Switzerland: The Little Economy That Could

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If you think of the global financial crisis as a global train wreck with only a few cars managing to stop right-side up, many would identify those fortunate few as China, India, Australia, Brazil and Canada.

But how about a landlocked country in Europe with a population of 7.8 million, a strong currency and major players in the banking industry?

That's Switzerland, at least as many of us know it.

Now how about *this* Switzerland:

"It's a real safe haven," says Joseph Foudy of NYU's Stern School of Business. "It's a government that's always had prudent policies with low inflation. It's a very diversified economy. And the labor market is very flexible."

For those reasons and others, Switzerland has not only recovered from the global recession of 2009 but has so far also coped well with a recent spike in an already strong currency.

"Low interest rates have stimulated the economy the way you would expect it to," says Jens Nordvig, senior currency strategist at Nomura Securities International.

The economy--GDP is about $500 billion--is on course for 2-percent growth this year—more than even the central bank originally forecast—following a 1.8 percent contraction in 2009.

That may not seem like much, but along with other yardsticks, it's something of an accomplishment, compared with the moribund and debt-ridden economies of the Euro-Zone, Japan and the U.S. where an out-sized stimulus package and other fiscal measures are almost entirely responsible for growth.)

Swiss Mix

Experts say much of the Swiss success story has to do with its government structure and its interplay with the economy.

"The Swiss economy is so decentralized," says Richard Rahn, senior fellow at the Cato Institute. "It's a federal system but much of the power is in the cantons [states] and cities You don't have the pressure of politicians from the central government to inflate the economy."

The perils of that are all too evident in the endless tug of war in the U.S. involving the Congress, White House and Federal Reserve, or the jockeying constituencies and conflicting agendas of the European Union's dozen-plus members.

"Very few small countries have been able to manage independent central banks without resorting to inflation," says Rahn, who's also chairman of the Institute for Global Economic Growth. "The central bank has done a great job managing the situation."

Inflation is running at less than 0.8 percent though June and the budget deficit is a stunningly low one percent of GDP, despite government programs to stimulate the economy and recapitalize one of its two international banks.

Though both **UBS** and **Credit Suisse** stumbled like others in the global banking sector, but had "less concentrated exposure to normal mortgage lending," says Nordvig.

In addition, smaller private banks play a big role in local lending, says Rahn, and based on their unlimited liability structure, take less risk in providing a wealth of local services.

"The Swiss being the Swiss didn't get themselves into excessive debt," says Rahn.

Experts also point to strength in other parts of the Swiss economy, from pharmaceuticals to chemicals to machinery, which drive exports.

"Swiss companies really have a strong emphasis on diversification," says Foudy. "They are also good at hitting a lot of niche products that are a little more resilient. These are not companies that compete on price."

Favorable corporate tax laws, a flexible labor market and highly skilled workers are also helping.

"Lots of people [are] looking at Switzerland as a place to set up business," says Nordvig.

Domestic demand had been solid. High wages—per capital income is about $67,000—and low unemployment rate (3.9 percent in June) have underpinned the growth, while housing prices have held firm, avoiding any significant hit to a key source of wealth and general well being.

"Domestic spending has held up better than others," says Foudy, pointing to "very strong balance sheets."

In addition to wages, that can be linked to a generous tax exemption for personal savings, a steady influx of wealthy foreigners—including a recent wave following tax hikes in European neighbors—and the relatively large and stable population of well-paid workers at international organizations, such as the UN.

"It's a much more stable environment," says Nordvig.

Mountain Or Mole Hill?

Maintaining that stability in an increasingly uncertain economic environment will likely challenge the Swiss, though not as much as others in the months ahead.

The central bank spent billions of dollars in the spring, intervening in the currency markets in an effort to slow, if not cap, the rise of the Swiss Franc.

The size and persistency of the capital inflow that came with the Franc's 15-percent appreciation against the Euro were rare, say experts, and has left Swiss authorities with a bit of a dilemma about how and where to invest the money.

The surge in the Franc will also eventually take a bit out of exports, but Swiss companies are used to competing with a strong currency. Exports in June, for instance, rose 12 percent.

There's also continuing pressure from the U.S. and others to weaken, if not eliminate, its famous bank secrecy laws.

Neither will likely rob Switzerland of much of its attractiveness--especially in uncertain times. Over the years, the Franc has been one of the more stable currencies and, much like US Treasurys, has more than its share of fans.

"[Switzerland] always been seen as a safe haven," says Foudy. "It helps its competitiveness."

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