Executive Board Minutes 23/43-1

May 31, 2023–10:00 a.m.

Switzerland—2023 Article IV Consultation

Documents: SM/23/118, and Cor. 1, and Sup 1; SM/23/124, and Cor. 1

Staff: Berkmen, EUR; Kang, SPR

Length: 45 minutes

ISSUED: August 1, 2024
APPROVAL: August 8, 2024

CEDA OGADA
Secretary

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[1] Minutes are the official record of a formal Board meeting in which the Board may adopt decisions and reach understandings related to the business of the Fund. Staff background documents issued before the meeting are the principal basis for the meeting. Preliminary "gray" or "buff" statements by Executive Directors and staff's responses to Directors' technical questions are circulated prior to the meeting. Adopted decisions and/or summings up—the Chair's "sense of the meeting" or policy conclusions/recommendations—are issued after the meeting. The minutes include all these elements, as well as the discussion record (a verbatim transcript of the discussion lightly edited for clarity). Minutes are made public consistent with the IMF's Open Archives Policy.

THE ACTING CHAIR'S SUMMING UP

Executive Directors broadly agreed with the thrust of the staff appraisal. They commended the authorities for their decisive actions to address financial stability concerns and the potential spillovers from the Credit Suisse episode. Acknowledging the current challenges faced by Switzerland, including the subdued and uncertain growth outlook and elevated inflation, Directors underscored the importance of continued prudent macroeconomic and financial policies. Further progress on addressing medium- to long-term challenges will also be critical for boosting competitiveness and growth.

Directors agreed that the expansionary fiscal stance with a continued surplus is appropriate in the near term. They welcomed the authorities' plans to offset past extraordinary spending and emphasized the importance of allowing automatic stabilizers to operate. Targeted and time-bound support, if downside risks materialize, would also be useful. Directors also stressed the need to address significant longer-term spending needs—for aging, climate, energy, and national security—within the ordinary budget and the fiscal balance rule. They generally noted that the tax reforms underway should carefully balance public policy objectives with revenue considerations.

Directors welcomed the Swiss National Bank's (SNB) data-driven monetary policy and encouraged continued tightening if second-round effects persist. Noting the current inflationary situation and risks associated with its large balance sheet, they suggested that the SNB continue to reduce FX holdings if facing depreciation pressures. Directors emphasized the desirability of continued reviews by the SNB of its investment strategy and maintaining adequate safeguards.

Directors stressed the need for close monitoring of the UBS-Credit Suisse merger and carefully reviewing and drawing lessons from the case. They also highlighted the importance of closely monitoring potential vulnerabilities from non-bank financial institutions, and the real estate and fintech sectors. Further efforts to implement recommendations from the 2019 FSAP, especially in improving financial supervision and regulation, and continued strengthening of the AML/CFT framework will also be needed.

Directors welcomed the authorities' efforts to ensure energy security and reduce emissions, as well as their steps to improve disclosure of climate-related financial information. Passage of the Third CO2 Act and the Climate Protection Act would be important milestones. Directors also underscored the importance of structural reforms and active labor market reforms to boost productivity and labor force participation, and they stressed the need for further actions to strengthen pension sustainability. They also encouraged continued dialogue with the EU regarding accession to the single market.

It is expected that the next Article IV Consultation with Switzerland will be held on the standard 12-month cycle.

EXECUTIVE BOARD ATTENDANCE [2]

A. Sayeh, Acting Chair

Executive Directors	Alternate Executive Directors
W. Nakunyada (AE)	
F. Sylla (AF)	
L. Herrera (AG)	
R. Nicholl (AP)	
A. Bevilaqua (BR)	
	Y. Qi (CC), Temporary
	P. De Ramon-Laca Clausen (CE)
	F. O'Brolchain (CO)
D. Palotai (EC)	
	C. Roman (FF)
J. Stephan (GR)	
	S. Dash (IN), Temporary
	M. Massourakis (IT)
J. Mizuguchi (JA)	
	M. El Qorchi (MD)
	A. Abdullahi (MI), Temporary
	L. Voinea (NE), Temporary
	A. Marcussen (NO)
	S. Potapov (RU)
	M. Alrashed (SA)
R. Lim (ST)	
M. Peter (SZ)	
S. Riach (UK)	
	A. Medearis (US), Temporary

E. Tsounta, Acting Secretary
V. Sola, Summing Up Officer
F. Rawah, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
Communications Department: M. Perez Morales ep. Coates. European Department: S. Berkmen, G. Dolphin, M. Horton, A. Jamaludin, M. Saxegaard, Y. Shi, L. Zeng, T. Zheng. Legal Department: A. Yiadom. Monetary and Capital Markets Department: M. Dobler,

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[2] For countries in each constituency, please see the Constituency Codes in the annex.

N. Griffin, B. Huang. Strategy, Policy, and Review Department: K. Kang, R. Varghese. Executive Director: A. BinZarah (SA), A. Buisse (FF), A. Guerra (CE), P. Jennings (CO), M. Mohieldin (MI), K. Subramanian (IN), Z. Zhang (CC). Alternate Executive Director: A. Alhosani (MI), C. Amarasekara (IN), R. Anwar (ST), J. Betancur Mora (CE), C. Just (EC), P. Loszewski (SZ), M. Matungulu (AF), M. Mert (EC), R. N'Sonde (AF), B. Saraiva (BR). Senior Advisors to Executive Directors: K. Badsi (MD), S. Chicas Cienfuegos (CE), M. Choueiri (MI), R. Gindrat (SZ), V. Grossmann-Wirth (FF), S. Naka (JA), J. Rojas (CE), C. Sassanpour (MD), A. Tolstikov (RU), S. Wongwaisiriwat (ST). Advisors to Executive Directors: Z. Abdelrahman (SA), A. Abdul Raheem (MI), F. Al-Kohlany (MI), R. Bah (AF), C. Becker (AP), M. Boehme (GR), K. Carvalho da Silveira (AF), L. Cerami (IT), M. Day (CO), R. Fayez (MI), T. Keating (US), R. Kraavik (NO), F. Kurniawan (ST), C. Kuth (SZ), V. Lankester Campos (CE), P. Mansaray (AE), M. Merhi (MI), R. Moral Betere (CE), A. Mostajo Soto (AG), I. Ogihara (JA), M. Pucnik (EC), I. Xaiyavong (ST), F. Yahya (AF), F. Lopez (CE), A. Evangelou (UK).

DISCUSSION RECORD [3]

The Acting Chair (Ms. Sayeh):

The consultation was held from late March through early April, immediately following the announcement of the acquisition of Credit Suisse by UBS—two globally systemically important banks. Considering the intensive market developments in the immediate run-up to the UBS acquisition, the need for the finalization of the transaction, and risk of reigniting global banking turmoil, the staff's first critical task was to assess the situation and pinpoint the most pressing steps for the current juncture. But it will also be essential over time to carefully review and draw lessons from the case, both for Switzerland and globally. In that respect, the staff report identifies key areas for future policy work and discussions.

Beyond banking and financial sector issues, there is also much to discuss about Switzerland's macroeconomic policies and structural reforms. The authorities have made commendable strides over the past year, evident in their effective management of the energy crisis and the adoption of Pillar 1 pension reforms, among others. But the Swiss economy is also facing challenges, such as slowing growth, persistently elevated inflation—although to a much lesser degree than many other economies—longer-term spending needs, and green and sustainable transitions.

Mr. Peter:

I just read this morning about the slowdown. Things do not seem that bad. During the first quarter, it seems there was some remarkable growth. Maybe Ms. Berkmen will enter into that. I think that is rather positive news.

Before I get to that, I just wanted to briefly address two issues that were mentioned very widely in the gray statements—financial stability and climate change.

First, on financial stability, we would like to reassure colleagues that the evaluation and implementation of the 2019 Financial Sector Assessment Program (FSAP) recommendations is ongoing in Switzerland, and the same is true for the close monitoring of financial stability issues. In particular, following the acquisition of Credit Suisse by UBS, the authorities are

[3] Edited for clarity.

conducting an in-depth review of the "too big to fail" regulations. A report on these issues is scheduled for March next year.

Second, on climate change, the authorities are fully committed to achieving net-zero emissions by 2050. Following the rejection in 2021 of the revised CO2 Act in a referendum, the Federal Council—that means the executive branch of our government—and parliament have agreed on framework legislation, the so-called Climate Protection Act, that sets out the path to the net zero goal. The bill on which the population will vote on June 18, in yet another referendum, provides for greenhouse gas emissions to be cut in stages, with specific reduction targets applying to industry, motorized traffic, and buildings. As part of this framework legislation, significant support worth roughly US$3.5 billion for investments in carbon-neutral technology and energy efficiency will be needed to achieve these climate goals.

These measures will be enacted in other laws, starting with the Third CO2 Act that is now in parliament. That said, the next step is to see what will be the outcome of the referendum on the Climate Protection Act on June 18. We hope for a different outcome than two years ago, where a few days after the Board meeting, the population actually voted "no" on this act.

The staff representative from the European Department (Ms. Berkmen):

I would like to provide a few brief updates on recent macroeconomic developments, including the growth figure that came out yesterday, as well as the latest progress in the UBS and Credit Suisse merger. I will also address two questions from the gray statements on the timing of the merger and the associated risks with it.

Headline inflation moderated from 2.9 percent in March to 2.6 percent in April. The decline was entirely driven by the energy and food prices, with core inflation staying flat at 2.2 percent. This was broadly in line with the staff's expectations. We have projected 2.5 percent average headline inflation for 2023. The next monetary policy assessment by the Swiss National Bank (SNB) is scheduled for June 22.

As mentioned by Mr. Peter, the first quarter of 2023 GDP figures released yesterday indicated a growth of 0.3 percent quarter on quarter compared with zero percent in the last quarter of 2022. Staff had projected a flat Q1. This is better than what we expected. This performance was mainly driven by private consumption and equipment investment. Sector-wise, the strong performance in Q1 appeared to be relatively broad based, with the exception of financial services. The Q1 results suggest that the full year growth of 2023 could be somewhat higher than currently projected in the staff report.

Let me turn to the updates concerning UBS and Credit Suisse. Staff remains in contact with the authorities as things develop. Based on our tracking, the merger of the two banks has secured approval from the U.S. Federal Reserve, the European Commission, and the Bank of England. The case is still under discussion with the U.S. Securities and Exchange Commission. Overall, it appears on track to be completed in June, as planned.

While the legal process is expected to be completed soon, the actual integration of the two banks is expected to take longer. Once UBS communicates its strategic plans for the combined bank, there will be more clarity on the completion of the business activities of the two banks—of the merger.

Looking at the market indicators of both UBS and Credit Suisse, these have stabilized after the initial high volatility, following the announcement of the merger. Share prices for both banks have since then been largely stable. The credit default swap spreads for UBS have declined, including in recent weeks, returning to more normalized levels, although they are still slightly higher than in January and February of this year.

Based on a statement from the UBS CEO in mid-May, the bank run on Credit Suisse has effectively stopped.

Until the merger is completed, risks remain. In the near term, implementation risks could include a renewed loss of confidence in banks globally, spilling over to the Swiss banking sector. It is noteworthy that the failure of First Republic Bank did not reignite market turbulence in Switzerland.

Other risks include unexpected losses from Credit Suisse assets and difficulties in progressing rapidly, given the complexities in structures and assets of two banks. In addition, numerous lawsuits have been filed against the Swiss Financial Market Supervisory Authority (FINMA) decision, requiring Credit Suisse to fully write down its AT1 bonds, including from AT1 bondholders and Credit Suisse staff holding similar securities as part of their compensation package. In this context, litigation risks and higher-than-expected job cuts could create challenges.

Medium-term risks could include a higher cost of capital for Swiss financial institutions. Over the medium term, as the staff report highlighted, it will be important to watch competition in certain segments of the market, where Credit Suisse and UBS each had strong positions.

Regarding the actions taken by the authorities after the mission, FINMA published its annual report on the recovery and resolution plans of systemically important institutions. The publication had been delayed due to the Credit Suisse situation. FINMA reported that certain improvements were achieved in 2022, such as the effective rating of the emergency plan of one of the domestic systemically important banks. Nonetheless, the crisis plans of the two domestic systemically important banks remained inadequate.

Recently, the authorities appointed a banking stability experts group to conduct an independent study of banking and financial sector issues. This is one of the steps to prepare for a comprehensive report on Credit Suisse, which the government has pledged to release end-March or early April next year. The authorities have also initiated the consultation process to convert the emergency ordinances enacted in March, which facilitated the UBS-CS merger to ordinary laws.

Mr. Bevilaqua:

As the first speaker today, on behalf of the Board, let me start by thanking staff for the detailed report and today's update; Mr. Peter and Mr. Gindrat for their informative buff statement; and Mr. Peter for his opening remarks.

We have issued a comprehensive gray statement, offering several specific comments. I would like to use this opportunity to stress three points we made in our gray statement.

First, in our view, the expansionary fiscal policy stance remains appropriate and consistent with the strong fiscal framework and the external balance. Indeed, despite the drop in revenues and sustained spending on refugees, energy, and national security, the fiscal accounts are expected to continue in surplus. In addition, the authorities have taken measures to address medium- and long-term spending pressures. Given low public debt and the strong fiscal framework, a more expansionary fiscal policy stance, together with tighter monetary policy and unsterilized foreign exchange intervention, allows for a balanced macroeconomic policy mix. Furthermore, considering the circumstances, we agree with the authorities that tax reform should prioritize policy objectives over revenue considerations.

Second, we know that monetary policy has successfully transitioned from the negative-policy-rate era. However, as inflation becomes more broad based, core inflation has increased and is currently above the SNB's target. In this context, we agree that the SNB must remain vigilant against inflation risks to maintain its credibility. We take positive note that near-term inflation expectations have eased and longer-term expectations remain anchored.

Finally, we commend the authorities for their decisive action to address financial stability risks, following the Credit Suisse event. Considering that this was the result of longstanding weaknesses at the bank and that the state-facilitated merger was done outside the resolution regime, we take positive note of the authorities' intention to review their too-big-to-fail framework and encourage them to address any shortcomings in the supervisory and resolution frameworks that could be identified. Furthermore, we encourage the authorities to continue implementing the 2019 FSAP recommendations, especially as regards the strengthening of FINMA's authority, governance, and accountability. We are reassured by Mr. Peter's remarks along these lines this morning.

Mr. Voinea:

We broadly concur with the staff's assessment. We also welcome Mr. Peter's comments this morning and would like to emphasize a few points, especially since we have not issued a gray statement.

First, on the fiscal stance, we agree that a small surplus remains appropriate, given the slowing nature of the economy and other underlying structural challenges, including the aging population and the need to invest more for climate change mitigation and the green transition. The debt brake has served the country well, and the pension reform will also contribute to fiscal space. Nevertheless, like Mr. Stephan and other Directors, we take note of the large contingent liabilities hinging from the UBS-Credit Suisse deal, which risks derailing the fiscal stance, if used.

Second, on the financial sector, the authorities reacted swiftly to contain the Credit Suisse crisis and maintain financial stability. However, it could be beneficial to critically assess the preferred resolution strategy and backup options that were in place for Credit Suisse before its acquisition, as the credibility of the resolution framework, in Switzerland and elsewhere, contributes to market confidence and resolvability. Ad hoc solutions may prove effective, but questions must be raised regarding the ex ante resolution strategies, especially considering some longstanding vulnerabilities.

Going forward, we deem it important to closely monitor the implementation of the acquisition by UBS, as UBS has become a significantly larger global systemically important bank. We agree with staff and the Swiss authorities that lessons must be learned and are very interested in the results of the review of recovery and resolution planning; capital and liquidity requirements; regulatory bodies' competencies; the rules governing compensation practices, auditing, and responsibilities of senior management; the provision of emergency liquidity assistance; and the deposit insurance system.

Third, regarding monetary policy, we welcome the policy mix implemented by the SNB to fight inflation. A large loss reported in 2022 was justified by this goal, yet this requires monitoring and a clear communication strategy.

Fourth, like Mr. Massourakis, we believe that monetary tightening might expose pockets of vulnerabilities in a context of an overheated real estate market and increased interconnectedness within the financial sector. We, thus, encourage the authorities to analyze the interactions with non-bank financial institution (NBFIs) and to consider a broader range of macroprudential tools.

Finally, on energy, we welcome the ambition to expand the renewable capacity and to strengthen the security of the energy supply. Like Mr. O'Brolchain and other Directors, we encourage the authorities to further pursue their goal of zero net emissions and agree that the Climate Protection Act would be a positive development in this direction.

Mr. El Qorchi:

We have issued a comprehensive gray statement and indicated our agreement with the staff appraisal. I just want to make the following points.

First, in the wake of the COVID-19 pandemic, Switzerland's economic activity experienced a brief upturn in 2021, followed by a slowdown in 2022, but it is expected to bottom out in 2023. We welcome the authorities' decisive actions aimed at addressing financial stability concerns and potential spillovers from Credit Suisse's failure. We positively note the availability of a broad range of fiscal tools to support growth, should downside risks materialize. We see merit in implementing the current plans for amortizing past extraordinary spending and for the ongoing tax reforms, including by improving efficiency, removing distortions, and leveling the playing field.

Second, we support the planned measures aimed at addressing the expected structural deficits and spending needs, including those related to aging, climate, and energy. While the monetary and exchange policy response has been instrumental in dealing with the challenges posed by inflationary pressure, effective and close monitoring of the UBS-Credit Suisse merger is critical, in tandem with a stronger macroprudential policy framework to address potential financial stability risks. Like Mr. Bevilaqua, we welcome the reassurances offered by Mr. Peter this morning.

Finally, we commend the authorities for the strides made in reducing carbon emissions, ensuring short-term energy security, and improving disclosure of climate-related financial information.

Mr. Dash:

We have issued a detailed gray statement, and I will offer the following two comments today.

First, regarding the UBS-Credit Suisse merger, it has been called "the deal of the century," and regulators have done their best. But now many market watchers wonder about the speed with which the regulators forge their alliance and the low financial bidding that claims the deal. Some would believe that the bidding was kept artificially low, as the final payout was 60 percent below the last loan market capitalization of Credit Suisse. I would like to raise this point just to highlight the need for greater transparency in the process. While the deal has gone through, one is left wondering whether there are more surprises down the line from this very deal, in terms of the knock-on effects on Credit Suisse shareholders. Also, I would like to stress the need for enhanced transparency in financial sector stability in our next flagship reports.

Second, on the issue about labor market tightness, while the staff report mainly focuses on improving labor market flexibility, tapping into domestic human resources from the EU region, we would like to emphasize the need to liberalize the services sector by encouraging immigration of skilled human resources from outside the EU region and harness remote work technology to facilitate services exports from other countries to plug the gaps in the labor market and improve productivity for the economy.

Mr. Massourakis:

We have written a comprehensive gray statement, and today I would just like to make a few remarks.

First, regarding the ongoing negotiations between Switzerland and the EU, we want to welcome the recent progress. We continue to encourage the Swiss authorities to engage constructively with the EU to strengthen the close and mutually beneficial relations between the two parties.

On climate policies, we understand the complexities of the Swiss institutional framework, which tend to slow down the decision-making process. However, the urgency to act is feasible also in Switzerland which, in the absence of a quick and effective policy response to climate change, stands to lose from a melting of its valuable alpine treasure. We encourage the authorities to broaden the scope of decarbonization measures beyond power generation. As noted in the selected issues paper, the Swiss power generation mix is almost entirely free of fossil fuels. Switzerland is, thus, well placed to expand the decarbonization of important sectors—most notably, transport—which will increasingly be based on electricity technologies.

Mr. Palotai:

Like other Directors, we are also encouraged by Switzerland's strong macroeconomic fundamentals and the demonstrated resilience against the fallout from Russia's war in Ukraine. The attainment of a continued budget surplus is commendable and should be wisely used to finance the implementation of structural reforms to assure sustained long-term growth. For example, we would welcome a green transition investment plan, including regulatory and, if necessary, also procurement reforms supporting it to firmly underpin the Third CO2 Act and Climate Protection Act. We are less convinced of short-term fiscal spending in view of likely inflationary impacts. We take note of staff's External Balance Assessment (EBA) and value staff's efforts to find credible explanations when results are not fully in line with the outcome of a largely mechanical exercise.

Switzerland's better-than-peers' inflation performance and possibly worse outcomes than peers in terms of inflation could preserve tendencies for safe haven capital inflows. In this context, we stress that the SNB must remain vigilant and, alongside staff's recommendations, consider further FX sales to reduce the SNB's balance sheet to lower financial risks and regain monetary space.

We commend the authorities' decisive actions to address the Credit Suisse challenges, but questions remain whether FINMA was sufficiently intrusive over time to be effective. We call on the authorities to address weaknesses forcefully, given that the new UBS is now even larger and at least as complex. We also ask the authorities to improve communication channels with other supervisors in case of systemic risk events. Given the constantly increasing share of NBFIs and fintech in the financial system, a swifter adaptation of the scale and scope of supervision may be particularly important.

Mr. Mizuguchi:

I would like to offer four remarks.

First, we commend the authorities' numerous measures to mitigate the fallout from Russia's war in Ukraine, including scaling up the supply of essential goods and support to refugees from Ukraine. We also welcome Switzerland's various steps to strengthen the energy supply to address energy security risks.

Second, on the monetary policy, the SNB's response to higher inflation and the policy tightening is appropriate. Inflation and risks for the second-round effects should continue to be closely monitored. If inflation is more persistent, it would be useful for the SNB to keep vigilant and raise interest rates further, as needed, to keep expectations anchored.

Third, on the financial sector, we welcome that the authorities acted quickly and decisively under extraordinary circumstances. Effective consideration of the UBS and Credit Suisse businesses will be critical. At the same time, a careful review and analysis of the case and the lessons learned, both for Switzerland and internationally, would be necessary. We appreciated the further update provided by the staff, and we encourage staff to closely monitor and carefully analyze its implications on the Swiss and international supervisory and regulatory frameworks. We agree with staff that macroprudential policies should continue to focus on safeguarding financial stability, taking into consideration the current cyclical position of the economy.

Fourth, on the External Sector Assessment (ESA), we agree with the authorities on the importance of appropriate accounting for measurement issues, as well as the impact of the temporary global factors. We encourage staff to continue discussions on the assessment in such a way that they incorporate the Swiss economy's structure and the global situation, while recognizing the limitations of the current ESA framework.

Mr. Sylla:

We have provided, in our written statement, our views on the policy and reform priorities for Switzerland. Therefore, I will limit my comments to two points.

First, like other Directors, we stress the importance of a careful and effective consolidation of the Credit Suisse and UBS businesses to minimize risks to the public finances. The merger now represents a large contingent liability to the government, estimated at about 14 percent of GDP. An exhaustive examination of execution risks—stemming from the size and weaker credit profile of Credit Suisse and the complexity of winding down its investment banking operations, as planned—will be critical for a smooth implementation of the merger and preventing further financial support from the government. In this connection, we see merit in a resolvability assessment of the merger and a review of the resolution plan. The timely disclosure of information to maintain market confidence will be equally important.

Second, we encourage the authorities to closely monitor pockets of financial vulnerability and take further steps to enhance the resilience of the system. We highlight the risks posed by interest rate volatility and tightening financial conditions to the real estate market and NBFIs. Steps should be taken to close regulatory data gaps for these institutions, activate the broad-based countercyclical capital buffer, and expand macroprudential tools to mitigate the buildup of risks. Efforts should also continue to fully implement the remaining recommendations of the 2019 FSAP to strengthen the resilience of the financial system and protect its reputation.

The staff representative from the European Department (Ms. Berkmen):

We heard all the comments. We would like to also thank the authorities for their close cooperation, both during the mission and afterwards.

Mr. Peter:

Let me start by expressing my sincere appreciation to colleagues for their thoughtful and very supportive gray statements and for the discussion. My Swiss authorities and I very much value this exchange at the Board.

Let me make three points, starting with fiscal policy, then briefly on monetary policy, and to end with the usual suspect, the external sector.

First, on fiscal policy, by following a fiscal rule that requires a balanced budget over time, Switzerland has opted not to rely on debt financing of its budget. This has provided the authorities with the necessary fiscal space to react promptly and flexibly in times of crisis, with the option to go beyond automatic stabilizers in exceptional circumstances, as shown by the response to the COVID-19 pandemic. I can reassure you that the authorities are well aware of the fiscal challenges that lie ahead, but they consider that debt financing is not necessary to address these challenges. Addressing the challenges with a balanced budget will require a compromise between the most desirable levels of government spending and taxation. Let me just note, in this context, that moderate debt service will help preserve budget space to deal with climate and the other structural challenges.

Second, on monetary policy, the SNB remains fully committed to bring inflation down and within the target range of what it defines as price stability—namely, an inflation rate between zero and 2 percent. In this context, additional increases in the policy rate cannot be ruled out. As noted by several Directors, the large balance sheet which results from the SNB's monetary policy actions comes with risks. Last year, the SNB incurred a big loss on its foreign exchange investments. However, this loss has no impact on monetary policy decisions and the implementation of monetary policy.

Regarding risks and communication challenges, the SNB has, one, issued early warnings of potential volatility in its profits; two, put in place sound safeguards, such as significant provisions; and three, provided transparent communication on its investment strategy, as also highlighted by staff in the selected issues paper on the SNB's balance sheet. The SNB pays utmost importance to these aspects now and in the future.

Third, on the external sector, the Swiss authorities agree with the staff's ESA, and we note that there is also very broad support for this assessment among colleagues. None of the adjustments to the current account norm are made specifically for Switzerland. This is also confirmed in the staff's very welcome written response to a question raised by one of the colleagues. For understandable reasons—the large foreign assets and liability position, the relatively low inflation, and the large portfolio of equity liabilities—the measurement adjustment just happens to be negative, and particularly important in the case of Switzerland. More generally, as also stressed by Mr. Stephan, in his gray statement, the external position should be informed by a holistic assessment of the economic situation, with the EBA results being just one element.

In closing, on behalf of my office and the Swiss authorities, I would like to express our sincere gratitude to our mission chief, Ms. Berkmen, and her very able team—Mr. Zeng, Mr. Jamaludin, Ms. Shi, Ms. Zheng, and Mr. Dolphin—for the excellent and fruitful engagement. We very much enjoyed the close dialogue and the exchange of views which, in our opinion, have once again been very well reflected in the reports. Let me also thank Mr. Horton, He is our former mission chief, but has continued the close interaction with us as a senior reviewer in the European Department. We thank them very much, again, for the very close collaboration, and we look forward to another cycle coming up soon.

The Acting Chair (Ms. Sayeh):

Switzerland is an Article VIII member, and no decision is proposed. The 2023 Article IV Consultation with Switzerland is hereby concluded.

Let me close with a few words of thanks to the Swiss authorities for their cooperation and support throughout the Article IV consultation, particularly during an especially challenging and demanding time for them. I must also thank Mr. Peter, all Directors, and staff for the participation in today's discussion. It is essential that our dialogue on banking sector issues continues in the future, with the implications that they may have beyond Switzerland.

Now, 2023 is a year full of challenges for Switzerland. However, it is worth noting that in the face of past difficulties, the Swiss authorities' macroeconomic and financial frameworks and the Swiss economy have consistently demonstrated resilience. We wish for the Swiss economy to emerge from the current challenges robust and prepared for the future.

Before concluding, I want to highlight that the Swiss Federal Council approved an SDR 500 million contribution to the Fund's Resilience and Sustainability Trust just two weeks ago. It is a very important contribution to this critical initiative. Let me take this opportunity to thank and commend the authorities, Mr. Peter, for the continued strong and generous support to the Fund which also extends to capacity development. We are deeply grateful for this partnership with Switzerland and wish the authorities continued success in the months ahead.

The Acting Chair (Ms. Sayeh) adjourned the discussion.

ANNEX

- Gray Statements
- Staff’s Responses to Executive Directors’ Technical Questions
- Constituency Codes

Statement by Mr. Peter and Mr. Gindrat on Switzerland
Executive Board Meeting 23/43
May 31, 2023

On behalf of our Swiss authorities, we thank staff for the insightful policy discussions and the thorough analysis presented in their report. The report covers the key policy challenges, and the authorities are in broad agreement with the staff's appraisal and the thrust of their recommendations. These recommendations will be useful in guiding the policies and further reform steps of our authorities.

Globally Active Banks

The authorities took decisive action under extraordinary circumstances on March 19, 2023, to enable the acquisition of Credit Suisse by UBS. Without a credible solution, Credit Suisse risked failing on Monday, March 20. The Swiss government, together with the Swiss National Bank (SNB) and the Swiss Financial Market Supervisory Authority (FINMA), acted quickly and decisively to (i) restore trust and calm, thus contributing to the stability of the Swiss and the international financial system; (ii) ensure the well-functioning of financial markets in Switzerland and internationally; and (iii) protect Swiss taxpayers. To achieve these goals, the authorities assessed several alternatives. A resolution plan, including a full bail-in, had been prepared and was carefully considered. However, given the global and specific circumstances, notably extraordinarily fragile financial markets and the widespread loss of trust in Credit Suisse, the solution of combining a private sector takeover with supporting measures by the authorities (in particular in the area of liquidity provision) was deemed most effective. The functioning of the services of the financial sector was guaranteed at all times and without interruption. The implementation of the acquisition is progressing well. It is the authorities' key priority that the takeover be completed in a timely manner.

The authorities agree with staff on the importance to conduct a thorough analysis of the case and lessons learned. They will undertake a broad review of the Too-Big-to-Fail (TBTF) regulatory regime by end-March 2024. This review will address a broad range of issues, covering recovery and resolution planning; capital and liquidity requirements; FINMA's competencies (including the power to impose fines); the rules governing compensation practices, auditing, and responsibilities of senior management; the provision of emergency liquidity assistance; and the deposit insurance system.

Economic Outlook

The authorities broadly agree with staff on the outlook and risks.

While Switzerland's GDP grew by 2.1 percent in 2022, growth was flat in Q4. The current economic indicators point to a more solid performance in Q1 2023. In relative terms, inflation has increased strongly, but its level remains much lower than in most other advanced economies.

The level of uncertainty associated with the outlook for the Swiss economy remains high. The further course depends to a large extent on global economic developments and the energy supply situation. The main risks stem from an economic downturn abroad, more persistent inflationary pressures, and the potential adverse effects of uncertainties in the global financial sector.

Against this backdrop, Swiss GDP is expected to expand by around 1 percent in 2023, significantly below average. This forecast assumes that there will be no energy shortages with widespread production outages next winter. At the same time, gas and electricity prices are expected to remain high by historical standards. The economic slowdown is likely to affect the labor market, albeit with a lag. Following an average of 2 percent in 2023, the unemployment rate is projected to sightly increase in 2024.

The impact of UBS's acquisition of Credit Suisse on the Swiss economy is expected to remain limited. The very low level of unemployment and continuing strong demand for labor should help cushion the expected negative impact of job cuts.

Monetary Policy

Inflation has decreased from a high of 3.5 percent in August 2022 to 2.6 percent in April 2023, with the latest decline driven by energy and food products. According to the SNB's conditional inflation forecast published in March, inflation is set to decrease further and reach 2 percent by the end of the year. Nevertheless, it cannot be ruled out that further policy rate hikes will be necessary to bring inflation back to the 0–2 percent range that the SNB equates with price stability. While policy rate changes are the main tool to ensure appropriate monetary conditions, sales of foreign currency are currently useful for dampening depreciation pressure, and thus imported inflation. The SNB also remains willing to buy foreign currency again, should excessive appreciation pressures materialize.

Fiscal Policy

The fiscal rule at the central government level—or debt brake—has served Switzerland well, maintaining credibility of the fiscal framework and ensuring fiscal sustainability, while allowing for extraordinary spending during past crises. As mentioned in the report, guarantees related to UBS's acquisition of Credit Suisse will only affect the fiscal position if called. Meanwhile, these guarantees are generating interest revenue for the central government.

Current plans for amortizing past extraordinary spending may be affected by the drop in future profit transfers from the SNB. At the same time, as noted by staff, the current projection of no profit transfers from the SNB until 2026 is a conservative assumption. Also, the authorities highlight (i) the extension of the deadline for eliminating the shortfall of the amortization account to 2035, with the option for a further prolongation to 2039, and (ii) the use of future structural surpluses, which will facilitate the compensation of extraordinary spending even without profit transfers from the SNB.

The authorities agree with staff that medium- and long-term spending needs for ageing, climate, energy, and national security will have to be addressed.

External Sector Assessment

The authorities agree with the staff's external sector assessment that Switzerland's current account surplus is broadly in line with fundamentals. While staff indicate that this assessment will be finalized in the upcoming External Sector Report, the authorities do not expect a significant change.

Measurement issues continue to significantly inflate the Swiss current account balance, and the authorities welcome that staff have considered these issues by adjusting the External Balance Assessment (EBA) current account gap accordingly. However, the authorities stress that, even though staff refer to this adjustment as Switzerland-specific, adjustments due to measurement issues are an integral part of the EBA methodology and, thus, systematically applied to other countries as well. Measurement issues help explain discrepancies between cumulated current account balances and the net international investment position (NIIP). Such discrepancies are not specific to Switzerland and should generally continue to be carefully analyzed by staff.

Other Financial Sector Issues

The authorities share staff's view that the vulnerabilities in the residential real estate market remain elevated, although high prices can partially be explained by structural factors, such as the tight supply of single-family houses and apartments. The authorities will continue to monitor these risks and review whether further measures are necessary, including an expansion of the macroprudential toolkit with legally mandated tools. The authorities also concur on the need to monitor risks related to non-bank financial institutions (NBFIs) and fintech firms to enhance resilience and mitigate downside risks.

Switzerland has a robust AML/CFT framework. The latest amendments to the AML Act and the AML Ordinance came into effect at the beginning of this year. Work is currently underway on draft legislation on a central register for beneficial ownership of legal entities.

The authorities are also working on extending AML provisions to the legal professions, notably the provisions on due diligence, reporting obligations, as well as supervision and sanctioning. Draft legislation will be submitted to public consultation in August.

Switzerland continues to implement the EU financial and economic sanctions against Russia. The authorities are in close contact with international partners, including on the enforcement of financial sanctions.

Structural Issues

The authorities agree that the timely passage of the revised proposal for the Third CO2 Act is critical to emission reductions over 2025–2030. Substantial investments will be needed to reach 2050 emission reduction targets, and Switzerland recognizes the necessity to provide the policy framework to mobilize private capital at a pace and a scale consistent with the targets and in the most efficient manner.

Statement by Mr. Massourakis and Ms. Cerami on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for the insightful papers and Mr. Peter and Mr. Gindrat for their helpful Buff statement. The Swiss economy has demonstrated resilience against the fallout of Russia's war in Ukraine, with growth projected to moderate further this year but to return to about its potential in 2024, while inflation would decline towards the policy target. Continued prudent macroeconomic and financial policies are needed to shield the outlook from the risks of a global slowdown, tightening financial conditions, and a sharp correction in housing prices. Further progress on addressing long-term challenges related to aging, labor market tightness, energy security, and climate change will be key to preserving competitiveness. We share staff's appraisal and offer a few remarks:

- **The current fiscal stance is appropriate but maintaining a structural balance over the medium term will be challenging.** Staff projects a fiscal surplus despite the expected shortfall of profits transfer from the central bank and sustained spending on refugees. The authorities' balanced approach to offset the extraordinary spending with future surpluses, broadly in line with staff's recommendations, will support compliance with the Swiss fiscal framework. However, going forward additional measures might be needed, especially if the overall impact of the ongoing tax reforms results in a revenue shortfall or the guarantees related to the UBS-Credit Suisse merger are called in. We, thus, support the authorities' work to identify and incorporate spending needs related to demographics and the green transition in their medium-term fiscal framework.

- **The approach of the Swiss National Bank (SNB) to monetary policy normalization has been effective.** The transition away from the negative interest rates framework, engineered through a series of interest rate hikes, changes to sight-deposit tiering, repos, and foreign exchange sales, has been smooth. Moreover, the widening interest rate differentials with other advanced economies has contributed to further tightening through the foreign exchange channel. Close monitoring of price developments is warranted amid risks of second round effects, given the tight labor markets. We appreciate staff's analysis of the SNB' balance sheet changes in 2022 and agree with the main conclusion that both large profits and losses create communication challenges.

- **The rescue of Credit Suisse appears to have contained spillovers but rising risks to financial stability require close vigilance.** We commend the authorities for the prompt response to the episode of Credit Suisse, which helped contain contagion in the financial sector. However, tightening financial conditions might expose pockets of vulnerabilities in a context of high real estate prices and increased interconnectedness within the financial sector. We, thus, invite the authorities to continue implementing FSAP recommendations and improving the collection of data on financial linkages between banks and non-banks financial institutions (NBFI), as well as across NBFI, as suggested by staff in a Selected Issues paper.

We welcome the emphasis on energy security and climate change challenges. The authorities have addressed short term risks to energy security with positive spillovers to the transition to renewable energy. However, further measures are needed to achieve the authorities' climate goals for 2030 and even more to reach zero emissions by 2050. While the adoption of the pending CO2 Act and Climate Protection Act will be critical to meeting climate objectives, we agree with staff that there is scope for additional measures, especially at the sectoral level, to accelerate the green transition. Above all, we share staff's view that clear climate policies are needed to attract green investments with a long-term horizon and support the development of green technologies and financial markets. *We note that a large share of Swiss carbon emissions targets depends on emissions compensation projects abroad and would appreciate some information on the progress of these projects, if available. Also, could staff comment on the size of Switzerland's international compensation projects compared to peers?*

Statement by Mr. Bevilaqua and Mr. Miranda on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for the report and Mr. Peter and Mr. Gindrat for their helpful statement.

After a strong recovery in 2021, economic growth in Switzerland moderated in 2022, while inflation rose above the SNB's target range. Slower growth this year is expected to eliminate the positive output gap, which should help in containing broadening inflation pressures. We take positive note that medium-term inflation expectations remained anchored. The current account surplus is expected to moderate to 7.8% of GDP, which staff assesses as broadly in line with fundamentals.

The fiscal policy stance remains appropriate and consistent with the strong fiscal framework. Despite the drop in revenues and sustained spending on refugees, energy and national security, the fiscal accounts are expected to continue in surplus. We agree with staff that the extension of the deadline for eliminating the shortfall in the government's amortization account strikes the right balance and note the conservative assumption of no extraordinary revenues via SNB profit transfers, which we consider appropriate. We commend the authorities for their efforts to address medium and long-term spending pressures. Given low public debt and the strong fiscal framework, we agree with the authorities that tax reform should prioritize policy objectives over revenue considerations.

Monetary policy has successfully transitioned from the negative-policy-rate era. We note the reappearance of repos and bills in the SNB balance sheet as monetary policy has moved to removing surplus liquidity to balance supply and demand, in line with the new tiering arrangement for sight deposits. We note that, as inflation becomes more broad-based, core inflation has increased and is currently above the SNB's target range for headline inflation. In this context, we agree that the SNB must remain vigilant against inflation risks in order to maintain its credibility, noting that near-term inflation expectations have eased, and longer-term expectations remain anchored.

We commend the authorities for their decisive action to address financial stability risks from the situation at Credit Suisse. Considering that this was the result of long-standing weaknesses at the bank and that the state-facilitated merger was done outside the resolution regime, we take positive note of the authorities' intention to review their too-big-to-fail framework and encourage them to address any shortcomings in the supervisory and resolution frameworks that are identified. We encourage the authorities to continue implementing the 2019 FSAP recommendations, especially regarding strengthening FINMA's autonomy, governance, and accountability.

Structural challenges include climate change, energy security and geo-economic fragmentation. We commend the authorities for the progress made in addressing these challenges in the short term, including through measures such as proposing new climate change legislation, procuring reserve energy supply from hydropower and gas-powered plants, and enacting Pillar 1 pension reforms. We encourage the authorities to persevere in their efforts to ensure that these challenges are tackled over the medium-to-long run.

With these remarks we wish the Swiss authorities success in their endeavors.

Statement by Mr. Nakunyada and Mr. Mansaray on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for the comprehensive reports as well as Mr. Peter and Mr. Gindrat for their insightful Buff statement.

The Swiss economy is experiencing a growth slowdown reflecting the negative repercussions of the spillovers from the on-going war in Ukraine. Specifically, the growth constraining effects of high inflation stemming from elevated energy and food prices and underlying financial stability risks, remains concerning. Further, growth prospects remain dominated by aging, attendant skills gaps, energy security risks, and geo-economic fragmentation. Additional downside risks stemming from tight monetary policy, subsiding of pent-up demand, tight labor market conditions, wage pressures, and a weaker global growth continue to cloud the outlook. Against this backdrop, policy efforts should be directed towards supportive fiscal policy actions to stimulate growth while addressing the needs of an aging population. Focus should also be placed on addressing pockets of financial vulnerabilities and removal of structural impediments to mitigate risks from geo-economic fragmentation. We, therefore, share the staff's appraisal and emphasize the following points.

An expansionary fiscal stance would be essential to stimulate economic activity and reverse the growth slowdown. We welcome the debt levels as well as improved fiscal performance underpinned by increased social security collections, and the roll-back of pandemic related expenditures. That said, additional fiscal reform measures would be required to moderate elevated medium-term spending on energy, security, aging, and refugees. Further we urge the authorities to accelerate reforms geared towards increasing revenue generation and stress the need for utmost care to minimize distortions and revenue losses from such measures. That said, we welcome the authority's adoption of the budget clean-up plan and earmarked items expected to bring in savings pronounced in the March 2023 budget. Nevertheless, a credible medium-term revenue strategy consistent with the debt-brake rule, would be essential to maintaining the fiscal balance needed to respond to emerging risks. *Could staff comment on the progress of the multilateral convention and the proposed individual tax reform?*

We view a tight monetary policy stance as warranted to anchor inflation expectations given the rising consumer and housing prices, and tight labor market conditions. Accordingly, we support the central bank's actions to tighten monetary conditions as important to bring down inflation to within the target range. That said, we urge the authorities to carefully consider foreign exchange interventions by limiting them to the smoothening of volatile market conditions. Should inflationary pressures persist, the SNB should stand ready to further tighten monetary policy to anchor inflation expectations. In this connection, we agree with staff on the need for clear communication of monetary policy decisions. *Could staff clarify how the authorities can ensure congruency between monetary and fiscal policies to ensure that they don't work at cross purposes?*

We commend the authorities' swift actions to restore financial stability but encourage them to remain attentive to emerging pockets of vulnerabilities including from non-banks. While the merger of UBS and Credit Suisse (CS) helped prevent the bank failure, we stress the need for further actions to ensure the successful completion of this merger. Further, the size of the merged bank and its implications for bank competition, public sector risks, and potential diseconomies of scale should be carefully managed to avoid the complacency of a too big to fail scenario. That said, we welcome the authorities planned review of the Too-Big-To Fail regulatory framework as highlighted in the Buff Statement. At the same time, we look forward to an in-depth analysis of the key lessons that can be drawn from the case of CS, and how such management shortcomings can be avoided in future including through early warning mechanisms. More generally, the recent banking crisis calls for continuous, effective, and risk-based financial monitoring and supervision to identify pockets of vulnerabilities and preserve financial stability. That said, we welcome progress made in implementing the recommendations of the 2019 FSAP report, especially increased allocation and improved monitoring and supervision of fintech and crypto activities. Going forward, we urge the authorities to develop and adopt a clear strategy to accelerate implementation of the remaining recommendations to identify and address risks and vulnerabilities and safeguard the financial system.

Structural reform efforts should be intensified to address constraints from the aging population, tight labor market conditions, and deficiency in human resource skills to help create jobs and ensure long-term growth and development. While the authorities are working to identify potential costs associated with climate change-related events and address the aging population, we commend efforts directed at preventing energy supply shortages. At the same time, we positively note the strides made towards legislating reforms geared towards renewable energy development and supply, as well as reducing carbon emissions and financial disclosure of climate financing instruments. We also welcome the progress made by the Swiss authorities in re-engaging with the EU but urge intensified efforts to ensure a business-friendly environment to promote trade, and development.

Statement by Mr. Mizuguchi, Mr. Naka, and Ms. Ogihara on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for the comprehensive set of reports and Mr. Peter and Mr. Gindrat for the helpful Buff statement. Switzerland experienced 2.1 percent economic growth in 2022 supported by strong private consumption, and favorable fiscal performance led to a positive surprise. However, Credit Suisse's long-standing weaknesses raised global concern in March, while we note the staff's assessment that the overall financial sector has remained resilient. Looking ahead, the growth outlook is slowdown, accompanied by notable risks that have the potential to cause significant setbacks due to elevated uncertainty levels. The authorities should address the near-term challenges and take steps to tackle longer-term structural issues. We broadly concur with the thrust of the staff appraisal and policy advice, and offer the following comments.

It is appropriate to adopt an expansionary fiscal stance while maintaining a surplus for 2023, given the slowing economy and heightened uncertainty. As for tax reforms, it is crucial to prioritize the efficiency, fairness, and long-term advantages of the tax framework, while carefully balancing the impacts on revenue. We encourage staff to continue engaging in discussions with the authorities concerning both the implications for revenue and the most appropriate tax systems that offer overall benefits over the long term. We concur with staff's view that the authorities should tackle medium- and long-term expenditure needs within the regular budget and adhere to the fiscal balance rule. Addressing challenges posed by demographic changes should be given priority. At the same time, we also share the authorities' view on the complexities involved in estimating fiscal costs associated with climate-related initiatives.

The SNB's response to higher inflation and policy tightening is appropriate. The SNB has appropriately responded to price pressures utilizing policy rate hikes, liquidity absorption, and net FX sales to tighten monetary policy. Should inflation or its second-round effects persist, the SNB should continue to tighten and keep expectations anchored in a data-dependent manner. Regarding external sector, we note staff's preliminary assessment, and *would appreciate staff's further elaboration on the impact of Switzerland's institutional pension features and "reversion to trend" property of the empirical model. We would also like to ask the impact of the SNB's monetary policy unwind on the external sector assessments.*

We positively note that the financial sector remains resilient, while facing potential risks and vulnerabilities. Higher volatility, and greater uncertainty could lead to losses in the financial institutions, and it is crucial to urge vulnerable institutions to bolster their buffers in order to mitigate potential challenges. Also, if risks in the residential real estate sector continue to evolve, it would be necessary to implement tighter prudential tools and activating the broad-based CCyB, as well as considering further measures. Furthermore, we encourage authorities to address delayed progress in implementing the 2019 FSAP recommendations. Regarding fintech, we take note of staff's assessment that it seemed not severely affected by the global downturn or volatility in 2022, and *we would like staff to further elaborate the government's initiatives on this front, such as regulatory data collection.*

Effective consolidation of UBS and CS businesses will be critical. While the event concerning CS is considered unique to the bank, it is crucial to conduct a thorough examination of the case and its impact on both Swiss and international supervisory and regulatory frameworks. We concur with the staff's viewpoint, emphasizing the need for close monitoring of the merger's implementation by the authorities. Additionally, we welcome the forthcoming reviews by the authorities and the Financial Stability Board (FSB) peers. Timely disclosure of information is also essential to maintain market confidence.

Tackling medium and long-term challenges is important to ensure sustainable growth and boost productivity. We welcome recent measures to strengthen energy supply, and agree with staff that further efforts are needed to ensure a secure, low-carbon energy system in the medium- and long-term. It is crucial to pass the revised proposal for the Third CO2 Act, as it plays a significant role in achieving the emissions targets set for 2030. Furthermore, preparatory work and measures need to be implemented to address substantial investment requirements and achieve objectives beyond 2030. Also, the tight labor market and labor shortages pose a threat to competitiveness, particularly in the face of persisting demographic pressures. It is worth noting that there are no quick solutions, considering the already high participation rate and individual work-leisure preferences. Therefore, enhancing labor productivity becomes paramount in this context. We welcome the Pillar 1 pension reform package passed in 2022, which will ensure adequate financing through 2030. However, further actions are necessary to ensure the long-term sustainability of the pension system, including measures concerning Pillar 2. It is essential to approach these reform measures while considering the complexities involved in achieving sustainable outcomes.

Joint Statement by Ms. Lim, Mr. Nicholl, Mr. Becker, and Mr. Kurniawan on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for the informative set of reports as well as Mr. Peter and Mr. Gindrat for their helpful Buff statement. We appreciate the focus of the discussion on the main short-term and structural economic challenges, as well as key policy challenges, and broadly concur with the staff analysis.

As economic growth is expected to slow in 2023, inflation appears to be broadly under control, and risks to economic growth are tilted to the downside, the current expansionary fiscal stance is appropriate. We note that the general government surplus in 2023 will be lower compared to the previous year and is driven by increased spending and an expected zero Swiss National Bank (SNB) dividend payment. Should downside risks to growth materialize, we agree that automatic stabilizers should be allowed to operate. Notwithstanding spending needs to address structural issues such as its aging population, climate change, energy, and national security, a clear medium-term plan on how fiscal space will be created within the fiscal balance-rule is important. We positively note that the debt-brake rule worked well, and that debt is expected to decline as discussed in the DSA.

The monetary policy response has been appropriate. With inflation risks on the upside, authorities should stand ready to tighten policy rates further should second-round effects persist. We welcome the explanation of the transition strategy from keeping money market rates close to the low-tier rate, to nearing the high-tier rate by balancing liquidity supply with demand in Box 1. We also note that net FX sales recently contributed to policy tightening. On monetary policy, we agree with staff that if second-round effects persist, further tightening will be needed. *Additional information on the interaction between inflation and wages, given tight labor market –which is mainly driven by structural factors– would be welcome.* We note that the SNB has taken measures to re-establish its capital position after a significant financial losses were incurred last year. In this regard we support the staff suggestion for the SNB to continue regular reviews of its investment strategy, maintain adequate safeguards, and consider FX sales to reduce the balance sheet.

We positively note decisive and prompt actions to address financial stability concerns by the authorities. As highlighted in the GFSR, the recent volatility in global financial markets, including the loss of market confidence in Credit Suisse (CS), underscores the challenges posed by the interaction between tighter monetary policy and financial conditions. While the state-facilitated UBS-CS merger helped to reduce potential financial risks and restore market confidence, we note that the consolidation of two G-SIBs will be complex and is expected to take time. Given the complexity of a fluid situation, it is important to continuously update the assessment of risks of the merger, such as the potential job losses and spillovers to the rest of the financial sector and economy more broadly. Staff rightly points out that closely monitoring the implementation of the merger and conducting a resolvability assessment of the merged UBS-CS are crucial to ensure effective consolidation. While the rest of the financial sector appears relatively sound, the importance of NBFIs to the financial sector stands out and will warrant close monitoring given the risks around the outlook for this sector globally. In this regard, hidden leverage and the potential for a sharp unwinding of elevated residential real estate prices warrant close study given the extent they will influence the asset side of balance sheets. We agree that activating broad-based countercyclical capital buffer and tightening prudential tools (within the self-regulation framework) can be considered, and structural issues should be addressed by supply-side measures. In light of recent financial sector developments, it is all the more pertinent that the authorities are steadfast in implementing the 2019 FSAP recommendations to strengthen financial resilience. Given that Switzerland is among jurisdictions historically promoting a comparative advantage in international financial services, this should be matched with maintaining the highest standards of regulation and oversight. In particular, we expect the governance, accountability, and autonomy of FINMA to be addressed as a priority.

It is imperative for the authorities to continue their reform efforts to tackle long-standing structural issues. Notwithstanding demographic challenges, we agree on the importance of sustaining efforts to address structurally tight labor market conditions, such as promoting broader and longer workforce participation. In this regard, we positively note the gradual retirement age increase for women as part of the first-pillar pension reforms that will come into effect in 2024. Efforts to ease labor market constraints should also help to lessen inflationary pressure in the medium to longer term. On climate policy, we agree with staff on the importance of the timely passage and implementation of proposed revisions to the CO_2 Act to achieve Switzerland's climate targets.

We agree with staff on the need for further efforts to strengthen the AML/CFT framework. Gaps in the compliance framework that continue to allow concealment of foreign proceeds of corruption should be addressed. We note from the authorities' views that draft legislation is already in train, and urge them to move expeditiously to put the necessary rules in place. Switzerland should be in a good position to comply more fully with global standard and best practices.

Statement by Mr. Bijani and Mr. Badsi on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for the well-written set of reports and Mr. Peter and Mr. Gindrat for their insightful Buff statement. We broadly concur with the thrust of the staff appraisal and offer the following comments.

After a brief upturn in 2021 following the pandemic, Switzerland's economic growth slowed down in 2022 but is expected to bottom-out in 2023. While supported by strong financial buffers, policies succeeded in keeping inflation under control against a backdrop of strong domestic labor market. We take positive note of the authorities' decisive actions aimed at addressing financial stability concerns and potential spillovers from Credit Suisse failure and its state-facilitated merger with UBS. We welcome the shared view between the authorities and staff on the external assessment and on the outlook and risks. The latter are skewed to the downside, mainly driven by an abrupt global slowdown, deepen geo-economic fragmentation, and a systemic financial instability.

On the fiscal side, we positively note the availability of a broad range of fiscal tools to support growth should downside risks materialize, including through automatic stabilizers, extraordinary provisions of the debt-brake rule, the low public debt level, and binding timelines. We see merit in the current plans for amortizing past extraordinary spending and commend the authorities for the ongoing tax reforms, including by improving efficiency, removing distortions, and leveling the playing field. We look forward to the parliament approval of the proposed VAT measures aimed at improving tax compliance, streamlining processes, and achieving specific social objectives. The proposed measures will also help address the expected structural deficits and spending needs, including those related to aging, climate, energy, and national security.

We welcome the Swiss authorities' monetary and exchange policy response which have been instrumental in dealing with challenges posed by inflationary pressures. Although the financial sector remains resilient with adequate buffers, stronger macroprudential policies would be warranted due to the growing financial stability risks. There is no room for complacency. While an effective and close monitoring of the UBS-CS merger is critical, we encourage the authorities to remain vigilant towards cyber, NBFIs and Fintech risks. We welcome the shared views between the authorities and staff on the monetary and the financial sector policies and call on the authorities to step up efforts to implement the remaining recommendations of the 2019 FSAP. *Could staff provide us with more elaboration on the scale of the US regional banking turmoil in the Swiss banking system?*

Strides made on reducing carbon emission, ensuring short-term energy security, and improving disclosure of climate-related financial information are commendable. We welcome the authorities' readiness to start preparatory work on measures for emission reductions beyond 2030. We support the staff's recommendation for tackling demographic challenges arising from an ageing population, which are vital for a smooth functioning of the labor market. We encourage the authorities to press ahead with tangible measures to address the remaining shortcomings on AML/CFT and to strengthen the anti-corruption frameworks.

Statement by Mr. De Ramon-Laca Clausen, Mr. Lopez, and Ms. Moral Betere on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for their insightful report and the timely selected issues. We also thank Mr. Peter and Mr. Gindrat for their informative Buff statement. We share staff's analysis and recommendations, which also concur with those of the authorities, and would like to add some remarks.

The Swiss economy has slowed down due to spillovers from the war in Ukraine. Switzerland's recovery has been undermined by the global slowdown linked to the war, while internal demand has remained strong, underpinned by an unusually tight labor market and a record low unemployment rate, putting pressure on inflation. Going forward, the economic outlook is subject to downside risks and high uncertainty, mainly associated with the evolution of the war in Ukraine, tighter monetary conditions globally, potential risks in the real estate and financial markets, and those derived from the progressive loss of access to the Single Internal Market of the EU after the non-signing of the Institutional Agreement (IA) with the European Union in 2021. In this vein, although we welcome progress made towards a potential accession to the EU single market, we believe that the report is too optimistic about the prospects of an agreement. *Could staff comment on a potential commitment regarding the time horizon within which a compromise could be reached?* We welcome the Selected Issues Paper on the influence of ECB monetary policy on the Swiss equity market, which only reinforces the need for regional convergence.

We concur with staff that the fiscal stance remains appropriate. Like staff, we believe that the decision to lengthen the amortization period of the extraordinary spending is adequate as it will smooth the consolidation path required by the debt brake rule without undermining the credibility of the fiscal framework. We welcome ongoing tax reforms aimed at improving efficiency and introducing international initiatives, and we concur with the authorities that public policy objectives may outweigh revenue considerations. Going forward, *how does staff assess the possibility of relaxing the actual framework to accommodate future challenges, like aging and climate transition, given that they imply structurally higher expenditures?*

The SNB should continue orienting its policy decisions in a data driven fashion, being ready to tighten further if inflationary pressures persist while prudently assessing the need for FX interventions. We agree with staff that past policy rate hikes have been effective and should continue as needed to maintain well-anchored inflation expectations. In the current context of upside risks to inflation, FX interventions should remain a useful and complementary monetary policy tool to confront only depreciation pressures resulting from interest rate differentials with other advanced economies. We also agree with staff that careful management of the SNB's balance sheet and a clear communication strategy to fully understand policy interventions by markets would help reduce financial risks. *Could staff comment on the impact of protectionist measures on agricultural products and inflation?*

It is important that Switzerland maintains its vigilance for financial stability given the challenging world macroeconomic outlook. Banks and NBFIs appear to have adequate buffers as per the stress test, but authorities should remain vigilant, particularly around interlinkages, in times of stress. If imbalances grow in the real estate market, authorities should be ready to activate the CCyB, and banks should use buffers to absorb losses if they materialize without hurting credit flow. Monitoring the implementation of the UBS-CS merger is critical, given its implications on many levels for the Swiss economy and because of the institution's standing among the largest GSIBs. Over time, reviewing the long-running unsuccessful efforts to stabilize CS and the choices and costs around its ultimate demise will be very welcome and necessary, and hopefully it will yield lessons for Switzerland and other regulators around supervising and resolving GSIBs. Finally, an expedited implementation of the remaining 2019 FSAP recommendations, aimed at ensuring effective and predictable supervision, is critical, given the importance of Switzerland as a financial center. Regarding NBFIs, we concur with staff on the need for enhanced coordination between the SNB and the different sectoral regulators; Swiss NBFIs handle a good deal of foreign saving, so the potential for significant spillovers in a crisis is not far-fetched.

Further efforts are needed to address major structural challenges to increase productivity. We welcome the progress made in the reform of the pension system, which is one of Switzerland's main challenges, and helps to ensure sufficient Pillar 1 financing through 2030. Going forward, further efforts are needed to guarantee the sustainability of Pillar 1 beyond 2030 and of Pillar 2. Regarding the labor market, boosting labor productivity is crucial to ease long-term market pressures, as is introducing certain measures to promote gender equality and increase female participation. We agree with staff and the authorities that the timely passage of the revised proposal for the Third CO2 Act is critical to emission reductions over 2025–2030 as well as the need for substantial investments to reach 2050 emission reduction targets. In this vein, could staff comment on whether Switzerland is providing the policy framework to mobilize private capital towards these objectives?

With all these comments, we wish the Swiss authorities all the best in their future endeavors.

Statement by Mr. Jennings, Mr. O'Brolchain, and Mr. Day on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for the clear and informative report and Mr. Peter and Mr. Gindrat for their helpful Buff statement. While growth in 2022 was still above medium-term potential, it was affected by Russia's invasion of Ukraine, through higher energy prices and inflation, and spillovers from the global slowdown. In 2023, growth is expected to slow further, inflation is above the price stability range (though remains lower than in most other advanced economies), risks are tilted to the downside, and uncertainty is high. **We broadly agree with staff's assessment** and offer the following comments for emphasis.

We agree with staff and the authorities that a clear medium-term plan is needed to address significant medium- and long-term spending needs within the ordinary budget and the fiscal balance rule. We note that additional measures will be needed to eliminate structural deficits during 2024–26 at the confederation level. We welcome that the authorities are updating their public finance sustainability report, including spending needs from demographics. For 2023, we note staff's assessment that a looser fiscal stance, while maintaining a continued surplus is appropriate given the nature of Switzerland's underlying factors and a slowing economy. *Noting that fiscal consolidation can take time, especially for expenditure, can staff comment on the consistency of the recommendations on addressing projected structural deficits in 2024-2026 and loosening fiscal policy in 2023*? If downside risks to growth materialize, automatic stabilizers should be allowed to operate. We positively note that the low public debt level provides a buffer against risks stemming from contingent liabilities. We generally welcome the authorities' planned tax reforms, including preparation for the OECD-led international initiatives, though note that revenue impact is uncertain at this stage. *What are the VAT measures aimed at achieving specific social objectives?*

We positively note that the policy response of the Swiss National Bank (SNB) to inflation has been appropriate, and has incorporated policy rate increases, liquidity absorption via repos/bills, and recent net sales of foreign exchange**.** The SNB should continue in a data-driven manner, and we agree with staff that enhanced SNB communications would be useful in guiding the market and achieving policy objectives. We thank staff for the Selected Issues Paper assessing the SNB balance sheet changes in 2022 and agree that this highlights communication challenges that the SNB faces. We positively note that this is not expected to have material impacts on Switzerland's macroeconomic policies or monetary policy operations.

We positively note that aside from Credit Suisse, the financial sector has remained resilient, though with pockets of vulnerability the authorities should continue to close regulatory data gaps, closely monitor risks, and adapt or strengthen regulations as needed. As implementing the merger will be long and complex, the authorities will need to carefully and transparently supervise its effects on the wider financial sector. We are encouraged from the Buff statement that the authorities agree with staff that a thorough analysis of the merger and lessons learned be conducted, and look forward to the review of the Too-Big-to-Fail (TBTF) regulatory regime by end-March 2024. We encourage the authorities to strengthen the Financial Market Supervisory Authority's autonomy, governance, and accountability. We welcome staff's Selected Issues Paper on non-bank financial institutions (NBFIs) and vulnerabilities. We positively note that Swiss NBFIs appear broadly sound, though agree that continued close monitoring and enhancing data collection on linkages is warranted given uncertainties surrounding global financial conditions. We note that Fintech in Switzerland did not seem to be severely affected by the global downturn or volatility in 2022. Residential real estate market imbalances remain a concern and we would encourage the authorities to consider further supply-side actions as suggested by staff. We agree that further progress is needed on the 2019 FSAP recommendations to strengthen resilience, noting staff's view that progress to date has been slow. We note progress and proposals to further strengthen the AML/CFT and anti-corruption frameworks.

We note from staff's Selected Issues Paper on climate change mitigation that meeting Switzerland's targets requires a substantial increase in the pace of emission reductions. We urge the authorities to swiftly implement the revised CO2 Law. We note that unlike the previous proposal, it does not include new taxes or revisions to existing environmental taxes or carbon pricing mechanisms: *staff comments on context and implications are welcomed*. The Climate Protection Act, subject to referendum, would be a positive development, enshrining in law sector-level emission reduction targets, and mobilizing capital investments. We welcome that as part of its sustainable finance strategy, Switzerland is also assessing the need for regulation to combat greenwashing.

Given the tight labor market and demographic challenges, we agree with staff that the authorities should continue to promote broader/longer participation. Policies should include closing skills gaps and improving childcare support. We would have appreciated analysis by staff on efforts to close remaining gender gaps: *staff comments are welcomed*. We note that further pension reforms will be required to ensure sustainability beyond 2030.

Statement by Mr. Subramanian and Mr. Dash on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for the well-written reports and Mr. Peter and Mr. Gindrat for their insightful buff statement. We broadly agree with the thrust of the staff reports and offer the following comments.

With a strong fiscal framework and continued surplus, the current expansionary stance is appropriate. The economy is on a declining growth trajectory and fiscal support can impart the stimulus to bring economic activity back on steam. At the same time, we agree with staff that fiscal support should become more targeted, time-bound, and non-distortionary in the event of further downside risks materializing. Also, the authorities need to provision for expected rise in social expenditures for the future and the longer-term spending needs . We also agree that tax reforms should not lead to revenue losses. We encourage further pension market reforms under Pillar 2 to improve coverage and fiscal sustainability.

Monetary policy should stay the course and be data driven while enhancing the communication for effective monetary policy transmission . We welcome the March 2023 policy rate hike by SNB to counteract high inflation which is well above the SNB's target of below 2%. SNB should stand ready to further raise policy rates to anchor inflationary expectations and bring the same down to the target range. The financial sector stability is extremely critical, and we commend the authorities for the swift action taken to nip the banking crisis in the bud when they implemented the UBS take-over of Credit Suisse as it was sliding into turmoil. The high interest regime is yet to play out its full course and there is need for close monitoring of the sector including the UBC-CS merger and other entities in the sector and tightening prudential norms if needed. We look forward to the review of the Too-Big-to-Fail (TBTF) regulatory regime and the recommendations on capital and liquidity requirements, emergency liquidity assistance and recovery and resolution. We would encourage full implementation of the 2019 FSAP recommendations.

Structural reforms are critical to ensure long-term sustainable growth and a green energy transition. We encourage the steps taken to secure the energy supply and the climate-friendly measures. We understand that the ordinance on mandatory climate disclosures would come into effect in 2024 . *Could staff clarify the probable impact on the financial sector stability from such mandatory disclosures by large public companies, banks, and insurance companies who have to report on both the effects that climate change has on them and the impact of their activities on climate change.? What contingency measures are being developed in this regard?* The tight labour market is a primary driver of the current inflationary pressures, and we welcome efforts to ease the conditions through higher greater labour force participation and addressing productivity and skill gaps. *It appears immigration into Switzerland has been on the decline since 2012 and it would be interesting to know if authorities are looking at policy measures to attract skilled labour by further* *liberalizing the services sector especially with the advent of technology facilitating remote services. Staff comments are welcome.* We also encourage the authorities for their continuing EU dialogue for more robust institutional framework with EU to further diversify the economy and secure a better future for the economy.

With this, we wish the authorities all success in their endeavours.

Statement by Mr. Herrera and Ms. Mostajo on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for the informative report and the Selected Issues paper on Switzerland and Mr. Peter and Mr. Gindrat for the helpful Buff statement.

We agree with staff's appraisal on Switzerland's Article IV consultation and support its completion. Against this backdrop, we would like to offer a few comments.

We agree with staff that if downward risks materialize, automatic stabilizers should be allowed to operate fully, while providing targeted and non-distortionary support to households and firms if necessary. On tax policy, we acknowledge staff's concerns regarding the revenue impact of the authorities' reform agenda on this front; however, we see merit on the authorities' view that public policy objectives may outweigh revenue considerations and that efficiency gains could raise revenues in the long term. Moving forward, we concur with staff that a medium-term fiscal plan is needed to address key long-term structural spending associated with demographics, climate, and energy and national security, while avoiding structural deficits. In this respect, we were encouraged to learn that the authorities are working on updating their public finance sustainability report to include spending needs from demographic, while also working on addressing the spending needs associated with climate change.

On the monetary front, we welcome the Swiss National Bank's (SNB) commitment to contain inflationary pressures. Given the high level of uncertainty surrounding the growth outlook and inflation dynamics, a continuous review of the pace and magnitude of monetary tightening is warranted and, therefore, a data dependent approach seems appropriate. Along the same vein, we take note that to provide appropriate monetary conditions, the SNB remains willing to be active in the foreign exchange market as necessary.

We take positive note of the sound levels of capital and liquidity of the overall banking system, but close monitoring of risks is warranted. We acknowledge that the Credit Suisse merger with UBS helped in preventing a crisis and restoring market confidence in a context of heightened uncertainties. In this matter, we underscore the importance of closely monitoring its implementation and impact on the Swiss financial system, as well as reviewing the lessons from the situation that led to the merge. We were encouraged to learn from the Buff statement that the authorities see as a priority to guarantee that the takeover is completed in a timely manner, as well as their plan to undertake a broad review of the bank resolution regime by early 2024. On other financial sector issues, closely monitoring risks arising from the real estate market, as well as from NBFIs and from the growing financial technology sector, is warranted. Against this backdrop, we welcome the progress in the implementation of the 2019 FSAP recommendations and encourage the authorities to further progress on strengthening and broadening the financial market supervisory authority (FINMA) autonomy and framework to enhance financial stability.

Addressing the remaining structural challenges on the labor market and climate change will be critical to maintain sustainable growth. Regarding the labor market, we welcome the authorities' pension and labor market reforms introduced in the past years; however, additional efforts are needed to ensure pension sustainability and labor market balance. *Given the demographic challenges ahead and the already high participation rates, we concur with the authorities on the need to increase labor productivity. In this regard, we would appreciate staff's views on the authorities' agenda on this front.*

We commend the authorities' efforts in securing energy supply in the short term and acknowledge that medium- and long-term adjustments will take time and sizable resources. Along the same vein, we recognize the authorities' ambitious carbon reduction targets and achievements so far in sustainable finance and encourage them to further enhance reforms and investment plans to meet their ambitious emission objectives. In this regard, we welcome that the revised Third CO2 Act proposal is currently being discussed in parliament. We concur with staff and the authorities that the timely passage of the proposal is critical to achieve the expected emission reductions over 2025-2030. Finally, we welcome that the authorities recognize the need to provide a policy framework to mobilize private capital at a pace and a scale that is consistent with emission targets.

Statement by Ms. Marcussen and Mr. Kraavik on Switzerland
Executive Board Meeting 23/43
May 31, 2023

The Swiss economy has continued to grow above medium-term potential, but growth is expected to decelerate with risks skewed to the downside. Weaknesses in the global economy and high uncertainty have a large impact on the growth outlook for Switzerland. **In this context, we broadly share staff's appraisal on fiscal, monetary, financial, and structural policies, and would like to offer the following comments for emphasis**.

Medium-term fiscal challenges require attention. The current fiscal stance is broadly appropriate in the context of elevated inflation and slowing growth. Given that spending pressures for ageing, climate, and security are expected to mount over the medium- to long-term, the authorities should continue refining their estimates of spending needs in these key areas. Guarantees related to the CS-UBS merger also create a potential source of vulnerability. We agree that the low public debt level helps to mitigate risks related to contingent liabilities. Yet, the authorities will need to explore ways to create necessary fiscal space. While we note the authorities' expectation about efficiency gains from tax reforms, we share staff's concerns about potential revenue losses in the short term that would complicate meeting medium-term spending needs.

The authorities will need to implement appropriate policies to ensure that targets for greenhouse gas emissions for 2030 and beyond will be met. Missing the 2020 national target, even if only by a narrow margin, signals the need for further action. We welcome the authorities' comprehensive climate mitigation framework. Yet, we fully agree that sector-specific measures identified by staff may need to be introduced if planned policies to reduce emissions fall short of expectations. More needs to be done to decarbonize road transport and buildings sectors. Also, further consideration of harmonizing and broadening the coverage of carbon pricing would be appropriate. We share the view that it will be important, to the extent possible, to link emission reduction targets with specific policies that are expected to be implemented to achieve these.

The monetary policy response has been appropriate to address increasingly broad-based inflation. The SNB will need to stay vigilant and monetary policy decisions remain data dependent. We agree with staff's recommendations to increase the frequency of publishing data on FXIs and to refrain from using FXIs to curb appreciation unless it is warranted to smooth excessive volatility. We thank staff for their assessment of the SNB's balance sheet changes last year.

Events leading to the UBS-CS merger, while appearing idiosyncratic, have reinforced the need to carefully monitor financial stability risks. The authorities will have to ensure an effective consolidation of UBS and CS in a timely manner. Risks related to the new large GSIB need to be mitigated. *Could staff share their initial views on potential risks related to the merger?* Lessons remain to be learned from this case for the TBTF regime and we welcome the planned review of the regulatory regime, as elaborated on in the helpful BUFF statement.

Risks to both banks and non-bank financial institutions are mitigated by relatively strong buffers. Notwithstanding the recent stress in the banking sector, we agree that NBFI risks will also need to be closely monitored. In light of recent events, consideration should be given to possibly advancing the implementation of FSAP recommendations. Further strengthening the AML/CFT framework will have to continue to be a priority.

Housing market vulnerabilities should be addressed. It can be expected that the increasing policy rate will have a cooling effect on the market, but we agree that both macroprudential and supply-side measures should be considered to increase the resilience of the market. *Could staff comment on how the relatively short duration of fixed-rate mortgages in Switzerland compares to other countries with significant housing market vulnerabilities?*

Statement by Mr. Trott and Ms. Freeman on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for the helpful papers and Mr Peter and Mr Gindrat for their informative buff statement.

We agree with the broad thrust of staff's assessment, particularly on the appropriateness of the current monetary and fiscal stances and the priorities for structural reform. The travails of Credit Suisse and its necessary merger with UBS clearly loom large over recent events, and we note that decisive action was taken to manage the situation and to contain wider risks to global financial stability. We agree that it will be vital to reflect on lessons to learn, at the appropriate time. These lessons should be for Switzerland itself, but the Fund should also incorporate these into its wider financial surveillance. It is early days but we would already anticipate such an exercise noting the value in the post-2008/9 reforms to resolution frameworks, as well as interactions with financial stability risks associated with non-bank financial intermediaries, and how these relate to the global reform agenda in this area. These could usefully have been drawn out more in the staff report and accompanying selected issues paper, even at this early stage. On the merger itself, the health of the Swiss financial sector and its interaction with the real economy will depend on how effectively these businesses are integrated, as well as managing the implications of greater concentration. Recent events also make further progress against 2019 FSAP recommendations even more important.

Strong financial buffers in the wider financial sector and a resilient underlying fiscal position helped make broader conditions conducive to the swift action taken last year. The stronger than expected fiscal surplus in 2022 is also welcome, as are actions to strengthen public finances over time, including pension reform. Amongst the reasons why this is valuable is the importance of ensuring the fiscal space to help manage demographic transition and to invest in accordance with necessary structural reforms, not least in support of energy transition. We note positively that steps to drive forward this process have been proposed by the Government, including the Third CO2 Act and the more comprehensive Climate Protection Act. Passage and implementation of both will be important. In addition, we agree with staff that more concrete plans to meet Switzerland's long-term energy strategy post 2030 could be usefully set out given the need to make investment plans in the medium-term, including a framework to mobilize private capital for the investment needed. On the financial side, we welcome progress on climate-related financial disclosures and on sustainable banking.

Joint Statement by Mr. Mohieldin, Mr. Alhosani, Mr. Alrashed, Mr. Abdel-Rahman, Ms. Alfawaz, and Mr. Al-Kohlany on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for the informative reports and Mr. Peter and Mr. Gindrat for their helpful Buff statement. Since we broadly concur with the thrust of staff's assessment, we would like to focus our remarks on the following points.

- **We welcome that the fiscal balance has turned into surplus in 2022 but note that further efforts are needed to address medium-term spending pressures.** We note that the fiscal balance is expected to remain in surplus in 2023. Also, we note that the rise in contingent liabilities due to the recent bank guarantees is mitigated by low public debt levels and the authorities' prudent approach in mitigating risks. Nonetheless, spending pressures are expected to increase over the medium and long term due to a number of structural factors, including population aging and climate change. Therefore, we see merit in staff's recommendation to articulate a medium-term plan to create adequate fiscal space to cope with these longer-term spending pressures and maintain a structural fiscal balance. In this context, while we recognize the authorities' view on the importance of the public policy objectives of the ongoing tax reforms, we concur with staff that these reforms should not lead to overall revenue losses, given the expected increase in medium-term spending needs.
- **We positively note the SNB actions to tighten the monetary policy to contain inflation.** We encourage the SNB to remain vigilant about upside risks to inflation and to continue to adjust the monetary stance in a data-dependent manner to ensure that inflation is on a firm downward path toward its targeted level. On a related matter, we take note of the SNB's significant financial loss in 2022 and we encourage the authorities to advance ongoing efforts to strengthen the SNB's balance sheet and ensure its capacity to conduct monetary operations to achieve the policy objectives. Moreover, it is important to ensure that the SNB's investment strategy is continued to be underpinned by adequate risk controls and safeguards to limit financial losses and we are encouraged to note that the authorities will continue to prioritize robust safeguards going forward.
- **We encourage the authorities to remain vigilant about emerging risks to financial stability following the Credit Suisse case.** We note that the overall financial system remains sound and we welcome the authorities' decisive actions to address potential spillovers from Credit Suisse. Nonetheless, maintaining close monitoring of emerging risks, including those associated with the real estate sector, and potential pockets of

vulnerabilities among banks and non-bank financial institutions remains important in view of the still fragile financial markets' sentiment. Here, we join staff in encouraging the authorities to continue to close relevant data gaps and adapt supervisory and regulatory frameworks as warranted. In this vein, we also agree with staff on the importance of conducting a thorough review of the Credit Suisse case and the lessons learned for banks' regulations and its timely enforcement through effective supervisory actions as well as the adequacy of banks' resolution tools to ensure the predictability of resolution actions and avoid the need to take exceptional measures outside the resolution regime that could further undermine market sentiment at the time of stress. Furthermore, it is critical to continue to closely monitor the implications of the UBS-Credit Suisse merger on the Swiss banking system and the economy in the near and medium-term. On a related note, we encourage the authorities to advance their efforts to implement the outstanding FSAP recommendations to help enhance financial system resilience. On the financial integrity front, we encourage the authorities to build on the recent progress and maintain efforts to further strengthen the AML/CFT regime along the lines outlined by staff to prevent the concealment of foreign proceeds of corruption.

- **Sustaining ongoing reform efforts is vital to further enhance economic resilience and sustainability.** Addressing the tight labor market through a combination of increased productivity and broader labor force participation is key to enhance competitiveness. Also, we encourage the authorities to maintain progress on pension reforms to ensure the sustainability of the pension system over the longer term considering the aging population. Moreover, ensuring energy security is key for economic growth prospects. Therefore, it is critical to continue to balance emission reduction goals with ensuring energy security. We are encouraged to note the broad agreement between staff and the authorities on the reform agenda and recognize the authorities' view that there is no quick fix to these structural challenges. Finally, we positively note the authorities' view on the importance of international cooperation and welcome their commitment to promoting a rules-based international economic and trade system and the efforts to expand their international cooperation and trade network with other partners.

With these remarks, we wish the authorities well in their endeavors.

Statement by Mr. Sylla, Mr. N'Sonde, and Mr. Carvalho da Silveira on Switzerland
Executive Board Meeting 23/43
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.

Statement by Mr. Zhang and Ms. Qi on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for the informative set of reports and Mr. Peter and Mr. Gindrat for their helpful Buff statement. Switzerland's post-pandemic recovery is expected to moderate. Prudent and data-dependent macroeconomic policies remain needed to guard against risks from synchronized global slowdown and sharper correction in housing markets. We commend the authorities for the decisive responses to address the financial stability concerns and potential spillovers from the challenges faced by Credit Suisse. We broadly agree with staff's appraisal and would like to offer the following comments for emphasis.

We agree with staff that the current fiscal stance remains appropriate and in line with the fiscal framework. We concur with staff that extending the deadline for amortization past extraordinary spending can avoid excessively sharp adjustments and strikes the right balance between limiting headwinds from higher surpluses and maintaining the credibility of the existing fiscal framework. There are multiple ongoing tax reform initiatives with uncertain revenue impact. We agree with the authorities that public policy objectives may outweigh revenue considerations on this front. Meanwhile, we welcome the authorities' continued efforts on allocating necessary resources to address aging, climate, energy security, and other key challenges pertaining to the longer term.

The Swiss National Bank (SNB) should remain vigilant against inflation risks. The combination of policy rate hikes, adjustments of sight-deposit tiering, and repo operations has been effective in containing inflation. As inflation has become more broad-based, the SNB is encouraged to continue tightening to deal with second-round effect. We note the SNB's financial loss, partially caused by mark-to-market accounting, created communication challenges. We encourage the SNB to continue prioritize robust safeguards in its investment strategy.

The spillovers of Credit Suisse have been contained by prompt rescue measures. We commend the authorities for their decisive response while encouraging the authorities to conduct a careful review and analysis of the case and lessons learned. The tightening global financing conditions might elevate financial vulnerabilities because the different financial segments are growing to be more interconnected. Therefore, the review should be comprehensive, assessing both bank and non-banks financial institutions (NBFI) risks and analyzing the implication of the Credit Suisse-UBS merger for the Swiss and global TBTF regime. As for the financial vulnerabilities of the residential real estate market, the regulator should guide the bank to tighten prudential tools and consider activating broad-based CCyB. We also encourage the authorities to consider supply-side solutions to play a synergetic role.

Effective structural reforms are key to promoting green and sustainable transformation. We stress that substantial investment is needed to reduce carbon emissions. Therefore, the timely passage of the Third CO2 ACT is critical for setting the right path to achieve 2030 emissions targets. Efforts to improve labor-market participation and pension-system sustainability should continue. In addition, we welcome the authorities' efforts to continuously strengthen its AML/CFT framework.

With these remarks, we wish the authorities every success in their policy efforts.

Statement by Mr. Stephan and Mr. Boehme on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for the interesting reports. We also thank Statement by Mr. Peter and Mr. Gindrat for their helpful Buff statement. We broadly concur with staff's assessment. Switzerland's economic growth slowed in 2022 and moved close to the medium-term potential of 2.1 percent of GDP while inflation has moderately exceeded the 2 percent target and is projected to remain above it until 2024. Financial sector uncertainties have risen in the context of the state-facilitated merger of UBS and Credit Suisse (CS). We acknowledge staff's assessment of downside risks to the outlook stemming not only from more persistent inflation but also from weaker global growth and geo-economic fragmentation. Against this backdrop, bilateral and multilateral cooperation as well as well-functioning free-trade agreements will continue to gain in importance for a small open economy such as Switzerland.

On fiscal policy, we take positive note of the projected balanced budget for 2022 and the compliance with the debt brake. While we appreciate the low level of public debt, we also notice a sizable increase in staff's public debt figures for 2023 due to a surge in contingent liabilities. According to staff this rise is "*reflecting contingent liability of CHF 109 billion [13.4 % of GDP] from government guarantees to SNB and UBS*" and *"represents an upper bound (...) as the government may recognize the contingent liability gradually over time"*. *Beyond the mentioned contingent liabilities, could staff elaborate on the differences of their public debt projections in Table 1 (p. 31) and Figure 4 in Annex VII (p. 52)?*

We agree with staff that the monetary response has been effective to contain inflationary pressures. Going forward, the SNB should stay vigilant in the fight against inflation and is well advised to continue with its data-dependent monetary tightening to firmly anchor inflationary expectations and ensure price stability. We note staff's recommendation that if faced with depreciation pressures, these could be mitigated by a reduction of FX holdings by the SNB.

The state-orchestrated take-over of Credit Suisse by UBS is leading to a significant change in the Swiss banking landscape which requires thorough supervisory monitoring and review. We echo staff's call that a resolvability assessment of the merged GSIB will be vital to safeguard financial sector resilience. Close monitoring and supervision are warranted due to the size and complexity of the merger and the involved impact on the

Swiss financial sector and economy in general. Additionally, we echo staff's call for a careful review and analysis of the case. This includes lessons learned from the merger which we deem vital not only to safeguard Swiss financial resilience, but also for the international financial system. In this regard, we look forward to the forthcoming reviews by the FSB.

We take note that staff assesses the external position of Switzerland to be broadly in line with medium-term fundamentals and considers existing policies as desirable. We notice the rather complex measurement issues and data revisions regarding the assessment of the external position which highlight that EBA norms should be interpreted with caution and policy recommendations need to be informed by a holistic assessment of the economic situation.

On the structural side, easing the tight labor market, stepping up climate change mitigation as well as pension fund reforms remain of the essence. Efforts to ease the tight labor market by promoting longer participation, to remove disincentives for hiring as well as measures to boost productivity – also considering current inflationary pressures and demographic challenges – remain an important policy area.

To achieve national and international climate targets, we agree with staff that more action is necessary as the overall as well as individual sector emission trajectories are not consistent with their respective 2040 emission targets. Meeting those targets requires a substantial increase in the pace of emissions reductions on the aggregate and sectoral levels.

We take positive note of the relatively mild impact from global supply chain disruptions and the repercussions of Russia's war of aggression in Ukraine for the Swiss economy due to its high competitiveness and extensive supply chain network. Nevertheless, disruptions to international trade and the global supply chain can be a high risk for a small open economy such as Switzerland. Against this backdrop, the relevance of bilateral and multilateral cooperation increases, and well-functioning free-trade agreements will continue to be essential.

Statement by Ms. Shortino, Ms. Medearis, and Mr. Keating on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for the informative report and Mr. Peter and Mr. Gindrat for the clear Buff statement. Switzerland has ably managed the exit from the pandemic, the energy spillovers from Russia's war against Ukraine, and an extraordinary financial stress episode. We agree that risks are tilted to the downside and that the growth outlook has weakened. **We encourage the Swiss authorities to use the fiscal space available to them due to their relatively low debt levels to make progress in addressing significant medium- and longer-term spending needs.** We do not share staff's assessment that Switzerland's current account surplus is broadly in line with fundamentals, and we see the persistently large current account surplus as providing further indication that there is scope to increase spending. We support the Swiss authorities' efforts to decisively address the financial stability implications of the deterioration of the long-standing weaknesses of Credit Suisse. We appreciate the informative and well-chosen topics covered in the selected issues papers.

We believe that Switzerland should aim for a looser fiscal policy stance given declining inflation and low debt, particularly because growth is slowing and the economy remains below its pre-COVID trend. With the upside surprise of a 1 percent of GDP fiscal surplus in 2022, we continue to see ample scope for the authorities to increase fiscal spending to address significant medium- and long-term spending and investment needs related to aging, climate, energy, and national security. *Staff comments on options for the authorities to refine their fiscal framework to lessen the structural bias toward fiscal surpluses and underspending would be welcome.* We commend the authorities' measured approach to amortizing extraordinary spending related to COVID. We applaud Switzerland's efforts to receive about 75,000 Ukrainian refugees and their plans to provide social services and support refugees.

We commend the authorities for the progress made towards implementing the OECD's Global Minimum Tax framework. We welcome efforts by the Swiss Parliament to make the constitutional changes to implement Pillar 1. We also appreciate the authorities' efforts to garner strong public support for approving Pillar 2, the global minimum corporate tax rate of 15 percent, for the upcoming referendum on June 18, 2023. While the overall revenue impact of these measures may be uncertain, we agree with staff that these and the authorities' other tax reform plans should be able to support medium-term spending needs.

We question staff's assessment that Switzerland's current account surplus of 10.1 percent of GDP in 2022 is broadly in line with medium-term fundamentals and desirable policies. The 2022 current account surplus increased from 2021 (8.8 percent) and remains higher than the ten-year historical average (6.6 percent), staff's medium-term forecast (7.8 percent), and staff's year-ahead projection from the 2022 Article IV (6.3 percent). Although there are some temporary factors such as an elevated merchanting surplus caused by higher commodity price volatility, we believe that there is a gap between the current account surplus and what is dictated by the Swiss economy's fundamentals and desirable policies. Staff justify its determination on the current account surplus with Swiss-specific adjustments in the income account, namely an adjustment for valuation losses on fixed-income securities arising from inflation (-3.6 percent). We remain skeptical of ad hoc adjustments to the EBA model outputs; *could staff comment on the extent to which similar adjustments were applied to other country cases this year?*

We view the Swiss National Bank's (SNB) policy response to higher inflation as appropriate and agree with staff that the authorities should pursue further rate hikes if incoming data suggest continued tightening is warranted. We agree with staff that the SNB should refrain from net foreign exchange intervention (FXI) if appreciation pressures arise, such as from a resumption in safe-haven inflows. *Could staff comment on how they would assess what constitutes "excessive market volatility" in the qualifier they use for their advice on avoiding FXI? How does this assessment relate to the Integrated Policy Framework?* We echo staff's call for more frequent publication of data on FXI.

We support the Swiss authorities in their efforts to take decisive action to shore up financial stability around the merger of UBS and Credit Suisse (CS). We commend the authorities for acting swiftly to find an effective resolution for CS and contain potential spillovers. We thank the Swiss authorities for their excellent communication and coordination with the U.S. government on all matters related to financial stability and regulation. We agree with staff that upcoming reviews, including by the authorities and the FSB, should look at the failure of CS management to address long-standing risks, the role of Swiss supervisors, and the implications of the merger for Switzerland's Too-Big-Too-Fail regime. We also agree with staff's assessment that residential real estate market imbalances are elevated and can pose a risk to financial stability. We encourage the authorities to address these risks by assessing the impact of higher interest rates on the real estate market and by easing constraints to housing supply, using target subsidies to support construction, and expanding social housing. We welcome the authorities' plans to carefully monitor risks related to non-bank financial institutions (NBFI) and the fintech sector. We look forward to progress on the draft beneficial ownership registry legislation and the authorities' work to extend AML provisions beyond the financial sector.

We agree with staff that passage of the Third CO_2 Act and the Climate Protection Act are important for achieving Paris Alignment, achieving emissions reductions targets for 2030 and 2040, and providing certainty to investors about Switzerland's commitment to achieving a green transition. We also commend the Swiss authorities for their efforts to expand utility scale solar and overall renewable energy capacity. We appreciated the thorough selected issues paper on "Climate Change Mitigation in Switzerland."

Statement by Mr. Potapov and Mr. Tolstikov on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for a set of well-written reports and Mr. Peter and Mr. Gindrat for their informative Buff statement. We broadly agree with the staff appraisal. The Swiss economy is slowing down, while inflation remains relatively high against the backdrop of external shocks and the tight labor market. Near-term macroeconomic policy mix should focus on reducing inflation while maintaining sound fiscal buffers. While the authorities should be commended for their resolute response to the Credit Suisse crisis, the revision of their too-big-to-fail framework is needed.

Given upside risks to inflation, further monetary policy tightening may be appropriate to contain second-round effects, proceeding in a data-driven manner. Inflation increased in 2022 and has become more broad-based. While tightening of the monetary policy stance by the SNB helped to slow down inflation in the first months of 2023, core inflation remains elevated. In case of persistently higher inflation or if policy interest rates differentials with other major central banks widen, the SNB may need to raise rates further and continue to reduce FX holdings.

Fiscal policy needs to be consistent with disinflation efforts and the credibility of the fiscal framework. Given its relatively ample fiscal buffers, Switzerland is less constrained in its fiscal policy choices. In this regard, we note that staff consider a looser fiscal stance appropriate in 2023, given the slowing economy. However, short-term loosening may not be in line with the authorities' disinflation goals, as well as the need to maintain credibility of the existing fiscal framework. Over the medium term, we see merit in a more gradual pace of offsetting extraordinary spending via future surpluses than it is assumed in the debt brake rule. Given the existing fiscal space, we agree with the authorities that the public policy objectives of the ongoing tax reforms may outweigh revenue considerations.

We commend the authorities for their efforts to maintain financial system stability. Their decisive actions successfully contained risks to the financial system from the Credit Suisse (CS) crisis. We look forward to the completion of the consolidation of UBS and CS. At the same time, we agree that a careful analysis of the CS case and its implications for the Swiss and international supervisory and regulatory frameworks is needed. We welcome the authorities' intention to review their too-big-to-fail framework. Residential real estate markets imbalances remain elevated, which creates vulnerability for the whole financial system through possible contagion. We agree that additional macroprudential measures may be needed to address rising risks.

Structural reforms should facilitate adjustments in the labor market. The authorities should continue to promote broader and/or longer participation of older workers, improve women labor market participation, and strengthen childcare support. Active labor market policies should enhance flexibility of the labor market. We take positive note of the implemented pension reforms, which are expected to ensure sufficient financing for Pillar 1 pensions through 2030. We welcome the development of further reforms to improve the pension fund long-term sustainability after 2030.

With these remarks, we wish the authorities further success.

Statement by Mr. Roman and Mr. Grossmann-Wirth on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for an insightful report, including the well-crafted and highly relevant set of selected issues papers. We also thank Mr. Peter and Mr. Gindrat for their very clear Buff statement. We agree with the thrust of staff's appraisal and policy recommendations and would like to make the following targeted remarks for emphasis:

- **A more accommodative fiscal policy is warranted in 2023 after a significant fiscal surplus in 2022. The uncertain environment and large fiscal space also call for flexibility going forward, while tackling longer-term challenges.** We support staff's view that that a more accommodative fiscal stance is appropriate in 2023 despite the high inflation environment, given the 2022 surplus, a slowing economy, and the nature of some factors (including the expected zero SNB profit transfers in 2023 – though we note, as highlighted by Mr. Peter and Mr. Gindrat in their Buff, that it is a conservative assumption). We also support staff's call for the consideration of targeted support to households and firms, beyond automatic stabilizers, in case of a materialization of downside risks. Finally, we agree that a careful planning of medium and long-term spending needs for aging, climate, energy and national security is warranted, including in the context of the fiscal balance rule constraints. We welcome the work by the Swiss authorities on identifying spending needs stemming from demographics and climate change. *Could staff comment further on whether they consider that the current fiscal framework, beyond the proven flexibility during crisis times, also allows for tackling longer-term challenges including climate change?*
- **We encourage the authorities to continue the close monitoring of financial risks, including in the context of the acquisition of Credit Suisse by UBS.** We appreciate the useful update on globally active banks provided by Mr. Peter and Mr. Gindrat in their Buff and support the continuation of a strong cooperation with European supervisory authorities. As mentioned both by staff and by Mr. Peter and Mr. Gindrat in their Buff, lessons remain to be learned from this case for the TBTF regulatory regime and we support the announced review by end-March 2024. We welcome the very informative and granular selected issue paper on NBFI. It does a good job in distinguishing the type of institutions, along the Annex 1 breakdown, and the type of key risks: leverage, liquidity, and interconnectedness. We indeed share staff main recommendations of a prudent regulatory and supervisory approach, the closing of regulatory data gaps combined with stronger risk management, and an enhanced coordination between regulators. We also agree that the fast-evolving nature of fintech deserve close monitoring.
- **We support the ongoing steps towards meeting the country's climate targets and encourage the authorities to consider additional measures to increase the pace of emission reductions.** The adoption and implementation of the third CO2 Act and the Climate Protection Act will be important steps. In addition, we agree with staff that

the pace of emission reductions should be increased. We welcome in this regard the informative selected issue paper on mitigation policies, which highlights the gap in the emission trajectories by sectors compared to targets and related policy-instrument and options to be considered. *In the context of recent discussions on climate in bilateral surveillance, this article IV is a good example of a substantive country analysis which should be preserved and generalized; could staff comment on the resources involved on climate analysis and whether it implied the contribution of additional climate experts?*

Statement by Mr. Palotai, Mr. Just, and Mr. Pucnik on Switzerland
Executive Board Meeting 23/43
May 31, 2023

We thank staff for the well-written and comprehensive reports, and Messrs. Peter and Gindrat for their helpful Buff statement. Notwithstanding the economic slowdown caused by the spillovers from Russia's war in Ukraine, Switzerland retains strong economic fundamentals, as well as credible and strong economic policies and frameworks. The Swiss banking system has remained sound despite Credit Suisse related challenges, but the enhanced monitoring of potential systemic risks is warranted to restore confidence in the financial system. Going forward, the authorities are encouraged to address long-standing challenges, which require efforts to ease the tight labor market, strengthen pension system sustainability, improve energy security and the green transition, and retain real-estate market stability. Progress in talks with the EU on forging closer ties is welcome. We broadly agree with the thrust of staff's appraisal and would like to emphasize the following points.

An accommodative and cautious fiscal policy is appropriate for supporting stronger growth, while being mindful of inflationary pressures and global uncertainties. Sufficient fiscal space should accommodate structural reforms, including strengthening energy security and boosting the green-digital transformation. We agree with staff that automatic stabilizers should be allowed to operate if growth further weakens, and see merit in targeted, timebound, non-discretionary support in case needed. *We would appreciate further information from staff on the size of an additional fiscal stimulus, beyond letting automatic stabilizers operate fully.* We note that the public debt is low and thus not at risk from contingent liabilities, including government guarantees to the SNB and UBS. In the longer term, however, Switzerland is not exempt from fiscal risk stemming from climate change, demographic factors, and an aging population. Therefore, rising spending needs should be addressed within the debt-brake rule, which continues to be the key anchor for fiscal sustainability, while allowing the necessary flexibility required by substantial economic uncertainty, and also to provide substantial financial support to Ukraine. We acknowledge the work on identifying spending needs stemming from climate change and wonder if the authorities plan to implement a cost ceiling strategy in this regard, similar to a debt-brake rule. *Staff comments are welcome*.

We commend the Swiss National Bank's (SNB) response to inflationary pressures, which maintained a low and stable inflation rate. Benefiting from a relative high share of administered prices, inflation outcomes have been more favorable than in peers. The SNB is a credible central bank with a strong monetary policy framework, and we are confident that the SNB will continue to act in line with its mandate. The SNB's balance sheet remains large due high foreign currency investments reflecting the CHF's safe haven status. This reduces the SNB's flexibility in its operations, due to sensitivity of FX developments. We take positive note that the SNB's total assets decreased materially, reflecting the efforts to reduce excess liquidity in the banking sector. In this regard, we echo staff's recommendation to consider further FX sales to reduce the SNB's balance sheet to lower financial risk and regain monetary policy space. We note with concern the authorities' slowing ambition to address the remaining recommendations from the 2019 Financial Sector Assessment Program, and close regulatory monitoring gaps related to nonbank financial institutions and Fintech.

The UBS-Credit Suisse merger should be closely monitored to mitigate potential systemic risks and restore confidence in the financial system. We positively note the authorities' decisive actions to address Credit Suisse challenges in the form of an acquisition by UBS, which restricted risk spillovers to the highly interconnected domestic and global financial system. UBS is-well advised to integrate Credit Suisse in a phased approach to better mitigate systemic risks stemming from the merger, and thus preserve the overall financial soundness of the banking system and ensure its further development, as well as limit job losses. Credit Suisse is raising broader policy questions regarding the FINMA's effectiveness in supervision, whether the communication channels among global financial supervisors are appropriate, and why the recovery and emergency plans of the too-big-to-fail provisions were not or could not be applied. *Could staff elaborate on how the UBS-Credit Suisse merger will affect domestic banking concentration, and on the new UBS ranking among the Global Systemically Important Banks?*

Vulnerabilities relating to the real estate market can be a source of systemic risk and the authorities should stand ready to act with appropriate measures. Mortgage lending remains robust and above the growth of the economy, while real estate prices continue to rise. As the reactivation of the residential-real estate countercyclical capital buffer to the highest level in September 2022 limits the ability to further mitigate risks stemming from the real estate market, we agree with the staff's proposal to expand the legally mandated macroprudential toolkit. In this regard, we encourage the authorities to cooperate with the European Systemic Risk Board in the development of macroprudential instruments to address specific systemic risks and conducting macroprudential policy. *We would appreciate further information from the staff on banks' exposure to residential mortgages.*

We encourage the authorities to address the tight labor market, sustainability of both pension system pillars, and promote the green-digital transformation. Efforts to expand labor-market participation among all ages while increasing flexibility and implementing supportive policies for skilled immigrants should be a policy priority to enhance Switzerland's potential growth and address the tight labor market. The long-run sustainability of the first pillar pension system hinges on the improved alignment with demographic and economic trends, including additional retirement age increases and promoting the partial employment of already retired citizens. Given large pension fund investment losses in 2022, additional reforms are needed on conversion rate modifications and insured pension fund performance. We positively note that the authorities have advanced with the green-digital transition as recommended in the 2022 Article IV Consultation. Switzerland's direct democracy can be paramount in achieving broad political consensus to implement wide-ranging structural reforms.

We welcome the re-engagement between Switzerland and the EU as a positive step to manage future trade relations.

With these remarks, we wish the authorities every success in their future endeavors.

Switzerland

Responses to Technical Questions Posed by Executive Directors in Advance of EBM/23/43—May 31, 2023

Staff's responses to technical questions are below. Questions regarding the time frame and risks associated with the acquisition of Credit Suisse by UBS will be addressed in staff's intervention at the Board meeting.

Outlook / Risks / External Sector

1. **Regarding external sector, we note staff's preliminary assessment, and would appreciate staff's further elaboration on the impact of Switzerland's institutional pension features and "reversion to trend" property of the empirical model.**

- On the relation between institutional pension features and current account, Koomen and Wicht (2022) find that the presence of a fully-funded system associates with a higher CA balance, and this effect increases with the system's generosity and coverage.[1] The study also shows that introducing pension indicators to the EBA model broadly improves the model fit. Such results suggest that the high share of fully-funded pension funds in Switzerland, along with relatively high replacement rate and broad coverage, may help to explain part of Switzerland's high current account balances.

- Staff has also found that some pension system characteristics (coverage rates and replacement rates of mandatory fully-funded systems) have implications for CA balances (IMF WP 23/47). However, due to uncertainties associated with the estimates and methodological differences regarding the measurement of pension parameters across databases, caution is warranted in interpreting the results. For this reason, pension characteristics have not been included in the EBA model at this stage.

- The REER of the Swiss franc exhibits a long-term appreciation trend. However, it is not the "reversion to trend" property of the empirical models *per se* that biases the results for Switzerland. Instead, the potential bias arises from these models' inability to fully capture the underlying drivers of this long-term appreciation trend, which could lead to results of sizable over-valuations. For instance, differences in productivity growth of tradable versus non-tradable sectors is an important driver of the franc's real appreciation. However, productivity in Switzerland is likely subject to significant measurement errors, especially in knowledge-based sectors where wages are used as the deflator to derive real output.[2]

2. **We would also like to ask the impact of the SNB's monetary policy unwind on the external sector assessments?**

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[1] Miriam Koomen, Laurence Wicht, Pension systems and the current account: An empirical exploration, Journal of International Money and Finance, Volume 120, 2022.

[2] See 2018 Article IV Consultation Staff Report, Box 2, Switzerland's Trend Real Appreciation.

- Two notable external sector developments in 2022 were influenced by the monetary policy normalization in Switzerland and other major advanced economies.

  - Due to the relatively low inflation in Switzerland, the Swiss National Bank (SNB) hiked its policy interest rate by less than some other central banks, such as the U.S. Federal Reserve and the European Central Bank (ECB). This has led to widened domestic-foreign interest rate differentials. Partly driven by such developments, private capital flows shifted from an average annual net inflow of 2.2 percent of GDP during 2009-2021 to a net outflow of 7.2 percent of GDP in 2022.

  - Partly due to the sharp monetary tightening in advanced economies, the global financial market experienced significant volatility and adjustments in 2022. Investment valuation losses linked to such market developments were the main driver of the decline in Switzerland's net international investment positions (IIPs) in 2022—despite a sizable current account balance, from 108 percent of GDP in 2021 to 93.3 percent in 2022.

3. We remain skeptical of ad hoc adjustments to the EBA model outputs; could staff comment on the extent to which similar adjustments were applied to other country cases this year?

- In the external sector assessment (ESA), staff have strived to apply country-specific adjustments to the EBA model results in a transparent, cross-country consistent, and even-handed manner. Two sets of adjustors were applied to the 2022 EBA model results: one for the transitory impact of the Covid-19 pandemic, totaling -0.1 percentage points for Switzerland, and the other for some known measurement issues under the sixth edition of the IMF *Balance of Payments and International Investment Position Manual* (BPM6), totaling -4.0 percentage points for Switzerland.[3] The Covid adjustors are being progressively phased out, with the medical and household consumption shift adjustors discontinued, while the travel and transport adjustors were kept (except for countries that were already back to normal in 2022). Regarding measurement bias adjustors, staff has adopted a cautious approach due to the uncertainty surrounding the estimates: adjustors were only applied when the underlying biases were found to be large, and consistent with IIP valuation changes (while striving to maintain a consistent approach over time). As in previous years, only a subset of countries use measurement bias adjustors, both on the surplus (e.g. Switzerland) and deficit (e.g. Canada) sides.

4. Could staff comment on how they would assess what constitutes "excessive market volatility" in the qualifier they use for their advice on avoiding FXI? How does this assessment relate to the Integrated Policy Framework?

- In identifying capital flows causing "excessive market volatility," very substantial volume and concentration in time are important—capital flows may be excessively large, overwhelming a country's capacity to safely manage them, or volatile, posing risks of costly reversals. These

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[3] A detailed discussion of the measurement issues under BPM6 can be found in "*The Measurement of External Accounts*" (IMF Working Paper 19/132).

risks may be heightened in the presence of domestic and international frictions. In Switzerland's case with a safe-haven currency, more often the relevant consideration is whether capital inflows are excessive. A few key factors may be taken into account: First, have the inflows been associated with higher-than-usual volatility of the exchange rate? Second, has appreciation of the franc significantly exceeded the movement implied by long-term historical trends? While the first factor may also be applied to other economies in general, the second may be more specific to Switzerland, given the set of challenges that Switzerland faced after the GFC and until the early stage of the pandemic. These included persistent low inflation pressures, effective zero lower bound considerations, and limited domestic assets for QE purchase. The SNB worked to cope with low or negative inflation for several years; franc appreciation threatened to place further downward pressures on inflation. As inflation risks have changed from deflation/low inflation to higher and possibly more persistent inflation, particularly in key trading partners, the second factor may be revisited.

- Using FXIs under circumstances of excessive market volatility (or disorderly market conditions) is broadly consistent with the frictions-based approach to FXI advice under the Integrated Policy Framework.

Fiscal Policy

5. Could staff comment on the progress of the multilateral convention and the proposed individual tax reform?

- Switzerland signed the Multilateral Convention in 2013 and the Multilateral Agreement on the Implementation of Tax Related Measures to Prevent Base Erosion and Profit Shifting (BEPS Convention) in 2017, which was approved by the Swiss parliament and came into force in December 2019. With it, Switzerland intends to adapt the Double Taxation Agreements (DTAs) with 12 countries (Argentina, Austria, Chile, the Czech Republic, Iceland, Italy, Lithuania, Luxembourg, Mexico, Portugal, South Africa and Türkiye) to the treaty-related BEPS minimum standards. For DTAs that will not be amended by the BEPS Convention, Switzerland will adapt to the BEPS minimum standards by means of bilateral amendments to the DTAs. So far, Switzerland and Luxembourg have adopted the exact wording of the amendments provided in the BEPS Convention and made the notification to the depositary of the BEPS Convention accordingly. Further agreements have since been concluded with Lithuania and the Czech Republic.

- On individual tax reform, the Federal Council has worked out a reform proposal in March 2023 to implement individual taxation of all taxpayers at both the federal and the cantonal levels. This reform intends to increase the labor participation incentive of second earners in married couples by lowering marginal tax rate. The estimated increase in labor supply resulting from an implementation of the reform is in the range of 10,000-47,000 full time equivalents. In addition, a proposal on taxation of imputed rental value and deductibility of interest is being discussed in Parliament. According to the proposal, the imputed rent on owner-occupied properties at the primary residence would no longer be subject to taxation. In return, maintenance costs at the primary residence would no longer be deductible. If the bill passes the Parliament, it may be subjected to a national referendum. A possible system change will likely go into force no earlier than 2026.

6. Going forward, how does staff assess the possibility of relaxing the actual framework to accommodate future challenges, like aging and climate transition, given that they imply structurally higher expenditures?

- Switzerland's fiscal framework has shown flexibility to accommodate unexpected and large expenditures, as demonstrated by the pandemic and war related expenditures. Going forward, given expected sizable expenditure needs the first step is to understand and estimate the size of these needs. This is what the authorities are currently working on. Once these spending needs are identified, the current system allows for various options including prioritizing, cleaning up, and increasing the efficiency of spending, which has been the focus of the authorities so far. But additional measures are likely to be needed. In this context, the current system allows for various options for revenue increases. If further tax increases and/or borrowing is needed, the threshold for change is higher. In particular, Switzerland's unique system of governance, which among others, gives an important role to direct democracy and strong checks and balances, suggests that a high threshold needs to be crossed before fundamental changes (especially those affecting the constitution) can be made to change the current fiscal framework.

7. Noting that fiscal consolidation can take time, especially for expenditure, can staff comment on the consistency of the recommendations on addressing projected structural deficits in 2024-2026 and loosening fiscal policy in 2023?

- Despite the looser fiscal stance in 2023, Switzerland is still expected to record a structural surplus. The looser fiscal position is mainly the result of the zero SNB profit transfers (out of the control of the government) and temporary (war-related) expenditures. Given the temporary nature of these expenditures, slowing economy, low public debt, continued structural surplus, and strong track record of prudent fiscal policy, staff considers this loosening appropriate. Going forward, the budget clean up measures are expected to close the structural deficit in 2024, while the remaining structural deficits in 2025 and 2026 are relatively small (CHF -0.6 billion for 2025 and CHF -0.2 billion for 2026) and staff expects that the authorities will be able close these gaps.

8. What are the VAT measures aimed at achieving specific social objectives?

- A various set of VAT measures have been scheduled for implementation. These VAT measures aim at improving tax compliance from online mail order platforms, streamlining VAT reporting processes for small and medium enterprises, clarifying the definition and treatment of subsidies, and lowering VAT on feminine hygiene products. In addition, a general purchase tax obligation for the transfer of emission rights, certificates and attestations is proposed to prevent tax fraud.

9. 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 Swiss government provides guarantees to the CS-UBS merger for a total of CHF 109 billion (13.6 percent of GDP). This includes i) a default guarantee in the amount of CHF 100 billion in favor of the SNB for additional liquidity assistance loans from the SNB to CS, which will only take effect in case of need; ii) loss protection guarantee in the amount of CHF 9 billion for UBS, which will take effect only if UBS actually incurs losses on the sale of these assets and the losses in question exceed CHF 5 billion. Guarantees connected with the CS-UBS merger currently doesn't have an impact on the fiscal position and will only affect if called. It is worth noting that in a statement in early May, the UBS CEO said that it would be "exceptionally unlikely" that the bank will need to cover losses with the public guarantees.

10. While we appreciate the low level of public debt, we also notice a sizable increase in staff's public debt figures for 2023 due to a surge in contingent liabilities. According to staff this rise is "reflecting contingent liability of CHF 109 billion [13.4 % of GDP] from government guarantees to SNB and UBS" and "represents an upper bound (…) as the government may recognize the contingent liability gradually over time". Beyond the mentioned contingent liabilities, could staff elaborate on the differences of their public debt projections in Table 1 (p. 31) and Figure 4 in Annex VII (p. 52)?

- The difference reflects the different vintages of data used for the DSA analysis, which was conducted using data available as of March 20, 2023. The magnitude of the difference is very small and does not affect the result of the DSA.

11. Staff comments on options for the authorities to refine their fiscal framework to lessen the structural bias toward fiscal surpluses and underspending would be welcome.

- Authorities are making progress to include adjustments to the existing framework that would help mitigate a built-in bias to surpluses and underspending. For instance, to avoid headwinds for recovery amortization period to offset Covid-19 spending has been extended. Other measures also include less-conservative revenue forecasts, greater in-year calibration, and spending ceilings that contain a built-in buffer or margin,. These changes to spending ceilings would aim to address and limit underspending. Going forward, there is also merit in continued outlays to support long-term green, which may necessitate a review of the fiscal framework and call for a medium-term fiscal plan (progress has been made in this area and the authorities have adopted a budget clean-up plan).

12. Could staff comment further on whether they consider that the current fiscal framework, beyond the proven flexibility during crisis times, also allows for tackling longer-term challenges including climate change?

- Switzerland's fiscal framework has flexibility to accommodate expenditures related to long-term challenges. Given expected sizable expenditure needs related to climate change, aging, national defense, and other key areas, the authorities have already started to work on fiscal plans to accommodate these spending needs. As the first step, they have started estimating the associated fiscal costs. An updated study on demographics-linked outlays is underway together with an analysis to quantify climate change-related spending needs. Once these spending needs are identified, the current system allows for various options including prioritizing, cleaning up, and increasing the efficiency of spending. But additional measures are likely to be needed. In this context, the current system allows for various options for revenue increases and/or borrowing, which however, according to the Switzerland's unique system of governance, might require a higher threshold needs to be crossed and longer time to implement.

13. We agree with staff that automatic stabilizers should be allowed to operate if growth further weakens, and see merit in targeted, timebound, non-discretionary support in case needed. We would appreciate further information from staff on the size of an additional fiscal stimulus, beyond letting automatic stabilizers operate fully.

- The current fiscal framework has proven its effectiveness and flexibility for a period. One key element is the provision for exceptional circumstances. During crisis or economic downturns, the Financial Budget Act makes allowances for an increase in budget due to exceptional and uncontrollable development in the form of extraordinary expenditures, which allows the government to provide extra fiscal stimulus beyond automatic stabilizers. A good example is the extraordinary expenditures during the COVID pandemic, which in total comes to around CHF 30.9 billion (equivalent to 4 percent of 2022 GDP). In addition, the federal government has budgeted CHF 5.7 billion (0.7 percent of 2023 GDP) for energy sector and refugees related extraordinary support in 2023.

Monetary Policy

14. Could staff clarify how the authorities can ensure congruency between monetary and fiscal policies to ensure that they don't work at cross purposes?

- Generally speaking, ensuring the congruency between monetary and fiscal policies could be challenging at times, especially if it is interpreted simplistically as the two tightening or loosening at the same time. The current situation in Switzerland is a good illustration of this challenge: while the outlook of inflation suggests that a tightening of macroeconomic policies might be needed, some loosening seems warranted on the other hand given the projected slowing of GDP growth to below potential. It is important to note that this trade-off is less pronounced in Switzerland than elsewhere given that inflation level, while above the target, is lower than its peers.
- In Switzerland, the key to ensuring the congruency between monetary and fiscal policies lies in a clear division of responsibilities between them, while safeguarding the independence of the SNB. To this end, the SNB operates under a single, well-defined mandate: ensuring overall price stability of the Swiss economy. All monetary policy operations are carried out to fulfill this mandate. Meanwhile, under the debt-brake rule, fiscal policy assumes a multitude of tasks. These include using the automatic stabilizers to counter cyclical shocks, providing targeted support to vulnerable groups when needed, handling unexpected, significant

shocks such as Covid with extraordinary expenditures, and enhancing competitiveness, ensuring energy securities and boosting green transitions through public investment, tax policies, and other structural reforms.

- In addition, the temporary and targeted nature of the elevated spending for 2023 contributes to the congruency by keeping demand pressures in check (in terms of horizon and areas that are in need). Finally, debt break rule is an important factor to anchor expectations by ensuring that the fiscal impulse today will need to be offset in future beyond cyclical considerations.

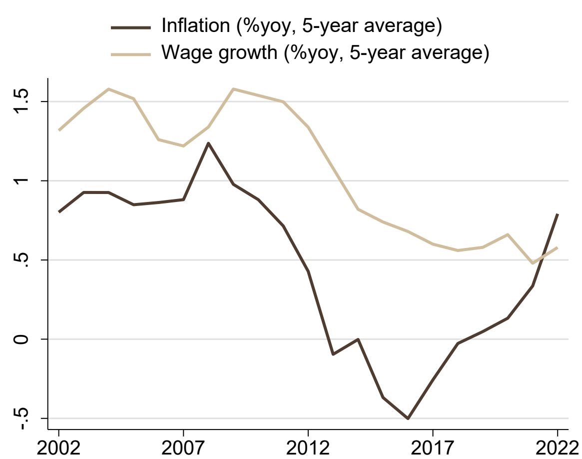
15. On monetary policy, we agree with staff that if second-round effects persist, further tightening will be needed. Additional information on the interaction between inflation and wages, given tight labor market –which is mainly driven by structural factors– would be welcome.

- In general, the interaction between inflation and wages in Switzerland aligns with patterns observed in other economies. Inflation is an important driver of nominal wage growth, along with other factors such as productivity growth and supply-demand conditions of the labor market. Conversely, wage growth also feeds into inflation and inflation expectations.

- A distinctive feature of the Swiss labor market, however, is the more cooperative nature of its business-labor relations compared with other economies. This has been supported by persistently low inflation and resulted in a consistent, albeit moderate, real wage growth, even during periods of negative inflation.

- In 2022, the medium-term inflation exceeded wage growth for the first time in two decades. This likely resulted from two factors: a rapid rise in inflation, and a delayed response of wage growth to both tightening labor market conditions and rising inflation. This delay partly reflects the aforementioned cooperative business-labor relations.

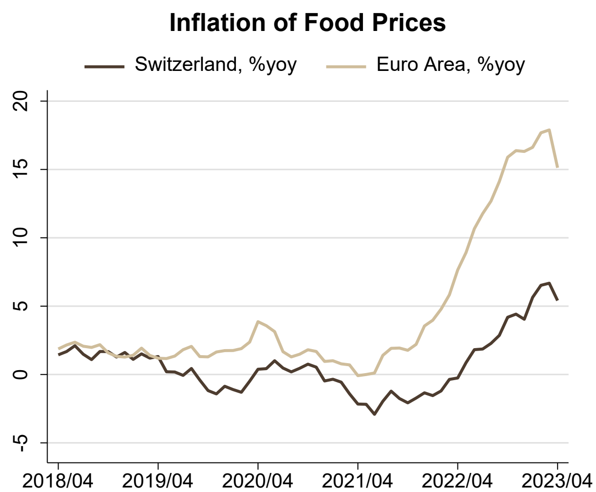
Switzerland: Inflation and Nominal Wage Growth



- Nonetheless, wages ultimately align with inflation, labor market conditions, and other macroeconomic fundamentals. In this context, staff highlighted in the report the need for the authorities to keep inflation expectations well anchored and to address labor shortages through structural reforms, to prevent a vicious cycle between rising inflation and wages.

16. Could staff comment on the impact of protectionist measures on agricultural products and inflation?

- Protecting domestic agricultural products is a nuanced issue. Simply from the perspectives of prices and inflation, two effects of these protective measures can be observed: First, the prices of agricultural products in Switzerland are generally higher than those on the international market. Second, the price movements of agricultural products in Switzerland follow the trends in international markets but with a more smooth fashion. More specifically, in 2022, the pressure of rising food inflation in Switzerland was mitigated to some extent by increased import quota.



Financial

17. Regarding fintech, we take note of staff's assessment that it seemed not severely affected by the global downturn or volatility in 2022, and we would like staff to further elaborate the government's initiatives on this front, such as regulatory data collection.

- FINMA has increased its resources dedicated to data collection and analysis regarding Fintech, and improved data reporting on Fintech activities. For example, banks and asset managers active in the crypto sector are required to report key relevant data to FINMA on a quarterly basis. FINMA also collects data on the number and activities of virtual asset service providers in Switzerland. To further strengthen the Fintech regulation, FINMA plans to roll out in 2023 a new reporting standard for banks regarding on-balance-sheet holdings of crypto assets and custody assets.

18. Could staff provide us with more elaboration on the scale of the US regional banking turmoil in the Swiss banking system?

- The Swiss banking system is unlikely to show vulnerability as seen in the US regional banks. Unrealized losses on held-to-maturity portfolio are not significant concerns for Swiss banks, especially the domestically focused ones, as they do not hold large investment portfolios.
- From an aggregate perspective, financial market investments only accounted for about 6 percent of total banking sector assets in February 2023 (CHF 223 billion out of 3.5 trillion). The share was even smaller when focusing on non-big banks. In addition, all types of banks had sufficient liquid assets (cash, deposits, and postal accounts) to cover potential losses from financial investments (see text chart in ¶24 of the staff report for details).

19. Risks related to the new large GSIB need to be mitigated. Could staff share their initial views on potential risks related to the merger?

- Staff will respond to this question during the Board meeting.

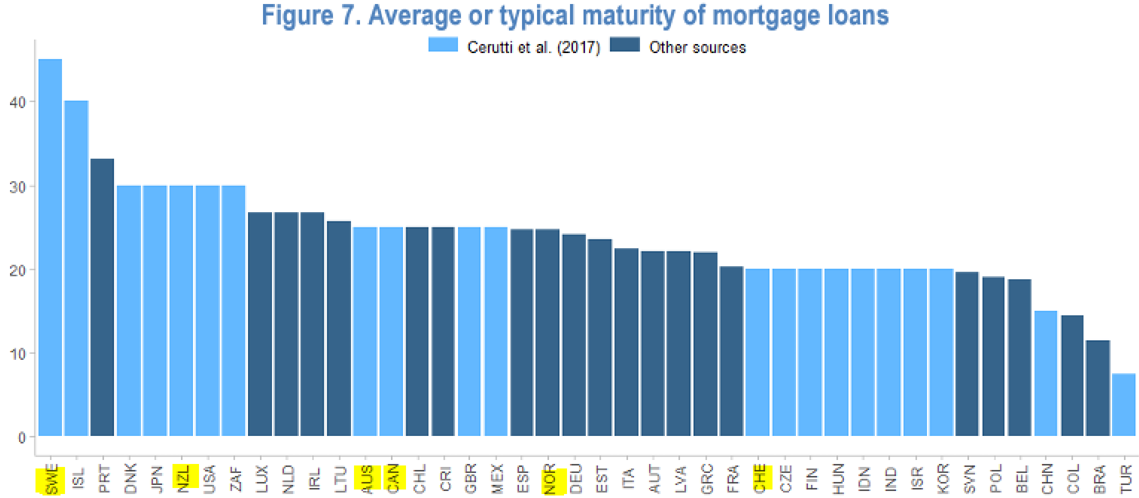
20. Therefore, we agree that a careful and effective consolidation of the two institutions and smooth implementation of the merger will be of upmost importance. In this regard, we would welcome comments on the timeline for the completion of the merger.

- Staff will respond to this question during the Board meeting

21. Could staff comment on how the relatively short duration of fixed-rate mortgages in Switzerland compares to other countries with significant housing market vulnerabilities?

- According to a recent OECD study on mortgage finance across countries, the average duration of typical mortgage loans in Switzerland is shorter compared to other countries with housing market vulnerabilities (Sweden, New Zealand, Australia, Canada, and Norway, see the chart below from the OECD study). The composition of fixed- versus variable-rate mortgages varies by country. In the case of Switzerland, the share of new mortgages tied to a reference rate (in general, to SARON) has increased from 28% to 55% between January and September 2022, but the share of fixed-rate mortgages among all outstanding loans remains high.
- Housing market vulnerabilities in Switzerland could be less than indicated by high price increases, because high prices are partly supported by structural factors such as supply-side constraints and also by the strong immigration trend, which are difficult to control in house price valuation models In addition, banks also take a cautious approach when granting mortgage loans – they calculate the affordability based on an imputed interest rate of 5 percent, which is still significantly higher than the current market interest rates.

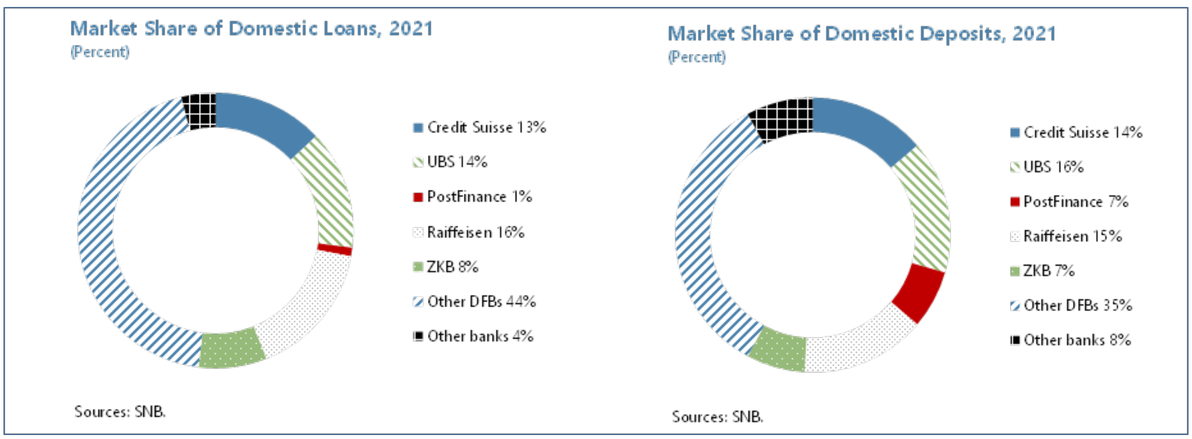
Figure 7. Average or typical maturity of mortgage loans



Note: The graph distinguishes between data from earlier work by Cerutti et al. (2017[4]) and more recent data that was available for some OECD countries from national sources. Where available, the national sources are preferred because they give actual averages rather than the typical maturities collected by Cerruti et al. (2017[4])
Source: Cerruti et al. (2017[4]) and national sources.

22. Could staff elaborate on how the UBS-Credit Suisse merger will affect domestic banking concentration, and on the new UBS ranking among the Global Systemically Important Banks?

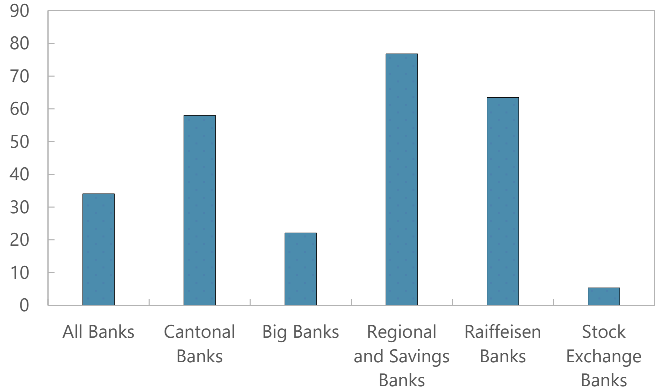
- In the domestic market, the combined share of UBS and Credit Suisse was around 30 percent in both deposits and loans before the merger. From an aggregate perspective, banking sector competition will likely remain sufficient after the merger. In particular, certain segments, such as real estate, are subject to good competition from other banks. Nevertheless, selected segments where the big banks had a strong presence, such as export financing, warrants close monitoring.
- By end-2021, UBS ranked the 17th and Credit Suisse ranked the 23rd among G-SIBs based on a matrix including size, interconnectedness, substitutability, complexity, and cross-jurisdictional activities (BIS, 2022). It is still too early to estimate the new ranking of the merged bank before a new business plan is finalized. Based on the banks' sizes only (and before any likely potential downsizing), UBS and Credit Suisse combined (without streamlining) would rank the 15th among G-SIBs, compared to the 31st and the 34th, respectively, before the merger.



23. We would appreciate further information from the staff on banks' exposure to residential mortgages.

- Overall, mortgage loans accounted for 34 percent of total banking sector assets in 2022. There is large heterogeneity within the baking sector: the portfolio of domestically focused banks, such as cantonal, regional, and savings banks, concentrated mostly in the residential mortgage market, whereas the big banks had a more diverse business profile.

Switzerland: Shares of Mortgage Loans in Banking Assets
(Percent, 2022)



Sources: Swiss National Bank and IMF staff calculations.

Climate

24. We note that a large share of Swiss carbon emissions targets depends on emissions compensation projects abroad and would appreciate some information on the progress of these projects, if available. Also, could staff comment on the size of Switzerland's international compensation projects compared to peers?

- Switzerland has committed to reducing greenhouse gas emissions by 55 percent (compared to 1990) by 2030. It intends to achieve approximately one third of the implied (cumulative) emissions reductions between 2021 and 2030 abroad; that is, through the international transfer of Mitigation Outcomes under Article 6.2 of the Paris Agreement. To that end, it has signed bilateral Implementing Agreements with the following countries: Peru, Ghana, Senegal, Georgia, Vanuatu, Dominica, Thailand, Ukraine, Morocco, Republic of Malawi, Uruguay. Further, it has signed a joint declaration with the Ministry of the Environment of the Republic of Chile.
- These implementing agreements establish the legal framework and state the requirements for recognition of the international transfer of Mitigation Outcomes. These agreements establish a legal basis for commercial contracts between buyers and sellers of emission reductions. As such, these agreements do not commit the Parties to any quantity of emission reductions or removals.
- As of May 26, 2023, two projects giving rise to the issuance of Mitigation Outcomes have been registered. One in located in Ghana, the other in Thailand. The maximum emission reductions (Mitigation Outcomes) that have been authorized for the period 2021-2030 represent 1.13 $MtCO_2e$ and 0.5 $MtCO_2e$, respectively. Taken together, this represents approximately 4 percent of cumulative emissions reductions to be achieved abroad between 2021-2030 (41.5 Mt $MtCO_2e$).
- To staff's knowledge, Switzerland is the first to have actual emission reductions transacted under any bilateral agreement. By comparison, New Zealand, which has a similar emissions

reduction target to Switzerland, is estimated (under a "with existing measures" scenario), to need 114 Mt CO_2e in emissions reductions abroad to meet its 2021-2030 carbon budget (571 Mt).

- Other countries (e.g., Singapore, Sweden) have agreed bilateral frameworks to enter into "cooperative approaches" under Article 6.2.

25. We agree with staff and the authorities that the timely passage of the revised proposal for the Third CO2 Act is critical to emission reductions over 2025–2030 as well as the need for substantial investments to reach 2050 emission reduction targets. In this vein, could staff comment on whether Switzerland is providing the policy framework to mobilize private capital towards these objectives?

- The rejection of an earlier version of the Third CO_2 Act in June 2021 created uncertainty that is likely to have weighed negatively on firms' decisions to invest in low carbon technologies. However, the extension of the Second CO_2 Act through 2024 and the development of a new proposal for the Third CO_2 Act (covering the period 2025-2030) provided positive policy signals. The Third CO_2 Act provides substantial support and incentives for the mobilization of private capital, especially in the buildings sector.
- It should also be noted that some of Switzerland's emissions (i.e., in industry and power generation) are subject to the Emissions Trading Scheme, which is linked to the EU ETS. As a result, the price signal—and incentive to invest in low-carbon technologies—depends largely on the evolution of the price of EU Allowances (EUA). The recent adoption of the reform of the EU ETS by the EU will strengthen the EU ETS and is likely to lead to higher EUA prices through 2030. This, in turn, strengthens the price signal for investors in Switzerland.

26. We note that unlike the previous proposal, it does not include new taxes or revisions to existing environmental taxes or carbon pricing mechanisms: staff comments on context and implications are welcomed.

- In June 2021, the Swiss people rejected an earlier version of the Third CO_2 Act. Among other measures, that version contained provisions to allow the CO_2 Levy to rise to CHF 210/t CO_2e. This measure was cited, among other factors, as a reason for the rejection of that version of the Third CO_2 Act. It is important to note, however, that some voters likely voted against that version because they deemed it insufficient.
- We note three potential implications. First, since the revised version of the proposal for a Third CO_2 Act leaves the maximum level of the CO_2 Levy unchanged (at CHF 120/ tCO_2e), there is a possibility that the real value of the Levy will be eroded over time due to inflation, hence reducing the emission reduction incentive of the Levy. Second, the emissions reduction measures that are proposed instead of an increase of the CO_2 Levy may be less cost-effective and hence increase the overall cost of emission reduction. Third, the absence of a carbon tax in the road transport sector deprives Switzerland of an instrument that would accelerate the turnover of the vehicle fleet. Measures incentivizing the purchase of zero

emission vehicles (e.g., purchase subsidies) incentivize new additions to the fleet but do not provide incentives to retire the existing CO2-emitting vehicles.

27. We understand that the ordinance on mandatory climate disclosures would come into effect in 2024. Could staff clarify the probable impact on the financial sector stability from such mandatory disclosures by large public companies, banks, and insurance companies who have to report on both the effects that climate change has on them and the impact of their activities on climate change? What contingency measures are being developed in this regard?

- The data disclosure requirements aim at improving the availability and depth of climate-related information. Specifically, firms will have to report on their exposure to climate risk (both physical and transition risk) and the impact of their activities on the climate. While realization of some climate risks may affect financial sector stability, Staff does not anticipate that the introduction of mandatory disclosure requirements *per se* would lead to systemic financial instability.
- It could, however, lead to an adjustment of the price of some financial assets or instruments issued by specific firms.

28. In the context of recent discussions on climate in bilateral surveillance, this article IV is a good example of a substantive country analysis which should be preserved and generalized; could staff comment on the resources involved on climate analysis and whether it implied the contribution of additional climate experts?

- The analysis of climate policies in this Article IV consultation was carried out by a climate expert in EUR (who participated to the mission), with some support from the FAD climate team. Some parts of the analysis relied on the Climate Policy Analysis Tool (CPAT), which allows for analysis of 'first-round' macro-fiscal impacts of sectoral or economy-wide climate mitigation policies.

Other structural

29. […] although we welcome progress made towards a potential accession to the EU single market, we believe that the report is too optimistic about the prospects of an agreement. Could staff comment on a potential commitment regarding the time horizon within which a compromise could be reached?

- Despite progress achieved over the past year, staff are not in a position to speculate on the prospect of the negotiations between Switzerland and the EU, including the time horizon within which a compromise might be reached.

30. We would have appreciated analysis by staff on efforts to close remaining gender gaps: staff comments are welcomed.

- In 2021, the Federal Council approved the *2030 Gender Equality Strategy*, the first national strategy with the specific aim of promoting gender equality in Switzerland. The strategy focuses on four action areas: promoting equality in professional life; improving the balance between work and family life; preventing gender-based violence; and fighting discrimination. It involves all federal departments and the Federal Chancellery, while cooperation with the cantons and communes also plays an important role.

- An action plan has been developed for the implementation of the *2030 Gender Equality Strategy*. The plan currently consists of 227 specific measures, implemented at the federal, cantonal, municipal, and international levels. The Federal Office for Gender Equality (FOGE) is responsible for monitoring the measures and for updating this plan. The latter happens twice a year and updates are published on the www.gleichstellung2030.ch website.
- The 2030 National Gender Equality Conference will take place in June 2023 in Bern. The aim of the conference is to inform stakeholders about the key topics of the *2030 Gender Equality Strategy* and its implementation status, and to define further measures to promote gender equality.

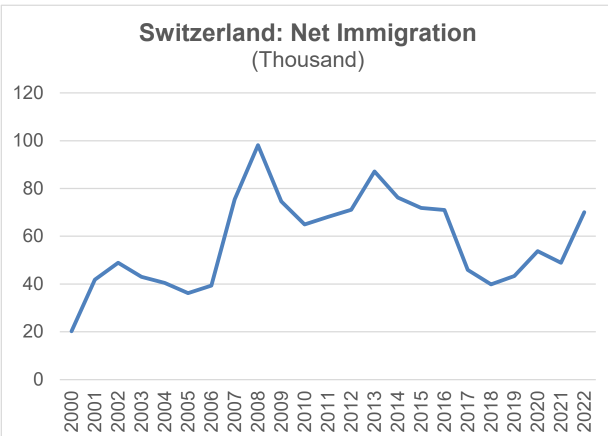
31. Given the demographic challenges ahead and the already high participation rates, we concur with the authorities on the need to increase labor productivity. In this regard, we would appreciate staff's views on the authorities' agenda on this front.

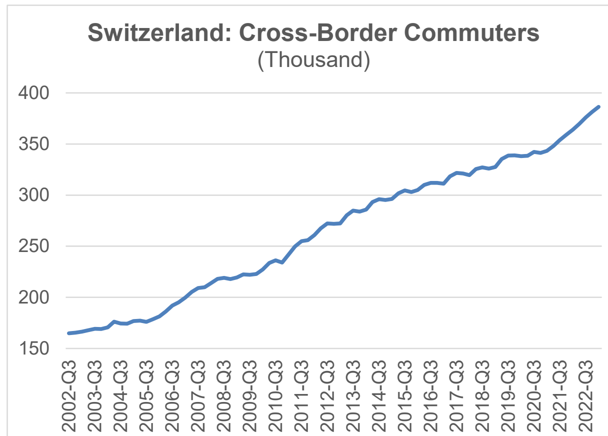
- The Swiss authorities have put considerable efforts into improving labor productivity by promoting digitization, enhancing education and training, supporting research and innovation, and refining labor market policies:
  - *Digitization*: Authorities have developed and regularly update a strategy to enhance digital skills and technologies in Switzerland. They also monitor the progress of this digital transition through various reports.
  - *Education*: Switzerland has a well-functioned education system, with an emphasis on vocational training and apprenticeship programs that create a skilled workforce. The government and the private sector collaborate to ensure the education system meets the needs of the labor market and promotes the development of skills that are in demand.
  - *Research and Innovation*: The government provides support to research institutions and encourages collaboration between academia and industry. The federal-level innovation agency, Innosuisse, promotes partnerships between academia and the market through innovation projects, networking, training, and coaching. This helps to lay the groundwork for successful Swiss startups and innovative products and services.
  - *Labor Market Policy*: The authorities are also working on labor market policies to increase labor productivity. One approach is to reduce disincentives for old-aged skilled workers to work, which also helps to raise the participation rate in the labor market.
- Despite the efforts mentioned above, there are still indications that labor productivity growth in Switzerland has slowed (OECD report). It's important to note, however, that this isn't a challenge unique to Switzerland. Many advanced economies are grappling with similar issues. Various interpretations have been proposed to explain this phenomenon. Some suggest that productivity growth is non-linear and that the current slowdown could merely be a precursor to an impending breakthrough. Others point to measurement problems—related to intangible capital, quality of services, etc.—as one of the reasons behind the widely

observed productivity deceleration. Despite these challenges, staff is of the view that the Swiss authorities' strategies to stimulate labor productivity growth are in the right directions.

32. It appears immigration into Switzerland has been on the decline since 2012 and it would be interesting to know if authorities are looking at policy measures to attract skilled labor by further liberalizing the services sector especially with the advent of technology facilitating remote services. Staff comments are welcome.

- After hitting a low in 2018, net immigration to Switzerland rebounded in the following years, reaching over 70,000 in 2022. Meanwhile, the number of cross-border commuters has maintained a steadily rising trend over time. The figure stood at 386K in 2023Q1, nearly 50K higher than in 2020Q1, at the onset of the Covid-19 pandemic.





- The Swiss authorities are also taking additional measures to attract skilled foreign workers, to alleviate the domestic labor shortage. For instance, the Federal Council decided in October 2022 that individuals from third countries who obtain a master's degree or a doctorate in areas with a shortage of skilled workers should be exempt from quota requirements and allowed to work in Switzerland.

- Currently, staff are unaware of any plans by the authorities to take advantage of remote-work technologies and further liberalize the services sector. That said, the authorities are indeed making adjustments to accommodate increased cross-border remote-working since the onset of the Covid-19 pandemic. For example, Switzerland and France have reached an agreement on sustainable tax regulations pertaining to remote work. For cross-border commuters, starting January 1, 2023, up to 40% of annual work hours can be performed remotely without affecting the taxation status of income.

Constituency Codes

OEDAE
Angola, Botswana, Burundi, Eritrea, Eswatini, Ethiopia, The Gambia, Kenya, Lesotho, Liberia, Malawi, Mozambique, Namibia, Nigeria, Sierra Leone, South Africa, South Sudan, Sudan, Tanzania, Uganda, Zambia, and Zimbabwe

OEDAF
Benin, Burkina Faso, Cameroon, Central African Republic, Chad, Comoros, Democratic Republic of Congo, Republic of Congo, Côte d'Ivoire, Djibouti, Equatorial Guinea, Gabon, Guinea, Guinea Bissau, Madagascar, Mali, Mauritania, Mauritius, Niger, Rwanda, São Tomé & Príncipe, Senegal, Togo

OEDAG
Argentina, Bolivia, Chile, Paraguay, Peru, and Uruguay

OEDAP
Australia, Kiribati, Korea, Marshall Islands, Federated States of Micronesia, Mongolia, Nauru, New Zealand, Palau, Papua New Guinea, Samoa, Seychelles, Solomon Islands, Tuvalu, and Vanuatu

OEDBR
Brazil, Cabo Verde, Dominican Republic, Ecuador, Guyana, Haiti, Nicaragua, Panama, Suriname, Timor-Leste, and Trinidad and Tobago

OEDCC
China

OEDCE
Colombia, Costa Rica, El Salvador, Guatemala, Honduras, Mexico, and Spain

OEDCO
Antigua and Barbuda, The Bahamas, Barbados, Belize, Canada, Dominica, Grenada, Ireland, Jamaica, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines

OEDEC
Austria, Belarus, Czech Republic, Hungary, Kosovo, Slovak Republic, Slovenia, and Turkey

OEDFF
France

OEDGR
Germany

OEDIN
Bangladesh, Bhutan, India, and Sri Lanka

OEDIT
Albania, Greece, Italy, Malta, Portugal, and San Marino

OEDJA
Japan

OEDMD
Algeria, Ghana, Islamic Republic of Iran, Libya, Morocco, Pakistan, and Tunisia

OEDMI
Bahrain, Egypt, Iraq, Jordan, Kuwait, Lebanon, Maldives, Oman, Qatar, Somalia, United Arab Emirates, and Yemen

OEDNE
Andorra, Armenia, Belgium, Bosnia and Herzegovina, Bulgaria, Croatia, Cyprus, Georgia, Israel, Luxembourg, Moldova, Montenegro, Netherlands, Republic of North Macedonia, Romania, and Ukraine

OEDNO
Denmark, Estonia, Finland, Iceland, Latvia, Lithuania, Norway, and Sweden

OEDRU
Russian Federation and Syrian Arab Republic

OEDSA
Saudi Arabia

OEDST
Brunei Darussalam, Cambodia, Fiji, Indonesia, Lao People's Democratic Republic, Malaysia, Nepal, Philippines, Singapore, Thailand, Tonga, and Vietnam

OEDSZ
Azerbaijan, Kazakhstan, Kyrgyz Republic, Poland, Serbia, Switzerland, Tajikistan, Turkmenistan, and Uzbekistan

OEDUK
United Kingdom

OEDUS
United States