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What impact will "Brexit" have on Switzerland?

A stronger Swiss franc, a weaker Europe, even lower interest rates: the outcome of Great Britain's EU referendum has far-reaching consequences for the Swiss economy.

SIMON SCHMID

In June, the people of Great Britain chose to leave the European Union. What will this mean for Switzerland and its economy? The effects are already being felt at several levels.

1. Interests rates will remain low for even longer

Brexit will go down in history as the mildest stock market crash ever. Although there was great anxiety in New York, London and Tokyo on the morning of 24 June, the panic had evaporated again within days. Indeed the losses had been recouped by the first week of July, including at the Zurich stock exchange. One reason for this is that investors realised that the result of the referendum would have almost no immediate consequences. After all, the negotiations between Great Britain and the EU are likely to drag on for two or more years. It is still not clear what future economic relations between the two will look like. The United Kingdom may even maintain relatively close ties with the Continent through the European Economic Area.

However, there's also another reason for the stock market rally: interest rates have fallen again. Major central banks like the Federal Reserve and the European Central Bank look likely to continue pursuing very expansive monetary policies. That will drive share prices upwards. Borrowing must remain cheap because the economy is still sluggish, especially in Great Britain, where the Bank of England cut its base rate to an all-time low in the aftermath of the Brexit vote in expectation of a significant economic slump.

These negative economic developments are affecting Switzerland, where returns on ten-year federal loans are now at -0.5 %, their lowest point ever. As a result, the hoped-for normalisation of global interest rates has moved further into the distance. This also means that the Swiss National Bank (SNB) will have to maintain for even longer its negative interest rates that are designed to put international investors and those with significant savings off the Swiss franc. This will particularly hurt the likes of pension funds and health insurers, which hold large amounts of liquid assets.

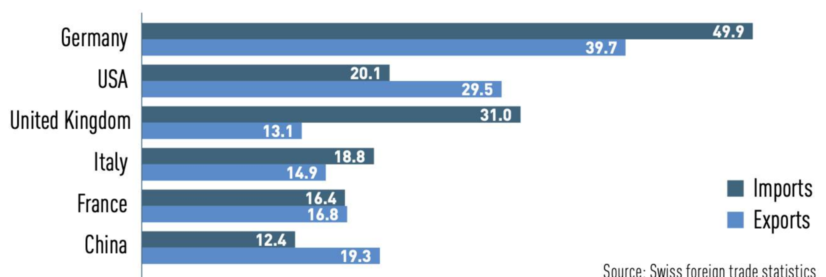
2. Pressure on the Swiss franc will remain high

The SNB weathered the initial post-Brexit storm well. Although the exchange rate against the euro fell from CHF 1.10 to CHF 1.06 in the immediate aftermath of the vote, it was soon back between CHF 1.08 and CHF 1.09. That was largely thanks to clear communication by the SNB and its intervention on the foreign exchange market. In the decisive phase around the Brexit referendum, the SNB spent CHF 11 billion buying up foreign currencies. However, it can't relax just yet. The foreign exchange market may explode again and the pressure on the Swiss franc looks unlikely to diminish. Observers reckon that the SNB is continuing to buy up foreign currencies to maintain a first line of defence at CHF 1.08. If tensions in Europe rise further, the SNB would have no choice but to cut interest rates again to stabilise the euro exchange rate at about CHF 1.05.

3. Damage to exports and tourism

Six percent of Switzerland's exports go to Great Britain. The eurozone accounts for 40 %. The slight upswing in these markets proved an important boost for the Swiss economy following the shock to the franc. Were investment as well as consumer spending in these regions to fall, this would also hit Swiss companies. With the exception of the crisis-resistant pharmaceutical industry, most export sectors are likely to feel the knock-on effect of Brexit. That's bad news for the tourist industry in particular, which is already in the dol-

Principal business partners in 2015 (in CHF billion)



Source: Swiss foreign trade statistics

drums, with fewer hotel bookings in the first half of the year. In a typical year, some 700,000 Brits visit Switzerland. The weaker pound means many of these will now stay at home. If they do travel to Lucerne, Mürren or Verbier, they will have less money for restaurants and souvenirs. Nonetheless, Theresa May spent her holidays in Zermatt in August. Her stay was a godsend: posing in hiking pants and a polo shirt with trekking poles and a backdrop of Swiss mountains, Great Britain's new prime minister told a mass of British journalists how wonderful it was to wander in the Alps.

The banks will have to get by without such advertising. Financial institutions like Credit Suisse have lost out on the stock exchange. The price of shares in Switzerland's second-biggest bank even briefly fell to below CHF 10. But Swiss banks aren't alone in their sorrows. Low interest rates are depressing revenues throughout Europe. As such, banks from Italy to Germany are suffering under low profitability and an uncertain future.

4. Agreement with Europe moving into the background

Brexit probably killed off any hopes for a rapid and strict implementation of the mass immigration initiative as intended by those behind it. It is widely believed the EU will now take great care not to make any concessions on migration whilst the negotiations with Great Britain are underway. On the other hand, this realisation has led Swiss politicians to speed up their search for a solution without the SVP. A compromise currently taking shape would involve implementation of the initiative with a slight domestic bias. Under this proposal, put forward by the FDP, employers would be obliged to report job vacancies to regional job centres in Switzerland before recruiting applicants from abroad. On the other hand, a regional and sector-specific protection clause suggested by the CVP would also apply. Experts are not ruling out the possibility that such a package, which would require neither ceilings nor quotas and would therefore be compatible with EU principles, could be approved by 7 February 2017.

A good omen? British Prime Minister Theresa May and her husband Philip spent their summer holidays in Zermatt.
Photo: Keystone

To what extent such a solution would restrict immigration remains to be seen. Nevertheless, it would be good for Swiss companies, which rely on stable underlying conditions and flexible migration policies.

5. A chain reaction: the political worst-case scenario

The Brexit vote has given nationalists yet another boost. Far-right politicians like Marine Le Pen are now demanding their own referendum on the EU and the euro. Their claim that European integration harms their countries more than it benefits them is backed up by economic developments. After all, figures released for the last few quarters show the eurozone economy in sluggish mood. Only Germany has grown. The French and Italian economies are stagnating.

The next test for the European project will come in November, when Italians vote on a constitutional amendment that Prime Minister Matteo Renzi has staked his political future on. France goes to the polls to elect a new president in 2017. Should eurosceptic movements like the Front National or Movimento 5 Stelle come to power, Europe's disintegration could gather pace. Already, a mere 49 % of Italians consider the European common currency to be beneficial.

It's hard to predict what impact such a scenario would have on the financial markets. The Swiss franc would undoubtably skyrocket in value. Were a country like Italy to leave the eurozone, an increase in unemployment and a recession would be the least that Switzerland could expect.

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