

A strong economic model but concern from CHF appreciation

General Information



GDP	USD685.434 bn (World ranking 20, World Bank 2013)
Population	8.08 mn (World ranking 96, World Bank 2013)
Form of state	Confederation (but similar to a federal republic)
Head of government	Didier BURKHALTER (PRD)
Next elections	2015, legislative



Strengths

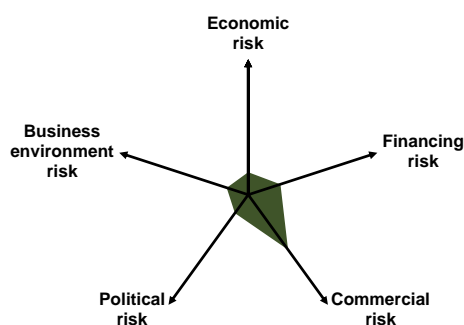
- Sound political institutions
- Specialised in manufacturing of high-quality goods with a relatively inelastic demand during economic crises
- Large current account surpluses
- Very good public finances with fiscal surpluses and low public debt

Weaknesses

- End of FX cap and the strong CHF appreciation highlight downside risks for exporters and feed deflationary pressures
- International pressures on bank secrecy, populist votes on immigration and an ageing population could affect the currently strong business environment in the medium term
- The banking asset to GDP ratio is amongst the largest in the world at 450% in 2013.

Country Rating

AA1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports	Rank	Imports
Germany	21% 1	28% Germany
United States	11% 2	11% Italy
France	8% 3	10% United States
Italy	6% 4	8% France
United Kingdom	5% 5	6% United Kingdom

By product (% of total)

Exports	Rank	Imports
Pharmaceuticals	25% 1	14% Non-Monetary Gold
Clockmaking	10% 2	9% Pharmaceuticals
Basic Organic Chemicals	6% 3	6% Jewellery, Works Of Art
Jewellery, Works Of Art	6% 4	5% Cars And Cycles
Precision Instruments	4% 5	4% Basic Organic Chemicals

Source: Chelem (2012)

Growth likely to dip below long run average

Real GDP growth accelerated to +2.0% in 2014 after +1.9% in 2013. Private and public consumption contributed +0.5ppps and +0.1ppps to 2014 growth, respectively. External trade activity declined significantly with exports declining -7.1%. As imports decreased even more (-9.4%) net exports thus contributed +0.5ppps to GDP growth. Inventories contributed +0.4ppps to annual growth. Going forward, growth should decelerate to +1.0% in 2015 as net exports are likely to be a drag on GDP growth with investment soft. 2015-16 are likely to be around half the long run growth average of 1.9%.

The end to the exchange rate cap comes with costs for the real economy

The SNB announced on January 15th an end to the exchange rate cap of CHF1.20/EUR introduced in late-2011, cut simultaneously the interests rate on sight accounts by 50bp to -0.75% and decreased the policy target range to -1.25% - -0.25%. The CHF appreciated immediately by 19% and levelled in the meantime around CHF1.07/EUR (11% below the FX cap). The move by the SNB will impact in particular the export sector and the domestic economy will feel the knock on negative impact.

Private consumption is key growth driver

Private consumption has been the main growth driver in the past years, supported by low unemployment, robust wage increases and a wealth effect coming from rising house prices. Switzerland's deflation experience over the past years has neither hurt consumption nor economic growth but rather bolstered real wage growth. Lower import and oil prices, coupled with negative interest rates, should bolster consumption as the key driver of 2015's GDP growth.

Downside risk for exporters though high current account surplus remains

Swiss trade statistics are highly dependent on gold trade as Switzerland plays a key role in the international gold market. Gold is usually imported from the UK (60% of Swiss gold imports), melted down and recast into smaller bars in Switzerland before being exported to Asian economies, mainly to Hong Kong (44%) and India (14%). In 2014, total exports in real terms decreased by -7.1% and imports by -9.4%. but when excluding non-monetary gold, real exports actually increased by +4.7% and imports by +0.4%. Non-gold exports are traditionally high value-added and luxury goods, enjoying a relatively inelastic demand, including pharmaceuticals, mechanical engineering and the clock making industry.

The end of the FX cap will bring downside risks for exports to the Eurozone (60% of exports). However, exports to non-Eurozone destinations should be less affected as the CHF depreciated significantly over the prior 6 months to the SNB decision. Accordingly, the USD/CHF exchange rate is now close to its summer 2014 level and is forecasted to converge to 1.06 by Q4/2015. Exports should benefit from the moderate recovery of world trade and should offset much of the negative FX effects in the Eurozone. Euler Hermes expects stagnating exports in 2015.

Switzerland's current account balance has recorded some of the highest surpluses in Europe over the past decade (along with Norway). In line with

Key economic forecasts

Switzerland	2013	2014	2015	2016
GDP	1.9	2.0	1.0	1.2
Consumer Spending	2.2	1.0	2.0	2.0
Public Spending	1.4	1.1	2.2	0.8
Investment	1.8	1.7	0.8	1.2
Stocks *	-2.5	0.4	0.2	0.0
Exports	15.4	-7.1	-0.1	2.5
Imports	13.6	-9.4	1.1	3.6
Net exports *	2.7	0.5	-0.7	-0.3
Current account **	68	46	78	77
<i>Current account (% of GDP)</i>	10.7	7.1	11.7	11.1
Employment	-0.3	0.0	0.4	0.6
Unemployment rate	3.1	3.1	3.3	3.3
Wages	0.4	1.0	1.7	1.8
Inflation	-0.2	-0.1	-0.9	0.0
General government balance **	0	1	2	1
<i>General government balance (% of GDP)</i>	0.0	0.2	0.3	0.1
Public debt (% of GDP)	34.4	33.5	32.3	30.9
Nominal GDP **	636	648	667	693

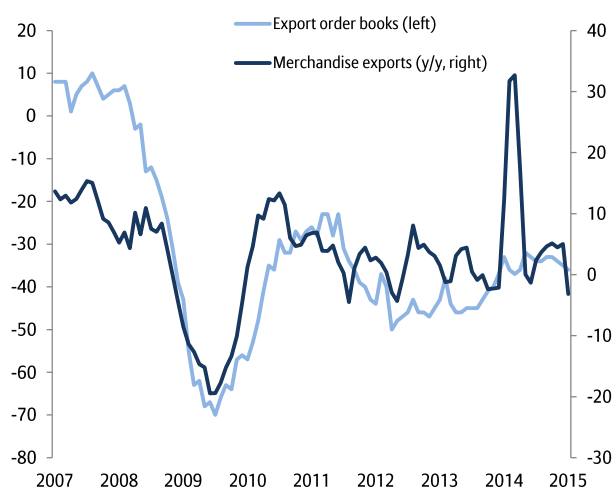
C change over the period, unless otherwise indicated:

* contribution to GDP growth

** CHF bn

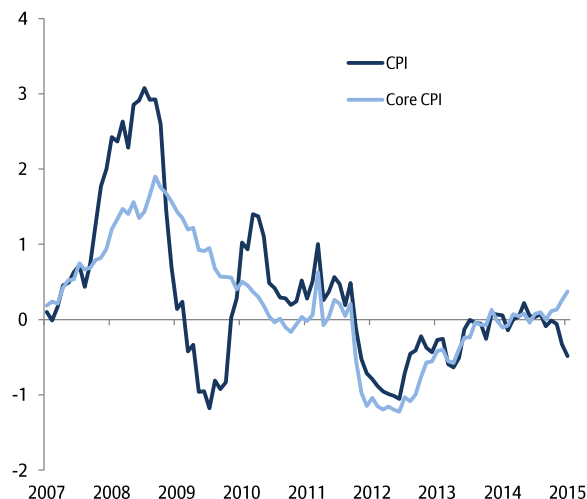
Sources: National sources, IHS, Euler Hermes

Export order books and merchandise exports



Sources: National sources, IHS, Euler Hermes

Inflation and core inflation



Sources: National sources, IHS, Euler Hermes

decreasing exports, the current account surplus narrowed to +7.1% of GDP in 2014. It should rebound to around +11.7% and +11.1% in 2015 and 2016 respectively.

The strong Swiss franc continues to feed deflationary pressures

Despite the negative policy rate, the strength of the franc continues to feed deflationary pressures. Inflation averaged -0.2% in 2013, and -0.1% in 2014. Under the influence of lower oil and import prices, inflation fell by -0.5% in January 2015. Euler Hermes forecasts a deflation in 2015 of -0.9%. The price level's decline should slowly ebb over the course of the year but deflationary pressures could continue into 2016.

Public finances are sound

Since 2006, government revenues have been higher than government expenditures, leading to small budget surpluses (except for a tiny deficit in 2012). In 2015-2016, annual surpluses of +0.3% and +0.1% of GDP are projected respectively.

Public debt is low and decreasing. It accounted for 33.5% of GDP in 2014 and is expected to lower to 32.3% of GDP in 2015 and 30.9% in 2016.

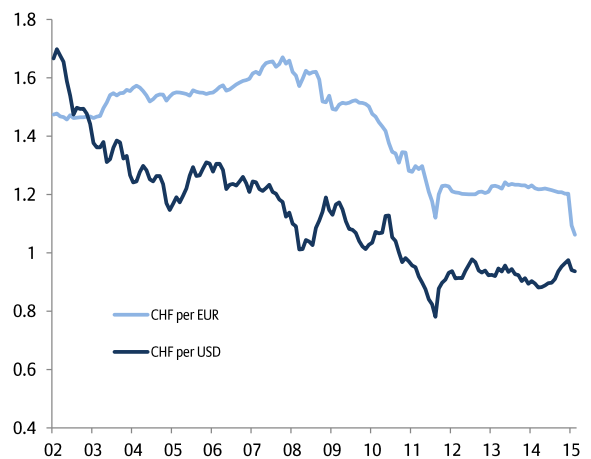
Companies enjoy a favorable environment

Switzerland is a business-friendly country, ranked 20th out of 189 economies in the World Bank's Doing Business 2015 survey. The number of corporate insolvencies edged up to 4570 cases in 2013 (+1%) but decreased to 4240 cases in 2014 (-7%). In 2015, Euler Hermes expects again an increase in insolvencies to 4450 cases in 2015 (+5%).

A key driver of the deterioration is the recent decision by the SNB to end the EURCHF floor, which will hinder competitiveness and will force many companies to cost cuts, driving some companies out of the market. Not only export orientated firms but likewise suppliers and consumer-orientated industries should be affected.

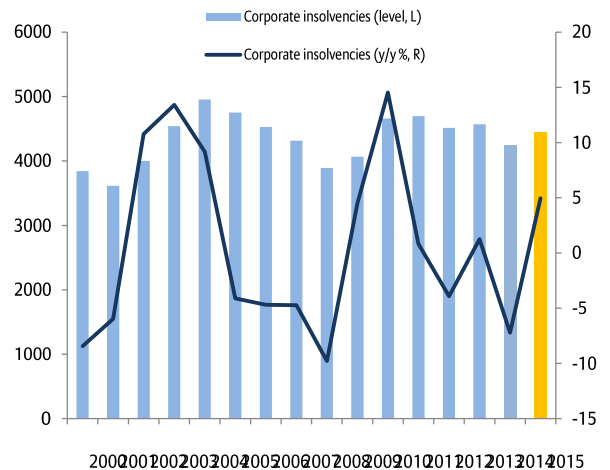
Moreover, the Swiss economic model has been challenged in the past months. Recent international initiatives to address tax evasion and money laundering are eroding bank secrecy and the tax treatment of corporate income on foreign activities is also coming under international scrutiny. In the 2000s, immigration has been an important contributing factor to rapid economic growth but a recent popular vote limiting immigration may inhibit corporations' ability to employ highly skilled employees.

Exchange rate (Swiss franc per USD and EUR)



Sources: National sources, IHS, Euler Hermes

Number of insolvencies and percentage change



Sources: National sources, Euler Hermes

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