Jean-Pierre Roth: Switzerland - a platform for global business

Keynote address by Mr Jean-Pierre Roth, Chairman of the Governing Board of the Swiss National Bank and Chairman of the Board of Directors of the Bank for International Settlements, at the Consulate General of Switzerland / Swiss-American Chamber of Commerce, New York, 1 June 2006.

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It is a great pleasure for me to be with you today and I would like to thank my dear friend, Ambassador Loretan, for hosting this lunch of the Swiss-American Chamber of Commerce.

Swiss people always feel at home, here, in this fascinating city. New York is a unique place, not only because of its size, its beautiful skyline, its location, but foremost because of its openness to the world and its multiculturalism. Compared to New York, is Switzerland anything more than just a small village located in the heart of Europe, a country of watchmakers and chocolate producers? Is there anything to see other than the Matterhorn and the water fountain on Lake Geneva?

It is interesting to note that, despite the strong presence of Swiss multinationals abroad and, of course, the very well-known Swiss flag – thanks to the Red Cross flag – Switzerland is largely ignored in international surveys and is almost non-existent in European statistics.

“To live happily, live out of sight!” (pour vivre heureux vivons cachés) is a well-known proverb. This may well be true, but it serves to fuel many clichés; and misconceptions are generally counterproductive.

Let me show you the hidden side of Switzerland. You will see that modern Switzerland is adjusting rapidly to the changing reality of the world economy. Let's consider a few facts:

- With 7.5 million people, Switzerland is indeed a small country. Although we have no natural resources, we have a highly developed economy and a GDP per capita that clearly exceeds the European average. Contrary to the situation among some of our neighbours, our population is still growing, thanks to immigration. Our foreign population now represents about 20% of the total population and 25% of the labour force. Despite strong immigration, our unemployment rate – 3.5% – is relatively low.
- Switzerland remains a slow-growing country when compared to the United States. Our weak growth performance is due in part to the full employment, the relatively high level of personal income and the limited scope for domestic investment. However, in recent years, the Swiss economy has been doing better than its neighbouring countries in terms of growth and employment, and also in terms of price stability. Obviously, the fact that we are not a member of the European Union is not an obstacle to our development.
- Switzerland is increasingly becoming a service-producing country. The flagship of our service industry is the financial sector, which expanded markedly in the 90s and now accounts for 15% of our GDP – more than the machine tool industry and the chemical industry together. The number of banks, however, was reduced by half during that period and the number of bank employees remained stable despite expanding financial activities. These figures show that our financial industry has been eager to react swiftly to the challenges posed by globalisation.
- Switzerland has a solid balance of payments position. Thanks to a large excess of savings over domestic investment, our current account surplus is constant and substantial. Contrary to popular belief, my country is not an importer of capital, but a net capital exporter. Our current account surplus represents 14% of our GDP, a level which can only be compared to that of some Asian countries. In recent years, our surplus in absolute terms was even larger than the surplus of the euro zone as a whole.
- Switzerland is well-known for its stable monetary framework. Average inflation over the last 20 years amounted to 1.8%. We never went through monetary reforms as many European countries did in the past few decades. In fact, we still use the coins put into circulation in 1850, when the Swiss franc was created. There is no better proof of monetary stability.
- Switzerland enjoys the lowest interest rate level in Europe. This situation has nothing to do with the appeal of our bank secrecy, as many believe, but with the abundance of savings

and the high degree of price stability. Since the introduction of the euro in 1999, the average interest rate on three-month euro deposits has been 3%, while the three-month Swiss franc rate has been 1.4%. If we assume a difference of about 1% in the expected level of inflation between the euro area and Switzerland, the Swiss real interest rate advantage accounts for 60 basis points.

- Switzerland is also a firm believer in flexible exchange rates. Our monetary regime has been unchanged since 1973, when the peg to the US dollar was removed. Today, the Swiss franc is freely determined by market forces. Our last foreign exchange intervention dates back to 1995 – and that was a coordinated action in favour of the US dollar!
- And what about the European issue? As you know, we are not a member of the European Union; nor do I foresee Switzerland joining the EU in the near future. The Swiss people remain sceptical about the efficiency of the Union and are very aware of what they stand to lose in terms of political rights and economic freedom in the event of integration. But our relationship with the EU is of key importance, since Europe accounts for two-thirds of our foreign trade. In order to secure our access to the European market and to avoid discrimination, we concluded two packages of bilateral agreements with the Union – in 2002 and 2004. The present situation – with free movement of goods, capital and labour, but without monetary and fiscal integration – is probably the best solution for us.
- Since we are so well integrated, why don't we peg the franc to the euro instead of pursuing an independent monetary policy? Wouldn't this help eliminate the exchange rate risk, without giving up monetary flexibility entirely?
- There is no such thing as a free lunch in monetary affairs! It is not at all certain that a peg would engender the foreign exchange stability that exporters dream of. We have learned from our experience with flexible exchange rates that any explicit foreign exchange target stimulates the appetite of speculators instead of calming the atmosphere. And this would be especially true if our pegging decision were to be taken unilaterally, without the prospect of a full and permanent integration into the euro area. Today, with global markets and global speculation, it would be an illusion to believe that a central bank can defend a specific exchange rate target unless there is strong convergence of economic fundamentals with the economy whose currency it is pegging the domestic currency to.

  Furthermore, a nominal peg against the euro would do little to stabilise the real value of the Swiss franc – the only thing that matters for the international competitiveness of the Swiss economy – or to stabilise the franc vis-à-vis third currencies, especially the US dollar.

  Last but not least, if Switzerland were to give up its monetary independence by pegging the franc to the euro or by joining the euro area, it would lose its privileged status and, consequently, Swiss interest rates would increase to European levels. Since higher interest rates mean lower asset prices and lower levels of investment, and also higher mortgage rates, the Swiss are understandably not keen on giving up their national currency. Since any major decision in Switzerland has to be approved in a public referendum, the prospect of EU and euro membership in the near future is thus highly unlikely.

  Given our exposure to global economic and financial shocks, and their arguably smaller importance for the euro area, pegging the Swiss franc to the euro is not a realistic option. Flexible exchange rates give us the room for manoeuvre we need.
- What has our experience been of coexistence with the euro so far? Very positive. Rather than crowding out independent currencies, the euro has stabilised the monetary scene in Europe. In fact, the franc is less volatile today than it was before European monetary integration. The price of the euro in Swiss francs these days is about 3% lower than it was in 1999, in other words, almost unchanged. We did have periods, however, when the franc was under pressure, especially after September 11 and before the outbreak of the war in Iraq. The safe-haven function of the franc then triggered a 10% appreciation in our currency against the euro. As a consequence, we had to conduct a more aggressive interest rate policy than the ECB in order to lower the attractiveness of our currency and give some leeway to our economy. Things have normalised since then and we have already lifted interest rates on four occasions in the last two years. As you can see, we conduct our monetary policy independently of the ECB.

I'm sure you will agree, that Switzerland is most definitely not an isolated island, as many still believe. It is clearly an open economy which has chosen to take up the challenges of the world economy. Large Swiss firms invest more money and create more jobs abroad than at home. Switzerland has become a major investor not only in Europe, but also here in the United States, as well as in Asia. Today, there are 4.2 million jobs in Switzerland and we count 1.8 million people working in Swiss firms abroad. Apart from Singapore and Hong Kong, there is no other country where foreign investments play that kind of leverage role.

Actually, Switzerland is not an alpine fortress, but a home base for globally active industries…

…in keeping with the long-standing tradition of watchmakers and chocolate producers!