

New aspects of the Swiss capital market

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In an article on Neuchâtel last September, "The Times" said there was a "Gay feeling of youth" about the town. It also reminded readers that Neuchâtel was at one time a principality of the Orange family, then under Prussian rule from 1707 to 1815, when it joined the Confederation. It is only 107 years ago that Prussia finally gave it up. There are several bodies concerned with preserving historic sites as well as natural beauty spots. Nature reserves are being created and legislation made to protect fauna and flora. Some time ago, the wreckage of a boat was discovered on the bottom of the lake. It was that of a trading vessel from the sixteenth century, loaded with pottery, bronze and iron goods. The historic bridge near St. Sulpice has been saved from destruction, and the "Sentiers du Doubs" have taken the initiative to preserve some of the old historic inns of the district.

The two Communes of La Chaux-de-Fonds and Le Locle are working together more and more. Le Locle will be using the slaughterhouse of La Chaux-de-Fonds, and the gas and water problems will in future be solved jointly. The hospitals will also co-operate. La Chaux-de-Fonds is undertaking special research into dental decay. These enquiries are of great interest to the Swiss statistical office; the results will be evaluated with the use of computers.

Neuchâtel has been host to a number of meetings and gatherings. After the fourth gastronomic fair, the "Quinzaine de la Defense Romande" and the leaders' meeting of the Swiss Y.M.C.A. had taken place there early last summer, the forty-fourth session of the Neuchâtel Reformed Church was held, followed a few weeks later by the A.G.M. of the Swiss Shorthand Writers. In October, the vintners' festival took place. This was of particular significance as the hard winter had destroyed as much as 100% of some of the vineyards. But even apart from the loss of vines through frost, the winegrowing area has been reduced considerably in the course of the last few years. The State had to pay compensation to some of the badly-hit winegrowers. Out of the financial surplus Neuchâtel achieved in 1962, half a million francs were donated to Neuchâtel wine-growing.

In November, the Swiss teachers of Esperanto gathered in Neuchâtel, and a few days later, the police chiefs of the Swiss municipalities met at La Chaux-de-Fonds. The Swiss "Georgsbund", whose aim it is to keep the boy scout ideals also in adult life, held a meeting in Neuchâtel. At the same time ASUAG, the general Swiss watch industry, had its annual meeting there. Early in the new year, the parliamentary press in Berne visited the Swiss Chemists' College in Neuchâtel, and in February, the Federation of Swiss Students met for their A.G.M. All Swiss universities and technical colleges were represented, and the Editor may be forgiven if she mentions with just a little pride that her son was one of the three delegates of the ETH, the Federal Institute of Technology.

Finally a few figures. At the end of 1963, the Canton of Neuchâtel counted 156,061 inhabitants, an increase of 1,708 over the previous year. Most of the increase took place in the town of Neuchâtel, Boudry and La Chaux-de-Fonds, whilst the population in the Val-de-Travers went back by 210 inhabitants. The district with the densest population is Neuchâtel which has a population of 45,907.

At the same time, the Canton counted 102,941 Protestants, 50,172 Roman Catholics, 666 Christian Catholics, 604 Jews and 1,678 persons of other or no denomination.

*(News items by courtesy of the
Agence Télégraphique Suisse.)*

NEW ASPECTS OF THE SWISS CAPITAL MARKET

By HANS ESCHER
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Lately there has been a certain change of emphasis in the problems which confront the Swiss money and capital market. In previous years, the large inflow of foreign funds was in the foreground. So far as banks are concerned, attention has now shifted to the task of obtaining funds necessary for a structurally sound financing of the very lively investment activity in our country.

In fact, Switzerland is today in the throes of an investment boom which has no parallel in her economic history. As a result, an excessive strain has been put on Swiss financial resources in the past few years. The volume of investments is estimated to have exceeded 11 milliard francs in 1961 and 13 milliard in 1962, this being more than two-thirds larger than in the last boom period of 1956-57. In the current year it may reach a new record level of 13.5 milliard francs.

This development has brought the banking system and the capital market under heavy pressure. At the 62 monthly reporting banks, the credit expansion in 1961 and 1962 reached a total of 8.6 milliards, which was 2½ times greater than in 1956-57. In the first nine months of 1963 the rate of expansion slowed down somewhat, due not least to an undertaking the banks gave in 1962 to the Central institution to observe certain limits when granting new loans in favour of domestic borrowers and for export financing. But even so, the increase of loans, calculated on an annual basis, was at the very high level of 3.5 milliards. Moreover, from the beginning of 1961 until the end of September 1963, fresh demands on the capital market by Swiss bond and share issues reached about 5 milliard francs or, in the monthly average, nearly twice the figure of 1956-57. If one also taken into account loans floated for foreign borrowers, an activity which was practically non-existent in 1956-57, the increase would be nearly four times as great.

Switzerland as capital importing country

In relation to the economic capacity of a country as small as Switzerland, the above-mentioned figures constitute enormous amounts which far exceed the savings potential of her population. According to official estimates, Switzerland showed a financing gap of one milliard francs in 1961 and 1½ milliard in 1962. This gap was closed by funds streaming into the country from abroad, including repatriated Swiss capital. In the current year, it is certain that at least as great an amount as last year will be needed for the same purpose.

Switzerland has thus lost its traditional function as a net exporter of capital and has become a capital importing country. Actually, as a capital exporter, today it only plays the role of a turntable, reinvesting abroad a portion of the funds it has received from foreign sources.

This development is for many reasons not very satisfactory. Above all, it makes Switzerland financially vulnerable. Thus a slowing down in the influx of funds has recently been very quickly reflected in signs of tightness in the Swiss capital market. This, together with the outcries of a few politically active apostles of cheap money, has induced our monetary authorities to put a brake on the floating of foreign loans which until recently were quite substantial. As numerous requests for loans are continuously reaching us from abroad, the waiting list, already

fairly extended, has of late become even longer. In view of this situation and the restrictions imposed on the American capital market by the proposed Interest Equalisation Tax, foreign firms have recently announced plans to float issues in Swiss francs; one such loan has already been placed. This is certainly a most undesirable development, representing from the monetary point of view a misuse of convertibility.

Deposit and loan business

A further problem arises from the nature of the inflowing funds. Actually, the influx consists of short-term funds which cannot be utilised in the domestic loan business, thus posing delicate liquidity problems for the banks. In order to protect themselves against sudden withdrawals, they have considerably strengthened their cash reserves and short-term assets. The five big banks alone have almost doubled their liquid assets since the beginning of 1960, and at the end of September 1963 they totalled approximately 12 milliard francs. Of these assets a substantial part has been placed at sight or short-term with foreign banks. A large portion found its way to London, where the funds have been invested principally in the Euro-dollar market. Considerable funds have also flowed, particularly in the form of Swiss franc deposits, to French and German institutions which have shown a special interest in this kind of money.

The problems of liquidity policy were all the more intricate as the massive influx of short-term money has been in juxtaposition with an increased demand for longer-term loans. This was in part a natural consequence of the investment boom, the financing of which requires considerable long-term funds. In addition, there are the requests for export credits of increasingly longer duration, to which the banks cannot turn a deaf ear in view of the heavy dependence of the Swiss economy on exports. Further, nearly all banking institutions carry large, unused credit lines which, especially in times of a stiffening capital market, could very quickly be utilised. Finally, an increased need for funds arises because the refunding of the banks' temporary overdrafts has been made more difficult by recent developments.

Structural problems of liquidity policy

These tendencies present the big Swiss commercial banks in particular with difficult problems. Unlike the English clearing banks, the Swiss institutions grant medium- and longer-term credits in addition to short-term facilities. Thus, one of their main problems consists in obtaining the longer-term deposits needed for the structurally sound financing of their loans. The solution is the more difficult because the authorities pursue an interest and capital market policy that tends to jeopardise the effectiveness of the Swiss banks' traditional means for the acquisition of longer-term funds — i.e., the medium-term notes, which are also known under the French term "bons de caisse". Thanks to the slight improvement in issuing terms recently conceded, it has been possible to arrest the decline in the outstanding amount of such notes. But the problem of attracting sufficient long-term deposits has by no means been solved, particularly as the Gentlemen's Agreement with regard to the influx of capital still remains in force and presents the banks from converting into fixed deposits those foreign funds which the owners are willing to leave in Switzerland for some time.

Consequently a considerable discrepancy has arisen between the banks' needs of long-term funds and the actual

amounts available to them. The size of the gap can be gauged from the fact that the five large banks, in order to establish the same relationship between total assets and long-term deposits as existed in 1955-1957, would have required about half a milliard francs more of such deposits at the end of June 1963 than they actually possessed.

New financing methods

It is understandable therefore that the big Swiss banks have been searching for ways and means of acquiring additional funds. In this endeavour — for the first time since the end of the last century — they are now attracting funds by the issue of long-term bonds. The initial step in this direction was made by the Banque Populaire Suisse in the spring of this year with a 3½ per cent convertible bond issue of 44 million francs, followed in the autumn by the floating of ordinary bonds with a 4 per cent coupon to the amount of 40 million francs. Though the larger institutions at first were content merely to maintain a watching brief, the Union Bank of Switzerland decided in the summer to cover the need of long-term funds with a 3¾ per cent bond issue of 100 million francs.

In the autumn, the Swiss Credit Bank followed suit, but, instead of ordinary bonds, they floated a convertible issue; the stock, bearing interest at a rate of 3½ per cent, was offered to shareholders. The issue amounted to 180 million francs, the largest loan operation ever conducted in Switzerland by a private institution. There are many reasons why the Bank decided to place convertible bonds in the market, although they are not normally used as a financing instrument by banks. In the first place, under existing conditions in Switzerland, the very large amount needed was practically unobtainable by other means. In addition, these comparatively low interest-yielding bonds possess the advantage of leaving the domestic interest structure unchanged and therefore were not out of line with official policy; indeed, the choice of this method of financing met with the full approval of the authorities. Further, convertible bond issues are well suited to the present economic situation in Switzerland because they protect their owners against bearish trends in the equity markets while allowing them to benefit fully from bull situations.

Prospects

In evaluating this finance technique it must be remembered that the issues do not entirely provide the banks with fresh funds, but serve to a considerable degree to bind on a long-term basis deposits already held by the banks. Thus, the funds available for loans have not increased to the full extent of the issue amount. Structurally, however, the balance sheet has improved and the flexibility of the banks therefore increased. Moreover, it has also to be considered that certain limits are fixed for the domestic loan business by the previously mentioned agreement with the Central Bank.

In principle, therefore, these issues do not encourage an inflationary credit expansion. In fact, as always, the banks unreservedly support the aims of the monetary authorities to keep boom conditions in Switzerland to limits within which the country would be able to provide its own finance, thus contributing to the maintenance of sound monetary conditions, an indispensable prerequisite for an economy which, like that of Switzerland, is heavily dependent upon world trade and finance.

(Reprinted from "The Statist" World Banking Survey December 1963.)