

**Switzerland: 2003 Article IV Consultation—Staff Report; Public Information Notice on the Executive Board Discussion; 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 2003 Article IV consultation with Switzerland, the following documents have been released and are included in this package:

- the staff report for the 2003 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on **February 24, 2003**, 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 April 30, 2003.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a Public Information Notice (PIN) summarizing the **views of the Executive Board as expressed during its May 23, 2003 discussion** of the staff report that concluded the Article IV consultation.
- a statement by the Executive Director for Switzerland.

The document(s) listed below have been or will be separately released.

Selected Issues Paper

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

SWITZERLAND

**Staff Report for the 2003 Article IV Consultation**

Prepared by the Staff Representatives for the  
2003 Consultation with Switzerland

Approved by Alessandro Leipold and Martin Fetherston

April 30, 2003

The 2003 Article IV consultation discussions were held in Zürich and Bern during February 14-24, 2003. The mission comprised Messrs. Corker (Head), Gagales, and Klingen (all EU1). Messrs. Zurbrügg, Executive Director for Switzerland, and Moser, Advisor, attended the meetings. The mission met with Federal Councillor Villiger, Minister of Finance; Federal Councillor Deiss, Minister of Economics; President Roth, Chairman of the Governing Board of the Swiss National Bank (SNB); senior officials of the federal administration and the SNB; and representatives from parliament, NGOs, and the private sector. The authorities released the mission's concluding statement and have agreed to the publication of the staff report.

Switzerland has accepted the obligations of Article VIII, Sections 2, 3, and 4 (Appendix II) and maintains an exchange system that is free of restrictions on payments and transfers for current international transactions. Switzerland subscribes to the Fund's Special Data Dissemination Standard (Appendix III). The last Article IV consultation was concluded on May 29, 2002 (IMF Country Report No. 02/106).

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**Main Websites for Swiss Data**

Data in this Staff Report reflect information received by April 30, 2003. In most cases, more recent data can be obtained directly from the following internet sources:

Swiss Federal Statistical Office ..... <http://www.statistik.admin.ch>

Swiss National Bank..... <http://www.snb.ch>

State Secretariat for Economic Affairs (SECO)..... <http://www.seco.admin.ch>

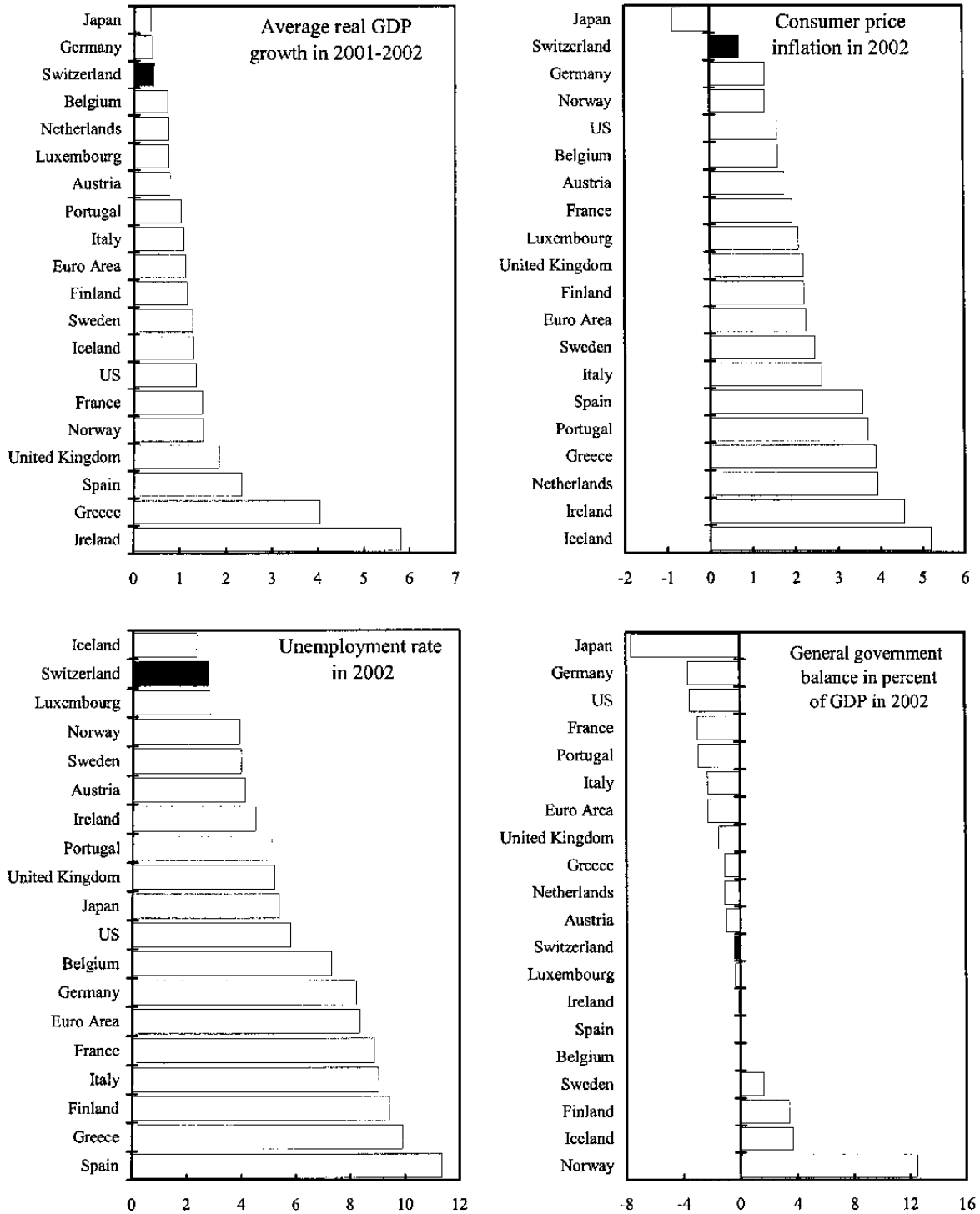
Federal Ministry of Finance..... <http://www.efd.admin.ch>

Federal Customs Administration..... <http://www.zoll.admin.ch>

Institute for Business Cycle Research at the  
Federal Institute of Technology (KOF) ..... <http://www.kof.ethz.ch>

Information and documentation on Swiss  
economic statistics can be found at the Special  
Data Dissemination Standard website of the IMF ..... <http://www.imf.org/external/country/CHE/index.htm>

Figure 1. Main Indicators  
(In percent)



Source: IMF, World Economic Outlook.

## I. INTRODUCTION

1. Switzerland has a high per capita GDP (and, given large net external assets, even higher per capita GNP) and an impressive record of low unemployment and inflation (Figure 1). However, trend real GDP growth is slow and when there are cyclical downswings, as at present, the economy flirts with recession. Current weakness is compounded by the collapse of global asset prices and related pressures on the important financial sector. More generally, while high income levels partly explain slow trend growth, Switzerland's underlying growth performance also reflects distortions in domestic markets and a sluggish pace of product market liberalization (Box 1).

2. Against this background, the consultation discussions focused on:

- How monetary policy should be conducted in an environment where interest rates and inflation are both close to zero and the output gap is still widening.
- How the credibility of the balanced federal budget rule (the “debt brake”), which came into effect this year, might be preserved in the face of an unexpectedly large structural deficit.
- How the financial sector is coping in the global downswing and the status of measures to further upgrade supervision, including those recommended under last year's Financial Sector Assessment Program (FSAP).<sup>1</sup>
- How to invigorate product market reform.

### **Box 1: IMF Policy Recommendations and Implementation**

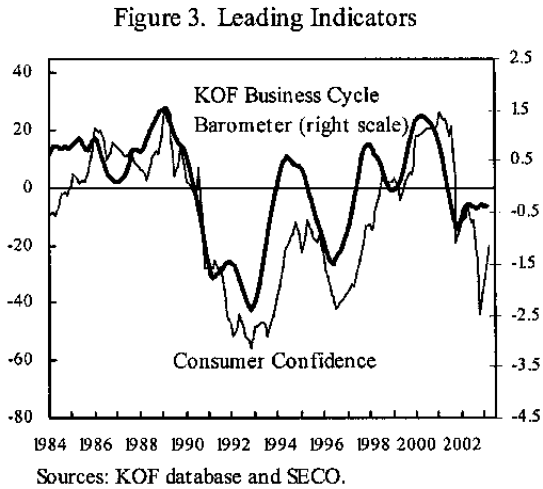
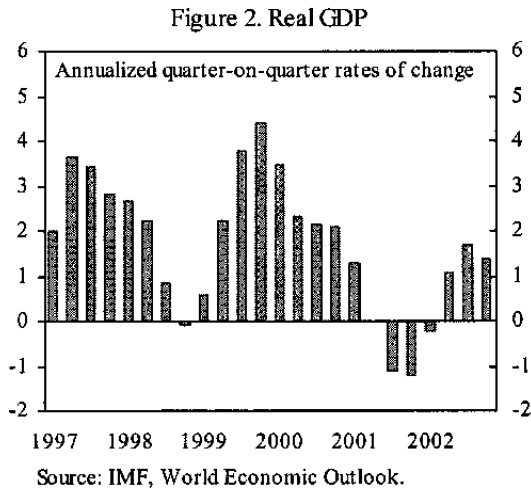
In concluding recent Article IV consultations, IMF Executive Directors have generally supported Switzerland's conduct of, and framework for, macroeconomic policies but have called for greater efforts to free up product markets. Particular focuses of attention have been the slow pace of addressing cartels, dismantling barriers across the internal market, and liberalizing network industries—areas where Switzerland lags behind many OECD countries. The authorities support reform, but under the federalist system and the need for referenda, have found it difficult to mobilize wider popular support. General elections in October 2003 present a further test for garnering support for reform this year.

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<sup>1</sup> See *Switzerland: Financial System Stability Assessment*, IMF Country Report No. 02/108 (June 2002).

## II. ECONOMIC BACKGROUND

3. **Following a solid expansion by Swiss standards in 1997-2000, economic activity has stagnated.** A brief and shallow recession in 2001 has given way to tepid growth at best (Figure 2).<sup>2</sup> In early 2003, conjunctural indicators pointed to an economy that remained broadly stagnant with little sign from expectations surveys that recovery was at hand (Figure 3). Unemployment has increased sharply and IMF staff estimate that, at end-2002, output was about 2 percent below potential.<sup>3</sup>



4. **Although weak external demand can explain the bulk of the slowdown in activity, a collapse of investment also points to domestic causes** (Table 1 and Figure 4). Weak external demand has been exacerbated by an appreciating Swiss franc (Figure 5). As to domestic demand, the decline in investment has gone beyond that in other industrial countries, suggesting excess capacity was built up during the late 1990s (Table 2). By contrast, consumption growth has remained steady throughout the downswing, notwithstanding wealth losses from tumbling equity prices (Figure 6).<sup>4</sup>

<sup>2</sup> The quarterly GDP estimates are based on a limited set of indicators and are not fully integrated into the system of national accounts. Some indicators suggest that the pattern of growth was flatter during 2002.

<sup>3</sup> The output gap estimate is subject to considerable uncertainty, not least because an elastic pool of foreign workers makes it difficult to gauge potential labor supply. Uncertainty has increased with the activation of free labor mobility with the EU as from June 2002.

<sup>4</sup> At end 2002, households' direct holdings of securities were estimated at SwF 450 billion (at par with GDP), having declined by one quarter in the previous two years. Modest house price  
(continued)

Table 1. Contributions to Growth Deceleration

	Contribution to growth		Contribution to growth deceleration	
	1999Q2-2000Q4	2001Q1-2002Q4	Gross	Net 1/
	(Annualized rate in percent)		(Percent)	
Private consumption	1.2	0.6	-0.6	0.3
Public consumption	0.2	0.4	0.2	0.2
Machinery and equipment investment	1.0	-1.5	-2.4	-0.4
Construction investment	0.2	-0.5	-0.8	-0.8
Stock building	-0.1	-0.3	-0.3	-0.1
Exports	4.1	0.0	-4.1	-1.9
Imports	-3.8	1.6	5.4	...
GDP	2.9	0.2	-2.7	-2.7

Sources: SECO; and IMF staff calculations.

1/ Net of the import content of exports, stock building, investment in machinery and equipment, and private consumption. The import content is estimated, respectively, at 55, 60, 85, and 14 percent.

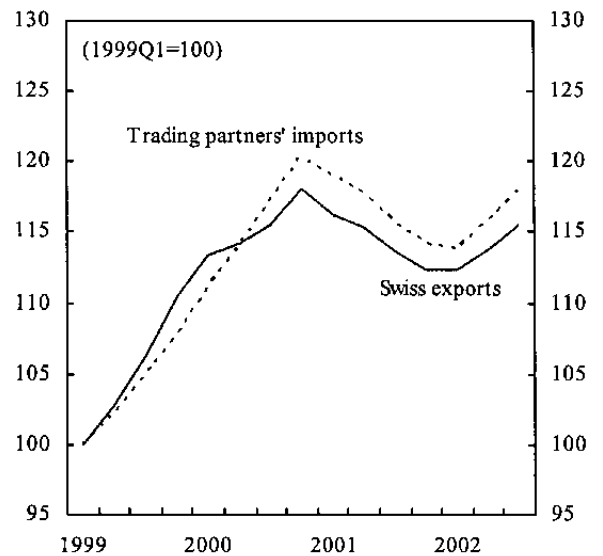
Table 2. Selected Countries:  
Decline of Machinery and Equipment Investment 1/  
(In percent)

Switzerland	-18.0
Euro area	-7.5
Germany	-17.0
France	-1.4
Japan	-8.2
United States	-8.3

Sources: IMF staff calculations; SECO; Deutsche Bundesbank; EUROSTAT; INSEE; ESRI; and BEA.

1/ In real terms since peak in 2000 or 2001 to present.

Figure 4. Exports and Partner Imports

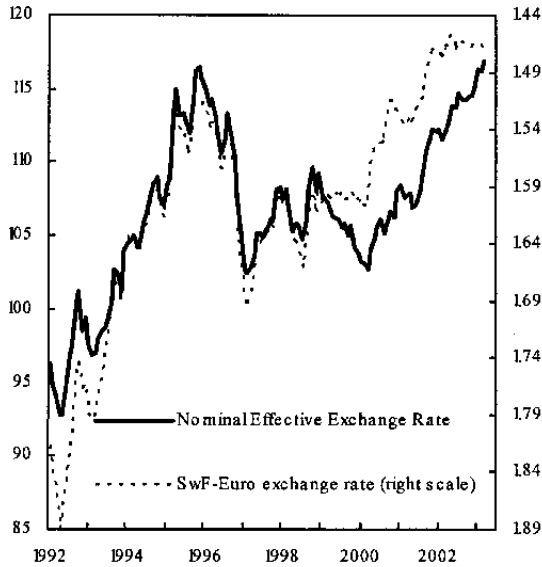


Sources: SECO; and IMF staff estimates.

risers and a pension system that shields households from stock market volatility would have attenuated wealth effects.

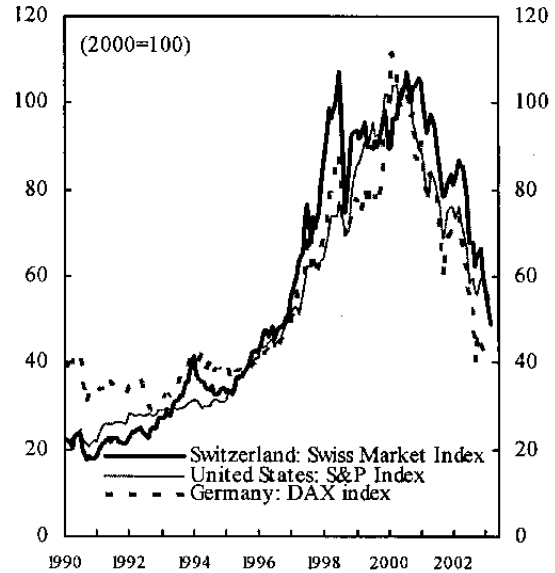


Figure 5. Exchange Rates



Sources: IMF, International Financial Statistics; and staff estimates.

Figure 6. Share Prices

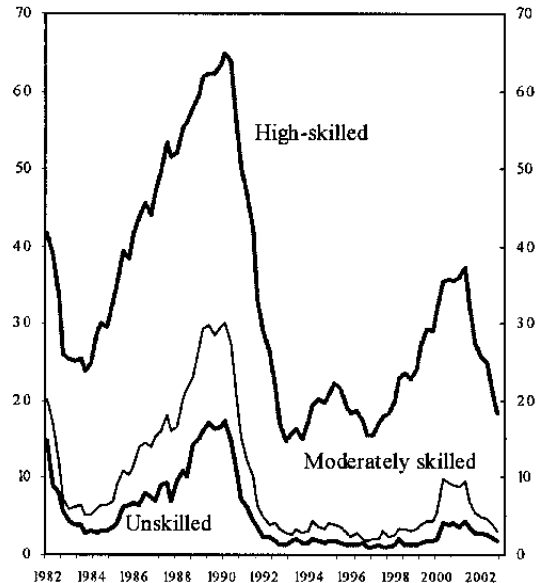


Sources: KOF database; and IMF, International Financial Statistics.

5. **The financial sector has been hit particularly hard in the slowdown.** The crunch in international financial markets has led to a drying up of fee-generating activities such as investment banking and wealth management, inflicting heavy losses and triggering consolidation in banks and insurance companies. After having accounted for about half of real GDP growth in the past decade, the financial sector is estimated to have contracted in the past two years.

6. **Throughout the current business cycle, inflation has remained low.** Underlying consumer price inflation has generally been below 1 percent since mid-2001 benefiting from the appreciating Swiss franc and, to a lesser extent, greater competition in some domestic markets. Low inflation has been underpinned by wage moderation. Wages are estimated to have increased by under 2 percent in 2002 and weak labor market conditions point to a smaller increase in the current wage round (Figure 7).

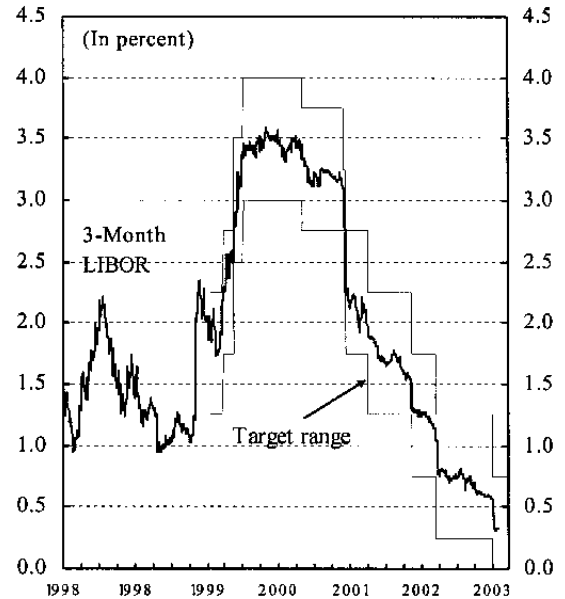
Figure 7. Percent of Firms Reporting Labor Shortages



Source: KOF database.

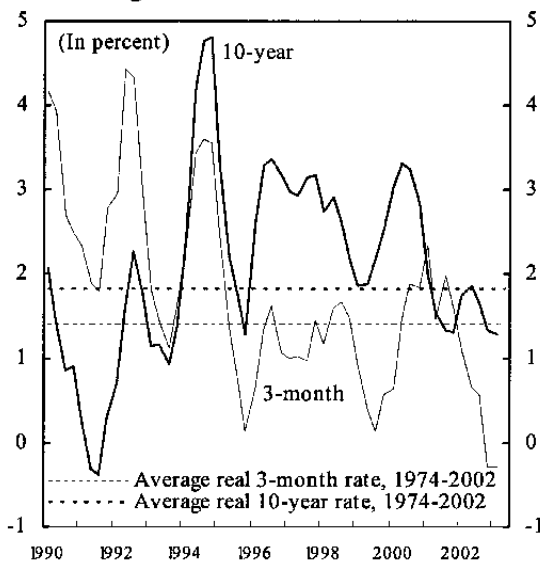
7. **With actual and projected medium-term inflation within its 0-2 percent price stability range, the SNB has cut interest rates aggressively but exchange rate appreciation has tempered the easing of monetary conditions.** Since March 2001, the SNB has lowered its benchmark interest rate by 325 basis points, to just ¼ percent, driving short-term interest rates further below euro area rates and pushing real short-term interest rates into negative territory (Figures 8-9). However, the monetary conditions index has declined substantially less owing to the appreciation of the franc (Figure 10). While some safe-haven effects are likely to have been at work, especially after September 11, 2001 and ahead of the war in Iraq, much of the appreciation since mid-2002 has reflected the general weakening of the US dollar against major currencies. Meanwhile, real borrowing costs have been held up by receding inflation expectations, a steepening yield curve and widening corporate spreads (Table 3). Although broad money has been expanding rapidly, domestic credit has declined slightly.

Figure 8. Policy Interest Rate



Sources: KOF database; and Bloomberg.

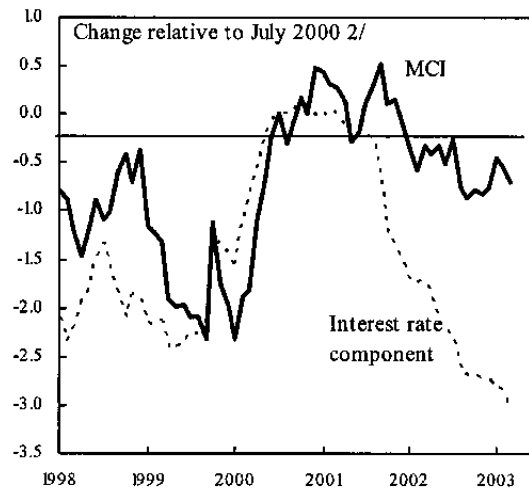
Figure 9. Real Interest Rates 1/



Sources: KOF database; and IMF staff estimates.

1/ Actual rates minus 12-month change in CPI index.

Figure 10. Monetary Conditions Index 1/



Source: IMF staff estimates.

1/ The weights of the interest rate and the detrended exchange rate are proportional to 3 to 1, respectively.

2/ At that date, the economy was estimated to have been at potential.

Table 3. Selected Countries: Yield Developments, December 2000-December 2002

	Decline of s-t yields	Wedge			Decline of real corporate borrowing costs
		Steepening yield curve	Increase in inflation expectations	Reduction in corporate spreads	
(In percentage points)					
Switzerland	2.75	-1.50	-0.25	-0.15	0.86
United States	4.85	-3.61	-0.22	-0.14	0.88
Germany	2.03	-1.46	-0.02	-0.90	-0.35
United Kingdom	1.80	-1.44	0.07	-0.10	0.33
Japan	0.39	0.19	-0.05	0.54	1.07

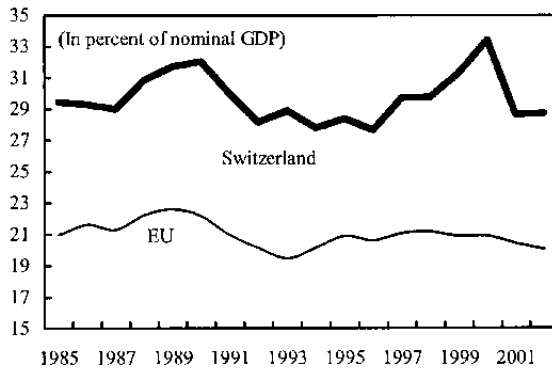
Sources: IMF staff calculations; SNB, Deutsche Bundesbank; Bloomberg; WEO; and The Economist.

8. **Fiscal policy is broadly neutral.** The general government structural deficit is small and a projected increase in the actual deficit (excluding privatization receipts) to 2.1 percent in 2003, from 1.2 percent of GDP in 2002, largely reflects the operation of the automatic stabilizers. At the federal level, following an unexpected shortfall of revenue toward the end of 2002, the deficit as defined under the debt brake is set to exceed SwF 3 billion (0.8 percent of GDP) this year. The debt brake would require a sharp correction in 2004.<sup>5</sup> Gross public debt is around 55 percent of GDP. Increases in the debt ratio in recent years have mainly reflected capitalization of pension funds for public sector employees. Such capitalization is well-advanced, but some further injections are scheduled in the years ahead to bring them into actuarial balance.

9. **The external current account surplus remains very large.** After a dip in 2001 due to lower net investment earnings, the surplus rebounded to 12 percent of GDP last year as imports contracted along with the decline in investment. As discussed in previous staff reports, the lion's share of the current account surplus appears to be structural and partly reflects a high national savings rate (Figures 11-12).

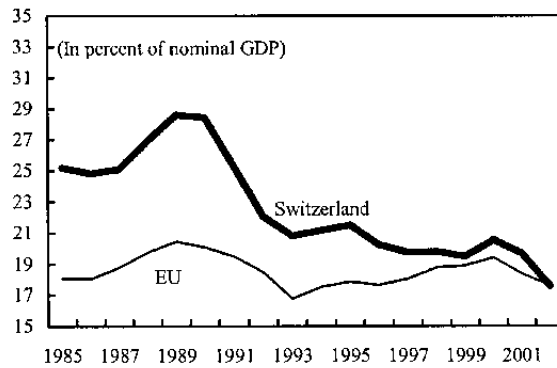
<sup>5</sup> The debt brake requires the *federal* accounts to be in balance after adjustment for the economic cycle. Expenditure is set equal to projected revenue scaled up by the ratio of trend-to-actual GDP. Unanticipated deficits must be reversed in the following years. The debt brake rules can be over-ridden in exceptional circumstances if supported by a majority of members in both chambers of parliament. See *Switzerland: Selected Issues*, IMF Country Report No. 01/75 (May 2001) for more analysis.

Figure 11. National Savings



Source: IMF, World Economic Outlook.

Figure 12. Investment



Source: IMF, World Economic Outlook.

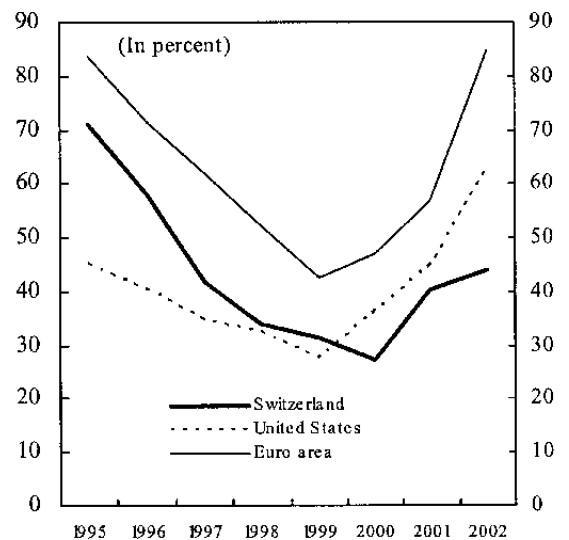
### III. REPORT OF THE DISCUSSIONS

#### A. The Economic Outlook

10. **The authorities, private forecasters and staff have a similar take on the outlook.** Conditional on a gradual pick up in world demand and resolution of global uncertainties, growth is projected to gather steam in the second half of 2003 on the back of strengthening exports and recovering investment. However, given the slow start, average growth would only be about ½ percent. Growth would firm to 1¼ percent in 2004, somewhat above potential.

11. **Nonetheless, the projected recovery is subject to considerable uncertainty with external risks predominating.** There are as yet no concrete pointers to an upturn and recovery hopes hinge primarily on a pick up in growth in Europe, where forecasts have been repeatedly downgraded. In this regard, Switzerland is not immune from the adverse impact on confidence of current geopolitical uncertainties and related risks of a safe-haven exchange rate appreciation—although with oil imports amounting to only about 1 percent of GDP, direct vulnerability to oil price gyrations is modest. That said, the authorities did not believe there were major domestic imbalances that would hold up recovery. They accepted that some over-investment may have taken place in the late 1990s, particularly in ICT. But the subsequent sharp contraction in investment would have corrected any overhang. Staff agreed, noting that corporate gearing is less high than

Figure 13. Debt-Equity Ratios of Non-Financial Corporations



Sources: IMF staff estimates.

in other European countries and the United States (Figure 13). Even so, given the uncertain external climate, it cautioned against expecting a strong rebound in investment.

12. **The inflation outlook is benign and a period of falling prices cannot be ruled out.** With sluggish recovery, inflation is expected to stay below 1 percent in 2003-04. Staff and the authorities agreed that inflation risks are not symmetric. Staff analysis (see accompanying *Selected Issues* paper) suggests that a combination of delayed recovery and exchange rate appreciation could easily push inflation into negative territory. On the other hand, a more forceful recovery would still leave inflation short of the SNB's 2 percent ceiling.

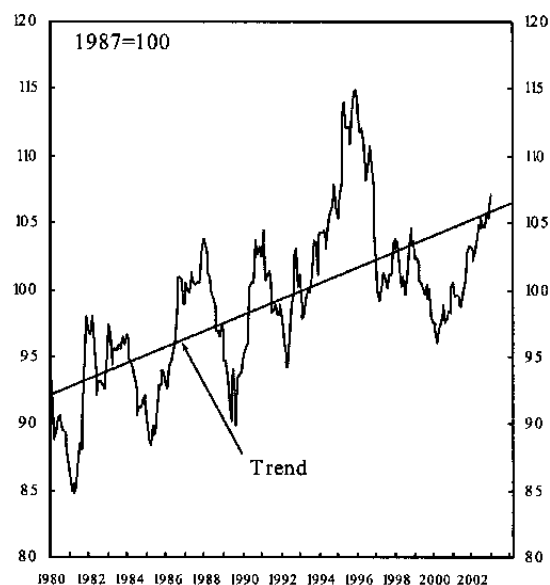
### B. Monetary Policy

13. **With economic activity stumbling and inflation risks negligible, the SNB saw the need to maintain an expansionary monetary policy stance for the foreseeable future.** Even at prevailing low interest rate rates, the SNB projected inflation would remain within their 0-2 percent price stability range over the next three years, although it would be close to the ceiling by 2005. Staff supported the SNB maintaining a bias toward easing, particularly if upward pressures on the Swiss franc persisted. Subsequent to the mission, the SNB reduced interest rates further, essentially using up the last remaining room for cuts.

14. **SNB officials were mindful of the risks of deflation even though they, and private sector analysts, believed them to be low.** They did not view the possibility of a short period of falling prices as problematic. But given the proximity of the zero interest rate floor, they were well aware of the potential costs of a liquidity trap if deflationary expectations were to take hold. They stressed that, if necessary, they would not shy away from using unconventional monetary policy instruments. Of the possible instruments, unsterilized foreign exchange market intervention would be the most effective. They had clearly communicated to the market their intention to intervene if unwanted appreciation pressures persisted.

15. **Staff welcomed the SNB's readiness to act to head off deflation, but noted that the decision to intervene in foreign exchange markets might not be clear-cut, raising the risk of a delayed policy response.** Staff pointed out that the likelihood of a short period of falling prices was significant, although it agreed that the risks of this leading to a deflationary spiral were low (Box 2). The SNB should thus keep interest rates close to zero for some time and should intervene to counter upward pressures on the Swiss franc. Even absent such pressures, the SNB might need to intervene if

Figure 14. Real Effective Exchange Rate (CPI based)



Source: IMF, International Financial Statistics; and staff estimates.

the expected recovery were further delayed. SNB officials acknowledged that they would be more reluctant to weaken the exchange rate for business cycle reasons, noting that the recent appreciation had merely brought the exchange rate back to its long-run trend (Figure 14). They would nonetheless continue to monitor economic developments and inflation prospects closely. Given that output losses could be substantial if deflationary expectations took hold, staff urged the SNB, if in doubt, to err on the side of being too loose rather than too tight.

### Box 2: Deflation Risks

Recent staff cross-country analysis puts the risk of deflation in Switzerland as moderate.<sup>1</sup> Switzerland has never before entered a downturn with such low inflation, the stock market has shed 140 percent of GDP in market capitalization during the last two years, and, although the steep fall in investment indicates that capacity is adjusting, a similar fall in Japan in 1992-94 failed to forestall deflation. But while there is a risk of falling prices leading to ingrained deflationary expectations, several factors suggest that the risks of a deflationary spiral reinforced by impaired corporate and financial sector balance sheets are low: inflation at the current rate of around 1 percent, with about one third of prices declining, has been the norm in recent years; real estate prices have held up well; the financial system is adjusting rapidly to recent strains (see below); and the corporate sector does not appear to be overly leveraged.

<sup>1</sup>*Deflation: Determinants, Risks, and Policy Response* (IMF, 2003).

16. **Within the monetary policy framework, staff saw a case for keeping inflation, on average, somewhat farther from zero than it has been over the past decade.** Staff and market analysts concurred that the framework had allowed the SNB to respond flexibly to business cycle and exchange rate developments over the past three years and to communicate its policy intentions effectively. The SNB's decision to start releasing in 2003 its medium-term inflation forecast on a quarterly basis—rather than every six-months—would further enhance policy transparency. Nonetheless, staff argued that with trend inflation close to zero—it averaged only 0.9 percent a year in 1993-2002—the SNB might too often in downturns find itself faced with the need to make difficult judgment calls on the use of unconventional monetary policy instruments.<sup>6</sup> Staff thus recommended that policy be designed to keep medium-term inflation close to the top of the 0-2 percent stability range. For their part, SNB officials considered that it would be difficult to fine tune the average level of inflation over the cycle and be confident of maintaining price stability given the lags and noise in the transmission mechanism. They doubted that pursuing a specific inflation target would have led to different decisions on interest rates in the past two years, noting that they had pursued an aggressive policy of easing.

<sup>6</sup> The accompanying *Selected Issues* paper discusses the challenges for monetary policy in a low inflation, low interest rate environment.

### C. Fiscal Policy

17. **It was agreed that the overall public finances were generally in good shape, strains in the federal budget notwithstanding.** Even without incorporating proposals to scale back spending plans, projected deficits in coming years have a large cyclical component and would be consistent with a broadly stable debt ratio (Table 4). In the long run, Switzerland is much better prepared to deal with the fiscal challenges of aging than most other European countries as it relies heavily on fully-funded pensions, including for public sector workers, with assets exceeding GDP. The authorities underscored that, since the rapid build-up of public debt during the prolonged economic slump of the first half of the 1990s,

Table 4. Staff Fiscal Projections 1/

	2001	2002	2003	2004	2005	2006
	(In percent of GDP)					
<b>General government</b>						
Revenue 2/	38.7	38.6	39.0	38.9	39.4	39.4
Expenditure	38.6	39.9	41.2	41.1	40.8	40.7
Actual balance 2/	0.1	-1.2	-2.1	-2.2	-1.5	-1.2
Structural balance 3/	0.1	-0.2	-0.3	-0.7	-0.6	-0.8
Fiscal impulse 3/	1.1	0.3	0.1	0.4	-0.1	0.2
Gross public debt	51.3	55.2	55.2	54.6	54.9	55.4
<b>Federal government</b>						
Revenue 4/	11.7	11.3	11.2	11.4	11.7	11.7
Expenditure 4/	12.2	12.3	12.3	12.5	12.8	13.0
Actual balance 4/	-0.5	-1.0	-1.1	-1.1	-1.1	-1.3
Balance according to debt brake rule 5/	-0.3	0.1	-0.8	-0.8	-1.0	-1.1
Limit under debt brake rule 6/	0.1	0.0	-0.1	-0.1	0.0	0.0
<b>Memorandum items:</b>						
Output gap according to debt brake rule 6/	1.0	-0.3	-1.1	-0.9	-0.2	0.2
Output gap according to staff estimates	-0.4	-1.5	-2.1	-1.6	-0.7	-0.2

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

1/ Medium-term expenditure based on current financial plan, i.e., excludes savings measures under discussion.

2/ Excluding privatization proceeds.

3/ Smooths erratic revenue items (withholding tax and stamp duties).

4/ Excluding privatization proceeds but including expenditure for large infrastructure projects.

5/ Includes large one-time privatization revenue (0.9 percent of GDP) in 2002; excludes expenditure for large infrastructure projects.

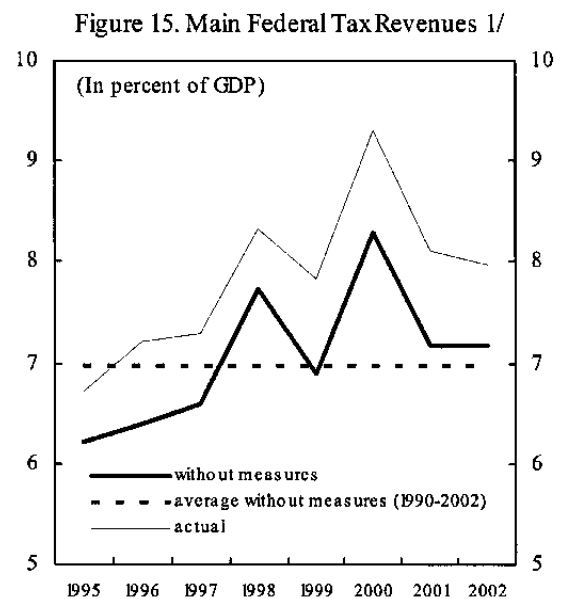
6/ Based on the HP filter.

federal expenditure growth had been successfully reined in. Indeed, growth of federal expenditure was roughly in line with that of nominal GDP in 1996-2002, having outstripped it by 2 percentage points in 1988-1995. Nonetheless, staff estimates suggest that, while public debt sustainability concerns are low, the debt ratio could rise significantly in the next few years if the economy again entered a protracted slump and nominal expenditure growth were not scaled back.<sup>7</sup>

<sup>7</sup> For example, under relatively extreme assumptions of no growth in nominal GDP and unemployment rising to 6 percent in 2003-06, the debt ratio would increase from 55 percent of GDP in 2002 to 60 percent of GDP in 2006 if planned real expenditure growth were maintained. Large net foreign assets imply that external debt sustainability is not an issue.

18. **Much of the discussion focused on how to bring the federal finances into compliance with the debt brake.** The authorities had deemed the federal budget to be in structural balance when they decided in 2002 to implement the debt brake from 2003. But with hindsight, it had been in structural deficit as the revenue shortfalls of 2002 proved largely permanent not cyclical. In conjunction with already-approved income tax cuts for 2005 (0.3 percent of GDP), the deficit would inch up to over 1 percent of GDP in the medium term. If applied rigidly, the debt brake would force elimination of the entire structural deficit in the 2004 budget. This would be neither feasible nor desirable. With the economy not in a severe recession, the authorities did not intend to invoke exceptional circumstances as a way round the debt brake strictures. Instead, they viewed as more transparent a process that, in recognizing the different starting position, modified the debt brake law and set out a clear path for bringing the federal finances into compliance with the debt brake. To this end, the government had proposed a three-step approach: (i) a savings package of 0.5 percent of GDP phased in over 2004 and 2005; (ii) postponement of the 2005 tax cuts; and (iii) tax increases if needed. Since the discussions, postponement of the tax cuts has failed in parliament and the government has asked the Ministry of Finance to propose compensating savings and tax measures. The government has also called for a related change in the debt brake legislation.

19. **Staff agreed that the debt brake had to be implemented in a pragmatic way.** Its own analysis confirmed that the recent revenue shortfalls had largely reversed an unsustainable increase in the revenue ratio in the boom years of the late 1990s and hence the unexpected deficit was largely structural (Figure 15). Full correction in 2004 would require measures of more than ½ percent of GDP. While the macroeconomic fall-out would register, especially if cuts in co-financed programs were amplified by cuts at the cantonal level, the main concern was the quality of federal spending. With primary federal expenditure accounting for less than 10 percent of GDP, the required cuts could be disruptive to public services. In these circumstances, and given available choices, staff acknowledged that seeking a transparent modification of the debt brake legislation was the preferable course of action. However, to avoid undermining credibility, it would be essential to establish a clear time line for eliminating the deficit, backed up by realistic and binding measures. In this context, staff emphasized that restraint in seeking supplementary budget allocations in 2003 and considerably scaling back the medium-term expenditure path would be important down payments. However, it was hard to see how tax hikes could be avoided: staff calculations, for example, suggest that the consolidation effort would otherwise require a three-year nominal spending freeze.



Sources: Federal Ministry of Finance; and Fund staff calculations.

1/ Federal direct tax, VAT (formerly turnover tax), withholding tax, and stamp duties.



20. **The debt brake mechanism could also benefit from technical refinements.** Under the authorities' current procedures, the responsiveness of deficit ceilings to the business cycle is overly muted, suggesting that a coordinated review of short-term revenue elasticities and the parameters used to detrend GDP is warranted. In addition, large fluctuations of erratic revenue items might require a rethink of whether the room for accommodating transitory deficit overruns is sufficient. Staff welcomed the government's decision to exclude federal lending and repayment operations with the unemployment fund for debt brake purposes, thus eliminating one potential source of procyclicality.

#### D. Financial System

21. **The supervisors and market participants acknowledged that the past year had been a difficult one for the financial sector but noted that recent strains had triggered rapid adjustment and capital cushions remained intact.** With the weakening of financial markets over the past two years, banks have suffered from a sharp drop in profits largely due to a fall in fee income. The two large international banks have been particularly affected—their combined profits declined from 4.8 percent of GDP in 2000 to -0.5 percent of GDP in 2002—owing to their relatively greater reliance on fee income, litigation costs in the United States and, in the case of one bank, spillovers from the poor performance of its insurance subsidiary. Private banks had also come under pressure from increasing competition in a shrinking market for asset management services. While some further worsening was expected, especially if the economic environment remained weak, supervisors noted that domestic banking had performed solidly, credit quality had not deteriorated significantly and overall capitalization remained comfortable (Table 5 and Figure 16). Moreover, banks had been quick to start consolidating, cutting costs, and strengthening management structures. Meanwhile, EU pressure to loosen Swiss bank secrecy to help prevent EU citizens from evading capital income taxes had receded. The issue appears to be moving toward a solution whereby Switzerland will impose and remit to the EU a withholding tax on EU residents' interest earnings.

Figure 16. Selected Industrial Countries:  
Tier 1 Capital in 2001

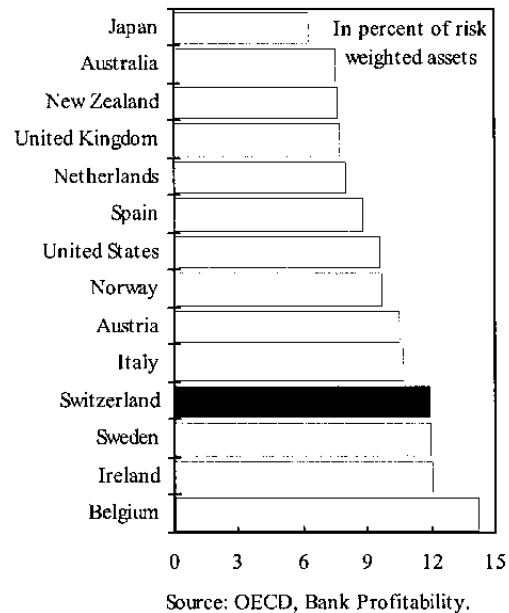


Table 5. Indicators of External and Financial Vulnerability  
(In percent of GDP, unless otherwise indicated)

	1996	1997	1998	1999	2000	2001	2002 1/
<b>External Indicators</b>							
Exports (annual percentage change, in U.S. dollars)	-2.2	-5.1	4.2	1.2	0.3	3.8	5.5
Imports (annual percentage change, in U.S. dollars)	-2.8	-3.5	5.8	-0.7	3.4	4.0	-1.3
Terms of trade (annual percentage change)	0.6	-0.8	3.3	3.1	-2.6	0.6	-0.5
Net factor income	4.3	6.3	6.8	7.9	8.8	6.1	6.4
Current account balance	7.4	9.9	10.0	11.8	12.9	9.1	11.9
Foreign direct investment (net)	-4.4	-4.3	-3.7	-8.3	-10.6	-3.4	-0.9
Portfolio investment (net)	-3.3	-4.2	-1.8	-15.8	-4.9	-16.7	-8.4
Official reserves (excl. gold, in billions of U.S. dollars, end-of-period)	38.4	39.0	41.2	36.3	32.3	32.0	40.2
Official reserves in months of imports	5.0	5.2	5.3	5.1	4.0	4.0	4.7
Broad money to reserves ratio	8.9	8.4	8.4	8.3	8.7	9.4	9.0
Central bank foreign liabilities (in billions of U.S. dollars)	0.0	0.0	0.1	0.2	0.3	0.9	0.1
Foreign assets of the financial sector (in billions of U.S. dollars)	231.4	279.4	334.4	402.2	400.4	381.9	...
Foreign liabilities of the financial sector (in billions of U.S. dollars)	221.0	268.1	302.9	393.2	424.1	419.7	...
Total external claims 2/	288.1	330.8	366.7	430.2	456.2	434.9	...
Total external debt 2/	196.4	251.4	277.8	332.3	386.7	353.9	...
Of which: General government debt	0.2	0.2	0.2	0.2	0.2	0.2	...
External debt to GNFS exports ratio	5.5	6.4	6.9	8.0	8.6	7.9	...
External interest payments to exports (in percent)	12.9	13.3	21.5	22.7	31.7	29.1	22.0
Exchange rate against U.S. dollar (period average)	1.24	1.45	1.45	1.50	1.69	1.69	1.56
Nominal effective exchange rate (1990=100)	111.1	104.3	107.1	106.0	105.1	109.2	113.6
Real effective exchange rate (CPI based, 1990=100)	109.1	100.9	102.2	100.2	97.9	100.7	104.4
<b>Financial Markets Indicators</b>							
3-month interest rate	1.9	1.5	1.6	1.4	3.1	2.9	1.2
3-month interest rate (real)	1.1	1.0	1.5	0.6	1.5	1.9	0.5
Spread of 3-month interest rate vs. Euro Area	-1.3	-1.6	-2.0	-1.5	-1.3	-1.3	-2.1
New Market Index, SNMI (percent change, end of period)	...	...	...	...	28.3	-57.9	-51.8
Share prices of financial institutions (percent change, end of period)	7.4	74.2	4.6	20.3	16.4	-7.5	-33.4
Overall stock market index, SMI (percent change, end of period)	19.5	58.9	14.3	5.7	7.5	-21.1	-27.8
Market capitalization (Swiss Performance Index)	147.6	226.0	249.1	279.4	310.0	207.2	154.4
<b>Financial Sector Risk Indicators 3/</b>							
Total loans to assets	42.0	36.1	32.3	31.2	33.1	32.2	30.8
Total loans to deposits	87.4	80.3	74.1	71.2	79.4	76.7	74.3
Deposits in foreign exchange (in billions of U.S. dollars)	174.0	196.5	261.2	238.0	222.8	249.3	273.7
Share of foreign deposits in total deposits	32.7	35.8	40.3	38.6	42.6	44.6	42.4
Share of foreign denominated liabilities in total liabilities (percent)	41.8	49.2	55.3	58.2	54.9	56.4	55.1
Share of foreign denominated assets in total assets (percent)	43.1	50.3	56.3	58.2	56.1	58.3	57.0
Share of mortgage credits to total loans (percent)	69.3	69.4	69.4	66.1	65.1	65.8	69.9
Share of non-performing loans in total loans (percent)	6.2	6.2	5.2	4.6	3.8	4.1	3.6
Share of non-performing loans in total assets (percent)	3.1	2.8	2.3	1.9	1.7	1.5	1.3
Capital adequacy ratio (percent)	10.3	10.7	11.4	11.4	12.8	11.8	12.6
Profitability ratio (percent)	0.3	5.0	17.1	18.8	18.2	11.2	8.6

Sources: Swiss National Bank; Swiss Federal Banking Commission; IMF, International Financial Statistics; and IMF, World Economic Outlook.

1/ Preliminary estimates.

2/ Excluding foreign direct investment.

3/ End-period data.

22. **The insurance and pension sectors were under considerable strain from depressed equity prices, low returns on assets, and high claims (Box 3).** Nonetheless, supervisors had not relaxed solvency requirements, insisting instead on recapitalization and consolidation. Asset sales had considerably reduced the equity allocation in pension fund and insurance company portfolios—which in the case of insurances, had been only 15 percent of their portfolio at end-2001 compared to 40 percent in the UK. To ease balance sheet pressures, the government had reduced the minimum interest rate on pensioners' assets from 4 percent to 3¼ percent.

### **Box 3. Underfunding of Pension Funds**

In the 1990s, second pillar pension funds invested increasingly large sums in equities. They hoped to exploit a high equity risk premium and to compensate for the drop in bond yields below the (then) 4 percent statutory minimum return and for a fall in the actuarial value of the conversion rate below the minimum 7.2 percent. By the end of 2000, second pillar funds had an average equity allocation of 32 percent—although this was still considerably less than the allocation for US (60 percent) and UK (70 percent) funds.

With the equity price crash, funds have shifted back to bonds but in the process have realized large capital losses. According to one estimate, their average funding level declined from 123 percent in 1999 to 105 percent in June 2002. Other estimates show that already by end-2001, 6 percent of pension funds (including public sector funds) covering almost 20 percent of the insured, were underfunded, with a shortfall equivalent to 3 percent of GDP.<sup>1</sup> The shortfall doubtless increased substantially in 2002. Shortfalls affect life insurance companies that manage such funds, the budget (in the case of public sector employees) and, to the extent that shortfalls are to be covered by employers, corporate earnings.

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<sup>1</sup>*Bericht des Eidgenössischen Departementes des Innern über die finanzielle Situation der Vorsorgeeinrichtungen und der Lebensversicherer*, Bern, November 2002. Half of the estimated shortfall carried public guarantees.

23. **Staff cautioned that the period ahead would remain a testing one for the financial sector, underscoring the call in last year's FSAP for heightened vigilance from supervisors.** There was as yet no sign that strains in global financial markets were dissipating and competition in banking services was likely to intensify. In this environment, less tangible and predictable risks, such as reputational risks, needed to be guarded against. Staff agreed that the difficulties in the pension and insurance sectors did not appear to constitute a systemic vulnerability for the financial system as, with one main exception, the sectors' links to the banking system were not strong.<sup>8</sup> Even so, it was incumbent on supervisors to ensure that corrective actions take place in a timely, orderly and transparent fashion. In this context, more up-to-date information was essential—the time lag for comprehensive data being currently up to two years. Staff also strongly supported a further reduction in the minimum interest rate on pensioners' assets given that it still exceeds the yield on government bonds.

24. **Supervision is continuing to adapt to the changing environment.** The Federal Banking Commission (EBK) has set up a unit for reviewing the performance of external auditors and introduced the practice of second examinations, to be performed periodically by independent third parties. Meanwhile, a draft law for creating an integrated financial sector

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<sup>8</sup> At end-2001, banks' exposure to domestic insurance companies and pension funds amounted to only 0.3 percent of bank's total assets.

supervisory authority is expected to be submitted to parliament by mid-2003. The law would provide for full budgetary and operational independence of the new entity, which initially would combine the operations of EBK and the Federal Office of Private Insurance. In this connection, a complete revision of the Insurance Supervision Law was also under way. Finally, a draft revised law on bank rehabilitation, liquidation and deposit insurance had been submitted to parliament. Staff welcomed these initiatives, which were in line with recommendations in last year's FSAP report, although noted that the strengthening of pension fund supervision needed to be accelerated.

25. **The authorities are further strengthening anti-money laundering (AML) and the regime for combating the financing of terrorism (CFT).** Effective July 2003, a revised Money Laundering Ordinance covering the banking sector will extend the application of AML instruments to the prevention of the financing of terrorism and require the systematic recording and computerized monitoring of all high-risk transactions. Also in July, a new Due Diligence Agreement will strengthen the procedures of customer identification. A bill for the ratification of the UN conventions on the financing of terrorism, and related amendments to the Swiss Penal Code, are with parliament and could enter into force in 2003.

#### E. Structural Policies

26. **With the financial sector likely to continue consolidating for some time, other sectors will have to contribute more to growth if the recovery is to be robust and sustained.** Absent higher productivity growth, the authorities agreed that potential growth would likely stay in the 1-1½ percent range for the next few years. Raising productivity growth would require removing market inefficiencies.<sup>9</sup> A poorly functioning internal market and the prevalence of sheltered sectors—agriculture, construction, and many services—not only hamper growth in the affected sectors but also keep prices and business costs high across the entire economy. This undermines the many attractive features that Switzerland offers to investors, not least a flexible labor market with well-educated workers. Meanwhile, external competitiveness does not seem to be a problem, notwithstanding adjustment strains inflicted by the recent appreciation of the Swiss franc. In the past twenty years, trend real appreciation has not held back a dynamic export sector and the current account surplus is projected to remain around 11 percent of GDP in the medium term. The solution for high domestic prices was product market reform, which has lagged that in other countries, not depreciation.

27. **While all could agree on the diagnosis and need for product market reform, the harder question was how to move forward.** The authorities considered that Switzerland's rejection of participation in the European Economic Area (EEA) in 1992 had been a blow to liberalization efforts as the EEA would have simultaneously provided access to EU markets and forced open Switzerland's internal market. Bilateral agreements with the EU—seven

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<sup>9</sup> See *Switzerland: Selected Issues*, IMF Country Report No. 02/107 (June 2002).

such agreements came into effect in 2002 and nine more were being negotiated—could eventually substitute for the former but the Internal Market Act had not addressed the latter satisfactorily. Joining the EU remained a long-term government objective, but currently commanded little public support. In the meantime, the authorities had been trying to advance reform on several fronts. However, the political economy environment was not propitious given the difficulties of mustering popular support in Switzerland's decentralized system of direct democracy.

28. **The authorities' current reform priorities include strengthening competition and the fight against cartels.** After some delay, a revised competition law was approved by parliament in March 2003 and is expected to enter into force in early 2004. The new law empowers the regulators to impose sizable fines and extends to first-time offenders and vertical agreements. Nonetheless, breaking up cartels would remain a challenge given the premise in Swiss competition law, unlike in other countries, that restrictions on competition are illegal only if they are not justified by legitimate business reasons. Preparations were also at a relatively advanced stage for revisions to the Internal Market Act and the Public Procurement Act. However, part of the ineffectiveness of the current Internal Market Act stems from the Federal Court's tendency to support cantonal rights rather than free market access; this would be difficult to change. Finally, reviving deregulation in network services was seen as an uphill task. Notwithstanding the visible benefits of lower prices that had followed from liberalizing telecommunication, liberalization of the electricity sector had failed in a referendum last fall. Highly publicized corporate scandals at home and abroad had contributed to a lack of trust in market solutions.

29. **Staff welcomed the efforts to improve competition and suggested that a more systematic sectoral approach might help build consensus for further change.** Focusing on the reasons for high prices in particular sectors and the benefits to consumers from removing obstacles to competition might help tip the balance in favor of reform. At the same time, the loss of trust in markets associated with corporate scandals should be addressed by building on recent private initiatives that have established codes of conduct for disclosure requirements and guidelines for good corporate governance. Maximum efforts should also be made to leverage the bilateral agreements with the EU to bring product market practices and the pace of deregulation more into line with the rest of Europe. The authorities explained that it was their intention to adopt a more systematic sectoral approach. As a first step, the Ministry of Economy had prepared a comprehensive report on the reasons for slow growth in Switzerland.<sup>10</sup> On corporate governance, a high-level group had been set up to look into current practices and the need for amendments and codification in the law. A review of the Federal Accounting and Auditing Act had also been initiated.

30. **Labor market policies are aimed at further easing supply constraints.** A shortening of the duration of unemployment benefits and lower contribution rates should help to sustain Switzerland's low structural unemployment rate. The coming into force in June

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<sup>10</sup> *Der Wachstumsbericht*, SECO, 2002.

2002 of the bilateral agreement with the EU on free labor mobility should help alleviate shortages of skilled labor, which in the last upswing had become a drag on growth. The launching of a pilot program for the expansion of daycare centers and a proposal for maternity benefits could help raise the already-high female participation rate. Finally, a budgetary priority was to raise allocations for education and research.

#### F. Other Issues

31. **Switzerland has a relatively open trade regime, with the exception of agriculture.**<sup>11</sup> The average tariff on farm products is 34 percent (nearly four times the Swiss average), and some import duties are almost 700 percent. This is coupled with a system of producer support that is the highest among OECD countries, amounting to three fourths of gross farm receipts according to WTO estimates. Although price support is being dismantled and replaced by direct payments, staff noted that it would take years on current plans before protection of agriculture dropped to even the high level of the EU. The authorities support the Doha Trade Round and are committed to the progressive opening of services on a multilateral basis. Switzerland reduced custom duties on imports from the least developed countries by 30 percent in 2002. It plans to reduce them by another 30 percent in 2004 and to eliminate the remainder in 2006.

32. The authorities reaffirmed their intention to raise **official development assistance** from 0.35 to 0.4 percent of GNP by 2010. Swiss ODA policy has been favorably reviewed by the DAC for its effectiveness and its focus on poor countries. Staff expressed the hope that some trimming of ODA in the current budget would prove only a temporary setback.

33. Swiss legislation conforms to the **OECD Convention on anti-bribery**, except in respect of liability of legal entities for bribery. However, the requisite amendment to the Criminal Code was adopted by parliament in December 2002 and is expected to come into force in 2003.

34. Despite continuing improvement, deficiencies in the availability and quality of **economic statistics** remain (Appendix III). The authorities explained that the annual national accounts would be overhauled this year, but noted that budgetary constraints impeded more determined efforts to improve the quality and coverage of statistics.

#### IV. STAFF APPRAISAL

35. **Switzerland is well-equipped to deal with the current economic slowdown.** The export sector has proved its resilience over the years despite an appreciating exchange rate. Labor markets are highly flexible. A stability-oriented policy framework has delivered low inflation. And the fiscal accounts are generally in good shape with a high reliance on fully-funded pensions lessening the longer-run strains from an aging population.

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<sup>11</sup> Switzerland's rating on the IMF's 1-10 scale of trade restrictiveness index is 4 (1 being the least restrictive), similar to that of most industrial countries.

36. **That said, insufficient competition in domestic sectors raises questions about the vigor of expected economic recovery.** For the short term, recovery is to a large extent hostage to the external environment: a firming of growth in the second half of the year is projected, but global uncertainties are significant. But regardless of the timing of recovery, it is hard to see Switzerland moving to a higher underlying growth rate, especially if the key financial sector remains depressed. That is because barriers to the internal market and the prevalence of cartels and sheltered sectors dampen the vitality of the economy.

37. **Structural reforms aimed at further liberalizing and creating competition in domestic product markets remain the priority if growth in the current decade is to improve on that of the 1990s.** This is not a new issue: the challenge, as always, is to build popular support for reforms. In this regard, a more systematic, sectoral approach that identifies the reasons for, and costs of, high prices in Switzerland might prove more convincing.

38. **The current macroeconomic policy stance is appropriately supportive.** The absence of inflationary pressures has allowed the SNB to reduce interest rates to practically zero—and rates can safely remain low for the foreseeable future. From the fiscal side, the automatic stabilizers are providing appropriate support to demand.

39. **However, near zero interest rates and inflation pose challenges for the SNB, which rightly wants to avoid inflation falling into negative territory.** The SNB has responded promptly and boldly to evolving economic conditions. With conventional policy options now exhausted, further upward pressures on the Swiss franc that led to an unwanted tightening of monetary conditions should be countered by unsterilized intervention. But absent a clear signal from the foreign exchange market, the SNB could be faced with a more difficult choice of when to use unconventional monetary policy instruments if the economy continues to stall. Given the potentially high costs of deflation, the SNB should, in these circumstances, err on the side of being too loose rather than too tight. To avoid being confronted with difficult choices in the future, it would be better to allow average inflation to be closer to the top end of the current 0-2 percent stability range.

40. **The unexpected federal deficit is the main problem for fiscal policymakers.** The overall fiscal position appears sound but the federal deficit threatens the credibility of the new debt brake. Preserving credibility will require a degree of pragmatism. Given the small base of spending that the federal government controls directly, front-loading adjustment in 2004 seems neither feasible nor desirable. The authorities' plan to modify the debt brake law to provide a transition period for eliminating the unexpected structural deficit appears to be a practical and transparent way forward—assuming that a clear time line is specified. However, it is equally important that sufficient, realistic and binding consolidation measures—including, probably, tax increases—are agreed upon. The debt brake rule might also benefit from technical modifications that would enhance its cyclical flexibility while preserving fiscal discipline over the medium term.

41. **The current environment is likely to remain difficult for the financial sector, which could face a protracted period of consolidation.** Banks are making considerable adjustments and supervision is continuing to adapt to the changing environment. In this

context, fast enactment of a revised law on bank rehabilitation, liquidation, and deposit insurance, as well as plans to integrate banking and insurance supervision are encouraged, along with increased resources for the supervisory authorities who need to continue their ongoing efforts to strengthen oversight of external auditors. Prospective new anti-money laundering ordinances should provide an additional reputational safeguard for Switzerland's financial sector.

42. **Strains in the pension and insurance sectors raise important public policy questions.** The reduction in the minimum interest rate on pensioners assets to 3¼ percent was an important step, but with government bond yields substantially lower than this, a further reduction seems necessary. From the supervisory perspective, closer oversight of pension schemes is needed to ensure that interventions remain timely and pensioners are protected.

43. The authorities are encouraged to bring forward their 2010 target for raising **official development assistance** to 0.4 percent of GNP. Development assistance will benefit from the authorities' initiative to eliminate all trade barriers for imports from poor nations. Committing to a faster pace of dismantling high trade protection and subsidization of agriculture would also help poor countries as well as benefiting Swiss consumers.

44. **Further efforts are needed to improve economic statistics.** Although some progress has been made and statistics are adequate for surveillance purposes, weaknesses in national accounts, flow of funds, government finance, social insurance statistics and other areas continue to hamper the analysis carried out by both policymakers and the private sector.

45. It is recommended that the next Article IV consultation with Switzerland be held on the standard twelve-month cycle.



## Switzerland: Basic Data

## Area and population

Total area	41,293 square kilometers
Total population (end-2002)	7.2 million
GDP per capita (2002)	\$ 36,612
GNP per capita (2002)	\$ 38,957

	1998	1999	2000	2001	2002 1/	2003 1/	2004 1/	2005 1/	2006 1/	2007 1/
(Percentage changes at 1990 prices)										
<b>Demand and supply</b>										
Total domestic demand	3.5	2.5	2.5	0.8	-1.4	0.8	1.4	2.1	2.1	2.1
Private consumption	2.3	2.2	2.0	1.8	0.9	0.7	1.1	1.9	2.0	2.0
Public consumption	1.3	1.2	1.5	2.6	2.0	1.7	1.0	1.0	1.0	1.0
Gross fixed investment	4.5	2.7	5.8	-5.2	-6.7	-4.3	2.5	4.1	3.6	3.1
Final domestic demand	2.7	2.2	2.9	0.1	-0.9	-0.3	1.4	2.3	2.2	2.1
Inventory accumulation 2/	0.7	0.3	-0.3	0.7	-0.5	1.1	0.0	-0.1	-0.1	0.0
Foreign balance 2/	-1.1	-0.9	0.6	0.1	1.5	-0.2	0.3	0.1	-0.1	-0.1
Exports of goods and nonfactor services	5.4	5.1	10.0	-0.1	0.3	3.0	4.8	5.2	5.4	5.7
Imports of goods and nonfactor services	8.3	7.4	8.5	-0.3	-2.9	3.5	4.3	5.1	5.7	6.1
GDP	2.4	1.5	3.2	0.9	0.1	0.6	1.7	2.2	2.0	1.9
GNP	2.5	2.0	5.0	-2.5	0.4	0.0	1.8	2.3	2.0	2.6
(In billions of SwF, at current prices)										
<b>GDP</b>	380.0	388.5	405.5	414.9	416.9	421.5	431.5	445.5	459.4	474.2
(In thousands, unless otherwise indicated)										
<b>Employment and unemployment</b>										
Employment	3,841	3,867	3,915	3,974	3,960	3,935	3,969	4,020	4,060	4,096
(Percent change)	0.9	0.7	1.2	1.5	-0.4	-0.6	0.9	1.3	1.0	0.9
Unemployment rate (in percent)	3.9	2.7	2.0	1.9	2.8	4.3	4.0	3.1	2.7	2.4
Output gap (in percent of potential)	-1.5	-1.6	0.0	-0.4	-1.5	-2.1	-1.6	-0.7	-0.2	0.0
<b>Prices and incomes</b>										
GDP deflator	0.0	0.7	1.2	1.4	0.4	0.5	0.7	1.0	1.1	1.3
Consumer price index	0.0	0.8	1.6	1.0	0.6	0.7	0.2	0.6	1.2	1.4
Nominal wage growth 3/	0.7	0.3	1.2	2.5	1.8	1.4	0.9	1.6	2.4	2.4
Unit labor costs (total economy)	-0.4	0.3	1.3	3.1	1.4	0.1	0.1	0.7	1.4	1.4
Real disposable income	0.5	2.5	1.3	-0.5	1.9	0.8	2.2	2.1	2.3	2.2
Personal savings ratio (in percent)	8.6	8.9	8.3	6.2	7.1	7.2	8.1	8.3	8.5	8.7
(In percent of GDP)										
<b>Public finances</b>										
General government										
Revenue	38.8	38.4	40.2	38.8	39.5	39.0	38.9	39.4	39.4	36.4
Expenditure	39.2	38.6	37.6	38.6	39.9	41.2	41.1	40.8	40.7	37.2
Financial balance 4/	-0.4	-0.2	2.6	0.2	-0.4	-2.1	-2.2	-1.5	-1.2	-0.8
Structural balance 5/	-1.1	0.9	1.3	0.1	-0.2	-0.3	-0.7	-0.6	-0.8	-0.7
Gross debt	54.5	51.4	51.2	51.3	55.2	55.2	54.6	54.9	55.4	54.3
Central government										
Revenue	12.4	11.1	12.7	11.8	12.2	11.2	11.4	11.7	11.7	11.7
Expenditure	12.4	11.9	11.8	12.2	12.3	12.3	12.5	12.8	13.0	12.9
Balance 4/	0.0	-0.8	0.9	-0.4	-0.1	-1.1	-1.1	-1.1	-1.3	-1.2
Balance according to debt-brake definition 6/	0.1	-0.7	1.1	-0.3	0.1	-0.8	-0.8	-1.0	-1.1	-1.0
Gross debt	27.7	25.3	26.0	25.5	29.3	29.2	28.8	29.5	30.4	30.2

1/ Fund staff estimates and projections unless otherwise noted.

2/ Change as percent of previous year's GDP.

3/ Nominal wage growth per employee.

4/ Including railway loans as expenditure.

5/ Excluding privatization proceeds; smooths erratic revenue items.

6/ Excludes transfers to the railway fund.

## Switzerland: Basic Data (concluded)

	1998	1999	2000	2001	2002 1/	2003 1/	2004 1/	2005 1/	2006 1/	2007 1/
	(In billions of SwF, unless otherwise indicated)									
<b>Balance of payments</b>										
Trade balance	-2.3	-0.1	-4.2	-4.6	4.5	3.8	4.4	3.3	1.9	1.2
Service balance	19.6	21.6	25.6	24.2	24.9	23.7	24.4	27.2	29.3	29.9
Net investment income	32.4	37.0	43.5	33.8	35.9	32.4	33.5	34.7	37.2	40.0
Net compensation of employees	-6.4	-6.5	-7.8	-8.6	-9.2	-8.2	-8.2	-8.2	-8.2	-8.2
Net private transfers	-3.1	-3.9	-3.3	-4.9	-4.9	-4.9	-5.0	-5.1	-5.1	-5.2
Net official transfers	-2.3	-2.3	-1.7	-2.0	-1.7	-1.7	-1.8	-1.8	-1.8	-1.9
Current account	37.9	45.8	52.2	37.9	49.5	45.0	47.4	50.1	53.3	55.9
(In percent of GDP)	10.0	11.8	12.9	9.1	11.9	10.7	11.0	11.3	11.6	11.8
Foreign direct investment	-14.2	-32.4	-42.9	-14.2	-3.9	...	...	...	...	...
Outward	-27.2	-50.0	-75.4	-29.2	-18.4	...	...	...	...	...
Inward	13.0	17.6	32.5	15.0	14.5	...	...	...	...	...
Portfolio investment	-6.7	-61.5	-19.9	-69.1	-35.2	...	...	...	...	...
Outward	-21.6	-70.4	-37.7	-72.3	-46.6	...	...	...	...	...
Inward	14.9	8.9	17.8	3.2	11.4	...	...	...	...	...
Banking sector, net	-16.7	27.5	11.0	18.5	-32.4	...	...	...	...	...
Memorandum items:										
Net investment income	32.4	37.0	43.5	33.8	35.9	...	...	...	...	...
(In percent of GDP)	8.5	9.5	10.7	8.1	8.6	...	...	...	...	...
Net external assets	492.3	570.1	521.5	601.7	617.7	...	...	...	...	...
(In percent of GDP)	129.5	146.7	128.6	145.0	148.2	...	...	...	...	...
Official reserves (billions of US\$, end period)	41.2	36.3	32.3	32.0	40.2	...	...	...	...	...
Reserve cover (months of imports of GNFS)	5.3	5.1	4.0	4.0	4.7	...	...	...	...	...
	(Percentage changes in annual averages)									
<b>Monetary and credit data</b>										
Money (M1)	8.0	8.6	-1.9	1.0	-0.3	...	...	...	...	...
Broad money (M3)	1.2	1.0	-1.8	3.1	5.0	...	...	...	...	...
Domestic credit	0.5	3.2	1.7	1.5	-0.5	...	...	...	...	...
	(Period averages in percent)									
<b>Interest rates</b>										
Three-month rate	1.6	1.4	3.1	2.9	1.2	...	...	...	...	...
Yield on government bonds	2.9	2.9	3.8	3.3	3.2	...	...	...	...	...
	(Levels)									
<b>Exchange rates</b>										
SwF per US\$ (end of period)	1.38	1.60	1.63	1.65	1.45	...	...	...	...	...
SwF per US\$ (annual average)	1.45	1.50	1.69	1.69	1.57	...	...	...	...	...
SwF per euro (annual average)	1.61	1.60	1.56	1.51	1.48	...	...	...	...	...
Nominal effective rate (1990=100)	107.1	106.0	105.1	109.2	113.6	...	...	...	...	...
Real effective rate (1990=100) 2/	102.2	100.2	97.9	100.7	104.4	...	...	...	...	...

Sources: IMF, World Economic Outlook database; Swiss National Bank; and Swiss Institute for Business Cycle Research.

1/ Fund staff estimates and projections unless otherwise noted.

2/ Based on relative consumer prices.

**Switzerland: Fund Relations**  
(As of March 31, 2003)

I. **Membership Status:** Joined 5/29/92; Switzerland has accepted the obligations of Article VIII, Sections 2, 3 and 4.

II. <b>General Resources Account:</b>	SDR Million	% Quota
Quota	3,458.50	100.00
Fund holdings of currency	2,068.04	59.80
Reserve position in Fund	1,390.46	40.20
Operational budget transfers (net)	75.00	

III. <b>SDR Department:</b>	SDR Million	% Allocation
Holdings	25.34	N/A

IV. **Outstanding Purchases and Loans:** None

V. **Financial Arrangements:** None

VI. **Projected Obligations to Fund:** None

VII. **Exchange Rate Arrangement:**

The Swiss National Bank does not maintain margins in respect of exchange transactions. However, the Swiss National Bank has intervened when warranted by the circumstances. Switzerland's exchange system is free of restrictions on the making of payments and transfers for current international transactions. However, Switzerland continues to apply exchange restrictions vis-à-vis Iraq (since August 1990).

VIII. **Article IV Consultations:**

Switzerland is on the standard 12-month Article IV consultation cycle.

IX. **Technical Assistance:** None

X. **Resident Representatives:** None

XI. **Other** FSAP, October 2001

### Switzerland: Statistical Issues

Switzerland publishes timely economic statistics and posts most of the data and the underlying documentation on the internet. Switzerland is in full compliance with the Fund's Special Data Dissemination Standard (SDDS) and its metadata are currently posted on the Dissemination Standards Bulletin Board. However, a number of statistical gaps and deficiencies remain to be addressed: wage statistics are available only on an annual basis; reliable general government finance statistics appear with considerable lags, mainly due to delays in compiling fiscal accounts at the level of cantons and communes; internationally comparable fiscal statistics on an accrual basis are not available; pension statistics are published with a long lag; the quarterly national accounts (compiled by the State Secretariat for Economic Affairs) lack a production account; national accounts are still based on ESA79; GDP by industry appears with considerable lag; capital stock data and flow-of-funds statistics are not available. To a large extent, these deficiencies reflect a lack of resources and the limited authority of the Federal Statistical Office (BfS) to request information.

To address statistical deficiencies, the authorities have recently taken or intend to take the following steps:

The Swiss National Bank (SNB) has shortened from nine to six months the lag of publishing annual data on the international investment position and plans to publish, starting from 2003, quarterly foreign debt statistics. The SNB participated in the 2001 Coordinated Portfolio Investment Survey.

The BfS will switch in 2003 to the *European System of Accounts 1995* (ESA95). In this connection, the BfS has reviewed the methodology of calculating value added in the financial services sector as well as the corresponding deflators and has been working (jointly with the SNB) on the methodology for compiling financial accounts and capital stock data (both for physical and financial capital). The BfS has also been negotiating a cooperation agreement with the European Union (EU) for the harmonization of Swiss statistics with EU standards.

The Federal Finance Administration has started preparations for the adoption of the *Government Finance Statistics Manual 2001* classification and the revamping of the accounting framework, although implementation of the new framework is not expected before 2006. In the interim period, government finance statistics for publication in the *GFS Yearbook* will be reported on a cash basis but presented in the *GFSM 2001* framework.

Switzerland: Core Statistical Indicators  
as of April 4, 2003

	Exchange Rates	Foreign Reserves	Central Bank Balance Sheet	Reserve/ Base money	Broad Money	Interest Rates	Consumer Price Index	Exports/ Imports	Current Account Balance	Overall Government Balance	GDP/ GNP	External Debt
Date of Latest Observation	3/03	3/03	3/03	2/03	2/03	3/03	3/03	1/03	12/02	2002	Q3/02	2001
Date Received	3/03	3/03	3/03	3/03	3/03	3/03	4/03	3/03	4/03	3/03	3/03	12/02
Frequency of Data	Daily	Each 10 <sup>th</sup> day	Each 10 <sup>th</sup> day	Monthly	Monthly	Daily	Monthly	Monthly	Quarterly	Annual	Quarterly	Annual
Frequency of Reporting	Daily	Monthly	Monthly	Monthly	Monthly	Daily	Monthly	Monthly	Quarterly	Annual	Quarterly	Annual
Source of Update	TRE	SNB	SNB	SNB	SNB	TRE/RES	BFS	SNB KOF tape	SNB KOF tape	MoF	BFK BFS	SNB
Mode of Reporting	Electronic	Mail	Website	KOF tape Website	KOF tape Website	Electronic Website	KOF tape Website	KOF tape Website	KOF tape Website	Mail	Website	Mail
Confidentiality	None	None	None	None	None	None	None	None	None	None	None	None
Frequency of Publication	Daily	Each 10 <sup>th</sup> day	Each 10 <sup>th</sup> day	Monthly	Monthly	Daily	Monthly	Monthly	Quarterly	Annual	Quarterly	Monthly

BFS = Federal Statistical Office

SNB = Swiss National Bank

KOF = Swiss Institute for Business Cycle Research

MoF = Federal Ministry of Finance

BFK = Federal Office for Economic Policy



INTERNATIONAL MONETARY FUND

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June 2, 2003

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700 19<sup>th</sup> Street, NW  
Washington, D. C. 20431 USA

## **IMF Concludes 2003 Article IV Consultation with Switzerland**

On May 23, 2003, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Switzerland.<sup>1</sup>

### **Background**

Following a solid expansion in the period 1997-2000, growth is currently stalled as exports have been hurt by the global slowdown and domestic investment has undergone a sharp downward correction from earlier high levels. The important financial sector has been hit particularly hard, in part because of the steep declines in equity prices both in Switzerland and abroad. Unemployment has doubled, although it remains low by international standards. Inflation is negligible and the external current account is running a large surplus.

In response to low inflation and the weak cyclical position of the economy, interest rates have been reduced rapidly and, at short maturities, are close to zero. However, the loosening of monetary conditions has been dampened somewhat by the appreciation of the Swiss franc. Fiscal policy is broadly neutral, with a projected rise in the general government deficit this year to just over 2 percent of GDP largely reflecting the operation of the automatic stabilizers and a drop-off in privatization receipts. The federal deficit is expected to fall outside the permissible range under the new balanced-budget rule, the debt-brake, which was introduced in January. Assuming a pick-up in external demand, IMF staff project a modest-paced recovery beginning in the second half of this year. Growth is projected at just under 2 percent next year. Inflation is expected to remain low.

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<sup>1</sup> 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. 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.

## **Executive Board Assessment**

Executive Directors commended the authorities' sound macroeconomic management and Switzerland's flexible labor markets, which have secured a continued low level of inflation and unemployment, and a high standard of living. The country's external position remains strong, with large external assets attributable in part to a high savings rate. Based on the sound reliance on fully-funded pensions, Switzerland is well prepared to handle the consequences of the aging of the population.

Directors observed, however, that average economic growth in the past decade has been low, owing in part most recently to uncertainties in international financial and equity markets and the evolution of external demand, but more generally because of highly protected domestic product markets. Against this background, Directors considered that the authorities should focus on setting the Swiss economy on a path of faster growth, through a carefully accommodative monetary policy and further product market liberalization, and avoiding a procyclical fiscal impact from the implementation of the fiscal rules set by the "debt brake."

Directors noted that growth is projected to revive in the second half of 2003, but stressed that insufficient competition in domestic sectors raises questions about the vitality of growth. In particular, barriers to the internal market, cartels, and sheltered sectors reflect a sluggish pace of product market liberalization. Directors thus welcomed recent efforts to strengthen the powers of the Competition Authority, and pressed for an acceleration of reforms aimed at further liberalizing domestic markets. They suggested that the authorities pursue a systematic, sectoral analysis to pinpoint the key reforms and build public support for them.

Directors observed that the monetary policy framework, with its focus on medium-term price stability, has allowed the Swiss National Bank (SNB) to respond flexibly to economic developments. With inflation risks remaining low, output below potential, and signs of recovery uncertain, the current low level of interest rates could be maintained for the foreseeable future.

Directors cautioned that, with interest rates near zero, the authorities would likely have to rely on quantitative measures, including unsterilized foreign exchange market intervention, to achieve further easing if the recovery should continue to stall. In the view of some Directors, those measures could be applied proactively. Noting that the potential costs of deflation could be high, Directors welcomed the authorities' determination to avoid deflation, and they emphasized the importance of responding swiftly to prevent the entrenchment of deflationary expectations. Most Directors were of the view that the SNB should err on the side of being too loose rather than too tight in the current circumstances. At the same time, to avoid having to resort to unconventional monetary policy instruments in future downturns, some Directors considered that the SNB should allow average inflation over the cycle to be closer to the top end of the current 0-2 percent range.

Directors considered the overall fiscal position to be sound. At this juncture, the automatic fiscal stabilizers are providing appropriate support to demand. Nonetheless, the unanticipated federal deficit threatens the credibility of the new debt brake rule. Bearing in mind the cyclical

position, Directors urged that the debt brake be implemented pragmatically. At the same time, specifying binding consolidation measures and a transparent timeline to eliminate the structural deficit will therefore be important. Directors also considered that the debt brake rule could benefit from technical modifications that would enhance its cyclical flexibility while preserving fiscal discipline over the medium term.

Directors were encouraged by the significant adjustment currently being undertaken by financial institutions, and by the authorities' continued efforts to further strengthen financial sector supervision. They welcomed the progress made in the enactment of a revised law on bank rehabilitation, liquidation, and deposit insurance; plans to integrate banking and insurance supervision, along with increased resources for the supervisory authorities; and the ongoing efforts to strengthen oversight of external auditors. They commended the authorities for the revised Money Laundering Ordinance and the new Due Diligence Agreement covering the banking sector, which will further strengthen anti-money laundering legislation and the regime for combating the financing of terrorism.

Directors emphasized that strains in the pension and insurance sectors arising from the decline in value of their equity portfolios need the continued, careful attention of supervisors. They considered the reduction in the minimum interest rate on pensioners' assets as a necessary step, but with government bond yields being still substantially lower, they recommended that a further reduction be considered.

Directors commended the authorities' initiative to eliminate all trade barriers to imports from poor nations. They encouraged them to accelerate the dismantling of the high level of trade protection and subsidization of agriculture. They commended the authorities for the effectiveness of Swiss official development assistance (ODA), and welcomed the intention to raise ODA to 0.4 percent of GNP by 2010.

Directors welcomed the accommodation of collective action clauses (CACs) in the Swiss legal framework, and the authorities' intention to introduce CACs in Switzerland's own sovereign bond issues.

Directors noted that Switzerland's economic statistics are generally adequate for surveillance purposes, but saw scope for strengthening data in key areas, including national accounts, public finance, wages, and on the activities of sub-national governments.

**Public Information Notices (PINs)** are issued, (i) at the request of a member country, following the conclusion of the Article IV consultation for countries seeking to make known the views of the IMF to the public. This action is intended to strengthen IMF surveillance over the economic policies of member countries by increasing the transparency of the IMF's assessment of these policies; and (ii) following policy discussions in the Executive Board at the decision of the Board.



Switzerland: Selected Economic Indicators

	1998	1999	2000	2001	2002	2003 1/
<b>Real economy</b>						
Real GDP	2.4	1.5	2.9	1.1	0.1	0.6
Real total domestic demand	3.5	2.5	2.3	1.0	-1.4	0.8
CPI (year average)	0.0	0.8	1.6	1.0	0.7	0.7
Unemployment rate in percent of labor force)	3.9	2.7	2.0	1.9	2.8	4.3
Gross national saving (percent of GDP)	29.8	31.3	33.4	28.6	28.7	28.2
Gross national investment (percent of GDP)	19.8	19.5	20.5	19.7	17.6	17.7
<b>Public finances (percent of GDP)</b>						
Confederation budget balance 2/	0.0	-0.8	0.9	-0.4	-0.1	-1.1
General government balance 2/ 3/	-0.4	-0.2	2.6	0.2	-0.4	-2.1
Gross public debt	54.5	51.4	51.2	51.3	55.2	55.2
<b>Balance of payments</b>						
Trade balance (in percent of GDP)	-0.6	0.0	-1.0	-1.1	0.9	0.7
Current account (in percent of GDP)	10.0	11.8	12.9	8.9	11.9	10.7
Official reserves (end of year, US\$ billion) 4/ 5/	41.2	36.3	32.3	32.0	40.2	38.0
<b>Money and interest rates</b>						
Domestic credit (end of year)	0.6	3.8	0.3	2.1	-0.9	...
M3 (end of year)	1.2	1.0	-1.1	5.5	6.5	...
Three-month Libor rate (in percent)	1.6	1.4	3.1	2.9	1.2	...
Government bond yield (in percent)	2.9	2.9	3.8	3.3	3.2	...
<b>Exchange rate</b>						
Exchange rate regime					Managed float	
Present rate (April 10, 2003)					SwF 1.38 per US\$1	
Nominal effective exchange rate (1990=100)	107.1	106.0	105.1	109.2	113.6	...
Real effective exchange rate (1990=100) 6/	102.2	100.2	97.9	100.7	104.4	...

Sources: IMF, International Financial Statistics; IMF, World Economic Outlook; and IMF staff projections.

1/ Staff estimates and projections

2/ Including privatization revenue.

3/ Including Confederation, cantons, communes, and social security.

4/ Excluding gold.

5/ Figures for 2003 refer to March.

6/ Based on consumer prices.

**Statement by Fritz Zurbrügg, Executive Director for Switzerland  
May 23, 2003**

1. My Swiss authorities would like to thank staff for constructive policy discussions and a comprehensive report. As usual, they look forward to the publication of the staff documents. This year's discussion very much resembled last year's. Indeed, the state of the Swiss economy has not changed much and the policy challenges, especially on the structural front, remain similar. My authorities largely concur with staff's assessments. The recommendations are appropriate and any backing in helping to build popular support for structural reforms is welcome.

2. Since the staff report was issued, there have been growing signs that the economic recovery might be further delayed. On May 16, the Swiss State Secretariat for Economic Affairs (SECO) cut its GDP growth forecast for 2003 to zero (from 0.8 percent) and for 2004 to 1.6 percent (from 1.9 percent). This is consistent with the latest results of the surveys and the economic barometer of the most important independent forecasting institute in Switzerland (KOF), which suggest only very modest growth for the second and third quarter. Consumption, both private and public, is expected to lose some momentum, while investment activity will remain in decline. Weak global and Euro zone economic activity will not allow for a return to growth until 2004. Inflation is forecast to remain below 1 percent for this year and next.

**Fiscal Policy**

3. Fiscal policy turned out to be trickier than expected. As staff points out, the problem is not so much the fiscal position but the implementation of the new constitutional commitment to keep the federal government budget in balance over the economic cycle. This so-called "debt brake," which was approved by the electorate with an overwhelming majority of 85 percent of the votes, was to be applied for the first time to the 2003 budget. However, the timing of the implementation was based on the assumption that the federal budget was in structural balance in 2002, an assumption which proved to be wrong. The unexpected shortfall in federal revenue toward the end of 2002 turned out to be of a structural rather than cyclical nature. A strict implementation of the debt brake rules would require the elimination of the entire structural deficit in 2004. As staff rightly points out, this is neither feasible nor desirable. The authorities are thus adopting a more pragmatic approach. They plan to combine a gradual implementation of a comprehensive consolidation package with a minor change in the debt brake legislation. This approach allows the federal government to maintain its counter-cyclical policy stance and hold back on excessively restrictive measures until the economy takes on momentum.

4. Initially, the strategy presented this spring was three-pronged: spending cuts across the board, postponement of the family tax reform envisaged for 2005, and tax increases as a last resort if needed. Postponement of the family tax package proved to be politically impossible, however, so that more emphasis has to be placed on the expenditure side. The

savings that are now proposed amount to CHF 3.5 billion (0.8 percent of GDP) from 2004-2006 and affect all areas of federal government activity: social welfare, transportation, defense, agriculture, education and research, international affairs. As a consequence, all ministries are forced to review their priorities and rework their planning and programs. In the course of these spending cuts, ODA also has to be cut temporarily. This, however, does not change the authorities' intention to raise ODA to 0.4 percent of GNP by 2010. The consolidation package will be presented to parliament shortly, and it is expected to enter into force in 2005. Certain measures will be implemented earlier, reducing expenditure in 2004 by CHF 800 million.

5. Together with the presentation of the consolidation package, my authorities will seek an amendment of the debt brake legislation. The purpose of the amendment is to allow for a gradual reduction of the structural deficit that already existed before the implementation of the debt brake. Possible technical refinements to the debt brake mechanism, as suggested by staff, are also under review.

### **Monetary Policy**

6. The staff report provides an excellent evaluation of the key monetary conditions, and the authorities are in broad agreement with the staff's assessment. The current stance of Swiss monetary policy is very expansionary. Low real interest rates, with short-term rates being negative, high growth rates for all money aggregates, and even the MCI point towards a very easy monetary policy. It should also be noted that the appreciation of the Swiss franc vis-à-vis the euro was much smaller in real than in nominal terms. The loose monetary policy stance is also reflected in the latest inflation forecast of the Swiss National Bank (SNB) published in March 2003, according to which inflation (given unchanged interest rates) would rise to 2.5 percent at the end of 2005, clearly above the SNB's range of price stability. The SNB agrees with staff that the expansionary monetary policy stance has to be maintained for the time being.

7. Regarding the trend of inflation within the SNB's range of price stability, staff recommends holding trend inflation close to the upper limit of 2 percent. The SNB would like to point out, however, that it neither attempts nor believes to be able to fine-tune inflation in a very narrow range. During upswings inflation is on average slightly higher than during downswings, even if the monetary policy stance is always optimally adjusted. The SNB regards it as an advantage of its policy framework that it allows for slightly different levels of inflation over the business cycle, making an excessively activist monetary policy unnecessary. With full employment and a closed output gap, inflation is expected to be close to 2 percent. With such a medium-term orientation, monetary policy can avoid to become itself a source of destabilization.

8. As staff points out in the selected issues papers, Switzerland has a long-standing experience with a low-inflation environment. So far, the low level of trend inflation has never been a problem for monetary policy. The SNB has reacted flexibly and very decisively during the recent economic downturn. Neither the policy reaction nor the policy options

would have been substantially different with a slightly higher level of trend inflation. As also noted in the selected issues papers, relative price flexibility is very high in Switzerland, which enables the economy to adjust to shocks even with a low trend inflation. The low level of inflation during the last 10 years has also been a result of structural adjustment due to market liberalizations and ensuing price declines as for example in the telecommunication industry.

9. Nevertheless, the SNB observes the risk of deflation very carefully and is confident that it would not react too late to a serious deflation threat. For such a threat to occur, a relatively strong appreciation of the Swiss franc vis-à-vis the euro would be necessary. While a short period with negative inflation rates is hardly worrisome and always possible due to specific shocks or adjustments, the SNB has always clearly stated that it would not allow a deflationary spiral to take hold. As staff points out, the SNB has pursued a very flexible policy under the new framework and did not hesitate to cut interest rates aggressively. The latest move on March 6 sent a strong signal to the markets and led to a notable weakening of the Swiss franc. The SNB also made it very clear that it would use foreign exchange market interventions if necessary.

### **Financial Sector**

10. Given the challenging environment, the financial sector has weathered the shocks of the sharp decline in stock market valuations and economic stagnation relatively well. While overcapacities have been reduced significantly, consolidation pressures in the sector are expected to subsist. However, market participants feel that the downward pressure is beginning to ease and that the worst earnings declines have been overcome. The authorities nonetheless fully agree with staff's assessment of the challenges and necessary actions, particularly with regard to the pension and insurance sector.

11. The supervisory authorities thus continue to press ahead with the reform schedule in line with the recommendations of last year's FSAP. The revised Insurance Supervision Law was recently submitted to parliament. It aims at a better protection of the insured through a more targeted surveillance of the long-term stability of insurance companies, taking into account the liberalized and internationalized market conditions. In summer, an expert committee will be presenting its report on an integrated supervisory agency, combining the operations of EBK and the Federal Office of Private insurance.

13. As noted in the staff report, a revised Money Laundering Ordinance and a new Due Diligence Agreement covering the banking sector will go into effect in July 2003, further strengthening anti-money laundering and the regime for combating the financing of terrorism. Non-banking sector regulations will be strengthened in a similar way later in 2003.

### **Structural Policies**

14. Lagging product market reform as a reason for sluggish growth is well recognized. The failure to liberalize the electricity sector in the referendum last fall is clearly a setback.

That the political environment is currently not favorable to further liberalization plans is also reflected in the current political discussions on the legally mandated provision of public services (e.g., postal services). Concerns about equality of supply also in peripheral regions are traded off against economic efficiency arguments. Staff's recommendation to focus on a more systematic identification of costs and benefits to consumers in order to mobilize popular support seems thus appropriate.

15. As pointed out by staff, my Swiss authorities support the Doha Trade Round and are committed to the progressive opening of services on a multilateral basis. It is also worth noting that the planned elimination of custom duties on imports from the least developed countries by 2006 includes agricultural products.

16. Finally, Switzerland is in the process of accommodating G-10-type collective action clauses (CACs) in its legal framework and intends to introduce CACs in its own sovereign bond issues.