



Decide with Confidence

D&B Country Report

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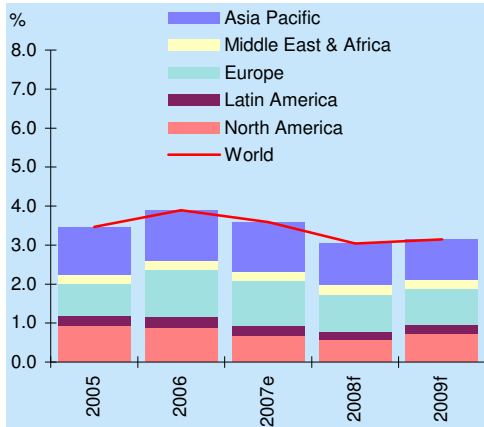
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This *D&B Country Report* was prepared in February 2008.

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Global Economic Outlook

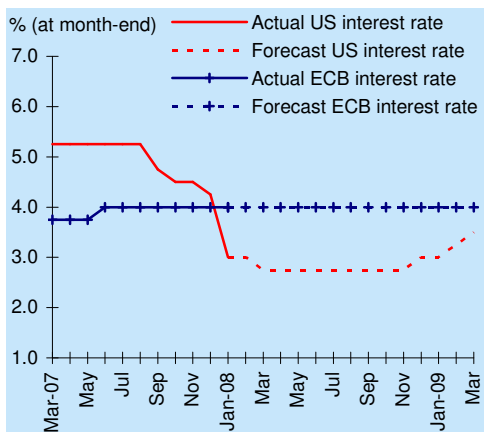
Real GDP growth forecast	2008f	Interest rates and oil price	Feb. 2008
World, %	3.1	US interest rate, %	4.50
US, %	1.8	ECB interest rate, %	4.00
Euroland, %	2.2	Japan interest rate, %	0.50
Japan, %	1.1	Oil price (Brent crude), USD/b	97.8



Sources: International Monetary Fund; D&B

World Growth

Despite stronger-than-expected US retail sales in January, increasing consumer pessimism is likely to lead to at least a technical recession in early 2008, before a huge fiscal stimulus package lifts household expenditure. US consumers account for 15% of world consumption: a downturn in the US economy will affect the rest of the world. However, a global recession is unlikely; world growth is supported by greater intra-regional trade among emerging markets, and continued strength in key economies such as China. Meanwhile, European markets with less exposure to the US should also continue to prosper, as should economies benefiting from sustained high world commodity prices.

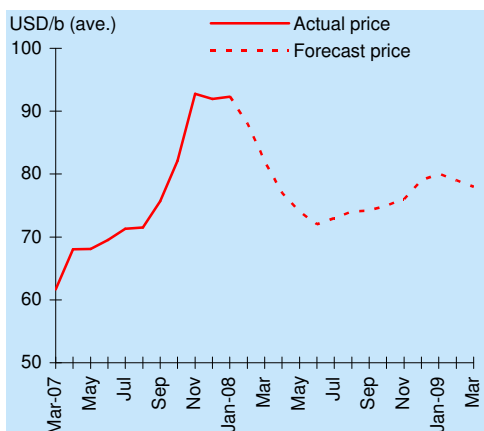


Sources: US Federal Reserve; European Central Bank; D&B

US and Euroland Interest Rates

US: The 125 basis points (bp) interest rate cuts by the Federal Reserve in January have been largely discounted by the markets, which expect a further 25bp cut in March. We expect activity to recover modestly towards the end of 2008, with high inflation necessitating a return to monetary tightening.

Euroland: The weakening of euro-zone growth displayed in recent Q4 2007 data, supports a softer stance on interest rates by the ECB in 2008. However, we still believe that the ECB will leave rates unchanged in the near term to prevent food and oil price spikes from translating into higher overall inflation expectations, which could dent consumer confidence more than the credit crunch.



Source: D&B

Oil Price (Brent Crude)

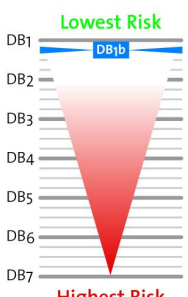
Fears of supply-side difficulties sustained robust oil prices in mid-February, as a row between Venezuela and US supermajor ExxonMobil over disputed back taxes and the nationalisation of the latter's assets threatened to escalate and Venezuela threatened to restrict oil supplies to the US. Meanwhile, geo-political factors in key oil producers Algeria, Iran, Iraq, Nigeria and Russia add further pressure to oil prices. Downward pressure on prices is maintained by the fears of a global downturn as a result of both the high oil price and the repercussions of the credit crunch. We maintain our forecast of USD78.0 per barrel (/b) in 2008 for Brent crude.

Country Risk Indicator

DB1b

For Country Risk Indicator Definition see page 58

Regional Risk Indicators	
Austria	DB1b
Switzerland	DB1b
Denmark	DB1c
Finland	DB1c
Germany	DB1c
Ireland	DB1c
Luxembourg	DB1c
Norway	DB1c
Sweden	DB1c
Netherlands	DB1d
UK	DB1d
Belgium	DB2a
France	DB2a
Malta	DB2a
Iceland	DB2b
Portugal	DB2b
Spain	DB2b
Greece	DB2c
Italy	DB2c
Cyprus	DB2d
Turkey	DB4a
Switzerland's Risk Indicator History	
End-2005	DB1c
End-2006	DB1c
End-2007	DB1b
Comparative Risk Indicators	
Australia	DB1c
Canada	DB1c
UAE	DB1d



Lowest Risk

Lowest degree of uncertainty associated with expected returns, such as export payments and foreign debt and equity servicing.

The DB indicator is a comparative, cross-border assessment of the risk of doing business in a country. The indicator seeks to encapsulate the risk that country-wide factors pose to the predictability of export payments and investment returns over a time horizon of two years.

Highest Risk

Overall Risk

- Country risk involved in doing business in Switzerland is virtually non-existent.
- A high level of political stability, sound economic policies, one of the highest per capita incomes worldwide and a favourable business environment make Switzerland one of the safest places to do business.

Positive Risk Factors

- + 2007 marked the fourth consecutive year of comparatively strong economic growth. This has been accompanied by a further improvement in Switzerland's already favourable external position, but has not jeopardised price stability.
- + By boosting earnings across the economy, robust economic growth has further reduced commercial risk. Meanwhile, Switzerland is one of the cleanest countries in terms of corruption.
- + With the fallout from the repeated jitters on financial markets limited to a small number of global players, financial sector stability is unlikely to suffer. That said, given the importance of finance for the economy, there are bound to be repercussions for growth.
- + The momentum for tackling long-standing structural weaknesses of the Swiss economy is the strongest it has been for some time. In particular, there have been a number of government initiatives aimed at removing barriers to effective competition.
- + Relations with the EU have become closer and more constructive, despite an ongoing dispute over the Swiss tax system. In recent years, the Swiss electorate sanctioned crucial aspects of a set of treaties governing bilateral relations.

Negative Risk Factors

- Economic growth is set to slow going forward. Cooling external demand and the repeated turbulence on financial markets are the likely triggers of the slowdown, with private consumption to follow as sentiment worsens.
- Weak productivity growth, the result of a lack of competition in sheltered sectors, means that Switzerland's long-term economic growth potential remains comparatively low. The Swiss political process is slow and gives vested interests ample opportunity to dilute policy proposals. It thus remains to be seen how successful the government is in implementing competition-enhancing measures.
- The challenges for fiscal policy lie in the medium to long term. Further structural reforms are needed to cope with an ageing population and soaring healthcare costs.
- With the Swiss People's Party (SVP), one of the four major political parties has renounced its government responsibility, with uncertain consequences for the highly consensus-driven political process. However, we do not expect this to result in policy gridlock.

Key Information

Economic and Development Information

	2005	2006	2007e	2008f	2009f
GDP (nominal)					
CHFbn	463.7	486.2	502.7	519.8	533.3
USDbn	372.4	387.8	418.8	440.5	440.8
Breakdown of GDP					
Agriculture (%)	1.3	1.2	1.2	1.3	1.2
Industry (%)	27.1	27.5	27.6	27.4	27.7
Services (%)	71.7	71.2	71.2	71.3	71.1
Economic indicators					
Real GDP growth (%)	2.4	3.2	2.7	1.9	1.5
Inflation, annual average (%)	1.2	1.1	0.7	1.5	1.1
Government balance (% GDP)	0.4	1.1	1.2	1.0	0.5
Unemployment (%)	3.8	3.3	2.8	2.7	3.0
Current account balance (% GDP)	13.7	14.7	16.5	13.5	12.0
Long-term real GDP growth potential, annual average, 2008-17: 1.5-2.0%					
Development indicators					
	Austria	France	Germany	Italy	Switzerland
Population, 2005 (m)	8.1	60.1	82.7	57.5	7.4
Population, 2015 (m)	8.1	61.8	80.6	55.1	7.6
Population, 2050 (m)	7.2	62.7	67.6	44.8	6.9
Urbanisation (% of population)	66	77	75	68	75
GNI per capita (USD)	37,190	34,600	34,870	30,250	55,320
GNI per capita (USD PPP)	33,140	30,540	29,210	28,840	37,080
Life expectancy (years)	79	80	79	80	81
PCs (per 1,000 people)	607	575	545	367	865
Dependency ratio, 2005	0.48	0.53	0.49	0.51	0.48
Dependency ratio, 2015	0.49	0.57	0.50	0.55	0.51
Dependency ratio, 2050	0.74	0.69	0.73	0.80	0.75

Political Information

Head of state	Federal President Pascal Couchepin (FDP)
Political system	Federal republic
<i>Present constitution adopted</i>	<i>1 January 2000</i>
Ruling coalition	SP, FDP and CVP
Last elections	October 2007 (legislative)
Next elections	October 2011 (legislative)

Miscellaneous Information

Religion(s)	Roman Catholic (42%); Protestant (35%); Muslim (4%)
Capital (population)	Bern (0.1m)
Timezone	GMT +1 hour

Sources: Swiss Federal Statistical Office; Organisation for Economic Co-operation & Development, *Economic Outlook*; State Secretariat for Economic Affairs; Swiss National Bank; World Bank, *World Development Indicators*; D&B

Executive Summary

Political Risk

The Swiss political environment underwent a radical change at the end of 2007. In mid-December, parliament failed to re-elect controversial Justice Minister Christoph Blocher from the right-wing Swiss People's Party (SVP) as a member of the Federal Council, the seven-seat executive. This prompted the SVP to distance itself from its two members whom parliament did vote into the Council and to 'enter opposition'. This marked the first time in Switzerland's highly consensus-driven political system that one of the main parties has renounced its responsibility to govern. Crucially, this came less than two months after the SVP had emerged as the strongest party from a parliamentary election.

However, we do not believe that the SVP will be successful in its attempts to provoke political gridlock. There is a faction within the SVP that favours more constructive engagement with the other political parties, while the electoral appeal of the party's core policy agenda, which opposes closer ties with the EU and loosening immigration restrictions, has begun to decline. It also remains to be seen how much will really change; even before his exclusion from the executive, Blocher frequently undermined the government's position. As such, we expect the momentum for tackling some of the notorious weaknesses of the Swiss economic framework, most notably the lack of competition in its internal market, to remain intact. A number of factors, among them the ascendance of policy-makers committed to spurring competition and the performance of the Swiss economy in recent years, have made economic reform more likely to succeed. That said, the Swiss policy-making process is extremely slow and it is hard to judge which proposals aimed at enhancing growth (such as increasing competition from abroad, or streamlining the tax regime) will eventually be implemented.

Meanwhile, the Swiss tax regime continues to be at the centre of a dispute between Switzerland and the EU. After the dispute peaked early in the year, Switzerland agreed in October 2007 to hold technical discussions on the issue. Overall, the dispute fails to dent the impression of improved relations between the two sides. Due to a comprehensive set of bilateral treaties, Switzerland is de facto nearly a member of the 27-nation bloc.

Macroeconomic Risk

The economy recorded a fourth consecutive year of robust growth in 2007. Following an increase of 3.2% in 2006, we estimate that real GDP grew by 2.7% in 2007, well above Switzerland's medium- to long-term growth potential. Despite this, the economic expansion has not come at the expense of price stability: the annual average CPI inflation rate only rose from 0.6% in 2003 (when real GDP contracted by 0.2%) to a high of 1.2% in 2005. By 2007, it had again fallen to 0.7%. Among the key factors limiting inflationary pressures are the overwhelming commitment of the central bank to price stability and a flexible labour market. In context, an influx of foreign workers, helped by the introduction of the principle of free movement of people with the EU, has been critical in containing wage pressures in recent years.

Generally speaking, the economy's continued strong performance in 2007 was better than expected. Going forward, we expect real GDP growth to slow to 1.9% in 2008 and 1.5% in 2009. The first factors to hit growth will be a slowdown of the global, notably European, economy; and, given the importance of the financial sector for the Swiss economy, the continuing jitters on international financial markets. On the demand side, this will show in a slowdown of net exports and gross fixed capital

formation, two important drivers of growth in recent years. As sentiment worsens, private consumption will follow this trend in the course of 2008.

Meanwhile, we expect the inflation rate to jump to 1.5% in 2008, but to fall back to 1.1% in 2009. The jump in the rate in 2008 will result from the sharp rises in oil and food prices in late 2007, which will keep the CPI significantly above its year-earlier level during most of 2008. This could, at long last, be exacerbated by rising wage pressure, as wage growth began to accelerate in 2007. Combined with the fact that interest rates were exceedingly low for some years and only recently returned to more 'normal' levels, this makes it unlikely that the central bank will cut interest rates at least until the second half of 2008. However, little suggests that inflation will stay at a higher level than in recent years.

External Economic Risk

A virtuous circle of strong outward investment and high current account surpluses characterises Switzerland's favourable external economic risk outlook. With outward FDI and portfolio investment usually far exceeding inward investment, the country has been able to build up vast foreign assets, which generate remitted earnings; this supports the large current account surpluses and allows for further investment abroad. In 2007, favourable external conditions resulted in an estimated current account surplus of 16.5% of GDP, an impressive figure for a country without many natural resources. Strong demand in the main export markets boosted the surpluses on the trade and the services account, while the strong performance of the world economy led to a further increase in the income generated by the country's foreign assets. A large deficit on the financial and capital account matched the current account surplus, although shortfall was much reduced from those in the previous two years. For 2008 and 2009, we expect the current account surplus to fall to around 13.5% and 12.0% of GDP as a result of a slowdown in the global economy in general and in Switzerland's main export markets in particular. Less favourable economic conditions will lead Swiss-based companies to cut investment abroad and increase demand for traditionally safe assets in the country; as a result, we expect the financial and capital account deficit to remain at a comparatively low level.

Given the extraordinarily strong external position, the prolonged weakness of the Swiss franc against the euro is hard to explain. Given the continuing robust economic fundamentals and increased uncertainty on financial markets, which will increase demand for a traditionally safe currency such as the Swiss franc, we expect the currency to appreciate somewhat vis-a-vis the euro in the near future. However, the increasing use of the euro (rather than the franc) as a reserve currency could mean that the weakness of the Swiss franc against the euro is more permanent.

Commercial Risk

Commercial risk is minimal. Four years of steady economic expansion have reduced credit risk, as shown by falling bankruptcy figures, and financial sector risk. Stress tests conducted by the central bank and the IMF found the financial system is resilient to significant shocks, while the effects of the turbulence on financial markets has been limited to a small number of global players. Moreover, Switzerland is considered one of the best-performing countries in terms of corruption, while a well-functioning legal system and strong respect for intellectual property rights further mitigate commercial risk.

That said, a close attachment to secrecy in financial matters warrants a degree of caution when taking on new business partners. Corporate governance and accounting are less transparent than modern international standards would dictate. In addition, bankruptcy procedures are lengthier and less efficient than the OECD average.

Political Risk

Key Point: Political tensions have risen within the Swiss executive following the exclusion of Christoph Blocher, leader of the Swiss People's Party (SVP) from the Federal Council; however, we do not expect the SVP's resultant renunciation of government responsibility to result in renewed policy gridlock.

Recent Developments

The Swiss political environment underwent a radical change in 2007. In mid-December, parliament failed to re-elect controversial Justice Minister Christoph Blocher from the right-wing Swiss People's Party (SVP) as a member of the Federal Council, the seven-seat executive. Blocher has become only the fourth member to be refused re-election since the founding of the federal state in 1848. In his place, the legislature elected Eveline Widmer-Schlumpf, another SVP member but from a more moderate, less nationalistic background than Blocher. This prompted the SVP to distance itself from its two members in the executive (the second member, Samuel Schmid, is also from a relatively moderate background) and to 'enter opposition'. This marked the first time in Switzerland's highly consensus-driven political system that one of the main parties has renounced its responsibility to govern.

These events occurred less than two months after the SVP had won the 21 October 2007 election to the National Council, the lower house of parliament, securing 28.9% of the vote. Having already become the strongest party in the chamber in 2003, this was the best result achieved by any party since 1919; the SVP now controls 62 out of the 200 seats in the National Council. The party's campaign on a highly nationalistic and radical anti-crime platform, which attracted international media attention as well as criticism from the UN, had thus paid off.

Table 1

Party Standings

Party	National Council (seats)		Council of States (seats)	
	2003	2007	2003	2007
Swiss People's Party (SVP)	55	62	8	7
Social Democratic Party (SP)	52	43	9	9
Free Democratic Party (FDP)	36	31	14	12
Christian Democratic People's Party (CVP)	28	31	15	15
Green Party of Switzerland	13	20	-	2
Others	16	13	-	1
Total	200	200	46	46

Source: Swiss Federal Statistical Office

The other winner of the election was the Green Party of Switzerland. Reflecting growing popular concern about climate change, the Greens obtained 9.6% of the vote, the party's best ever showing. The party now holds 20 seats in the National Council. The main loser was the Social Democratic Party (SP), which remains the second-largest party in the National Council but, gaining 19.5% of the vote, lost nine of the 52 seats that it had held previously. Meanwhile, the centre-right Free Democratic Party (FDP) remains the third-strongest party, despite seeing its share of the vote drop to 15.6% and losing four seats (now 31). The other main centrist force in Swiss politics, the Christian Democratic People's Party (CVP), managed to stop a long-term decline in its support and gained 14.6% of the vote and 31 seats. No fewer than seven parties hold the remaining 13 seats. The lack of a minimum threshold that needs to be cleared to secure parliamentary presentation enabled one party to secure a mandate with 0.4% of the vote.

Christoph Blocher had joined the executive at the end of 2003, when, reflecting the steady increase in support for the party since the early 1990s, the SVP gained a second seat in the Federal Council. With Blocher having been the driving force behind his party's ascent, his four years as justice minister saw a number of controversies. On more than one occasion, he publicly showed his reluctance to endorse the executive's official position, thus breaking one of the biggest taboos in Swiss politics. In a public speech in early 2006, for example, he wrongly described two Kosovo Albanians as criminals. Later in the year, he reassured the Turkish government, without the backing of his colleagues, that he shared the government's unease at an anti-racism clause in Switzerland's penal code (the clause, sanctioned in a referendum in 1995, allowed for the sentencing of a Turkish politician in March 2007 for repeatedly denying the Turkish genocide of Armenians in 1915). Meanwhile, an enquiry into the departure of a federal prosecutor published in September 2007 accused Blocher of exceeding his competencies and ignoring the separation of powers. It was such episodes that eventually sealed Blocher's demise as a member of the Federal Council.

At a policy level, the increased weight of the SVP in the executive and the strong support for the party's programme resulted in a number of nationalistic policies. In referendums held in 2004 and 2006, voters denied simplified naturalisation to second- and third-generation immigrants and overwhelmingly approved restrictions for asylum seekers and non-European immigrants. The latter vote, which was seen as a victory for Blocher, provoked criticism from international organisations such as the UN refugee agency UN High Commission for Refugees and various NGOs. According to the UN Human Rights Council, Swiss asylum laws are now among the most restrictive in Europe.

Political Environment

The highly decentralised nature of the political system, which distributes power among geographic entities, branches of government as well as the people (see box), accounts for several conspicuous features of Swiss policy-making. Most importantly, the extensive involvement of citizens renders the political process highly consensus-driven: a political player that feels disadvantaged by a policy always has the option of appealing to the electorate. Therefore, all four major parties have been represented in the executive for decades, and there has been no 'opposition' as such. It also explains the strong involvement of interest groups in the political process and why policy-making is generally slow and favours the status quo. Positively, this system of government provides an effective check on the executive's actions, helps to limit the size of the public sector and has contributed to Switzerland's high degree of political stability.

By renouncing its government responsibility in retaliation for the exclusion of Christoph Blocher from the executive (see **Recent Events**), the Swiss People's Party (SVP) hopes to exploit these peculiarities of the political system to block policy-making. In many ways, the party is seeking a return to the situation before 2004. Until then, the SVP had only one member in the seven-seat executive, whereas the other three major parties, the Social Democratic Party (SP), the Free Democratic Party (FDP) and the Christian Democratic People's Party (CVP), had two each. However, the SVP under Blocher's leadership gradually gained support throughout the 1990s and by late 2003 had become the largest party in parliament's lower chamber by campaigning on a confrontational, radically anti-European and anti-immigration platform, which at times verged on outright xenophobia. Exploiting its role as a political outsider, it frequently used its growing influence to obstruct policy-making. When the party was granted a second seat in the Federal Council at the end of 2003, this was not only to correct the (by then unjustified) under-representation of the SVP in the executive but also to unblock the political process.

However, we do not believe that the SVP will be able to provoke renewed political gridlock. First, it is questionable how much will really change. Even with Blocher in the executive, the SVP often took positions that contradicted that of the government. While this is nothing unusual as such (other parties do it as well from time to time), on more than one occasion Blocher himself publicly demonstrated a reluctance to endorse the official government position, which had been previously virtually unheard of behaviour for a member of the executive. Second, the SVP was most successful at guiding public opinion on immigration and Switzerland's relations with the EU. Recently, however, the party lost key votes on European policy (see **Relations with the EU**), while following a number of key decisions in recent years, immigration policy has ceased to dominate the policy agenda. Thirdly, and perhaps most importantly, the recent events revolve primarily around the personality of Blocher as well as his and his supporters' political style. Parliament did not question the SVP's representation in the executive. Tellingly, justifying her decision to enter the Federal Council against the will of Blocher's faction, his successor Eveline Widmer-Schlumpf said she was convinced that the SVP should adopt a more constructive and less adversarial approach in government. Several other factions of the party have echoed this concern. Thus, in areas such as economic and social policy, the continuing presence of two SVP members in the executive will ensure that policies do not deviate too far from the party's position. In turn, this will undermine the hardliners' intention to block the political process.

Political System

Switzerland is a federal republic consisting of 23 cantons (20 full cantons and six half cantons), which retain extensive powers and are key to the country's identity. The cantons themselves are divided into nearly 3,000 municipalities, whose degree of autonomy varies between cantons. At the beginning of 2000, Switzerland adopted a revised version of the federal constitution, which contains only minor changes from its predecessor of 1874.

Federal legislative powers reside with the bicameral Federal Assembly (*Bundesversammlung* or *Assemblée Federale*), the two houses of which have equal powers. The 200-member lower house (*Nationalrat* or *Conseil National*, National Council) is elected for a four-year term by universal adult suffrage under a system of proportional representation. The 46-member upper house (*Ständerat* or *Conseil des Etats*, Council of States) comprises two members from each of the 20 full cantons and one from each of the six half cantons.

Executive power lies with the Federal Council (*Bundesrat* or *Conseil Federal*), which comprises seven members elected by a joint session of the Federal Assembly. The members of the Federal Council must to be confirmed by the Federal Assembly after every parliamentary election. However, non-conformation is an extremely rare event, which means that members of the executive generally determine themselves when they resign. Each year, one member of the Federal Council assumes the post of federal president, the closest Switzerland has to a head of state. The president's role is almost entirely ceremonial: she or he represents the country abroad and supervises relations between the confederation and the cantons, but is otherwise no more than a 'first among peers' and a co-ordinator rather than a leader of government. The four major political parties, the Swiss People's Party (SVP), the SP, the Free Democratic Party (FDP) and the Christian Democratic People's Party (CVP), are all represented in the executive. The number of seats held by each party has changed only once since 1959: in late 2003, the SVP gained a second seat at the expense of the CVP, after steadily gaining support for more than ten years. The SP and the FDP also hold two seats.

The most striking feature of the Swiss political system is the strong element of 'direct democracy', which means that citizens' participation in the political process goes far beyond casting votes in elections. At the federal level, people can propose constitutional changes; provided the petition features at least 100,000 signatures,

there will be a binding vote on the proposal. In addition, by obtaining 50,000 signatures or the support of eight cantons (a system that is advantageous to smaller cantons), people can force a binding vote on laws adopted by parliament. Some parliamentary decisions automatically require approval in a plebiscite, including constitutional amendments and international treaties that establish the country's membership of supranational bodies.

Policy Agenda

Recent years have seen the adoption of a more liberal stance in economic policy-making, alongside a gradual shift in Switzerland's policy on European integration (see **Relations with the EU**). Arguably, the momentum for tackling key weaknesses of the Swiss economic framework, such as the lack of competition on the internal market, is the strongest it has been for a long time. Among the factors that account for this change are: the failure of isolationist policies in the 1990s; the ascendance of policy-makers committed to spurring competition, among them Doris Leuthard of the CVP, who replaced Joseph Deiss (also of the CVP) as economy minister in August 2006; and the recent good performance of the Swiss economy (see **Short-Term Economic Performance**), which has alleviated some of the fears linked to economic reform. Generally, the areas requiring the government's attention will continue to do so for some time as they concern medium- to long-term challenges to the country's socio-economic framework.

Competition Policy: Competition has traditionally been hindered both by the decentralised political system, which ensures that there are numerous obstacles to competition at the cantonal level, and by the country staying outside the EU. This has allowed various sectors to remain protected from competition. In order to tackle Switzerland's notoriously high average consumer prices, prices are around 20% higher than in EU-member Luxembourg, which has an income level similar to that of Switzerland) and weak economic growth, the Federal Council submitted a series of proposals in 2004 aimed at boosting competition. Among other things, the Federal Council has suggested introducing the EU's 'Cassis de Dijon' principle, which would permit products legally manufactured in an EU state to circulate freely in Switzerland. However, implementation of the suggested policies has been slow.

Social Welfare Reform: An ageing population, high deficits in the disability-insurance scheme (which has been absorbing an increasing number of people forced out of the labour market) and surging healthcare costs have made deep reform of the country's welfare state imperative. The Federal Council has recognised the need for action but progress has been slow. For example, a reform of the disability-insurance scheme approved by parliament in mid-2006 was challenged by several political groups and only approved a year later in a referendum. Reform of the publicly financed, pay-as-you-go part of the old-age pension system and of the partly private healthcare system is also regularly obstructed in both parliament and popular votes. A cautious reform of the occupational benefit schemes, the second 'pillar' of the old-age pension system, came into force in 2005.

Fiscal Policy: The government is committed to a policy of balancing the federal budget, as embodied in the 'debt brake' (see **Government Consumption**). As a consequence, cuts in public spending have figured prominently on the political agenda. For example, the Federal Council has pledged to continue streamlining the public sector, with the number of staff employed in the federal administration due to fall to 31,270 by 2010 (down by 3,600 from 2004). While the favourable economic conditions have alleviated the problem recently, Finance Minister Hans-Rudolf Merz has not ruled out further spending cuts over the medium term.

Tax Reform: Since taxes are levied at three different levels (federal, cantonal and municipal, see **Taxation**), the Swiss tax system often lacks transparency. In order to preserve the country's favourable business climate, the Federal Council has sought to reform the tax system. However, the project suffered a setback early on in May 2004, when voters rejected a bill on the taxation of families, the tax treatment of owner-occupied houses and the stamp duty on financial transactions. At present, reform efforts focus on three areas: corporate taxes, with the electorate in late February 2008 narrowly sanctioning an easing of the double taxation of company profits (see **Taxation**); the taxation of married couples; and streamlining VAT, which currently features three different tax rates and numerous exemptions.

Socio-Political Risk

Internal Stability

Switzerland is free of politically motivated violence. In addition, the social climate is very stable and the rate of criminal offences is among the lowest in the world.

Interest Groups

Since a political party or interest group that feels disadvantaged by a policy always has the option of appealing to the electorate (see **Political System**), interest groups play a critical role in the policy-making process. In order to prevent referendums from causing policy gridlock, interest groups are also involved in the legislative process at the parliamentary stage through regular hearings. However, on highly publicised, divisive issues, mobilising the electorate for a referendum still tends to be more effective than lobbying parliamentarians.

Business Community: Founded in 2000 as an umbrella organisation, *economiesuisse* is the largest of several business and employers' associations. It enjoys the support of more than 30,000 businesses, which together employ 1.5m people. In the course of 2006, three crucial members from the industrial sector threatened to leave the association, arguing that *economiesuisse* too narrowly represented the interests of the powerful pharmaceutical and financial sectors; one of the three members subsequently confirmed its exit. Unsurprisingly, *economiesuisse* is advocating a hard line in Switzerland's tax dispute with the EU (see **Relations with the EU**).

Due to the importance of the financial sector in the Swiss economy, the financial community, represented primarily by the Swiss Bankers' Association, also enjoys great influence. While the manufacturing and the financial sectors agree on many issues, their views have traditionally diverged on the question of European integration. The manufacturing sector has generally favoured closer ties with the EU, whereas the banking sector has feared EU pressure to end Swiss banking secrecy laws. However, the deal on the taxation of savings reached with the EU in June 2003 (see and **Banking Secrecy and Taxation of Savings**) has alleviated such fears.

Farmers: Switzerland's 65,000 farming businesses, represented primarily by the Swiss Farmers' Union (SBV), form a powerful lobby. They are particularly wary of WTO and EU efforts to liberalise trade in agricultural goods. Swiss farmers may have welcomed individual Swiss-EU agreements (such as the liberalisation of cheese trade, where they see significant export potential for themselves) but they are generally opposed to abolishing tariffs and subsidies, as these would put their income under pressure. This protectionist position became particularly evident in 2005, when Switzerland and the US entered negotiations on a free-trade agreement and the US insisted on the full liberalisation of agricultural trade (eventually, the two parties agreed on the establishment of a joint forum to boost economic ties, see **Trade Environment**). Similarly, while nearly 60% of agricultural exports to the EU have been liberalised, the SBV opposes further steps in this direction.

Campaign for an Independent and Neutral Switzerland (AUNS): This pressure group, which has close links with the Swiss People's Party (SVP), was founded in the run-up to the 1986 referendum on Switzerland's UN membership and has since campaigned against a vast number of motions aimed at integrating Switzerland into multilateral organisations. It also played a strong role in the popular rejection of simplified naturalisation for second- and third-generation immigrants in 2004 and in the electorate's backing of tough asylum rules in 2006 (see **Recent Developments**).

Further interest groups include trade unions, several environmental groups as well as the Roman Catholic and the Protestant churches. By contrast, other religious groups and the numerous immigrants (around one-fifth of Switzerland's population of 7.4m, most of them from the EU and other countries of the European Economic Area, EEA) do not exert significant influence.

Labour Relations

Around one-quarter of Switzerland's full-time workforce is unionised. Many individual trade unions are members of one of two umbrella organisations, the Swiss Trade Union Association (SGB, which represents 16 unions and approximately 380,000 employees) and Travail.Suisse (13 unions and some 160,000 employees), the product of the 2002 merger between the associations of the Christian and the white-collar unions. Notwithstanding a wave of consolidation in the Swiss trade union movements that started in the 1990s in response to shrinking membership, a number of unions have remained independent.

Labour relations between employers and employees are generally good, with disputes typically settled by negotiation rather than confrontation. Switzerland currently has around 700 collective bargaining agreements, which are regularly renewed without major difficulties. The right to strike is enshrined in the constitution, but over decades, trade unions have continued to renew an industrial peace accord with employers. Therefore, until recently, the country was virtually strike-free.

However, the unfortunate combination of large-scale restructuring and redundancies triggered by an economic slowdown at the beginning of the new decade and soaring salaries for top executives and exuberant bonus payments in the financial sector have strained the peace accord with employers. Uncertainties over under-funded pension schemes (see **Financial Sector Risk**) and the prospect of a rise in the retirement age have further added to unions' concerns. Thus, while the number of working days lost due to strikes remains among the lowest in the OECD, labour relations have become more antagonistic over the past seven years. This is reflected in the fact that the number of working days lost due to industrial action rose from 19,545 between 1990 and 1995 to 92,750 between 2000 and 2005. In terms of labour relations, 2006 and 2007 were marked by standoffs between workers and the management over the closure of a metal factory and between unions and employers in the construction sector.

External Political Risk

External political risk is extremely low due to the principle of neutrality in foreign policy and the close and generally good relations with the EU.

Neutrality Policy

Switzerland's neutrality precludes the country's involvement in military alliances; this caution also extends to political ties. The country did not join the Council of Europe until May 1963, the IMF and the World Bank until 1992, and the UN until 2002. However, it was a founding member of the broad-based Conference on Security and Co-operation in Europe (CSCE), renamed the Organisation for Security

and Co-operation in Europe (OSCE) in December 1994. Since 1996, Switzerland has also participated in NATO's Partnership for Peace (a decision not subject to referendum approval) and deployed forces to Bosnia & Herzegovina in April 1996 in support of the OSCE mission. Swiss troops also participated in operations in the late 1990s to promote peace in the Balkans, particularly in Kosovo.

In June 2001, voters approved legislation for the deployment of armed Swiss troops for international peacekeeping missions under UN or OSCE purposes, as well as closer international co-operation in military training. Nonetheless, the country's doctrine of neutrality still applies in wartime. For example, during the Iraq conflict in 2003 the Swiss government banned US military overflights and imposed an embargo on arms sales to the US-led coalition.

Relations with the EU

Switzerland's neutrality caused it to reject the European Economic Community following the latter's establishment in 1957 in favour of the looser European Free-Trade Association (EFTA), which was founded in 1960. In 1972, Switzerland and the European Community concluded a free-trade agreement, and in the early 1990s, a drive towards closer integration with the rest of Western Europe prompted the Swiss government and the business community to seek participation in the European Economic Area (EEA, which extends the EU's single market to EFTA countries). However, in a vote in late 1992, the Swiss electorate rejected EEA membership, which also put on hold the country's EU application, submitted in May that year.

Instead, Switzerland opted for the negotiation of bilateral treaties with the EU, the first set of which were approved by parliament in October 1999 and sanctioned in a referendum in 2000. The two parties came together for another round of negotiations in 2002. Initially, the EU was reluctant to launch the talks, as Switzerland's preference for issue-by-issue negotiations over full membership has been seen as 'cherry-picking' in EU circles. However, this hesitancy was overcome when the EU secured Switzerland's co-operation in matters of taxation. The second round of bilateral negotiations was concluded in May 2004. Altogether, Switzerland and the EU have concluded 16 bilateral agreements on matters as diverse as:

- the free movement of people (fully implemented between Switzerland and 17 of the EU's 27 member states as of June 2007, although Switzerland retains the right to reimpose quotas until 2014);
- the removal of technical barriers to trade (see **Trade Environment** for those accords that are relevant to bilateral trade);
- civil aviation;
- Switzerland's inclusion in the EU's Schengen and Dublin accords (with Switzerland scheduled to join the border-free Schengen area in late 2008);
- the taxation of savings and respect for Swiss banking secrecy (see **Banking Secrecy and Taxation of Savings**); and
- the promotion of European film.

While taxation has been a thorny issue in Swiss-EU relations for a long time, starting in late 2005, various EU member states and the European Commission have renewed their criticism of the Swiss tax regime. After the dispute had reached its height early in the year, Switzerland agreed in October 2007 to hold technical discussions with the EU on the issue. The latter has argued that the practice employed by several Swiss cantons of exempting profits earned abroad by management companies, mixed companies and holding companies from profit tax (see **Taxation**) is in breach of the 1972 Swiss-EU free-trade agreement, as it constitutes a competition-distorting subsidy. Switzerland has rejected this criticism and has insisted on the cantons' wide-ranging tax competencies, claiming that the 1972 agreement exclusively refers to trade of goods and was not meant to lead to a harmonisation of national legislation.

Although it may sound paradoxical, the recent debate on the Swiss tax regime is evidence of how close relations between the EU and Switzerland have become since the beginning of the decade. While formal EU membership is not on the political agenda of any of the major political forces, the bilateral treaties mean that Switzerland is de facto nearly a member of the Union. Moreover, in referendums in 2005 and 2006, the Swiss approved their country's participation in the EU's Schengen and Dublin accords (on co-operation in matters of justice, police, asylum and migration), the extension of the principle of free movement of people (established between Switzerland and the EU by the first set of bilateral treaties) to new EU member states and a CHF1bn contribution to the EU Cohesion Fund, all of which have been controversial parts of the second set of bilateral treaties.

This shows that the Swiss have come to realise how vital the EU is for their country's continuing prosperity. Brussels knows this and, in turn, is seeking to extract as many concessions from Switzerland as possible in areas that matter to the EU. Tellingly, the latest wave of criticism of the Swiss tax regime set in immediately after the favourable outcome of the referendum on the extension of the principle of free movement of people to the new EU member states.

Political Risk Outlook

The Swiss political environment underwent a radical change at the end of 2007. In mid-December, parliament failed to re-elect controversial Justice Minister Christoph Blocher from the right-wing Swiss People's Party (SVP) as a member of the Federal Council, the seven-seat executive. This prompted the SVP to distance itself from its two members whom parliament did vote into the Council and to 'enter opposition'. This marked the first time in Switzerland's highly consensus-driven political system that one of the main parties has renounced its responsibility to govern. Crucially, this came less than two months after the SVP had emerged as the strongest party from a parliamentary election.

However, we do not believe that the SVP will be successful in its attempts to provoke political gridlock. There is a faction within the SVP that favours more constructive engagement with the other political parties, while the electoral appeal of the party's core policy agenda, which opposes closer ties with the EU and loosening immigration restrictions, has begun to decline. It also remains to be seen how much will really change; even before his exclusion from the executive, Blocher frequently undermined the government's position. As such, we expect the momentum for tackling some of the notorious weaknesses of the Swiss economic framework, most notably the lack of competition in its internal market, to remain intact. A number of factors, among them the ascendance of policy-makers committed to spurring competition and the performance of the Swiss economy in recent years, have made economic reform more likely to succeed. That said, the Swiss policy-making process is extremely slow and it is hard to judge which proposals aimed at enhancing growth (such as increasing competition from abroad, or streamlining the tax regime) will eventually be implemented.

Meanwhile, the Swiss tax regime continues to be at the centre of a dispute between Switzerland and the EU. After the dispute peaked early in the year, Switzerland agreed in October 2007 to hold technical discussions on the issue. Overall, the dispute fails to dent the impression of improved relations between the two sides. Due to a comprehensive set of bilateral treaties, Switzerland is de facto nearly a member of the 27-nation bloc.

Macroeconomic Risk

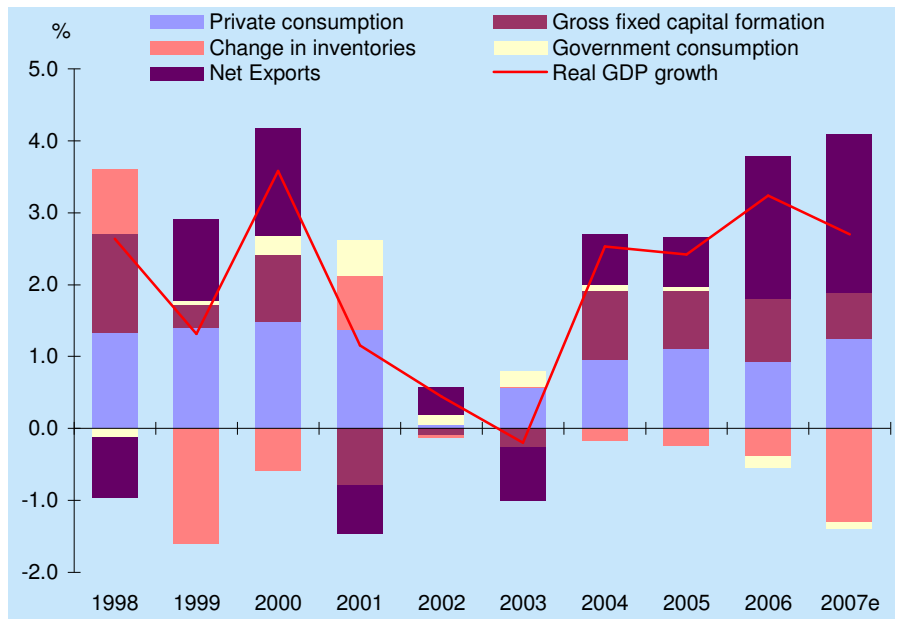
Key Point: We expect real GDP growth to moderate from an estimated 2.7% in 2007 to 1.9% in 2008. The first factors to hit growth will be a cooling of external demand and the continued turbulence on financial markets.

Short-Term Economic Performance

Switzerland has been experiencing the strongest economic expansion since the technology boom of the late 1990s. Real GDP grew by an average of 2.7% per year during 2004-07, compared with just 0.5% per year during 2001-03. Following an increase of 3.2% in 2006, we estimate that real GDP grew by 2.7% in 2007, still well above Switzerland's medium- to long-term growth potential (see **Long-Term Economic Potential**). Although expansionary monetary policy supported the recovery up to 2005, price stability has been maintained: the annual average CPI inflation rate only rose from 0.6% in 2003 (when real GDP contracted by 0.2%) to a high of 1.2% in 2005. By 2007, it had again fallen to 0.7%.

Chart 1

Yearly GDP Growth Contribution by Demand



Sources: State Secretariat for Economic Affairs; D&B

Generally speaking, the economy's continued strong performance in 2007 exceeded expectations, including ours. Going forward, while the broad-based nature of the recent expansion makes it unlikely that it will come to an abrupt end, we nevertheless expect real GDP growth to slow to 1.9% in 2008 and 1.5% in 2009. The first factors to hit growth will be a slowdown of the global, and in particular the European, economy; and, given the importance of the financial sector for the Swiss economy, the continuing jitters on international financial markets. On the demand side, this will show in a slowdown of net exports and gross fixed capital formation. As sentiment worsens, private consumption will follow this trend in the course of 2008. Meanwhile, we expect the annual average CPI inflation rate to jump to 1.5% in 2008, but to fall back to 1.1% in 2009. Little suggests that the rate should remain significantly above its 1998-2007 average of 0.8%.

Components of Growth

Table 2

Contributions to Growth

	2005	2006	2007e
<i>Real growth rate (%):</i>			
Private consumption	1.8	1.5	2.1
Gross fixed capital formation	3.8	4.1	2.9
Government consumption	0.5	-1.4	-0.8
Exports	7.3	9.9	9.5
Imports	6.7	6.9	6.4
Real GDP	2.4	3.2	2.7
<i>Share of GDP (%):</i>			
Private consumption	60.3	59.2	58.9
Gross fixed capital formation	21.2	21.3	21.4
Change in inventories	0.4	0.8	-0.4
Government consumption	11.6	11.1	10.7
Exports	48.8	52.5	55.9
Imports	42.3	44.9	46.5
<i>Contribution to real GDP growth (percentage points):</i>			
Private consumption	1.1	0.9	1.3
Gross fixed capital formation	0.8	0.9	0.6
Change in inventories	-0.2	-0.4	-1.3
Government consumption	0.1	-0.2	-0.1
Net exports	0.7	2.0	2.2

Sources: State Secretariat for Economic Affairs; D&B

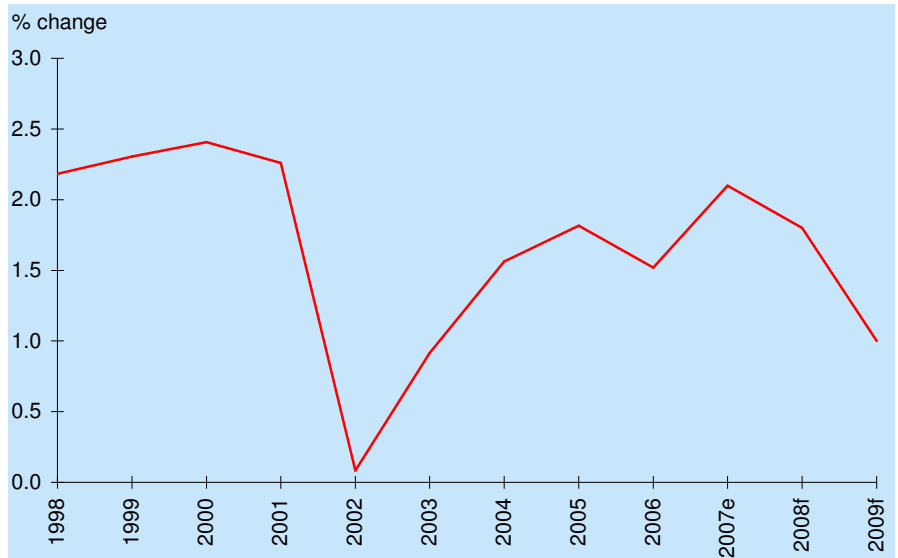
Private Consumption

Accounting for just below 60% of GDP, private consumption is the largest demand-side component of the Swiss economy and one of the main drivers of the recent expansion. It is also the component with the least volatile real growth rates. Unlike gross fixed capital formation, government consumption and net exports, private consumption has not contracted in real terms for more than a decade, not even at the height of the 2001-03 slowdown. During 2004-07, growth of private consumption averaged 1.7% per year in real terms, peaking at an estimated 2.1% in 2007.

While high living standards and a comprehensive system of social insurance explain its relative resilience to cyclical downturns, rising employment and a rebound in wage growth have increasingly supported private consumption in recent years. As expected, rising interest rates have hardly hampered consumption: household debt is low by international standards, and many Swiss households have a large pool of savings that generates interest income; this element of household income will grow as interest rates rise. Unsurprisingly, the quarterly consumer confidence survey conducted by the State Secretariat for Economic Affairs had reached its highest level in six years in April 2007 and had only slightly fallen by January 2008.

Going forward, although short-term labour market developments remain favourable, we expect the increase in private consumption to decrease somewhat in 2008, to 1.8% in real terms. The main reason for this is that we expect a deterioration of consumer confidence in the course of 2008, as people become more and more concerned about signs of an economic downturn, triggered primarily by cooling external demand and trouble in the financial sector. Private consumption will moderate further in 2009; the experience of 2001-02, when Switzerland's last period of strong economic growth came to an end, suggests that the slowdown of consumption could be relatively sharp in 2009.

Chart 2
Private Consumption

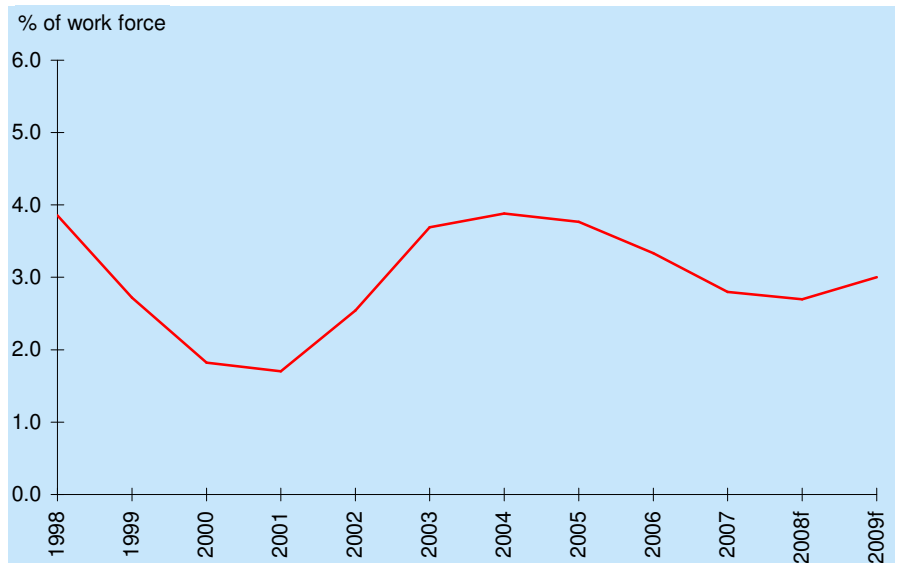


Sources: State Secretariat for Economic Affairs; D&B

Unemployment and the Labour Market

Strong economic activity has increasingly left its mark on the labour market. According to the authorities, the unemployment rate fell gradually from a cyclical peak of 3.9% in 2004, the highest rate since 1998, to 2.8% in 2007 (the OECD’s figures, which are only available up to 2006, show similar dynamics but report unemployment rates that are around 0.5 percentage points, pp, above the national figures). After increasing by 1.6% in 2006, employment in the secondary and tertiary sectors rose by another 2.7% year on year (y/y) during the first nine months of 2007. In Q3 2007, employment in the two sectors reached a new record level, with nearly all branches of the economy showing continued robust increases.

Chart 3
Unemployment



Sources: Swiss National Bank; D&B

Meanwhile, the impact of favourable economic conditions on wages has been more limited. 2004-06 saw nominal wages rise by an average of 1.0% per year, with real wages stagnating. For 2007, the most important collective agreements foresaw an

average nominal wage increase of 2.0%, the highest since 2001; with an annual average CPI inflation rate of 0.7%, this would have translated into a real wage increase of 1.3%, also the highest since 2001. That said, a government official said in mid-November 2007 that he saw real wages increase by no more than 0.8%. In 2006, Switzerland's median gross salary stood at CHF5,674 (that is, half the salaries were higher, and the other half lower than this).

Traditionally low levels of unemployment and limited wage pressure are at least in part the result a flexible labour market, with relatively weak job-protection legislation, decentralised wage bargaining and no legal minimum wages. With the gradual introduction of the free movement of people between Switzerland and the EU (started in 2002 and completed in mid-2007 for 17 of the EU's 27 member states; see **Relations with the EU**), the labour market has gained further flexibility in recent years; this helps explain the robust increase in employment in recent years and the limited impact of strong growth on wages. Given the somewhat lagged relationship between economic activity and the labour market, and with many businesses reporting difficulties to fill vacancies, we expect the unemployment rate to remain at a low 2.7% in 2008. For 2009, we expect the rate to increase to 3.0%. In turn, as rising employment has shifted bargaining power from employers to employees and as inflation is accelerating, we expect another robust increase in wages in 2008. Trade unions as well as a survey conducted by UBS, Switzerland's largest bank, predict a nominal wage increase of around 2.5% for the present year.

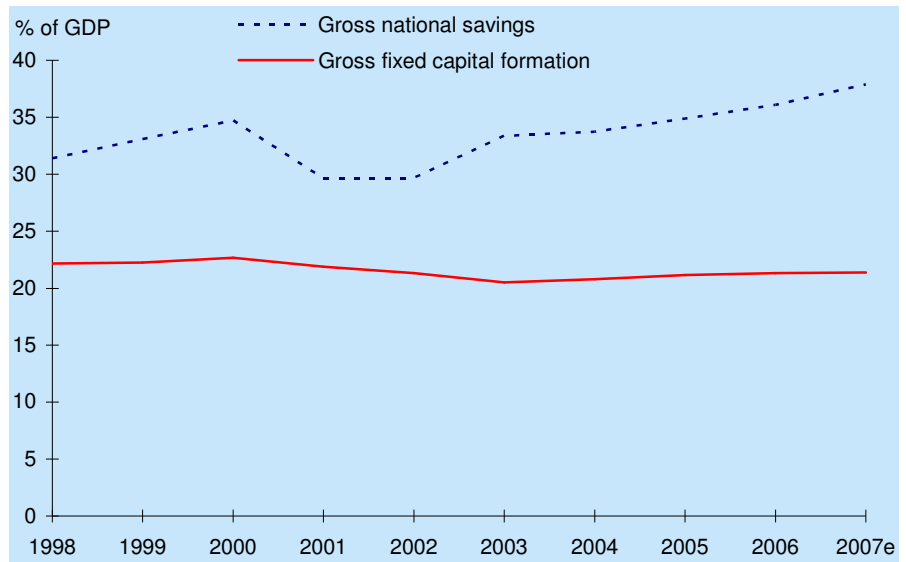
Gross Fixed Capital Formation

Gross fixed capital formation, which accounts for around one-fifth of GDP, expanded by an average 4.1% per year in real terms and contributed 0.9pp to annual economic growth during 2004-6. It increased by another 4.5% y/y in real terms during the first half of 2007 but cooled in the second half of the year; we estimate that it expanded by 2.9% during 2007 as a whole, contributing 0.6pp to real GDP growth.

The slowdown in investment activity in the second half of 2007 reflects the component's high volatility. Before rebounding from 2004 onwards, fixed capital formation contracted for three years in a row. Given the stability and favourable nature of Switzerland's investment environment (primarily a low tax environment compared with neighbouring countries, low interest rates and a well-educated, multilingual workforce; see **Long-Term Economic Potential** and **Investment Environment**), changes in the level of fixed capital formation are driven predominantly by businesses' expectations and the degree of capital utilisation. In other words, there tends to be over-investment during periods of strong economic growth (as in 1997-2000 and 2004-06) and under-investment in times of slowing economic activity (as in 2001-03). This pattern is particularly evident in companies' equipment investment but less so in construction activity.

Gross national savings typically fluctuate around 30% of GDP, which is among the highest rates in the OECD (together with Norway and South Korea). This means that the availability of financing is not a constraint on domestic investment. Indeed, excess savings have allowed Switzerland to invest heavily abroad, which, in turn, generates additional income for the domestic economy (see **Current Account** and **Financial and Capital Account**). The business sector accounts for more than half of gross national savings, aided at least in part by low corporate tax rates. Therefore, the stock of savings is closely linked to the performance of the economy: gross national saving fell from 35.0% in 2000 to 29.0% in 2002, but reached a new high of an estimated 37.9% in 2007. Meanwhile, at 9.3% of disposable household income in 2006, the household saving rate is not exceptionally high by international standards.

Chart 4

Gross National Savings and Investment

Sources: State Secretariat for Economic Affairs; Swiss National Bank; D&B

Going forward, separate surveys conducted by the central bank, UBS, and Credit Suisse, (the latter are Switzerland's two largest banks), show decreasing but still robust levels of business confidence. Sentiment is bound to be worst in the financial sector, with a number of key players hit hard by the repeated jitters in financial markets in 2007 and early 2008. UBS posted a loss of CHF4.4bn for 2007, the first loss in the bank's ten-year history; re-insurance company Swiss Re has also been among the worst affected businesses, while Credit Suisse announced that it would cut 500 jobs even before writing off CHF3.1bn in mid-February 2008. As signs of a slowdown of economic activity become more evident over the course of 2008, confidence will undoubtedly deteriorate in other sectors as well. Against this backdrop, we expect growth of fixed capital formation to slow to 1.7% in 2008 and 0.8% in 2009, with the component's contribution to real GDP growth falling to 0.2pp by the end of the forecast period.

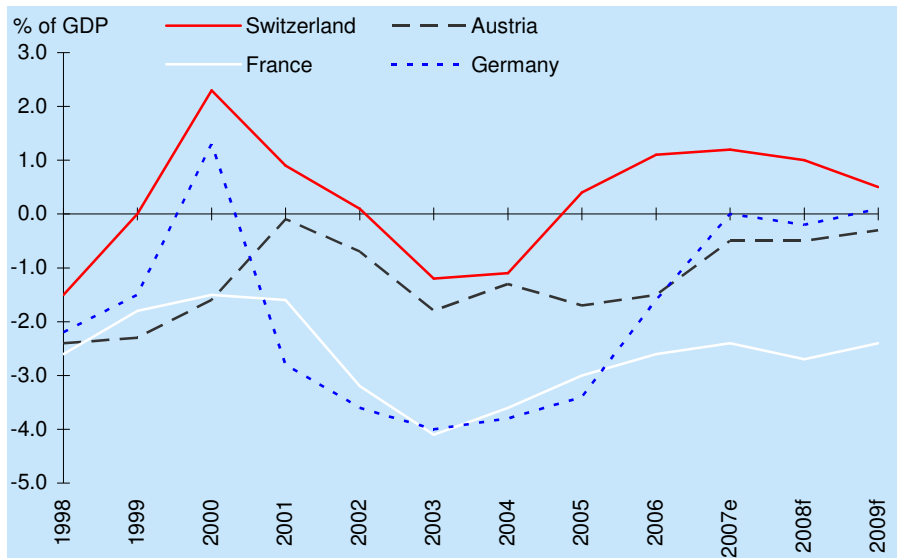
Government Consumption

Recent figures on public finances reflect the authorities' efforts to rein in government spending. After shrinking by 1.4% in real terms in 2006, we estimate that government consumption fell by another 0.8% in 2007. This would mean that during the 2004-07 period of strong economic growth, government consumption shrank by an average 0.2% per year, making hardly any impact on overall growth. Similarly, the general government balance (which includes federal as well as cantonal and municipal finances) turned from a deficit of 1.2% of GDP in 2003 into an estimated surplus of 1.2% of GDP in 2007. In early February 2008, Finance Minister Hans-Rudolf Merz announced that the 2007 federal accounts registered a surplus of CHF4.1bn, nearly five times as much as budgeted and markedly above the CHF2.5bn in 2006 (which had been the first surplus in six years and also exceeded expectations).

Together with the need to enhance competition in domestic markets, putting public finances back on a firm footing poses the greatest challenge to Swiss economic policy (see **Policy Agenda**), after public debt had risen to harmful levels. The government has launched numerous initiatives since the second half of the 1990s in order to tackle the problem. Recently, the introduction of the 'debt brake' (see box), which had been accompanied by a heated political debate, has enhanced budgetary discipline. In line with the stipulations of the debt brake, two consolidation programmes (which cut expenditure mainly in the areas of social welfare, transport,

defence and agriculture) launched in 2003 and 2004 have reduced expenditures by around CHF5bn per year on a permanent basis. In combination with the favourable economic situation (which has boosted revenues), these programmes allowed for the better-than-expected fiscal performance in both 2006 and 2007.

Chart 5

General Government Balance

Sources: Organisation for Economic Co-operation & Development, *Economic Outlook*; D&B

The Debt Brake

The debt brake came into force in 2003, after receiving approval in a 2001 referendum; it was conceived to halt the steep increase in public debt. While it applies to the accounts of the federal government only (that is, not to cantonal and municipal finances), several cantons have since introduced similar tools.

Put simply, the debt brake mandates that the government accounts be in balance over the business cycle: it requires revenues to exceed expenditures at times of above-trend economic growth, while it allows for a deficit when the economy grows more slowly than usual. Expenditures above the ceiling stipulated by the rule must be compensated over following years, whereby this can be offset against 'savings' accumulated in years in which expenditures remained below the ceiling. In extraordinary situations, such as severe recessions or natural disasters, qualified majorities in both chambers of parliament can raise the expenditure ceiling.

While the debt brake is in principle an adequate instrument to stabilise the country's debt burden in absolute terms (which, with growing GDP, would result in a falling debt-to-GDP ratio), its implementation is not problem-free. Most importantly, there is always uncertainty attached to estimates of the economy's trend growth or, in other words, of how fast the economy would grow under 'normal' circumstances. This makes it difficult to assess the economy's exact position on the business cycle and, hence, to calculate the expenditure ceiling. The favourable economic situation since 2004 has masked this difficulty so far.

Following these achievements in recent years, fiscal policy is set to loosen somewhat in the near future. Part of the fiscal loosening will stem from large one-off expenditures outside the debt break in 2008, among them the creation of a new off-budget infrastructure fund. In addition, after the main focus of fiscal reform had hitherto been on the spending side, the authorities have started to streamline the revenue side. At the federal level, for example, the government is seeking to mitigate the tax burden on disbursed company profits and to streamline VAT. Meanwhile, many cantons have moved to cut tax rates following strong revenue performance,

debt reductions with proceeds from gold sales by the central bank and a new financial equalisation system among the cantons. While this is all in line with the goal of spurring Switzerland's long-term economic potential and need therefore not result in permanently lower revenues, the short-term effect of these measures will prove expansionary. Against this backdrop, we expect government consumption to accelerate somewhat, and, with economic growth slowing, the general government surplus to fall to 1.0% of GDP in 2008 and 0.5% in 2009.

Beyond these short-term projections, the government has launched a comprehensive review of its spending commitments. The main purpose of this review is to provide a framework for further adjustments needed to cope with the effects of an aging population. In contrast to the recent consolidation packages, which have consisted primarily of discretionary spending cuts, dealing with these effects will require more fundamental, structural changes. Switzerland's highly consensus-driven political system (see **Political System**) means that this will not be an easy task. In the past, even relatively moderate reform measures have been challenged and subjected to referendums (such as a reform of the disability-insurance scheme approved by parliament in mid-2006, which required approval in a referendum a year later).

Government Debt

At 47.4% of GDP in 2006 (the latest year for which reliable data are available), consolidated public debt (outstanding debt of the federal, the cantonal and the municipal governments) is less of a pressing a problem than it is in neighbouring France (64.2%), Germany (67.5%) and Italy (106.8%). Nevertheless, the 1990s in particular saw a worrying deterioration of public finances. Total public debt reached a high of CHF246.5bn in 2004, 2.5 times its level in 1990; in per capita terms, it had risen from CHF14,264 to CHF33,063 over the same period. Today, Switzerland spends around CHF7bn per year, or 7% of total tax revenue, on debt servicing. However, efforts to rein in expenditures at all levels of government and favourable economic conditions have alleviated the situation somewhat recently. For example, at the federal level, the sale of shares in Swisscom, the formerly state-owned telecoms supplier, generated extraordinary revenues of CHF3.2bn, which helped to reduce debt from a high of CHF130.4bn in 2005 to CHF123.6bn in 2006.

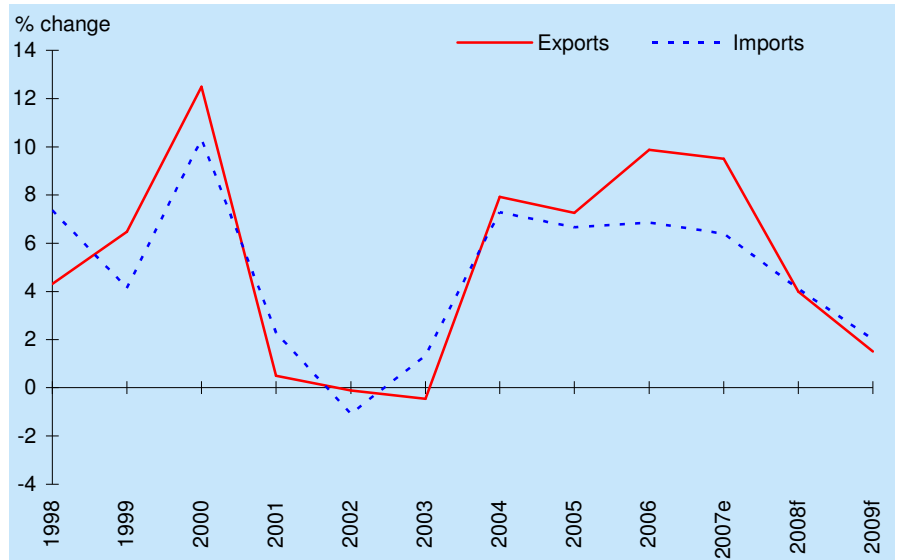
Net Exports

Together with gross fixed capital formation, a rebound in net exports initiated the recovery of the Swiss economy from 2004. After net exports had reduced real GDP growth by 0.7pp in 2003, they contributed an average 1.1pp during 2004-06. In 2007, an exceptionally successful year for Swiss exporters (see **Current Account**), the contribution increased to 2.2pp.

Due to the small size of the domestic market and the lack of raw materials, the economy is highly dependent on both exports and imports of goods and services. The high degree of openness of the Swiss economy is reflected in the fact that taken together, exports and imports of goods and services amounted to an estimated 102.4% of GDP in 2007. Growth rates of export and import volumes are highly volatile (fluctuating between -0.5% and 12.5% since 1998 in the case of exports) but despite this, net exports are regularly among the main drivers of real GDP growth.

We expect net exports to make a contribution of 0.4pp to real GDP growth in 2008 and to detract 0.1pp in 2009, as export growth falls from an estimated 9.5% in 2007 to 4.0% in 2008, and import growth slows from an estimated 6.4% in 2007 to 4.1% in 2008. Exports will suffer as a result of the expected slowdown in the global, and in particular the European, economy. Services exports could also suffer from an expected appreciation of the Swiss franc against the euro (see **Exchange Rate Risk**), while the effect of this on goods exports will likely be limited. Meanwhile, a cooling of both private consumption and investment will reduce import growth.

Chart 6

Export and Import Growth

Sources: State Secretariat for Economic Affairs; D&B

Monetary Environment

Monetary policy is conducted by the Swiss National Bank, one of the world's most independent central banks. The overall goal of monetary policy is to ensure price stability, which the central bank defines as an annual average CPI inflation rate below 2%. Based on a broad range of real and monetary indicators, the Swiss National Bank compiles quarterly inflation forecasts, against which it assesses the need for monetary policy action. The operational goal of monetary policy is set in the form of a 1 percentage point target range (e.g. 2.25-3.25% as currently) for the three-month Swiss franc London Interbank Offered Rate (LIBOR). To keep the LIBOR within the announced target range, the Swiss National Bank relies primarily on short-term repo transactions (in which commercial banks exchange securities for money for a specified period of time, after which they pay back the sum lent to them plus interest at the so-called repo rate; the higher the repo rate, the more expensive it is for commercial banks to borrow money and, hence, the tighter is monetary policy).

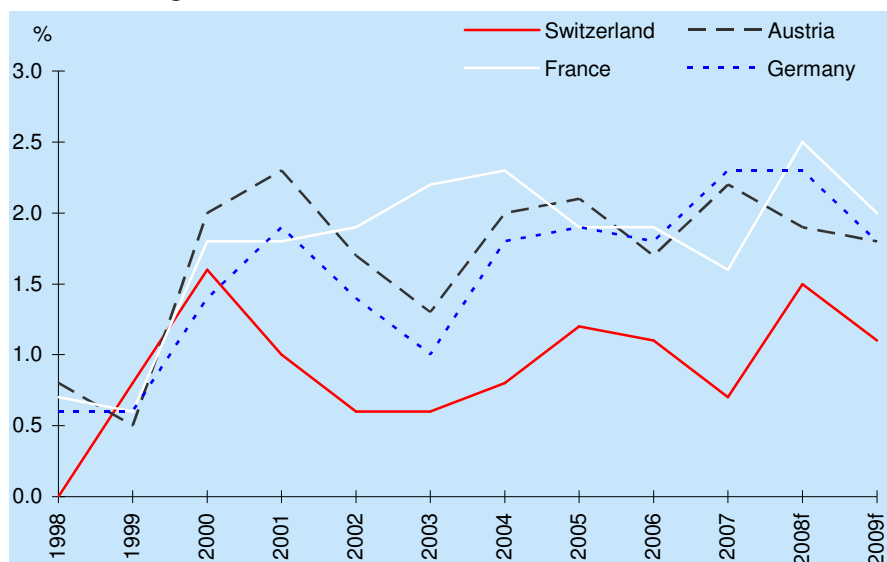
Inflation

A modest rise in inflationary pressures has accompanied the economic expansion since 2004, as real GDP growth has risen above the long-term output potential of the Swiss economy (see **Long-Term Economic Potential**). Other contributory factors include the global surge in oil prices in recent years and strong increases in food prices in 2007. However, the annual average CPI inflation rate has not threatened the Swiss National Bank's overall goal of price stability: it averaged 0.7% during 2004-06, and peaked at 1.2% in 2005. The inflation rate has also remained well below that of neighbouring Austria, France and Germany.

Factors accounting for traditionally low inflation rates include the high credibility of the central bank's monetary policy, which anchors inflation expectations effectively, and a flexible labour market, which contains wage pressure. In this context, the gradual introduction of the free movement of people between Switzerland and the EU (started in 2002 and completed in mid-2007 for 17 of the EU's 27 member states; see **Relations with the EU**) has been instrumental in containing inflation in recent years, as an influx of foreign workers has added to labour supply and mitigated wage pressures. Recently, increased competition in retail trade brought about by the entry of foreign supermarkets has also helped to quell inflationary pressures. Traditionally, the strength of the Swiss franc has also played its role, as a

stable currency limits inflation that stems from increases in the price of imported goods. That said, the franc has recently displayed a rather unusual spell of weakness vis-a-vis the euro in particular (see **Exchange Rate Risk**), although the impact of this on inflation has apparently been limited.

Chart 7

Annual Average Inflation

Sources: Swiss National Bank; Eurostat; D&B

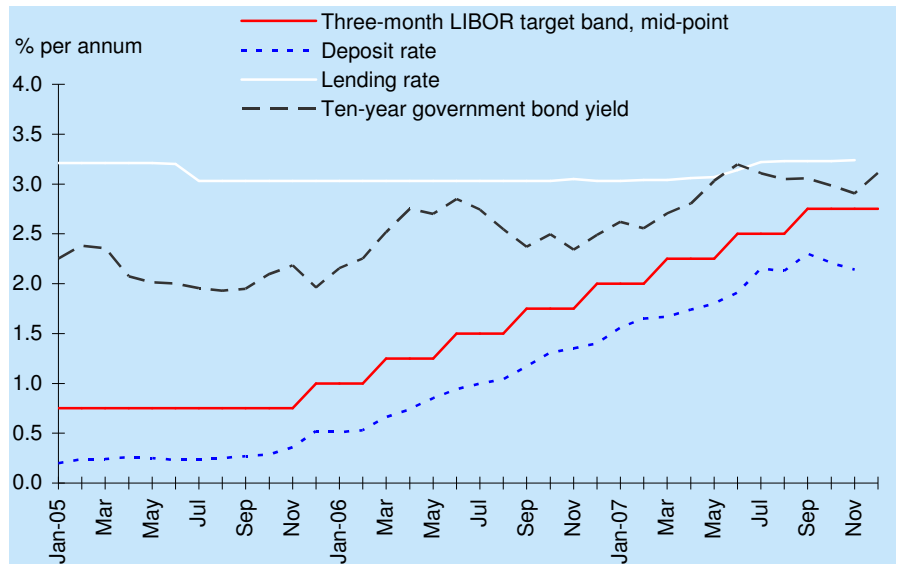
Based on the most recent inflation forecasts of the Swiss National Bank, we expect the annual average inflation rate to rise to 1.5% in 2008, before returning to 1.1% in 2009. The jump in the rate in 2008 will result from the sharp rises in oil and food prices in late 2007 (December saw the year-on-year inflation rate jump to 2.0%, the highest since July 1995), which will keep the CPI significantly above its year-earlier level during most of 2008. This could, at long last, be exacerbated by rising wage pressure, as wage growth has accelerated starting in 2007. At the same time, little suggests that inflation will stay at a higher level than in recent years: economic growth is moderating; the central bank has demonstrated its commitment to keeping inflation low; fiscal policy is tight; energy prices are unlikely to continue to rise at the pace of recent years; we expect the Swiss franc to appreciate somewhat against the euro; and the authorities plan to further increase competition in the domestic markets, which would exert downward pressure on prices in hitherto sheltered sectors.

Interest Rates

In order to contain inflationary pressures during the economic expansion since 2004, the Swiss National Bank has gradually tightened its monetary stance. From December 2005 to September 2007, the bank lifted its target band for the three-month Swiss franc LIBOR by 25 basis points at each of its eight quarterly rate-setting meetings. At the end of 2007, the band stood at 2.25-3.25, the highest since 2001, when Switzerland's last period of strong economic growth came to an end. This had a knock-on effect on the deposit rate, which rose from 0.5% at the end of 2005 to 2.3% in September 2007. The lending rate remained relatively stable at around 3% throughout this period. Meanwhile, the reaction of the yield on the ten-year government bond to the increase in short- and medium-term interest rates has been limited; among other things, this suggests that economic actors expect the projected increase in the inflation rate in 2008 to be temporary.

Chart 8

Interest Rates



Source: International Monetary Fund, *International Financial Statistics*; Swiss National Bank

The Swiss National Bank's determined tightening of monetary policy (even as late as September 2007, when other central banks started worrying about the stability of the financial sector) has demonstrated its commitment to price stability and led to a 'normalisation' of Swiss interest rates. While traditionally lower than in the EU, interest rates were until recently low even by Swiss standards. The virtual absence of inflation and related fears of a deflationary spiral prompted the Swiss National Bank to cut interest rates to record lows from 2001. Accordingly, the one-year real interest rate (the 12-month nominal interest rates minus the expected inflation rate over the same period) calculated by the Swiss National Bank was negative during 11 out of 12 quarters between 2002 and 2005 (put simply, this means that interest earned on deposits does not compensate for the loss of the deposited money's purchasing power, thus reducing the incentive to save, while it makes borrowing money cheaper). By Q2 2007, however, the one-year real interest rate calculated by the central bank had recovered to 1.75%, slightly above its historical average of 1.6%.

In early 2008, speculation grew that an imminent economic slowdown could soon lead the Swiss National Bank to cut interest rates. However, y/y inflation rates close to, or even above, the bank's ceiling of 2% and the danger that wage settlements could perpetuate stronger inflationary pressures make this unlikely in our view. The fact that interest rates were exceedingly low for some years and only recently returned to more 'normal' levels also suggests that the central bank will be in no hurry to cut interest rates. Therefore, we expect the bank to leave its target band for the three-month Swiss franc LIBOR unchanged at least until the second half of 2008.

Short-Term Economic Outlook

The economy recorded a fourth consecutive year of robust growth in 2007. Following an increase of 3.2% in 2006, we estimate that real GDP grew by 2.7% in 2007, still well above Switzerland's medium- to long-term growth potential. Despite this, the economic expansion has not come at the expense of price stability: the annual average CPI inflation rate only rose from 0.6% in 2003 (when real GDP contracted by 0.2%) to a high of 1.2% in 2005. By 2007, it had again fallen to 0.7%. Among the key factors limiting inflationary pressures are the overwhelming commitment of the central bank to price stability and a flexible labour market. In context, an influx of foreign workers, helped by the introduction of the principle of free movement of people with the EU, has been critical in containing wage pressures in recent years.

Generally speaking, the economy's continued strong performance in 2007 was better than expected. Going forward, we expect real GDP growth to slow to 1.9% in 2008 and 1.5% in 2009. The first factors to hit growth will be a slowdown of the global, notably European, economy; and, given the importance of the financial sector for the Swiss economy, the continuing jitters on international financial markets. On the demand side, this will show in a slowdown of net exports and gross fixed capital formation, two important drivers of growth in recent years. As sentiment worsens, private consumption will follow this trend in the course of 2008.

Table 3

Short-Term Economic Forecasts

<i>Forecast</i>	<i>2008f</i>	<i>2009f</i>
<i>Real growth rate (%):</i>		
Private consumption	1.8	1.0
Gross fixed capital formation	1.7	0.8
Government consumption	0.2	0.0
Exports	4.0	1.5
Imports	4.1	2.0
Real GDP	1.9	1.5
<i>Contribution to real GDP growth (percentage points):</i>		
Private consumption	1.1	0.6
Gross fixed capital formation	0.4	0.2
Change in inventories	0.1	0.8
Government consumption	0.0	0.0
Net exports	0.4	-0.1
Inflation, annual average (%)	1.5	1.1

Source: D&B

Meanwhile, we expect the inflation rate to jump to 1.5% in 2008, but to fall back to 1.1% in 2009. The jump in the rate in 2008 will result from the sharp rises in oil and food prices in late 2007, which will keep the CPI significantly above its year-earlier level during most of 2008. This could, at long last, be exacerbated by rising wage pressure, as wage growth has accelerated starting in 2007. Combined with the fact that interest rates were exceedingly low for some years and only recently returned to more 'normal' levels, this makes it unlikely that the central bank will cut interest rates at least until the second half of 2008. However, little suggests that inflation will stay at a higher level than in recent years.

Long-Term Economic Potential

At USD55,320 per capita, Switzerland's gross national income is among the highest in the world. The country also has an impressive record of low unemployment (see **Unemployment and the Labour Market**) and inflation (see **Inflation**), as well as one of the most robust external risk profiles in the world (see **External Economic Risk**).

However, growth of per capita income has lagged behind the OECD average for many years. Arguably the main reason for this has been a traditional lack of competition, caused by both the decentralised political system, which ensures that there are numerous obstacles to competition at the cantonal level; and Switzerland's decision to stay outside the EU, which has allowed various sectors to remain protected from competition. Limited competition, in turn, has resulted in:

- low productivity growth, with labour productivity growing more slowly during 1998-2005 even than in all OECD countries with higher initial productivity levels, according to a 2007 OECD report (large sectoral differences persist, and it is the most sheltered sectors, such as agriculture and construction, which drag down the overall level of productivity); and
- a notoriously high price level, with prices being around 20% higher than in EU member Luxembourg, which has an income level similar to that of Switzerland (the largest price differentials between Switzerland and the EU are in rents for housing, healthcare services and food, all of which are sectors with high trade barriers).

Positively, the government has started to address the problem by implementing policies to boost long-term economic growth (see **Policy Agenda**). Progress has been made in competition policy (Switzerland is a late starter in this area, introducing anti-trust legislation only in the mid-1990s). A revamped competition law came into force in June 2003, under which the Competition Commission (COMCO) won stronger powers to crack down on cartels and illegal monopolies, while a new regulatory framework for the electricity industry came into force at the beginning of 2008. However, the OECD warned in late 2007 that product market reform was still lagging compared with other member countries. In particular, it noted that the independence and resources of COMCO should be strengthened, and reinforced that products marketed in the EU should be allowed to enter Switzerland without having to comply with further technical requirements (the so-called 'Cassis de Dijon' principle, which is also advocated by the Swiss economy minister).

Meanwhile, enhanced economic integration both at the European and the global level (see **Relations with the EU** and **Trade Environment**) are in part intended to increase the exposure of the Swiss economy to foreign competition. The authorities have recognised that the main area of growth in international trade is the services sector; as such, trade integration is not so much about tariff reduction as about cross-border harmonisation of regulatory standards, which often constitute the highest practical barriers for trade in services. In this context, the agreement on the free movement of people between Switzerland and the EU should facilitate cross-border provision of services.

These encouraging developments notwithstanding, we estimate Switzerland's real GDP growth potential for 2008-17 at a comparatively low 1.5-2.0% per year. This reflects both the fact that raising productivity levels is a long-term process and that Swiss policy-making is slow and offers plenty of opportunities for vested interests to dilute policy proposals that would be detrimental to them (see **Political Environment**).

Population

The ageing of the Swiss population and already high employment rates corroborate the assessment that spurring productivity growth is critical for future growth prospects. The expected increase in the dependency ratio (the proportion of those aged 0-14 and over 64 to those aged 15-64) from its current 0.48 to 0.80 by 2050 is broadly similar to that in neighbouring countries. This will also put a considerable strain on Swiss public finances as social security expenditures rise. The Swiss system may be comparatively well-prepared to meet the costs of an ageing population, as a large part of old-age pension provision is achieved in the second pillar (i.e. privately funded schemes). However, funding pressures will still emerge and significant reforms to the basic, publicly financed pay-as-you-go old age-pension system are imperative. An overhaul of this system was rejected in a referendum in 2004, which has delayed a satisfactory resolution of the problem.

Employment rates in Switzerland are among the highest in the OECD (84.3% in 2006, compared with an OECD average of 67.7%), which is an important contributor to Switzerland's relatively high per capita income. However, high employment ratios hide the fact that part-time employment is widespread, particularly among women. Reducing tax disincentives for mothers to work, developing early childhood education and care and removing disincentives to the participation of older workers are among the solutions that have been suggested to improve the utilisation of labour and to spur growth.

Through the gradual introduction of the principle of free movement of people with the EU, Switzerland started to open its labour market in 2002 (the last restrictions vis-a-vis 17 of the EU's 27 member states fell in mid-2007). The Swiss economy is benefiting from this liberalisation as it both increases the supply of highly skilled labour, of which there are regular shortages in times of buoyant economic activity, and help to cap wage growth. This has already become evident in recent years, when an influx of foreign workers helped the Swiss economy to expand at a robust pace. The OECD has highlighted the role of immigration in boosting Switzerland's long-term economic potential and recommended a number of measures aimed at taking full advantage of the recent influx of foreign workers.

Technological Progress

With a highly skilled labour force and correspondingly high labour costs, the Swiss economy has specialised in high-tech activities with high value-added and low price elasticity, such as pharmaceuticals, precision instruments and sophisticated financial services. Several indicators underline Switzerland's status as one of the most technologically advanced countries in the world:

- the number of patents per capita is by far the highest in the OECD;
- R&D expenditure in relation to GDP is also high, particularly in industries that are exposed internationally; and
- IT penetration is high even by European standards, with the number of PCs per 1,000 people virtually double that of neighbouring countries.

Weaknesses include a gap between basic and applied research and an inefficient system of higher education (for example, participation in tertiary education is rather low, there is a perceived mismatch between what higher education offers and what the economy needs, and it takes too long to complete university studies). These weaknesses need to be tackled if Switzerland's high living standards are to be maintained, with a particular focus on boosting innovation by small- and medium-sized enterprises. However, the fact that innovation is already generally good further underlines the need for enhancing competition.

Investment

The share of gross fixed capital formation in the Swiss economy has been very stable at around one-fifth of GDP for many years (see **Gross Fixed Capital Formation**), which is high by international standards (in Germany, for example, investment accounts for around 17% of GDP). Going forward, this investment rate is unlikely to rise, as adding ever more capital to the already large capital stock of the Swiss economy does not promise high returns. The fact that national savings considerably exceed domestic investment and that companies prefer investing excess savings abroad testifies to this assessment. Heavy investment abroad, in turn, has resulted in significant foreign assets, and the income these assets generate regularly contribute to large surpluses on Switzerland's current account. The weak prospect of additional domestic investment again shows that raising productivity holds the key to enhancing the growth potential of the Swiss economy.

Long-Term Economic Outlook

While Switzerland remains one of the wealthiest countries in the world, growth of per capita income has been lagging behind the OECD average for many years. The prime reason for lacklustre economic performance has been poor productivity growth, which in turn stems from a lack of competition in the Swiss economy (productivity is lowest in sheltered sectors such as agriculture and construction).

Employment rates are already very high (although this hides the fact that part-time work is widespread), Switzerland is one of the most technologically advanced countries and further increasing the country's capital stock promises little gain, which leaves raising productivity as the only way to enhance the country's long-term economic growth potential. Enhancing this potential is imperative if the country is to preserve its high living standards and avoid a funding crisis in the social security system as the population ages.

Positively, the authorities have recognised the need for action and dismantling barriers to effective competition has clearly moved up the policy agenda; greater competition should in turn spur productivity growth. However, the Swiss political process is known to be extremely slow and gives vested interests ample opportunity to dilute policy proposals. As a result, we estimate Switzerland's real GDP growth potential for 2008-17 at a comparatively low 1.5-2.0% per year.

External Economic Risk

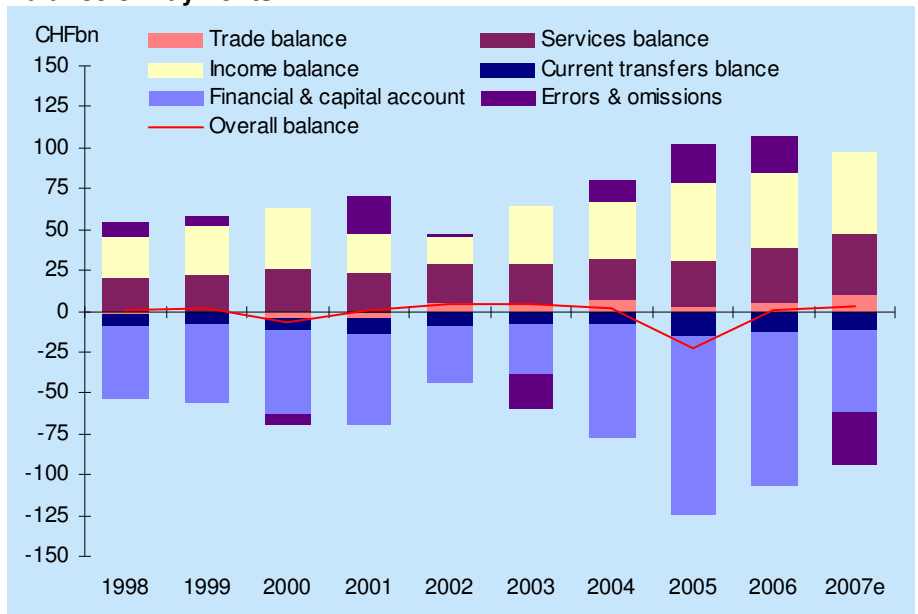
Key Point: Switzerland traditionally enjoys a very strong external position, reflected in a current account surplus of an estimated 16.5% of GDP in 2007 and large foreign assets. Meanwhile, we expect the Swiss franc to regain some of its strength against euro in the near future.

Balance of Payments Performance

Despite the lack of natural resources, Switzerland has traditionally enjoyed a highly favourable external position. We estimate that the country recorded a current account surplus of 16.5% of GDP in 2007 (with the current account comprising the trade, services, income and current transfers accounts).

Chart 9

Balance of Payments



Sources: Swiss National Bank; D&B

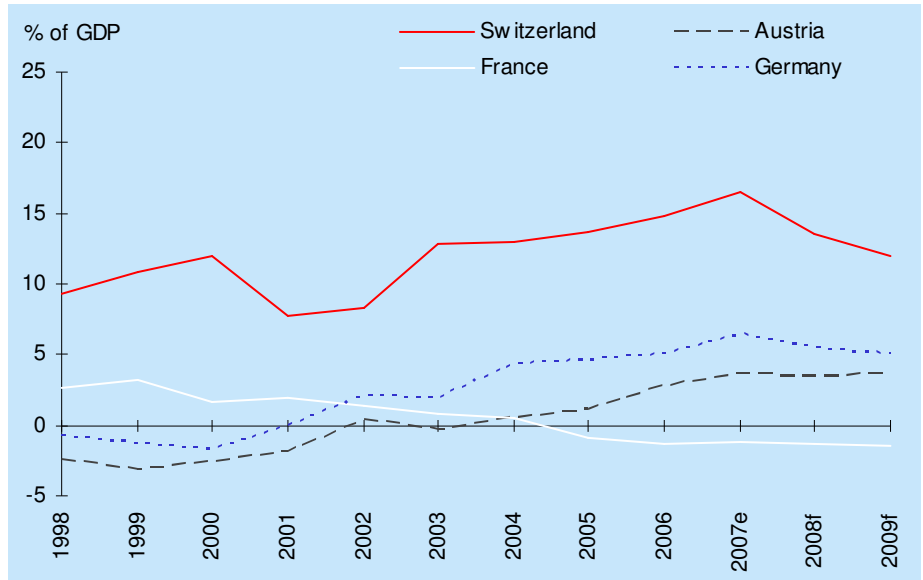
In many ways, Switzerland is the archetypical small open economy, while a history of prudent economic policy-making, political stability and neutrality has earned the country a reputation as a safe haven. Regular large current account surpluses are primarily the result of the strength of the services and the income accounts, although 2007 also saw a record trade surplus. In turn, the surplus on the income account reflects the profit generated by Switzerland's vast foreign assets. As such, it is linked to the large deficits on the financial and capital account that consistently accompany the current account surpluses, and which reflect the strength of outward investment by economic actors based in Switzerland. Going forward, we expect lower economic growth abroad (see **Global Economic Outlook**) and at home (see **Short-Term Economic Performance**) to bring an end to the steady increases in the current account surplus in recent years and to keep the financial and capital account deficit at the comparatively low 2007 level.

Current Account

Specialisation in high-value-added export products, competitive services and significant earnings generated by assets held abroad regularly result in large current account surpluses. As a percentage of GDP, the current account surplus increased

steadily from 8.3% in 2002 to an estimated 16.5% in 2007, an impressive figure indeed for a country with virtually no natural resources.

Chart 10

Current Account Balance

Sources: Organisation for Economic Co-operation & Development, *Economic Outlook*; D&B

Traditionally large current account surpluses reflect the strength of the services and the income accounts, although 2007 also saw a record trade surplus. The high degree of openness of the economy is underlined by the fact that imports and exports of goods and services together accounted for an estimated 102.4% of GDP in 2007. Going forward, we expect the current account surplus to decrease to 13.5% of GDP in 2008 and 12.0% of GDP in 2009, as a gradual slowdown of domestic (see **Short-Term Economic Performance**) and external economic growth will reduce export earnings and income generated by Switzerland's foreign assets.

Trade Account

Both imports and exports increased rapidly in recent years. Driven by strong demand in Europe, where Switzerland's main export markets are located, exports increased by an average 9.5% per year during 2004-06, peaking at 13.6% in 2006, the strongest export growth in 27 years. In the first nine months of 2007, exports were up by another 12.9% year on year (y/y); if this trend continued in Q4 2007, Switzerland experienced double-digit export growth for two consecutive years for the first time in more than 30 years. While these are nominal figures, export growth was still impressive in volume terms (see **Net Exports**). Meanwhile, strong domestic demand for both consumption and investment goods as well as the global surge in energy prices translated into average import growth of 9.6% during 2004-06, also peaking in 2006 (at 12.5%). During January-September 2007, imports grew by another 10.6%. Together, this resulted in trade surpluses between CHF3.0bn (2005) and around CHF10bn in 2007. The latter is the highest surplus on record and roughly twice the size of the CHF5.1bn surplus in 2006.

Although trade flows dominate the Swiss current account (in 2006, for example, goods exports generated 45.7% of total current account revenue), the contribution of the trade account to the current account surplus is modest. Higher trade surpluses are inhibited by the need to import commodities as well as a broad range of consumption and investment goods that would be too expensive to produce domestically. Going forward, export earnings will suffer from a slowdown of global, and particularly European economic growth. While cooling domestic demand and moderating oil prices will also reduce import growth, the trade surplus will fall in the near term.

Services, Income and Current Transfers Accounts

Large surpluses on the services and income accounts are the two key drivers of Switzerland's strong current account performance. The surplus on the services account reached around CHF37.0bn in 2007, up gradually from CHF24.0bn in both 2001 and 2002. Tourism, insurance products, transit trade, transport and technological services dominate the services account. Many of these services suffered when the technology boom came to an end at the beginning of the decade; they were also adversely affected by the 2001 terrorist attacks on the US. In recent years, they benefited from robust global growth, which, for example, has generated demand for sophisticated financial services and Swiss technological know-how and has made holidays in Switzerland affordable for more people. Tourism in particular has also benefited from the weakness of the Swiss franc against the euro in recent years, which has given Swiss tourist destinations a price advantage over regional competitors (particularly Austria). Accordingly, with the Swiss currency likely to appreciate somewhat against the euro (see **Exchange Rate Risk**) and economic growth slowing globally, Switzerland's services surplus will decrease going forward.

With Swiss investment abroad regularly exceeding foreign investment in Switzerland (see **Financial and Capital Account**), the country has built up vast foreign assets. As of Q3 2007, the country's net foreign assets stood at CHF668.7bn, equal to around 133% of the estimated 2007 GDP. The income generated by these assets account for the regular surpluses on Switzerland's income account. Following the end of the technology boom in the late 1990s, this surplus fell to CHF16.3bn in 2002, as corporate earnings plunged worldwide and Swiss shareholders received smaller dividend payments. However, driven by the recent global recovery, it rose to around CHF50bn in 2006. Since 2003, the income account has been the largest contributor to Switzerland's current account surplus.

Finally, the deficit on the current transfers account stood at an estimated CHF12.0bn in 2007, down from CHF12.9bn in 2006. The account persistently posts a shortfall as a result of remittances by foreign workers and a net outflow of insurance payments.

Export Profile

Generally speaking, the country exports goods that are relatively immune to fluctuations in price and exchange rates. The chemicals sector (including pharmaceuticals), which dominates the Swiss industrial sector, accounts for slightly more than one-third of total exports. However, investment goods (particularly machinery, equipment and electronics) also account for a significant share of exports (around one-fifth). This in part explains the Swiss economy's vulnerability to global economic downturns: investment tends to be the first area to be cut back when businesses face economic hardship.

Table 4

Principal Exports¹

% of total exports	2006	2007
Chemicals	35.5	35.3
Machinery, equipment & electronics	21.8	21.6
Watches	7.7	7.9
Metals	7.6	7.9
Precision instruments	7.3	7.0
Textiles, clothing & footwear	2.5	2.4

Note: ¹Data for 2007 are for January-November.

Source: Swiss National Bank

Over 60% of Swiss exports go to the EU, with Germany being the largest single export destination, purchasing around 20% of Swiss exports. The second most important export market is the US, the destination of about 10% of Swiss exports and closely followed by Italy and France.

Table 5
Exports by Destination¹

% of total exports	2006	2007
Germany	20.2	20.9
US	10.3	9.3
Italy	9.0	9.0
France	8.6	8.4
UK	4.7	4.8
Spain	3.9	3.8
Austria	3.3	3.2
Japan	3.6	3.1
Netherlands	3.4	3.1
China	2.1	2.4

Note: ¹Data for 2007 are for January-November.

Source: Swiss National Bank

Import Profile

Switzerland's main export products are also its main import products: chemicals and machinery, equipment and electronics account for nearly half of total imports, and precision instruments, watches and jewellery, for another 7%. This high degree of intra-industry trade is evidence of Switzerland's strong integration into the international, notably European, economy. Meanwhile, since the country does not manufacture cars, vehicles also account for a relatively large share of total imports.

Table 6
Principal Imports¹

% of total imports	2006	2007
Chemicals	21.6	22.6
Machinery, equipment & electronics	19.4	19.0
Vehicles	9.4	9.4
Precision instruments, watches & jewellery	7.4	7.4
Textiles, clothing & footwear	5.7	5.5

Note: ¹Data for 2007 are for January-November.

Source: Swiss National Bank

As a small country with virtually no raw materials, Switzerland is also dependent on imports of large quantities of raw materials, energy and foodstuffs. As a result, primary and semi-finished goods account for more than 25% of total imports, and energy resources, for another 7-8%. The largest category by use is consumer goods, which account for some 40% of total imports.

Similarly, Switzerland's principal export markets are also its main suppliers, with around 80% of imports originating in the EU. Again, Germany is the most important single market. Meanwhile, the high share of imports coming from the EU means that the US' significance as a supplier is somewhat smaller than its significance as an export destination. Overall, industrialised countries provide approximately 90% of Swiss imports, and Switzerland usually runs a trade deficit with this group of countries. Meanwhile, Switzerland buys far less from emerging, developing and transition countries than it sells there, an unusual feature for a rich Western European country. As a case in point, Switzerland consistently posts trade surpluses with OPEC, reflecting low energy intensity of the Swiss economy.

Table 7

Imports by Source¹

% of total imports	2006	2007
Germany	33.3	33.9
Italy	11.1	11.2
France	10.3	9.6
US	5.0	5.2
Netherlands	5.0	4.8
Austria	4.5	4.4
UK	3.6	3.9
Ireland	2.8	3.2
Belgium	3.1	2.9
China	2.4	2.6

Note: ¹Data for 2007 are for January-November.

Source: Swiss National Bank

Financial and Capital Account

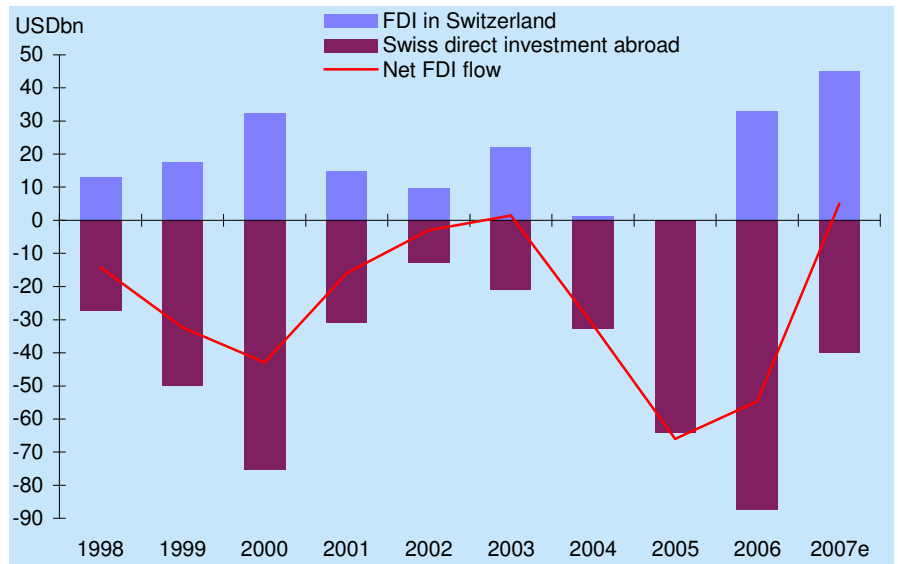
Switzerland's traditionally large current account surpluses (see **Current Account**) are matched by large deficits on the financial and capital account. We estimate that the deficit reached around CHF50.0bn in 2007, which is rather low compared with recent years: in 2005, the shortfall had reached a high of CHF109.4bn. Extensive cross-border investment flows are another sign of the openness of the Swiss economy. Illustrating this openness, as well as the attractiveness of Switzerland's business environment, is the fact that nearly 80% of the outward FDI stock of finance and holding companies is held by foreign-controlled companies.

From an accounting perspective, the surpluses on the current account and the deficit on the financial and capital account reflect excess national savings, which are invested abroad (in turn, this has enabled Switzerland to build up vast foreign assets, which have created a steady inflow of earnings and contribute to the surpluses on the current account). As one would expect, outward investment flows and the financial and capital account deficit generally increase at times of strong economic growth and decrease when economic activity cools. With both domestic (see **Short-Term Economic Performance**) and global (see **Global Economic Outlook**) economic growth set to moderate, we do therefore not expect the financial and capital account deficit to rebound significantly over the two-year forecast period.

Foreign Direct Investment Flows

Swiss direct investment abroad generally far exceeds inward FDI. The development of outward FDI also roughly reflects the business cycle: after a dip in 2001 and 2002, when the Swiss economy slid into recession, it climbed to a record CHF87.6bn in 2006, at the height of the country's recent economic expansion. We estimate that outward FDI fell back to around CHF40.0bn in 2007. In terms of countries, the bulk of Swiss FDI goes to the EU and the US. In 2006, 62.3% of Switzerland's outward FDI stock of CHF632.2bn was located in the two (with offshore financial centres accounting for another 17.9% of the capital stock). Within the EU, Germany, France, Luxembourg, the Netherlands and the UK have been the main recipients. In terms of sectors, 59.5% of the outward FDI stock was held by the services sector (within which finance and holding companies, banks, and insurance firms dominate), while chemicals and plastics companies accounted for a further 19.1%.

Chart 11

Direct Investment Flows

Sources: Swiss National Bank; D&B

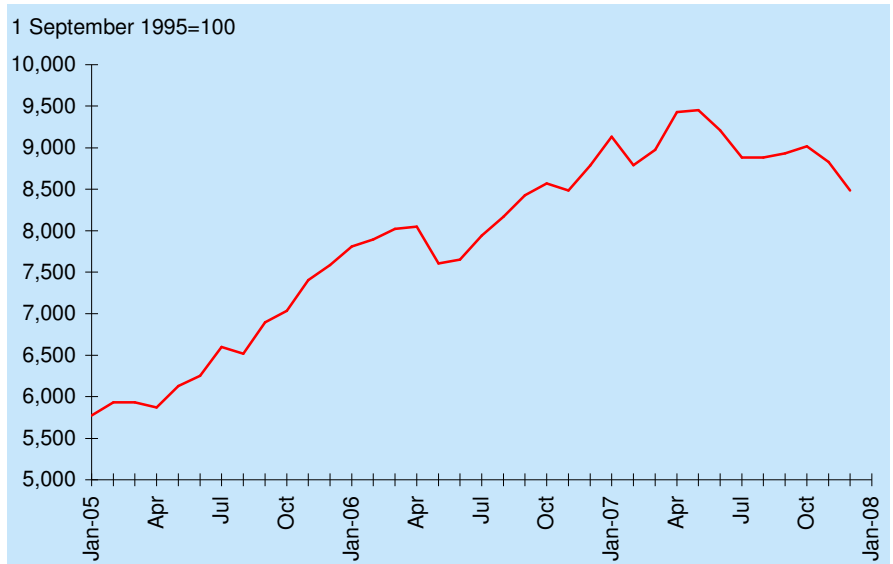
Meanwhile, the lack of significant natural resources, high labour costs and a low rate of return on investment in a country as capital-rich as Switzerland usually keep inward FDI low. That said, with the global economy growing strongly, 2006 and 2007 have witnessed a strong increase in FDI in Switzerland; this predominantly reflects acquisitions of stakes in Swiss companies by foreign entities and foreign businesses relocating or expanding to Switzerland. The geographic and sectoral distribution of inward FDI mirrors that of outward FDI: as of 2006, France, the Netherlands and the US held a combined 59.0% of Switzerland's stock of inward FDI (of CHF266.0bn), while finance and holding companies as well as insurance firms accounted for 80.8% of the stock of inward FDI.

Portfolio Investment Flows: Equities

Cross-border investment in equities resulted in deficits between CHF3.1bn (in 2002) and CHF22.1bn (in 2001) in recent years. In 2006, outward investment in equities of CHF17.5bn and inward investment of CHF0.7bn resulted in a deficit of CHF16.8bn. As with the overall financial and capital account, the picture changed somewhat in 2007, with outward investment falling to CHF5.0bn during the first nine months of the year. However, with foreign investors selling more Swiss equities than buying new ones, the country still recorded a deficit of CHF9.0bn during this period.

Meanwhile, the repeated jitters on international financial markets in 2007 and early 2008 have also brought an end to the strong performance of the Zurich-based SWX Swiss Exchange, Switzerland's main equity market, in recent years. At the end of January 2008, the Swiss Market Index (SMI), the main performance indicator of the exchange (see **Stock Market**), stood at 7,670 points, down from an all-time high of 9,548 in early June 2007 and taking the index back to where it had been in mid-2006; after increasing by 33.2% in 2005 and 15.8% in 2006, the SMI lost 3.4% in 2007. The strong performance of the exchange up to mid-2007 is also reflected in the steady increase in the capitalisation of the stocks included in the broader Swiss Performance Index (SPI) from CHF643.8bn at the end of 2002 to CHF1,337.5bn (2.7 times the estimated 2007 GDP) at end-May 2007. Given the continuing uncertainty on financial markets and slowing economic activity, it will be difficult for the SMI to recover the ground lost in recent months in the near future.

Chart 12
Swiss Market Index (SMI)

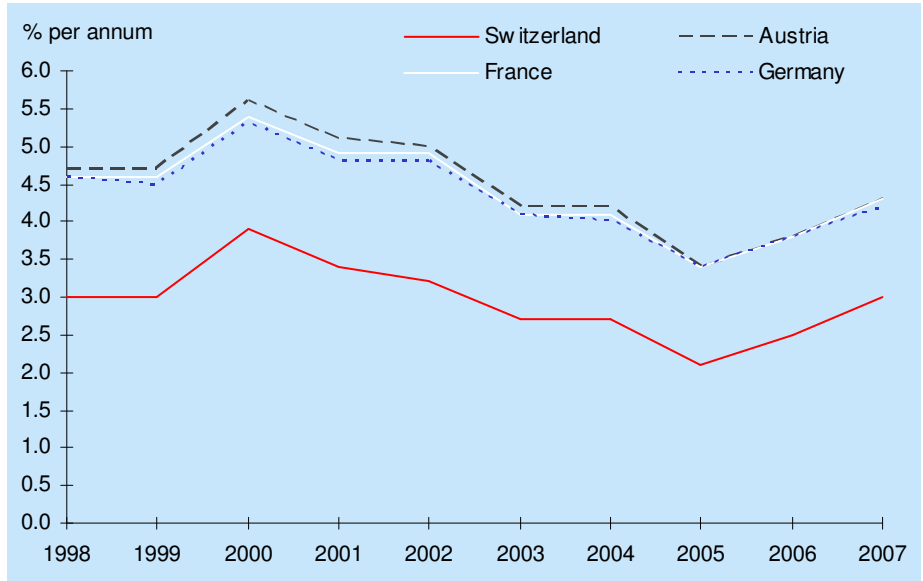


Source: SWX Swiss Exchange

Portfolio Investment Flows: Debt

For more than 20 years, Switzerland has incurred a deficit in cross-border investment in debt securities (of up to CHF47.0bn, in 2001). In 2006, outward investment amounted to CHF36.1bn, while inward investment was negative (meaning that fresh investment by foreigners did not compensate for their sales of Swiss securities). During the first nine months of 2007, outward investment in debt securities of CHF16.9bn still exceeded inward investment by no less than CHF16.1bn.

Chart 13
Ten-Year Benchmark Government Bond Yields



Source: Organisation for Economic Co-operation & Development, *Economic Outlook*

Domestic and foreign borrowers publicly issued Swiss franc-denominated bonds worth CHF80.6bn in 2007, down from a record CHF84.3bn in 2006. More than 70% of these were issued by foreign borrowers. Among domestic borrowers, mortgage bond institutions and banks accounted for around half of the bonds issued. Reflecting the good performance of the Swiss economy in recent years, redemptions by domestic borrowers exceeded their issues throughout 2005-07. Developments on the

sovereign bond market have also reflected efforts to put public finances back on a firm footing (see **Government Consumption**): the share of bonds issued by the federal, cantonal and municipal governments fell from 30.8% of total bonds publicly issued and denominated in Swiss francs in 2004 to 7.2% in 2006; and while net borrowing of the federal, cantonal and municipal governments amounted to CHF11.7bn in 2003, redemptions exceeded issues in 2006 and 2007. Due to the low risk involved in lending funds to the Swiss government, interest rates on long-term federal-government bonds have traditionally been below those in neighbouring EU countries.

Bank Lending

The state only borrows in domestic currency, which means that Switzerland's foreign debt overwhelmingly consists of banking sector liabilities stemming from financial transactions.

Table 8

Maturity and Sectoral Distribution of Bank Lending to Switzerland

USDbn	Jun-06	Dec-06	Jun-07
<i>Maturities:</i>			
Up to & including one year	459.5	416.1	547.8
Over one year & up to two years	5.8	15.5	18.4
Over two years	60.8	83.0	93.0
Unallocated	44.2	42.3	64.9
Total	570.3	556.9	724.2
<i>Sectors:</i>			
Banks	432.9	404.3	538.0
Public sector	21.3	20.3	21.7
Non-bank private sector	93.8	116.6	140.8
Unallocated	22.3	15.8	23.8
Total	570.3	556.9	724.2

Source: Bank for International Settlements

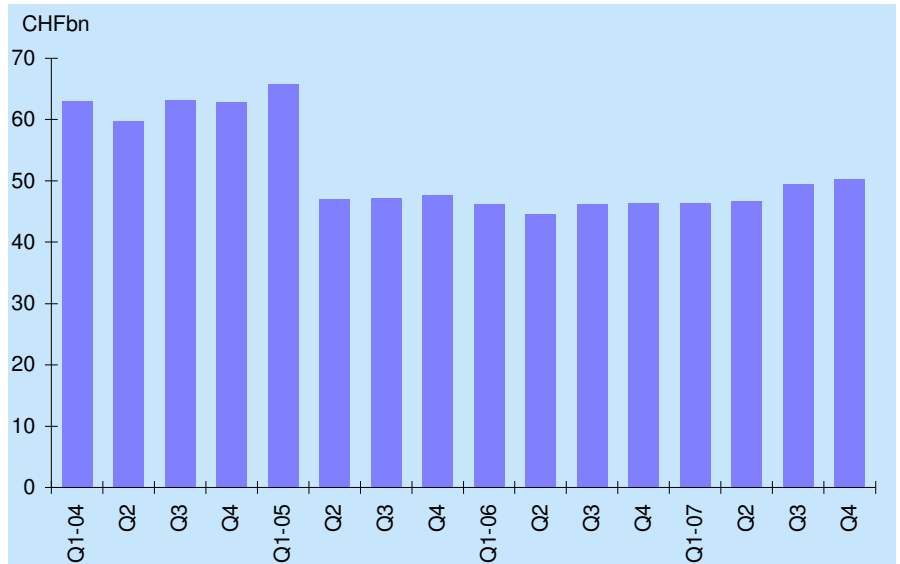
Foreign Debt and Default Risk

Since the state borrows only domestically, there is no public sector foreign debt and consequently no default risk. Switzerland enjoys prime sovereign credit ratings (applicable to its domestic debt). A widespread default of Swiss companies is also extremely unlikely, although the possibility of individual company defaults cannot be ruled out entirely (see **Credit Risk**).

Foreign Reserves

Foreign reserves (excluding gold) held by the Swiss authorities are highly stable: between Q2 2005 and the end of 2007, they stayed persistently within CHF44.5bn and CHF50.3bn. The increase in reserves up to Q1 2005 and the subsequent substantial drop were due to the sale of excess gold reserves held by the central bank and the distribution of the proceeds from the sales among the federal government and the cantons. For Q1 2008, we expect the foreign reserves to provide import cover of 2.3 months. Although below the 3.0-month minimum recommended by the IMF, this is still sufficient given Switzerland's low-risk status and export strength.

Chart 14
Foreign Reserves (Excluding Gold), End-Quarter

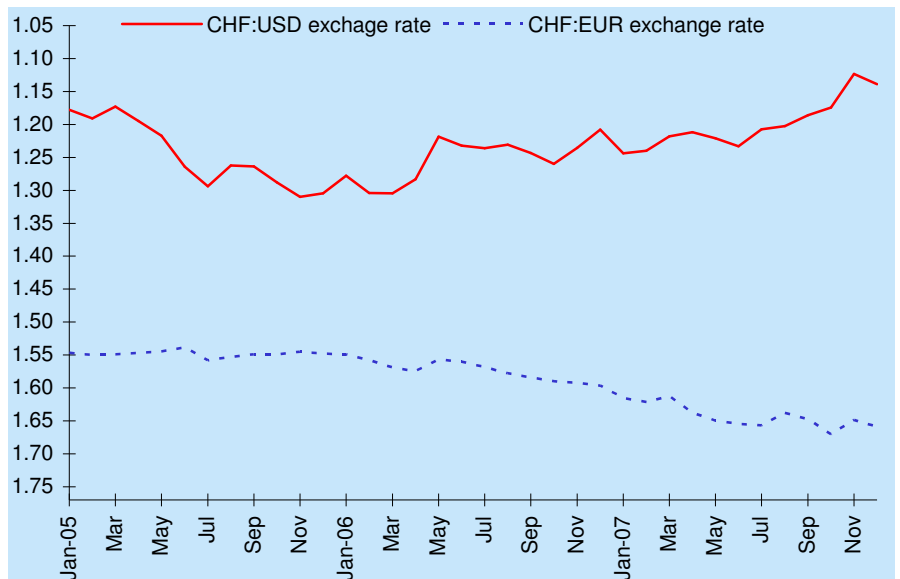


Source: Swiss National Bank

Exchange Rate Risk

The Swiss franc is allowed to float freely, which means that any intervention on the currency market on the part of the central bank is merely aimed at moderating exchange rate movements (rather than at maintaining the franc at a certain rate). The Swiss franc has traditionally fluctuated against the euro between CHF1.46:EUR and CHF1.67:EUR since the launch of the euro in 1999. However, since February 2006, the Swiss franc’s exchange rate against the euro has been weaker than the 1999-2007 average of CHF1.55:EUR, and the October 2007 value of CHF1.67:EUR was the weakest since the euro was introduced. At the same time, the present weakness of the US dollar has resulted in a steady appreciation of the Swiss franc against the US currency during 2006 and 2007. In November 2007, at CHF1.12:USD, the Swiss franc’s average monthly exchange rate against the US dollar reached its strongest level ever.

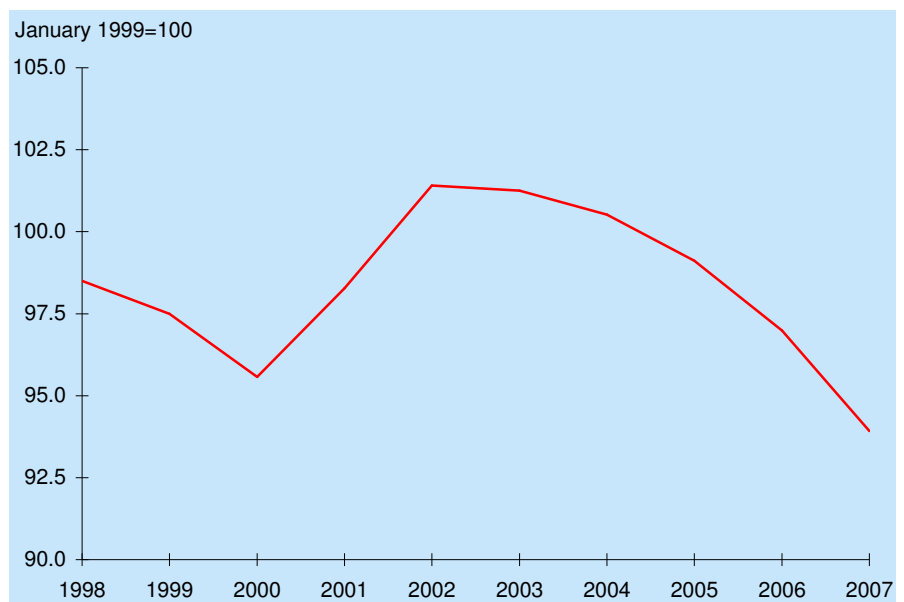
Chart 15
Swiss Franc Against the US Dollar and the Euro (Inverted Scale)



Source: Swiss National Bank

The recent weakness of the Swiss franc against the euro, as well as low inflation rates (see **Inflation**), have also been evident in the development of the real effective exchange rate (which takes into account inflation differentials between currencies and is weighted according to the different currencies' importance in Switzerland's foreign trade). After appreciating between 2000 and 2002, the Swiss franc's real effective exchange rate has steadily depreciated, with the index value falling from an annual average of 101.4 in 2002 to 93.9 in 2006. Positively, this real depreciation has made Swiss goods and services cheaper abroad, thus contributing to the strong performance of Switzerland's current account in recent years (see **Current Account**). That said, most of Switzerland's export products do not rely on price competitiveness, so that the downsides of continued real depreciation would outweigh its benefits over the medium to long term. Among the negative effects of continued real depreciation are upward pressures on the domestic price level as imports become more expensive and, particularly in the case of Switzerland, potential disadvantages for the financial sector, which relies on a stable currency.

Chart 16

Real Effective Exchange Rate

Source: Swiss National Bank

Going forward, we expect the Swiss franc to gain some of the ground lost against the euro. Given the large and increasing current account surpluses in recent years, which should have led to a strengthening of the domestic currency, the prolonged weakness of the Swiss franc has been a conundrum. One explanation is that favourable global economic conditions have dampened demand for the Swiss franc: international investors have been reducing holdings in Swiss francs and investing in currencies that yield higher interest. While exchange rate movements will equal out such disparities in the medium term, market participants are known to take advantage of such arbitrage opportunities in the short run, possibly prolonging the weakness of the Swiss franc. Accordingly, with global economic conditions becoming less favourable, the demand for safe assets in Swiss francs should now increase, causing the Swiss currency to appreciate somewhat. This has regularly happened at times of heightened economic uncertainty, as can be seen from the development of the real effective exchange rate over the past ten years (decreasing up to 2000 and increasing thereafter, following the collapse of the late 1990s technology bubble). In addition, Switzerland's external position will remain favourable over our forecast period. That said, since the euro has stabilised the European currency landscape and established itself as a global reserve currency, the reduction in the demand for the Swiss franc and its weakness could become more entrenched.

External Economic Risk Outlook

A virtuous circle of strong outward investment and high current account surpluses characterises Switzerland's favourable external economic risk outlook. With outward FDI and portfolio investment usually exceeding inward investment by far, the country has been able to build up vast foreign assets, which generate remitted earnings; this supports the large current account surpluses and allows for further investment abroad.

In 2007, favourable external conditions resulted in an estimated current account surplus of 16.5% of GDP, an impressive figure for a country with virtually no natural resources. Strong demand in the main export markets boosted the surpluses on the trade and the services account, while the strong performance of the world economy led to a further increase in the income generated by the country's foreign assets. A large deficit on the financial and capital account matched the current account surplus, although shortfall was much reduced from those in the previous two years. For 2008 and 2009, we expect the current account surplus to fall to around 13.5% and 12.0% of GDP as a result of a slowdown in the global economy in general and in Switzerland's main export markets in particular. Less favourable economic conditions will lead companies based in Switzerland to cut investment abroad and increase demand for traditionally safe assets in the country; as a result, we expect the financial and capital account deficit to remain at a comparatively low level.

Table 9

External Forecasts

<i>% of GDP</i>	<i>2008f</i>	<i>2009f</i>
Current account balance	13.5	12.0
Financial & capital account balance	-10.0	-9.0
Overall balance of payments	1.0	1.0
Import cover (months)	2.4	2.3

Source: D&B

Given the extraordinarily strong external position, the prolonged weakness of the Swiss franc against the euro has been hard to explain. Given the continuing robust economic fundamentals and increased uncertainty on financial markets, which will increase demand for a traditionally safe currency such as the Swiss franc, we expect the currency to appreciate somewhat vis-a-vis the euro in the near future. However, the increasing use of the euro (rather than the franc) as a reserve currency could entrench the weakness of the Swiss franc against the euro.

Trade Environment

Key Point: In line with its dependence on external markets, Switzerland operates a liberal trade regime: Switzerland has a close relation with the EU and in the wake of the stalled negotiations on free trade at a global level, the country is seeking a series of bilateral free-trade agreements.

Trade Overview

In line with its dependence on external markets, Switzerland has long operated a fairly liberal trade regime and has favoured the establishment of an encompassing set of rules on international trade under the framework of the WTO. In this context, one of Switzerland's major concerns is the strengthening of the rules on trade in services, which would benefit the country's financial sector in particular.

At the same time, Switzerland's reluctance to join the EU (see **Relations with the EU**) and the strong involvement of interest groups in the political process (see **Political Environment**) mean that trade policy is rather protectionist in some sectors, among them agriculture and pharmaceuticals. At the end of 2007, the government renewed its backing for the existing ban on the parallel import of goods protected by patents (with few exceptions). This ban is an example of the numerous barriers to competition that account for Switzerland's notoriously high price level and weak productivity growth (see **Long-Term Economic Potential**). The government justifies its position with reference to the importance of intellectual property rights protection for the innovation- and research-based domestic economy.

European Free Trade Association

Switzerland was a founding member of the European Free-Trade Association (EFTA), which was established in 1960. Currently, EFTA comprises just three other members: Iceland, Norway and Liechtenstein. While Liechtenstein forms a customs union with Switzerland (and also uses the Swiss franc as its currency), EFTA is not a customs union: members maintain their own external tariffs, and tariff duties have only been eliminated among member states on trade in industrial products. EFTA countries have free-trade agreements with a number of partners worldwide (among them the EU, Turkey and Israel), providing duty-free trade in industrial goods and certain farm and fishery products. Switzerland applies the preferential EU-EFTA terms when an importer from a member country makes a request on the import declaration and produces a certificate of origin.

Bilateral Treaties with the EU

While EFTA has lost most of its significance, ties with the EU have become closer over time (see **Relations with the EU**). Although formal membership of the Union is currently not under consideration, de facto Switzerland is nearly a member of the 27-nation bloc. Currently, there are 18 agreements of significance between the two sides. With respect to Switzerland's trade environment, the most important are:

- *Free-Trade Agreement:* The 1972 agreement dismantled tariff barriers (customs duties and quotas) in industrial trade. Since the agreement does not amount to a customs union, customs checks at border crossings are still carried out.
- *Insurance Agreement:* This 1989 agreement guarantees insurance companies from both contracting parties the freedom to establish operations in the territory of the other contracting party.
- *Free Movement of People:* The EU and Swiss labour markets are being progressively opened to Swiss and EU nationals respectively. Like the following five accords, free movement of people between Switzerland and the EU was

established as part of the first set of bilateral treaties, which were concluded in 1999 and came into force on 1 June 2002.

- *Civil Aviation:* The agreement defines the terms by which Swiss airlines will be allowed access to the deregulated European civil aviation market on a reciprocal basis (for example, the removal of ownership restrictions).
- *Overland Transport:* The accord includes provisions for a gradual opening by Switzerland and the EU of their respective road and rail transport markets, for both persons and goods, on a reciprocal basis. It provides for a transitional period for road traffic, with a definite arrangement to be in place by 2008.
- *Agriculture:* A number of tariff and non-tariff barriers have been lowered, improving the mutual market access. While free trade for cheese will be introduced five years after the date of entry into force, fresh meat, wheat and milk are excluded from the agreement.
- *Public Procurement:* The free access for EU firms to federal and cantonal public procurement markets guaranteed under WTO rules is extended to local authorities, the telecommunications and rail transport sectors and the procurements of private enterprises that operate on the basis of concessions or an exclusive right.
- *Technical Barriers to Trade:* The agreement calls for the mutual recognition of declarations of conformity (tests, certificates, product approvals etc.) for most industrial products. In most cases, a single test of conformity is now sufficient for commercialisation of the products in both signatories.
- *Processed Agricultural Goods:* This is the only agreement within the second set of bilateral treaties (which were concluded in 2004) that affects bilateral trade. Following up on the earlier agriculture agreement, the accord liberalised trade in processed agricultural products (e.g. chocolate, biscuits, soups, sauces, pasta).

Other Bilateral Accords

The government has announced that it will continue to focus its trade policy on the WTO (which has its headquarters in Switzerland), despite the gridlock in the Doha talks. However, in the meantime, Switzerland is seeking to boost trade relations by concluding bilateral trade agreements. Most notably, Switzerland is looking to reach agreements with the emerging markets of Brazil, Russia, India and China (the so-called BRIC) as well as Japan. Meanwhile, attempts at establishing a free-trade agreement with the US failed in early 2006, primarily over disagreements on trade in agriculture. However, the two countries decided in February 2006 to set up a joint Trade and Investment Co-operation Forum to strengthen bilateral ties and lay the foundation for a resumption of trade talks in the future.

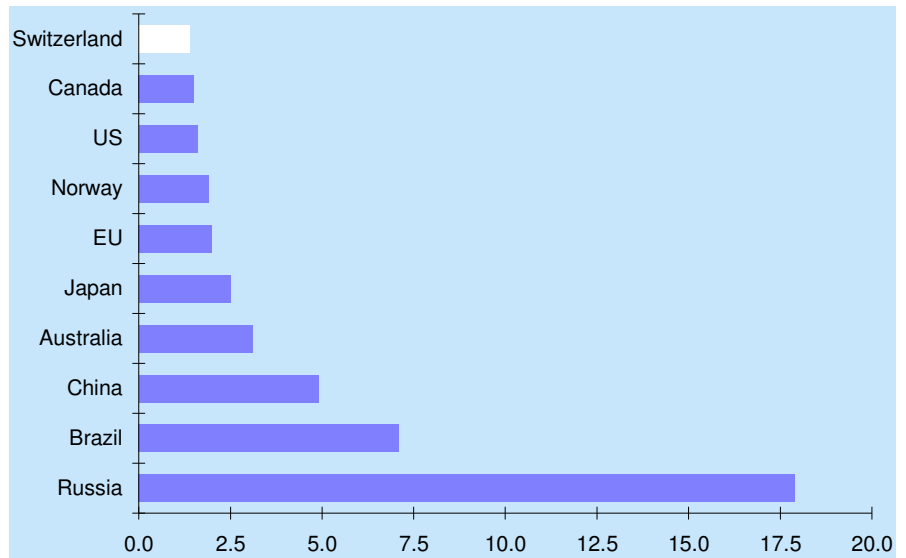
Current Account Exchange Regulations

From May 1992 Switzerland accepted the obligations of Article VIII, Sections 2, 3 and 4 of the IMF to refrain from imposing restrictions on the making of payments and transfers for current international transactions or from engaging in discriminatory currency arrangements or multiple currency practices without IMF approval.

Tariff Barriers

In general, duties are specific (based on the weight of goods), rather than ad valorem (based on their value). The customs duty varies according to the item imported. The Swiss customs tariff uses the Harmonised System for the numerical classification of goods. Switzerland has liberalised over 90% of its imports from WTO member countries, to which it extends most-favoured-nation tariff treatment. Import duties are generally low (under 3% for most raw materials and industrial products). Preferential duties are offered to a large number of developing countries. Switzerland has signed the Information Technology Agreement (ITA) under the WTO, which agreed to eliminate tariffs on IT products.

Chart 17

Weighted Mean Tariffs for All Products, 2005¹

Note: ¹The figure for Norway is for 2003.

Source: World Bank, *World Development Indicators*

Imports of agricultural products are subject to import and supplementary duties and tariff-rate quotas. While the average tariff on manufactured products is 2.3%, the average tariff on agricultural products is 34%. Supplementary duties are levied on cereals, potatoes, beer and certain other food products. In addition, Swiss regulations often allocate agricultural tariff-rate quotas to importers that have incentives to purchase domestic products. High tariffs and preferential tariff rates for other countries make Switzerland a relatively difficult market to enter for many foreign agricultural products, particularly from outside the EU.

There are monopoly duties on alcohol, products containing alcohol and certain ancillary items. Additional duties are charged on certain goods such as beer, grain used in the preparation of brewing malt, some alcoholic beverages (including wine), raw materials for distilling and motor fuels. Excise taxes are also charged on certain goods including cigarettes and liquor. In addition to customs duties, the Swiss customs administration levies a 3% statistical tax on the total customs duty payable. This fee is designed to cover the cost of preparing relevant foreign trade statistics.

Imports are also subject to VAT. The standard VAT rate is 7.5%, with a reduced rate of 2% for certain goods and services, including foodstuffs, agricultural products (meats, cereals, plants, seeds and flowers), medicine and drugs, newspapers, magazines, books and other printed materials (the same rates apply to domestically produced goods). The VAT is levied at the border; it is usually prepaid by the customs broker or freight forwarder who maintains an account with the Swiss Customs Administration.

Environmental taxes on imported items are collected by the importer or distributor and are known as 'prepaid elimination fees'. All environmental taxes are included in the final retail prices and, as a result, are paid by consumers. Environmental taxes are generally used to cover recycling costs and presently applied on automobiles, bottles and cans, office and consumer electronics, batteries and volatile organic compounds. Switzerland is an adherent to the conventions covering anti-dumping duties, subsidies and countervailing duties negotiated under the General Agreement on Tariffs & Trade (GATT) and now assumed by the WTO.

Non-Tariff Barriers*Licences and Quotas*

Import licences are required only for a limited number of products. These generally fall into two categories: measures to protect local agricultural production (often through quotas) and measures of state control. In order to protect the agricultural sector, Switzerland imposes licensing requirements and restrictions, including quotas, on agricultural imports.

Import licences are also required for certain products not subject to quotas, but covered by special regulations concerned with public health, plant health, quarantine (plants), veterinary regulations and regulations concerning the protection of species, safety measures, price control (for certain textile products) and measures for the protection of the Swiss economy and public morality. Applications to import products subject to this regime are considered individually by the departments responsible and within the limits of the quotas. Licences are issued only to persons and firms domiciled in Switzerland.

There are no specific deadlines for obtaining a licence. The validity period of a licence depends on the product. Extensions may be granted on a case-by-case basis. No tolerances are allowed over the value and quantity stated on the licence. Imports of diamonds are permitted only under the Kimberley Process Certification scheme.

Documentation

Following are the documentary requirements exporters must meet when shipping to Switzerland. The number of copies required follows below; in general, comply with importer's or shipper's instructions when additional copies are requested. Information in each document should correspond exactly to the details contained in other documents for the same shipment.

Notification via computer (Customs Model 90) and the authorised consignee procedure can benefit the import of all kinds of goods. This simplified import procedure also accelerates clearance, even with large consignments. The importer uses a computer file that includes all customs codes. The customs data (for customs documents and trade statistics) is entered at source.

Bill of Lading: No special requirements. 'To order' bills of lading are usually acceptable. Mail and parcel post shipments require postal documentation in place of bills of lading; air cargo shipments require airway bills in place of bills of lading.

Certificate of Origin: Shipments of certain wines, whisky, brandy and seed potatoes require a certificate of origin in duplicate (as well as a commercial invoice in duplicate). No special form of origin certificate is required; the general form, as sold by commercial stationers, is acceptable. However, origin certificates must be certified by a chamber of commerce, which will want to retain an additional notarised copy. An importer may occasionally request certificates of origin for other goods. Special certificate of origin (Form A) requirements obtain with regard to shipments from developing countries eligible for preferential rates of customs duties. Imports from the EU and the European Economic Area must be covered by a document of origin in order to get preferential rates of customs duties. Special wines of high alcoholic content, sweet wines and liqueurs require the certificate of origin in order to be admitted at preferred duty rates. Documents should show the exact name of the beverage, the brand name, any marking, and the place of production or manufacture.

Commercial Invoice: These are required in triplicate. The following information is required by the consignee for declaration of the shipment and should be furnished, accordingly, in the commercial invoice or other document: description of goods; gross and net weight; quantity in pieces or litres or other metric unit; description of packing; marks; numbers; number of packages. The market value of merchandise prevailing in the place of shipment should be declared, as well as all additional costs of transportation and insurance to the Swiss frontier. The commercial invoice should give the origin of the goods and must be signed by a responsible member or representative of the exporting firm.

Insurance Certificate: Normal commercial practices obtain. Follow instructions of importer and/or insurance company.

Packing List: No known special requirements. If used, data contained in this document must agree with data in other documents.

Preshipment Inspection: No known government requirement. May be requested by importer.

Pro-Forma Invoice: This may be requested by the importer (e.g. as an opening step in negotiating an import contract). When requested, follow importer's instructions. The pro-forma should nevertheless contain the correct market value.

Alcohol Shipments: Shipments of brandy must be accompanied by an official certificate attesting that the product consists of natural brandy made from wine. Whiskey has to be covered by certificates of origin that note the age of the whiskey.

Diamonds: Switzerland is a participant of the Kimberley Process and requires a Kimberly Process Certificate to accompany any shipment of rough diamonds.

Endangered Species: The convention on international trade in endangered species of wild fauna and flora (CITES) makes such shipments subject to special import restrictions.

Health Requirements: Certain types of fresh fruits and vegetables, living plants and seeds must be accompanied by a sanitary certificate in accordance with the Plant Protection Convention of the UN. Imports of foodstuffs and beverages are subject to regulations of the Federal Office for Public Health and the Veterinary Office. There are strict regulations pertaining to residues of chemicals on imported fruits and vegetables. Comprehensive requirements apply to the use of additives in foodstuffs. Live animals, meat and meat products, game, eggs for hatching, bees, and shellfish and some fish products must be accompanied by a health certificate. Imports of fresh and frozen meat, poultry and fish are regulated by the Federal Veterinary Office.

Wood Imports: Special documentary requirements, plus prohibitions in some cases, apply to wood products (requirements and prohibitions vary by country of export).

Consular Fees: No general requirement to have documents legalised. If requested to legalise a shipping or legal document, Swiss officials will usually do so at no cost or for a nominal sum. Check policy of office used regarding this matter.

Commercial Risk

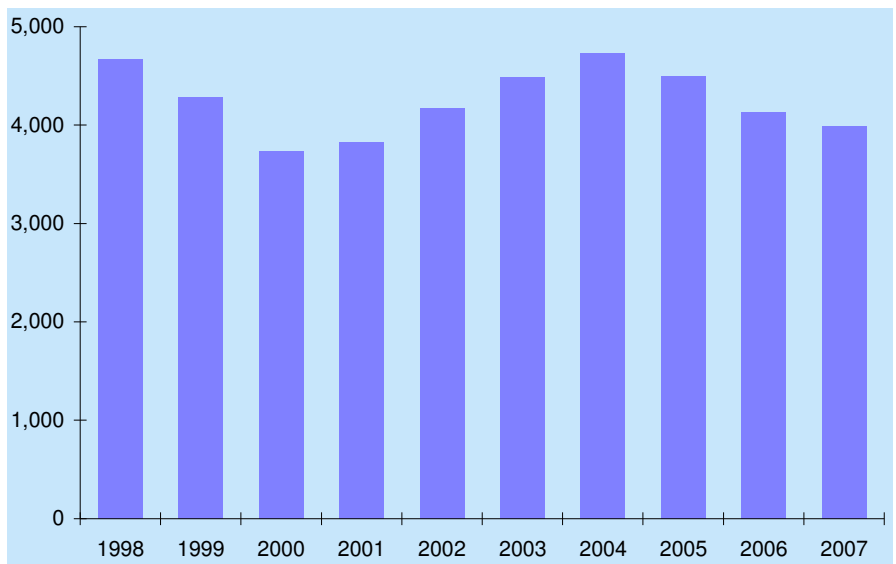
Key Point: Commercial risk is low, although slowing economic growth will adversely affect credit risk in the near future.

Credit Risk

Switzerland's economic prosperity has traditionally ensured low levels of credit risk by international standards. This is true not only with respect to the country's impressive roster of multinational corporations (including two of Europe's top pharmaceutical companies, Roche and Novartis, the bio-technology giant Serono and the world's largest food company, Nestle), but also in dealing with the numerous small- and medium-sized enterprises that form the backbone of the domestic economy and dominate sectors such as manufacturing and retail trade. Moreover, the economic recovery underway since 2004 has further mitigated credit risk, as reflected in the number of business failures: in the wake of the technology boom of the late 1990s, bankruptcies of businesses registered with the Federal Commercial Registry rose to a high of 4,729 in 2004, but subsequently declined to 3,991 in 2007.

Chart 18

Business Failures



Source: D&B

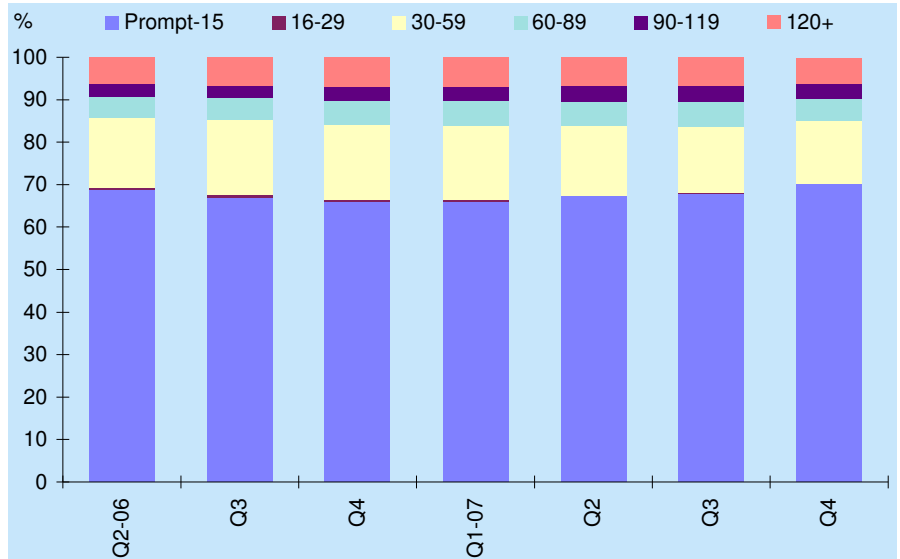
However, three caveats are in place. Firstly, Switzerland has a strong attachment to secrecy when it comes to financial matters. As a result, corporate governance and accounting are less transparent than modern international standards would dictate. Smaller companies are often reluctant to disclose their trading position, so a degree of caution is recommended when taking on new business partners. Secondly, bankruptcy procedures are comparatively weak. According to the World Bank's *Doing Business* database, it takes 3.0 years to resolve failing businesses (compared with an OECD average of 1.3 years). At 4.0% of the value of the estate, the cost of the process may be somewhat lower than in other OECD countries (7.5% on average), but at 47.1%, the recovery rate is poorer than the OECD average (74.1%). Thirdly, with economic growth slowing (see **Short-Term Economic Performance**), credit risk is set to increase in the near future. Creditors have already complained about declining payment discipline and demanded an increase in the interest rate that can be applied on overdue payments (currently 5%).

Payments Experience

According to D&B data, 70.2% of payments made to US shippers arrived promptly or no more than 15 days beyond terms in Q4 2007. While Switzerland compares favourably in Western Europe in terms of payments arriving 30 or more days late (29.6% of total payments in Q4 2007), the share of payments made 120 or more days late (6.1% in Q4 2007) is high by regional standards.

Chart 19

Switzerland's Payments Performance



Source: D&B

Swiss law allows for the application of an interest rate of 5% per year on overdue payments, applicable from the date the payment falls due. A higher interest rate can be agreed, with the top permitted rate being 15% per year.

Usual Terms: Liberal trading terms are the norm, and D&B recommends OA on most business dealings with Switzerland.

Usual Terms	
Minimum Terms:	OA
Recommended Terms:	OA
Usual Terms:	0-30 days

Transfer Situation: Transfer risk is minimal, as Switzerland is highly solvent and many large businesses deal in euros. Import cover is somewhat below the three-month minimum recommended by the IMF but still sufficient given Switzerland's low-risk status and export strength. Moreover, Switzerland is a net creditor to the world and would have ready access to international finance.

Transfer Situation	
Local Delays:	0-1 month
FX/Bank Delays:	0-1 month
Import Cover:	2.3 months

Export Credit Agencies: Owing to the country's high degree of political and economic stability as well as its sound commercial environment, full cover is readily available when exporting to Switzerland.

Export Credit Agencies

US Eximbank	Full cover available
Atradius	Full cover available
ECGD	Full cover available
Euler Hermes UK	Full short-term cover available

Financial Sector Risk

The Swiss financial sector is highly developed, which is reflected in both the sector's size and its low-risk profile. Among the factors accounting for the attractiveness of Switzerland as a financial centre are the country's history of peace and political stability (which is in sharp contrast with the rather turbulent 20th century experienced by its four neighbours Austria, France, Germany and Italy, with which the Swiss share common languages) and its tradition of banking secrecy (see box). Within Switzerland's financial sector, banks dominate: in the recent past, the banking sector has regularly generated around 9% of GDP, compared with around 4% for the insurance sector; and in Q3 2007, more than 130,000 of the financial sector's 212,000 employees worked in credit institutions. By the end of 2006, the total assets of Swiss banks exceeded CHF4,500bn, nearly ten times the country's GDP (the highest asset-to-GDP ratio worldwide, followed by 5.3 for Belgium). Nearly four-fifths of these assets were held by the two largest banks, UBS and Credit Suisse, which are the only significant international players among the Swiss banks.

Table 10

Top Ten Swiss Banks by Tier One Capital, End-2006

Bank	Tier One Capital (USDbn)	Total Assets (USDbn)	Capital-Assets Ratio (%)	Pre-tax Profit/Loss (USDm)	Return on Assets (%)
UBS	33.2	1,963.9	1.7	12,019	0.6
Credit Suisse Group	28.8	1,029.2	2.8	11,718	1.1
EFG Bank European Financial Group	6.4	83.5	7.7	1,269	1.5
Raiffeisenbanken-Verband ¹	4.5	82.3	5.5	591	0.7
Zurcher Kantonalbank ¹	4.1	65.4	6.2	617	0.9
HSBC Private Bank Holdings (Suisse) ¹	3.9	61.1	6.3	782	1.3
Banque Cantonale Vaudoise ¹	2.4	26.5	9.0	288	1.1
Basler Kantonalbank	2.0	21.0	9.4	262	1.2
EFG International	1.9	13.0	14.4	213	1.6
Julius Baer Group	1.8	29.5	6.1	927	3.1

Note: ¹End-2005Source: *The Banker*

The repeated jitters on global financial markets in 2007 and early 2008 are unlikely to endanger the stability of Switzerland's financial sector. After some of the most famous banks and insurers had announced big losses in 2002, restructuring efforts and favourable economic conditions have resulted in a steady improvement in the sector's risk profile. In 2006, net profits in the banking sector rose to a record CHF30bn, up 13% over 2005, and return on equity for the sector as a whole stood at a healthy 17%. While conditions on financial markets have become much less favourable recently, it is worthy of note that only UBS and Credit Suisse, as well as re-insurance company Swiss Re, have suffered severely from the US subprime mortgage crisis; UBS incurred a loss of CHF4.4bn in 2007, the first loss in the bank's ten-year history, while Credit Suisse had to write off CHF3.1bn in mid-February 2008. Crucially, the two banks' aggressive lending policies on foreign markets had been of concern to the Swiss National Bank, the central bank, for some time. But while these companies are in a position to absorb such shocks, other banks have had virtually no exposure to subprime assets and in some cases even managed to boost their profits in 2007. In addition, stress tests conducted by the Swiss

National Bank and the IMF found the financial system resilient to significant shocks. However, given the importance of the financial sector for Switzerland's economy, the repeated turbulence on financial markets is having a negative effect on short-term growth prospects. For example, Credit Suisse announced that it would cut 500 jobs even before the CHF3.1bn write-off (see **Short-Term Economic Performance**).

Banking Secrecy and Taxation of Savings

Dating back to the Middle Ages and first codified in a 1934 law, banking secrecy is both a central tenet of the Swiss financial sector and a source of irritation to many. In order to combat tax avoidance by its residents, the EU has targeted banking secrecy laws within individual member states as well as in neighbouring locations, including Switzerland. However, as part of a second set of bilateral treaties with the EU (see **Relations with the EU**), and following intense lobbying by the domestic banking sector, Switzerland's principle of banking secrecy has been respected in an international accord for the first time ever.

Instead, Switzerland has undertaken to tax all income from savings deposited in the country by natural persons with tax residency in an EU member state. This withholding tax started at a rate of 15% in July 2005 and is to increase to 35% (equal to the domestic withholding tax rate) by 2011. Switzerland passes on 75% of the revenues from the withholding tax to the countries of residence of the account holders (without revealing their identities) and retains 25% to cover the cost of collecting the tax. The account holder can avoid the withholding tax by disclosing the amount of interest received to the tax authorities of their country of residence. However, there is no automatic exchange of information between tax authorities.

The health of insurance companies and private pension funds (the second pillar of the pension system, the first pillar being a publicly financed pay-as-you-go scheme) has also improved, in part thanks to the strong performance of equity markets. However, despite improved risk management, higher premiums and restructuring, life insurance firms' reserves remain slim. Similarly, partial under-funding and weak supervision of private pension funds continue to cause concern. In 2005, a reform package aimed at tackling the problems that have been plaguing the private pension funds and increasing the sustainability of the system came into force. Among other things, workers' and employers' contributions have been raised, and the rate for calculating payouts at retirement will be progressively reduced until 2015. In 2006, the government announced its intention to cut the rate even further in order to account for changing market and demographic conditions. Unsurprisingly, the announcement has met with criticism from labour unions and the Social Democratic Party (SP).

The authorities have sought to strengthen financial sector supervision in recent years, a task made necessary by the growing importance of hedge funds, private equity leverage and derivatives trading:

- in 2004, a revised Banking Act brought the supervision, reorganisation and liquidation of banks under the sole responsibility of the Swiss Federal Banking Commission (formerly shared with the Federal Office for Private Insurance);
- since 2005, external auditors of banks and brokers have been required to prepare risk analysis and audit reports;
- a revised Insurance Supervision Act has been adopted that is aligning Swiss legislation with EU directives by 2010; and
- in January 2007, the new Basel II capital adequacy rules for the financial sector came into force.

All of these measures, as well as efforts to enhance cross-border collaboration with foreign supervisors, should help to guard against an increase in financial sector risk going forward. In order to further strengthen the regulatory framework and to make better use of synergies, the supervision of banking, insurance, securities and anti-

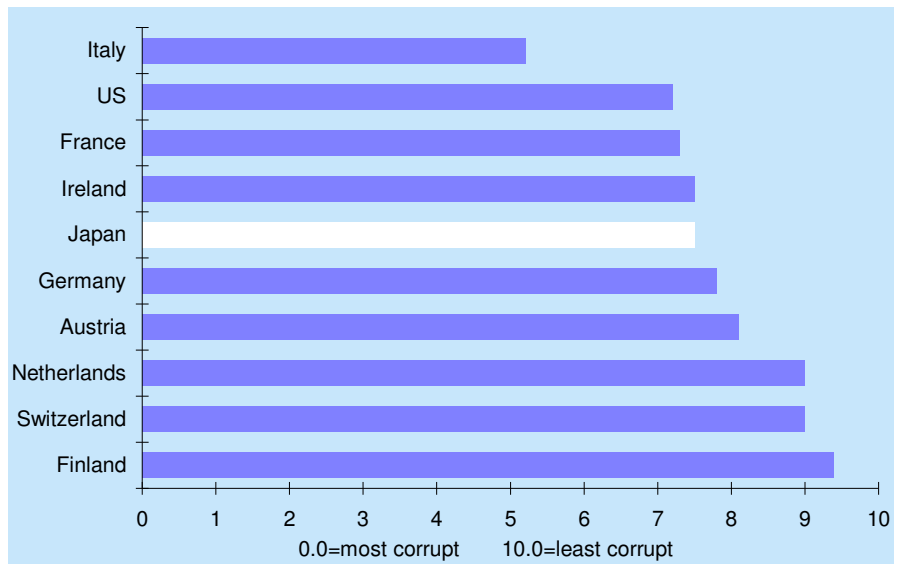
money laundering will be brought together under a new Financial Market Supervisory Authority (FINMA). However, the supervisory competencies of this new authority, which will become operational in 2009, do not extend to private pension funds, which are arguably the financial institutions most in need of improved supervision.

Corruption

Levels of corruption are low. In Transparency International's 2007 *Corruption Perceptions Index*, Switzerland scored 9.0 (where 0.0 represents the highest perceived level of corruption and 10.0 the lowest). As such, it was outperformed only by Denmark, Finland, New Zealand (all 9.4), Singapore, Sweden (both 9.3) and Iceland (9.2), ranking a joint seven (with Netherlands) out of 180 countries included in the survey.

Chart 20

Corruption Perceptions for Selected Countries, 2007



Source: Transparency International, *Corruption Perceptions Index*

Other Commercial Risks

Switzerland boasts a long tradition of having a well-functioning legal system, free private enterprise and secure property rights. The country upholds intellectual property rights and is a member of all major international conventions in this area. Patent protection is comparable with that of the US and is applied to foreigners and nationals alike. Due to the importance of R&D activities to its chemical and pharmaceutical industry, Switzerland was a strong advocate of the agreement on Trade-Related Intellectual Property Rights (TRIPs) in the Uruguay-round negotiations on trade liberalisation under what is now the WTO. Switzerland is a member of the European Patent Convention and the Patent Co-operation Treaty, which means that inventors can file for a patent in the US and also receive protection in Switzerland.

Commercial Risk Outlook

Commercial risk is minimal. Four years of steady economic expansion have reduced credit risk, as shown by falling bankruptcy figures, and financial sector risk. Stress tests conducted by the central bank and the IMF found the financial system resilient to significant shocks, while the fallout from the turbulence on financial markets has been limited to a small number of global players. Moreover, Switzerland is considered one of the best-performing countries in terms of corruption, while a well-functioning legal system and strong respect for intellectual property rights further mitigate commercial risk.

That said, a close attachment to secrecy in financial matters warrants a degree of caution when taking on new business partners. Corporate governance and accounting are less transparent than modern international standards would dictate. In addition, bankruptcy procedures are lengthier and less efficient than the OECD average.

Investment Environment

Key Point: While Switzerland has long offered an attractive investment environment, recent efforts to tackle some of the structural weaknesses have further boosted international competitiveness.

Investment Overview

Switzerland benefits from a very favourable investment environment and has a number of other attractive attributes. It is located at the centre of Europe and enjoys excellent communication links with neighbouring countries. In bio-technology, it operates one of the most liberal legal regimes, after Swiss voters approved a relaxation of restrictions on stem-cell research in a referendum in late 2004. Other traditional advantages include political and macroeconomic stability, peaceful labour relations (see **Labour Relations**), a highly skilled, hard-working and multilingual workforce, low taxes, an efficient capital market with a low cost of capital (see **Interest Rates**), a generally efficient bureaucracy, and low levels of corruption (see **Corruption**).

Among the disadvantages are high labour costs and prices, low productivity growth (see **Long-Term Economic Potential**), regulatory differences vis-a-vis its surrounding countries (since Switzerland is not a member of the EU) and relatively weak disclosure requirements for companies, reflecting an attachment to secrecy in financial matters. Arguably the most important drawback is a traditionally weak competition culture. The lack of competition in some sectors has both contributed to a high price level and made it hard to achieve productivity gains and stronger growth. However, competition has featured more prominently on the policy agenda in recent years (see **Political Environment**).

The favourable investment environment has long been reflected in strong rankings in cross-country comparisons of competitiveness, while efforts to tackle some of the structural weaknesses have led to further improvements in such surveys. In September 2006, for instance, the World Economic Forum's *Global Competitiveness Report 2006-07* (which looks at institutions, infrastructure, the macroeconomy, health and primary education, higher education and training, market efficiency, technological readiness, business sophistication, and innovation) ranked Switzerland the world's most competitive economy (up from fourth in 2005), with a score of 5.8 out of a possible 7.0. In the report a year later, Switzerland came second only to the US, with a score of 5.6. In the World Bank's *Doing Business 2008* report, Switzerland ranked 16 out of 178 countries in the overall ease of doing business. According to the survey, the investment environment is particularly favourable when it comes to registering property (rank 12) and paying taxes (15), while weak disclosure requirements mean that Switzerland compares less favourably in terms of protecting investors (158).

Capital Account Exchange Regulations

The Swiss National Bank, the country's central bank, is the advisory and executive authority in FX matters. There are no restrictions on transfer of investment income, royalties and repatriation of capital. No Swiss government policies or laws exist that would regulate or limit the inflow or outflow of capital. FX markets are free and access to FX is uncontrolled.

Foreign Direct Investment Environment

The federal government welcomes foreign investors, but does not directly encourage them by offering incentives. Instead, it confines itself to creating and maintaining

favourable business conditions for both Swiss and foreign investors. However, some cantons have established specific economic development agencies or seek to lure investors through tax waivers.

Foreign ownership of Swiss companies is not restricted, although residency requirements apply. For example, the board of directors of a joint stock company registered in Switzerland must consist of a majority of Swiss residents; in the past these also had to be Swiss citizens, but eligibility has been extended to nationals of the European Economic Area (EEA: EU plus Norway, Iceland and Liechtenstein) in the context of the bilateral treaties with the EU (see **Trade Environment**). In the case of a limited liability company, at least one managing director with the authority to sign legal documents must be domiciled in Switzerland, but there are no citizenship requirements.

The right of free establishment, acquisition and disposal of business interests apply to foreign and domestic investors alike. There is no general screening of foreign investment and national treatment is granted. However, sectoral restrictions apply, e.g. in financial services, utilities, transport, the nuclear industry and sectors that involve national security issues. Swiss companies with registered shares may impose certain restrictions on the transfer of these shares to prevent hostile takeovers.

Taxation

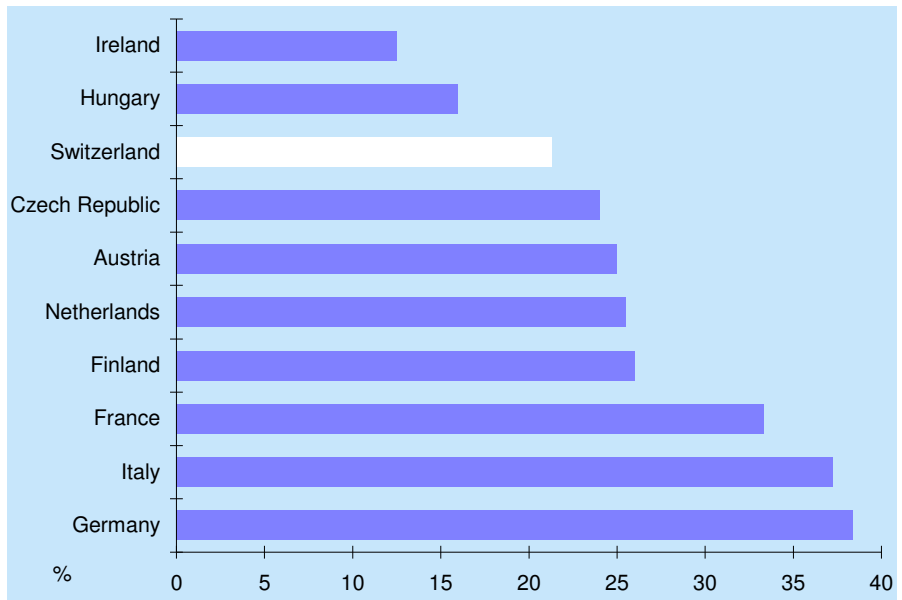
The Swiss tax system is decentralised: the federal authorities can levy both direct and indirect taxes, while at cantonal and municipal level only direct taxation is allowed. Consequently, the rate and effective level of taxation vary from canton to canton, or even from municipality to municipality. These differences can be significant, which makes the choice of location an important element in investment decisions.

This tax competition has ensured relatively low tax rates. The statutory federal tax rate on corporate income is 8.5%. In addition, the cantons levy taxes at varying rates, bringing the average effective tax burden to 21.3% of corporate earnings, according to the KPMG *Corporate and Indirect Tax Rate Survey 2007*. The nominal tax rates are generally higher because taxes can be deducted retroactively as an expense. In addition to the taxation of profits, Swiss cantons levy a capital tax on the paid-in nominal capital and the general reserves, as well as certain hidden reserves (although efforts are underway to reduce these taxes).

Both the cantons and the federal authorities give preferential treatment to holding companies, with the result that there is largely no federal tax on pure holding companies. Some cantons relieve holding companies from all income taxes, so that all dividends and interest income are tax-free. Preferential tax treatment is also granted to domiciliary companies, i.e. companies without direct business activities in Switzerland. The favourable tax treatment has caused friction with some EU countries, which argue that Switzerland is in violation of its agreements with the EU (see **Relations with the EU**).

Dividends paid out by Swiss companies are subject to a 35% withholding tax. In addition, the recipient of the payout is liable to declare the dividend income as part of their taxable income. Consequently, dividends are taxed twice in Switzerland. The government has recognised that this puts investors in an unfavourable position by international standards, and in late February 2008, the electorate sanctioned an easing of this double taxation.

Chart 21

Corporate Tax Rates in Selected Countries, 2007

Source: KPMG, *Corporate and Indirect Tax Rate Survey*

A 35% withholding tax is also levied on interest payments on bonds, debentures and deposits in Swiss banks to natural persons resident in Switzerland for tax purposes. In June 2003, Switzerland agreed to also levy this tax on interest paid to EEA residents, with the rate increasing progressively to 35% by 2011. This was the concession Switzerland had to make in order to keep its banking secrecy rules intact (see **Banking Secrecy and Taxation of Savings**). The withholding tax came into force in July 2005, together with other bilateral treaties between Switzerland and the EU. Fears that the tax would have negative implications for the demand for Swiss financial services have so far proven unfounded.

Company Organisation

The most common forms of organisation in Switzerland for foreign businesses are the corporation and the branch. All companies (with the exception of the sole proprietorship) must be registered with the Federal Commercial Registry, which must also be advised of any subsequent changes. Foreign firms are free to operate except in fields where the government retains a monopoly. The forms of company organisation in Switzerland are:

- *Joint Stock Company (Aktiengesellschaft, AG, or Societe Anonyme, SA)*: The joint stock company is the most common form of association, offering liability limited to the assets of the corporation, shareholder anonymity and the option to transfer shares easily (including listing shares on a stock exchange). It can be founded by at least three shareholders, who can be natural or legal persons. There is no need to publish financial accounts, unless the corporation has outstanding bonds or is listed on a stock exchange.
- *Private Limited Company (Gesellschaft mit Beschränkter Haftung, GmbH, or Societe a Responsabilite Limitee, Sarl)*: Only two shareholders are required to found the company, which offers limited liability in a similar fashion to the joint stock company. The transfer of company shares is more difficult and shares cannot be traded on a stock exchange. The maximum capital allowed for this form of company is CHF2m.
- *Simple Partnership*: In this business association of two or more individuals, each partner is jointly and severally liable. As partnerships are not legal entities, corporate taxation does not apply to them; instead the partners are taxed according to the relevant personal income tax laws.

- *Limited Partnership (Kommanditgesellschaft or Societe en Commandite)*: This is similar to the simple partnership, although at least one partner must have unlimited liability.
- *Branch of Foreign Corporation*: A foreign company can set up a branch in Switzerland, which is economically, but not legally, independent. It is taxed as a joint stock company.
- *Sole Proprietorship*: Individuals with a residence permit can set up a business without the requirement to register in the Commercial Registry.

Portfolio Investment

The Swiss financial markets are deep and liquid, have a strong investor base, advanced trading technologies and integrated links to clearing and settlement systems. There are no capital restrictions or exchange controls that apply to portfolio investors in equities or fixed-income assets. Changes to corporate governance regulations are expected as the government is currently preparing a reform that will strengthen the position of shareholders in areas such as information rights. Indeed, some minor changes have already occurred or will soon be introduced; however, the large-scale overhaul of the current legislation is unlikely to come into force before 2010.

Stock Market

Established as the world's first fully automated trading system and replacing floor trading systems in Geneva, Basel and Zurich, Zurich-based SWX Swiss Exchange operates Switzerland's main equity market. Underlining its international outlook, SWX has established a network of international linkages, such as those with Eurex (the European derivatives market) and virt-x (the first pan-European trading platform for blue-chip equity securities that represent around 80% of European market capitalisation). SWX also participates in STOXX, a joint venture of SWX, Dow Jones & Company and Deutsche Borse AG, which enjoys a high level of market acceptance; and Scoach, a joint venture with Deutsche Borse AG for the trade in structured products.

The main performance indicator is the Swiss Market Index (SMI), which comprises 20 of the largest and most liquid Swiss stocks traded at the exchange (among them the country's most renowned companies, such as Nestle, Novartis, Roche, UBS and Credit Suisse). The stocks contained in the SMI account for around 85% of the free-float capitalisation of the Swiss equity market. A broader indicator is the Swiss Performance Index (SPI), which comprises all the stocks listed on SWX of companies based in Switzerland or the Principality of Liechtenstein.

Bonds

As a leading international financial centre, the Swiss franc bond market is also large and liquid. It is an attractive issuing currency thanks to the environment of traditionally low interest rates and well-developed currency and interest-rate swap markets. The market hosts a variety of issuers, including the three levels of government (federal, cantonal and municipal) and domestic corporate borrowers. The domestic private sector has traditionally accounted for a larger share in the Swiss domestic debt market than public borrowers.

Foreign issuing in Swiss francs also plays an important role in the Zurich marketplace. This feature makes SWX the third-largest market worldwide for foreign-issued bonds (excluding Eurobonds, which, unlike foreign bonds, are not subject to any one national jurisdiction). Overall, the Swiss fixed-income market offers a high level of liquidity, which makes it attractive for placing issues.

Additional Sources of Information

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<http://www.seco.admin.ch>

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Fax: +41 (0)44 631 3911
<http://www.snb.ch>

Integration Office FDFA/FDEA

Bundeshaus Ost
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<http://www.europa.admin.ch>

Swiss Federal Statistical Office

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<http://www.swx.com>

Credit Information

D&B provides information relating to over 115m companies worldwide. Visit www.dnb.com for details. Additional information relevant to country risk can also be found in the following services:

International Risk & Payment Review: Provides timely and concise economic, political and commercial information and analysis on 132 countries. Available as a subscription-based internet service (www.dnbcountryrisk.com) and monthly update journal, the IRPR carries essential information on payment terms and delays. It also includes the unique D&B Country Risk Indicator to help monitor changing market conditions.

Exporters' Encyclopaedia: Information on 220 world markets to help customers decide where they can safely and profitably do business. Data provided include key contacts, transportation information, legislation affecting export commerce and tips on foreign business travel. Published annually in August plus ad hoc updates. English language edition.

Glossary

Balance of payments	The sum of payments made to all other nations less the sum of external receipts.
Basis point	One one-hundredth of a percentage point.
CAD	Cash against documents: On payment, the buyer receives the documents that give access to the purchased goods.
CiA	Cash in advance: The buyer pays the seller before shipment is effected.
CIS	Commonwealth of Independent States (Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyz Republic, Moldova, Russia, Tajikistan, Ukraine and Uzbekistan)
CLC	Confirmed letter of credit: A letter of credit in which payment is guaranteed by the opening bank in the buyer's country and by another bank.
CPI	Consumer price index
Current account balance	Part of the balance of payments that records a nation's exports and imports of goods and services, and income and transfer payments.
CWP	Claims waiting period: The time between when the covered risk materialises and the earliest time when indemnification of a claim can take place.
DSR	Debt service ratio: Annual interest and principal payments on a country's external debts as a percentage of exports of goods and services.
ECB	European Central Bank
ECGD	Export Credits Guarantee Department (UK)
EU	European Union
Eximbank	Export Import Bank (US)
FDI	Foreign direct investment: Investment in productive assets by a company incorporated in a foreign country.
Fitch	Fitch Ratings
FX	Foreign exchange
G7	Group of Seven industrial nations (Canada, France, Germany, Italy, Japan, UK and US)
G8	Group of Eight industrial nations (G7 plus Russia)
GDP	Gross domestic product: The value of goods and services produced within an economy.
GNP	Gross national product: GDP plus net income from abroad.
Government balance	The balance of government expenditure and receipts.

HIPC	Heavily Indebted Poor Countries initiative: A framework for creditors to provide debt relief to the poorest and most heavily indebted countries.
IMF	International Monetary Fund
Import cover	The amount of official FX reserves a country has in relation to the average monthly value of imported goods and services.
Inflation	The increase in prices over a given period.
IT	Information technology
LC	Letter of credit: A guarantee of payment to a seller from a buyer's bank. Payment is conditional on named documents being presented by specific dates.
Moody's	Moody's Investors Service
MP	Member of parliament
NATO	North Atlantic Treaty Organisation
NGO	Non-governmental organisation
Nominal effective exchange rate	The weighted average exchange rate of the local currency vis-à-vis a basket of foreign currencies.
OA	Open account: credit extended that is not supported by a note, mortgage or other formal written evidence of indebtedness.
OECD	Organisation for Economic Co-operation & Development
OPEC	Organisation of Petroleum Exporting Countries
Q1; Q2; Q3; Q4	First, second, third and fourth quarter
R&D	Research and development
Real effective exchange rate	The nominal effective exchange rate adjusted for inflation differentials with the country's trading partners.
Real GDP	GDP adjusted for inflation
S&P	Standard & Poor's
SD	Sight draft: A draft or bill that is payable on demand or on presentation.
STIPP	Short-Term Insurance Pilot Program (US): Provides short-term cover to buy US goods in countries where Eximbank is otherwise not open for medium-term financing in the public or private sector.
Terms of trade	The ratio of the index of export prices to the index of import prices. A rising ratio indicates improving terms of trade.
UN	United Nations
VAT	Value-added tax: A consumption tax levied at each stage of production based on the value added to the product at that stage.
WTO	World Trade Organisation

Country Risk Indicator Definition

D&B's Country Risk Indicator provides a comparative, cross-border assessment of the risk of doing business in a country. The indicator seeks to encapsulate the risk that country-wide factors pose to the predictability of export payments and investment returns over a time horizon of two years. The risk indicator comprises a composite index of four over-arching country risk categories:

<i>Political risk -</i>	internal and external security situation, policy competency and consistency, and other such factors that determine whether a country fosters an enabling business environment;
<i>Macroeconomic risk -</i>	the inflation rate, government balance, money supply growth and all such macroeconomic factors that determine whether a country is able to deliver sustainable economic growth and a commensurate expansion in business opportunities;
<i>External economic risk -</i>	the current account balance, capital flows, foreign exchange reserves, size of external debt and all such factors that determine whether a country can generate enough foreign exchange to meet its trade and foreign investment liabilities;
<i>Commercial risk -</i>	the sanctity of contract, judicial competence, regulatory transparency, degree of systemic corruption, and other such factors that determine whether the business environment facilitates the conduct of commercial transactions.

The DB risk indicator is divided into seven bands, ranging from DB1 through DB7. Each band is subdivided into quartiles (*a-d*), with an *a* designation representing slightly less risk than a *b* designation and so on. Only the DB7 indicator is not divided into quartiles.

Indicator Meaning Explanation

DB1	Lowest risk	Lowest degree of uncertainty associated with expected returns, such as export payments, and foreign debt and equity servicing.
DB2	Low risk	Low degree of uncertainty associated with expected returns. However, country-wide factors may result in higher volatility of returns at a future date.
DB3	Slight risk	Enough uncertainty over expected returns to warrant close monitoring of country risk. Customers should actively manage their risk exposures.
DB4	Moderate risk	Significant uncertainty over expected returns. Risk-averse customers are advised to protect against potential losses.
DB5	High risk	Considerable uncertainty associated with expected returns. Businesses are advised to limit their exposure and/or select high-return transactions only.
DB6	Very high risk	Expected returns subject to large degree of volatility. A very high expected return is required to compensate for the additional risk or the cost of hedging such risk.
DB7	Highest risk	Returns are almost impossible to predict with any accuracy. Business infrastructure has, in effect, broken down.