Zeitschrift: Swiss review : the magazine for the Swiss abroad
Band: 42 (2015)
Heft: 3

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DOI: https://doi.org/10.5169/seals-907104

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The abandonment of the exchange rate cap reveals fears of a loss of control

Economists believe the Swiss National Bank's decision to abandon its policy of pegging the Swiss franc to the euro was swayed by a fear of losing control over the currency. A look at how the rising Swiss franc threatens the national economy.

STÉPHANE HERZOG

On 15 January, the Swiss National Bank announced the end of the exchange rate cap that set a floor of CHF 1.20 to the euro. The value of the Swiss franc, a safe-haven currency in Europe, immediately soared, reaching record levels, with the euro at times worth no more than CHF 0.80. At the same time, the Swiss stock exchange (SMI) recorded a fall of almost 15 % as a direct result of the announcement.

The Swiss franc rate has fallen significantly since then and Swiss shares have regained their value. However, the Swiss currency remains too high due to its attractiveness, increasing by 14 % from January to the end of March. Blaise Matthey, chief executive of the FER (Fédération des Entreprises Romandes) Genève, expects this situation, which is causing Swiss production costs to rise, to lead to a "slowdown in economic activity this year and probably a rise in unemployment". Marcelo Olarreaga and Michel Girardin, professors of economics at the University of Geneva, believe Switzerland will be rocked by the decision.

The reasons

Why has the SNB chosen this moment to unbridle the Swiss franc? And why did it decide to set a rate cap in September 2011? Both professors consider this to have been an "excellent" decision. "The European currency had fallen sharply owing to the debt crisis in the eurozone," points out Marcelo Olarreaga. "Swiss goods were becoming more expensive and people were increasingly attracted to the Swiss currency. There was a risk of recession." Faced with a euro whose value had almost reached parity and under pressure from the business community, the SNB decided to set a rate capped at 1.20.

This independent body, which bears responsibility for the nation's monetary stability, therefore began buying and exchanging Swiss francs at this rate (and not below). "The SNB sold Swiss francs and purchased assets in euros as well as European bonds, which has enabled the country's economic activity to be maintained," sums up Marcelo Olarreaga. However, by printing Swiss francs to buy foreign

currencies – in yen, dollars, roubles etc. – the SNB saw its balance sheet rise to CHF 550 billion, or the equivalent of 80 % of Swiss GDP, thus creating anxiety.

Marcelo Olarreaga believes the abandonment of the minimum rate was influenced by the SNB's fear of losing monetary control. "The fall of the rouble, the civil war in eastern Ukraine and the European Central Bank's announcement of its intention to make huge bond purchases sparked fears of a slump in the euro. In light of this situation, maintaining the Swiss franc at 1.20 would have required the purchase of even more euros to sustain the franc at acceptable levels," he explains. At the same time, the SNB believed that all of these Swiss francs in circulation created a risk of inflation in Switzerland. "The SNB feared losing its independence in a situation where those holding Swiss francs – banks, pension funds and private investors – would decide to sell their francs, producing a downward impact on the Swiss currency," adds Geneva-based economist Olarreaga.

250 billion in the coffers

The two Geneva economists also point out that the SNB transfers a share of its profits to the cantons. The central bank was apprehensive about their reaction should these contributions dry up, suggests Michel Girardin. Knowing that the SNB at that point had almost EUR 250 billion in its coffers – currency purchased in part at between CHF 1.40 and 1.50 – "it decided to cut off its arm before the wound became too severe". In other words, the SNB wanted to avoid further inflating its balance sheet and finding itself with mountains of depreciated euros when it decided to lift the minimum rate.

And the two Geneva economists agree on one further point: the decision was not taken at the right moment. Michel Girardin does not believe the SNB's main argument justifying the timing of its decision holds water. "The SNB said that the Swiss franc was less overvalued at the beginning of January 2015 than in September 2011, when the minimum rate came into force." However, the situation had not changed between these two points in time. The evidence, according to Michel Girardin, is that the real parity of purchasing power be-

tween the two zones had remained stable (at CHF 1.31 to EUR 1.00). The professor's view is that the weakening of the Swiss franc since 2011 is solely due to movements in the dollar exchange rate which has had a positive impact on the section of the Swiss economy exporting goods to the dollar zone.

Marcelo Olarreaga points to the difficulty faced by Latin American countries in sustaining their currency, a policy which involves buying their own money with dollars. "Defending a floor rate is easier than supporting a ceiling. Switzerland did not need dollars to sustain its policy but instead just francs which it prints itself. It could have maintained the minimum rate without major risks, reacting only in the event of a real fall in the euro."

The situation is even worse at the moment, in the view of this expert in development economics, because Switzerland will now have to intervene to a much greater extent on the market to convince people that the franc is not as strong as it seems. "The minimum rate gave an idea of the value of the currency. Furthermore, the SNB had not intervened for months before the end of 2014. Now there is no longer any reference point," he concludes.

The implications of an excessively strong Swiss franc

Increase in export prices, rising relative wages, decline in the competitiveness of Swiss companies and growth in unemployment: these are the ills threatening the Swiss economy. Blaise Matthey, chief executive of the FER Genève, provides two specific examples of the impact of the rise in the Swiss franc. The first concerns a Swiss manufacturing company that asked a foreign supplier – which is paid in Swiss francs – to adjust its prices. "It refused, leaving the Swiss business backed into a corner," sums up the head of the FER Genève. The second example relates to a Swiss company near France which prints books and exports them to the eurozone. "It recently invested in a new production line. But now its export prices are too high. It therefore plans to cross the border to carry out the bulk of its production, just keeping its administrative activities in Switzerland," reveals Blaise Matthey. The advice to companies from the State Secretariat for Economic Affairs (SECO) provokes acerbic laughter. "Companies have already taken action in a number of areas to improve their productivity, innovation and so on," he underlines.

Describing an industrial sector under pressure, he believes that Switzerland's "going it alone" is no longer a tenable option in an economy now faced with major economic blocs, not least Europe and the US. He asks, "What is the value of a Swiss franc which is strangling its economy?".

With the end of the minimum rate, Swiss salaries rose sharply by 15 to 20 %, points out Professor of Economics Marcelo Olarreaga. With a large share of its exports going to Europe, the country is seeing its prices increase, resulting in a fall or at best stabilisation of its GDP. "It's quite simple," he observes, "you can now go skiing in neighbouring France for far less."

"The strong Swiss different approach

A specialist in cutting production times,

STÉPHANE HERZOG

American management professor Suzanne de Treville believes the abandonment of the minimum rate paradoxically represents an opportunity for Swiss companies. "Some business owners have told me they face a desperate situation. But at the same time their willingness to explore new opportunities will be greater, a bit like someone who has suffered a heart attack being more receptive to advice on their diet," explains the researcher and professor at the Faculty of Business and Economics of the University of Lausanne (HEC). It is also a chance to reaffirm their faith in the Swiss economy, which is based on "excellent foundations".

At the end of March, Suzanne de Treville flew to Washington to take part in a conference organised under the aegis of the US Department of Commerce. The relocation of firms was a subject under discussion. The Harvard-educated academic nevertheless believes that this often creates more problems than it resolves, not least because it