food processing machinery and paper and printing machinery reported higher exports than in the previous year. Nonetheless, sentiment in the Swiss mechanical engineering sector has brightened considerably since 2015. A survey conducted by KOF in early August found that 77% of the responding companies considered their current business “satisfactory”, 14% “good”, and only 8% “bad”. In fact, the latest economic surveys suggest that order intake has risen in recent months, which will eventually work through to higher production and sales in the quarters ahead. For the full year 2016, however, we expect sales to be lower due to declines over the year to date. Next year’s outlook for the sector is cautiously positive. The course of business will depend heavily on economic developments abroad. The global environment is currently delivering moderately positive stimulus. Accordingly, we expect mechanical engineering sales to rise only slightly in 2017.

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Export growth only gradual so far

Exports in CHF million; year-on-year change in %

Employment slowly stabilizing

Employment in full-time equivalents, year-on-year change in %

Source: Swiss Federal Statistical Office, Credit Suisse
Source: Swiss Federal Customs Administration, Credit Suisse
Source: Swiss Federal Customs Administration, Credit Suisse
Source: Swiss Federal Statistical Office, Credit Suisse

2016 exports still negative in many segments

Exports in CHF, 12-month average, index: January 2012 = 100

Source: Swiss Federal Customs Administration, Credit Suisse

Sales in the first half 3% lower than a year earlier

Year-on-year change in %; 4-quarter average, index: 4Q 2010 = 100

Source: Swiss Federal Statistical Office, Credit Suisse

No. of employees
Metals industry

Despite deceleration in sales decline, many firms still struggling

While the metals industry appears to have overcome the worst effects of the franc shock, it would be premature to call this a broad-based recovery. The decline in sales slowed significantly again in the second quarter of 2016, without, however, reaching the previous year’s level (–1.1% year-on-year). After a low phase that was virtually unbroken for months, producer prices rose slightly in the spring of 2016 before subsiding again in the summer months. This primarily reflects the development of global market prices for industrial metals, which have recovered somewhat this year since their collapse in 2015, triggering an increase in producer prices last spring, particularly in the steel industry. In most other segments, though, prices have been moving sideways or even continuing to decline since the beginning of the year. The ongoing strength of the Swiss franc means persistent pressure on prices and from imports in the sector.

Recent KOF surveys reveal that sentiment in the Swiss metals industry has improved only slightly over the last few months. The companies that view their business situation as “bad” (37% in August) still significantly outnumber those who feel it is “good” (12%). The corresponding KOF indicator suggests that many companies have seen weak order intake in the year to date. We therefore expect sales in the metals industry to continue to decline for the full year 2016. The outlook for 2017 remains mixed, and will be shaped by developments in the key domestic customer segments. The revival in the construction industry and the expected recovery in mechanical engineering would stimulate demand. The outlook for the watch industry remains gloomy.

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Sales erosion slowed in Q2 2016
Year-on-year change in %; 4-quarter average, index: 4Q 2010 = 100

Source: Swiss Federal Statistical Office, Credit Suisse

Rise in producer prices during the summer at a halt
Year-on-year change in %; index: December 2015 = 100

Source: Swiss Federal Statistical Office, Credit Suisse

Company sentiment still depressed
Assessment of current business situation

Source: KOF Swiss Economic Institute at ETH Zurich, Credit Suisse

Relatively flat export momentum so far this year
Exports in CHF million; year-on-year change in %

Source: Swiss Federal Customs Administration, Credit Suisse
Food industry

Sales stuck in a slump

Several factors resulted in the food industry again producing (–2.7%) and selling (–2.5%) less in the second quarter of 2016 than in the year-earlier period. The sector faces huge and ongoing challenges through shopping tourism and heightened pressure from imports after last year’s appreciation of the franc. Prices for imported groceries were still some 4% cheaper than they were at the end of 2014. In the first half of 2016, imports of baked goods, cheese and vegetables into Switzerland reached record-high volumes. However, part of the sales decline in the second quarter also had to do with Easter falling early in the calendar; compared to 2015, companies had already reported more of their Easter sales in the first quarter.

On top of that came the bad weather in May and June, which also weighed on sales. After a dynamic first half, exports also tapered off in the summer. Between June and August, food and beverage sales fell by 1.4% year-on-year, with the sharpest decrease reported in soft drinks.

The outlook for the coming months is mixed. On the one hand, the KOF surveys show that more companies expect business conditions to improve than to worsen in the months ahead. On the other hand, pressure from imports and the level of shopping tourism are likely to remain high. Consequently, we expect overall sales for full-year 2016 to be stagnant or even slightly lower. The trend should be similar in 2017, or at most slightly positive, since we do not foresee any fundamental changes in the macroeconomic situation.

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Sales fell in Q2 2016 for the fifth consecutive quarter

Prices continue to rise

Export momentum cools off in summer

Soft drinks pull sector exports into the red
Watch industry

The carnage continues

The Swiss watch industry is currently in its most difficult phase since the financial crisis of 2009. Sentiment among watchmakers, as measured by the KOF business confidence indicator, fell in August 2016 to its lowest point in six and a half years: 39% of respondents consider their current business situation “bad” and 61% “satisfactory”. Production capacity utilization averaged just 85.2% in the second quarter of 2016, the lowest figure since the end of 2009. The collapse in demand is visible in exports, which contracted further in recent months (June–August: –11.6% year-on-year, adjusted for number of working days). In the meantime, watch exports have fallen back to the 2011 level. Exports plummeted across the board: Between June and August they were lower than the previous year’s period in 12 of the 15 largest export markets, most severely in Hong Kong (–29.1% year-on-year), Saudi Arabia (–23.1%) and France (–23.0%). Moreover, while all categories are affected, the low to mid-price segment (factory price < CHF 500) and luxury segment (factory price > CHF 3000) were hardest hit. Many areas, particularly Asia, still report surplus watch inventories, while end-customer demand is waning. Demand is drying up for many reasons, including economic slowing in China, competition from smart watches, and events with a negative impact on global travel (such as fear of terror attacks or stricter visa requirements for Chinese visitors to Europe). Since many of these uncertainties will continue to exist, the pressure on the Swiss watch industry is unlikely to abate for the time being. We also expect sector sales to be lower in 2017 than in 2016.

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Construction

A big boost for the main construction trade

The construction index climbed to a record 144 points in the third quarter, suggesting a considerable increase in momentum in the main construction trade. We expect sector sales in 2016 to be higher than in 2015, in both civil engineering and building construction. However, in the finishing industry, which employs around two-thirds of the workers in the construction business, there are only early signs of brightening business conditions. While we expect third-quarter sales to be 3.5% higher (seasonally adjusted) than the previous quarter, the high level achieved in the third quarter of 2015 is probably out of reach. The revival in building can be mainly attributed to the negative interest-rate policy. While this policy tends to have a dampening effect on demand for apartments and offices, it increases the appeal of real estate as an asset class. A good 18 months after the unexpected interest-rate move by the Swiss National Bank, many building projects are currently being realized that were planned or advanced due to the effects of negative interest rates. With planning applications stable at a high level, there is little likelihood that the trend will reverse any time soon. The number of building projects currently in planning is above the average in the regions between Lake Geneva and Lake Neuchâtel, in Northeast Switzerland, and in Cantons Lucerne and Ticino. We expect building activity to continue at a similarly high level in 2017. Nonetheless, the medium-term risk of a bumpy landing for the building construction segment has increased. This could be triggered by further declines in immigration, another financial crisis or a rapid rise in interest rates.

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<table>
<thead>
<tr>
<th>Sales 2016</th>
<th>Sales 2017</th>
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Tailwind for the main construction trade

Construction index: quarterly values and moving 4-quarter average, 1996 indices = 100

Residential construction driven by negative interest rates

Yield spread between 10-year government bonds and dividend yield for real estate funds (left scale), planning applications in number of housing units (right scale)

Brisk project planning activity in Western Switzerland

Building construction, deviation in the volume of planning applications submitted in last 6 months from 10-year average, by economic region

Source: Swiss Contractors’ Association, Credit Suisse

Source: Baublatt, Datastream, Credit Suisse

Source: Baublatt, Credit Suisse, Geostat
Retailing and automotive trade

A sobering summer for retailing, but the automotive trade is moving closer to normal

The situation for retailing eased somewhat in the spring of 2016, but problems resurfaced in the summer. Bad weather in June and temperatures that were cooler in July than a year earlier impacted sales, especially in DIY, leisure, apparel, and food/near food. Only the home electronics segment reported higher sales in these two months, and this was probably boosted by the European soccer championship and related special offers. On balance, sales in food/near food stagnated at the previous year’s level (January–July 2016: –0.1%), while those in non-food fell by 2.8% (full-year 2015: –3.2%) and in apparel by 7.7%. We expect the situation to ease slightly in the coming months. One positive contributing factor should be the stabilization in shopping tourism (albeit at a high level). And we expect the slight easing to continue into 2017. Consumer confidence should not deteriorate any further given the apparent stability of the labor market.

In the automotive trade, sales volumes continued to trend back towards normal. On balance, 4.7% fewer motor vehicles were sold between January and July 2016 than in the near-record previous year. The price declines on new and used vehicles and spare parts also flattened off considerably. A key reason for this is the stable trend in the EUR/CHF exchange rate. The normalization in the auto industry should stay on track in the coming months. We expect 2017 sales to move in a sideways pattern compared to the previous year.

Source: GfK, Swiss Federal Statistical Office, Credit Suisse; *adjusted for number of calendar days

<table>
<thead>
<tr>
<th>Retailing: Bad weather in June erodes sales</th>
<th>Automotive trade: sales approaching normal levels</th>
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<tbody>
<tr>
<td>Quarterly values, year-on-year change in %</td>
<td>Road vehicles (including trailers): Year-on-year change in %; 12-month total</td>
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<tr>
<td>Retail prices</td>
<td>New registrations: year-on-year change</td>
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<tr>
<td>Nominal retail sales*</td>
<td>New registrations: 12-month total (right axis)</td>
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<td>Real retail sales*</td>
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<td>Q1 2013</td>
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<td>07/2013</td>
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<td>Q1 2015</td>
<td>07/2016</td>
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Source: Swiss Federal Statistical Office, Credit Suisse

<table>
<thead>
<tr>
<th>Apparel sales still in free-fall</th>
<th>Prices in the service business stagnant in July</th>
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<tbody>
<tr>
<td>Nominal sales*: Quarterly values, year-on-year change in %</td>
<td>Consumer prices: Year-on-year change in %</td>
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<tr>
<td>Total</td>
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<tr>
<td>Food/Near food</td>
<td>Used vehicles</td>
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<tr>
<td>Clothing, footwear</td>
<td>Replacement parts/accessories</td>
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<tr>
<td>Personal care and health</td>
<td>Maintenance/repairs</td>
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<td>Home electronics</td>
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<tr>
<td>Q1 2013</td>
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<td>Q1 2016</td>
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</table>

Source: GfK, Credit Suisse; *adjusted for number of calendar days

Source: Swiss Federal Statistical Office, Credit Suisse
Hotels and catering

Recovery ahead in 2017

Various special factors are causing the Swiss hotels and catering segment to lag behind the recovery in the economy as a whole. Chinese guests, who accounted for a 36.9% year-on-year increase in overnight stays in 2015, were far fewer between May and July 2016 (–20.2% overnight stays) due to a slowing home economy, complicated visa procedures and terror attacks in Europe. The strong franc continued to discourage guests from key European countries, with 1.5% fewer overnight stays in the same period – but the trend has decelerated sharply (full-year 2015: –10.1%). The strongest force for growth was tourists from the USA (+5.7%, January–July 2016), while Swiss guests had a merely stabilizing effect on hotel revenues (+0.1%). In July, the first month after the Brexit decision, British guests spent 3.3% fewer overnight stays in Swiss hotels than in July 2015, but since most of those bookings were made before the referendum, the number of overnight stays cannot be directly linked to the result. Nonetheless, we think that the decision is likely to at least slow the previously solid growth in overnight stays recently reported (UK: +3.3%, January–June 2016 year-on-year).

In light of an ongoing decrease in the number of guests from Asia, and a gradual decline in room prices (–2.1% year-on-year, August 2016), we expect the sector as a whole to report lower sales compared to a year earlier. The recovery should work through to the hotel and catering business in 2017. We expect the effect of the strong franc to gradually diminish; as it does, visitor numbers from the euro zone and room prices should slowly return to normal. Swiss tourists should maintain their stabilizing role in 2017. It remains to be seen how Chinese tourists’ travel will unfold next year.

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Overnight stays still falling in early summer

Overnight stays in hotels and spa resorts

Source: Swiss Federal Statistical Office, Credit Suisse

Many Swiss vacationed in Ticino in early summer

Overnight stays and bed occupancy rate by tourist region

Source: Swiss Federal Statistical Office, Credit Suisse

Strong growth stimulus from UAE

Overnight stays by country of origin, average for May–July 2016

Source: Swiss Federal Statistical Office, Credit Suisse

Gastronomy: sentiment eroding further

Change in sales and % of catering businesses with a good business situation

Source: KOF Swiss Economic Institute at ETH Zurich, Credit Suisse
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