

Strong Swiss franc: still no threat ... yet

Due to Switzerland's size and location, as well as the openness of its business sector, exports have traditionally played an important role in the domestic economy. Exchange rate fluctuations therefore play a significant role in economic success. This is best demonstrated by the recent slide in the euro; nevertheless, not all Swiss companies are affected in equal measure.

By Dr. Jörg Zeuner | Switzerland's neighbouring countries have traditionally been its most important trading partners: roughly 58 per cent of the Alpine confederation's exports go to the European Union, with a third of that total attributable to Germany alone. Since the autumn of 2008, the Swiss franc has appreciated against the euro by nearly 13 per cent, and in May 2010, it reached a new all-time high. This development has had a negative effect on the competitive position of many Swiss companies because their exports have become more expensive as a result.

SNB can't halt the appreciation

In order to cushion the negative effects on domestic companies, the Swiss National Bank (SNB) has been attempting to limit the Swiss franc's appreciation. However, at the heart of the SNB's intervention efforts, is the impending deflationary threat that falling import prices pose to the Swiss economy.

In any case, the central bank is making open-market purchases of euros to stem any excessive increase in the value of the franc. In turn, these transactions bloat the SNB's foreign currency reserves. Since the beginning of the year, SNB foreign

exchange reserves have risen by over 60 per cent, to almost SFr 59 billion. These holdings now represent 68 per cent of assets listed on the central bank's balance sheet – clearly no trifling amount.

As a result of interventions, the proportion of this figure held in euros rose during the first quarter, from 58 per cent to 65 per cent. And in light of the rapid expansion of the Swiss franc cash supply, further leeway for SNB operations in the currency markets is becoming progressively more limited. Because of this situation, the central bank could soon respond to the bulge in liquidity by issuing new debt securities.

Mixed consequences

In the Swiss equity market, there are only a few companies selling their products and services exclusively in Switzerland. These include the media enterprise Tamedia, the cantonal banks, Zurich's airport operator, as well as real estate companies, such as PSP, Swiss Prime Site and Allreal – all medium-sized enterprises. Internationally active companies dominate the large-cap SMI index, with even partially state-owned Swisscom booking almost a quarter of its revenues in euros.

Large-cap winners and losers

Foreign currency fluctuations impact internationally active Swiss companies to differing extents. The tourism industry has been particularly hard hit: for Europeans, holidaying in Switzerland costs a pretty penny these days. The solid purchasing power of Swiss consumers is unlikely to compensate for lost revenues of this nature. Many companies that rely on "Swissness" as a marketing instrument – advertising with "made in Switzerland" or the Swiss cross as unique selling points – must produce their goods in Switzerland: the watch industry is just one example.

The foreign business of small- and medium-sized exporters is traditionally more reliant on euro-zone customers, than that of Switzerland's major companies. And it is frequently the case that small companies in particular, do not hedge their foreign revenue-flows via Forex transactions. In this area as well, in most cases, the companies manufacture their products in Switzerland.

Large companies, on the other hand, rigorously manage their foreign currency exposure. Moreover, their size alone enables a natural elimination/offset of foreign exchange risks. By producing locally, they incur costs in the same currency as



the revenues they generate. In addition, the Swiss large-caps are more broadly diversified on an international scale.

Large companies often have counterbalancing businesses in North America and Asia. Here, the dollar is used as the accounting currency; since the beginning of 2010, the greenback has outperformed even the Swiss franc.

The franc's strength is nothing new

For Swiss companies, the franc's current appreciation is not a new development. Over the past decades, the currency has progressively gained in value, as a result of inflation rate differentials with other countries. This has helped domestic companies learn to deal with the problem. Accordingly, the typical Swiss enterprise focuses less on cost leadership than on innovation and quality. Exchange rate fluctuations only come into serious play in terms of revenues and profits, when a company is active in a mass market. For the type of specialised player so often seen in Switzerland, price is of little consequence.

Despite the latest dip, the EUR/SFr exchange rate is still above the crucial threshold that would pose a serious threat to Switzerland's export-sector. In a survey conducted by the renowned ZEW Institute (the Center for European Economic Research), 52 per cent of the financial market experts polled felt that the 1.30–1.35 range represented the tipping point. At the end of May, the franc was trading at 1.42

versus the euro, and thus considerably above that mark.

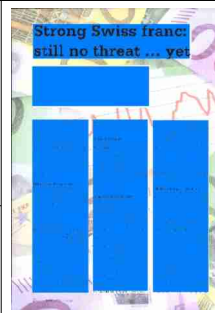
In fairness, there are not just disadvantages associated with the euro's weakness: for example, procuring semi-finished goods from European suppliers has become cheaper as a result. Not forgetting the added attractiveness of acquiring a European competitor or complementary firm: many Swiss companies can easily afford such purchases thanks to their strong balance sheets, large cash positions and low leverage.

Forex effects should not be overestimated

Foreign exchange fluctuations – both negative and positive – have an impact. However, this is not of greater significance for companies and their shares, than the environment in which those firms do business. In the wake of the recent cyclical economic downturn, corporate profits are now poised for recovery, as is global trade. The consensus assumption among analysts is that profits at companies traded in the Swiss equity market will expand by roughly 34 per cent.

The bottom line

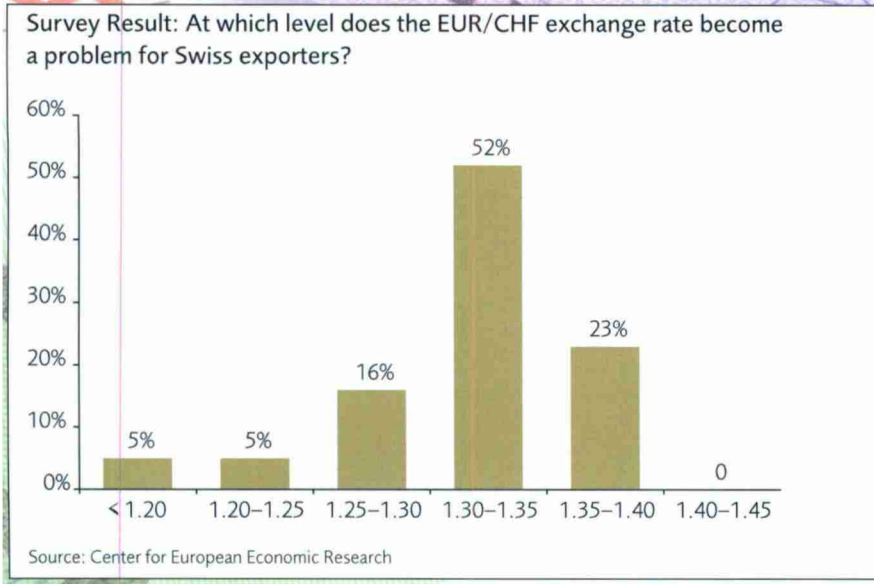
The franc's appreciation versus the euro weighs on Switzerland's exports to EU member states; however, the effects should not be overestimated. Swiss companies have learned how to deal with this situation, and for decades their competitiveness has not been defined by the price tag. The Swiss equity market offers a wide range of well-positioned companies with solid financial underpinnings.



Swiss Businesspress SA
8052 Zürich
044/ 306 47 00
www.swissnews.ch

Medienart: Print
Medientyp: Spezial- und Hobbyzeitschriften
Auflage: 2'665
Erscheinungsweise: monatlich

Themen-Nr.: 220.62
Abo-Nr.: 1002054
Seite: 24
Fläche: 67'629 mm²



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