Danger on the Swiss Stock Exchange

Difficult negotiations between Switzerland and the European Union could lead to a non-renewal of stock exchange equivalence for the Swiss stock exchange. This could have a significant economic impact. Here is what you need to know

Source: Shutterstock

1 A context of difficult negotiations

Switzerland and the EU are currently renegotiating their relations for the coming years. The EU wants a "framework agreement" to formalise relations and replace the 120 existing treaties. The purpose of this agreement is to force Swiss legislation to automatically align with European rules in certain areas. Currently, Switzerland has access to the European common market and adheres to the principle of free movement of people. In practice, it is estimated that more than 33% of current Swiss legislation derives from European law, even though no agreement currently obliges Switzerland to transpose European rules onto its own law books. A framework agreement would make the process more automatic by forcing Swiss rules to automatically align with European rules in the areas specified in the agreement (legal developments, supervision, interpretation and dispute settlement). In addition, an arbitration panel would settle disputes between Switzerland and the European Union, and the EU Court of Justice would have a crucial role to play.

Negotiations between the EU and Switzerland have become bogged down lately and it is difficult to see how a framework agreement could be concluded quickly. The problem for the Swiss government is that negotiations with the EU are taking place in a hostile domestic climate.

- The ultra-nationalist Swiss People's Party (SVP or UDC) - the most powerful political movement in the country - is campaigning against European agreements.
- Swiss unions have been strongly opposed to a loosening of the national regulation protecting wages - the "accompanying measures". These measures force foreign employers who send workers to Switzerland to meet the country's minimum wage and labour conditions. They help keep Swiss wages much higher than in the EU. The EU wants these measures abolished because it believes they penalise foreign companies and are discriminatory. A framework agreement without a modification of these accompanying measures would therefore seem unacceptable to the EU. The opposition of trade unions thus greatly complicates the negotiations between the Swiss and European authorities.

2 Stock exchange equivalence as a means of pressure

In December 2017, the EU decided to put pressure on Switzerland to speed up negotiations. It has decided to link the progress of the negotiations to obtaining stock market equivalence for the Swiss stock exchange. In short, in December 2018, without sufficient progress in the negotiations, European's access to the Swiss stock exchange and securities listed in Switzerland could be threatened.

Equivalence is necessary for European traders to carry out their Swiss securities transactions directly on the Swiss market. Without equivalence, European traders would be forced to trade Swiss securities on European platforms rather than on Swiss stock exchanges. For the Zurich Stock Exchange, this would be a real problem because currently the majority of trading of the main Swiss shares is carried out by brokers based in the EU. In practice, a large part of the liquidity of Swiss shares would be migrated to European stock exchanges and the Swiss stock market would see its volume of transactions drop drastically. The Swiss Finance Minister estimates that the volume of trading would decrease by 70% to 80% without equivalence. This situation could lead Swiss issuers to consider transferring their main listings to European regulated markets, thus distorting the position of the Swiss financial centre and impacting the entire Swiss economy.

The consequences would therefore be significant and that’s the reason why this equivalence is considered by the EU as a means of pressure on Switzerland. Apparently, it was not strong enough and negotiations for a framework agreement have not really progressed in 2018. As a result, Valdis Dombrovskis, the European Commission Vice-President in charge of financial stability and capital markets, said on November 28 that "there is not enough progress" to renew stock exchange equivalence.

3 Swiss reaction

The Swiss reaction was not long in coming. On 30 November, the Swiss government passed a law suspending the right of European stock exchanges to trade Swiss equities if equivalence is not granted. The goal is to still allow Swiss securities to be traded by European traders in Switzerland. Indeed, according to European law, when securities of Swiss companies are not traded on European stock exchanges, then European traders can trade Swiss securities in Switzerland without the need for equivalence (as there is no other means to exchange these securities). It is a way to maintain a sufficient volume of transactions on the Swiss stock market and avoid a liquidity problem for Swiss companies.

The government has therefore proposed a plan to safeguard the Swiss stock market to avoid a disaster. The plan is not perfect because the risk that trading participants leave the Swiss stock exchange cannot be ruled out. But the plan should limit the negative consequences of a loss of equivalence for Switzerland, at least initially.

4 Beyond the stock market, economic consequences

Difficult negotiations between Switzerland and the EU and threats from both sides could leave long-term traces on the relationship between the two entities and on Switzerland's economic performance. In the eyes of the Swiss, the EU now appears uncompromising, which affects its image. The Swiss consider that they are "treated without dignity" by the EU. This could strengthen eurosceptics and the nationalist UDC party, who could win seats in parliament in the upcoming elections scheduled for October 2019.

In addition, the break down in relations makes the conclusion of an agreement increasingly complicated. This could result in uncertainty and difficulties for Swiss companies trading goods and services with the EU. The EU is Switzerland's largest economic partner. Some 53% of Swiss exports are destined for the EU (18% for Germany), and 71% of Swiss imports come from the EU (28% from Germany). Switzerland is also a small, open economy whose GDP growth depends heavily on foreign trade. Together, the value of exports and imports represent more than 82% of the annual GDP of Switzerland. Worsening relations and greater difficulties in trading with the EU, its main partner, would therefore be very damaging for the Swiss economy. Switzerland has nothing to gain from this battle.

> *Deteriorating relations and greater difficulty in trading with the EU would therefore be extremely damaging for the Swiss economy.*

Author

Charlotte de Montpellier
Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com