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# CIO Viewpoint

# Swiss fiscal resilience offers economic opportunity

Investment Solutions

**26 January 2021**

**Switzerland's financial strength and resilient economy position it for a recovery later this year. The pandemic crisis has created space for expansionary spending. However, unlike its neighbours, Switzerland's recovery will be driven by the corporate sector rather than government stimulus.**

Covid-19 is taking a toll on Swiss health systems and its population. Based on 17 January international data, Switzerland had more cases per 100,000 people than Spain, France, Germany or Italy. The country applied additional measures in mid-January, closing restaurants, sport facilities and non-essential shops until the end of February. Switzerland's vaccination programme is also proving slightly slower than many neighbours. For now, vaccinations in Switzerland lag the rollout in the UK, Italy and Spain at around 2% per 100 people as of 24 January, on a par with Germany. Still, once operating at full speed, the vaccine should be quickly available thanks to orders for 15.8 million doses from Moderna, Pfizer and AstraZeneca.

Alongside its public health measures to manage the crisis, Switzerland has created credit worth CHF 28 billion to support research and education over four years, as well as measures to support exports, and small and medium businesses. At 4.8% of gross domestic product, the Swiss pandemic stimulus has been less significant than the massive amounts injected into the economies of France, Germany, the UK, Japan and US (see chart, page 2). The Swiss government budget was in surplus for 12 of the 14 years prior to 2020. Last year, gross government debt rose by almost 5 percentage points as a share of GDP to 30.4%. That leaves the country with an enviable total debt burden, one of the lowest among developed nations.

"Economists are almost unanimous: a stimulus package would not make sense at the moment," said Guy Parmelin, president of the Confederation, in a recent interview. "I believe that the best recovery plan is one that allows people to work."

Moreover, Switzerland benefits from one of the lowest unemployment rates. The jobless rate, undoubtedly cushioned by the country's furlough programmes, jumped from 2.5% in February 2020 to 3.5% in December. We expect the rate to fall below 3% by the end of 2021. In most economies, even these jobless rates would be classified as full employment.

**Stéphane Monier**
Chief Investment Officer, Lombard Odier Private Bank

### Key takeaways

- We expect the Swiss economy to expand by 4.2% this year with unemployment under 3%
- Defensive Swiss equities mean investors must be highly selective to capture cyclical rebound
- Swiss financial centre fortunes are now partly tied to a future EU/UK market access accord
- Switzerland's resilient economy now has a window for investing for its future growth.

Switzerland looks set to return to its pre-crisis levels of output in the second half of 2021, expanding by 4.2% this year. Inflation, which fell to -0.7% in 2020 according to the Federal Statistics Office, should rise to a still moderate 0.4% in 2021, a level last seen in 2019. The central bank's key deposit rate will likely remain unchanged at a record low of -0.75%.

## Backed by the strong franc

The mandate of the Swiss National Bank (SNB) is to ensure price stability; among the instruments used, the value of the Swiss franc plays a pivotal role. The Swiss franc's safe-haven status has again come to the fore during the pandemic. While central banks that defend their currencies against depreciation can run out of reserves, in theory at least, the SNB can keep selling francs to buy foreign currency because it has the means to keep printing notes. Intervention in foreign currency markets, SNB president Thomas Jordan has said, is part of the central bank's toolbox to achieve monetary policy stability – and in particular keep a lid on the overvalued currency and so prop up exports.

The franc posted a six-year high of CHF 0.88 against the US dollar on 22 January. In 2020, the SNB recorded its highest foreign currency interventions since 2012, when it still maintained a floor against the euro. Based on sight deposit data, we estimate that the SNB spent CHF 119 billion weakening the currency, compared with CHF 10.4 billion in 2019. Much of last year's intervention happened in the first half of the year as the pandemic took hold of the world's economies.

However, Swiss intervention has not gone unnoticed. In early December 2020, the US Treasury labelled the SNB a 'currency manipulator,' based on the Swiss current account balance, trade surplus and more than 2% of GDP in net currency purchases. It's worth noting that in the last few months, SNB's FX intervention has come to a halt due to a rebound in global activity and trade.

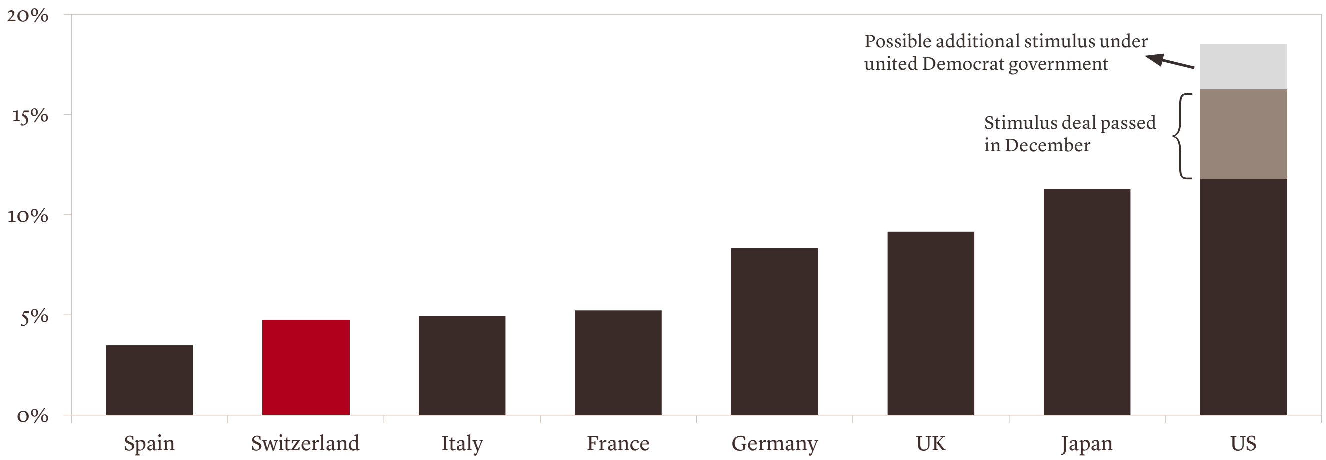
Adding to the government's financial strength, the SNB reported a profit of CHF 13 billion from foreign currency position for 2020, and in line with 2019, will distribute a CHF 4 billion profit to the Swiss government and cantons.

## Defensive equities

The Swiss market is defensive by nature with around 60% of the Swiss Market Index (SMI), for example, made up of defensive businesses including consumer staples and pharmaceutical firms. Last year, this served Swiss equity markets well when they proved more resilient to the crisis. The SMI posted a 4.3% rise over 2020, while the SPI Extra recorded a 8.1% gain over the 12-month period.

However, as investors turn to vaccination rollouts and markets focus on the business recovery this Swiss defensive bias offers fewer opportunities to capitalise on the cyclical rebound. In Swiss franc terms, the rebound in Swiss stocks has already lagged the rest of the world and forward price-to-earnings are trading at a ratio of more than 19-times.

### Switzerland's fiscal response to Covid vs major economies




Sources: IMF, Lombard Odier calculations

Consensus for earnings growth point to a 17% rise in the SMI this year and a further 11% rise in 2022. However, that is only around half the forecast levels for other European markets.

Nevertheless, some market leaders, which have created niche positions, including many small to mid-capitalisation companies, should benefit from improving post-pandemic demand. In this context, we have maintained a selective and neutral exposure to Swiss companies.

## International competition

Switzerland's financial sector, which accounts for around one-in-ten jobs in the country, also faces a new challenge. Since 1 January, Brexit positions the UK as a rival financial centre. The two countries published a joint position paper in April 2020 calling for "improved and reciprocal market access," and in June, the two governments signed a declaration of intent.

Both must negotiate financial market access to the bloc with the European Commission. That largely ties Switzerland's EU access as a financial centre to the relationship that the UK eventually secures over the coming months or years.

Switzerland already has some experience of the challenges of negotiating with the European Commission through more than 120 bilateral agreements signed over the past four decades. In June 2019, the EU dropped its equivalence recognition of Swiss stock exchanges, preventing EU-based brokers from trading shares on the Swiss markets and re-directing European equity orders through European platforms.

## Window of opportunity

Switzerland's political infrastructure, which devolves many decisions to its 26 cantons, leaves it poorly equipped to kick-start the kind of nation-wide economic boom that the US is attempting and the European Union approved last year. On the other hand, that built-in political inertia has also historically protected it from economic busts.

The country now has the opportunity to build further economic strength by encouraging its private and public sector to join forces through public-private partnerships.

Short-term economic resilience should create a window for investing in the country's future. Relatively low levels of government debt and a current account surplus, a return to economic growth and low unemployment all set the stage for a sustainable recovery.

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