DOI: 10.1007/s10272-012-0411-1

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The Impact of the Euro Crisis on Switzerland

The euro area crisis is the main external factor threatening the Swiss economy. In 2010 and 2011, the Swiss franc was rapidly appreciating against the euro, causing a drop in exports, losses for the tourism business and a rise in unemployment. This paper gives an overview of developments in the euro area and explains the reasons for the strength of the franc, the effects it had on the economy and the measures taken to curtail its appreciation.

Although Switzerland is a member of neither the European Monetary Union nor the European Union, the euro crisis is finding its way into this country. In the summer of 2011, the euro and Swiss franc were briefly at parity for the first time since the European single currency had been introduced. The rise of the Swiss franc against the crisis-ridden euro was only stopped by the introduction of a minimum exchange rate of 1.20 francs to the euro by the Swiss National Bank (SNB). This means, however, that the Swiss franc is still overvalued. The strength of the Swiss franc has meanwhile affected not only the balance sheet of the SNB but also the Swiss economy. The consequences are revenue losses in the tourist industry, a drop in exports, a weak economy and job losses.

In the following, the impact of the euro crisis on the Swiss economy is examined in detail. An overview of the situation in the euro countries is given, three possible scenarios for managing the crisis are discussed, the development of the euro-Swiss franc exchange rate is presented and influencing factors are analysed. The measures taken by the Swiss National Bank and the Swiss Federal Council to curtail the strength of the Swiss franc are explained. Based on this, the impact of the strong Swiss franc on the global economy is analysed.

The Future of the Euro – Crisis Indicators Signal Danger

The future of the euro seems less certain than ever. The crisis in the peripheral countries of the eurozone – Greece, Portugal and Ireland – has persisted for almost two years. In addition, the focus has now shifted to the larger economies of Italy and Spain, and their interest rates have risen significantly. The markets do not foresee an end to this crisis, which is reflected in the high rates of return on the government bonds of the crisis-stricken countries.

Greece, Portugal and Ireland, as well as Italy and Spain to a lesser extent, are among the group of unstable eurozone countries. The financial markets consider investments in these countries to be significantly riskier than in Germany, for example. This is why their interest rates for ten-year government bonds have increased significantly in recent months (see Figure 1). In January 2012, ten-year government bond yields were over 25% for Greece, 13% for Portugal, 7% for Ireland, 6% for Italy, and 5% for Spain. Germany, France, the Netherlands, Finland and Austria are among the stable eurozone countries. They are able to procure capital in the financial markets at relatively low interest rates. For example, in January 2012, Germany paid less than two per cent interest on ten-year government bonds. France and Austria paid around three per cent.[1]

The markets are now almost as uncertain as they were during the financial crisis of 2008. To prevent a credit crunch, the European Central Bank (ECB) released the record sum of EUR 489bn in three-year loans to the eurozone's commercial banks in December 2011. The average life of ECB loans thus increased from a mere ten weeks to 21 months.[2] Nevertheless, in January 2012, the funds of the ECB's deposit facility reached an all-time high of over EUR 500bn, despite a very low interest rate of 0.25%.[3] When banks cease to trade liquid assets in the overnight market, this is a clear sign of their in-

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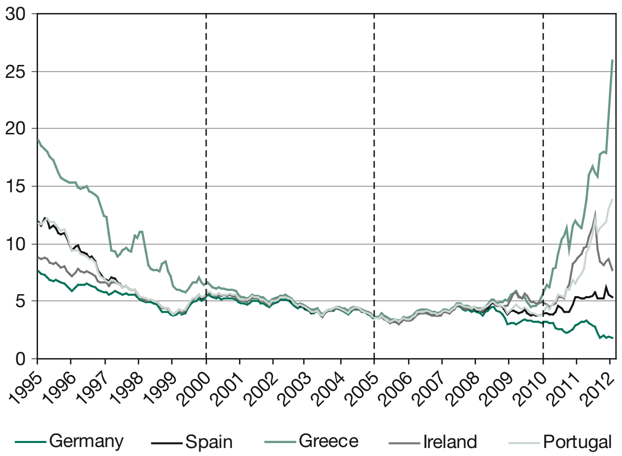
1 See http://www.ecb.int/stats/money/long/html/index.en.html.
2 See The Economist, 31 December 2011, http://www.economist.com/node/21542187.
3 See ECB: Monthly Bulletin – Euro Area Statistics Online, January 2012.

Figure 1
Long-term Government Bond Yields (10 Years' Maturity)
in per cent



Source: European Central Bank.

creasing distrust of each other. The price of gold, which reached an all-time high of USD 1,921 in September 2011, can serve as another crisis indicator. Jean-Claude Trichet, who was president of the ECB from November 2003 to October 2011, described the current crisis as "the worst global crisis since World War II"[4].

The main cause of the crisis is high national debt. The four eurozone countries with the highest national debt are Greece (163% of GDP), Italy (121%), Ireland (108%) and Portugal (102%). Of the five most troubled countries, only Spain, at 70%, has a national debt that is significantly lower than both the average national debt of eurozone countries (88%) as well as that of Germany (82%).[5]

The weak euro states know that other countries will support them in case of an emergency in order to prevent a domino effect. In the absence of any kind of sanctions, this creates an incentive to incur excessive debt (moral hazard). The concept of "moral hazard" originates from insurance theory and describes the added incentive to engage in risky behaviour once an insurance policy has been purchased.[6] In the context of the banking sector, this means that banks tend to make riskier investments, knowing that they will receive government bailouts in case of an emergency. The American economist Hyman Minsky once said: "If a bank is too big to fail, it is too big."[7] In these times of increasingly interconnected financial institutions with a high risk of contagion, the IMF has termed this "too connected to fail"[8].

To prevent such domino effects, the current rescue mechanism, the European Financial Stability Facility, is to be succeeded by the permanent relief fund European Stability Mechanism (ESM) in mid-2012, rather than in mid-2013 as originally planned. The total capital will be EUR 700bn. Of this, EUR 80bn will be in the form of paid-in capital and EUR 620bn in the form of callable capital from the euro states.[9] The contribution of each country is determined by the share of its national central bank in the ECB's capital, which is calculated using a key that equally reflects each country's share of the total population and gross domestic product of the EU. The ECB updates the contributions every five years and each time a new country joins the EU. If all 27 EU member states were taken into account, Germany would contribute 18.9% of ECB capital. Since only 17 euro states will be contributing to the ESM, the German share will be 27.1%. Decisions on ESM aid programmes will no longer require unanimity by the eurogroup. Such decisions will be taken by a qualified majority of 85% of votes by share of ECB capital in case the ECB and the European Commission conclude that a failure to make an urgent decision regarding financial assistance would put the economic and financial sustainability of the eurozone at risk. This gives each of the three largest eurozone economies, Germany (27.1%), France (20.4%) and Italy (17.9%), veto power in decisions regarding the use of ESM funds.[10]

In 2010 and 2011, the heads of state or government of the eurozone held 14 emergency summits to try to calm the markets. The 13th euro summit in Brussels in late October 2011 marked the first time that a debt conversion (nominal discount of 50% on notional Greek debt held by private investors) and the creation of a European fiscal union (constant economic surveillance of supported states) were agreed upon.

The introduction of national debt brakes modelled on the German debt limit, which will become effective in 2016, was decided at the 14th euro summit in early De-

4 Jean-Claude Trichet, President of the ECB, Interview with Die Welt, Friday, 7 October 2011, http://www.ecb.int/press/key/date/2011/html/sp111011.en.html.
5 Values in per cent of respective GDP, estimate for 2011, source: Eurostat.
6 See E. Feess: Mikroökonomie: eine spieltheoretische und anwendungsorientierte Einführung, Marburg 1997, p. 765.
7 G. Braunberger: Keynes für jedermann: Die Renaissance des Krisenökonomen, Frankfurt am Main 2009, p. 229.
8 IMF Working Paper: Regulatory Capital Charges for Too-Connected-to-Fail Institutions: A Practical Proposal, April 2010.
9 See ECB: Monthly Bulletin, July 2011, p. 75.
10 See Annex 1 of the Treaty establishing the European Stability Mechanism, http://www.european-council.europa.eu/media/582311/05-tesm2.en12.pdf.

cember 2011. These debt brakes specify that the annual structural, i.e. cyclically adjusted, budget deficit may not exceed 0.5% of the GDP of each state. This rule is less strict than the German debt brake, which specifies a limit of 0.35% of GDP.[11] The European Commission is tasked with monitoring compliance and is given greater enforcement privileges. The European Court of Justice will verify compliance with debt brake rules. In an intergovernmental treaty, all EU states, with the exception of the United Kingdom and the Czech Republic, agreed on automatic sanctions against states in violation of debt limits, which only a decision by a qualified majority of the Council of Minsters may prevent. This is a reversal of the previous practice in which offenders judged offenders. The Stability and Growth Pact was proposed by Germany, yet curiously in 2002 it was the two largest euro countries, Germany and France, that were the first to be found in breach of it, and it was upon their initiative that the rules were significantly relaxed.[12] The credibility of 14 euro summits in 22 months is especially problematic. This means that new resolutions were drafted every seven weeks.[13]

Possible Ways of Solving the Sovereign Debt Crisis

The following possible scenarios for solving the sovereign debt crisis are discussed below: debt restructuring, withdrawal from the eurozone and creation of a European fiscal union.

Debt Restructuring

Debt restructuring involves a debt cut, which forces creditors to write off some of their claims. Since there is no insolvency law for states like there is for companies and private individuals, insolvency in such a case requires a high level of cooperation by all parties involved. The immediate advantage for the country restructuring its debt is that the debt burden is reduced in one fell swoop. In this case, the agreed debt cut of 50% for private creditors is meant to reduce the national debt of Greece from the current 163% to 120% of the GDP by 2020. The main problem, however, is that the creditors of this national debt (mainly banks and institutional investors) will have to write down their claims. Numerous European banks require government support in order to prevent bank failure and thus systemic risks. The cost of these support measures largely depends on market reaction. If debt restructuring is seen as a one-time exception, the cost will be much lower than if it is regarded as a precedent for further cases of national debt restructuring. In December 2011, the heads of state or government of the eurozone countries decided to preclude the future involvement of private creditors due to inevitable market distortions.

Withdrawal from the Eurozone

There is a view that weak crisis-ridden countries should withdraw from the eurozone. The direct result for withdrawing states would be a massive devaluation of the new currency by up to 70%, which would initially increase a country's ability to compete internationally. Seen on its own, this constitutes an advantage for exporting companies of the withdrawn country. It would, however, also lead to a massive flight of capital to states with a stable currency, which could cause a collapse of the national banking system. Salaries and pensions could not be paid, and the food supply would be jeopardised; potential consequences include everything from social unrest to a threat to democracy. Withdrawal from the eurozone is thus neither a desirable nor a realistic alternative.[14]

Withdrawal is also not to be recommended for stronger states. It would lead to a massive upward revaluation of the new currency, causing a drop in export earnings and an increase in unemployment. Switzerland, for example, struggled with an extreme revaluation of the Swiss franc because Switzerland is generally seen as a stronghold of stability in times of crisis. The exchange rate of the Swiss franc rose from CHF 1.50 to the euro in January 2010 to near parity with the euro in August 2011.[15] Reintroduction of the German mark or the creation of any kind of "northern euro" would most likely lead to revaluation pressure at least as high as that on the Swiss franc, especially as the market would be much larger than Switzerland, meaning greater liquidity and thus higher demand. Furthermore, Germany would be in a much

11 See K.H. Hausner, S. Simon: Die neue Schuldenregel in Deutschland und die Schuldenbremse der Schweiz – Wege zu nachhaltigen öffentlichen Finanzen?, in: Wirtschaftsdienst – Zeitschrift für Wirtschaftspolitik, Vol. 89, No. 4, 2009, pp. 265-271.

12 See K.H. Hausner: Der neue Stabilitäts- und Wachstumspakt und die deutsche Staatsverschuldung, in: Wirtschaftsdienst – Zeitschrift für Wirtschaftspolitik, Vol. 85, No. 4, 2005, pp. 238-243 and Fiscal Federalism in Austria and Germany and the European Stability and Growth Pact, in: Public Finance/Finances Publiques, Vol. 54 (1999/2006), pp. 211-230.

13 The first emergency euro summit took place on 11 February 2010; the most recent one on 9 December 2011.

14 See S. Dullien, D. Schwarzer: Gefährliches Spiel mit dem Euro-Ausstieg, in: SWP-Aktuell, No. 54, November 2011.

15 A more detailed discussion about Switzerland follows below.

worse position than Switzerland because it would not have the opportunity to peg its currency to those of its most important trading partners.[16]

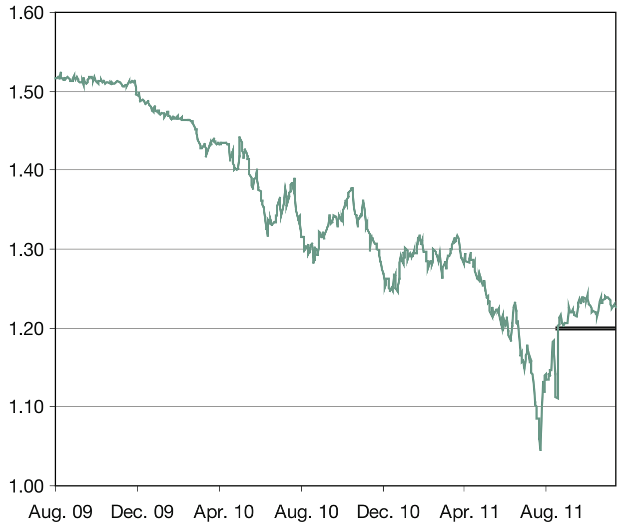
European Fiscal Union

In the 1990s, before the introduction of the euro, the German Bundesbank supported the “coronation theory”, which held that a common currency should only be the crowning achievement of a political union.[17] It is obvious that a unified monetary policy is only sustainable if it is combined with a coordinated fiscal policy. The economic consequence would be for the member states to relinquish their budgetary autonomy to the European Union. This would, however, mean a significant loss of national sovereignty, as control over public finances is considered one of the last bastions of a sovereign state. The larger member states Germany and France would especially have trouble accepting this step. Udo Di Fabio, a judge at the German Constitutional Court, fittingly referred to budgetary power as the “crown jewel of parliament”.[18]

A paper by former ECB chief economist Jürgen Stark et al. proposes significantly stricter provisions for the Stability and Growth Pact. According to this paper, national budget deficits must be approved by the EU in order to prevent excessive debt. This could entail financial receivership for states with excessive budget deficits, which would severely limit national budget autonomy.[19]

Habermas[20] accurately laments the lack of EU powers for the necessary harmonisation of the national economies, which are drastically drifting apart in terms of their power to compete, and consequently calls for the creation of a political union. This union cannot be achieved marching in lockstep, however, but will most likely increasingly be made up of states moving at different speeds. The concept of a core Europe, consisting of a vanguard of states willing to integrate, for certain policy areas (e.g. euro or Schengen) without exclusion of the other members seems to be the most promising model.[21]

Figure 2
Swiss Franc to Euro Nominal Exchange Rate



Source: European Central Bank.

Thus, the only remaining economically reasonable course of action is to implement the fiscal union much sooner than would have been the case if the crisis had never happened. A political union must be formed to ensure democratic legitimacy. The crisis thus serves as a catalyst for European integration.

Development of the Swiss Franc to Euro Exchange Rate

The European debt crisis has long extended beyond the eurozone. Switzerland, has been especially affected, as its major trading partner is the European Union. Almost 60% of all its merchandise exports in 2010 went to the EU. Switzerland’s most important trading partner is Germany, which purchases 20% of all Swiss merchandise exports.[22] The impact on Switzerland can be seen above all in the development of the exchange rates. During the last two years, the franc increased in value significantly against the euro. On 9 August 2011, the euro reached a record low of CHF 1.0070. Only since 6 September, when the SNB announced its plans to defend the minimum exchange rate of CHF 1.20 by all means, has the exchange rate for the euro levelled off between CHF 1.21 and 1.24 (see Figure 2).

16 See German Council of Economic Experts: Verantwortung für Europa wahrnehmen, Annual Report 2011/12, p. 98.
17 See G. Galahn: Die Deutsche Bundesbank im Prozeß der europäischen Währungsintegration: rechtliche und währungspolitische Fragen aus deutscher Sicht, Berlin, New York 1996, p. 27.
18 See http://www.spiegel.de/spiegel/print/d-80266934.html.
19 See L. Schuknecht, P. Moutot, P. Rother, J. Stark: The Stability and Growth Pact – Crisis and Reform. European Central Bank Occasional Paper Series No 129, September 2011.
20 See J. Habermas: Zur Verfassung Europas, Berlin 2011, p. 40.
21 See W. Weidenfeld: Die Europäische Union, 2. ed., München 2011, pp. 201-207.
22 See Swiss Federal Customs Administration, http://www.bfs.admin.ch/bfs/portal/de/index/themen/06/05/blank/key/handelsbilanz.html.

The drama of currency developments is placed somewhat in perspective when the real exchange rate is taken as a base. But also in real terms, the Swiss franc has strongly increased in value against the euro in recent quarters. In order to decide whether the Swiss franc really is overrated, we must answer the question of what a fair exchange rate is. According to the theory of purchasing power parity, this fair exchange rate would be about 1.35 francs to the euro.[23] It should be taken into consideration, however, that there are large differences in purchasing power throughout the eurozone. A fair exchange rate with Germany would be lower, for example, than an exchange rate with Greece.[24] It is, however, clear that the Swiss franc actually is overvalued at its current rate of just over 1.20 to the euro.

Reasons for the Strength of the Swiss Franc

The economic uncertainty caused by the European debt crisis is surely the main cause of the current strength of the Swiss franc and even more so of the strong appreciation of the franc against the euro in recent quarters. Large budget deficits and high levels of debt in the euro countries led to a major loss of confidence in the financial markets and caused investors to buy Swiss francs. This resulted yet again in the “safe-haven” effect of the Swiss franc in times of crisis[25], i.e. the fundamental facts of the real economy are a less decisive factor for investors than the lack of safe investment alternatives.[26]

The strength of the Swiss franc cannot, however, be explained by the safe-haven effect alone. There are also numerous structural reasons for the long-term appreciation of the Swiss franc against the euro.[27] For one thing, the nominal strength of the Swiss franc will prevail as long as the inflation rate in the EU significantly exceeds that in Switzerland. For another thing, Switzerland traditionally has a strong export sector, which regularly leads to trade balance surpluses and increases the demand for Swiss francs worldwide to pay for Swiss export products. Additionally, Switzerland also features stable, long-term macroeconomic conditions ranging from sound public budgets to moderate taxation. Financial and real-capital investors will continue to be attracted as long as the economic prospects for the eurozone do not stabilise considerably.

Measures to Weaken the Swiss Franc

Since the strength of the Swiss franc is a problem that affects the whole of the economy, it must be tackled not only by the SNB and its monetary instruments but also by the state and its fiscal policy.

The SNB started taking liquidity measures against the overrated Swiss franc on 3 August 2011.[28] It announced that it would lower the target range of three-month Libor to 0.0–0.25% and aim for a three-month Libor close to 0.0%. Furthermore, it announced that it wanted to raise the sight deposits of domestic banks at the SNB from CHF 30bn to CHF 80bn. This limit was continuously extended during the following weeks until sight deposits were ultimately more than CHF 250bn. To provide the Swiss franc financial market with such high liquidity, the SNB used a number of instruments such as foreign exchange swaps and repo agreements.[29] The M3 money supply increased by around CHF 35bn solely in the period from January to August 2011. On 6 September, the SNB set a minimum rate of CHF 1.20 to the euro. In a statement, the SNB said that it was “aiming for a substantial and sustained weakening of the Swiss franc” and that “it will no longer tolerate a EUR/CHF exchange rate below one Swiss franc twenty”. It added: “[The SNB] is prepared to purchase foreign exchange in unlimited quantities. … If the economic outlook and deflationary risks demand it, the SNB will take further measures.”[30] This minimum exchange rate is widely accepted by businessmen, politicians and academics in Switzerland[31], although some regard it as too low.[32] Since then, the SNB has successfully defended its exchange rate target and recently confirmed the exchange rate of 1.20 francs to the euro in its assessment of the monetary situation of December 2011. The SNB “will continue to enforce the minimum exchange rate of CHF 1.20 per euro with the utmost determination. ... Even at the current rate, the Swiss franc is still high and should continue to weaken over time.”[33]

23 See UBS Outlook Schweiz, 4th quarter 2011, p. 11; see also Economiesuisse: Frankenstärke – was tun? Dossierpolitik 9/2011, p. 3.

24 See T. Flury, G. Staunovo: Currency Market. Is the euro fair? Wealth Management Research UBS, 20 July 2010.

25 See J.-P. Danthine: The strong franc and the future of Switzerland’s financial market infrastructure: Two current challenges for the SNB, speech at the Money Market Event in Geneva on 3 Nov. 2011, pp. 9 f.

26 See T. Jordan: Auswirkungen der Staatsverschuldung auf die Unabhängigkeit der Geldpolitik, speech at the 21st International Europe Forum Lucerne on 8 Nov. 2011, p. 9.

27 See Economiesuisse, op. cit., pp. 4 ff.

28 See Swiss National Bank Quarterly Bulletin 3/2011, Volume 29, p. 53.

29 Cf. J.-P. Danthine: Introductory note to the news conference, Bern, 15 Nov. 2011.

30 P. Hildebrand: Short statement with regard to the introduction of a minimum Swiss franc exchange rate against the euro on 6 Sep. 2011, Bern.

31 See Neu Zürcher Zeitung: Viel Lob für SNB-Entscheid, 7 Sep. 2011, p. 27.

32 See Neu Zürcher Zeitung am Sonntag: Seco rechnet mit 40 000 zusätzlichen Arbeitslosen, 6 Nov. 2011, p. 40.

33 Press release: monetary policy assessment of 15 Dec. 2011, p. 1.

In addition to the SNB, the state also responded to the strength of the Swiss franc. Unlike the SNB, the Swiss government cannot directly affect the strength of the franc but can attempt to soften its impact on the national economy. In late summer, the Swiss Federal Council announced a catalogue of support measures for 2011 with a volume of CHF 870 million. More than half of these funds are for unemployment insurance, about CHF 210 million will be used for stimulating knowledge and technology transfers, and another CHF 100 million will benefit the hospitality industry via the Swiss Society for Hotel Credit (Schweizerische Gesellschaft für Hotelkredit).[34] It is, however, widely agreed that fiscal impulses of this kind can only be short-lived and that only permanent improvements to macroeconomic conditions (e.g. reducing bureaucracy) can sustainably strengthen the economic attractiveness of a country and thus compensate for losses caused by the exchange rate.[35]

Impact of the Strong Franc on Switzerland

The strong Swiss franc has affected Switzerland and will continue to be felt in official statistics and corporate balance sheets in the future, since many changes such as dismissals only appear after a delay and a further weakening of the Swiss franc is not expected soon.

Effects on Companies and the National Economy

The export industry is particularly affected by the strong external value of the franc.[36] The negative effects, however, are distributed unevenly. In particular export-oriented companies that do not work in niche markets, do not have a high degree of specialisation or do not purchase goods or services from "cheap" foreign countries are having difficulties, as is the case with the paper industry. Such companies are forced to reduce prices in order to stay competitive in international markets. As a consequence, their profit margins will continue to decrease unless they are able to reduce their costs. If these companies relocate their businesses, lay off workers or reduce the prices they pay for materials and services, the economy as a whole will be directly affected.

What applies to many branches of the export industry applies especially to tourism. One out of three visitors to Switzerland is from the eurozone, and most foreign visitors come not for business but for vacation and recreation. Price increases caused by the currency situation play an important role in decisions made by tourists.[37] Besides the tourism industry, the financial sector is also feeling the negative consequences of the strong Swiss franc.[38] Because of the safe-haven effect, foreign money does indeed go to Switzerland, but a large part of the revenue is generated in foreign currencies, while costs are mainly incurred in Swiss francs.

In comparison, the impact is less strong on companies that produce mainly for the domestic market and export businesses that obtain products from the eurozone and/or work in specialised, niche markets, where price competitiveness is less of an issue. In the meantime, a number of companies have adopted strategies such as extending working hours without pay increases, paying some of their employees – cross-border commuters from adjacent euro countries – in euros or writing invoices to foreign customers in Swiss francs if their market position allows them to do so.[39] What is more, the extraordinary liquidity measures of the SNB in the summer of 2011 considerably reduced short- as well as long-term interest rates.[40] A substantial amount of short-term interest rates were even negative; investors have been willing to accept slight losses in their investments because of their fear that foreign investments could lead to even greater losses. On the whole, the difference in interest rates in comparison to the euro countries increased significantly, and comparatively low-interest loans are now available for Swiss companies, which may also lessen the impact of the strong Swiss franc.

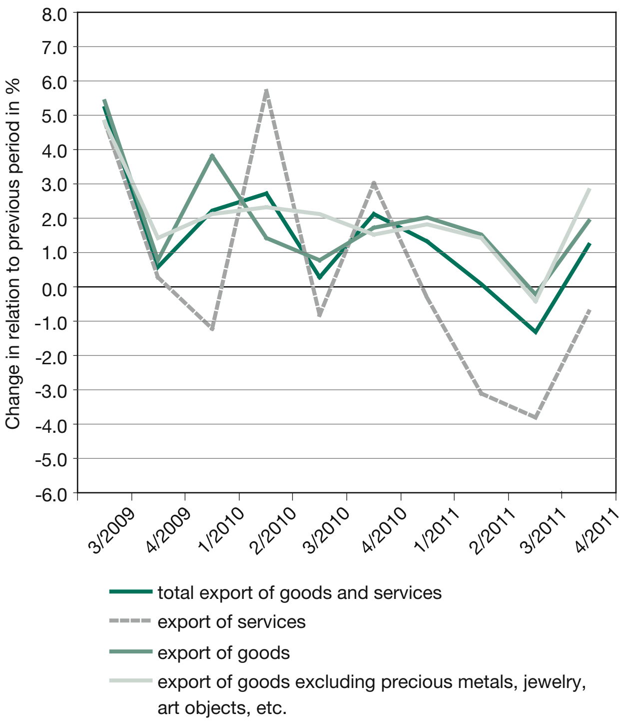
In a survey of 164 Swiss companies, 58% of the surveyed companies stated that they were affected by the revaluation of the Swiss franc. Companies in the chemical, pharmaceutical, metal, mechanical engineering and textile and clothing industries as well as manufacturers of electronic products and precision instruments experienced the strongest negative effects of the revaluation.[41] These effects can now be seen in official statistics.

The Swiss economy slowed down considerably in the third quarter of 2011, when the real gross domestic product only increased by 0.2%. Positive economic growth

34 For more details, see http://www.seco.admin.ch/aktuell/00277/01164/01980/index.html?lang=de&msg-id=40867.
35 See Economiesuisse, op. cit., p. 12.
36 See ibid., pp. 6 ff.

37 See E. Kreilkamp: Produkt- und Preispolitik, in: G. Haedrich, C. Kasper, K. Klemm, E. Kreilkamp (eds): Tourismusmanagement, 3rd ed., Berlin 1998, pp. 325-357.
38 See Economiesuisse, op. cit., p. 9.
39 See F. Gilgen: Diesen Firmen kann der starke Franken nichts anhaben, Neu Zürcher Zeitung of 9 Oct. 2011, p. 43.
40 See J.-P. Danthine: Introductory note ..., op. cit.
41 See SNB: Quartalsheft 2/2011, Bern, p. 40.

Figure 3
Export Development[1]



[1] Seasonally adjusted quarterly figures, at prices of the previous year.

Source: State Secretariat for Economic Affairs (SECO).

was created by private and public consumption and by new construction, whereas exports (-1.2%) as well as plant and equipment spending (-2.3%) decreased for the first time.[42] While tourism exports have been shrinking for a year now, declines in the remaining service exports as well as the exports of goods followed later and are not as bad as feared (see Figure 3).[43] However, the decline in exports would likely have been worse if measures had not been taken by the SNB.[44] In addition, the minimum exchange rate has unquestionably given companies more reliability for planning. There has thus been a considerable minimisation of risks in contrast to the situation before 6 September 2011, when the euro was in free fall against the Swiss franc.

The strength of the Swiss franc has started to have an impact on the job market as well. According to seasonally adjusted figures, unemployment rose slightly for the first time in two years.[45] Economists expect unemployment to further increase during the coming year as a result of the strong Swiss franc.

Consequently, economic research institutes revised down the growth forecast for the GDP for 2012. While the State Secretariat for Economic Affairs (SECO) still expects GDP growth of 0.5% compared with the previous year, the Swiss Economic Institute (KOF) of the Swiss Federal Institute of Technology in Zurich (ETH) only expects GDP growth of 0.2%.

Effects on Consumers

Swiss consumers have unqualified benefits from the strong Swiss franc as long as they spend their holidays in eurozone countries. Those who live near the border have also been taking advantage of the exchange rate. Shopping tourism in the eurozone is booming. To what extent consumers of domestic goods and services are noticing savings depends on whether reduced prices are passed on to them or not. In 2007, the SNB first looked into the question of whether exchange rate fluctuations were reflected in import prices and consumer pricing.[46] SECO's analysis of the present situation shows that a revaluation of the Swiss franc results in a reduction in import prices after about four quarterly periods with a probability of 40%.[47] Depending on the category of goods, however, savings are not always sufficiently passed on. Over the course of one year, price differences between Switzerland and Germany increased by 15 percentage points, which just about equals the change in the exchange rate. Surprisingly, this increase also occurred in goods with a high percentage of imported products, which suggests that reductions in import price will not be felt by consumers.[48] This finding adds weight to the discussion in Switzerland about it being an "island of high prices"[49]. "The strong Swiss franc has merely accentuated a structural problem."[50]

Implications for the Swiss National Bank

The impact of the strong Swiss franc and the consequences of the resulting monetary measures are particularly clear in the SNB balance sheet.

42 See SECO: Konjunkturtendenzen Winter 2011/2012, Bern, p. 13.
43 See SECO: Press Release, 1 March 2012.
44 See Neue Zürcher Zeitung: Starke Wachstumsverlangsamung in der Schweiz, 2 Dec. 2011, p. 27.
45 See SECO. op. cit., p. 22.

46 See Stulz: Exchange Rate Pass-Through in Switzerland: Evidence from Vector Autoregressions, SNB Economic Studies, No. 4, 2007.
47 See SECO: Weitergabe von Einkaufsvorteilen aufgrund der Frankenstärke. Working Paper, Bern 2011.
48 See P. Balastèr: Weitergabe von Einkaufsvorteilen aufgrund der Frankenstärke, in: Die Volkswirtschaft. Das Magazin für Wirtschaftspolitik; No. 11, 2011, pp. 56-60.
49 G. Buchwalder: Überhöhte Preise: Kampf gegen Windmühlen?, in: Die Volkswirtschaft. Das Magazin für Wirtschaftspolitik, No. 11, 2011, p. 65.
50 Ibid.

At the end of the first half of 2011, the SNB showed a loss of CHF 10.8bn. This was caused mainly by losses on foreign currency positions of some CHF 10bn, which were a consequence of exchange rate-induced valuation losses.[51] The SNB subsequently experienced a massive loss of equity, which caused some anxiety and led Thomas J. Jordan, vice chairman of the SNB, to make a statement in which he stressed the SNB's capacity to act even at negative equity levels:

> … the SNB cannot be compared with commercial banks or other private enterprises. For one thing, a central bank cannot become illiquid. This means that a central bank's capacity to act is not constrained if its equity turns temporarily negative. Moreover, unlike other enterprises, it is not forced to implement recovery measures or go into administration. For another, central banks enjoy a funding advantage … owing to their banknote-issuing privilege, and, in the long term, they are able to rebuild their equity after suffering losses.[52]

The SNB, however, was able to turn this loss into a consolidated profit of CHF 5.8bn in the third quarter of 2011 as a result of the combination of a weakening of the Swiss franc due to the minimum exchange rate and the high price of gold. In addition, the SNB had only had relatively small expenditures for measures to defend its exchange rate goal.

> The introduction of a minimum exchange rate has not had serious consequences, because the majority of market participants are of the opinion that the chosen minimum rate is clearly below an equilibrium exchange rate and because the SNB can afford to defend it as no serious inflationary threats are expected.[53]

In addition, the market response to the minimum exchange rate is also clear proof of the trustworthiness of the SNB. And yet this positive result cannot hide the fact that the euro crisis is far from over and that the unconventional monetary policy of the SNB resulted in a bloated balance sheet total, which leads to higher volatility. While the balance sheet total was just under CHF 270bn at the end of 2010, it reached its highest level at just over CHF 381bn in September 2011. It is hardly surprising that foreign exchange reserves increased by about CHF 100bn to CHF 305bn during this period[54], which was mainly a consequence of the foreign currency measures (e.g. foreign exchange swaps) carried out before the introduction of the minimum exchange rate. At almost CHF 155bn, the majority of these investments were in euros. On average, the investments in euros were around 51% in previous years.[55] By November 2011, the currency holdings of the SNB were again reduced to CHF 262bn. The SNB has already drawn conclusions from currency-induced uncertainty and has reduced the annual distribution of profits to the federal and canton governments from CHF 2.5bn per year to CHF 1bn.

Conclusion

The euro crisis is having an impact on the Swiss economy. Export-oriented industries are particularly affected because the strong Swiss franc has reduced their ability to compete in terms of price. The domestic economy has also felt the effects of the strong Swiss franc, for example, as a result of the strategies adopted by export businesses. The strong Swiss franc has therefore become a challenge for the economy as a whole. The SNB initially reacted by carrying out measures to increase liquidity and eventually introduced a minimum exchange rate of 1.20 francs to the euro. The SNB has managed to defend this minimum rate with relatively little effort because, from the perspective of market participants, it is clearly below the equilibrium rate. This, however, explains why the situation will remain difficult for a large part of the economy. In addition, global demand is decreasing as the global economy slows down. According to the SNB inflation forecast, there are no noticeable inflationary risks for Switzerland in spite of its expansionary monetary policy[56], which means that in this regard it will be able to maintain the minimum exchange rate. The euro crisis is, however, not over for Switzerland. Seldom have the well-being of the Swiss economy in general and the success of Swiss monetary policy in particular been this dependent on the euro. "If the eurozone manages to solve its problems, the safe-haven effect will lose its importance and the Swiss franc … will become weaker. If there are, on the other hand, major problems ahead, the minimum exchange rate will become truly expensive."[57]

51 See SNB: Zwischenbericht der Schweizerischen Nationalbank, 30 June 2011, Zurich, www.snb.ch.

52 T.J. Jordan: Does the Swiss National Bank need equity? Remarks at the Statistisch-VolkswirtschaftlicheGesellschaft Basel on 28 Sep. 2011, p. 2.

53 P.A. Fischer: Nationalbank-Erfolge mit wenig Schatten, in: NZZ of 1 Nov. 2011, p. 21.

54 See balance sheet items of the SNB of 31 Oct. 2011.

55 See SNB: Bilanzpositionen der SNB per Ende November 2011, Bern, p. 13.

56 See SNB: Einleitende Bemerkung zur geldpolitischen Lagebeurteilung, 15 Dec. 2011, Bern, p. 4.

57 P.A. Fischer: Nationalbank-Erfolge ..., op. cit.