

Masaaki Shirakawa: Reviewing the economies of Switzerland and Japan

Remarks by Mr Masaaki Shirakawa, Governor of the Bank of Japan, at the 30th Anniversary Luncheon of the Swiss Chamber of Commerce and Industry in Japan (SCCIJ), Tokyo, 10 October 2012.

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Before I begin, I would like to thank Chairman Thomas Jordan for his detailed and informative presentation on the state of the Swiss economy and the issues faced by the Swiss National Bank. I believe that everybody in this room would agree that we have learned a great deal. In the next five minutes, instead of commenting directly on what Thomas has just explained, let me offer you some thoughts that come to my mind when I look at the Swiss and Japanese economies.

Switzerland and Japan are very different. Switzerland is land-locked. It is in effect an island in the sea of the European Union, where about 60 percent of its exports are headed and 80 percent of its imports derive (Chart 1). Japan is far more populous. The Japanese economy is about nine times as large as the Swiss economy. Nevertheless, there are similarities. For example, both countries enjoy, or even suffer from, very stable prices. The average annual inflation, measured by headline CPI, over the twenty years from 1992 to 2011 was 1.1 percent in Switzerland and 0.1 percent in Japan (Chart 2). In August this year, the year-on-year change was -0.5 percent in Switzerland and -0.4 percent in Japan. Consequently, interest rates are also low (Chart 3). In recent weeks, the yield on ten-year government bonds has been hovering around 0.5 percent in Switzerland, slightly below Japan's 0.7 to 0.8 percent range. Both currencies, as Thomas has explained, are at historically elevated levels.

In this regard, the news media and the public are usually focused on a specific traded exchange rate between currencies, such as the Swiss franc to the euro or the yen to the U.S. dollar. These rates are important, but there are additional indicators for exchange rates.

In order to understand what would happen in an economy when exchange rates fluctuate, exchange rates for all the trading partners must first be taken into account. From this viewpoint, we must look at the nominal effective exchange rate, which is a trade-weighted index of exchange rates. In the case of Switzerland and Japan, compared with January 2000, the nominal effective exchange rates in August 2012 were 41.4 percent and 17.4 percent higher, respectively (Chart 4).

Secondly, we also need to consider the fact that higher inflation will erode competitiveness. In other words, further information could be derived from the real exchange rate, which is the nominal rate adjusted for inflation. When a higher nominal exchange rate is offset by lower inflation, the real exchange rate stays at the same level. Actual calculation of these rates is admittedly difficult because of issues involved with comparing inflation between economies, but the rates fluctuate considerably over the long term. For example, between January 2000 and August 2012, the real effective exchange rates for Switzerland appreciated by 12.5 percent, whereas Japan's depreciated by 19.3 percent (Chart 5).

More recently, between December 2007 and August 2011, the real effective exchange rates for Switzerland and Japan moved in tandem with each other, appreciating by 16.9 percent and 23.3 percent, respectively. These movements of the last few years are to an extent representative of the fallouts from the Great Financial Crisis. The prevalent mood of risk aversion resulted in the unwinding of carry trades. Both countries are now also confronted by the so-called flight-to-safety capital flows. The appreciation of the two currencies coincided with the most severe financial and economic dislocations in the advanced economies.

With regard to interventions in the foreign exchange market, in Switzerland, the Swiss National Bank has the power to intervene. In Japan, the government – not the central bank –

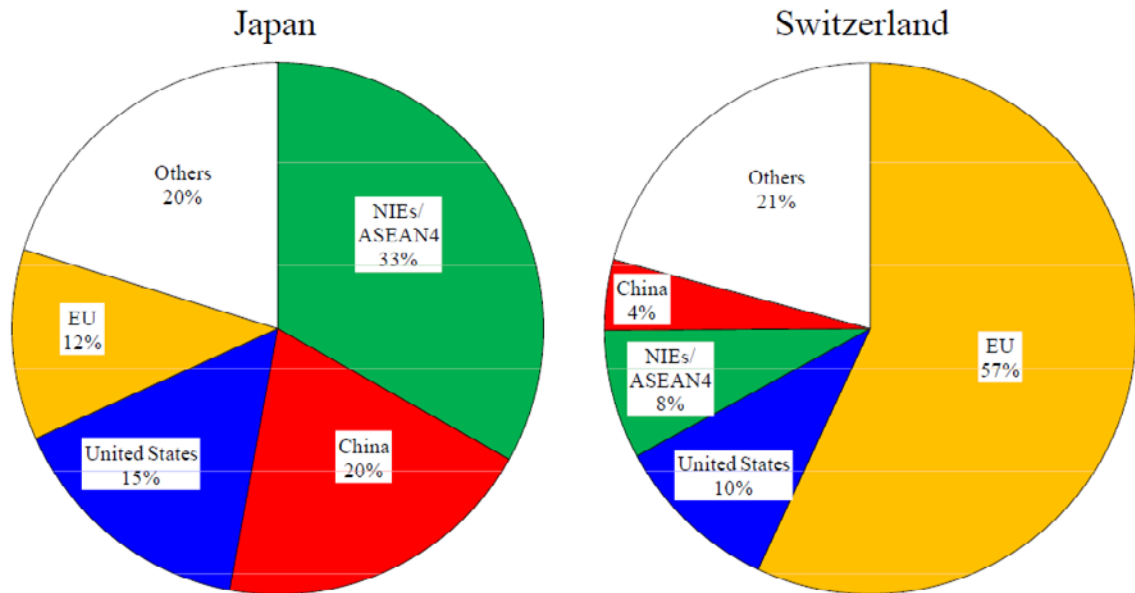
is mandated by law to direct such interventions. The Bank of Japan is conscious of the effects that the rapid appreciation of the yen could have on Japan's economy and inflation outlook in terms of the conduct of the Bank's monetary policy. Concern over these effects of exchange rate developments has been one of the factors that influenced the Bank's series of decisions to further ease its monetary policy.

While both Switzerland and Japan suffer from strong exchange rates, I am also struck by the dynamism of the Swiss economy. The U.S. dollar value of exports in Switzerland increased by 192 percent between 2000 and 2011, a threefold increase, whereas the comparable figure for Japan was an increase of 74 percent. Meanwhile, the domestic currency values increased by 53 percent and 28 percent, respectively (Chart 6). Exports by the pharmaceutical, precision machinery, and watches industries have increased considerably. This is particularly remarkable in view of the Swiss franc's significant appreciation during the period, which was more than the yen's, and such large shocks as the Great Financial Crisis and the more recent turmoil in the euro area.

All in all, one often underappreciated benefit of globalization is the enhanced opportunity to learn from each other's similarities and differences. Today, Thomas has provided us with a valuable insight into Switzerland, and I hope that he can take something home from this visit to Japan. Let me now conclude by thanking him once again for his superb presentation. Thank you, Thomas.

Chart 1

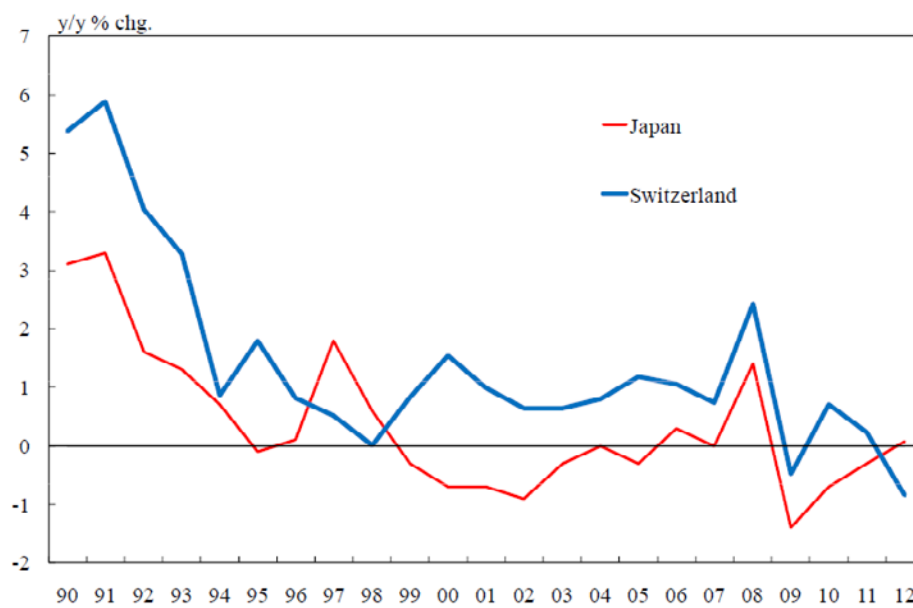
Share of Exports by Destination



Note: Figures are for 2011. The NIEs consist of Korea, Taiwan, Hong Kong, and Singapore. ASEAN4 refers to Thailand, Indonesia, Malaysia, and the Philippines. Sources: Swiss National Bank; Ministry of Finance; IMF.

Chart 2

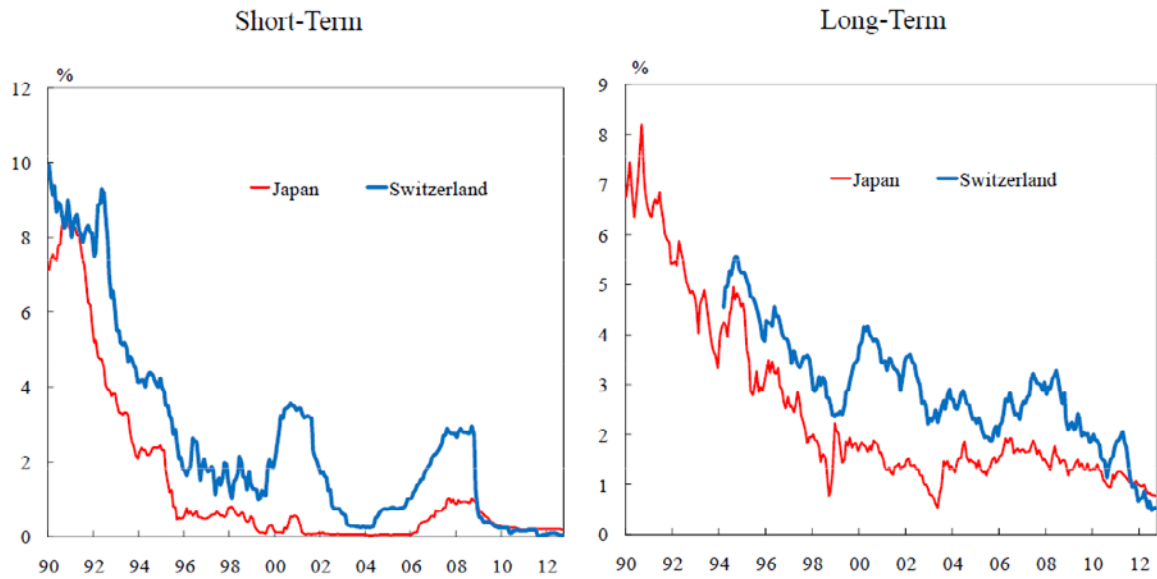
Consumer Price Inflation Rates (Headline)



Sources: Ministry of Internal Affairs and Communications; IMF.

Chart 3

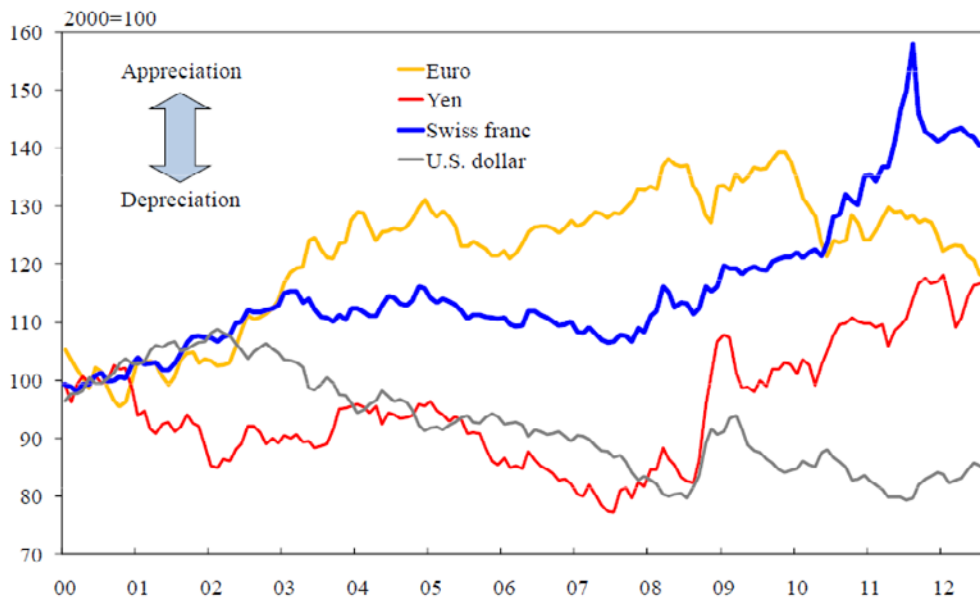
Interest Rates



Note: Short term interest rates are 3 month yen Libor and 3 month Swiss franc Libor. Long term interest rates are 10 year government bond yields.
Source: Bloomberg.

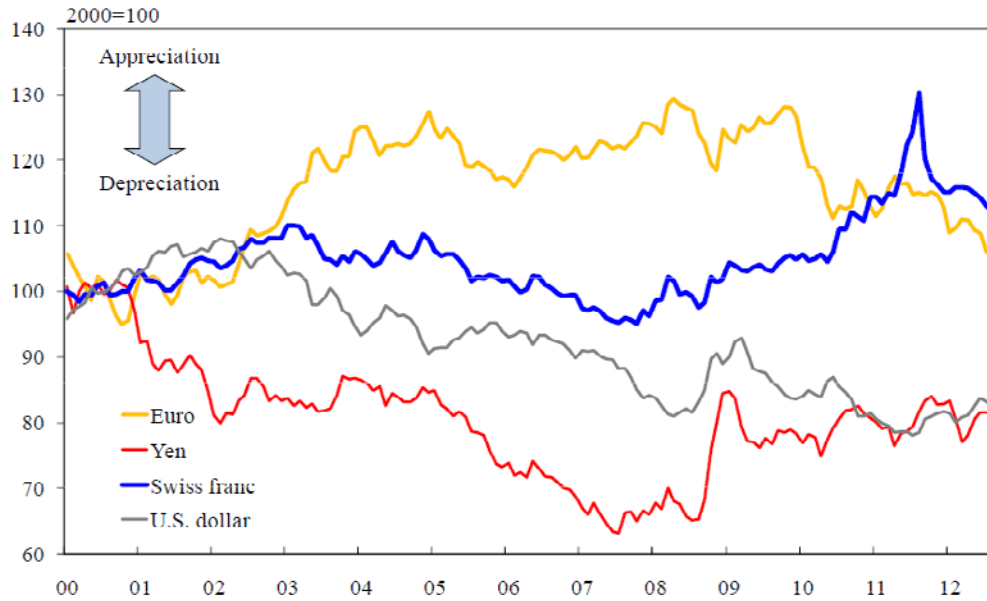
Chart 4

Nominal Effective Exchange Rates



Note: The nominal effective exchange rate is an indicator that measures the overall value of individual currencies. It is derived by calculating the weighted average of each currency's exchange rate against other currencies using the annual value of each country's trade with its counterparties as its weights.
Source: BIS.

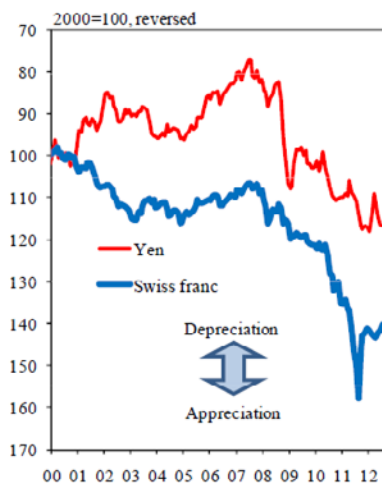
Real Effective Exchange Rates



Note: The real effective exchange rate is an indicator of a country's overall international competitiveness, calculated as follows. First, each of the exchange rates of the country's currency against other currencies (i.e., nominal exchange rates) is deflated by the price indices of those countries to calculate the real exchange rate. Then, the weighted average of the real exchange rates is calculated using the annual value of the country's trade with its counterparties as its weights.
Source: BIS.

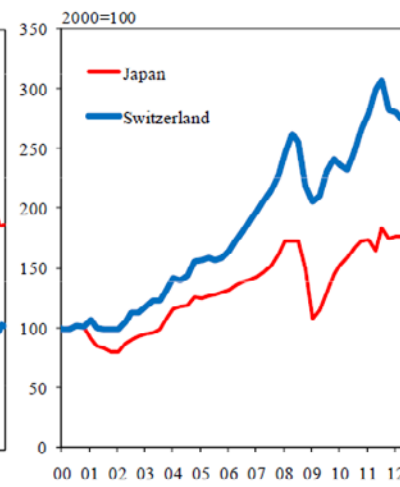
Exchange Rates and Exports of Switzerland and Japan

Nominal Effective Exchange Rate

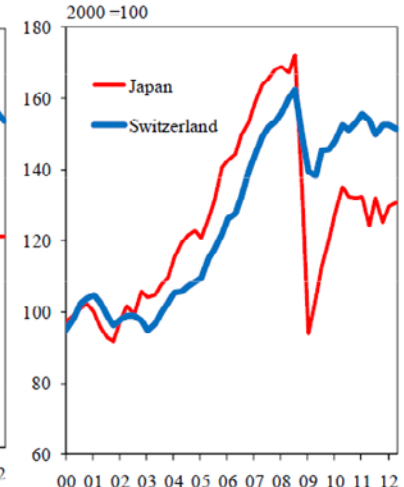


Value of Exports

U.S. Dollar Basis



Domestic Currency Basis



Sources: Cabinet Office; Eurostat; Bloomberg; BIS.