Press release

Swiss franc: offshoring looms following the removal of the exchange-rate floor with the euro

Swiss companies may be preparing to shift production out of the country after the franc was unpegged from the euro. This is one of the main conclusions of the first academic study of the topic, which was conducted by economists from EPFL and the University of Geneva.

In January 2015, the Swiss National Bank (SNB) announced that it would abandon the currency floor of 1.2 Swiss francs per euro. In one day, the franc reached parity with the euro, and the Zurich stock market lost 9% of its value. One year later, economists from EPFL and the University of Geneva completed the first academic analysis of the real impact of this event. The results confirm a number of widely accepted beliefs. These include the problem of rising production costs for Swiss exporters. But the study also sheds light on two key points: the seismic event continues to weigh on the economy, and the offshoring of production appears to be on the horizon.

The researchers analyzed data from some 200 Swiss companies listed on the stock exchange, as they are required to publish detailed financial results. They then sorted these companies by whether they produce and sell in Switzerland or abroad.

Made in Switzerland and sold abroad? Bad idea
Exporting companies have been hardest hit. They produce their goods in Switzerland and make their money abroad, largely in the eurozone. The study shows that the SNB's move had significant and immediate effects: in the following six months, exporters' revenues declined by 16.3% on average and net profit fell by 20.4%. "Their costs are in francs and their revenues are in euros," said Rüdiger Fahlenbrach, a researcher at EPFL's Swiss Finance Institute and co-author of the study. "When the Swiss franc is more expensive, their costs go up, their margins shrink and their international competitiveness is damaged."

Since the exchange-rate peg was removed, exporters also reduced investments by 30%. At the same time, the proportion of their acquisitions abroad – mainly infrastructure and production sites – increased from 45% to 63%. Such transactions are often the precursor to a shift in production to other countries and at the same time betray a certain level of urgency, according to Fahlenbrach. "Rather than building a production site, you buy an existing one. It's faster."

The financial press has widely reported on the acquisition of such sites, which include Bobst in Italy, Comet Group in the United States and Sonova in Germany. "It is difficult to determine whether a given company is investing abroad in reaction to the strength of the franc or in line with a long-standing strategy," said Fahlenbrach. "But the rapid and widespread rise in the number of deals leaves little doubt that many of them are correlated with the removal of the exchange-rate floor."

Swatch is another exporter that has felt the sting. "It is hard to imagine this company massively shifting production abroad and abandoning the 'Made in Switzerland' label. But they too have seen their margins shrink – something that also bodes poorly for jobs."

A better bet: based in Switzerland, made the world over

Companies that the researchers consider 'international' are less exposed to the perils of a strong franc. Consider Nestlé and Novartis. "They are headquartered in Switzerland, but they manufacture around the world. If you make yogurt in France and sell it in the same country, your production costs and revenues are denominated in the same currency. This means no exchange-rate losses."

However, companies' net profits have to be repatriated. So they too have suffered from the exchange rate, but significantly less than exporters have. "They are in a more enviable situation," said Fahlenbrach. "And this is confirmed by our observations: exporters are trying to develop an international model by shifting their production abroad."

How are small and medium-sized businesses faring?

Two thirds of jobs in Switzerland are with small or medium-sized companies. But the researchers were not able to include them in their study – because they are not publicly listed, they are not required to publish detailed financial statements.

"Without going out on a limb, we believe that most small and medium-sized businesses in Switzerland are in the most exposed category, that of exporters," said Fahlenbrach. "A typical example is a company in the machine-tool sector. Switzerland is too small of a market for this type of firm." These companies probably do not have the money needed to move production abroad. And this does nothing to resolve their revenue problem or, in the longer run, the threat to jobs, according to Fahlenbrach.

Recently, the Swiss franc has shown some signs of weakening. This has to do with its role as a buffer, according to Fahlenbrach: "Because it's expensive, the franc is hurting economic activity, which in turns weakens the franc." The researcher does not, however, foresee a sharp drop in the value of the franc. "I'm afraid that some companies will not survive without automating production and laying off employees."

Despite its high cost, Switzerland is one of the most industrialized countries in Europe. The euro was worth 1.60 francs in 2009, but the country had little trouble navigating the shoals until the exchange-rate floor – set at 1 euro for 1.20 francs – was jettisoned. Is the current situation a result of the sudden removal of the exchange-rate floor, or have we in fact reached a critical threshold? "That's the million dollar question!" said Fahlenbrach. "Time will tell, but the results of our study are not very promising."

Reference

Efing, Matthias, Rüdiger Fahlenbrach, Christoph Herpfer, and Philipp Krueger, 2016, *How do investors and firms react to an unexpected currency appreciation shock?*, Swiss Finance Institute Working Paper 15-65.

Download the article here: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2709637

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