Switzerland: Survey highlights growing export risks

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Executive summary

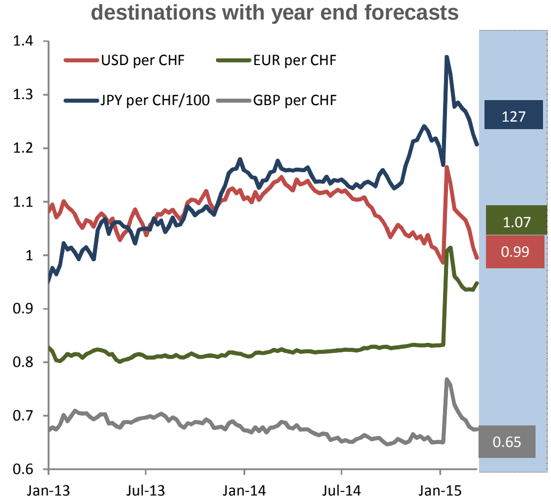
- Swiss exporters have a high awareness of risks to their export trade. A poll by the *Berner Fachhochschule* and Euler Hermes shows that 88% of companies are affected by currency risk. 69% of companies expect currencies pressures to compound in the year to come, while 50% expect higher commercial risk, 28% more political risks and 23% higher credit risk.
- Export growth in 2015 should come from the U.S. and China (+CHF5.3bn and +CHF1.8bn respectively) but cannot offset all of the negative FX effects in the Eurozone (export losses of –CHF11.1bn). Total exports should decrease by -0.1% in volume and by -1% in value as export prices should fall.
- Companies have some blind spots in their safeguards. 32% of companies are not protected against political risk, 23% and 13% of companies do nothing against commercial and credit risk respectively. Due to the FX risk EH downgraded already four sectors and revised Switzerland's insolvency forecast for 2015 from -3% up to +5%.

Internal and external upheavals force companies to reevaluate their export strategy

Currency risk is taking a toll on exports
Not surprisingly, currency risk is currently the most important issue for Swiss exporters, after the decision of the SNB to end the FX cap of CHF1.20/EUR in January 2015. In a survey, conducted by the *Berner Fachhochschule* and Euler Hermes, 88% of companies stated that they were affected by currency risks in the last two years (45% strongly and 43% somewhat); with 69% of companies expecting pressures to compound in the year to come.

Exports to the Eurozone, Switzerland's main export destination with 46% of total exports, will feel the pinch of a strong CHF. After the initial knee-jerk 20% appreciation against the EUR following the SNB decision, we anticipate the CHF will settle around CHF1.07 per EUR in H2 2015, 14% stronger on average for the year. At the same time, due to dovish monetary policy in Japan, the CHF should appreciate by 10% against the JPY in 2015. Such developments cannot take place without affecting the competitiveness of firms. Our survey indicates

Figure 1: CHF against currencies of major export destinations with year end forecasts



Sources: Bloomberg, Euler Hermes

56% of companies report lost orders due to the stronger CHF, while the potential growth for Eurozone exports decreased sharply. As a result, companies see overall risks to their European business expanding: increasing risks are expected for France (named by 39% of companies), Italy (36%), Germany (30%) and the rest of Europe (30%).

But there are also opportunities as exports to the U.S. and markets whose currencies are pegged or linked to the USD should benefit from tighter monetary policy in the U.S. Euler Hermes expects the CHF to converge to close to parity against the USD by the end of the year, and to depreciate by an average of 11% y/y in 2015. Benefiting markets are located in the Middle East (Bahrain, Iraq, Jordan, Lebanon, Oman, Qatar, Saudi Arabia and the United Arab Emirates) as well as Latin America (such Bolivia, Ecuador, and Venezuela) and the Caribbean (a hotbed for pegged currencies) although the latter region accounts for only a small share of Swiss exports.

Commercial and political risk remain key concerns

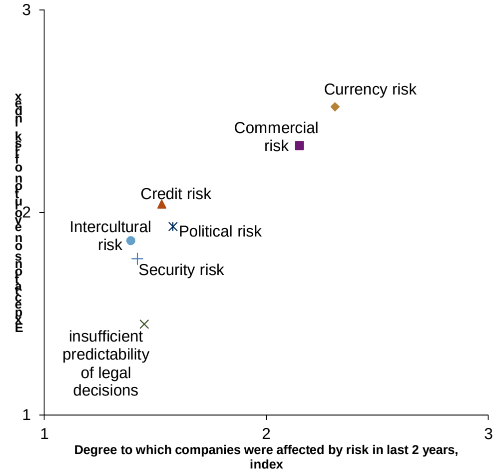
88% of the surveyed companies were affected by commercial risk either strongly or fairly in the last two years, while 46% of companies were affected by political risk. 27% of export companies report lost orders due to political developments in an export market. The risks are likely to remain a concern in the future, with both commercial (50%) and political risk (28%) expected to rise.

A key concern for exporters remains Russia, where 50% of companies expect export risks to increase next year. Exports to Russia decreased in 2014 by -11% and comprise a mere 1.3% of total exports; however the downside risk for exporters remains high. Russia entered a crisis of confidence in 2014 which Euler Hermes expects will deepen in 2015 with a severe recession where GDP declines by -5.5%. Russian imports are expected to fall by -25%, a reduction of roughly CHF2bn. The sectors with the highest exposure are textiles, and the forestry and agrifood sector, where exports to Russia account for 2.3% and 2.2% respectively of global exports. Also, the machinery sector with an export share to Russia of 1.7% and the jewellery and watch sector with a share of 1.3% may feel strong repercussions. Brazil is also anticipated to enter recession this year, plagued by weak demand, coupled with tighter monetary policy and heightened uncertainty about the outlook for business. 20% of Swiss companies expect an increase in export risk, with lower demand for Swiss goods expected to reduce exports by CHF100mn.

The plague of credit risk and non-payments

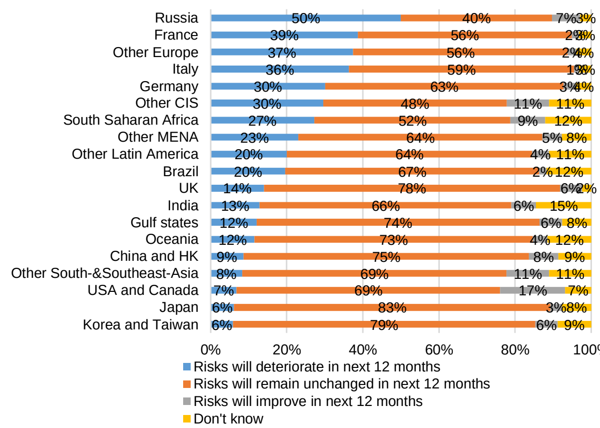
55% of the companies in the survey report being impacted by a strong or a medium degree of credit risk in the last two years, and one in four companies expects this to increase. Credit

Figure 2 : Company assessment and expectations of risks, by type



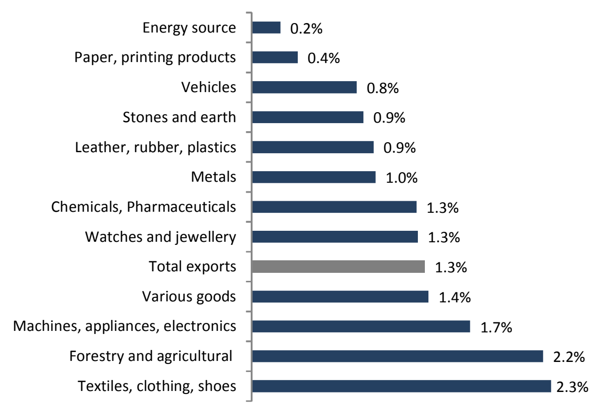
Sources: Berner Fachhochschule, Euler Hermes

Figure 3: Expectation of risk development, by country



Sources: Berner Fachhochschule, Euler Hermes

Figure 4: Exports to Russia in % of total exports, by sector

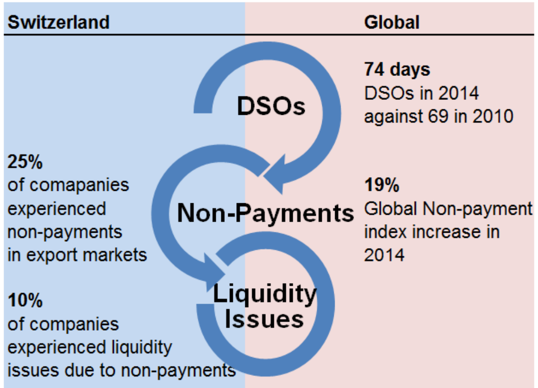


Sources: Swiss-Impex, Euler Hermes

risk may stem from different sources. On a global scale, DSOs increased to 74 days on average in 2014 compared to less than 69 days in 2010, as credit remains *de facto* under restrictions in several countries and is used as a financing tool.

At the same time, non-payments remain an unpleasant event that exporters have to anticipate. One in four companies in the survey experienced non-payment events in export markets. In line with this, Euler Hermes' global non-payment index increased by +19% in 2014. Particularly for small companies, a shock of non-payments can affect the business markedly; 10% of companies in the study experienced liquidity problems caused by non-payments. With DSOs and non-payments on the rise, global insolvencies are expected to decrease only by -2% in 2015 despite the modest recovery, and still remain 10% above the pre-crisis level in 2007.

Figure 5: Figure: Non-payments and liquidity problems

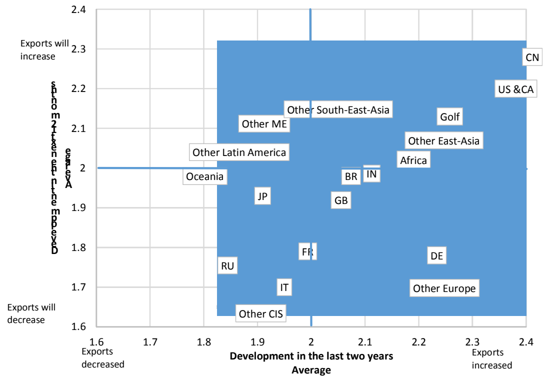


Source: Euler Hermes

A further diversification of export destinations should decrease Swiss dependence on the Eurozone

Since the economic and financial crisis began in 2008 Swiss exports to Europe fell by -11% while exports to North America and Asia increased by 34% and 24%, respectively. The current global economic environment is likely to see a further diversification of Swiss exports, shifting away from Europe and the Eurozone. The majority of Swiss exporters expect a decline of exports to Europe: 39% expect exports to Germany to decline (vs. 18% expecting an increase), 38% for France (vs. 16%), 42% for Italy (vs. 12%) and 41% to the rest of Europe (vs. 16%). Expectations are also downwardly skewed for Russia (47% vs. 18%), the CIS (48% vs. 18%), Japan (29% vs. 22%) and the UK (21% vs. 19%). Exporters expect the growth drivers during next year to be China (46% of companies expect an increase vs. 17% expecting a decline), the U.S. (37% vs. 17%), Gulf states (33% vs. 20%), Korea and Taiwan (26% vs. 19%) and India (25% vs. 17%).

Figure 6: Survey: Development of exports in the last 2 years vs. expectations for the year to come



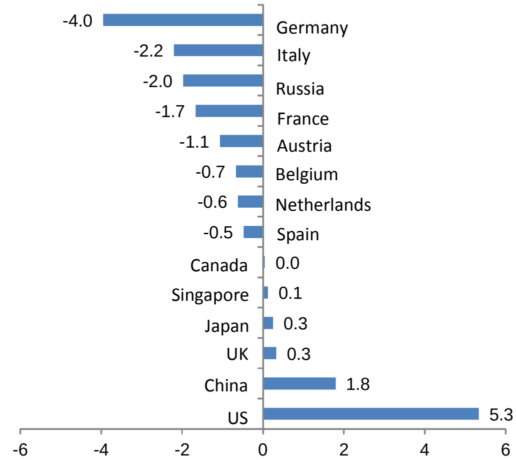
Sources: Berner Fachhochschule, Euler Hermes

Exports to decrease in value by CHF4bn

Overall, the moderate pickup in world trade and the beneficial effects of USD strength should offset much, but not all, of the negative FX effects in the Eurozone. Euler Hermes expects that exports are to decrease marginally by -0.1% in 2015 by volume. In value terms however, 2015 exports are expected to experience a more significant decline (by -1.0%, i.e. CHF4bn). Behind this deceleration of nominal exports stands an expected decrease of export prices caused by (i) the headline deflation due to the appreciation of the CHF against major trading partners; (ii) higher price competition in deflationary key outlets; and (iii) lower energy prices (energy accounts for about 3% of exports).

Among Switzerland's top 10 trading partners,

Figure 7: 2015 potential export gains and losses in key export markets (CHF bn)



Sources: Chelem, IMF, Euler Hermes

exports to all Eurozone countries are expected to decrease. Germany alone, accounts for 20% of Switzerland's exports, is expected to demand –CHF4.0bn less in imports from Switzerland; for the Eurozone in total, Euler Hermes expects exports to decrease by -CHF11.1bn. The largest export gains should come from the U.S. (+CHF5.3bn), China and Hong Kong (+CHF1.8bn) and the UK (+CHF0.3bn).

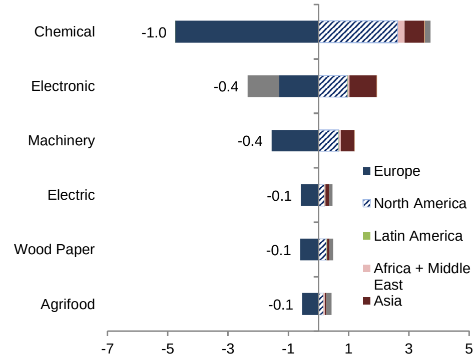
The drag from Europe on exports translates into overall export losses on a sector level, particularly those with large nominal exports to the Eurozone. Euler Hermes expects chemical exports to decrease by –CHF1.0bn, in the electronic and machinery sectors by –CHF400mn each, and in the electrical, the wood and paper and the agrifood sectors by -CHF100bn each.

Blind spots in safeguards should see insolvencies in Switzerland increase by +5%

According to the survey, one in five Swiss exporting companies used credit insurance in the last two years – this is comparable to the practice in neighboring Germany. Despite the high awareness of risks, however, Swiss companies appear to have blind spots in their safeguards: 32% of companies are not protected against political risk, 23% of companies do nothing against commercial risk while 13% of companies are unprotected against credit risk. Nonetheless, the hazard from currency risk is well acknowledged across firms as 95% of firms employed some measure to mitigate FX risk in the last two years.

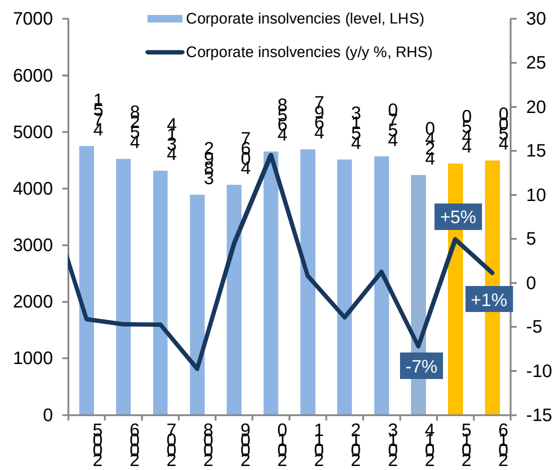
Our survey indicates that companies are well advised to adapt their risk management. For example the loss in competitiveness of exports to the Eurozone due to the end of the FX cap will not only force companies to cut costs but will also drive a number of companies out of the market. Euler Hermes revised its insolvency forecast in response to the SNB decision from –3% to +5% in 2015, with the majority of insolvencies should come from export-orientated firms and its suppliers. Sectors that remain prone to FX risks include automotive suppliers, textile, retail and machinery sectors, all of which Euler Hermes downgraded (by 1 notch) in the wake of the SNB decision.

Figure 8: Potential export gains in 2015 for 6 largest export sectors (CHF bn)



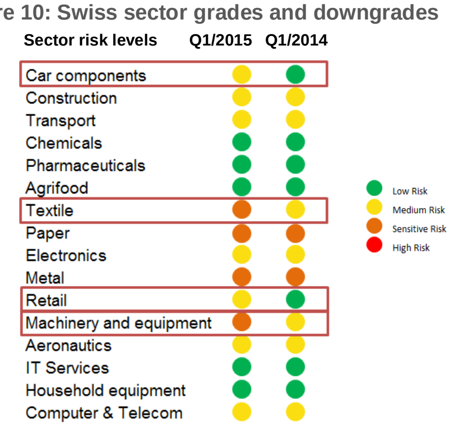
Sources: Chelem, IMF, Euler Hermes

Figure 9: Corporate Insolvencies



Sources: National Sources, Euler Hermes

Figure 10: Swiss sector grades and downgrades



Sources: Euler Hermes

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