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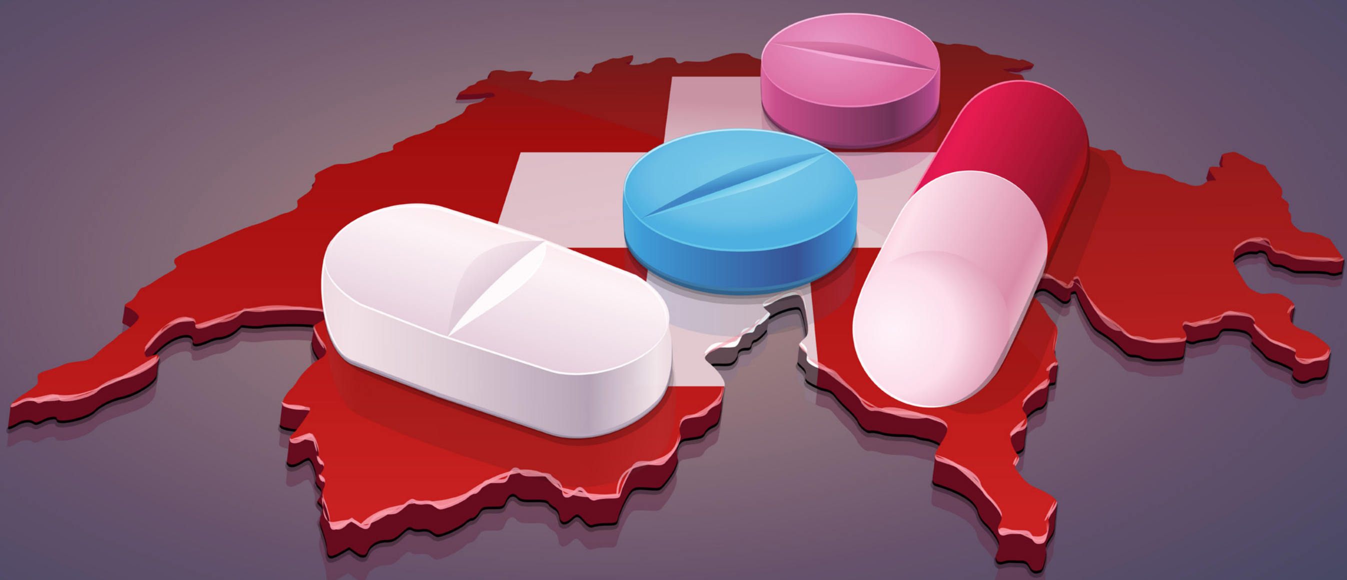
Swiss economic resilience and export specialisation



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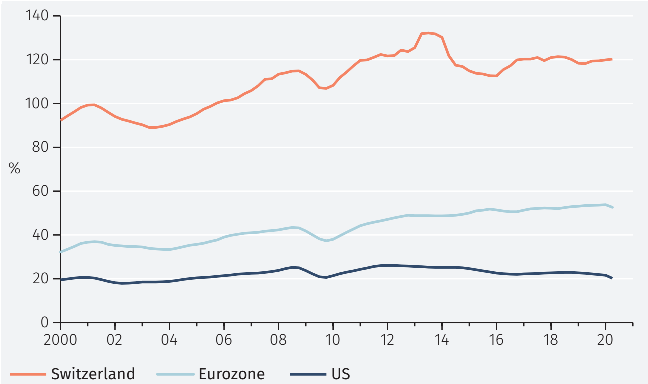
As a small open economy, Switzerland might reasonably have been expected to suffer from the decline in international trade triggered by the Covid19 pandemic. However, Swiss GDP is expected to fall by less than that of most industrialised countries, most notably the eurozone. In this edition of *Infocus*, GianLuigi Mandruzzato looks at the factors that have contributed to the resilience of the Swiss economy, including specialisation in the export of chemical and pharmaceutical products that benefit from ageing populations in much of the world.

Switzerland, a resilient small open economy

Switzerland is the archetype of a small economy open to international trade. In 2019, the Confederation's GDP was CHF700bn, about 5.5% of that of the eurozone and about 3.5% of that of the USA. Switzerland is much more open to international trade than both the eurozone and the US. The sum of exports and imports of goods and services is equal to 120% of GDP in Switzerland, about 50% in the eurozone and about 22% in the USA (see Figure 1).

1. Openesss to trade



Source: Refinitiv and EFGAM calculations. Data as at 1 October 2020.

The Covid-19 pandemic caused the collapse of international trade. In the World Economic Outlook of June 2020, the IMF predicted that global trade of goods and services would decline by almost 12% in 2020. The high sensitivity of the Swiss economy to international trade would be expected to influence Switzerland to a greater extent than more closed economies. However, analysts expect that in 2020 Swiss GDP will fall significantly less than in the eurozone and at a pace similar to that of the US (see Figure 2).

It is interesting for two reasons to compare the economic performance of Switzerland and the eurozone. They are geographically close to each other and the governments

2. 2020 GDP growth consensus

Source: Bloomberg. Data as at 1 October 2020.

of both followed similarly severe strategies to contain the Covid-19 pandemic, as measured by the University of Oxford's Stringency Index (see Figure 3).

3. Lockdown Stringency Index

Source: Oxford University, Refinitiv and EFGAM calculations. Data as at 1 October 2020.

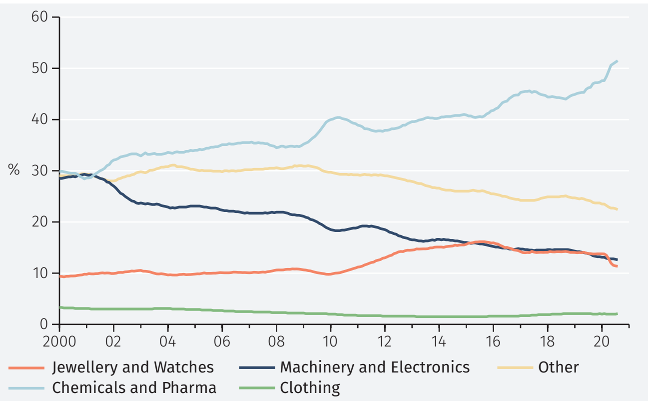
In the first half of 2020, the Swiss economy fared much better than the eurozone. Swiss GDP fell by only 5.1% year-on-year compared to -9% year-on-year in the eurozone. Among the main expenditure items, fixed investment fell by 3.8% year-on-year in Switzerland and 10% year-on-year in the eurozone, while exports fell by 4.7% year-on-year in Switzerland against 12.3% year-on-year in the eurozone. Given the importance of exports in both economies, it is not surprising that the investment dynamics were closely linked to export behaviour. The resilience of Swiss exports has therefore favoured the economy beyond the direct impact on the trade balance.

But why have Swiss exports been stronger than those in the eurozone? To answer this question, we have analysed the sectoral composition and geographical destination of Swiss and eurozone exports.

Composition and destination of exports

Over the past 20 years, Swiss export sector specialisation has shifted towards chemical and pharmaceutical goods. In the twelve months to August 2020, this sector accounted for more than 50% of total exports, up from 30% in 2000 (see Figure 4). Meanwhile, exports of machinery and electronics goods lost importance, falling to 10% from 30% of total exports in 2000. Exports of jewellery and watches remained stable at around 10%. It should also be noted that Switzerland's exports of vehicles, which were among the sectors hardest hit by the crisis, is negligible.

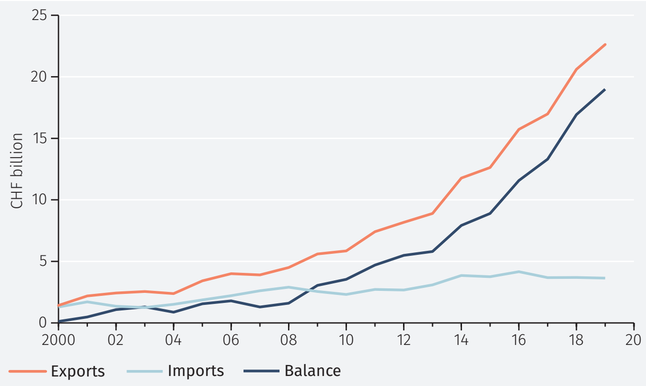
4. Swiss export composition by sector



Source: Refinitiv and EFGAM calculations. Data as at 1 October 2020.

Demand for pharmaceutical goods is driven by population ageing and, unsurprisingly, has so far been little affected by the pandemic.[1] In the first eight months of 2020, Swiss chemicals and pharmaceuticals exports were the only sector that continued to grow, by 4.9% year-on-year, while other Swiss exports fell by -18.9% year-on-year. Since 2009 the rise of pharmaceutical products exports has been driven by increased demand from the US (see Figure 5), which was responsible for 40% the growth while the EU contributed another 21%.

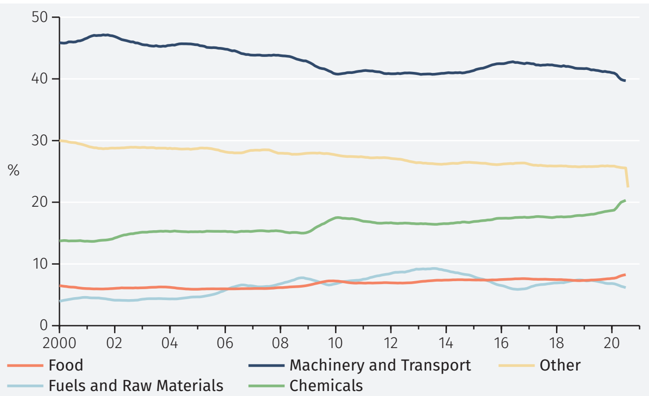
5. Swiss-US pharmaceutical goods trade



Source: UN Comtrade, Refinitiv and EFGAM calculations. Data as at 1 October 2020.

In contrast, the eurozone specialises in the export of machinery and transport goods, a sector that accounts for around 40% of its total exports (see Figure 6). The highly cyclical fuels and raw materials sector makes up about 7% of the total and has also penalised eurozone export performance. The weight of chemical goods has been rising and is now 20%.

6. Eurozone export composition by sector

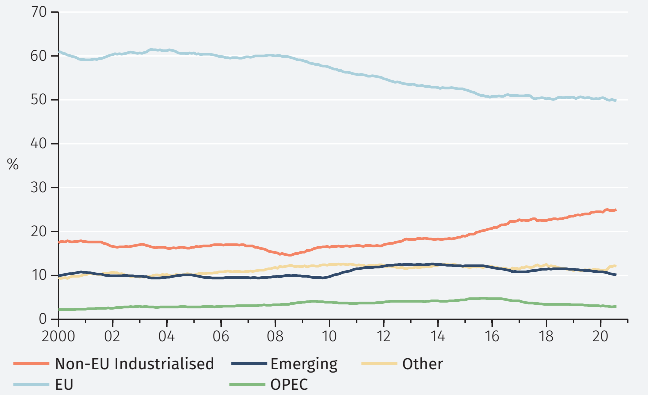


Source: Refinitiv and EFGAM calculations. Data as at 1 October 2020.

Looking at the destination of Swiss exports, the weight of the European Union (EU) is dominant. This is not surprising given the geographical proximity, but its weight has dropped by more than 10 percentage points since 2009 and is now around 50% (see Figure 7). In recent years, the share of exports going to other industrialised countries, in particular the USA, has increased and now accounts for about 25% of Swiss exports. Surprisingly, the weight of emerging countries is only around 10%, suggesting little sensitivity of Swiss exports to growth in those economies. However, the actual sensitivity is likely to be greater since some Swiss intermediate goods exports to the EU ultimately depend on demand from emerging countries.

[1] Health-care related per capita spending is significantly higher for the elderly than for working-age adults and children. See David Lassman et al, *US Health Spending Trends By Age And Gender: Selected Years 2002–10*, Health Affairs n. 5, 2014, and WHO, *World Report on Aging and Health*, 2015.

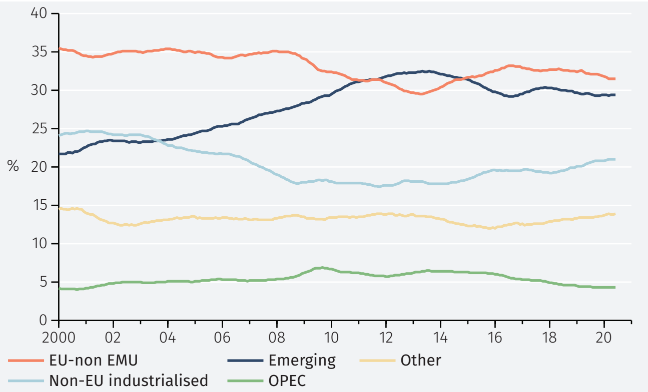
7. Swiss exports by destination



Source: Refinitiv and EFGAM calculations. Data as at 1 October 2020.

In fact, emerging countries are the second largest destination of eurozone goods and services exports, absorbing just under 30% of the total (see Figure 8), a share close to that of the other EU countries (32%). The share of other industrialised countries has increased to 21%, but the increase was less than in Switzerland.

8. Eurozone exports by destination



Source: Refinitiv and EFGAM calculations. Data as at 1 October 2020.

Conclusions

A comparison of the sectoral composition and geographical destination of Swiss and eurozone exports suggests that the former plays a significant role in explaining the different performance of the two economies since the outbreak of the Covid-19 pandemic. The dominant weight of the chemical and pharmaceutical sectors in Swiss exports limited the direct damage to growth from the decline in international trade and its spillover to fixed investment in the face of lower expected demand.

In comparison with the eurozone, this was more relevant than the distribution of export markets. The latter should have favoured the eurozone, with around 30% of exports absorbed by emerging countries, whose GDP growth remains higher than that of industrialised countries. In contrast, the destination of Swiss export is dominated by the European Union, an area expected to record one of the steepest declines in GDP in 2020, although its weight in total Swiss exports has dropped since 2008.

The ageing of the population should support growth in demand for the chemical and pharmaceutical goods over the next decades. Switzerland seems well positioned to benefit from this secular trend. This should foster a reduction in the volatility of exports and gross fixed capital formation across economic cycles, thereby stabilising Swiss growth rates.

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