Financial Stability and Fiscal Policy in Europe: Switzerland

Daniel Heller
Swiss National Bank

New Orleans, November 2012

«In the past few years, the Swiss have – almost uniquely in the western world – managed to control their national and local debts. That partly reflects their conservative nature, but another crucial issue is that most Swiss cantons… operate with a strong sense of active democracy.»

Gillian Tett, FT, November 10, 2012
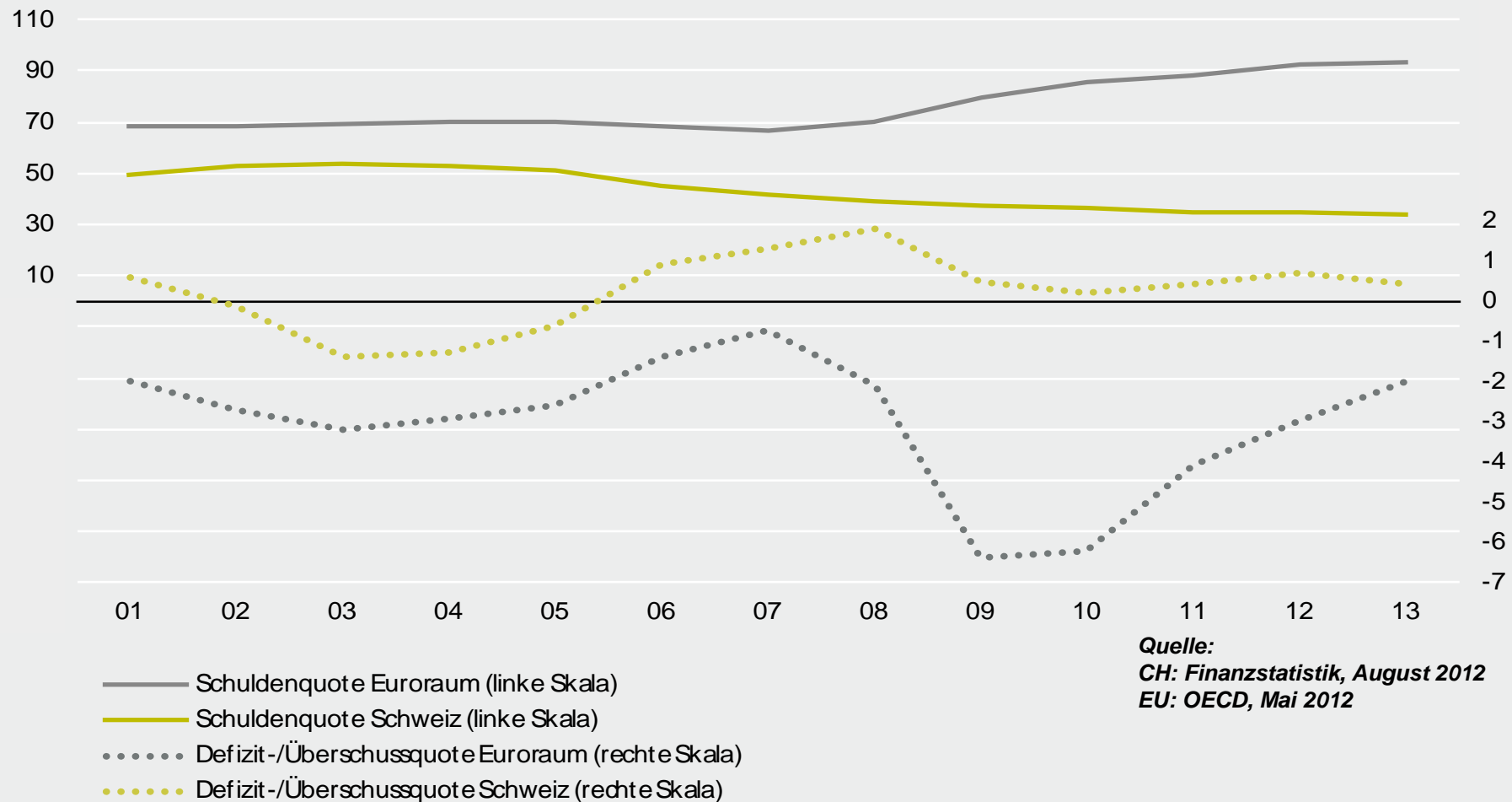
International Comparison: 2007-2012

	Debt/GDP		Nominal Debt
	2007	2012	Change 2007-2012
G7	83%	125%	+65%
Switzerland	56%	47%	-8%

International Comparison (2010)
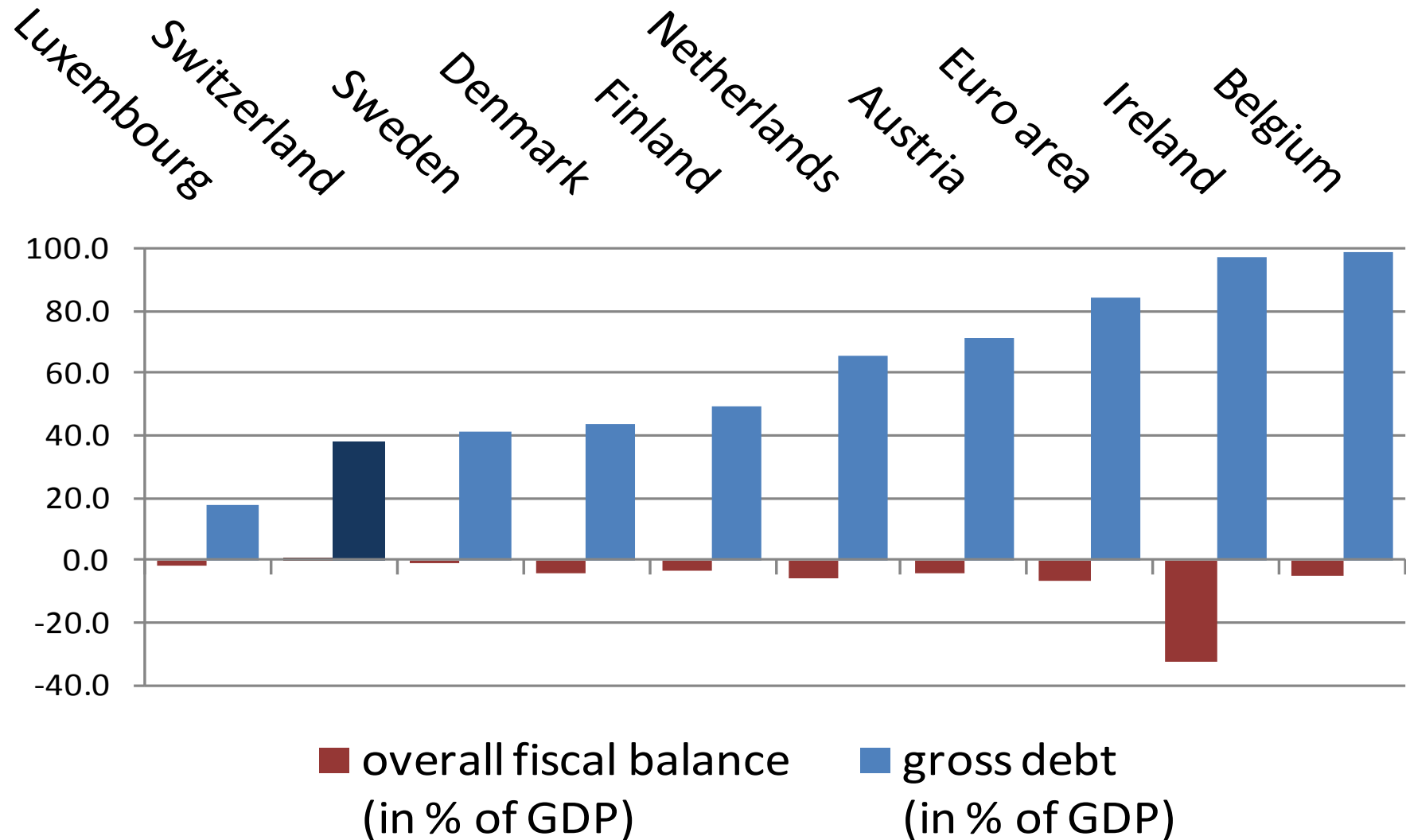
Comparison: Switzerland – Euro Area

Vergleich Defizit-/Überschussquote und Schuldenquote Schweiz und Euroraum
in % BIP

Schuldenquote Euroraum (linke Skala)
Schuldenquote Schweiz (linke Skala)
Defizit-/Überschussquote Euroraum (rechte Skala)
Defizit-/Überschussquote Schweiz (rechte Skala)

Quelle:
CH: Finanzstatistik, August 2012
EU: OECD, Mai 2012

Reason 1: It is cultural

- Swiss like to save
  - consistently large current account surplus
  - private debt mostly real-estate related (tax incentivized…)

- Important budget decisions (at municipal, or state/ federal level) can be brought to a ballot

- Maximum federal tax rate is specified in the constitution
  - can only be changed through mandatory ballot

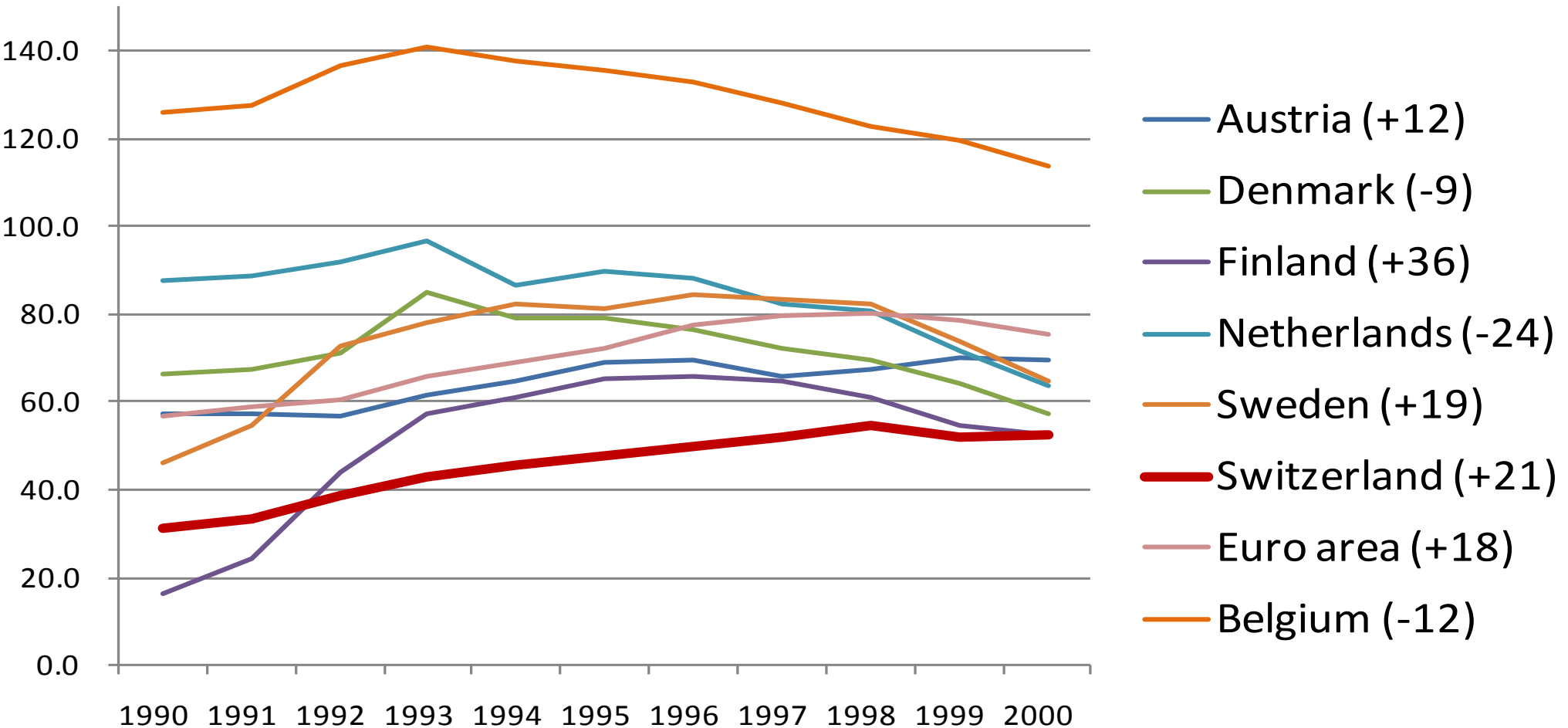# **Reason 2: Decentralized structure**

- High level of fiscal autonomy for municipalities and states/cantons
  – Far reaching democratic controls

- Tax competition between states/cantons and municipalities keeps per capita tax burdens low.

- Nonetheless: Eleborate system of transfers from wealthier to poorer states/cantons and municipalities

Reason 3: Federal debt brake

- Accepted in 2001 by 85% of voters

- Goal: maintain balanced structural budget, but allow for countercyclical balances.

- Rule requires elimination of cumulative deficits without specifying the time horizon
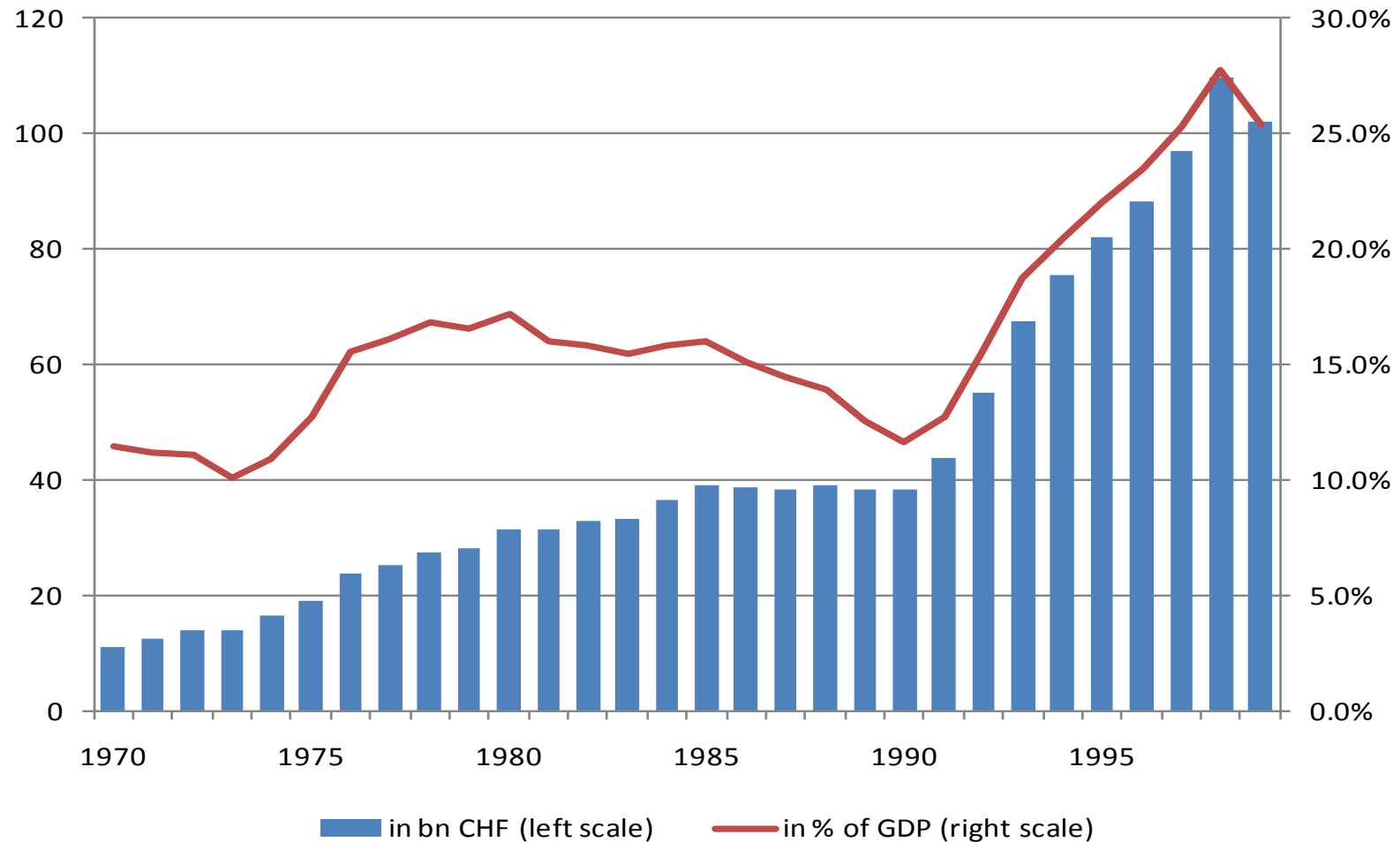 – Stabilization of *nominal debt level* in the long run, not debt ratios

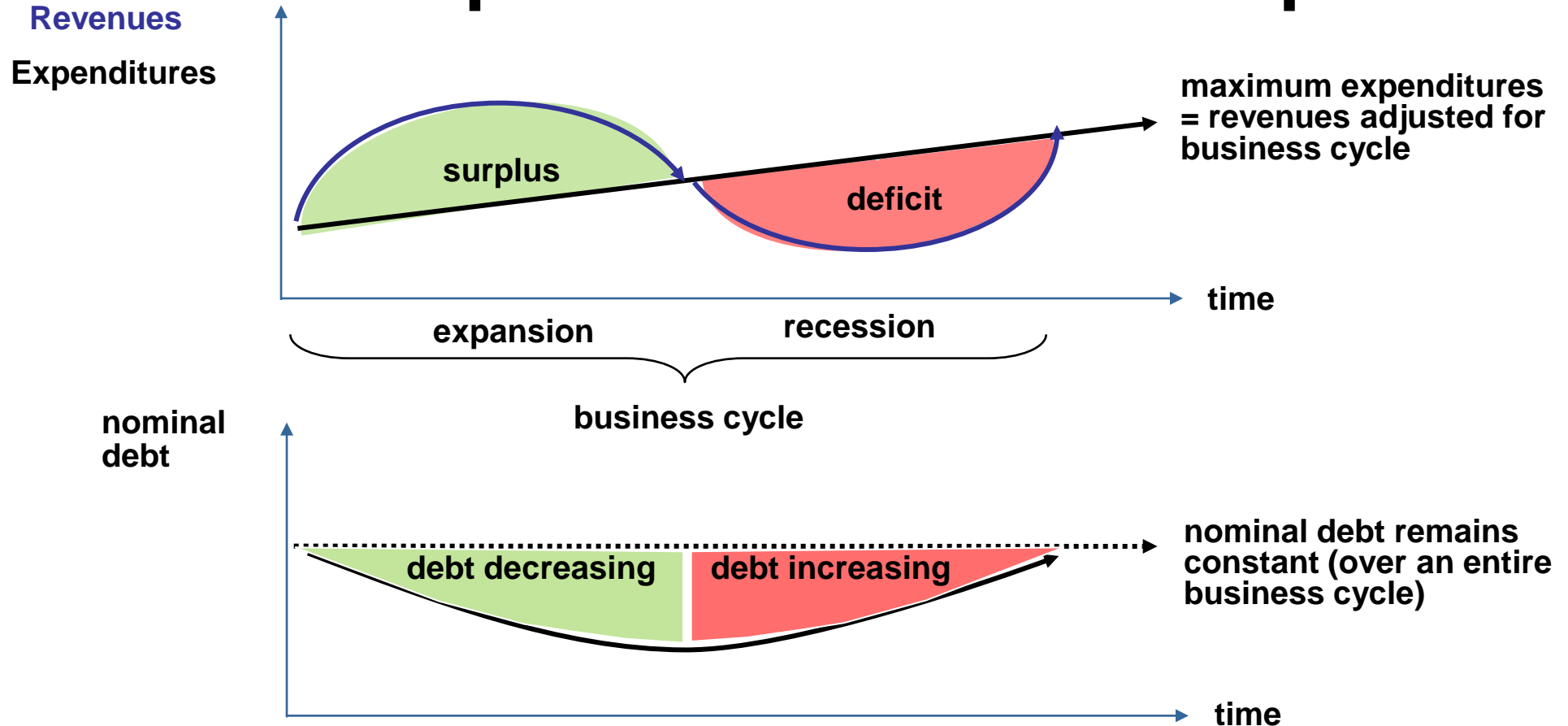Development of Debt Ratios 1990-2000

Austria (+12)
Denmark (-9)
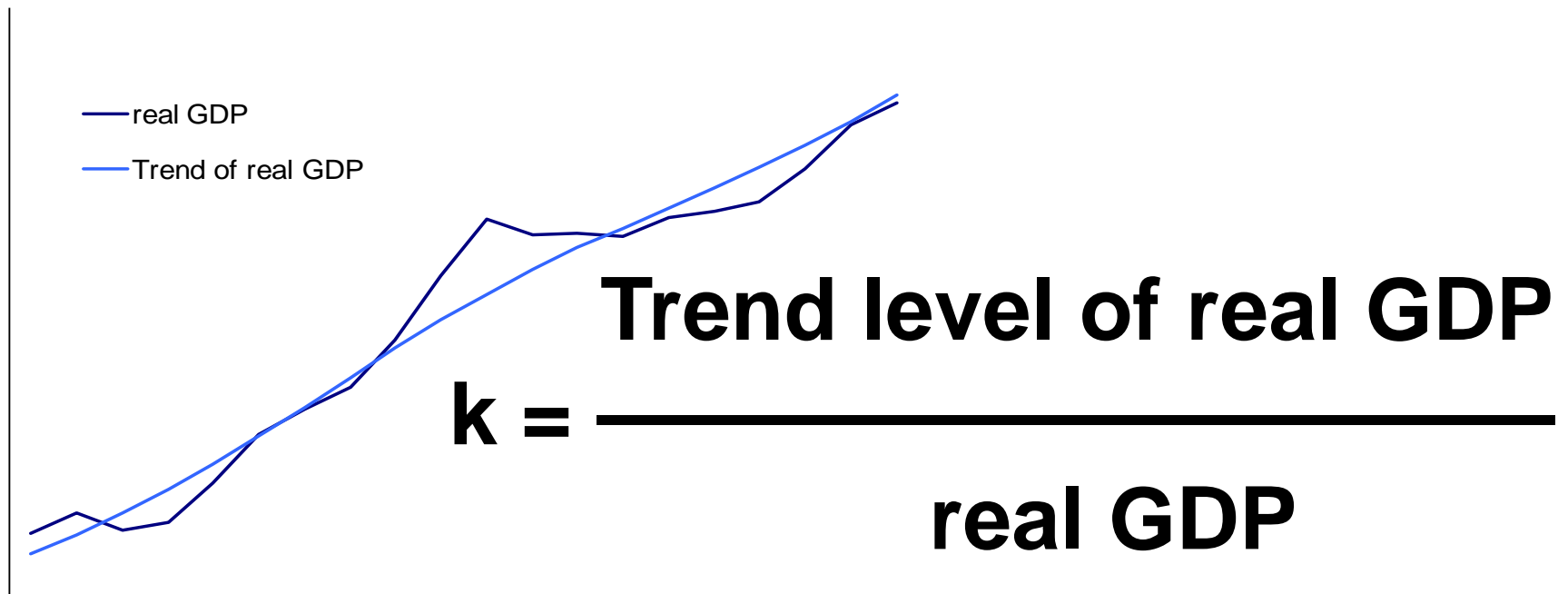Finland (+36)
Netherlands (-24)
Sweden (+19)
Switzerland (+21)
Euro area (+18)
Belgium (-12)

Development of Federal Gross Debt

in bn CHF (left scale)   in % of GDP (right scale)

Expenditure rule : concept

Revenues

Expenditures

surplus

deficit

maximum expenditures = revenues adjusted for business cycle

time

expansion

recession

business cycle

nominal debt

debt decreasing

debt increasing

nominal debt remains constant (over an entire business cycle)

time

Expenditure Ceiling = Revenue x k

k is the „business cycle adjustment factor

real GDP

Trend of real GDP

$$k = \frac{\text{Trend level of real GDP}}{\text{real GDP}}$$

Escape Clause

- Flexibility for unforeseen events is essential for
    - long-term credibility of a fiscal rule
    - steady accomplishment of public tasks

- Possibility of increasing ceiling in case of
    - exceptional and uncontrollable developments
    - changes in accounting practices

- Extraordinary spending must be
    - adopted by a qualified majority of Parliament (50% of all MPs)
    - compensated for during following six years

- Counterpart: extraordinary receipts
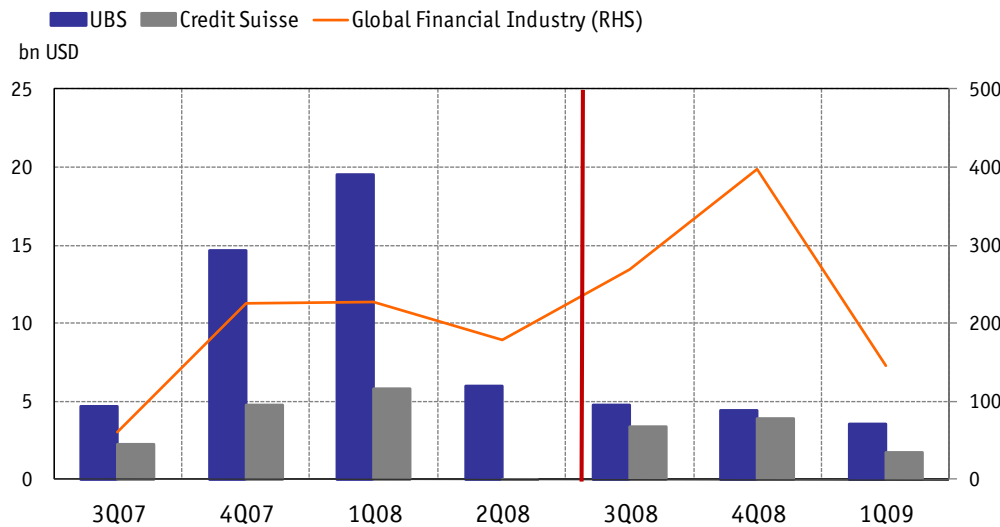
Evolution of Federal Debt
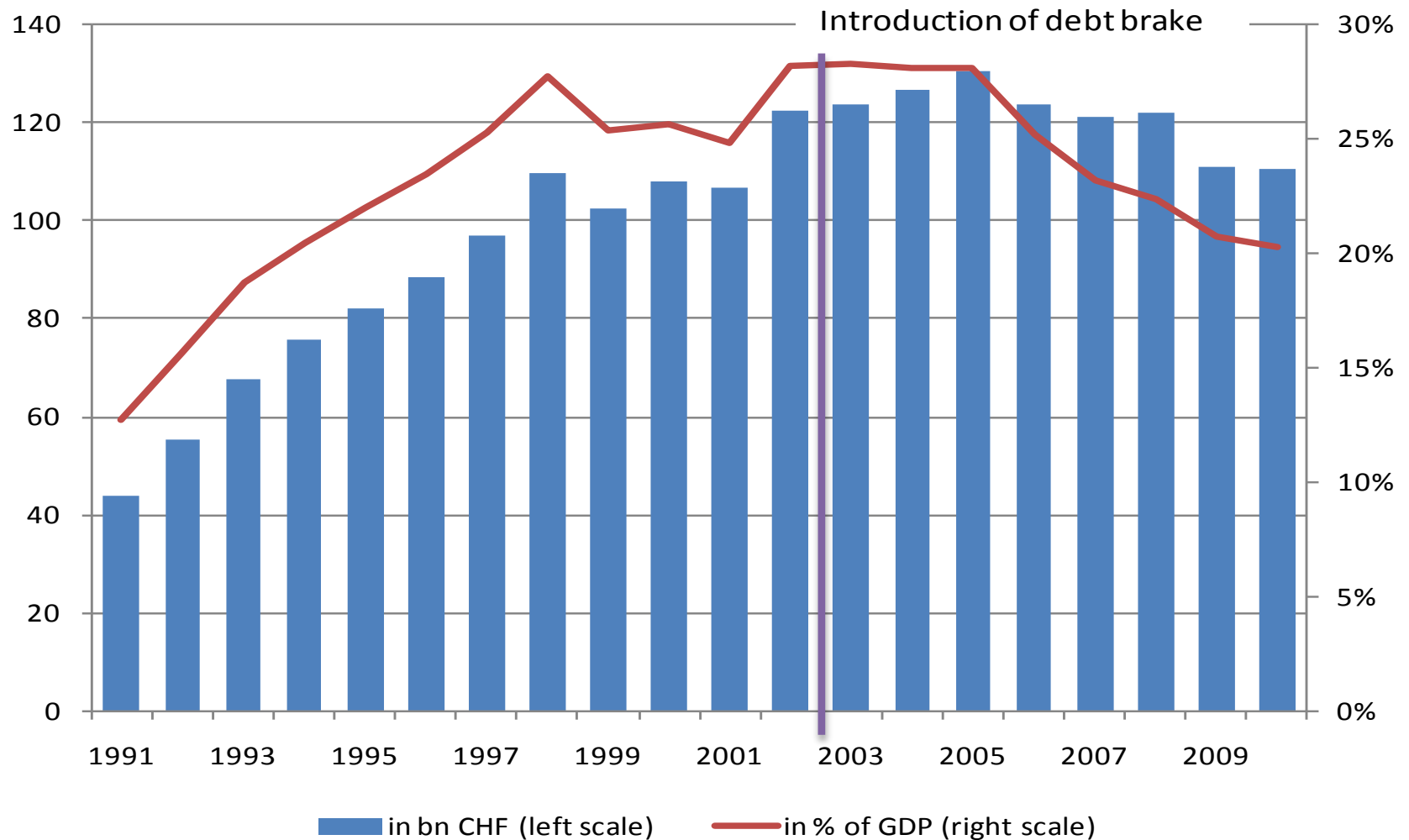
Reason 4: «Off balance sheet» rescue package

- The Swiss universal banks were heavily affected by the subprime crisis

- Authorities were forced to act one month after the collapse of Lehman Brothers (October 2008).

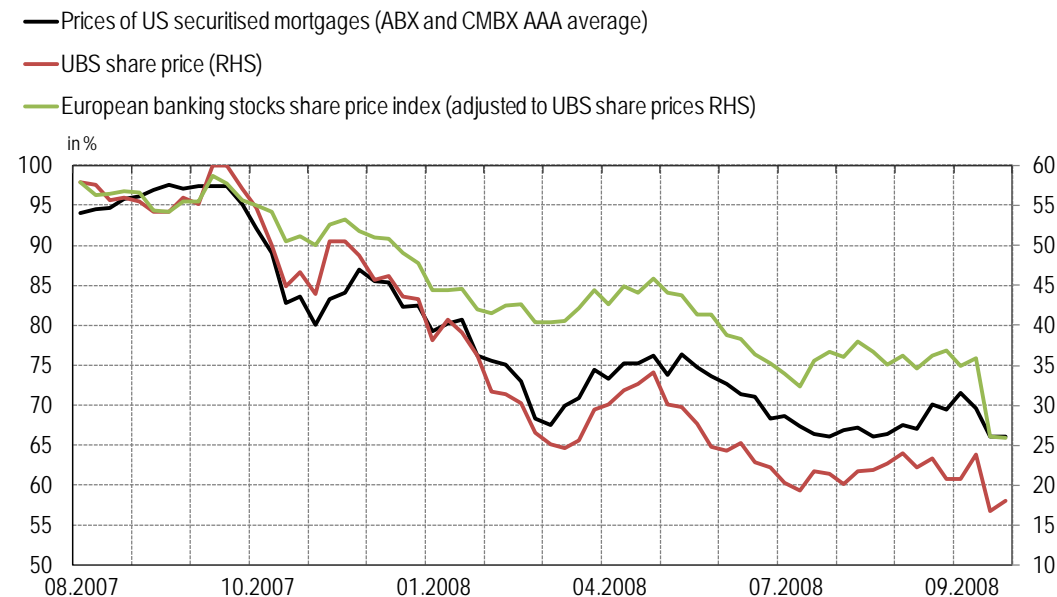- Most risks were borne by the central bank
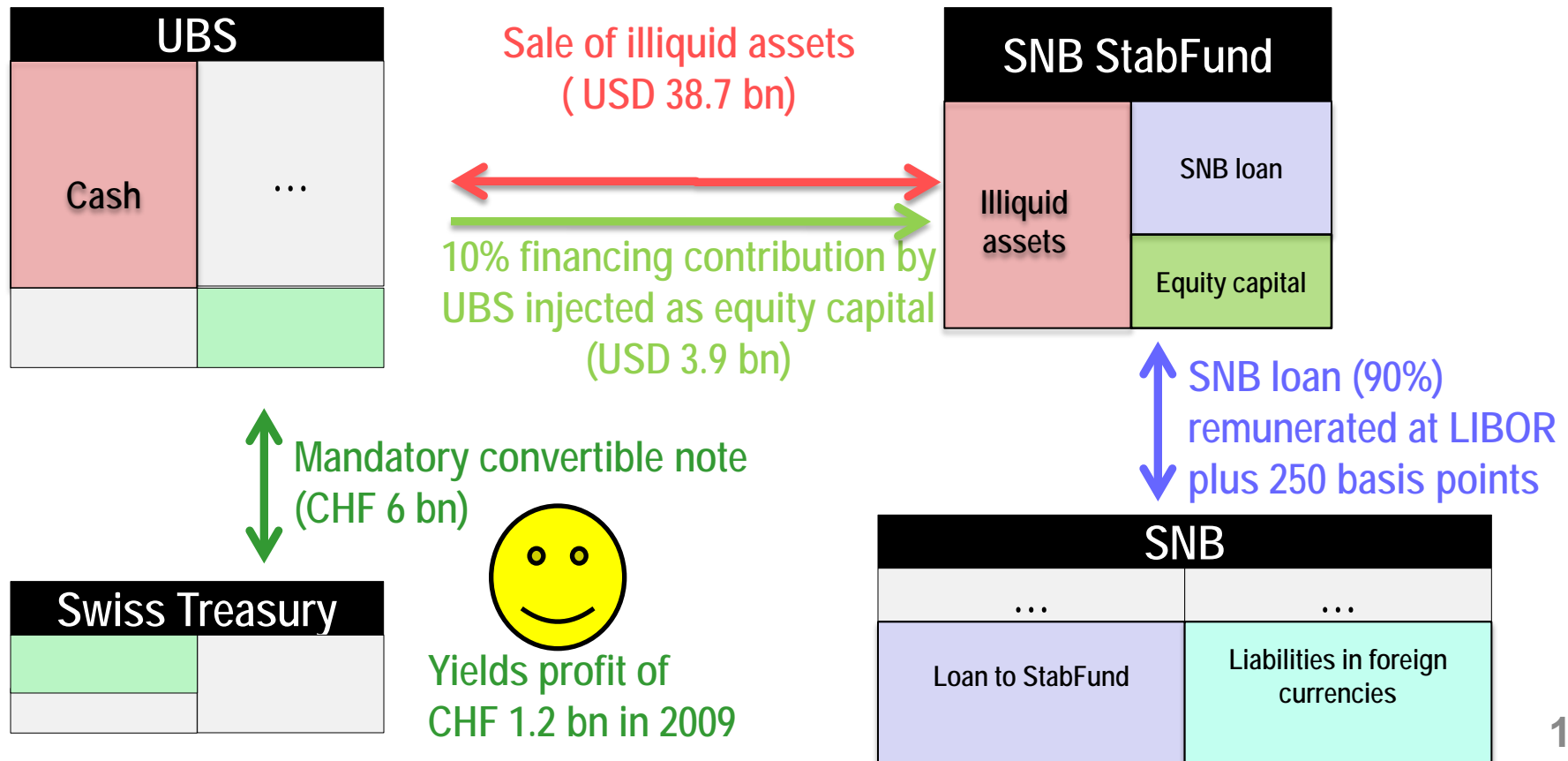
Heavy losses of UBS in 2007 and 2008

Writedowns and Credit Losses

■ UBS ■ Credit Suisse ── Global Financial Industry (RHS)

bn USD

Source: SNB StabFund Market Intelligence, Bloomberg

── Prices of US securitised mortgages (ABX and CMBX AAA average)

── UBS share price (RHS)

── European banking stocks share price index (adjusted to UBS share prices RHS)

in %

UBS support package of October 2008

UBS

Cash	…

Sale of illiquid assets
(USD 38.7 bn)

10% financing contribution by
UBS injected as equity capital
(USD 3.9 bn)

SNB StabFund

Illiquid assets	SNB loan
	Equity capital

SNB loan (90%)
remunerated at LIBOR
plus 250 basis points

Mandatory convertible note
(CHF 6 bn)

Swiss Treasury

Yields profit of
CHF 1.2 bn in 2009

SNB

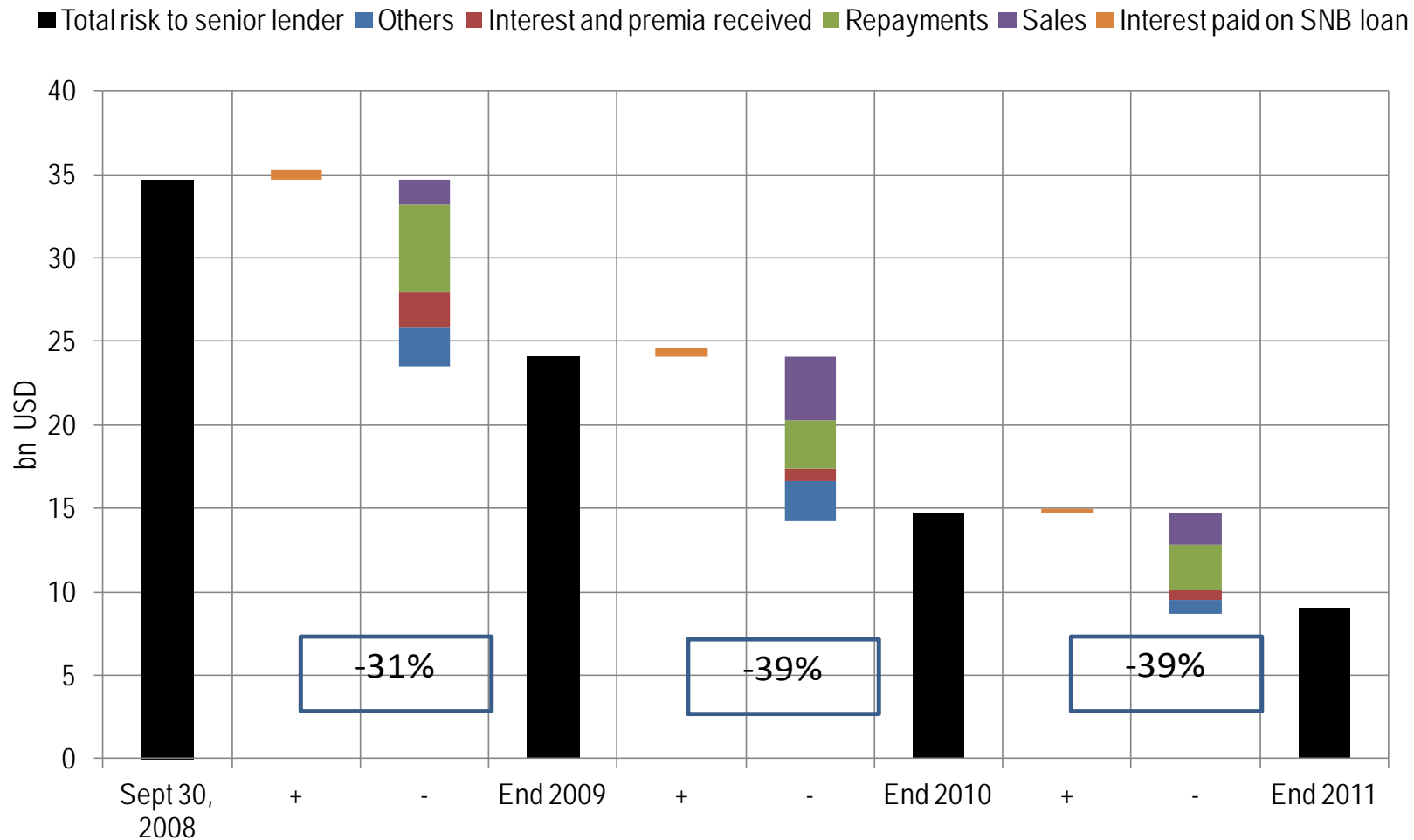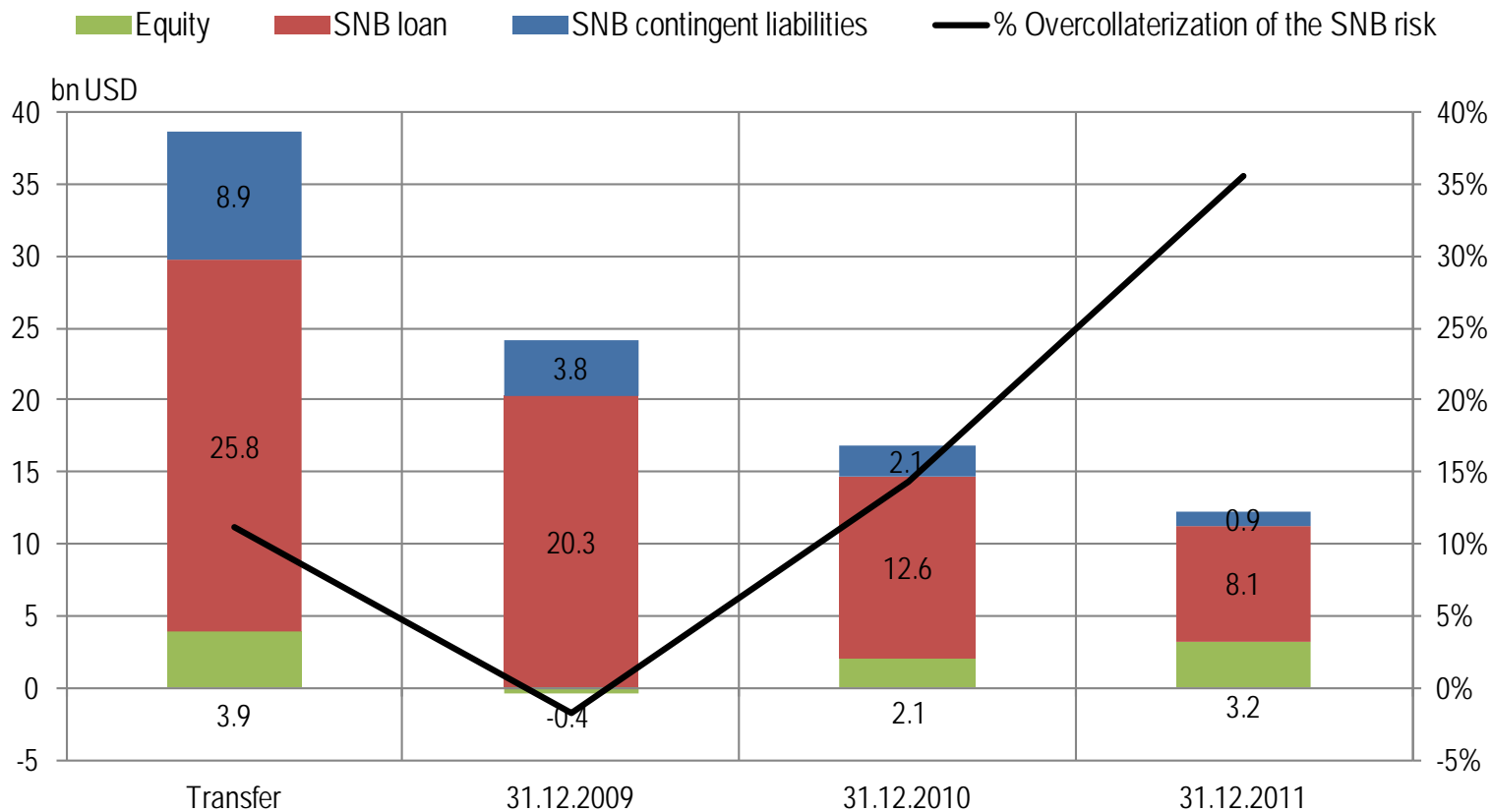| …	…
Loan to StabFund	Liabilities in foreign currencies

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Cash flows and evolution of SNB risk

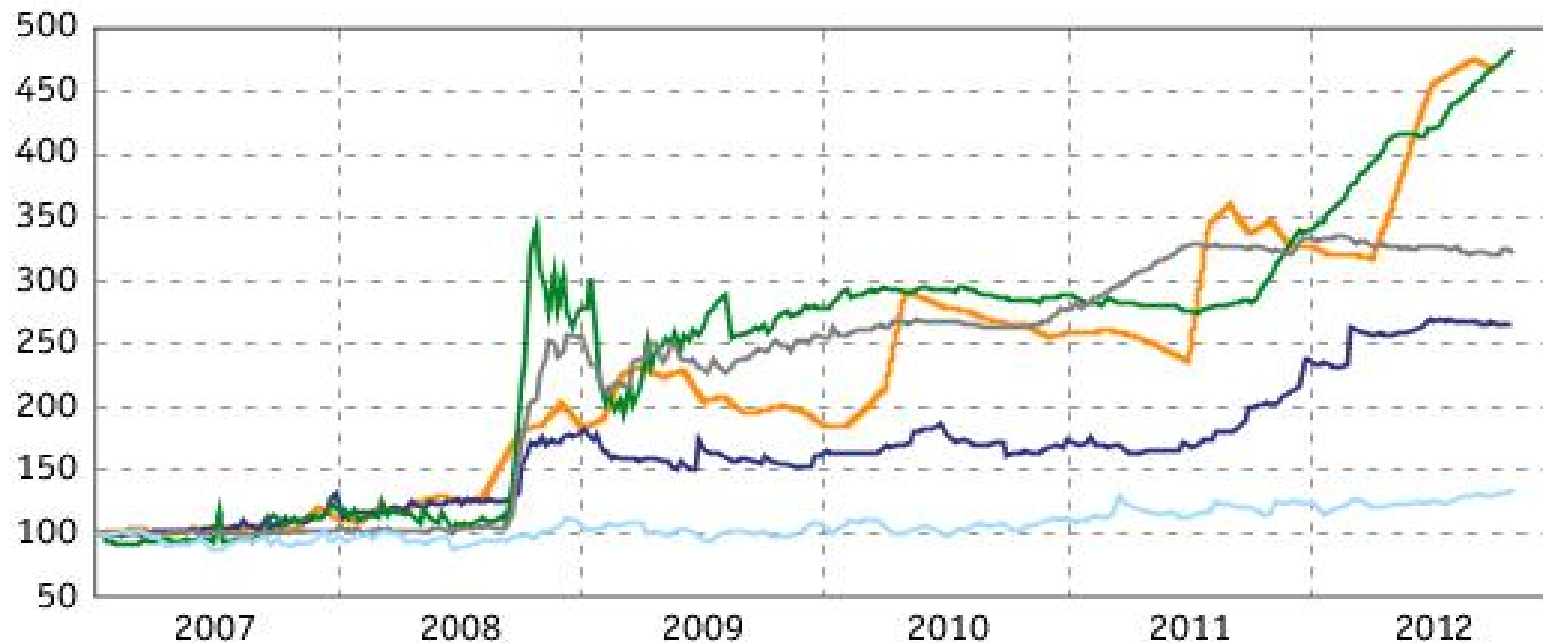# Deleveraging and rebuilding of equity

Supporting Factor 1: Monetary Policy

Central banks' total assets

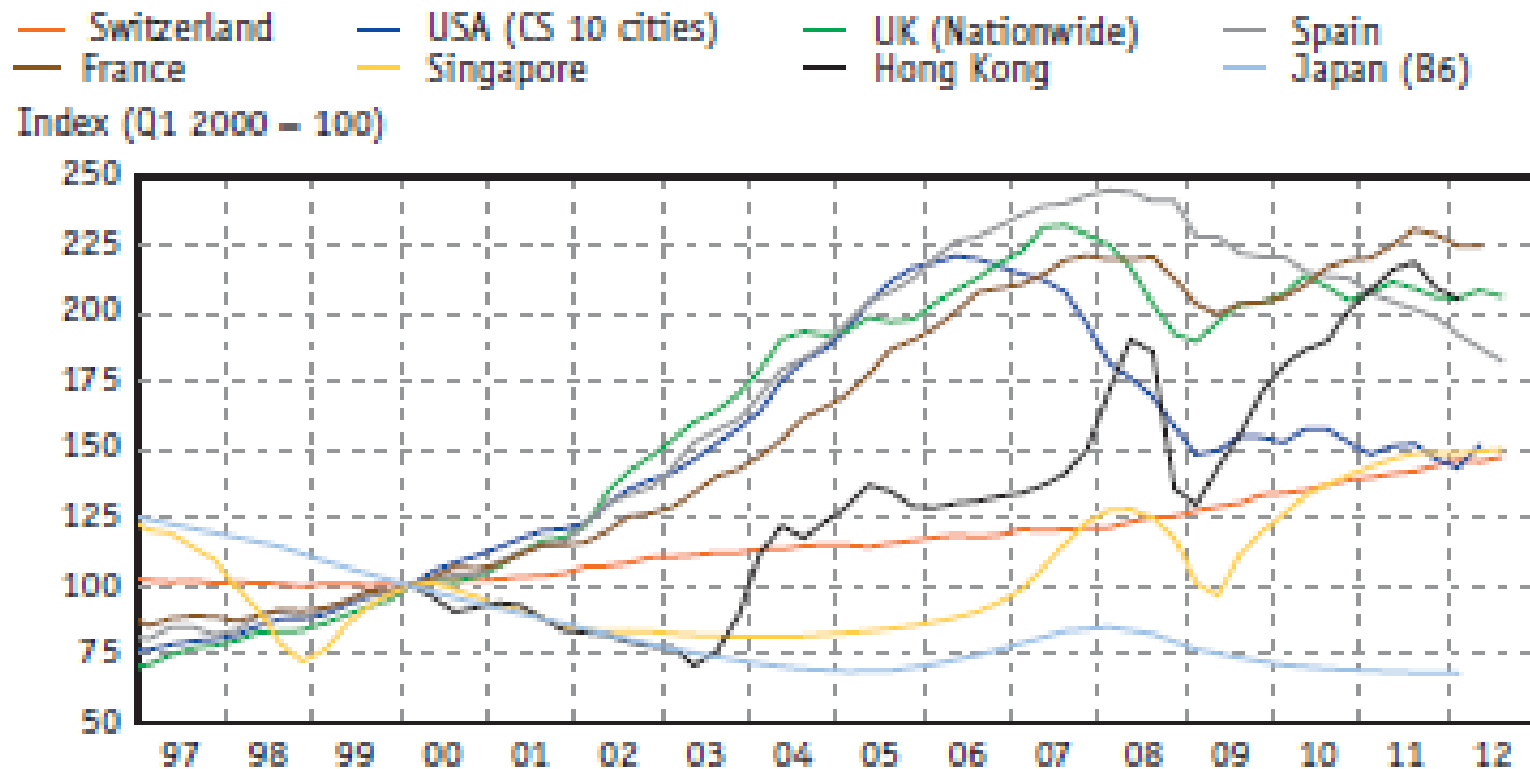— SNB — ECB — BoE — FED — BOJ

Index 100 = 1.2007

Sources: SNB Markets Analysis Platform, SNB, BoE, FED & Bloomberg

07.11.2012 16:18:45

Supporting Factor 2: no real estate bubble

Global housing prices

— Switzerland — USA (CS 10 cities) — UK (Nationwide) — Spain
— France — Singapore — Hong Kong — Japan (B6)

Index (Q1 2000 = 100)

Sources: SNB Markets Analysis Platform, Bloomberg

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Supporting Factor 3: Immigration

- Since 2000
    - Foreign population: +29%
    - Foreign population from EU and EFTA: +38%
    - Total population: +11%

- Immigration of high skilled labor: 33% hold university degrees

- Supports domestic consumption and construction

- Fosters competitiveness

Future challenges

- Tax revenues are highly correlated with GDP growth
    - Deveolpments in Euro Area are essential

- Aging population calls for reform of pension system

- Size of central bank balance sheet