INTERNATIONAL MONETARY FUND

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SWITZERLAND

June 2019

2019 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR SWITZERLAND

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2019 Article IV consultation with Switzerland, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its June 17, 2019 consideration of the staff report that concluded the Article IV consultation with Switzerland.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on June 17, 2019, following discussions that ended on April 1, 2019, with the officials of Switzerland on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 30, 2019.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Switzerland.

The documents listed below have been or will be separately released.

Selected Issues
Financial Stability System Assessment

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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June 27, 2019

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IMF Executive Board Concludes 2019 Article IV Consultation with Switzerland

On June 17, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Switzerland.

The Swiss economy has performed relatively well in recent years. Buoyant external demand in early 2018 lifted GDP growth to 2½ percent last year, despite a slowdown in the second half on weaker global trade and one-off factors. While a prompt recovery of momentum is expected, carry over from last year will cause annual growth to temporarily dip to 1.1 percent in 2019. Over the medium term, growth is projected to quickly return to a more normal pace of 1½ percent, with the biennial cycle of international sporting events adding some year-to-year fluctuations. Inflation has remained muted, despite a period of rising energy prices and depreciation of the franc in mid-2018, owing to subdued domestically-sourced inflation. Over the medium term, inflation is expected to remain around the mid-point of the Swiss National Bank's 0–2 percent price stability objective. The current account surplus, which rose to 10.2 percent of GDP in 2018 on recovery in primary income, is expected to remain broadly unchanged.

Overall, policies have been supportive of growth, although no new macroprudential measures have been taken in recent years to address financial stability risks. Accommodative monetary policy, comprising a negative interest rate and a willingness to purchase foreign currency, helped to mitigate safe-haven pressures on the franc, thereby averting deflation and supporting real activity. Sustained structural fiscal surpluses, amid moderate-and-declining public debt and negative borrowing costs, have consistently overperformed the objective of the debt brake rule, thereby providing an unwarranted drag on growth during periods of cyclical weakness. Despite the long period of low interest rates, which has fueled risks in the real estate and mortgage markets, no tightening of macroprudential policies has been implemented since 2014.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Looking ahead, the Swiss economy is facing several external and domestic downside risks. Weaker-than-expected foreign demand, intensification of global trade tensions, and uncertainty over Brexit could adversely impact the highly-open Swiss economy via trade and financial channels. Volatility in international financial markets could reignite safe-haven pressures and impact the profits of large globally-active banks. On the domestic side, search for yield in a low-growth and low-inflation environment increases risks to financial stability, and any price correction in the real estate market would reverberate through the economy. In addition, further delay in agreeing an institutional framework for Swiss-EU relations and remaining uncertainty regarding key parameters for corporate taxation and old-age pensions could reduce Switzerland's appeal as an investment destination.

Executive Board Assessment[2]

Executive Directors commended the Swiss authorities for the economy's good performance since the global financial crisis. Directors considered that prospects are favorable, with moderate growth and subdued inflation, although intensification of international trade tensions, renewed safe-haven pressures, and imbalances in the domestic real estate market weigh on the outlook.

Directors praised the authorities' overall management of the macroeconomy, although many Directors saw scope to rebalance the policy mix. Very accommodative monetary policy has helped deter safe-haven pressures and reverse earlier deflation, but has also encouraged search for yield by the financial sector. Directors concurred that the current accommodative monetary stance should be maintained. While limited room remains to further ease monetary policy if needed to secure price stability, many considered a more prominent role for fiscal policy in view of the substantial fiscal space. A few Directors, however, emphasized that public spending would not be effective at addressing exchange rate shocks. Directors agreed that any reduction in the policy interest rate would also reinforce the need to tighten macroprudential policies. Foreign exchange intervention should be reserved for addressing large exchange market pressures, provided the trend appreciation is allowed.

Directors welcomed the reduction in public debt achieved under the fiscal debt break rule, while recognizing that the current framework has served the country well. Many Directors recommended moving to a balanced structural position in light of the low level of public debt and favorable debt dynamics, including through refinements to avoid underspending. Doing so would allow room for addressing long-term challenges such as technological change and population aging, and compensating any revenue shortfalls from corporate tax reform. A few other Directors underscored that the primary purpose of the debt break rule is to avoid a deficit bias and ensure the predictability of fiscal policy.

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors welcomed the FSAP's findings and endorsed its main recommendations. They supported expanding the macroprudential toolkit to encompass additional mandated instruments, accompanied by a framework with enhanced expectations to act. Directors also recommended strengthening the governance, autonomy, and resources of the financial sector supervisor and recommended allowing it to directly contract and pay for outsourced supervisory audits. They encouraged further reinforcement of the financial safety net and crisis management arrangements, including improving banks' recovery and resolvability and establishing an effective public deposit insurance agency. To contain risks in the real estate sector brought by low interest rates, Directors called for introducing new measures to restrain demand for high-risk mortgages, together with tighter amortization requirements and removal of tax incentives that encourage high household leverage. Directors welcomed the authorities' actions to strengthen anti-foreign bribery enforcement and looked forward to continued progress in enhancing the anti-corruption and AML/CFT regimes.

Directors recommended continuing to prepare for population aging, increased automation and new work arrangements. They welcomed the recent approval of the referendum on corporate income taxation and pension systems as important and encouraged prompt implementation of these reforms. They also encouraged maintaining the high-quality of education and investment in innovation and reviewing social safety nets to ensure they are compatible with new work arrangements.

Switzerland: Selected Economic Indicators

Population (2017): 8.42 million

Quota (current; millions SDRs / % of total): 5,771.1 / 1.21%

Key export markets: Euro area (44%), US (15%)

	2017	2018	2019 Proj.	2020 Proj.
Output				
Real GDP growth (%)	1.7	2.5	1.1	1.6
Unemployment				
Unemployment (%)	3.2	2.6	2.8	2.8
Prices				
Inflation (period average, %)	0.5	0.9	0.4	0.7
General government finances				
Revenue (% GDP)	34.2	33.7	33.6	32.8
Expenditure (% GDP)	33.0	32.4	32.6	32.4
Fiscal balance (% GDP)	1.2	1.3	1.0	0.4
Public debt (% GDP)	42.7	40.5	38.7	37.3
Monetary and credit				
Broad money (% change)	3.5	3.1	…	…
Credit to the private sector (% change)	2.7	4.0	…	…
3-month Treasury bill interest rate (%)	-1.1	-1.0	…	…
Balance of payments				
Current account (% GDP)	6.7	10.2	9.7	9.8
Net FDI (% GDP)	2.6	3.2	2.8	2.9
Reserves (end-of-period, billions of US dollars)	762.2	738.5	…	…
External debt (% GDP)	280.1	265.0	…	…
Exchange rates				
REER (% change)	-4.3	-3.9	…	…

Sources: IMF's Information Notice System; Swiss Institute for Business Cycle Research; Swiss National Bank; and IMF staff estimates.

INTERNATIONAL MONETARY FUND

SWITZERLAND

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION

May 30, 2019

KEY ISSUES

The Swiss economy has performed relatively well since the global financial crisis. Growth compares favorably with most other advanced countries and aggregate employment has grown robustly. The fiscal position is strong and the external trade surplus remains large and stable despite several episodes of intense appreciation pressure owing to the Swiss franc's reputation as a safe haven. Growth is expected to temporarily dip to 1.1 percent in 2019 on weakness in external demand. Risks to the outlook are tilted down. Switzerland is also facing several policy challenges: low interest rates are fueling risks in the real estate and mortgage markets; persistent subdued inflation has decreased the operational space for monetary policy; and population aging and technological change will require further upskilling and generate new demands for public resources.

Key Policy Recommendations:

- Policy imbalances should be redressed. The current accommodative monetary stance is appropriate, but room for further easing is limited and risks to financial stability are rising. New macroprudential measures are needed. Shifting from a sustained structural fiscal surplus to a balanced position—consistent with the debt brake rule—would provide a one-off boost to growth, room for permanently-higher spending to address long-term challenges and reduce overreliance on monetary policy.
- New targeted macroprudential measures are needed to restrain demand for high-risk mortgages on residential investment property. The toolkit for mandated measures should be expanded, supported by a framework with enhanced expectations to act.
- Financial sector supervision has been significantly strengthened. However, the authority and independence of the financial supervisor should be further strengthened to be commensurate with the very large and complex financial sector and institutions that it supervises.
- Remaining gaps in international commitments and in compliance with international standards, including on anti-corruption, should be eliminated, and the corporate tax reform should be implemented expeditiously.
- Continued successful adaptation to population aging and technological change will require raising the retirement age, amending the pension system, continuing to welcome foreign workers, tailoring education to facilitate life-long learning, and ensuring social safety nets are compatible with new work arrangements.

Approved By
Enrica Detragiache (EUR) and Martin Kaufman (SPR)

Discussions took place in Zurich and Bern during March 21–April 1, 2019. The staff team comprised R. van Elkan (head), A. Apostolou, S. Maslova, S. Nowak (all EUR) and S. Hebous (FAD). P. Mathieu (FSAP Mission Chief, MCM) joined part of the mission. P. Inderbinen (Executive Director) and G. Heim (Senior Advisor to the Executive Director) attended some of the meetings. O. Ftomova, C. Jin and R. Vega (all EUR) supported the mission from headquarters.

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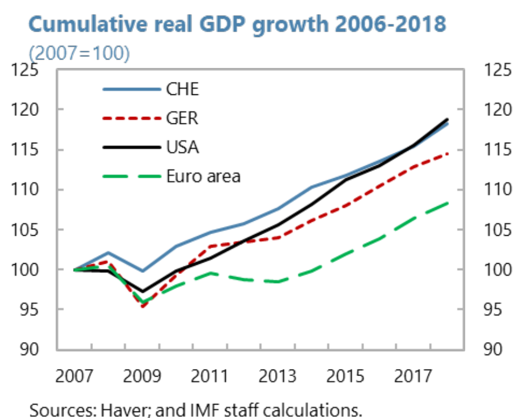
CONTEXT

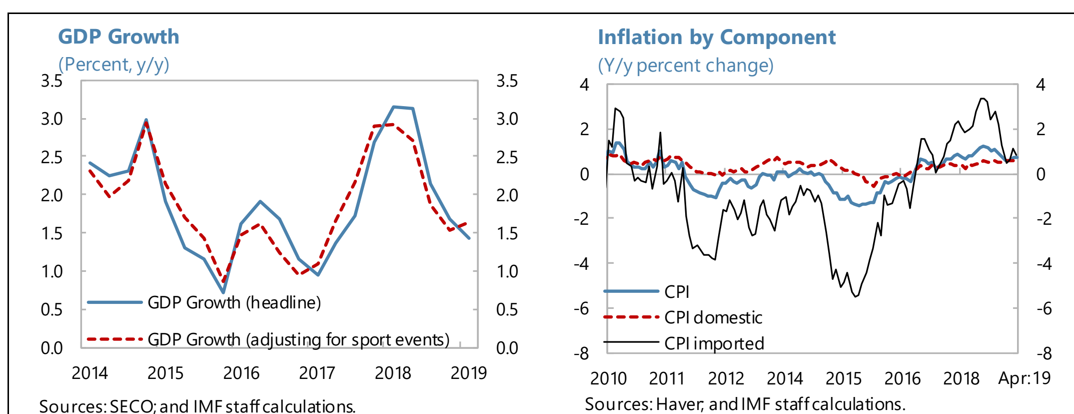
1. The Swiss economy has performed relatively well during the decade since the global financial crisis, notwithstanding periodic safe-haven pressures. Cumulative economic growth compares favorably with other advanced economies. The high standard of living reflects high-quality human and physical capital, supported by sizable ongoing investment in innovation and education. Aggregate employment has grown robustly, and productivity is among the highest in the OECD. The fiscal and public debt positions are strong, and the external trade surplus remains large and stable despite several episodes of intense appreciation pressure. Strong fundamentals and sound macroeconomic management have contributed to the Swiss franc's reputation as a safe haven.



Sources: Haver; and IMF staff calculations.

RECENT DEVELOPMENTS

2. Output grew well-above trend in 2018, although momentum slowed during the second half of the year. Robust external demand early in the year buoyed net exports and investment. However, weaker global trade since mid-2018, combined with temporary factors—a drought that prevented transporting goods to market and bottlenecks in the European auto sector—caused growth to slow and temporarily turn negative in Q3:2018. In all, output grew by 2.5 percent last year, around one percentage point higher than in 2017, with proceeds from biennial international sporting events contributing about 0.3 percentage points.[1] Year-on-year growth was 1.4 percent in Q1:2019.



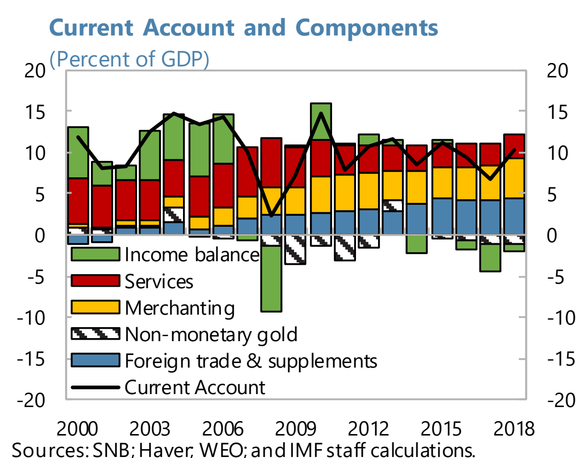
Sources: SECO; and IMF staff calculations.

Sources: Haver, and IMF staff calculations.

[1] Fees from licensing and broadcast rights generated by the summer and winter Olympics and the Football World Cup contribute to Swiss GDP as their parent associations (IOC, FIFA, UEFA) are based in Switzerland. These events are held in even-numbered years, and the absence of similar events in odd-numbered years leads to year-to-year fluctuations in seasonally-adjusted, quarterly GDP growth rates of about 0.5–0.6 percentage points (See Box 1 of the Staff Report for the 2018 Article IV Consultation).

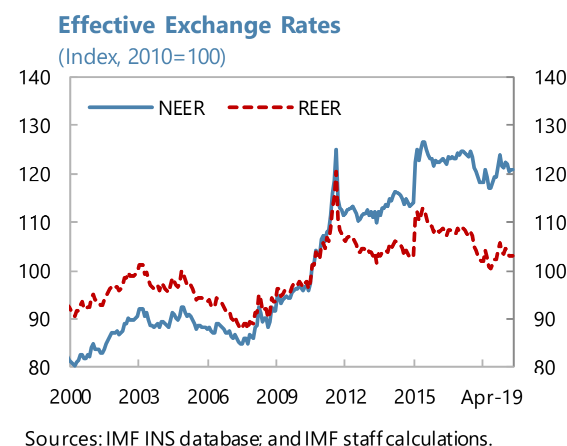
3. Despite a tightening labor market, inflation remains subdued. A surge in imported energy prices and depreciation of the franc temporarily pushed headline inflation above 1 percent in mid-2018. Subsequent reversals caused inflation to moderate to 0.7 percent in April 2019, below the mid-point of the SNB's 0–2 percent price stability band. At around ½ percent, domestic-sourced inflation is lower and more stable than its headline counterpart. The unemployment rate has continued to decrease, reaching 4.6 percent at end-2018,[2] and job openings point to shortages of engineers and IT specialists. Rising productivity and inflows of foreign workers have kept unit labor costs contained. While varying by sector, capacity utilization remains in line with—or somewhat above—long-term averages, consistent with a modest positive output gap.

4. The current account surplus increased strongly in 2018 owing to a rebound in investment income. At 10.2 percent of GDP in 2018, the current account (CA) surplus was around 3½ percentage points higher than the downwardly-revised value for 2017 on a swing in direct investment income. Nonetheless, the balance on trade in goods and services has remained stable at around 11 percent of GDP, notwithstanding fluctuations in the REER. The NIIP remained broadly constant at 128 percent of GDP.



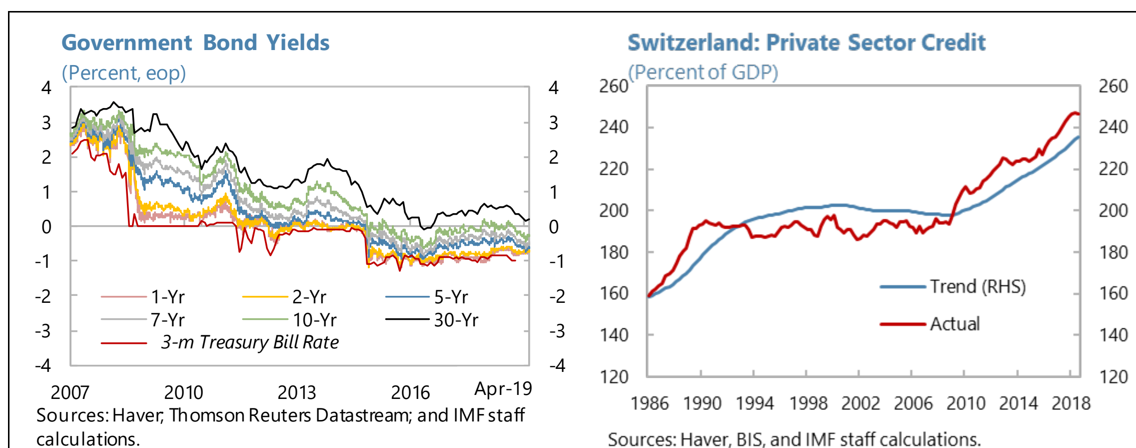
Sources: SNB; Haver, WEO; and IMF staff calculations.

5. Expectations of continued loose financial conditions are fueling investment in real estate. The franc depreciated sharply in nominal effective terms in early 2018, but has since partially reversed its previous weakness following a series of risk on-off cycles that created volatility for the safe-haven currency. However, from a longer-term perspective, the CPI-based REER has continued to appreciate. Interest rates remain near historical lows, with negative yields on government bonds with maturities up to 10 years. Private sector credit relative to GDP has risen strongly since the GFC, mainly for mortgages, and exceeds its long-term trend. The prospect of continued low interest rates has increased risk-taking in residential real estate, where prices are high or rising.



Sources: IMF INS database; and IMF staff calculations.

[2] According to the ILO definition. On the national definition, which excludes those not registered with regional placement offices, the unemployment rate was 2.4 percent in April 2019.



REPORT ON DISCUSSIONS

A. Outlook and Risks

Staff's Views

6. Following a near-term slowdown, GDP growth is expected to quickly return to a more-normal pace on a recovery in foreign demand. Annualized growth is expected to slow to around 1.1 percent in 2019 on more subdued global trade, carryover from weakness in the latter part of 2018 and the absence of biennial international sporting events. Nonetheless, momentum is forecast to recover quickly alongside the dissipation of the temporary restraining factors. As a result, output excluding the effects of international sporting events is projected to grow by around 1½ percent from 2020, close to its potential, keeping the output gap broadly closed over the medium term. In addition, the biennial cycle of sporting events will continue to add year-to-year volatility to headline GDP growth. The tightening labor market and limited spare economic capacity are projected to gradually return inflation close to the mid-point of the SNB's inflation band by end-2020, while continued inflows of foreign workers will contain incipient wage pressures. The CA surplus is expected to remain broadly stable at around 10 percent of GDP, notwithstanding the hard-to-predict income balance.

7. External and domestic risks to the outlook are tilted down. A more sustained regional slowdown, intensification of international trade tensions, persistent weakness in global import demand, and a disruptive Brexit would adversely affect the very-open Swiss economy. High global indebtedness could create financial market volatility that transmits to the Swiss financial system and its globally-active banks. As a safe-haven currency, the franc remains vulnerable to appreciation pressure from renewed global or regional risk aversion. Search for yield in a prolonged low growth-low inflation setting could cause risks in the domestic real estate market to materialize. Uncertainties regarding an institutional agreement between Switzerland and the European Union and some remaining aspects of the domestic reform agenda—including for corporate taxation and old-age pensions—could increase volatility and reduce Switzerland's appeal as an investment destination.

Authorities' Views

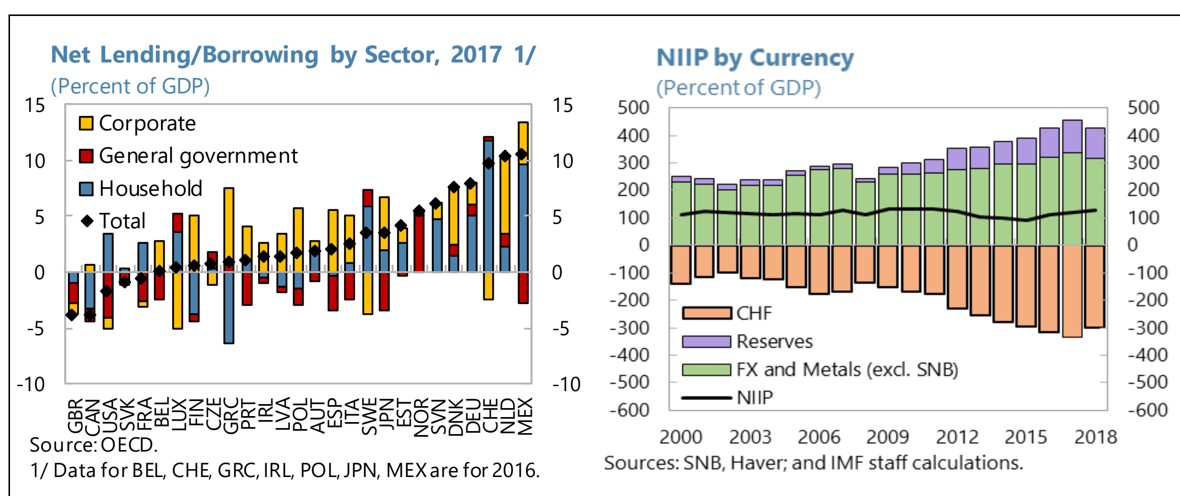
8. Following a temporary slowdown, the authorities expect economic activity to recover and grow in line with potential. From mid-2017 to mid-2018, growth benefitted from an uplift from major trading partners' import demand. A somewhat weaker effective exchange rate also provided support and enabled firms to rebuild profit margins. The direct effect of US tariffs on Swiss exports has been limited, but indirect effects are larger. As in other countries, Swiss growth momentum slowed in the second half of 2018. While growth should recover in 2019, carryover from the latter half of 2018 will weigh on growth this year, with GDP growth expected to reach 1.1 percent. Domestic and external demand are projected to raise growth to around 1.7 percent in 2020 and keep the output gap broadly closed. Conditioned on an unchanged policy interest rate, inflation is forecast to slightly decline in 2019 before rising gradually to 1.2 percent by 2021 (as of March 2019).

9. Risks to growth are seen as skewed to the downside. Greater recourse to protectionist policies, uncertainty over Brexit or concerns about fiscal sustainability in some euro-area countries could weaken global growth and trigger volatility in international financial markets that revives safe-haven pressures and impacts profits of the Swiss G-SIBs. On the domestic front, persistent imbalances in the mortgage and real estate markets, especially for residential investment property, create the risk of a price correction. In addition, further delays in finalizing an institutional agreement between Switzerland and the EU could prolong uncertainty for businesses and gradually erode access to some EU markets.

B. External Sector Assessment

Background

10. The size and composition of the external accounts are influenced by Switzerland's role as a financial center and corporate hub. Large CA surpluses—averaging around 10 percent of GDP since the GFC—are increasingly driven by goods trade and profits from merchanting, with a declining contribution from services. Responsiveness of several components (profits from



Source: OECD.
1/ Data for BEL, CHE, GRC, IRL, POL, JPN, MEX are for 2016.

Sources: SNB, Haver; and IMF staff calculations.

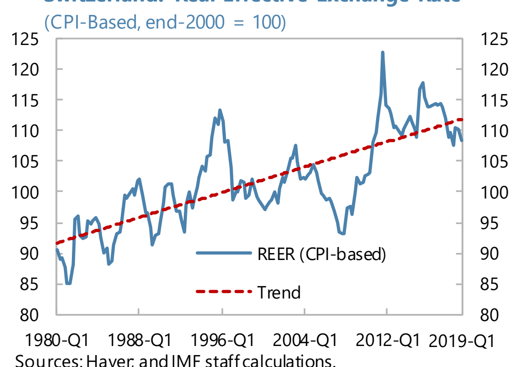
merchanting, trade in pharmaceuticals and luxury products) to changes in the REER appears limited. Direct investment income is subject to sizable year-to-year swings that introduce volatility into the CA, as well as to large ex post revisions that can make the CA difficult to predict.[3] From a saving-investment perspective, the CA surplus is attributed to households' net lending, which is partly offset by corporates' more-moderate net borrower position.[4] The positive NIIP of 128 percent of GDP has been relatively stable over time, despite persistent accumulation of past CA surpluses, reflecting valuation losses on net foreign assets. Gross financial flows and stocks are large relative to GDP, reflecting pass-through investment by multinationals, private sector safe-haven flows and accumulation of official reserves. Gross positions declined in 2018 in reponse to the US Tax and Jobs Act.[5] Errors and omissions also tend to be volatile. The CPI-based REER is 16 percent higher than in 2008.

Staff's Views

11. While the REER has been volatile since the GFC, moderate trend appreciation is consistent with Switzerland's highly-productive and profitable sectors. Despite at times very large FX purchases, several episodes of extreme safe-haven pressure resulted in sharp real appreciations, which have since been largely unwound by subsequent nominal depreciation and lower inflation in Switzerland than elsewhere. Nonetheless, from a longer-term perspective, the REER has generally strengthened in line with its trend, consistent with the presence of high value-added sectors that exert upward pressure on wages and prices across the economy. Thus, while the REER has returned to the level that prevailed during the floor against the euro, employment in more-traditional sectors exposed to international competition remains pressured.

Switzerland: Real Effective Exchange Rate

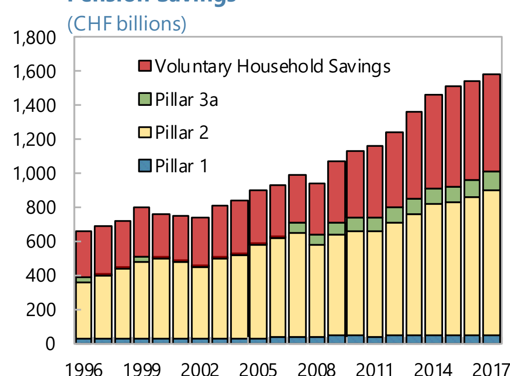
(CPI-Based, end-2000 = 100)



Sources: Haver; and IMF staff calculations.

Pension Savings

(CHF billions)



Sources: Swiss Federal Social Insurance Office, Federal Statistical Office; and IMF staff calculations.

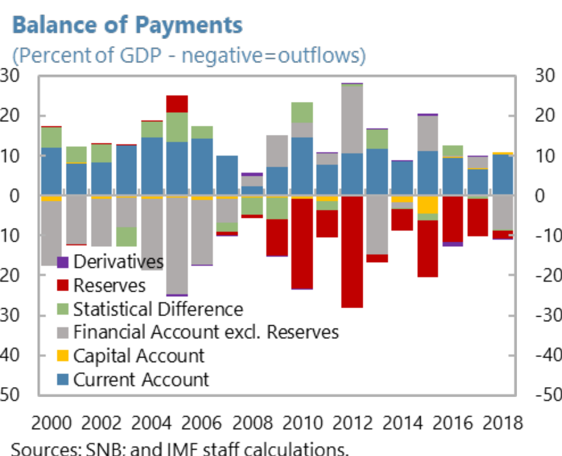
12. High household saving is a major contributor to Switzerland's current account surplus. Large saving under the mandatory pillar 2 pension scheme, supplemented with (partly

[3] The 2017 CA surplus was recently revised down by more than 2½ percentage points to 6¾ percent of GDP.

[4] Employers' pillar 2 contributions on behalf of workers are allocated to household saving.

[5] The US tax reform, which eliminated taxation of repatriated profits, encouraged foreign-controlled finance and holding companies (which perform intra-group financing and holding activities, and accounted for around one-fifth of Switzerland's gross foreign assets—and liabilities—in 2016) to scale back their gross positions in Switzerland. However, in net terms, the international investment position and financial flows were largely unaffected. Going forward, incentives for intra-group financing activities will be lower.

tax incentivized) voluntary pension saving, reflects the sizable share of the population approaching retirement age and facing a long remaining life expectancy. A bequest motive among high net worth individuals also adds to saving. The high saving rate combined with limited domestic investment opportunities suggests a sustained external contibution to Switzerland's GDP growth, and some rebalancing toward domestic absorption over the medium term would reduce this dependence. However, high savings could compress yields and encourage further saving in order to secure a target income in retirement. This effect is reinforced by a preference for domestic assets to avoid valuation losses on unhedged foreign-currency assets (or the cost of hedging) in the context of the higher post-crisis risk of appreciation given the franc's safe-haven status. High household net lending, together with the increased preference for Swiss assets since the GFC, contributed to the rapid buildup of reserves by the SNB in previous years. At about 115 percent of GDP, reserves are large, but more moderate relative to short-term foreign liabilities.[6] Reserves are the byproduct of monetary policy operations aimed at avoiding volatility in output and inflation especially when the policy interest rate is close to the effective lower bound. Resumption in mid-2017 of private financial outflows restored the pre-GFC balance of payments pattern.



Sources: SNB; and IMF staff calculations.

13. Switzerland's external position in 2018 was broadly consistent with medium-term fundamentals and desirable policies. Based on a cyclically-adjusted CA surplus of 10.4 percent of GDP and an external balance assessment (EBA) norm of 6.0 percent, policy gaps and the unexplained residual sum to 4.4 percent of GDP. However, some factors especially-relevant for Switzerland are not appropriately treated in the income account of the CA, and contribute 3.5 percentage points to the EBA unexplained residual (see Table 7).[7] Excluding these factors results in a remaining CA gap centered on 0.9 percent of GDP with an uncertainty band of ±2 percentage points.[8] Hence, the remaining CA gap is within—

Switzerland--2019 Preliminary External Balance Assessment
(For the year 2018; percent of GDP)

a	**Current Account (actual)**	10.2
b	**Cyclical contributions**	-0.2
c=a-b	**Current Account (cyclically adjusted)**	10.4
d	**EBA current account norm**	6.0
e=c-d	**Total gap**	4.4
	of which	
	policy gap contribution	-0.8
	unexplained residual	5.2
f	**Adjustments for measurement issues**	3.5
	of which	
	valuation losses due to inflation	2.2
	retained earnings on portfolio equity	1.3
g=e-f	**Remaining current account gap**	0.9

[6] See accompanying Selected Issues Paper, "Switzerland's International Reserves."

[7] Consistent with the Balance of Payments Manual, the measured CA treats as income (and hence saving) the compensation for expected valuation losses on fixed income securities and considers retained earnings of Swiss corporations owned by foreign portfolio investors as Swiss income.

[8] The extent of uncertainty is highlighted by frequent large revisions to previous years' income balances, mostly in the downward direction, as well as volatile errors and omissions.

but close to the upper bound of—the “broadly consistent” range, with the corresponding REER gap estimated at [-6.5, +1.0] percent. Further real depreciation could therefore affect future assessments.

Authorities' Views

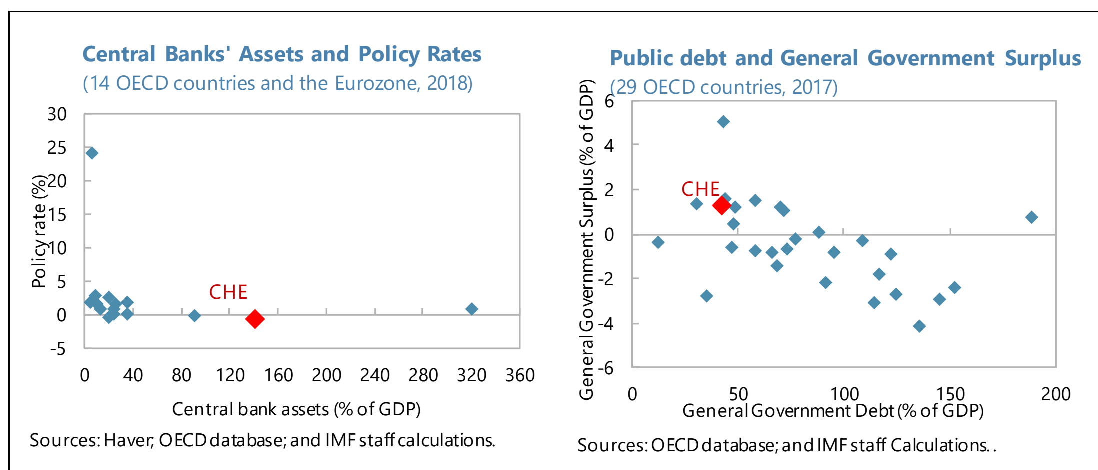
14. The authorities consider the Swiss franc highly valued—with the extent of overvaluation varying by currency—and the current account of an appropriate size. Trend nominal appreciation has quickened since the GFC on downside limits to interest rates and safe-haven pressures. Nonetheless, the CA has been largely stable as the flexible private sector and higher foreign-than-domestic inflation helped preserve competitiveness and restore profit margins. The size of the CA surplus reflects saving by an aging population in the context of high pension contributions and rising longevity, as well as conceptual measurement bias in international statistical standards. Low interest rates tend to encourage additional saving for retirement. Given small Swiss capital markets, part of wealth is invested abroad. However, since the GFC, increased uncertainty and concerns about losses on foreign currency investments may have discouraged the private sector from recycling the CA surplus abroad, while also encouraging foreign investors to move into Swiss franc investments. This has likely contributed to Swiss franc appreciation pressure, causing the SNB to lower interest rates and to intervene as necessary to meet its price-stability mandate. Private placements abroad resumed in mid 2017, and are partially hedged, thereby mitigating the risk of reversals during safe-haven episodes.

POLICY CHALLENGES

A. Macroeconomic Mix for Stability and Growth

Background

15. During the past decade, Switzerland's macroeconomic policies have been unevenly employed. Public debt is among the lowest, and fiscal balances are among the highest, within the group of OECD countries. Meanwhile, central bank assets are considerably-larger than in most other countries and the nominal policy rate is the lowest in the world.



Sources: Haver, OECD database; and IMF staff calculations.

Sources: OECD database; and IMF staff Calculations. .

Staff's Views

16. Some rebalancing of monetary and fiscal policies is warranted. With the Swiss franc a safe-haven currency, the policy interest rate in negative territory and a large SNB balance sheet, monetary policy is approaching its limits, while fiscal policy remains underutilized, even within the existing debt brake (DB) rule (see below). Borrowing costs for the Swiss government are negative and among the lowest in the world, while benefits from continuing to reduce already-moderate public debt are minimal. The current dip in economic growth provides a good opportunity to shift to a structurally-balanced fiscal position through a step increase in the public spending to GDP ratio—including by the cantons—with a focus on preparing the economy and the population for technological change and aging. It would also avoid over-reliance on monetary policy, which contributes to financial stability risks. Given the more-limited monetary policy space but substantial fiscal space, in case downside risks to activity were to materialize, fiscal policy should contribute more decisively to supporting growth. If accompanied by safe-haven inflows, leaning against the wind of large appreciation pressures—while ensuring that the secular trend is maintained—should be part of the policy response.

Authorities' Views

17. The authorities consider that assignment of macroeconomic policies should reflect the source of economic weakness. Several bouts of strong appreciation pressure on the Swiss franc have been a drag on activity during the past decade. With the Swiss franc highly valued, monetary policy should prevent excessive appreciation. The debt brake rule allows a cyclical deficit when GDP is below its potential. Lower public debt provides additional fiscal space if domestic demand were to fall sharply. A more-predictable fiscal policy also helps with calibrating monetary policy. Public spending is not very effective at offsetting exchange rate or foreign demand shocks. Even so, public policies have supported aggregate demand during the last ten years, with the creation of 200,000 new jobs in health, education, public administration and social services,[9] against 70,000 job losses in sectors exposed to international competition (industry, tourism).

Monetary Policy

Background

18. Since removing the exchange rate floor in early 2015, the SNB has utilized dual instruments to implement an accommodative monetary policy. The interest rate on sight deposits placed at the SNB has been set at -0.75 percent, the lowest in the world. The negative rate applies only to banks' balances above generally-elevated exemption thresholds (tiering), implying that the average rate is considerably less-negative than the marginal rate. Unsterilized foreign

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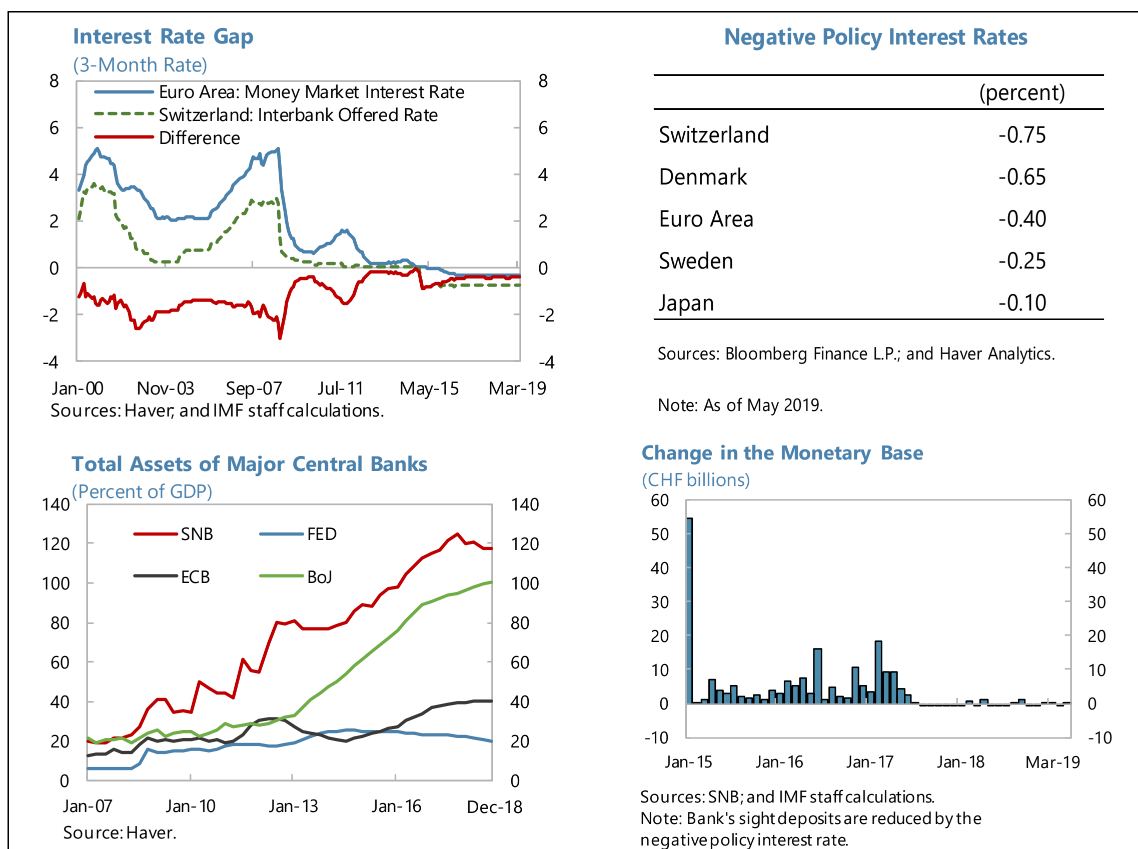
[9] Consistent with government finance statistical standards, the health sector is classified as part of the nongovernment sector.

exchange intervention, reflected in changes in the sum of sight deposits at the SNB and currency in circulation, have expanded the SNB's balance sheet. Discretionary intervention largely ceased since mid-2017, although the SNB purchased modest amounts on several occasions in H2:2018.[10] These dual tools are intended to reduce the attractiveness of the Swiss franc, thereby easing appreciation pressures in order to keep inflation within the price stability band of 0–2 percent.



Negative Policy Interest Rates

	(percent)
Switzerland	-0.75
Denmark	-0.65
Euro Area	-0.40
Sweden	-0.25
Japan	-0.10

Sources: Bloomberg Finance L.P.; and Haver Analytics.

Note: As of May 2019.

Staff's Views

19. Monetary policy has been effective at avoiding deflation and supporting the economy despite difficult conditions at times. Reflecting the franc's status as a safe haven, around 85 percent of FX acquisitions occurred during severe risk-off episodes.[11] Despite episodes of volatility, the SNB's actions allowed the REER to appreciate broadly in line with its long-term trend. Policy normalizing steps by some major central banks in recent years relieved incipient appreciation pressure on the franc. Moreover, the asynchronous pace of tightening between the Federal Reserve and the ECB could have encouraged unhedged franc-dollar carry trades, even as the policy interest rate differential with the euro—which carries a larger weight for Switzerland—remains

[10] Interest income and dividends cause passive increases in reserves, which are also subject to valuation changes.

[11] Defined as monthly increases in sight deposits that exceeded the average by at least one standard deviation.

compressed.[12] Tiering the negative policy rate and setting a high threshold helped protect most retail depositors from negative rates and insulated banks' profitability.[13]

20. The SNB retains the needed policy space to respond to a substantial deterioration in economic conditions, although less than in the past. Continued accommodative policies by major central banks could constrain the flexibility of Swiss monetary policy. A more negative rate risks "runs to cash" by the public and "search for yield" by banks, while larger reserves bring more volatile valuation changes. Hence, policy space is limited. However, moving somewhat further into negative interest rate territory—including by introducing a second, lower interest rate tier—remains feasible if needed to meet persistent low inflation. Doing so would strengthen the already-pressing need for tighter macroprudential measures to contain excessive risk-taking in the real estate sector. FX intervention should be reserved mainly for leaning-against-the-wind of large safe-haven pressures that would otherwise cause excessive volatility in inflation and output, but while preserving the trend appreciation. As a matter of good policy and transparency, regular and timely publication of foreign exchange intervention data is encouraged.

Authorities' Views

21. The authorities agreed that the current expansionary monetary policy remains appropriate, and that room to act is available if economic conditions were to deteriorate. The two pillars of the SNB's policy remain essential in the context of the still-fragile FX market, as evidenced by one-sided positioning and the ongoing risk of renewed safe-haven pressure. Policy actions by the Federal Reserve and the ECB are relevant for the Swiss economy and thus the SNB's decision making, with the latter carrying somewhat greater importance. While Swiss monetary policy has been stretched, room exists to further reduce the interest rate and resume FX purchases if needed to achieve price stability, with the circumstances determining the choice of instrument. Nonetheless, some volatility in prices and output can be tolerated. No adjustments to monetary policy in either direction are needed at present. While the SNB's FX purchases have been modest in the past two years, its balance sheet is large, creating the potential for volatile profits. In recent years, intervention has been conducted only in the spot market, and FX intervention is apparent from sight deposits held at the SNB. These data are available weekly and complement the yearly intervention data published in the SNB's annual report.

22. The authorities concurred that monetary policy continues to work well, and that side effects can be mitigated. Low long-term interest rates reflect fundamentals, including demographics, and monetary policy works through the short-term rate. A tiered remuneration structure was adopted at the beginning of the negative interest rate policy to discourage pass-through of negative rates to retail deposits and to alleviate pressure on banks' profits. Macroprudential policies complement monetary policy.

[12] See accompanying Selected Issues Paper, "The Swiss Franc – Living In A Multipolar World."

[13] Due to tiering, the effective negative policy rate is around 0.3 percent.

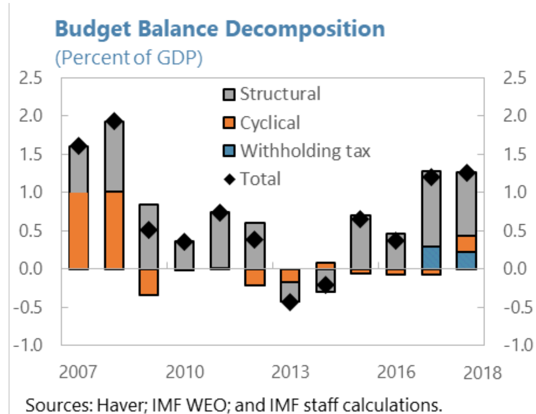
Fiscal Policy

Background

23. Switzerland's fiscal position is strong. The general government headline surplus averaged 0.6 percent of GDP since the mid-2000s following the introduction of DB rules by the federal government and most cantons around 2003.[14] General government gross debt has decreased by almost 18 percentage points during this period to 41 percent of GDP.[15] The federal DB rule calls for a structural (cyclically-adjusted) balance on an ex ante basis. In case of ex post spending overruns, offsetting structural surpluses are required in subsequent years. No similar offset requirement exists for ex post underspending. Fiscal surpluses in 2017–18 were 1.2 and 1.3 percent of GDP, respectively, partly due to an exceptional ¼ percentage point increase in withholding tax revenue.

Staff's Views

24. Fiscal policy has consistently overperformed the DB rule's structural-balance objective, imposing a sustained drag on output. Adjusting for cyclical conditions and exceptional withholding tax revenue in 2017–18, staff estimates structural surpluses averaged 0.5 percent of GDP since 2006 (cumulating to around 6 percent of 2018 GDP), considerably higher than the balanced position mandated in the DB rule. Overperformance reflects conservative forecasting of structural revenue, including by generally overestimating the output gap, as well as under-executing expenditures to avoid breaching the approved ceiling. Systematic conservative implementation of the rule imposes an undesirable pull on growth during cyclical downswings. Running a balanced structural position would nonetheless deliver the DB rule's goal of a declining public debt ratio.



Sources: Haver; IMF WEO; and IMF staff calculations.

25. A less-conservative implementation of the DB rule would make room for additional spending, including to deal with long-term economic trends. Surpluses could be used to compensate cantons in case of any residual revenue loss from corporate tax reform, thereby obviating the need for them lower spending to comply with their DB rules. With population aging, growing demands for health care and other social spending will need to be accommodated. In addition, changes in technology and the nature of work will require additional outlays to upskill the population and smooth potentially more-frequent and longer-duration employment transitions (see paragraph 37). This additional public spending would be an investment in Switzerland's future, and

[14] See accompanying Selected Issues Paper, "Fiscal Federalism."

[15] More recently, debt reduction, which includes net acquisition of financial assets and valuation changes, has tended to fall short of what is implied by primary surpluses and automatic debt dynamics (Annex II). On a Maastricht definition, gross public debt stood at 28 percent of GDP in 2018.

by boosting potential growth, would be partly self-financed. Instead, current proposals to allocate surpluses to various tax expenditures would make the tax system more distortionary.

26. Several refinements would enhance the operation of the existing rule. Improving the procedures for assessing the output gap and forecasting revenue would reduce systematic underestimation of structural revenue. The countercyclical function of the rule should be increased by estimating the cyclical position on the basis of GDP excluding the effects of biennial international sporting events. The previous widening of individual spending categories covered by administrative units' budget limits has achieved some success in reducing within-year underspending. However, allowing the rule's ex post provision to operate symmetrically, thereby permitting spending to catch up the following year, is advised to more effectively reduce systematic under-execution of the budget.

Authorities' Views

27. The authorities consider that the debt brake framework provides growth-enhancing and counter-cyclical support. While the expenditure-to-GDP ratio has been broadly unchanged since 2014, within this envelope, additional spending on growth-enhancing education and physical infrastructure has been financed through prioritization of spending and lower interest payments. Automatic stabilization on the spending side is provided through generous unemployment benefits and subsidies for mandatory health contributions. Part of recent revenue overperformance is likely temporary, reflecting withholding taxes associated with negative interest rates and the 2018 US tax reform, and will be balanced out by positive revenue forecast errors in the next several years. However, spending will likely continue to undershoot budgeted ceilings, leading to systematically better than budgeted fiscal outturns. Sustained overperformance has raised questions about the implementation of the rule. In 2017, a group of experts recommended not to change the debt brake rule for the time being, and—if any changes were made—to lower taxes,[16] rather than to raise spending. Switzerland does not have obvious public investment gaps, and increasing fiscal spending could introduce inefficiencies.

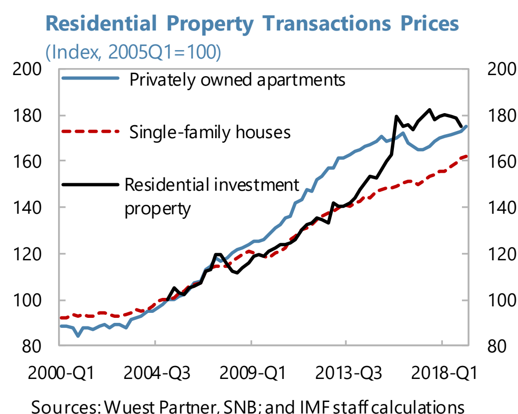
B. Taming Financial Stability Risks

Background

28. Persistent low growth and low inflation, accompanied by very-low interest rates, intensifies financial stability risks. Prices of privately-owned housing have risen since 2017 after having slowed in response to tighter macroprudential measures introduced during 2012–14. However, prices of

Residential Property Transactions Prices

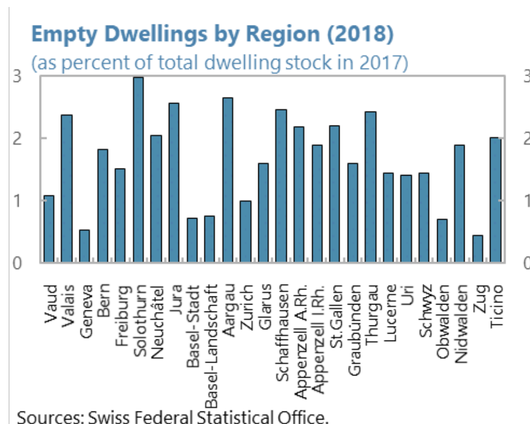
(Index, 2005Q1=100)



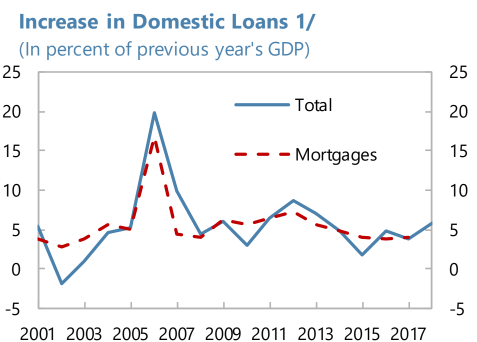
Sources: Wuest Partner, SNB; and IMF staff calculations

[16] Options currently under discussion are to raise the personal income tax (PIT) deduction for health insurance contributions and for children, and to abolish PIT on imputed rental income, while in some instances also eliminating the deductibility of mortgage interest payments.

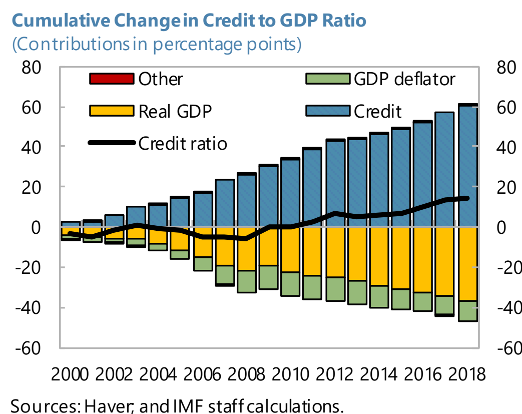
apartment buildings, which are used for investment purposes, jumped sharply around 2015 following monetary policy loosening in Switzerland. While prices of investment properties have since declined slightly, vacancy rates have risen as construction has outpaced demand. Notwithstanding a 40 percent home-ownership rate, household leverage is among the highest in the OECD, and mortgages—which comprise 85 percent of banks' domestic loans and more than 200 percent of GDP—are increasing by about 5 percentage points of GDP per year. With yields on residential investment properties above those on government bonds, pension funds and insurance companies have allocated about a quarter of their resources to the real estate sector,[17] and are an important driver of real estate dynamics. Households' direct and indirect exposure to real estate on both sides of their balance sheet is very high through ownership of property and related mortgages, and savings held in bank deposits, pension and insurance vehicles, and holdings of real estate-related equities and investment funds. An SNB survey finds that about 40 percent of banks' new lending is mortgages for investment properties, and these tend to be more risky, with a greater incidence of both high loan-to-value and low loan-to-income characteristics. With slower growth in nominal incomes, automatic debt dynamics will contribute less than in previous decades to passive reduction of very-high debt-to-income ratios, especially because mortgage interest rates have not decreased as much as the policy rate.



Sources: Swiss Federal Statistical Office.



Sources: SNB; and IMF staff calculations.
1/ Jump in 2006 reflects wider coverage of credit institutions beginning that year. Data for 2017 covers the period through November, and is annualized.



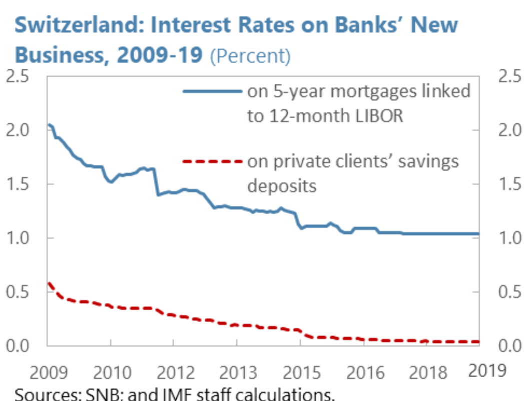
Sources: Haver, and IMF staff calculations.

Staff's Views

29. Considerable progress has been made in strengthening banking sector resilience, but sustained low interest rates and high real estate exposure are creating risks. Stress tests performed in the context of the Financial Sector Assessment Program (FSAP) find financial institutions to be well-capitalized and liquid and resilient to severe shocks, although some banks would breach their capital buffers under a very adverse scenario. However, very low and flat yield curves are encouraging greater risk-taking by banks as they pursue higher-yielding lending to

[17] Part of this includes direct provision of mortgages, although these comprise less than 10 percent of the total mortgage market.

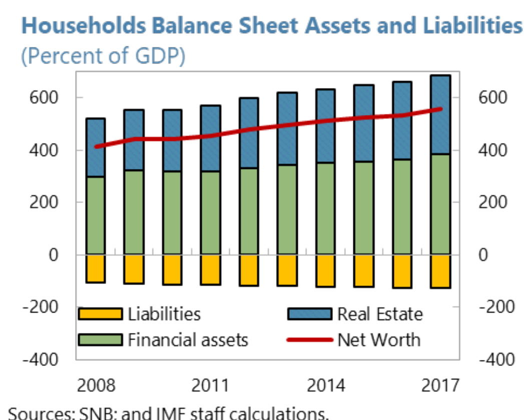
counter narrowing interest margins caused by deposit rates floored at zero, downward pressure on lending rates from competition from nonbanks with lower funding costs and rollover of maturing mortgages at lower rates. Pension funds and insurance companies, which face high statutory payout rates, continue to invest in residential investment properties, including in regions with high vacancy rates. The combination of elevated residential property prices, high leverage and rising vacancy rates increases the likelihood of a price correction. A large jump in interest rates could also induce a drop in prices. Given the widespread and extensive exposure to real estate, any shock to property prices could resonate through the economy, with significant financial stability, economic and social costs.



Sources: SNB; and IMF staff calculations.

30. New targeted macroprudential measures, supported by a framework with enhanced expectations to act, are needed. Curtailing the buildup of risk in residential investment mortgages through tighter eligibility and amortization requirements is overdue, and the prospect of global "low-for-long" interest rates heightens this imperative. With the authorities having chosen not to create legally-mandated tools for such demand-side measures, the Swiss Bankers' Association indicated it may fill the void by adopting new self-regulation measures targeting residential investment mortgages. However, self-regulation by banks is subject to concerns about timeliness and stringency. Instead, the toolkit for mandated demand and capital-based macroprudential measures should be broadened, accompanied by an accountability framework that specifies expectations to act.

31. Policies encouraging high household leverage should be unwound. The combination of high debt and large financial assets is fostered by the tax treatment of owner-occupied property, lax amortization requirements, and low interest rates. While aggregate household balance sheets appear strong at current valuations, a correction in asset prices or interest rates could significantly compress net worth. Current proposals to eliminate taxation of imputed rent should be accompanied by removal of mortgage interest deductibility to preserve tax neutrality of real estate and avoid incentivizing further increases in indebtedness and further raising house prices. Tightening the existing amortization requirement on owner-occupied mortgages (currently, one-third of collateral value within 15 years, after which the loan becomes interest-only until maturity) is also needed.



Sources: SNB; and IMF staff calculations.

32. The complexity and large size of the Swiss financial system calls for continual upgrading of regulatory and supervisory frameworks and capacities (Annex III). Considerable progress has been made to strengthen supervision, although important deficiencies remain. To better manage conflict of interest and objectivity concerns, FINMA should directly contract and pay audit firms for supervisory audits of banks, and should itself conduct more on-site inspections, especially of the largest banks. Protections against cyber risk and closer oversight of fintech activity are warranted. In addition, strengthening the autonomy of FINMA is critical to preserving the strong international reputation of the Swiss financial system and to limiting contingent fiscal liabilities. Strengthening the governance and autonomy of FINMA and upholding its authority to set binding prudential requirements are critical to maintaining financial stability. Progress in reinforcing financial sector safety nets and crisis management arrangements has been made, but more work is needed to further improve banks' recovery and resolvability and to create a public and fully-funded bank deposit insurance agency, in line with international norms. Important data gaps including on fintech should be remedied.

Authorities' Views

33. The authorities agree that new measures to curb imbalances in mortgage and real estate markets are needed, and are being prepared. FINMA has already intensified its supervision of income-producing residential real estate (IPRRE), and levied targeted capital surcharges on risky lending by individual banks. In addition, macroprudential measures targeting IPRRE are needed. Were the tighter self-regulation measures currently under consideration by the Swiss Bankers Association (SBA) to be recognized by FINMA, they would become a binding regulatory standard. The government is simultaneously preparing changes to the Capital Adequacy Ordinance that would raise risk weights on residential investment mortgages. Implementation of the proposed change could be suspended if the self-regulation measures proposed by the SBA were deemed sufficient and implemented. Changes to property taxation would help to reduce high household debt. Parliament is currently discussing options to remove the tax on imputed rent while in some instances also eliminating the tax deductibility of mortgage interest payments.

34. Potential further macroprudential measures would be anchored within the existing institutional framework. Macroprudential policy-making has technical as well as political-economy dimensions. This is reflected in the current framework, where shared responsibility and collaboration among the authorities facilitates exchange of views and ensures that measures enjoy broad support and legitimacy, while also preserving institutional independence and respecting the existing individual roles, mandates and prerogatives of the SNB, FINMA and the Federal Council. Were new macroprudential measures—including demand-side tools—to be considered, decision-making should be formalized, and responsibilities clearly assigned, in line with existing procedures for the countercyclical capital buffer.

35. The authorities concurred that amending the frameworks for supervision and regulation is needed, which will require political support. Allowing FINMA to contract, design and pay for banks' supervisory audits, which requires legislative approval, would strengthen the depth and efficiency of these audits. Cost savings could be used to build in-house capacity and to

outsource analysis of new issues, including fintech and cyber security. An ordinance to more clearly specify FINMA's mandate and affirm its current responsibilities has been prepared, and is currently under consultation. Support exists for increased pre-funding of deposit insurance, but a government backstop fund could encourage moral hazard. To maintain a dynamic financial sector, Switzerland is welcoming of innovation, including in the area of fintech, without compromising financial stability and integrity.

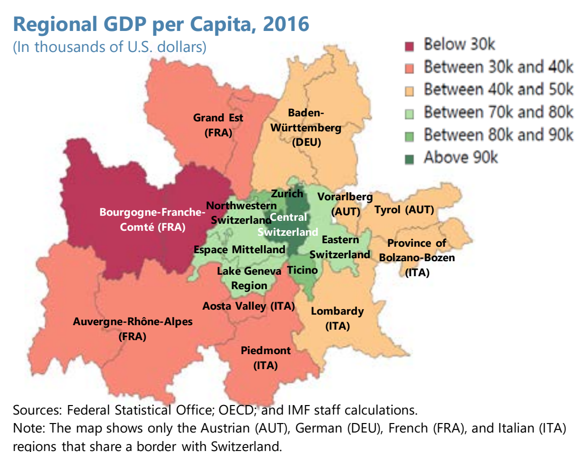
C. Adapting to Structural Challenges

Cross-Border Wage Gaps and Automation

Background

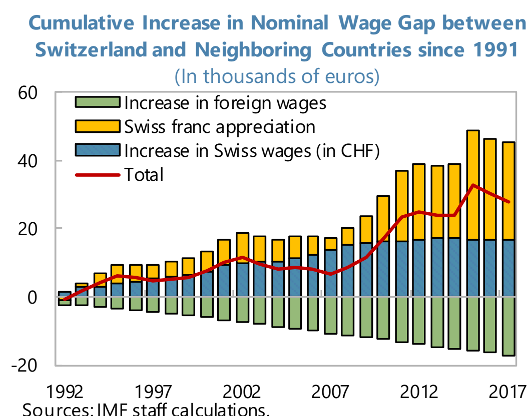
36. Swiss wages are considerably higher than in neighboring regions. Cross-border wage gaps have persisted notwithstanding a significant increase in foreign workers since opening to the EU labor market in 2002. Foreign workers account for about one-third of the Swiss labor force. During the past decade, employment has risen strongly and the wage distribution has been stable.[18] However, nearly half of Swiss jobs are at moderate or high risk of automation, among the highest in the OECD.[19] In a 2016 popular vote, Switzerland rejected an initiative for a universal basic income that would have paid CHF 2,500 per month to every adult.

Regional GDP per Capita, 2016
(In thousands of U.S. dollars)



Sources: Federal Statistical Office; OECD; and IMF staff calculations.
Note: The map shows only the Austrian (AUT), German (DEU), French (FRA), and Italian (ITA) regions that share a border with Switzerland.

Cumulative Increase in Nominal Wage Gap between Switzerland and Neighboring Countries since 1991
(In thousands of euros)



Sources: IMF staff calculations.

Staff's Views

37. Persistent cross-border wage gaps reflect strong Swiss fundamentals and appear not to have been dampened by international labor mobility, but could be affected by automation. High Swiss productivity accounts for much of the long-standing cross-country wage differential, while large appreciations temporarily widen the gap.[20] The

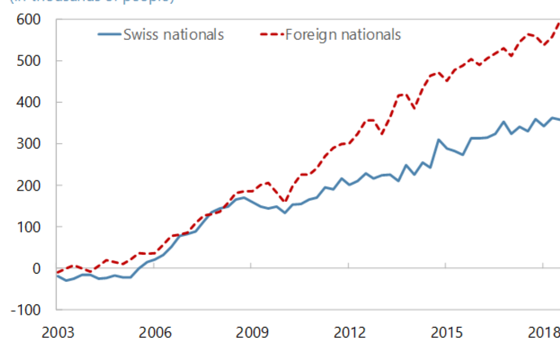
[18] The ratio of the 90th to 10th percentile of the wage distribution for full-time employees narrowed marginally during 2008 to 2016 to 2.6. In addition, the ratio of the top to the bottom income quintiles declined somewhat during this period to 4.2.

[19] Deloitte (2015), "Impact of Automation on the Swiss Job Market," using the methodology of Frey and Osborne (2013), "The Future of Employment: How Susceptible Are Jobs to Computerization?" Oxford University.

[20] See accompanying Selected Issues Paper, "Switzerland: Cross-Border Wage Gaps – Possible Drivers."

increase in foreign workers—most of whom are highly skilled—has coincided with net job creation for Swiss nationals and rising average wages that, in turn, stimulated faster productivity growth. Addressing shortages of skilled labor by maintaining the standard of excellence in Swiss education and remaining open to foreign labor is likely to continue to benefit the Swiss economy and its population. Nonetheless, automation could bring substantial changes to the labor market, including greater polarization of wages, less-permanent forms of employment, and more rapid obsolescence of skills. Social safety nets should be reviewed to ensure they provide adequate support in the event of more-frequent or longer-duration transitions in-and-out of employment, while still encouraging job search. Eliminating higher contribution rates for older workers under the second pillar pension scheme would help reduce disincentives for employing these workers.

Switzerland: Cumulative Change in Employment since 2002
(In thousands of people)



Sources: Federal Statistical Office; and IMF's staff calculations.

Authorities' Views

38. High Swiss wages and prices reflect productivity in cutting-edge sectors, supported by investment in human capital. Wages in high-productivity sectors are determined internationally. The sizable share of these activities in the Swiss economy relative to other countries tends to pull up the level of prices and, in turn, wages in lower-productivity activities. Wages for less-skilled workers are also underpinned by sectoral minimums that apply to foreign workers as well. While Swiss workers tend to be employed on a permanent basis, cross-border worker flows tend to be more responsive to cyclical conditions and skill shortages. As a result, the free movement of workers has increased the elasticity of labor supply, dampened the cyclicality of wage and price inflation and helped expand the technology frontier. Large and growing private and public spending on education and vocational training have supported the continuous upskilling of employment, which enabled routine, low-skilled jobs to be replaced with ones less-vulnerable to automation, thereby avoiding wage polarization. However, workforce aging presents a challenge as older workers find it more difficult to return to employment if they are laid off, reflecting more-dated skills. A program to strengthen basic skills in the workplace was adopted in 2017, and a report is under preparation on increasing the flexibility of social insurance in the context of new forms of work and new business models.

Corporate Tax and Pension Reform

Background

39. Reform of corporate income taxation and the pension system is proceeding. Recent approval of the referendum allows for the implementation in 2020 of the new CIT framework that abolishes preferential tax regimes in compliance with the OECD's Base Erosion and Profit Shifting project and initiatives by the EU, including by equalizing treatment of multinationals and other firms.

Full implementation also requires changes by the cantons. The referendum also modestly increases funding for the first-pillar, pay-as-you-go public pension scheme, although current obligations would still fall short of current revenue even before the projected bulge in retirements (see Box 1).

Staff's Views

40. Reforming the pension system and corporate taxation are essential. Rising longevity and fewer people of working age in the total population will require additional adjustments to the pension system, including equalizing male and female retirement ages and raising them over time, as well as sourcing additional tax revenue. For the second pillar, sustainability would be improved by lowering the guaranteed rate at which pension savings are converted into annuities, and linking it to market yields on long-term sovereign debt and life expectancy at retirement. Promptly completing corporate income tax reform at the cantonal level is needed to maintain competitiveness.

Authorities' Views

41. The authorities welcomed the recent approval of the referendum on corporate income taxation and pension systems as important steps in the reform process. Switzerland is expected to remain an internationally-attractive business location following the CIT reform. While the static revenue effect will be somewhat negative, cantons will be partly compensated for any revenue loss through higher revenue sharing of direct federal tax, which is already budgeted for 2020. However, revenue effects could be positive in the medium and longer term. The recently approved first pillar pension financing package is a necessary first step, but additional reforms are needed to both the first and second pillars to ensure sustainability.

Addressing Supply and Concealment of Corruption

Staff's Views

42. Anti-foreign bribery enforcement has strengthened in recent years.[21] The report by the OECD Working Group on Bribery in International Business Transactions, which for Switzerland is the basis for staff's assessment, commends the increase in prosecutions and convictions, including of legal persons.[22] With several Swiss multinationals operating internationally in sectors prone to bribery (e.g., oil and pharmaceuticals), Swiss enforcement actions by the Office of the Attorney General have had a positive impact at both the national and international levels. The positive assessment reflects confiscation of considerable amounts of assets, proactive responses to mutual legal assistance (MLA) requests, spontaneous forwarding of information, establishment of joint investigation teams, and analysis by the Financial Intelligence Unit (FIU) of suspicious transaction reports (STRs) that contributed to detection of bribery.

[21] OECD Working Group on Bribery (WGB) Phase 4 report, published in March 2018. Staff's views do not prejudice the Working Group's monitoring of the implementation of the OECD Anti-Bribery Convention.

[22] A progress report by the OECD Working Group is expected to be published in March 2020.

43. Continuing to build on recent efforts is encouraged in view of the size of the economy and the bribery risks inherent in some sectors and legal structures (e.g., domiciliary companies). Some imposed sanctions are not effective, proportionate or dissuasive, particularly in relation to legal persons, for which the maximum fine (CHF5 million) is low. With the majority of foreign bribery cases resolved outside the courts through summary punishment orders, some elements of concluded cases should be published. Prompt adoption of a whistleblower framework in the private sector and strengthened protections for public whistleblowers are urged. Ongoing review of access conditions to MLA requests and appeals by interested persons is encouraged. Fund staff agrees with these recommendations by the OECD Working Group and urges the authorities to move forward with implementing them.

44. Switzerland's AML/CFT regime has both strengths and challenges, including in addressing foreign bribery. The Mutual Evaluation Report by the Financial Action Task Force (FATF) identifies corruption as one of the main money laundering threats in the context of Switzerland's 2015 national risk assessment, and noted that risks are highest among private banks, independent asset managers, fiduciaries, lawyers and notaries.[23] The application of enhanced due diligence measures on politically exposed persons and complex corporate vehicles was positively noted. While Swiss companies (including those with bearer shares) are required to maintain an up-to-date register of shareholders/partners and their beneficial owners, no criminal or administrative sanctions exist for shareholders who do not comply. The conduct by the authorities of large-scale complex investigations, which led to money laundering convictions, particularly in relation to foreign corruption, is commended. While MLA is overall obtained without undue delay (including freezing and restitution of sums linked to foreign corruption), shortcomings exist as regards maintaining confidentiality of requests (i.e., financial intermediaries are obliged to inform customers of such requests).

45. The authorities' ongoing efforts to enhance the effectiveness of the AML/CFT framework are welcome. Several draft laws are pending before parliament: (i) a new sanctions regime for breaches of the notification requirements for beneficial owners; and (ii) conversion of bearer shares in non-listed companies into nominal shares. In addition, lawyers, notaries and fiduciaries would be subject to AML/CFT measures concerning the establishment, management and administration of legal persons and arrangements. MLA will be simplified and sped up by permitting the early transmission of information to facilitate foreign investigations (with possible maintenance of confidentiality). Reform of the MLA framework would also allow for setting up joint investigation teams. The FIU will also be empowered to request information from financial intermediaries based on a foreign request, even in the absence of a STR in Switzerland. Staff encourages timely passage of these measures and their effective implementation.

[23] FATF, Switzerland: Mutual Evaluation Report (December 2016).

Authorities' Views

46. The IMF's assessment of recent progress, ongoing efforts and remaining issues related to the supply-side of corruption is welcome. The assessment confirms Switzerland's strong improvements in implementing the OECD Anti-Bribery Convention, witnessed by the significant rise in prosecutions and convictions. It also confirms Switzerland's commitment to implement the main actions recommended by FATF. Several important laws are before Parliament with a view to further enhancing the detection and prosecution of corruption and related money laundering. The authorities remain actively engaged in the discussions on issues related to the fight against corruption in the relevant international fora.

STAFF APPRAISAL

47. Following a temporary soft patch, prospects for the Swiss economy remain favorable, although risks are present. Signs of recovery from the temporary slowdown in late 2018 are visible, consistent with resilient—though moderate—global growth in early 2019. As a result, GDP is expected to expand in line with its potential rate of around 1½ percent from 2020, with the output gap remaining broadly closed and the current account largely unchanged. Nonetheless, this outlook could be disrupted by intensification of international trade tensions or renewed global or regional risk aversion that would constrain Switzerland's tradable sectors. Low-for-longer interest rates could accentuate risks in the real estate market, while lack of clarity on long-term relations with the EU could unsettle the business climate.

48. Switzerland's external position is broadly in line with medium-term fundamentals. Households' large net creditor position reflects high saving by the large prime-saver-aged population and long life expectancy. A desire for inter-generational transfers may also boost saving. A preference for domestic assets, due in part to the franc's safe-haven status, may also encourage saving by compressing yields. Excluding items not appropriately treated in international statistical standards reduces the current account close to the level consistent with Switzerland's fundamentals. The real overvaluation that followed the exit from the exchange rate floor in early 2015 has been fully unwound.

49. The current imbalance between monetary and fiscal policy utilization should be redressed. Very accomodative monetary policy helped deter safe-haven pressures and reverse earlier deflation, but room for further easing is limited. Meanwhile, negative borrowing costs, sustained fiscal surpluses and moderate-and-declining public debt indicate substantial fiscal space, even relative to Switzerland's own debt brake rule. Shifting from a sustained structural surplus to a balanced fiscal position through higher public spending in 2019 when growth is predicted to be subdued would provide a one-off boost to growth, create room for permanently-higher public spending to address structural challenges and alleviate pressure on monetary policy.

50. Limited room exists for further monetary accomodation if needed to secure price stability, and should be accompanied by a more prominent role for fiscal policy given the substantial fiscal space. Previous normalizing steps by major central banks alleviated pressure on

Swiss monetary policy, although asynchronous tightening across central banks implies the effect was uneven. While residual flexibility is limited, space remains for a modest reduction in the policy rate, but which would accentuate the already-pressing need for tighter macroprudential policies and for fiscal policy to play a more-decisive role in supporting activity. Foreign exchange intervention is best suited to absorbing part of safe-haven pressures that would otherwise push the real exchange rate well-above its trend appreciation path, provided that this secular trend is maintained. Timely publication of foreign exchange intervention data is encouraged.

51. The stabilizing and growth-enhancing aspects of the debt brake rule should be strengthened. Systematic conservative implementation of the rule imposes an unwelcome drag on output when—as is expected in 2019—growth is below potential. Better delivering on the rule's automatic stabilizing objective would be achieved by more accurate revenue forecasts and avoiding overly-strong assessments of cyclical positions. Eliminating the structural surplus would allow additional spending with a focus on preparing for technological change and population aging and to cover any revenue shortfalls from corporate tax reform that might otherwise require cantons to reduce spending. Changes to key parameters in the public pay-as-you-go and private pension systems are also needed to reinforce the sustainability of social safety nets.

52. New targeted macroprudential measures are needed to curtail the further buildup of risk in the banking and real estate sectors. Banking sector resilience has increased in recent years, but sustained low interest rates are encouraging risky mortgages and excess supply in the residential investment property segment. New measures to restrain demand for high-risk mortgages are overdue and made more urgent by the prospect that interest rates will remain low for an extended period. Self regulation by banks is not sufficiently timely or stringent, and the toolkit for mandated measures should be expanded, supported by a framework with enhanced expectations to act. In addition, tax policies that encourage high household leverage related to owner-occupied property should be removed in a neutral manner that avoids further incentivizing debt and boosting house prices. Existing generous amortization requirements should also be tightened.

53. Financial sector regulation and oversight should be proportionate to the size and complexity of the Swiss financial system in order to protect its strong international reputation. Supervision has been strengthened over the past decade, but the authority and independence of FINMA are not fully adequate to the very large and complex financial sector and institutions that is supervises. FINMA should directly contract and pay audit firms for outsourced supervisory audits, its governance and autonomy should be strengthened and its ability to set binding regulation should be upheld. In addition, the financial sector safety net should be strengthened and important data gaps closed. Balancing receptiveness to innovation with a proactive approach to protecting financial stability and integrity is urged.

54. Preparing for population aging and for automation and new work arrangements should continue. Reform of the first and second pillars should continue to ensure long-run sustainability, including in the event of persistent low interest rates. Maintaining the high-quality of education and investment in innovation, while continuing to welcome foreign workers, will help ensure Switzerland remains at the technological frontier and reduce the risk of future wage

polarization. Social safety nets should be reviewed to ensure they are compatible with new, more-varied, work arrangements and that the structure of contributions does not penalize specific segments of the workforce.

55. Remaining gaps in meeting international commitments should be quickly resolved. Reforms to continue to align legislation and practices to international standards, including on corporate taxation, anti-corruption and AML/CFT, should be implemented expeditiously.

56. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Box 1. Corporate Tax and First Pillar Pension Funding (STAF) Reform

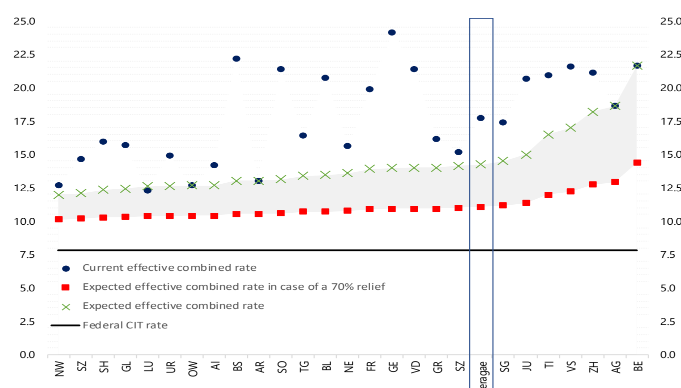
A tax and pension reform will come into effect at the beginning of 2020, following recent approval of the referendum in a popular vote. The reform mainly affects the corporate income tax (CIT) and the first-pillar pension system.

Tax Reform

The reform abolishes cantonal preferential tax regimes that no longer conform with international standards. Existing regimes largely exempt qualifying "status companies" from cantonal and municipal CITs, which significantly lowers their combined CIT rates toward the federal rate of 7.83 percent.

The reform also provides cantons with three new bases for corporate tax relief, consistent with international standards: patent box regimes, super R&D tax deductions, and, under certain condition, an allowance for corporate equity. Cantons also retain their existing autonomy to set cantonal CIT rates. These elements will allow CIT bases and rates to differ across cantons.

Pre- and Expected Post-Reform Effective Tax Rates in Switzerland
(In percent)



Source: IMF staff calculation.
Note: Expected reactions by the largest four cantons are indicated by blue arrows. Canton Vaud (VD) lowered its CIT rate to 13.79 as of January 2019. A referendum in November 2018 in Bern rejected lowering its CIT rate. The simulation of expected effective combined rates assumes that cantonal and municipal taxes are imposed on only 30 percent of pre-tax profit, while the federal tax is imposed on the entire pre-tax profit, and the tax amount is itself deductible. Firms' effective taxation will be somewhere in the gray shaded area. Most status companies currently face a CIT rate close to the federal CIT rate or above the federal rate but below the expected effective combined rate.

Cantons are expected to respond by lowering their CIT rates. The authorities expect the overall reform to produce a static revenue loss at the general government level of around 0.3 percent of GDP, although this estimate is uncertain as it depends on decisions of cantons and firms. To partially compensate cantons for lower tax revenue, the reform raises their share of direct federal tax revenue from 17 to 21.2 percent.

Switzerland is expected to remain internationally competitive. The reform is expected to raise taxes somewhat on existing status companies (by abolishing preferential regimes and subjecting them to the standard CIT rate) and lower taxes on non-status companies (owing to the decrease in standard CIT rates). The reform is likely to result in relatively competitive effective CIT rates from an international perspective, on the order of about 10 percent (taking into account tax relief), depending on the canton. The current OECD average statutory CIT rate is 22.4 percent, higher than the expected unweighted Swiss cantonal average rate of 14.3 percent.

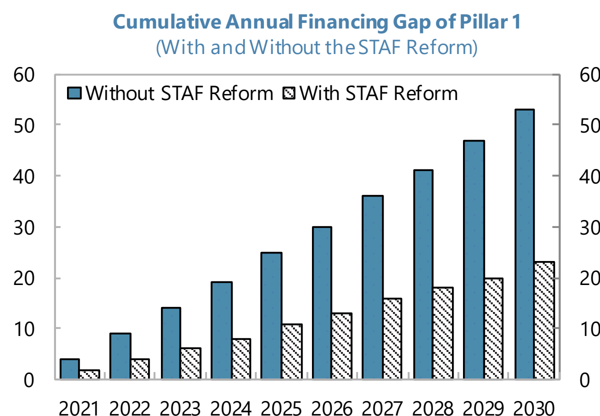
Pension Reform

The Swiss pension system consists of three pillars:

- First pillar, the old age and survivors' insurance (AHV), is a pay-as-you-go scheme where all employers, employees and the self-employed pay a mandatory contribution of 4.2 percent. Other components are disability insurance and income compensation allowances. The goal is to guarantee a "minimum existence," and it is fully organized by the federal government.
- Second pillar, the occupational pension scheme, is a mandatory pension plan for employees (meeting certain criteria, but is optional for others including the self-employed) and is funded by mandatory contributions from employees and employers. Employers can select the pension fund and may contribute above the mandatory contribution. Together, the goal of the first and second pillars is to "maintain living standards."
- Third pillar is an optional private pension schemes, financed by insured individuals, with tax incentives on some part of contributions.

Box 1. Corporate Tax and First Pillar Pension Funding (STAF) Reform (concluded)

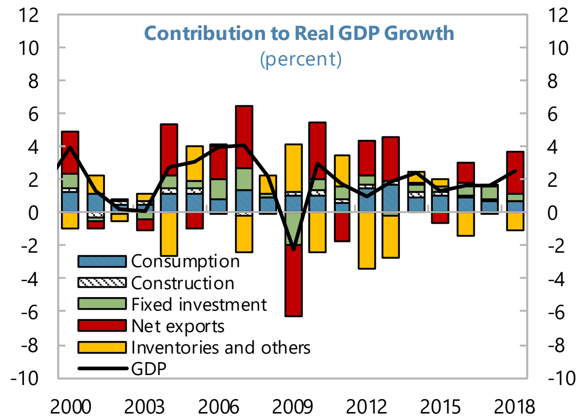
The new pension reform increases funding for the first pillar by CHF 2 billion (0.3 percent of GDP) annually. The additional financing comes from raising mandatory social security contributions paid by employers and employees from 4.2 to 4.35 percent (1.2 billion CHF) and increasing the federal transfer by CHF 0.8 billion (0.3 billion from increasing the federal payment from 19.55 percent to 20.2 percent of pillar one expenditures, and 0.5 billion from earmarking VAT).

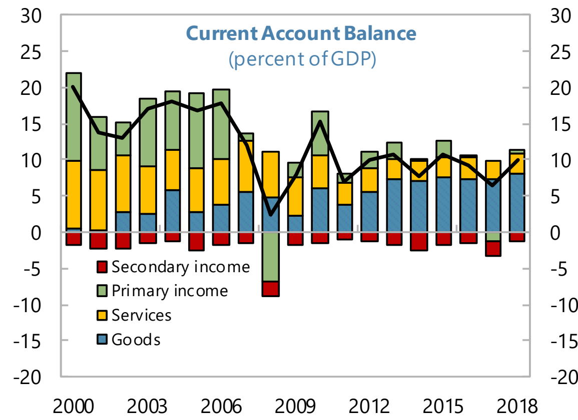


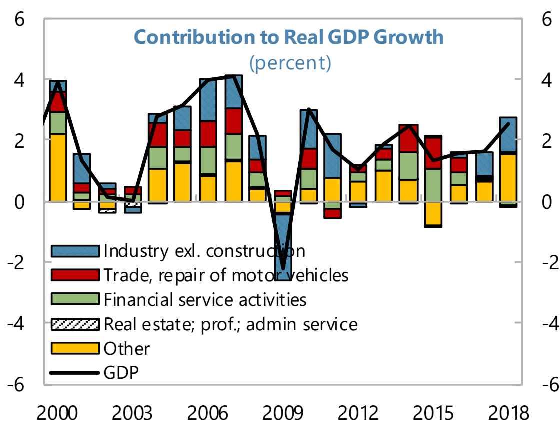
Sources: Bundesamt für Sozialversicherungen (BSV).

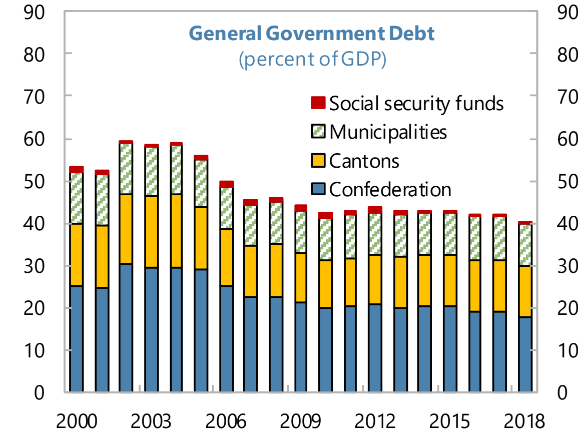
Further pension reforms will be needed, including increasing the retirement age and revisiting the pillar 2 conversion rate. Without the STAF reform, cumulative financing shortfalls for pillar 1 would reach CHF 53 billion (about 8 percent of 2018 GDP) by 2030. Even with the STAF reform, the financing gap is estimated at CHF 23 billion calling for further measures to finance the pension system.

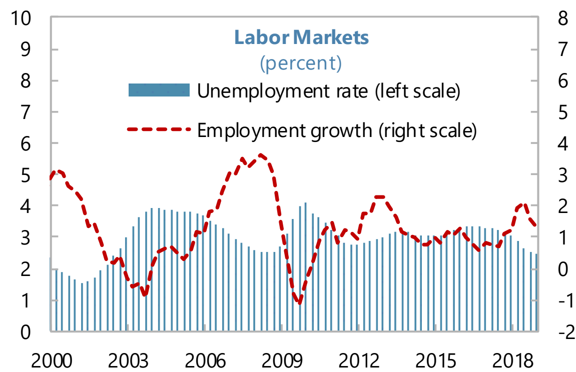
Figure 1. Switzerland: The Long View, 2000–18

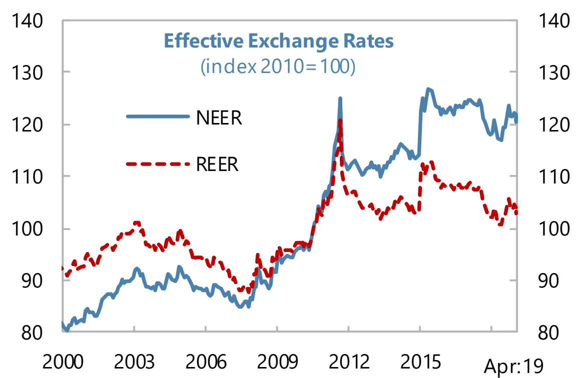




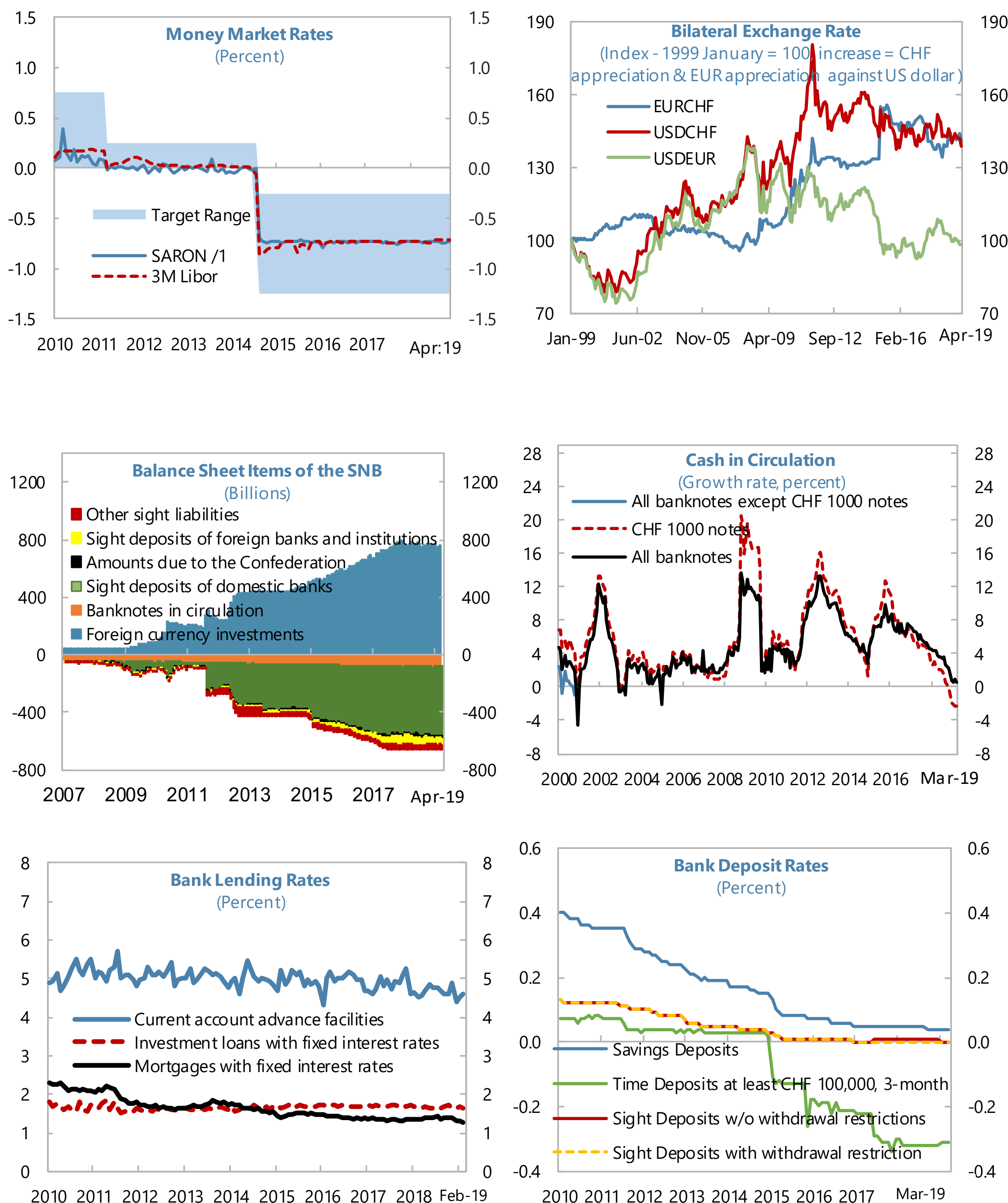






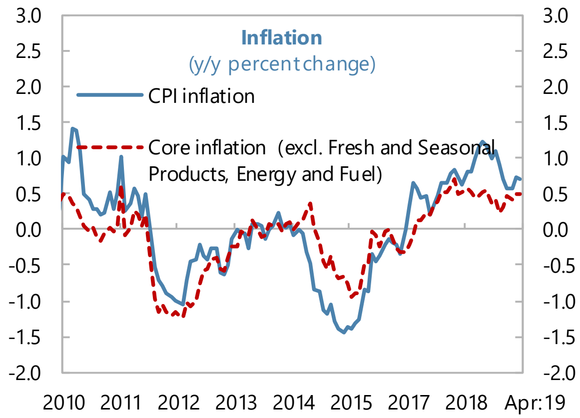


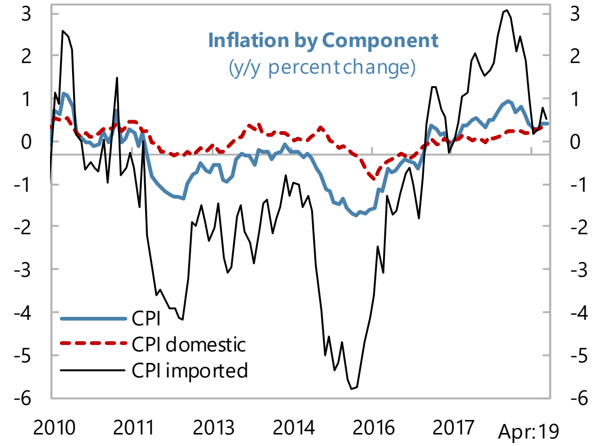
Sources: Haver Analytics; Federal Finance Administration; Information Notice System; State Secretariat for Economic Affairs; and Swiss National Bank.

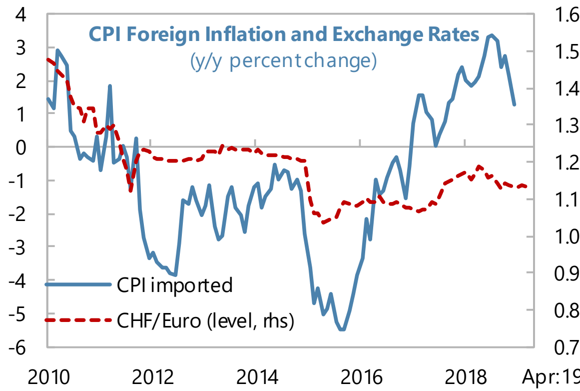


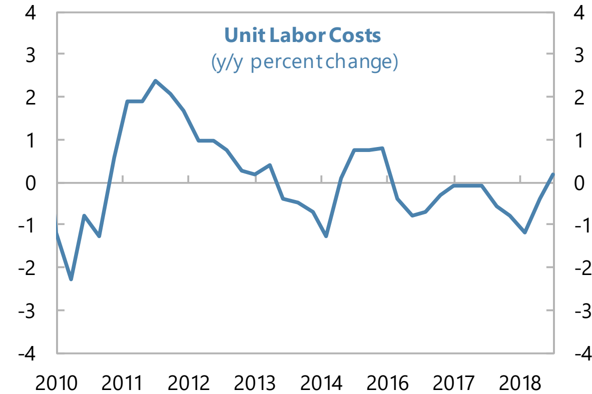
Sources: Swiss National Bank; Bloomberg Finance L.P; Haver; and IMF staff calculations.
1/ SARON (Swiss Average Rate Overnight) is an overnight average rate referencing the Swiss Franc interbank repo market.

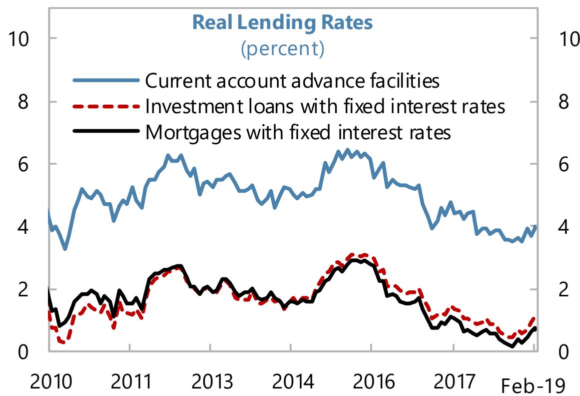
Figure 3. Switzerland: Selected Monetary Indicators, 2010–18

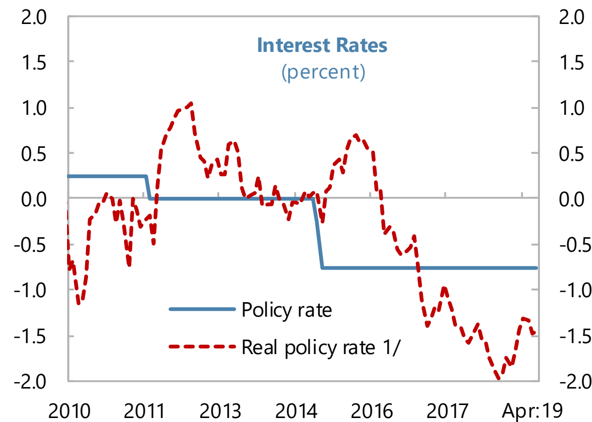






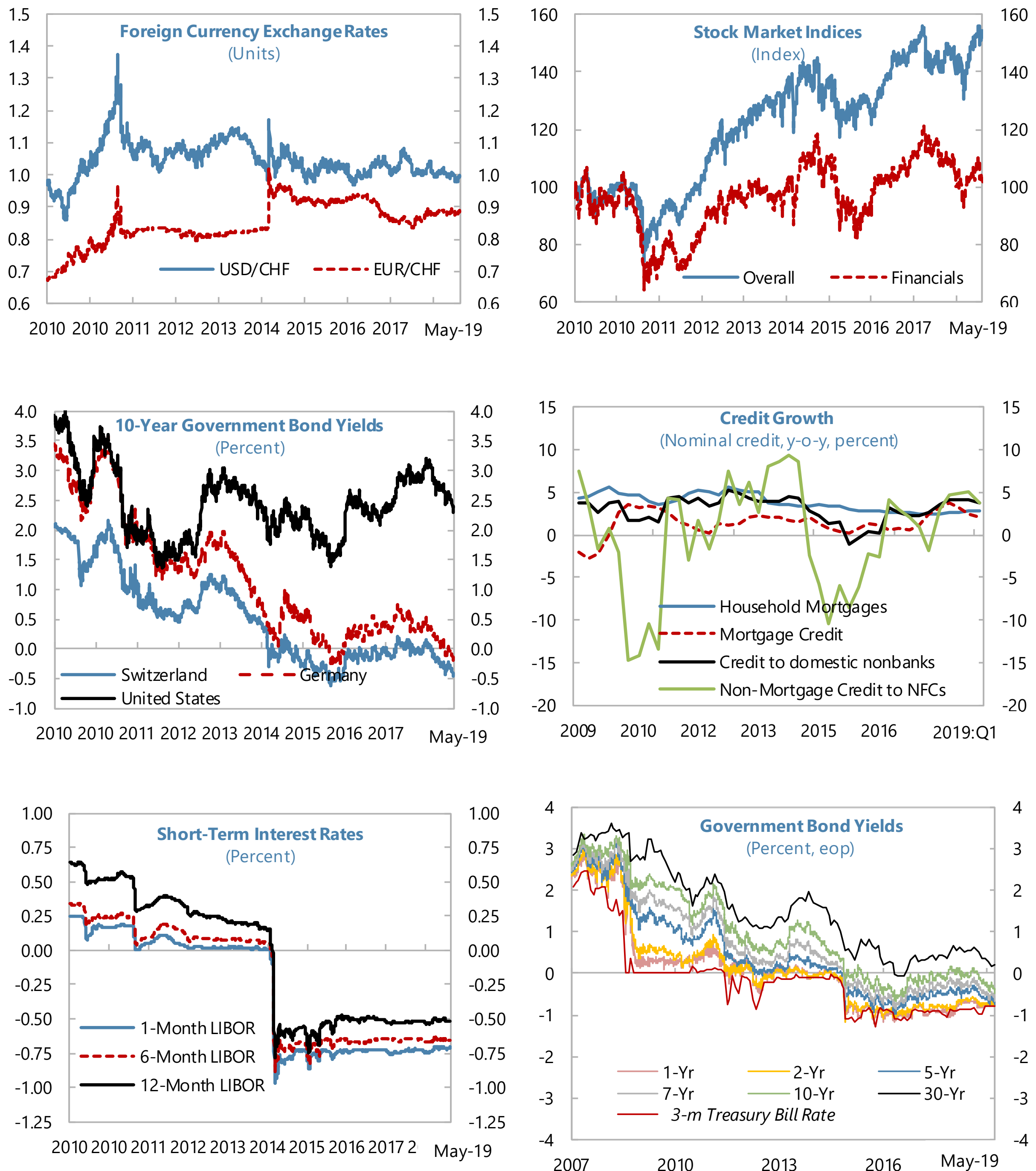






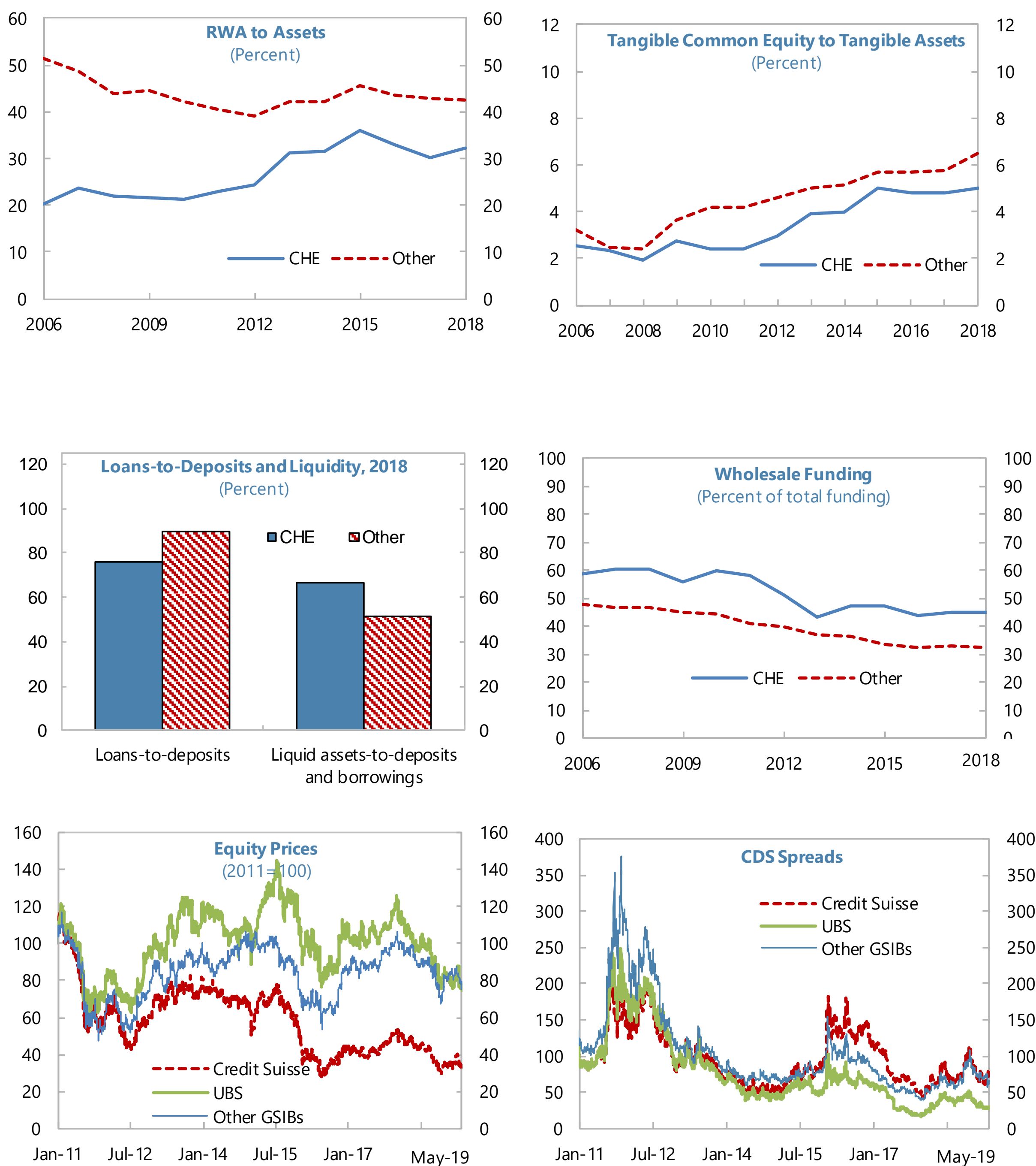
Sources: Haver Analytics; Swiss Federal Statistics Office; and Swiss National Bank.
1/ Nominal rate minus inflation

Figure 4. Switzerland: Selected Financial Indicators, 2007–19



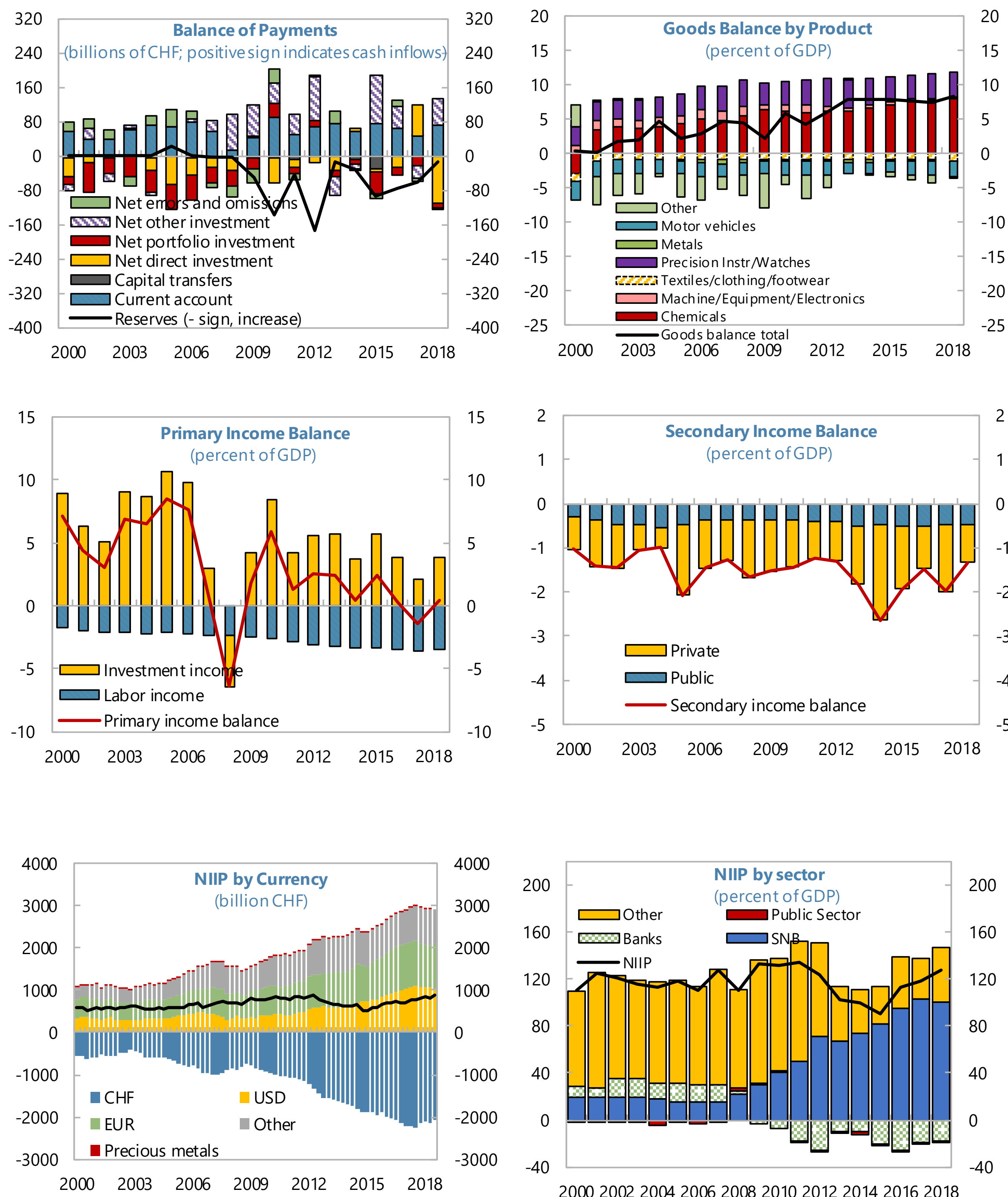
Sources: Thomson Reuters Datastream; Haver; and IMF staff calculations.

Figure 5. Switzerland: Indicators for Global Systemic Banks, 2006–18 1/



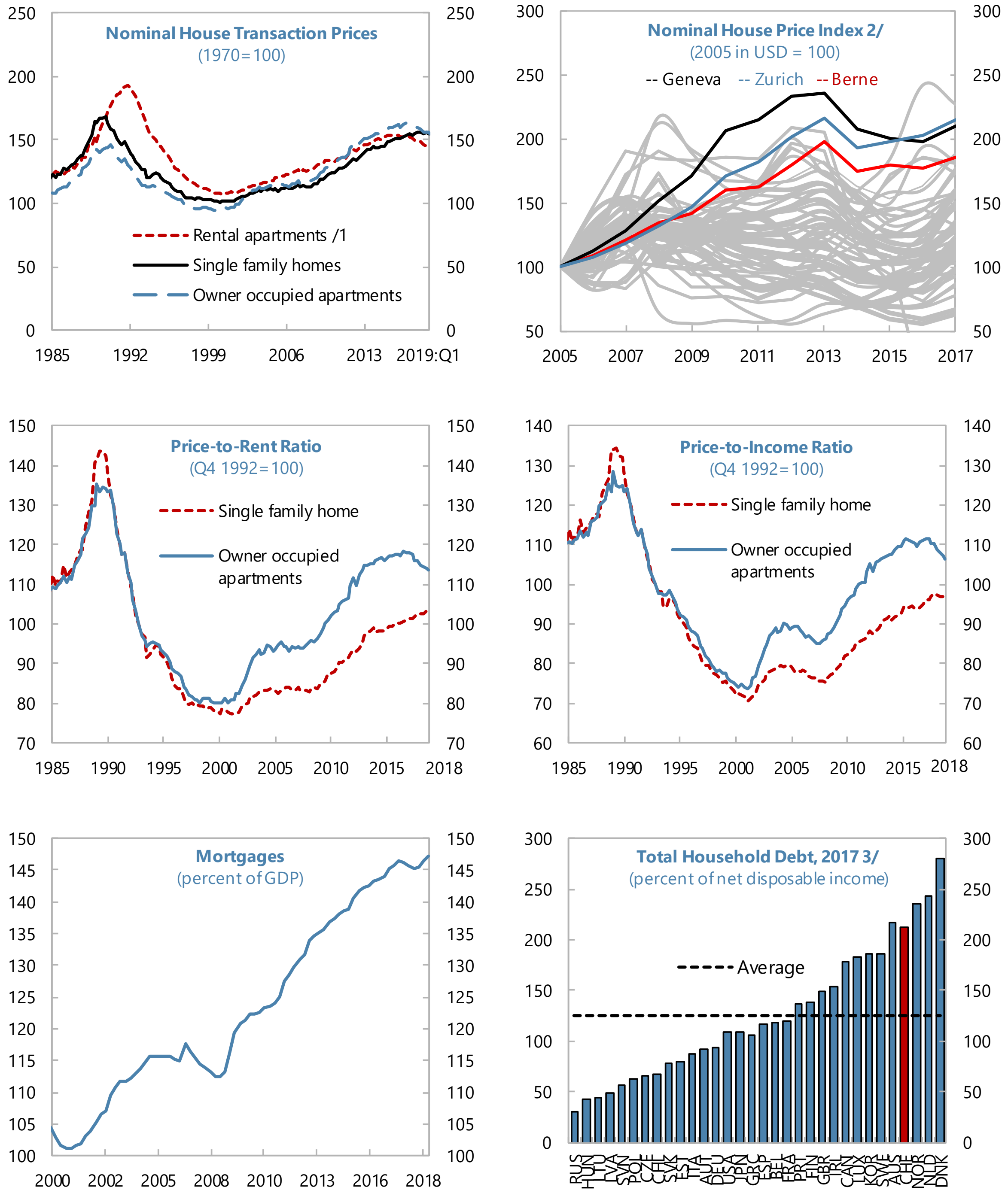
Sources: Thomson Reuters Datastream database; S&P Global Market Intelligence database; and IMF staff calculations.
1/ Switzerland numbers are for Credit Suisse and UBS. "Other" includes Citigroup, Deutsche Bank, HSBC, JP Morgan Chase, Barclays, BNP, Bank of America, New York Mellon, Goldman Sachs, Mitsubishi, Morgan Stanley, Royal Bank of Scotland, Bank of China, BBVA, BPCE, Crédit Agricole, ING, Mizuho, Nordea, Santander, Société Générale, Standard Chartered, State Street, Sumitomo, UniCredit, Wells Fargo, Commerzbank, and Lloyds.

Figure 6. Switzerland: External Accounts and Exchange Rates, 2000–18



Sources: Swiss National Bank; World Development Indicators database; and Haver Analytics.

Figure 7. Switzerland: Housing Markets, 1985–18



Sources: Haver Analytics; IMF Global House Price Index; OECD; State Secretariat for Economic Affairs; EMF; Swiss National Bank; and Wuest and Partner.

1/ Refers to rents in this segment.

2/ Major cities reported in European Mortgage Federation (EMF), Hypostat 2018, plus Toronto, Ottawa, Vancouver, Bern, Geneva and Zurich

3/ 2015 data for RUS and CHL.

Table 1. Switzerland: Selected Economic Indicators, 2016–24

	2016	2017	2018	2019	2020	2021	2022	2023	2024
			Staff projections						
Real GDP (percent change)	1.6	1.7	2.5	1.1	1.6	1.6	1.6	1.6	1.6
Total domestic demand	0.4	1.6	-0.1	0.9	1.1	1.1	1.7	1.3	1.3
Private consumption	1.5	1.2	1.0	1.1	1.2	1.1	1.0	1.1	1.1
Public consumption	1.2	0.9	1.0	1.1	1.0	1.0	1.0	1.0	1.0
Gross fixed investment	3.5	3.4	2.1	0.4	0.5	0.7	3.2	1.9	1.6
Inventory accumulation 1/	-1.5	-0.2	-1.2	0.0	0.0	0.0	0.0	0.0	0.0
Foreign balance 1/	1.2	0.3	2.6	0.4	0.7	0.7	0.2	0.5	0.5
Nominal GDP (billions of Swiss francs)	660.5	668.7	689.8	705.9	723.7	742.1	761.1	781.2	801.9
Savings and investment (percent of GDP)									
Gross national saving	32.4	30.1	33.3	33.3	33.3	33.3	33.3	33.3	33.3
Gross domestic investment	22.9	23.4	23.1	23.6	23.5	23.5	23.5	23.6	23.6
Current account balance	9.4	6.7	10.2	9.7	9.8	9.8	9.8	9.8	9.8
Prices and incomes (percent change)									
GDP deflator	-0.6	-0.4	0.6	1.2	0.9	0.9	1.0	1.0	1.0
Consumer price index (period average)	-0.4	0.5	0.9	0.4	0.7	0.9	1.0	1.0	1.0
Consumer price index (end of period)	0.0	0.9	0.7	0.3	0.9	1.0	1.0	1.0	1.0
Nominal hourly earnings	0.7	0.4	0.5	1.1	1.0	1.0	1.0	1.0	1.0
Unit labor costs (total economy)	-0.5	-0.1	-2.3	0.2	0.3	0.6	0.6	0.6	0.6
Employment and slack measures									
Unemployment rate (in percent)	3.3	3.2	2.6	2.8	2.8	2.8	2.8	2.7	2.7
Output gap (in percent of potential)	-0.3	-0.3	0.5	0.0	0.0	0.0	0.0	0.0	0.0
Capacity utilization	73.9	74.6	73.8	...	...	...	...	...	...
Potential output growth	1.7	1.7	1.7	1.6	1.6	1.6	1.6	1.6	1.6
General government finances (percent of GDP)									
Revenue	33.3	34.2	33.7	33.6	32.8	32.8	32.8	32.8	32.8
Expenditure	33.0	33.0	32.4	32.6	32.4	32.4	32.4	32.4	32.4
Balance	0.4	1.2	1.3	1.0	0.4	0.4	0.4	0.4	0.4
Cyclically adjusted balance	0.5	1.3	1.1	0.9	0.4	0.4	0.4	0.4	0.4
Gross debt 2/	41.8	42.7	40.5	38.7	37.3	36.0	34.7	33.4	32.1
Monetary and credit (percent change, average)									
Broad money (M3)	3.0	3.5	3.1	...	...	...	...	...	...
Domestic credit, non-financial	3.1	2.7	4.0	...	...	...	...	...	...
Three-month SFr LIBOR	-0.7	-0.7	-0.7	...	...	...	...	...	...
Yield on government bonds (7-year)	-0.6	-0.3	-0.2	...	...	...	...	...	...
Exchange rates (levels)									
Swiss francs per U.S. dollar (annual average)	1.0	1.0	1.0	...	...	...	...	...	...
Swiss francs per euro (annual average)	1.1	1.1	1.2	...	...	...	...	...	...
Nominal effective rate (avg., 2000=100)	123.3	122.6	119.6	...	...	...	...	...	...
Real effective rate (avg., 2000=100) 3/	110.7	108.8	105.0	...	...	...	...	...	...

Sources: Haver Analytics; IMF's Information Notice System; Swiss National Bank; and IMF Staff estimates.

1/ Contribution to growth. Inventory accumulation also includes statistical discrepancies and net acquisitions of valuables.

2/ Reflects new GFSM 2001 methodology, which values debt at market prices. Calculated as the sum of Federal, Cantonal, Municipal and Social security gross debts.

3/ Based on relative consumer prices.

Table 2. Switzerland: Balance of Payments, 2016–24

	2016	2017	2018	2019	2020	2021	2022	2023	2024
		Staff projections							
(In billions of Swiss francs, unless otherwise indicated)									
Current account	**62**	**45**	**71**	**69**	**71**	**73**	**74**	**76**	**78**
Goods balance	50	49	57	57	65	68	70	74	79
Exports	312	311	325	330	347	363	378	395	414
Imports	262	262	268	274	282	295	308	321	335
Service balance	20	18	20	22	18	20	22	23	24
Net primary income	2	-9	3	-1	-1	-2	3	4	4
Net secondary income	-10	-13	-9	-9	-11	-13	-21	-25	-28
Private capital and financial account	**84**	**18**	**59**	**50**	**56**	**56**	**58**	**60**	**62**
Capital transfers	2	-14	-6	-10	-8	-9	-8	-8	-8
Financial account	82	31	65	59	63	64	66	68	70
Net foreign direct investment	27	17	22	20	21	20	21	21	21
Net portfolio investment	20	36	28	32	30	31	30	30	30
Net financial derivatives	7	1	4	3	3	3	3	3	3
Net other investment	-49	-84	-2	5	9	10	12	14	16
Change in reserves	77	61	13	0	0	0	0	0	0
Net errors and omissions	**17**	**-6**	**-1**	**0**	**0**	**0**	**0**	**0**	**0**
(In percent of GDP, unless otherwise indicated)									
Current account	**9.4**	**6.7**	**10.2**	**9.8**	**9.8**	**9.8**	**9.8**	**9.8**	**9.8**
Goods balance	7.5	7.4	8.2	8.0	8.9	9.1	9.2	9.5	9.8
Exports	47.3	46.5	47.1	46.8	47.9	49.0	49.6	50.6	51.6
Imports	39.7	39.2	38.8	38.8	39.0	39.8	40.4	41.1	41.8
Service balance	3.0	2.7	3.0	3.1	2.5	2.7	2.9	2.9	2.9
Net primary income	0.3	-1.4	0.4	-0.2	-0.1	-0.2	0.4	0.5	0.5
Net secondary income	-1.5	-2.0	-1.3	-1.2	-1.6	-1.8	-2.8	-3.2	-3.5
Private capital and financial account	**12.7**	**2.6**	**8.6**	**7.1**	**7.7**	**7.5**	**7.7**	**7.6**	**7.7**
Capital transfers	0.4	-2.0	-0.8	-1.3	-1.0	-1.1	-1.1	-1.1	-1.0
Financial account	12.3	4.7	9.4	8.4	8.7	8.7	8.7	8.7	8.8
Net foreign direct investment	4.2	2.6	3.2	2.8	2.9	2.7	2.7	2.6	2.6
Net portfolio investment	3.0	5.3	4.0	4.5	4.1	4.1	4.0	3.9	3.8
Net financial derivatives	1.0	0.2	0.6	0.4	0.4	0.4	0.4	0.4	0.4
Net other investment	-7.5	-12.6	-0.3	0.8	1.3	1.4	1.6	1.8	2.0
Change in reserves	11.7	9.2	2.0	0.0	0.0	0.0	0.0	0.0	0.0
Net errors and omissions	**2.5**	**-0.9**	**-0.2**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Memorandum items:									
Net IIP (in percent of GDP)	112.4	118.3	128.2	139.2	141.9	144.0	145.3	146.4	147.2
Official reserves									
(billions of U.S. dollars, end-period)	644.3	762.2	794.8	…	…	…	…	…	…
Reserve cover (in months of imports)	21.8	24.4		…	…	…	…	…	…

Sources: Haver Analytics; Swiss National Bank; and IMF staff estimates.

Table 3. Switzerland: SNB Balance Sheet, 2010–18

	2010	2011	2012	2013	2014	2015	2016	2017	2018
(Millions of Swiss francs; unless otherwise indicated)									
Assets									
Gold	43,988	49,380	50,772	35,565	39,630	35,467	39,400	42,494	42,237
Foreign currency reserves	203,810	257,504	432,209	443,275	510,062	593,234	696,104	790,125	763,728
IMF, international, and monetary assistance loans	6,038	8,057	7,332	6,834	6,664	6,486	5,903	5,577	5,889
Swiss franc repos	...	18,468	...	...	...	...	...	...	...
U.S. dollar repos	...	371	...	...	...	...	...	...	...
Swaps against Swiss francs	...	...	...	...	...	...	...	...	...
Money market, Swiss franc securities, other	16,119	12,300	9,121	4,709	4,845	4,965	5,095	5,110	5,214
Total assets	269,955	346,079	499,434	490,382	561,202	640,152	746,502	843,306	817,069
Liabilities									
Currency in circulation (banknotes)	51,498	55,729	61,801	65,766	67,596	72,882	78,084	81,639	82,239
Sight deposits	48,917	216,701	369,732	363,910	387,666	469,034	530,049	573,679	574,827
Repo, SNB bills and time liabilities	121,052	15,086	...	...	...	...	...	...	...
Foreign currency and other liabilities	5,897	5,441	9,825	12,682	19,635	37,183	53,841	50,821	39,770
Provisions and equity capital	42,591	53,123	58,075	48,023	86,305	61,053	84,527	137,168	120,232
Total liabilities	269,955	346,079	499,434	490,382	561,202	640,152	746,502	843,306	817,069
Memorandum items:									
Nominal GDP (billions of Swiss francs)	609	621	626	638	650	654	660	669	690
Balance sheet, percent of GDP	44.3	55.7	79.7	76.8	86.4	97.8	113.0	126.1	118.4
Banknotes, percent of total liabilities	19.1	16.1	12.4	13.4	12.0	11.4	10.5	9.7	10.1
Refinancing operations, percent of total assets	...	5.4	...	...	...	...	...	...	...
Provisions and equity capital, percent of total assets	15.8	15.3	11.6	9.8	15.4	9.5	11.3	16.3	14.7
Monetary base 1/	90,208	137,728	284,381	360,765	375,305	455,863	504,140	551,849	549,374

Sources: Swiss National Bank; and IMF staff estimates.
1/ Currency in circulation and sight deposits of domestic banks.

Table 4. Switzerland: General Government Finances, 2016–24

	2016	2017	2018	2019	2020	2021	2022	2023	2024
		Estimate	Staff projections						
(In billions of Swiss francs, unless otherwise specified)									
General government									
Revenue	220	229	233	237	237	243	250	256	263
Expenditure	218	221	224	230	234	240	247	253	260
Net lending/net borrowing	2	8	9	7	3	3	3	3	3
Confederation (Federal government) 1/									
Revenue	72	77	79	81	81	83	85	88	90
Expenditure	71	72	75	77	80	82	84	85	88
Net lending/net borrowing	1	5	5	4	1	1	2	2	2
Cantons									
Revenue	90	93	95	98	99	101	103	106	109
Expenditure	89	90	93	96	97	99	103	106	109
Net lending/net borrowing	1	2	2	2	2	2	0	0	0
Communes/municipalities									
Revenue	47	48	49	50	51	52	53	54	56
Expenditure	47	48	49	50	51	52	53	54	56
Net lending/net borrowing	0	0	1	0	0	0	0	0	0
Social security 2/									
Revenue	62	63	63	64	65	65	67	69	71
Expenditure	62	62	63	63	64	66	66	68	70
Net lending / net borrowing	1	1	0	1	1	1	1	1	1
General government gross debt 3/	276	286	280	273	270	267	264	261	258
Confederation (Federal government) 1/	131	136	133	129	127	126	125	122	120
Cantons	83	82	81	79	77	75	75	75	75
Communes/municipalities	64	65	66	66	66	66	66	66	66
Social security 2/	3	3	2	1	0	0	-1	-2	-3
(In percent of GDP)									
General government operations									
Revenue	33.3	34.2	33.7	33.6	32.8	32.8	32.8	32.8	32.8
Expenditure	33.0	33.0	32.4	32.6	32.4	32.4	32.4	32.4	32.4
Net lending/net borrowing	0.4	1.2	1.3	1.0	0.4	0.4	0.4	0.4	0.4
Confederation (Federal government) 1/	0.1	0.8	0.7	0.6	0.2	0.1	0.2	0.3	0.2
Cantons	0.1	0.3	0.3	0.3	0.3	0.2	0.0	0.0	0.0
Communes/municipalities	0.0	0.0	0.2	0.0	0.0	0.0	0.0	0.0	0.0
Social security	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
General government gross debt 4/	41.8	42.7	40.5	38.7	37.3	36.0	34.7	33.4	32.1
Confederation (Federal government) 1/	19.8	20.3	19.3	18.2	17.6	17.0	16.4	15.6	15.0
Cantons	12.5	12.3	11.8	11.2	10.6	10.1	9.9	9.6	9.4
Communes/municipalities	9.7	9.7	9.5	9.3	9.1	8.8	8.6	8.4	8.2
Social security 2/	0.5	0.4	0.3	0.1	0.0	0.0	-0.1	-0.3	-0.4
Memorandum items:									
Nominal GDP (billions of francs)	660	669	690	706	724	742	761	781	802
Output gap (percent)	-0.3	-0.3	0.5	0.0	0.0	0.0	0.0	0.0	0.0
General Government cyclically adjusted balance	0.5	1.3	1.1	0.9	0.4	0.4	0.4	0.4	0.4

Sources: Federal Ministry of Finance; and IMF staff estimates.

1/ Includes the balance of the Confederation and extrabudgetary funds (including Public Transport Fund, ETH, Infrastructure Fund).

2/ Includes old age, disability, survivors protection scheme as well unemployment and income loss insurance.

3/ Forcasted

Table 5. Switzerland: General Government Operations, 2008–18

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
	(In billions of Swiss francs, unless otherwise specified)										
Revenue	194.2	192.8	197.0	203.1	203.9	208.8	210.9	219.1	220.1	228.5	232.7
Taxes	123.1	121.0	123.7	126.2	126.8	129.8	131.5	136.5	138.6	145.3	144.7
Taxes on income, profits, and capital gains	74.5	72.8	73.6	75.7	76.3	78.3	79.3	83.7	85.0	89.8	87.3
Taxes on goods and services	37.3	36.6	38.3	39.0	38.9	39.3	39.4	39.6	39.5	40.9	43.8
Taxes on property	9.7	9.9	10.0	9.8	9.9	10.4	10.9	11.2	12.0	12.5	11.5
Taxes on international trade and transactions	1.0	1.0	1.1	1.0	1.0	1.1	1.1	1.1	1.1	1.1	1.2
Social contributions	37.0	38.3	38.7	41.3	42.3	43.0	43.5	44.3	44.8	45.3	46.2
Grants	0.1	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3
Other revenue	33.9	33.4	34.5	35.4	34.7	35.7	35.6	38.1	36.5	37.6	41.5
Of which: property income	9.1	8.6	8.5	8.9	7.1	7.3	6.3	8.1	7.0	7.7	8.1
Expenditure	182.6	189.9	194.9	198.5	201.5	211.5	212.3	214.9	217.7	220.5	223.8
Expense	181.4	188.1	192.9	196.6	200.5	210.1	210.9	212.9	216.0	218.0	225.3
Compensation of employees	41.5	43.5	44.7	45.8	46.9	47.8	48.6	49.4	50.0	50.8	51.3
Purchases/use of goods and services	20.4	21.4	21.6	22.0	22.6	23.5	24.0	24.2	24.2	24.4	25.2
Interest expense	6.1	5.5	5.2	4.8	4.4	4.0	3.7	3.6	3.2	2.8	3.8
Social benefits	60.4	65.2	67.1	67.6	69.2	71.4	72.8	74.1	76.3	77.5	81.0
Expense n.e.c.	53.0	52.4	54.2	56.4	57.3	63.4	61.7	61.7	62.4	62.6	64.1
Net acquisition of nonfinancial assets	1.1	1.8	2.0	1.9	1.0	1.4	1.4	1.9	1.7	2.5	-1.5
Net operating balance	12.7	4.8	4.2	6.5	3.4	-1.3	0.0	6.2	4.1	10.5	7.4
Net lending/borrowing	11.6	3.0	2.2	4.6	2.4	-2.7	-1.4	4.2	2.5	8.0	8.9
Net acquisition of financial assets	...	8.9	-18.4	11.8	21.2	-5.4	41.4	-23.7	21.6	79.7	25.6
Net incurrence of liabilities	...	6.0	-20.5	7.2	18.8	-2.6	42.8	-28.0	19.1	71.7	16.7
	(In percent of GDP)										
Revenue	32.3	32.7	32.4	32.7	32.6	32.7	32.5	33.5	33.3	34.2	33.7
Taxes	20.5	20.5	20.3	20.3	20.2	20.3	20.2	20.9	21.0	21.7	21.0
Taxes on income, profits, and capital gains	12.4	12.4	12.1	12.2	12.2	12.3	12.2	12.8	12.9	13.4	12.7
Taxes on goods and services	6.2	6.2	6.3	6.3	6.2	6.2	6.1	6.1	6.0	6.1	6.3
Taxes on property	1.6	1.7	1.6	1.6	1.6	1.6	1.7	1.7	1.8	1.9	1.7
Taxes on international trade and transactions	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social contributions	6.2	6.5	6.3	6.6	6.7	6.7	6.7	6.8	6.8	6.8	6.7
Other revenue	5.7	5.7	5.7	5.7	5.5	5.6	5.5	5.8	5.5	5.6	6.0
Expenditure	30.4	32.2	32.0	32.0	32.2	33.1	32.7	32.8	33.0	33.0	32.4
Expense	30.2	31.9	31.7	31.6	32.0	32.9	32.5	32.5	32.7	32.6	32.7
Compensation of employees	6.9	7.4	7.3	7.4	7.5	7.5	7.5	7.5	7.6	7.6	7.4
Purchases/use of goods and services	3.4	3.6	3.5	3.5	3.6	3.7	3.7	3.7	3.7	3.6	3.7
Interest expense	1.0	0.9	0.8	0.8	0.7	0.6	0.6	0.6	0.5	0.4	0.5
Social benefits	10.1	11.1	11.0	10.9	11.1	11.2	11.2	11.3	11.5	11.6	11.7
Expense n.e.c.	8.8	8.9	8.9	9.1	9.1	9.9	9.5	9.4	9.5	9.4	9.3
Net acquisition of nonfinancial assets	0.2	0.3	0.3	0.3	0.2	0.2	0.2	0.3	0.3	0.4	-0.2
Net operating balance	2.1	0.8	0.7	1.0	0.5	-0.2	0.0	0.9	0.6	1.6	1.1
Net lending/borrowing	1.9	0.5	0.4	0.7	0.4	-0.4	-0.2	0.6	0.4	1.2	1.3
Net acquisition of financial assets	...	1.5	-3.0	1.9	3.4	-0.8	6.4	-3.6	3.3	11.9	3.7
Net incurrence of liabilities	...	1.0	-3.4	1.2	3.0	-0.4	6.6	-4.3	2.9	10.7	2.4

Source: Federal Ministry of Finance.

Table 6. Switzerland: Bank Soundness Indicators, 2010–18

	2010	2011	2012	2013	2014	2015	2016	2017	2018:Q2
Capital adequacy									
Regulatory capital as percent of risk-weighted assets 1/	17.1	16.6	16.9	18.7	16.6	17.0	16.1	18.6	18.5
Regulatory Tier I capital as percent of risk-weighted assets 1/	15.4	15.4	15.7	17.8	16.1	16.6	15.7	18.2	18.2
Non-performing loans net of provisions as percent of tier I capital	6.0	5.4	5.0	4.5	3.7	3.8	3.9	3.0	2.5
Asset quality and exposure									
Non-performing loans as percent of gross loans	0.9	0.8	0.8	0.8	0.7	0.7	0.7	0.6	0.7
Sectoral distribution of bank credit to the private sector (percent)									
Households	68.3	68.8	68.4	68.0	68.6	69.5	69.4	69.4	69.0
Agriculture and food industry	1.3	1.2	1.2	1.2	1.2	1.2	1.2	1.2	1.1
Industry and manufacturing	3.0	2.9	2.7	2.4	2.1	1.9	1.8	1.9	2.0
Construction	1.6	1.7	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Retail	3.2	3.1	3.0	2.8	2.9	2.6	2.8	2.6	2.7
Hotels and restaurants / Hospitality sector	1.1	1.1	1.0	0.9	0.9	0.9	0.9	0.9	0.8
Transport and communications	0.9	0.7	0.8	0.8	0.8	0.8	0.8	0.8	0.8
Other financial activities	0.5	0.5	0.6	0.8	0.7	0.7	0.5	0.6	0.7
Insurance sector	0.6	0.4	0.6	0.6	0.6	0.4	0.6	0.7	0.7
Commercial real estate, IT, R&T	12.1	12.4	12.8	13.3	13.6	13.6	13.8	14.0	14.0
Public administration (excluding social security)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Education	0.1	0.1	0.1	0.1	0.2	0.1	0.1	0.1	0.1
Healthcare and social services	1.1	1.1	1.2	1.3	1.3	1.4	1.4	1.4	1.4
Other collective and personal services	1.0	1.0	0.9	0.9	0.8	0.8	0.8	0.8	0.9
Other 2/	5.3	5.0	5.0	5.3	4.7	4.4	4.3	4.0	4.2
Earnings and profitability									
Gross profits as percent of average assets (ROAA)	0.3	0.5	0.1	0.3	0.1	0.2	0.3	0.3	0.3
Gross profits as percent of average equity capital (ROAE)	4.3	6.9	2.1	3.6	2.1	2.9	3.2	4.5	3.4
Net interest income as percent of gross income	27.9	31.1	31.6	32.3	34.5	34.1	34.5	34.2	31.2
Non-interest expenses as percent of gross income	73.3	72.0	73.7	71.6	69.4	72.9	76.6	74.0	66.8
Liquidity									
Liquid assets as percent of total assets 3/	10.3	15.5	17.0	12.5	11.9	…	…	…	
Liquid assets as percent of short-term liabilities	23.3	33.9	35.4	47.4	47.4	140.3	152.7	150.9	155.9
Net long position in foreign exchange as percent of capital	-36.7	-56.9	-44.5	-38.8	-45.6	-72.8	-95.1	-65.3	-73.7

Source: Swiss National Bank.

1/ Based on parent company consolidation. This consolidation basis equals the CBDI approach defined in FSI compilation guide plus foreign bank branches operating in Switzerland, and minus overseas deposit-taking subsidiaries.

2/ Mining and extraction, production and distribution of electricity, natural gas and water, financial intermediation, social security, ex-territorial bodies and organizations, other.

3/ In 2015, the indicator was redefined in line with Basel III regulations, leading to a series break. The 2015 value under the new definition is not yet available.

Table 7. Switzerland: External Sector Assessment

<table>
<tr><th></th><th>Switzerland</th><th>Overall Assessment</th></tr>
<tr><td>Foreign asset and liability position and trajectory</td><td>Background. Switzerland is a financial center with a positive net international investment position (NIIP) of 128 percent of GDP and gross foreign asset and liability positions of 694 and 565 percent of GDP, respectively, as of end 2018. NIIP reflects both current account (CA) surpluses, which average nearly 10 percent of GDP, and large, bi-directional valuation changes although valuation losses tend to dominate.1/ These valuation changes reflect fluctuations in exchange rates and prices of securities and precious metals that interact with mismatches between assets and liabilities in terms of currencies and financial instruments.2/
Assessment. Switzerland's large gross liability position and the volatility of financial flows present some risk, but these are mitigated by the large gross asset position and the fact that about 2/3 of external liabilities are denominated in Swiss francs. Nonetheless, given the large gross positions and compositional mismatch between assets and liabilities, relatively modest changes in exchange rates and asset prices can have a material effect on the NIIP.</td><td rowspan="6">Overall Assessment:
Switzerland's external position was broadly consistent with medium-term fundamentals and desirable policies in 2018, although this assessment is subject to especially-high uncertainty. REER overvaluation following the exit from the floor in 2015 had been unwound by 2017. Were real depreciation to resume, future assessments could be affected.

Potential Policy Responses:
With a generally-balanced external position, macroeconomic policies should be geared to ensure balanced contributions to GDP growth from domestic and external demand. This requires moving to—and maintaining—a structurally-neutral fiscal stance, which would also ease the burden on monetary policy that faces operational limits during periods of economic weakness or safe-haven appreciation pressures. Monetary policy should continue to be directed at maintaining inflation within the definition of price stability, with foreign currency intervention reserved for addressing large exchange market pressures. Macroprudential policies should be used to address excessive private credit (related to</td></tr>
<tr><td>2018 IIP
(% GDP)</td><td><table><tr><td>NIIP</td><td>128.2</td><td>Gross Assets</td><td>693.6</td><td>Debt Assets</td><td>217.3</td><td>Gross Liab.</td><td>565.4</td><td>Debt Liab.</td><td>192.1</td></tr></table></td></tr>
<tr><td>Current account</td><td>Background. Switzerland has run large CA surpluses, averaging nearly 10 percent of GDP since 2006. The CA balance is estimated at 10.2 percent of GDP for 2018, an increase from the downwardly-revised surplus of 6.7 percent for 2017. Ex post CA revisions are frequent, mainly due to changes in estimated investment income. Surpluses on trade of goods and services (including merchanting) has been driving the overall positive CA balance.
Assessment. Based on a cyclically-adjusted CA surplus of 10.4 percent of GDP and an EBA CA norm of 6.0 percent of GDP (which partly reflects the demand for saving by the large share of prime-age savers), the overall EBA estimated CA gap equaled 4.4 percent of GDP in 2018. Domestic policy gaps account for -1.0 percentage points of the CA gap and consist of excessive private sector credit (-1.3) and fiscal underspending (0.4), while policy gaps in the rest of the world contribute for +0.2 percentage points. Some Switzerland-specific factors not appropriately treated in the income account lower the CA gap: (i) inclusion of estimated retained earnings on portfolio equity investment and (ii) compensation for valuation losses on fixed income securities arising from inflation.3/ After accounting for these factors, staff estimates a CA gap of about 0.9 percent of GDP (with a range of ±2 percentage points).4/</td></tr>
<tr><td>CA Assessment
2018 (% GDP)</td><td><table><tr><td>Actual CA</td><td>10.2</td><td>Cycl. Adj. CA</td><td>10.4</td><td>EBA CA Norm</td><td>6.0</td><td>EBA CA Gap</td><td>4.4</td><td>Staff Adj.</td><td>3.5</td><td>Staff CA Gap</td><td>0.9</td></tr></table></td></tr>
<tr><td>Real exchange rate</td><td>Background. The CPI-based REER appreciated by 16 percent during 2008–18, including two episodes of rapid appreciation in response to safe-haven inflows. The first spike occurred in July 2011 and led the SNB to establish a floor of 1.20 for the CHF-EUR exchange rate in September 2011. After appreciating sharply following the exit from the floor on January 15, 2015, the REER moderated, initially on account of a partial unwinding of the overshooting of the nominal effective exchange rate and, subsequently, on lower inflation in Switzerland than in its trading partners. The average REER for 2018 weakened by 2.8 percent relative to the 2017 average. As of March 2019, the REER had appreciated by 0.3 percent compared to the 2018 average.
Assessment. The EBA REER index and level models suggest the average REER in 2018 was 11–17 percent overvalued, with policy gaps accounting for a modest amount of the total gap. To a large extent, this finding reflects the "reversion to trend" property of the empirical model in the context of the prior rapid appreciation episodes. However, due to measurement issues, these results may not fully capture the secular improvement in productivity, especially in knowledge-based sectors. Based on the CA gap, staff assesses the REER gap to have been in the range of [-6.5, +1.0] percent in 2018.</td></tr>
</table>

Table 7. Switzerland: External Sector Assessment (concluded)

	Switzerland	Overall Assessment
Capital and financial accounts: flows and policy measures	**Background.** In recent years, Switzerland has experienced large inflows in the form of currency and deposits, in part due to its status as a safe haven. Since 2007, these cumulative net inflows amounted to about 75 percent of GDP. To reduce the attractiveness of these inflows, since January 15, 2015 banks' placements at the SNB (above a certain threshold) have been subject to a negative interest rate of 0.75 percent. These inflows stopped in mid-2017 and foreigners reduced holdings of currency and deposits in 2018. There are no restrictions on financial flows**.** **Assessment.** Financial flows are large and volatile, reflecting Switzerland's status as a financial center and a safe haven, with inflows tending to accelerate during periods of heightened global and regional uncertainty.	mortgages lending) and reduce financial sector risks. Meanwhile, reforming the corporate income tax would encourage SME investment and reduce corporate net saving.
FX intervention and reserves level	**Background.** Foreign exchange reserves amounted to USD788 bn (114 percent of GDP) at end-2018, down USD24 bn (including valuation changes) since end-2017. About 75 percent of reserves were accumulated during 2009–15, including to defend the previous exchange rate floor. Since exiting the floor, the SNB has intervened periodically, purchasing sizable volumes in response to large appreciation pressures from safe-haven surges, as well as more frequently but in smaller amounts. Purchases dwindled since mid-2017, amounting to only CHF2.3 bn in 2018. **Assessment.** Reserves are large relative to GDP but more moderate when compared with short-term foreign liabilities. The high level of reserves reflects monetary policy operations aimed at avoiding persistent undershooting of inflation (which averaged -0.15 percent during 2012–18) as a result of inflow surges and given the limited scope for significant further easing via other monetary policy tools. In particular, the supply of domestic assets available for purchase is very limited, and the marginal interest rate on banks' deposits at the SNB is -0.75 percent, which is the lowest in the world. Past interventions also helped to avoid potentially-large exchange rate overvaluation.	
Technical Background Notes	1/ Other stock-flow adjustments include changes in statistical sources, such as changes in the number of entities surveyed and items covered, although their quantitative importance is not known. 2/ As a result, an appreciation (depreciation) of the Swiss franc has a negative (positive) effect on the NIIP, while a symmetric percentage increase in share prices in Switzerland and abroad would reduce the NIIP. 3/ The underlying CA is adjusted for: (i) retained earnings on portfolio equity investment that are not recorded in the income balance of the CA under BPM6; and (ii) the recording of nominal interest on fixed income securities under the BPM framework, which compensates for expected valuation losses (due to inflation and/or nominal exchange rate movements), even though this stream compensates for the (anticipated) erosion in the real value of debt assets and liabilities. Adjusting for both of these effects and taking into account the lagged NFA contribution to the norm, the underlying CA would need to be reduced by about 3.5 percent of GDP. 4/ The CA gap range reflects the uncertainty inherent in the assessment.	

Annex I. Risk Assessment Matrix[1]

Source of Risks	Relative Likelihood	Time Horizon	Expected Impact	Policy Response
Global Risks				
Weaker-than-expected global growth. The global growth slowdown could be synchronized as weakening outlooks in the U.S., Europe and China feed off each other and impact on earnings, asset prices and credit performance.	**High (Europe)/ Medium (U.S., China)**	**ST, MT**	**High** The Swiss GDP growth has been largely externally driven. Thus, a slowdown in Europe and the U.S., its main trading partners, or indirect spillovers from the weaker global demand because of spillovers from China, would dampen Swiss GDP growth.	Loosen fiscal policy to support the domestic economy and reduce reliance on external demand. Improve domestic productivity to increase resilience and competitiveness. Temporarily suspend the fiscal rule to allow a sustained countercyclical stimulus. If needed, in case of excessive currency volatility, consider pre-announced regular foreign exchange purchases.
Rising protectionism and retreat from multilateralism. In the near term, escalating and sustained trade actions threaten the global trade system, regional integration, as well as global and regional collaboration. Additional barriers and the threat of new actions reduce growth both directly and through adverse confidence effects (increasing financial market volatility). In the medium term, geopolitical competition and fraying consensus about the benefits of globalization lead to economic fragmentation and undermine the global rules-based order, with adverse effects on growth and stability.	**High**	**ST, MT**	**High** The Swiss economy is a small open economy, highly integrated in the world trade and capital market. The large current account surplus is largely driven by the goods and service trade. Any obstacles to trade and/or capital flows could have an impact on the domestic saving and investment decisions, negatively affecting growth.	Continue to work with international partners to secure the benefits of economic integration and cooperation across Europe and internationally. Consider options to increase geographical diversification of the trade partners. Strengthen supervision of bank and non-bank financial sector to increase their resilience. Make preparation for alternative EU banking "getaways." In case of growth downturn, consider fiscal loosening.
Sharp tightening of global financial conditions. This causes higher debt service and refinancing risks; stress on leveraged firms, households, and vulnerable sovereigns; capital account pressures; and a broad-based downturn. The tightening could be a result of a sustained rise in risk premium in reaction to concerns about debt levels in some euro area countries; a disorderly Brexit; or idiosyncratic policy missteps in large emerging markets.	**Medium**	**ST**	**Medium** The nonfinancial private sector, especially households, have a large debt stock (although financial assets of households are larger than liabilities). An abrupt and prolonged increase in interest rates could stress leveraged borrowers. This may also reduce real estate prices, thereby lowering the value of	A pre-emptive slowing of bank lending to the private sector (which is expanding by 5 percentage points of GDP per year) through macroprudential measures is needed to prevent a further increase in vulnerabilities. In the event of a growth slowdown, and given substantial fiscal space, a countercyclical discretionary

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Source of Risks	Relative Likelihood	Time Horizon	Expected Impact	Policy Response
Global Risks				
			collateral for mortgages (85 percent of bank loans). Higher interest payments and negative wealth effects could curtail consumption and investment.	fiscal stimulus would be warranted.
Cyber-attacks on interconnected financial systems and broader private and public institutions that trigger systemic financial instability or widely disrupt socio-economic activities.	Medium	ST, MT	Medium Cyber-attacks would disrupt financial operations and encourage the adoption of substitute forms of financial intermediation, including cash.	Ensure adequate cyber-security defenses in vital infrastructure (finance, energy, telecommunications, transportation). Develop strategies to limit financial stability risks that could arise in the context of fintech.
Country-Specific Risks				
Resumption of safe haven inflows in response to renewed global risk-off sentiment. The Swiss franc would appreciate.	Medium	ST, MT	High Switzerland is a major financial center and is seen as a safe haven. Flight to safety would lead to sharp appreciation pressures on Swiss franc assets. The franc appreciation adds to deflation and hurts Swiss competitiveness and growth.	Use targeted foreign exchange purchases to prevent a sharp appreciation of the Swiss franc. Allow full operation of the structural-balance fiscal rule and allow a temporary discretionary fiscal stimulus if the downturn is deep and/or sustained. Further enhance the anti-corruption and AML/CFT frameworks to protect the financial sector against inflows from foreign illicit proceeds.
Prolonged low-growth and low-inflation environment, leading to persistent very low interest rates that increase financial stability risks.	Medium	MT	High Continued low interest rates could encourage search for yield in real estate. Given economy's large exposure to the property market, any decline in property prices could create significant stress for domestic players with large balance sheet exposure to real estate; posing a risk to economic and financial sector stability.	Expand macroprudential toolkit to reduce financial sector's vulnerabilities. Strengthen banks' buffers against the property-related exposure. Assess risks in the construction sector. Consider changes to limits on portfolio allocations for pension funds (indicative) and insurance companies.
Political developments which negatively affect Swiss-EU relationships; however, an internationally compliant CIT has been adopted.	Low	MT	High Removal of EU-equivalence of Swiss stock exchange and remaining uncertainty regarding corporate taxation could reduce Switzerland's appeal as an investment destination, with considerable knock-on effects to real activity.	Seek to limit economic fallout by preserving efficient flows of goods, labor and financial services with the EU. Use the "exceptional" circumstances clause in the fiscal rule to inject a discretionary stimulus.

Annex II. Debt Sustainability Analysis[1]

Summary: Public debt sustainability risks remain contained due to the strict implementation of fiscal rules and the low stock of public debt. The debt-to GDP ratio edged up in 2017 as a result of a new valuation method for some bonds held on the liabilities side of the statement of financial position.

Baseline scenario: The key assumptions underlying the baseline scenario are a gradual but steady recovery of economic growth and the continued adherence to federal and sub-federal fiscal rules. Under the baseline scenario, public debt is projected to decline from 40.5 percent of GDP in 2018 to about 32 percent of GDP in 2024. Gross financing needs are expected to remain slightly negative during the medium term.

Stress tests: The main risk to debt dynamics is a negative growth shock. Other risks such as an adverse interest rate shock or a shock to financing needs affect the public debt trajectory only to a minor extent.

- **Real GDP growth shock.** Real GDP growth rates are assumed to be one standard deviation (1.4 percent) below the baseline during 2020–21. Under this scenario, the debt-to-GDP ratio stays around 40 percent in 2021 (about 4 percentage points higher than the baseline).

- **Primary balance shock.** The primary balance in 2020–21 is hit by a negative shock of 0.3 percent of GDP. This shock results in a debt-to-GDP ratio that is about 1.3 percentage point above the baseline during 2020–24.

- **Real interest rate shock**. The nominal interest rate increases by 200 basis points during 2020–24. The debt-to-GDP ratio becomes slightly higher than the baseline but continues declining.

- **Real exchange rate shock**. This scenario assumes that the nominal CHF/USD exchange rate increases by 9 percent in 2020 relative to its 2018 level. As with other non-growth related shocks, the impact of this shock on the trajectory of public debt is minor.

- **Combined shock**. A simultaneous combination of the previous three shocks would result in an increasing debt-to-GDP ratio that approached 40 percent in 2021 (approximately 4 percentage points higher than the baseline). However, after 2021, the debt would start declining on a trajectory that is almost parallel to the one under the baseline scenario.

[1] For the purpose of this analysis, the general government includes the federal government, cantonal governments, municipal governments, and the social security fund.

Figure 1. Switzerland Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(In percent of GDP, unless otherwise indicated)

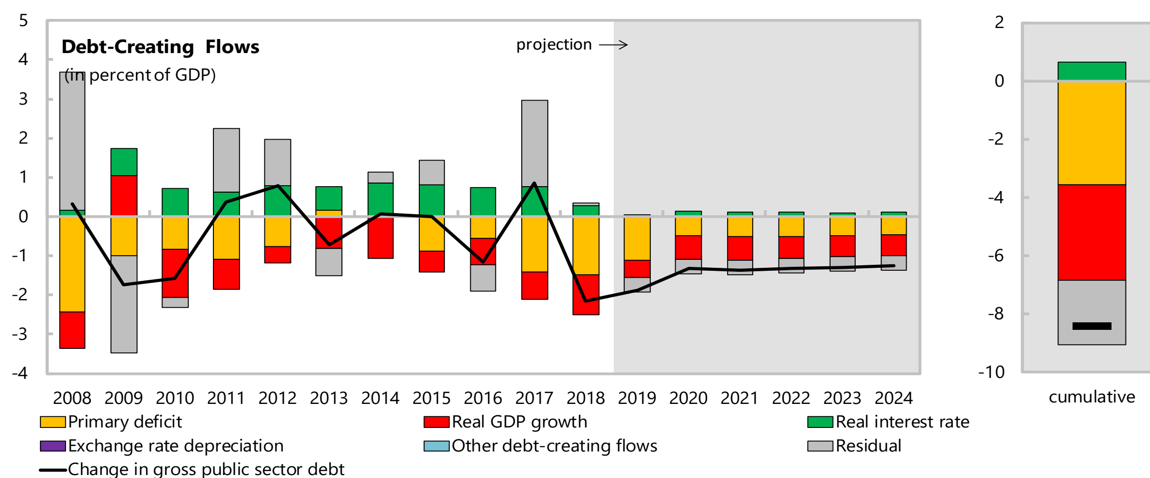
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2008-2016 [2/]	2017	2018	2019	2020	2021	2022	2023	2024
Nominal gross public debt	43.3	42.7	40.5	38.7	37.3	36.0	34.7	33.4	32.1
Public gross financing needs	-0.5	-1.2	-1.3	-0.6	-0.5	-0.6	-0.9	-1.4	-1.6
Real GDP growth (in percent)	1.4	1.7	2.5	1.1	1.6	1.6	1.6	1.6	1.6
Inflation (GDP deflator, in percent)	0.1	-0.4	0.6	1.2	0.9	0.9	1.0	1.0	1.0
Nominal GDP growth (in percent)	1.5	1.3	3.2	2.3	2.5	2.5	2.6	2.7	2.6
Effective interest rate (in percent) [4/]	1.7	1.4	1.3	1.3	1.3	1.2	1.3	1.3	1.4

As of May 14, 2019		
Sovereign Spreads		
Germany (bp) 3/		-35
5Y CDS (bp)		7
Ratings	Foreign	Local
Moody's	Aaa	Aaa
S&Ps	AAA	AAA
Fitch	AAA	AAA

Contribution to Changes in Public Debt

	Actual			Projections							
	2008-2016	2017	2018	2019	2020	2021	2022	2023	2024	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-0.4	0.9	-2.2	-1.9	-1.3	-1.4	-1.3	-1.3	-1.2	-8.4	
Identified debt-creating flows	-0.8	-1.3	-2.2	-1.5	-1.0	-1.0	-1.0	-0.9	-0.9	-6.2	
Primary deficit	-0.8	-1.4	-1.5	-1.1	-0.5	-0.5	-0.5	-0.5	-0.5	-3.6	-0.4
Primary (noninterest) revenue and gr	32.4	33.8	33.4	33.2	32.4	32.4	32.4	32.4	32.4	195.3	
Primary (noninterest) expenditure	31.5	32.4	31.9	32.1	31.9	31.9	31.9	31.9	32.0	191.7	
Automatic debt dynamics [5/]	0.1	0.1	-0.8	-0.4	-0.5	-0.5	-0.5	-0.4	-0.4	-2.6	
Interest rate/growth differential [6/]	0.1	0.1	-0.8	-0.4	-0.5	-0.5	-0.5	-0.4	-0.4	-2.6	
Of which: real interest rate	0.7	0.8	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.6	
Of which: real GDP growth	-0.6	-0.7	-1.0	-0.5	-0.6	-0.6	-0.6	-0.5	-0.5	-3.3	
Exchange rate depreciation [7/]	0.0	0.0	0.0	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
0 (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Eur	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	0.3	2.2	0.1	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-2.2	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

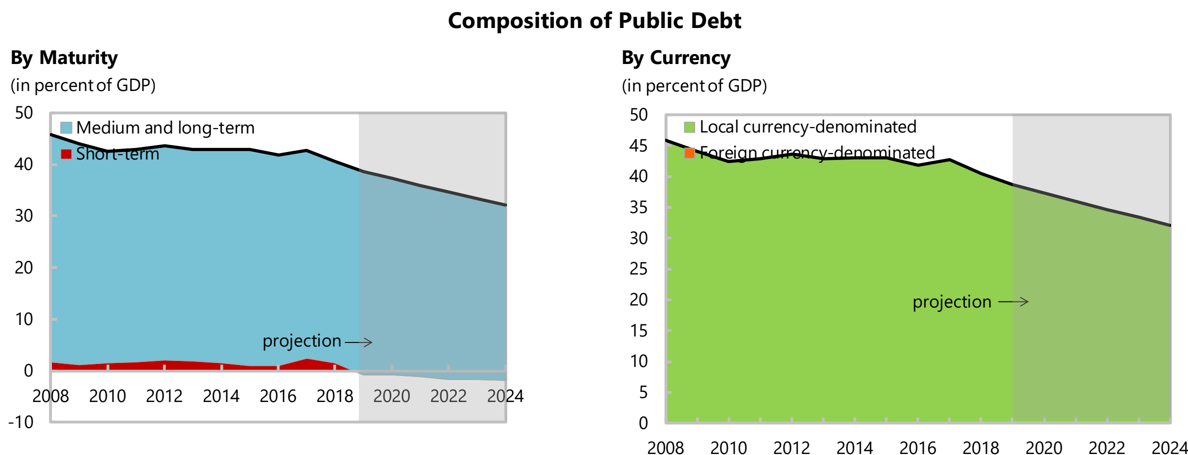
6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

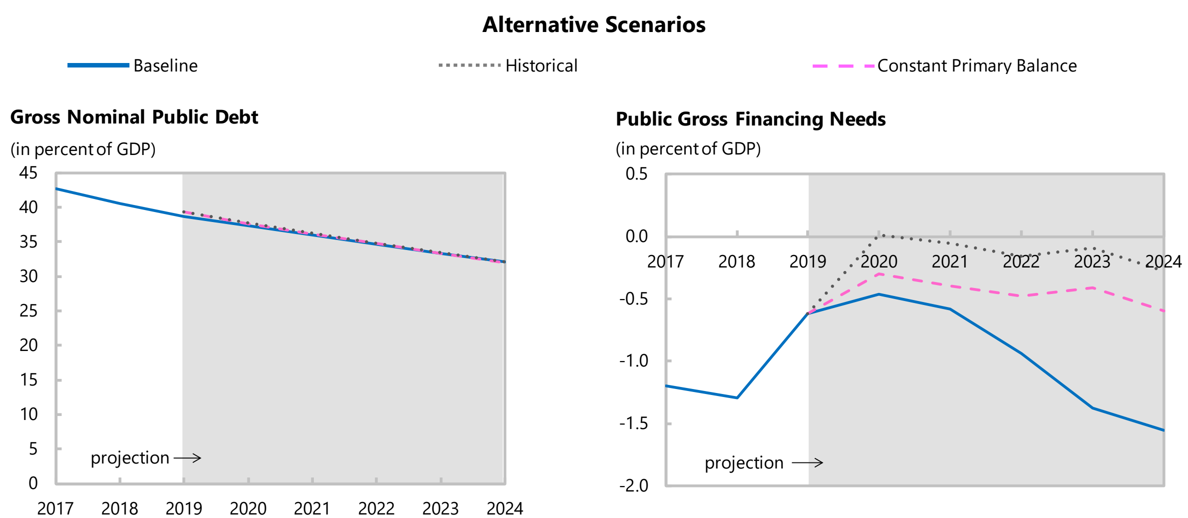
7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Figure 2. Switzerland Public DSA—Composition of Public Debt and Alternative Scenarios





Underlying Assumptions
(in percent)

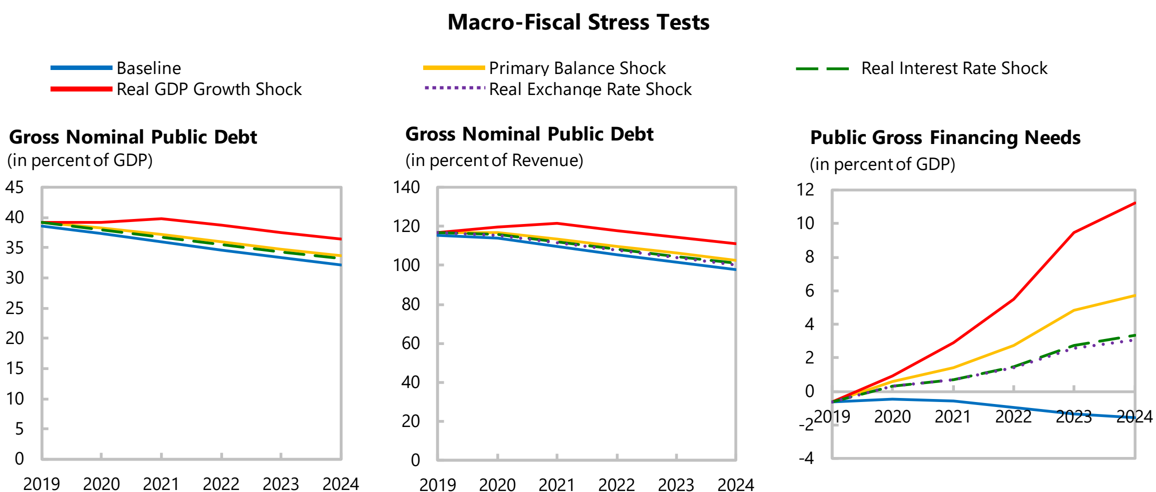
Baseline Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	1.1	1.6	1.6	1.6	1.6	1.6
Inflation	1.2	0.9	0.9	1.0	1.0	1.0
Primary Balance	1.1	0.5	0.5	0.5	0.5	0.5
Effective interest rate	1.3	1.3	1.2	1.3	1.3	1.4
Constant Primary Balance Scenario						
Real GDP growth	1.1	1.6	1.6	1.6	1.6	1.6
Inflation	1.2	0.9	0.9	1.0	1.0	1.0
Primary Balance	1.1	1.1	1.1	1.1	1.1	1.1
Effective interest rate	1.3	1.4	1.4	1.4	1.4	1.4

Historical Scenario	2019	2020	2021	2022	2023	2024
Real GDP growth	1.1	1.5	1.5	1.5	1.5	1.5
Inflation	1.2	0.9	0.9	1.0	1.0	1.0
Primary Balance	1.1	0.8	0.8	0.8	0.8	0.8
Effective interest rate	1.3	1.4	1.4	1.4	1.4	1.4

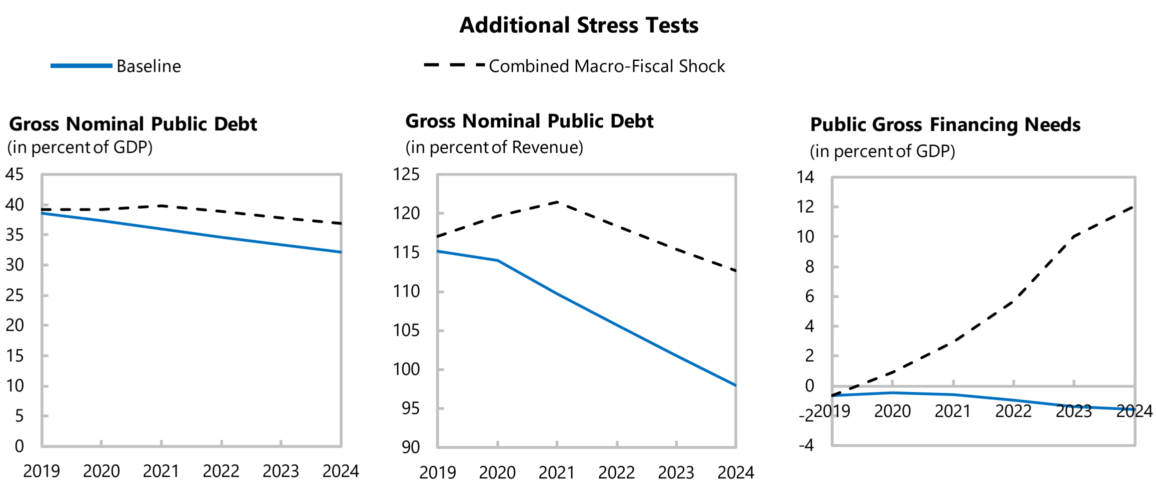
Source: IMF staff.

Figure 3. Switzerland Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	1.1	1.6	1.6	1.6	1.6	1.6
Inflation	1.2	0.9	0.9	1.0	1.0	1.0
Primary balance	1.1	0.2	0.3	0.5	0.5	0.5
Effective interest rate	1.3	1.4	1.5	1.7	1.7	1.7
Real Interest Rate Shock						
Real GDP growth	1.1	1.6	1.6	1.6	1.6	1.6
Inflation	1.2	0.9	0.9	1.0	1.0	1.0
Primary balance	1.1	0.5	0.5	0.5	0.5	0.5
Effective interest rate	1.3	1.4	1.5	1.6	1.7	1.8
Combined Shock						
Real GDP growth	1.1	0.2	0.2	1.6	1.6	1.6
Inflation	1.2	0.5	0.5	1.0	1.0	1.0
Primary balance	1.1	-0.1	-0.6	0.5	0.5	0.5
Effective interest rate	1.3	1.4	1.8	2.3	2.4	2.5

Real GDP Growth Shock	2019	2020	2021	2022	2023	2024
Real GDP growth	1.1	0.2	0.2	1.6	1.6	1.6
Inflation	1.2	0.5	0.5	1.0	1.0	1.0
Primary balance	1.1	-0.1	-0.6	0.5	0.5	0.5
Effective interest rate	1.3	1.4	1.6	2.0	1.9	1.9
Real Exchange Rate Shock						
Real GDP growth	1.1	1.6	1.6	1.6	1.6	1.6
Inflation	1.2	1.2	0.9	1.0	1.0	1.0
Primary balance	1.1	0.5	0.5	0.5	0.5	0.5
Effective interest rate	1.3	1.4	1.5	1.5	1.5	1.6

Source: IMF staff.

Annex III. FSAP Main Recommendations

	Recommendation and Responsible Authority	Timing*
1.	Strengthen FINMA's autonomy, governance, and accountability, and preserve the primacy of its prudential mandate (FDF/FINMA; ¶32–34)**	C
2.	Increase resources for high-quality data gathering and analysis of financial system risks, especially for the fast-moving fintech sector, and to advance recovery and resolution planning. (SNB/FINMA/ Oberaufsichtskommision (OAK BV); ¶18, ¶38, ¶41, ¶67; ¶72)**	MT
Financial Stability Policy Framework		
Macroprudential		
3.	Expand the macroprudential toolkit with mandated supply- and demand-side tools, and strengthen accountability and expectations to act in decision-making (SNB/FINMA/FDF; ¶36)**	ST
Banking		
4.	Ensure that FINMA—rather than banks—contracts and pays directly for supervisory audits using 'audit-level' practices in critical areas (FDF/FINMA; ¶38)**	ST
5.	Focus supervisory audits and increase FINMA's risk-based on-site inspections (FINMA; ¶38)**	ST
6.	Strengthen assessments of key risk management and control practices (FINMA; ¶39)**	MT
Financial Market Infrastructures		
7.	Strengthen recovery and resolution planning for financial market infrastructures (FMIs) (FINMA/SNB/SIX; ¶49)**	I
8.	Improve independence of FMIs' governance arrangements (SNB/SIX; ¶48)**	ST
Asset Management		
9.	Better monitor and manage concentration risk of regulated funds, and empower FINMA to impose administrative fines (FDF/FINMA; ¶52–53)**	ST
Fintech and Crypto-Assets		
10.	Enhance the monitoring of activities and address regulatory gaps (FDF/FINMA; ¶58–59)**	ST
Financial Safety Net and Crisis Management		
11.	Enhance, expand, and expedite recovery and resolution planning, including resolvability (FDF/FINMA; ¶63, ¶65–66)**	ST
12.	Thoroughly reform the DIS with a public DIA that is included in the crisis management framework, ex-ante DIS funding, and the authority to use deposit insurance funds for resolution funding, subject to safeguards (FDF; ¶67–68)**	MT
* C = Continuous; I = Immediate (within one year); ST = Short Term (within 1–2 years); MT = Medium Term (within 3–5 years).		
** Paragraph numbering in the above table refers to the 2019 Switzerland Financial System Stability Assessment		

Annex IV. Status of Previous Recommendations

2018 Article IV Recommendations	Policy Actions
Fiscal Policy	
Allow a larger (smaller) countercyclical response when debt is below (above) long-term sustainable levels.	Overperformance of the federal-level debt brake rule has continued. An expert group recommended to use space from persistent underspending to reduce taxes.
Loosen fiscal policy to relieve pressure on monetary policy tools during low inflation period.	The fiscal policy remained underutilized, as it should be used to caution against domestic rather than external shocks.
Improve pension system's viability, including by linking the conversion rate for the second pillar to yields and life expectancy.	Some changes to the pension system, in particular, a cut to the conversion rate, were approved in the May 2019 referendum.
Monetary Policy	
Given the elevated uncertainty ahead, policy should remain data-dependent and well-communicated.	The SNB continued accommodative policy as inflation hovered in the lower part of the 0–2 percent range and growth weakened. Interest rate has been kept flat at -0.75 percent since 2015.
Utilize foreign currency purchases only to address capital inflow surges. Allow some real appreciation.	The SNB's FX interventions were limited in 2018, amounting to CHF 2.3 billion, as volatility of capital flows reduced.
Financial Sector Policy	
Reinforce the macroprudential framework for real estate.	The Banking Association is considering tightening demand-side macroprudential tools as part of a self-regulation. The authorities proposed an introduction of higher risk weights for IPRE lending in case self-regulation is not implemented and/or insufficient to alleviate risks to financial stability.
Remove tax deductibility of mortgage interest payments together with elimination of imputed rental income's taxation.	Several proposals to remove tax deductibility are currently being considered.
Remove guarantees on cantonal banks.	Guarantees for cantonal banks are a part of ongoing negotiations.
Structural Reforms	
Meet international standards on CIT in a timely manner.	Measures to bring the CIT in line with the international standards were approved in the May 2019 referendum.
Address shortcoming to AML/CFT regime identified in the 2016 FATF evaluation report.	AML efforts are ongoing and some measures to address the shortcomings are being considered. Exchange of tax information with numerous countries—under the OECD's initiative—is being implemented.

Source: IMF staff.

INTERNATIONAL MONETARY FUND

SWITZERLAND

STAFF REPORT FOR THE 2019 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 30, 2019

Prepared By	European Department

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FUND RELATIONS

(As of April 30, 2019)

Membership Status: Joined May 29, 1992; Article VIII

General Resources Account

	SDR Million	Percent Quota
Quota	5,771.10	100.00
Fund holdings of currency	5,302.76	91.88
Reserve position in Fund	468.40	8.12
New arrangements to borrow	419.97	

SDR Department

	SDR Millions	Percent Allocation
Net cumulative allocation	3,288.04	100.00
Holdings	3,256.13	99.03

Outstanding Purchases and Loans: None

Financial Arrangements: None

Projected Payments to Fund:[1]
(SDR Million; based on existing use of resources and present holdings of SDRs):

			Forthcoming		
	2019	2020	2021	2022	2023
Principal					
Charges/Interest	0.27	0.42	0.41	0.42	0.42
Total	0.27	0.42	0.41	0.42	0.42

Exchange Rate Arrangement:

The de jure exchange rate arrangement is free floating. The exchange rate of the Swiss franc is determined by market forces in the foreign exchange market, and all settlements are made at free market rates. On January 15, 2015, the SNB ended the exchange rate floor of CHF 1.20 per euro, and the franc has since been floating. However, the SNB may intervene in the foreign exchange market. The SNB publishes information regarding its foreign exchange transactions in its annual accountability report. The de facto exchange rate regime is a floating arrangement as the exchange rate has been floating between 1.12 and 1.20 CHF per euro, with limited SNB intervention, over the last 12 months.

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Switzerland has accepted the obligations of Article VIII, Sections 2, 3, and 4, and maintains a system free of restrictions on the making of payments and transfers for current international transactions except for restrictions in place for security reasons notified to the Fund pursuant to Decision No. 144-(52/51).

On May 8, 2019, Switzerland notified the IMF of the exchange restrictions that have been imposed against certain countries, individuals, and entities, in accordance with relevant UN Security Council resolutions and EU regulations.

Latest Article IV Consultation: The last Article IV consultation was concluded on June 11, 2018, with the staff report published on that date. Switzerland is on the standard 12-month consultation cycle.

Technical Assistance: None

Resident Representatives: None

Financial System Stability Assessment Update and ROSCs:

- The 2019 FSAP missions were held during November 2018 and January 2019. The findings were discussed with the authorities during the Article IV consultation discussions in March 2019 and were presented to the Executive Board for discussion alongside the Article IV staff report on June 17, 2019. The report for the precious FSAP update was issued on May 28, 2014.

- Reports on the Observance of Standards and Codes (Basel core principles, IAIS core principles, and IOSCO objectives and principles) were conducted in 2013–14, and the report was issued on May 28, 2014.

STATISTICAL ISSUES

(As of May 2019)

I. Assessment of Data Adequacy for Surveillance
General: Data provision is adequate for Fund surveillance. Switzerland publishes timely economic statistics and posts most of the data and the underlying documentation on the internet.
National Accounts: National accounts are timely (including the expenditure, production and income approaches). GDP by canton and a detailed disaggregation of GDP by industry are published with a significant lag, however, with 2017 data being released in late 2019. Responsibility for national accounts compilation is split between two different agencies: quarterly national accounts are published by the State Secretariat for Economic Affairs, and annual national accounts are published by the Federal Statistics Office.
Price Statistics: Consumer price indices and producer and import price indices are collected by the Federal Statistical Office. They are published monthly with a base period of December 2015. The Federal Statistical Office is developing additional producer price indexes for services and construction (currently published just twice a year).
Government Finance Statistics: General government finance statistics are compiled by the Federal Finance Administration. Data for general government are finalized with eight months lag, mainly due to delays in compiling fiscal accounts at the level of cantons and communes. With the exception of financial transactions in financial assets and liabilities, the conceptual and methodological reconciliation with the Swiss system of national accounts of the Federal Statistical Office was completed with the publication of 7 September 2017. The Swiss National Bank publishes statistics on outstanding and new bond issues by the Swiss Confederation.
Monetary and Financial Statistics: The Swiss National Bank (SNB) reports monetary statistics for the monetary authorities, deposit money banks, and other banking institutions for publication in the IMF's *International Financial Statistics (IFS)*. However, data are reported with a long lag, using report forms that are not consistent with the Standardized Report Forms (SRFs) developed based on the IMF's *Monetary and Financial Statistics Manual and Compilation Guide, 2016*. To improve data reporting, the SNB has worked on migration to the SRFs. As a result, the SRFs 1SR for central bank and 2SR for other depository corporations have been compiled and reported for dissemination. While the SRF 1SR is sufficient, the SRF 2SR needs further improvement before the data can be published in *IFS*. STA is working with the authorities to fix the pending issues on the SRF 2SR. Switzerland reports data on some basic series and indicators of the Financial Access Survey (FAS), including the two indicators adopted by the UN to monitor Target 8.10.1 of the Sustainable Development Goals (SDGs).
Financial Sector Surveillance: Switzerland reports 11 of the 12 core Financial Soundness Indicators (FSIs) and 9 additional FSIs for deposit takers, and 4 FSIs for real estate markets. All FSIs are reported on an annual basis. The FSI data and metadata have been posted on the IMF's FSI website.
External Sector Statistics: Balance of Payments (BOP) and international investment position (IIP) statistics are published based on the sixth edition of the IMF's Balance of Payments and International

Investment Position Manual (BPM6). Official data in BPM6 format are available from 1999 onwards. Switzerland reports to the IMF annual data on the Coordinated Direct Investment Survey (CDIS); semi-annual and annual data on the Coordinated Portfolio Investment Survey CPIS); and monthly data on the International Reserves and Foreign Currency Liquidity. Switzerland is also reporting quarterly external debt data to the World Bank database.
II. Data Standards and Quality
In June 1996, Switzerland subscribed to the IMF's Special Data Dissemination Standard (SDDS), and its metadata are currently posted on the Dissemination Standards Bulletin Board. Switzerland is in full observance of SDDS requirements, and is availing itself of the SDDS's flexibility options on dissemination of production index data (for periodicity and timeliness) and of wages and earnings data (for periodicity). The Swiss Federal Council has announced its decision to seek to adhere to IMF's highest tier of data dissemination standards—the SDDS Plus. Implementation of the requirements of SDDS Plus in Switzerland—a task in which an interagency working group (SIF, SNB, FSO, FFA, FSIO, SECO, and FINMA) plays an active role—is scheduled for 2020.

Switzerland: Table of Common Indicators Required for Surveillance

(As of May 8, 2019)

	Date of Latest Observation	Date Received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]
Exchange Rates	Same day	Same day	D and M	M and M	D and M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Mar 19	Apr 19	M	M	M
Reserve/Base Money	Mar 19	Apr 19	M	M	M
Broad Money	Mar 19	Apr 19	M	M	M
Central Bank Balance Sheet	Apr 19	May 19	M	M	M
Consolidated Balance Sheet of the Banking System	Apr 19	Apr 19	M	M	M
Interest Rates[2]	Same day	Same day	D and M	M and M	D and M
Consumer Price Index	April 19	May 19	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	2017	Apr 19	A	A	A
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	2017	Apr 19	A	A	A
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2017	Apr 19	A	A	A
External Current Account Balance	Q4/18	Mar 19	Q	Q	Q
Exports and Imports of Goods and Services	Mar 19	Apr 19	M	M	M
GDP/GNP	Q4/18	Mar 19	Q	Q	Q
Gross External Debt	Q4/18	Mar 19	Q	Q	Q
International Investment Position[6]	Q4/18	Mar 19	Q	Q	Q

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

Statement by Mr. Paul Inderbinen, Executive Director for Switzerland and Mr. Gilbert Heim, Senior Advisor to the Executive Director
June 17, 2019

On behalf of our Swiss authorities, we thank staff for their insightful reports, which provide a thorough analysis of macroeconomic developments and the financial sector. We broadly share staff's views on the challenges going forward, and appreciate their recommendations, many of which are in line with policies that are currently being implemented.

Outlook

The authorities broadly agree with staff on the outlook. Amid a weaker global economy, Swiss GDP growth lost momentum in the second half of 2018. Growth accelerated in Q1:2019, driven primarily by domestic demand and partly as a result of temporary factors. However, the authorities expect GDP to grow at a below-average rate in 2019. Leading indicators show weakening signs, primarily for the industrial sector, and the outlook remains subject to risks, especially related to the external environment. Spiraling protectionist tendencies could weigh on external demand, while global political uncertainty could affect investments. The Swiss franc could come under pressure as a safe haven asset, should global risks materialize. Domestically, imbalances in the residential real estate sector persist, with the risk of price corrections and related macroeconomic repercussions. On the upside, the domestic economy may grow more strongly than forecast on the back of the favorable situation in the labor market.

Policy Mix

The authorities consider the current policy mix to be appropriate. Fiscal policy has contributed to stabilizing the economy during the last decade. Over this period, education and research expenditure at the federal level has increased by around 44 percent, while expenditure on transport infrastructure rose by 38 percent. In 2016 and 2018, the authorities have set up two infrastructure funds, while also raising infrastructure expenditures. As a general point, the authorities are of the view that the policy mix should best depend on the nature of the economic issues and associated challenges that need addressing.

Fiscal Policy

Switzerland has a strong fiscal position, with general government debt at 40.5 percent of GDP, and all levels of government enjoying sound finances. The debt brake fiscal rule at the federal level aims for a structurally balanced budget. This cautious policy framework continues to serve the country well. Controlled expenditure growth has allowed for the creation of fiscal space within the budget, including through lower debt service, and its use for priority tasks (e.g. education and research). Moreover, the structural surpluses in federal finances since 2006 have allowed to reduce federal debt and to further strengthen the resilience of the economy. Along with strong and resilient institutions, the fiscal rule enables the financing of a well-developed welfare state, a top-level education system, and an extensive and interconnected public infrastructure. There is no lack of public investment in the authorities' view, and they are not convinced that an increase in public spending would sustainably boost growth.

In 2017, a group of experts reviewed the debt brake fiscal rule. Building on their recommendations, the Ministry of Finance conducted an in-depth analysis of the rule and monitored the development of budget underruns. Based on the results, the government decided in May 2019 not to adjust the fiscal rule, recognizing that current expenditures, investment and growth in priority areas can be financed through existing instruments. The government did, however, decide to simplify procedures for within-year supplementary budgets. This should reduce incentives for line ministries to maintain precautionary margins in spending execution, and allow the expenditure ceiling prescribed by the debt brake to be better utilized.

Monetary Policy
The authorities concur with staff that the current accommodative monetary policy remains appropriate. The Swiss franc is still highly valued and the recent appreciation of the Swiss franc against the euro has shown that the situation in the foreign exchange market remains fragile and that monetary conditions can change rapidly. Moreover, CPI inflation remains low and is expected to increase only gradually. Therefore, the negative interest rate on sight deposits and the SNB's willingness to intervene in the foreign exchange market as necessary remain essential. This keeps the attractiveness of Swiss franc investments low and eases pressure on the currency, in line with the mandate of the SNB to ensure price stability while taking due account of economic developments.

External Sector Assessment
The authorities welcome the careful analysis of the external sector, and in particular of the current account (CA). The two issues that are of particular interest in the Swiss case, i.e., measurement and demographics, are also relevant for many other members. Further work on these issues is warranted, including on the impact of intangible assets on the CA, and on how demographics and pension systems interact and effect savings. The external sector assessment, however, should not be limited to an analysis of the CA only. In order to facilitate a broader assessment, we encourage staff to pursue work on a better understanding of the apparent disconnect between the CA and the REER, as well as on the REER models of the EBA methodology.

Structural Issues
Major progress has been achieved in corporate income taxation (CIT) reform. Following the recent approval of the Federal Act on Tax Reform and AHV Financing (STAF) in a referendum, the new CIT framework will be effective starting from 2020. Corporate taxation will thus be compliant with international standards and will remain internationally competitive.

The authorities concur that pension reform is essential to maintain a sustainable and effective social safety net against the backdrop of an aging population and the low interest environment. The STAF package will generate the necessary additional financing for the first-pillar of the pension system, thus contributing to its sustainability. Given that the first pillar remains a reform priority, the government will submit a reform proposal (AHV 21) to parliament in 2019. Its objective is to secure the level of benefits and the financial sustainability of the first pillar. Key elements of the proposal include: (i) the unification of the

retirement age at 65, (ii) additional earmarked revenue, and (iii) more flexibility in the retirement age, with incentives for working longer.

The authorities welcome staff's assessment of recent progress in the detection and repression of transnational corruption. They are well aware of the risks of transnational corruption, given the openness of the economy and the financial sector. The authorities are determined to tackle remaining issues to combat corruption effectively and in line with international best practices and standards. The voluntary assessment of its anti-bribery and AML/CFT frameworks under the 'forth element' of the Fund's Enhanced Engagement on Governance is consistent with Switzerland's long-standing support for the Fund's work on promoting good governance, as well as financial sector integrity, across the membership.

Financial Sector Policies

The authorities welcome the positive assessment of financial system stability. The results of the FSAP stress tests attest to the strong resilience of the financial sector. The authorities share staff's assessment that financial institutions are well capitalized and could withstand severe macrofinancial shocks.

Important reforms have been implemented since the 2014 FSAP. These include the timely adoption of the Basel III framework; also, the 'too-big-to-fail' regime has been strengthened, with regulation for systemic banks that is more stringent than international standards. There has also been notable progress in strengthening financial sector supervision. Moreover, the regulatory framework for financial market infrastructures was further improved, particularly through the entry into force of the Federal Financial Market Infrastructure Act (FMIA) in January 2016. The adoption of Federal Financial Services Act (FinSA) and of the Federal Financial Institutions Act (FinIA), both of which will enter into force in 2020, will enhance client protection and supervision of asset management.

Regulatory reform continues. For example, in line with the principle of proportionality underlying the Swiss regulatory framework, FINMA is currently running a pilot for a small bank regime, to be implemented through a regulatory change effective as of January 2020. Moreover, a proposal for a resolution regime for insurance companies is currently in the parliamentary process and expected to enter into force in 2021. Under the ongoing review of legislation on insurance supervision, further key features of the Swiss Solvency Test (SST) will be more comprehensively enshrined in binding legislation, thus enhancing legal clarity and certainty.

The authorities are aware that the environment of persistently low yields entails risks and creates challenges to existing business models and profitability of financial firms over the medium term. They are closely monitoring developments and are continuously evaluating the need for additional regulatory and supervisory action.

In addition, the authorities will continue to monitor developments on the mortgage and real estate markets closely. Options for additional macroprudential measures and for strengthening existing measures to limit the build-up of risks and to strengthen the capacity to respond will be considered as needed. For any new macroprudential tools, decision making would be formalized and responsibilities and accountabilities clearly assigned, in line with the country's

institutional framework of shared responsibility, collaboration, and respect for the mandates and independence of individual authorities.

The authorities welcome staff's recognition of the strength of financial sector supervision. FINMA's size and available resources are adequate to fulfil its mandate. FINMA's budgetary independence is clearly anchored in the law, and the level of resources can be adjusted flexibly. Moreover, an increase in resources is planned in the context of the supplementary tasks relating to independent asset managers, and FINMA regularly assesses the need for adjustments to its human resource allocation. Most recently, it increased resources in the fields of cyber risk, outsourcing, and fintech.

Important progress has been achieved in strengthening the financial safety net and crisis management arrangements. The authorities agree that further work is needed to finalize resolution plans and to improve resolvability of systematically important banks, in particular in the area of resolution funding. They also agree that this should not be restricted to global systemically important banks (G-SIBs), but also include other institutions, notably domestically-focused systemically important banks (D-SIBs). The strengthening of recovery and resolution planning for FMIs will be a priority for the medium term.

The authorities agree on the need for deposit insurance reform. Public consultation on a reform proposal was initiated in early March 2019. The reform would be a step forward, for instance by moving to a partially ex-ante funded system and introducing more stringent deadlines for pay-outs. Meanwhile, the authorities consider the deposit insurance system (DIS) an integrated system that includes the deposit insurance agency "esisuisse", FINMA, and the liquidator, with different members of this system in charge of different DIS components. In the authorities' interpretation, the Swiss DIS is, in this respect, in conformity with the IADI Core Principles.

Switzerland welcomes innovation and embraces the opportunities of fintech. At the same time, the authorities are firmly committed to ensuring financial stability and integrity, as well as addressing potential risks. FINMA conducts strong supervision and strict enforcement, and informs the public on risks, e.g. of ICOs. The authorities are also in close contact and exchange with fintech industry representatives and experts. Moreover, it is important to underline that financial market legislation and regulation applies to fintech entities and activities, in line with the principle of technology-neutrality. Notably, the AML/CFT regulations apply fully in the fintech area. The authorities have conducted an in-depth examination of legislation and regulation with a view to identify potential needs for amendments. A government report was published in December 2018 and, as a follow-up, legislative measures on several fronts have been prepared and will be presented to Parliament in the coming months.