



Storm threatens Swiss safe haven

Switzerland's reputation as a safe haven during financial and economic storms is facing a challenge due to the global financial crisis. More than a year after the meltdown in subprime lending triggered a crunch in worldwide credit markets, the real economy is starting to feel the effects. And Switzerland is not immune.

By Tom Armitage | At the top of Zurich's posh Bahnhofstrasse shopping district, close to the main train station, is a UBS bank branch. Its windows display the current stock prices of Switzerland's blue chip companies, plus prices of stock market indices from around the world. For many years, those walking past would generally have seen these numbers appearing in green – showing that stocks were posting healthy gains. But for the past year, most of these numbers have been red as global stock market losses mount.

What began as a crisis of confidence in the credit markets has slowly started to take its toll on the broader economy. Property prices have fallen sharply in the United States, the UK and certain European countries like Spain.

Companies such as the United States' 'big three' Detroit carmakers (Chrysler, Ford and GM) have sought funding from the U.S. government, while high-street names in the UK such as retail chain Woolworths and furniture store MFI have already fallen victim to the econom-

ic slowdown. So far, Switzerland has managed to remain relatively unscathed. Economists increasingly agree, however, that the Alpine nation won't be left untouched for long.

Root causes

With all the headlines about the financial crisis it is sometimes hard to fathom exactly where the issue is. Under normal circumstances, banks loan cash to one another on a short-term basis through the interbank markets, charging a small rate



The strong Swiss franc makes Swiss exports more expensive.

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of interest for the privilege. However, the collapse in the value of subprime assets caused a crisis of confidence within the banking industry, staunching the flow of such credit and leading to a freeze in interbank lending.

Without banks lending to one another, the banking system grinds to a halt. Some banks failed – 25 in the United States alone from January 2008 through October 2008, according to the Federal Deposit Insurance Corporation (FDIC) – while others began cutting back on the money they loan to companies for investments or to individuals for items such as mortgages and student loans.

The consequences of such measures are rippling through the entire economy, leading to a decline in demand for houses, a collapse in consumer confidence and, ultimately, to rising unemployment.

While some countries have been hit worse than others, Switzerland is clearly starting to feel the pain too.

Fast reactions

Since the beginning of the financial crisis, trillions of dollars have been lost on stock

exchanges around the world. Bankers, politicians and businessmen have been calling the current situation the worst financial markets crisis since the 1930s. The major difference between now and then is the way in which national institutions in the United States, Great Britain and Europe have reacted.

Governments have won plaudits from economists for injecting capital into banks through emergency loans, and buying stakes in others at rock-bottom prices. Central banks around the world have attempted to ease the pressure on businesses and consumers by slashing interest rates to low levels, thus reducing the burden on borrowers and removing the incentive for savers.

Switzerland is no exception: the Swiss National Bank (SNB) has been extraordinarily aggressive in cutting interest rates as worries mount over the economic outlook for 2009. After several years of above-trend growth, Switzerland is heading for a recession, the likes of which has not been seen for at least 15 years. Unemployment could rise to as much as four per cent next year, as a result.

Sharp downturn

“The global economic environment has sharply deteriorated over the past few months,” said the SNB in a mid-December statement. “Economic activity has declined in both the U.S. and Europe, and has slowed considerably in Asia.”

BAK Basel Economics, an economics research group, predicts that in 2009, United States and European economies will contract by as much as two per cent. Switzerland is expected to see a decline in gross domestic product of 0.7 per cent next year, according to BAK. This would be the sharpest downturn since 1991.

On the positive side, the sharp downturn in the Swiss economy and the steady decline in the price of oil also mean that inflation will decline substantially next year, said the SNB. This gave the central bank more room to manoeuvre on interest rates, allowing it to reduce the basic rate of interest by 50 basis points in December, for a target rate of 0.5 per cent. The reduction comes on top of 200 basis points in cuts between October and December 2008. Prior to the first cut in October, the target rate was three per cent.



Deteriorating consumer confidence now ... inflation on the horizon?

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BAK says the decline in oil prices and the cuts in interest rates might help to coax shoppers back to the high streets in 2009. Their researchers believe that the Swiss economy will start to trend higher in the second half of the year, in line with other global economies.

Companies, too

As far as Swiss companies go, it is not just those in the highly publicised banking sector that could cause the economy trouble in 2009. Exports of capital goods will also be affected as customers in countries outside of Switzerland scale back their plans for investment into such non-consumer equipment – especially those in the automobile and construction industries. Not only does this apply to the United States and Europe but also to emerging markets like China and India, which in recent years have shown an insatiable appetite for such goods, but are now also suffering from the crisis.

“The worsening outlook for sales will lead to an adjustment of investment plans in Switzerland as well,” said the Swiss central bank.

“All these factors have brought about a sharp deterioration in business confidence, which should put a damper on job creation in our country,” the central bank added.

However, the SNB noted that the historically low interest rates now available to potential borrowers could stimulate the housing sector, which has been in decline in recent years.

Swiss franc fluctuations

As well as being highly dependent on the demand from customers outside of Switzerland for its products and services, the Alpine nation also has to contend with the vagaries of its own currency.

In times of economic uncertainty, the Swiss franc is traditionally seen as a safe haven currency – a place where foreign investors may park their cash and be reassured of its security thanks to the gold reserves held by the Swiss National Bank.

In the wake of the most recent spasm in financial markets, the value of the Swiss franc has shot higher. This makes Swiss-produced goods even more expen-

sive for buyers abroad, thus reducing the attraction of importing Switzerland’s products. By slashing interest rates, the Swiss central bank hopes to make it less attractive to hold Swiss francs, since investors can in theory get a better return on their money elsewhere.

Next hurdles to clear

Those with foresight are already looking beyond the current financial crisis, and warning that another problem might be looming around the corner – inflation.

The Swiss central bank is tasked with trying to keep inflation below two per cent. However, the drop in prices and the need to stimulate the economy means target interest rates worldwide have been pared to the bone, leaving little more to shave. These low rates could lead to a problem in the future, namely that prices will start to rise.

Thus, after the current crisis is over, inflation could be the next problem to face consumers. What is certain is that 2009 will be a tough year for workers, consumers and central bankers – and Switzerland will not be immune.