GRAY/23/4927

May 26, 2023

Statement by Mr. Sylla, Mr. N'Sonde, and Mr. Carvalho da Silveira on Switzerland (Preliminary)
Executive Board Meeting
May 31, 2023

We thank staff for the set of reports and Mr. Peter and Mr. Gindrat for their insightful Buff statement.

Despite the resilience shown throughout the Covid-19 pandemic, the Swiss economy is expected to cool down amid challenging domestic and global contexts and vigilance is required to contain the elevated downside risks and prepare for their potential materialization. We commend the authorities for the decisive measures taken to mitigate the fallout from the war in Ukraine on the economy and shield the most vulnerable households and firms. Notwithstanding, we share the view that global uncertainties could affect the country's outlook. These uncertainties emanate primarily from an intensification of the conflict in Ukraine, slower global recession, geopolitical fragmentation and persistent global inflation. Another risk pertains to the stress in the housing and financial sectors that led the Credit Suisse (CS)-UBS merger facilitated by the Swiss authorities. Against this background, priority should be given to policies that counter risks to the outlook and support growth within the fiscal-balance rule, tackle inflation while addressing financial stability concerns. It is also critical to advance long-term structural reforms related to labor market, climate, and energy security.

Fiscal stance should remain broadly balanced in line with the debt-brake rule, while also being agile to respond to short and medium-term spending pressures. We recognize the extraordinary outlays associated with emergency spending for the pandemic, refugees from Ukraine as well as energy and national security. In this context, we find merit in the authorities' decision to extend the amortization period for this spending to 2035 to avoid a sharp fiscal adjustment going forward. We share the view that consideration should be given to well targeted and non-distortionary support to vulnerable households and firms if risks came to materialize, while allowing automatic stabilizers to continue to play their role. That said, the CS-UBS deal seems to represent a large contingent liability for the government. *Specifically, we would appreciate staff's further elaboration on the size (in percentage of GDP) and guarantees connected with the merger and their potential impact on the fiscal position, if activated*. The recently adopted budget clean-up plan represents an important step towards a full-scale medium-term fiscal plan necessary to maintain structural balance and address longstanding challenges, including those associated with demographics, energy security, and climate change. In this connection, swiftly implementing the ongoing tax reforms to enhance the efficiency of the tax system will be equally important.

The Swiss National Bank (SNB) should sustain efforts to reduce inflationary pressures while also being mindful of potential risks to its balance sheet. We welcome the various measures undertaken to tighten monetary policy, including policy rate hikes, FX sales and repo operations. We also note from the Buff statement that the latest SNB forecast points to a decrease in inflation to 2 percent by end of 2023. Nonetheless, the SNB should stand ready to tighten further should inflation risks persist as recommended by staff. Regarding the central bank's large balance sheet, we are reassured by staff's analysis in the Selected Issues Paper that the SNB's financial loss in 2022 reflects market developments and is not expected to have an impact on monetary policy operations. We are also pleased to note that the SNB has put in place appropriate safeguards against such risks, including more transparent communications on its investment strategy. Looking ahead, ensuring regular reviews of the investment strategy and continued reduction of FX holding could help shrink the SNB's balance sheet and mitigate financial risks.

We commend the authorities for the swift intervention to prevent the default of a globally systemically important bank to safeguard financial stability and restore confidence. Although a banking crisis may have been avoided, we are concerned that the CS-UBS deal might have been arranged hastily. Therefore, we agree that a careful and effective consolidation of the two institutions and smooth implementation of the merger will be of upmost importance. *In this regard, we would welcome comments on the timeline for the completion of the merger*. Given that the complexity of the merger and that UBS will be a much larger globally systemically important bank (GSIB), we also see merit in conducting a resolvability assessment of the merger and a review of the resolution plan to make it more transparent, better understood and more successful. Lessons should be learned from this intervention as the first to address a GSIB since the global financial crisis in 2008. In this respect, focus should be aimed at the implications for the supervisory and regulatory frameworks, including contingency arrangement and coordination, liquidity in resolution, shareholders' rights as well as communication.

Although the financial sector is broadly sound, vigilance is still necessary for potential risks related to the real estate and non-bank financial institutions. Slow growth and interest rate volatility create risks to housing market through mortgage rates and to non-bank financial institutions (NBFIs) due to their exposure to managed products and interlinkages. We therefore concur that attention should be paid to the build up of these risks, including by considering the tightening and further expansion of macro-prudential measures and activating the broad-based countercyclical capital buffer (CCyB). Efforts to implement the remaining 2019 FSAP recommendations to enhance financial sector resilience should also continue.

Finally, we welcome the progress on the structural front and encourage the authorities to accelerate key reforms to strengthen the economy. In this regard, priorities should be aimed at addressing housing imbalances, securing energy supply, improving labor market mismatches, and enhancing the economy's resilience notably to climate. We welcome the broad agreement between the authorities and staff on policies to achieve these objectives. Further, we positively note the ongoing discussions with the EU including for an agreement on an approach that gives clarity on EU-Swiss relations and on Swiss access to the EU single market. The authorities also made strides on strengthening the AML/CFT and anticorruption frameworks with the January 2023 revision to combat bribery and prevent the concealment of foreign proceeds of corruption. Work should continue on this front.

With these comments, we wish the Swiss authorities continued success.