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Line in the Alps

In May and again in June, the Swiss central bank materialized new Swiss francs equivalent to 11.2% of the $573 billion Swiss GDP. It was as if the Bank of Bernanke printed up $1.7 trillion not once but twice in the space of only 60 days. Now unfolding is a speculation on the consequences of this seemingly un-gnome-like demarche, as well as a note on the popular resistance that's forming against it.

Let it be said that the Swiss don't usually go around tempting hyperinflation. It isn't like them. Manageable debts, low inflation and—over the sweep of decades—a strong exchange rate are the hallmarks of Swiss public finance. But facts are facts: The Swiss National Bank is creating strong francs with which to buy weak euros. The euro shall trade no lower than 1.20 Swiss francs, the SNB decreed one year ago, and the central bank has defended that line in the Alps with feats of money printing.

Desperate times have driven the Swiss to desperate measures. The era of pure paper currencies, groaning public debts and speculative commercial banking seems to be ending—certainly, it ought to be ending. The world is primed for a better system, we believe, one grounded in objective value rather than in the whims of the monetary mandarins. And such a system, in fact, Swiss monetary amateurs are helping to make ready.

Swiss monetary professionals, meanwhile, are doing their duty as they see that duty—protecting and defending the currency against haven-seekers. Switzerland's economy is open and foreign-facing. In the first quarter, 52.2% of Swiss production wound up in foreign markets, most of them, evidently, in the European Union; in 2010, almost 59% of Swiss exports never left the Continent.

In the short term, a stronger franc should point to weaker Swiss exports, other things being the same. Yet, in the long run, other things seem decidedly not the same. Over the course of decades, the franc and corporate Switzerland have thrived together. A hard fiat currency is almost a contradiction in terms, but the franc has appreciated by 308% against the greenback since the close of the Bretton Woods era 41 years ago, compared to gains of 142% for the Singapore dollar and 16% for the Norwegian krone, to pick a pair of strong-currency aspirants out of the hat.

Such globally dominant Swiss businesses as Roche, Richemont and Lindt & Sprüngli have somehow surmounted the short-run inconvenience of an appreciating currency. So have innumerable other Swiss producers: This year, not a great season for exporting things priced in hard money, the Swiss current account surplus is expected to reach 12% of GDP.

"The Swiss [stock] market," Boris Zhilin, a principal at Armor Capital, New York, and a Swiss resident, tells colleague Evan Lorenz, "if you just look at the quality of the businesses listed on a per-capita basis or relative to the size of the GDP, it's an incredible outlier in the positive direction. There are many more great companies here than even I would say in Germany, certainly in Italy, Spain, France—companies that operate in great competitive positions, earning great returns on capital, the sort of businesses that Warren Buffett would salivate over. It's just a disproportionate number of them here."

And one might bestow the same kudos on the Swiss monetary and fiscal teams, leaving aside the errant and—who knows?—perhaps only temporary delinking in the year 2000 of the franc and gold bullion. Possibly, the Swiss themselves recoiled at what they did to the gold franc, for in 2001 they voted to restrict government spending to trend-line growth in government revenue. Since 2003, when that law went into effect,

King of the 'hard' currencies
selected currency values in U.S. dollars

	8/15/71	7/24/12	% chg.
Swiss franc	$0.25	$1.01	308%
Deutschemark*	0.30	0.62	109
Canadian dollar	0.99	0.98	-1
Singapore dollar**	0.33	0.79	142
Norwegian krone	0.14	0.16	16
Danish krone	0.13	0.16	22

*exchange rate of DM 1.95583 to €1
**exchangeable at par with Malaysian ringgit until 1973

gross Swiss government debt as a share of Swiss output has fallen to 48.6% from 67.7%. Over the same eight years, incidentally, America's ratio of gross federal debt to GDP has vaulted to 102.9% from 60.4%.

Alas, Switzerland is as tiny as it is (ordinarily) prudent. The euro zone's output is 20.3 times greater than Swiss output; the output of even the euro zone's most crisis-prone economies—Greece, Ireland, Italy, Portugal and Spain—is 6.7 times larger than Switzerland's own. It isn't all glamour being a beacon of solvency on the threadbare old Continent. Before the SNB took aim at the euro last year, demand for Swissies had pushed the franc exchange rate to a point at which probably even the likes of Richemont and Roche were praying for central bank relief.

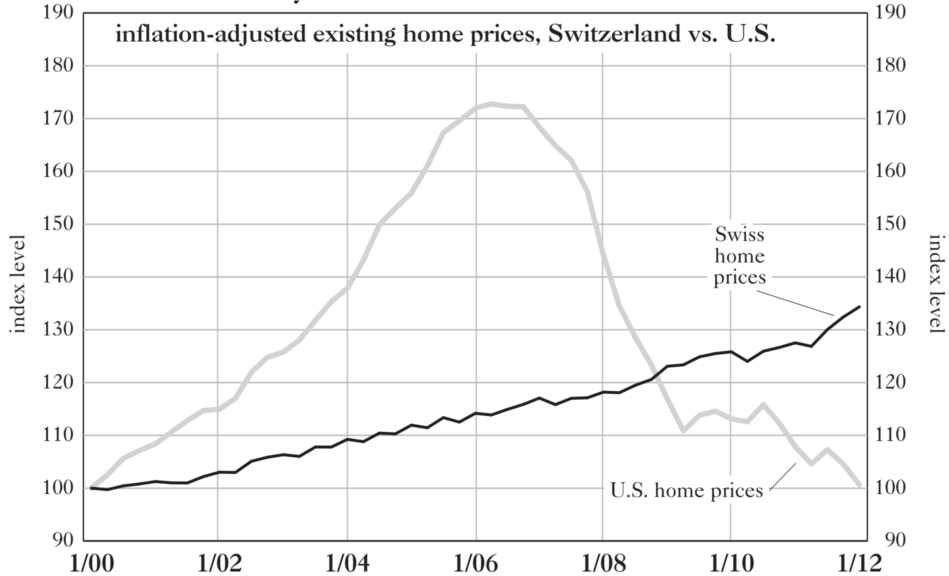
"The U.S. should be aware that the situation in Switzerland is really very special right now," Peter A. Fischer, the head of the economics, business and financial section of the German-language daily *Neue Zürcher Zeitung*, tells Lorenz. "You have a currency which is important but is small relative to the euro, and it's in the middle of Europe. It's a very open and outward-oriented economy. So what do you do if you have this kind of pressure suddenly?"

Why, the answer turns out to be, you "buy foreign currency in unlimited quantities," to quote Philipp Hilde-brand, the then-chairman of the SNB, speaking on Sept. 6, 2011. And with what medium of exchange do you buy it? With the medium that you yourself create on a computer keyboard. From that day to this, the central bank's foreign exchange holdings have jumped to 365 billion Swiss francs, the equivalent of 64% of GDP from 45% of GDP in August 2011, and from a mere 9% in December 2008.

There was nothing else the SNB could do, the argument goes. If foreign exchange market intervention was a necessary evil, capital controls would have been economic self-destruction. Swiss commercial-bank assets sum to a number almost five times greater than Swiss GDP, and more than one-fifth of Swiss residents hold non-Swiss passports. Free movement of money is Switzerland's lifeblood.

Not that the SNB's mighty franc-printing program exacts no costs or distorts no prices in the Swiss economy. By official count, apartment prices are showing year-to-year gains of 6.3% (or were at the latest

'Bubble'?—not yet in Switzerland



sources: S&P/Case-Shiller, Swiss National Bank

reckoning in January). Alternative methods of calculation make the action in prices—and rents, too—much bubblier. "When it comes to real estate," Zhilin, a resident of Lausanne, tells Lorenz, "it went from being very unaffordable to extremely unaffordable and continues trending in that direction."

This is not Las Vegas c. 2005, our informants hasten to add. There is no bidding frenzy—for one thing, the Swiss seem to stay planted at one address—only a persistent push to the upside owing to interest rates jammed to the downside. In the case of government securities yields, you have to go out seven years to find a return greater than zero.

"Most mortgages in Switzerland are structured as bullet maturities," Lorenz relates. "And many include no direct principal amortization. You can borrow at 1.45% for five years while enjoying a tax regime tilted—even by American standards—to stimulate maximum borrowing." So while the Swiss Federal Housing Office estimates that only 40% to 41% of households own their primary residences, the sum total of Swiss mortgage debt foots to 106% of Swiss GDP. In the United States, by unexpected comparison, where the home ownership is 65.4%, it is 63% of GDP. And as for those world-beating Swiss companies, Zhilin relates that Armor Capital sold its Swiss names about three months ago, mostly on the grounds of valuation. Though consumer prices in the Swiss Confederation showed a year-over-year decline of 1% in June, Swiss asset prices are on the boil.

Having chosen to prop up a slumping euro, the SNB must likewise resign itself to round-the-clock franc printing. And because Swiss capital controls are a non-starter, Zurich must practice other forms of financial repression to tamp down inflation. A recent SNB working paper about the public communication of monetary policy concluded that a central bank should either hold its tongue or speak in riddles, the better to confuse money holders about the unvarnished monetary facts. Meanwhile, on the regulatory front, the authorities this month banned interest-only mortgages and ordered lenders to require a borrower to make some small progress in paying down his principal over the course of 20 years. However, short of unthinkable capital controls, the Swiss would seem to be stuck with a close approximation of the monetary policy that wrecked Zimbabwe.

And how do the Swiss like it? Many shrug, some buy gold, others—professional investors, especially, we are told—go into cash-holding hibernation in protest against the official manipulation of the exchange rate. Still others—the ones who most interest us—start petition drives. Two of these popular initiatives may resonate with the greater *Grant's* community.

One, the Gold Initiative (www.goldinitiative.ch), would require the SNB to hold 20% of its assets in gold, to repatriate any Swiss gold stored abroad and to prohibit the selling of any more gold from the hoard that had dwindled to 1,025.1 metric tons in 2011 from 2,274.5 metric tons in 1999, the year before the gold franc was transformed into paper. "The more uncertain are the economic times," the organization's Web site declares, "the more important gold reserves." What it does not say is that the Swiss gold should circulate as Swiss money.

A more intriguing thrust at the monetary establishment, we would say, is the initiative to mint a parallel Swiss gold franc (www.goldfranc.org). Small-denomination coins would contain a fixed, legally stipulated weight of gold. A former Swiss Air pilot, Thomas Jacob, is spearheading the cause. As he tells Lorenz, Zurich would set standards and prosecute counterfeiters, but private mints would be free to produce their own money. Untaxed, the coins would circulate freely (or, actually, probably not circulate, at least at first, but lie still in the darkness of bank vaults) alongside government paper. People could choose which to hold and which to spend.

"You should be able to get gold from the ATM, just like you can press a button for the Swiss paper franc or euros. . . ," Jacob says of his projected alternative. "Most important of the whole thing is the legal protection on a constitutional level—protection from taxes and trade hindrances. If you have no constitutional protection—if the lawmakers can change the rules any time—nobody will really invest in gold financial products in the long run. It makes re-monetization for the little guy simpler, more practical and legally safe."

Jacob, progenitor and president of the Gold Franc Association, said the idea of a new gold franc came to him some years ago, while airborne, his former profession affording him plenty of time for creative monetary thinking. He managed to get the proposition before a parliamentary commission in May, only to watch the solons vote it down, 17 to 7. Unbowed, Jacob predicts that the gold-franc legislation will come before the full parliament this fall. But there's another, and potentially faster, way forward, he says.

In Switzerland, 100,000 signatures on a petition can force a referendum. In 1999, the voters approved a referendum to permit the demonetization of gold and the sale of half of the SNB's 2,274.5 metric-ton store of bullion. At the time, gold fetched $280 an ounce. Central banks the world over were moving away from the barbarous relic and into bonds and even equities. "At best," a New York mutual fund manager was quoted as saying by Bloomberg around the time the Swiss voted to get in step with the modern times, "you can achieve 2% to 3% returns annually by lending it. Why do that when you can hold U.S. Treasurys, which are just as safe but yield more?"

If the politicians fail to pass his gold-coin legislation, Jacob tells Lorenz, he will organize a signature collection drive, taking his case directly to today's presumably sadder and wiser Swiss population.

Some 13 years ago, the Swiss public helped to put in the bottom of the gold bear market. Is it not inconceivable that, one day soon, a popular vote for Jacob's initiative may put in the top? We ourselves would cheer if that price were the one by which the parallel franc were fixed as an objective weight of gold. We would cheer three times if, through such a demonstration, the Swiss helped to push the world toward a monetary system based not on the command and control of government central banks but on objective value and freedom of choice.

The pair of Swiss gold initiatives, Lorenz has discovered, enjoy substantial Swiss academic support. Peter Bernholz, emeritus professor of economics at the University of Basel, is one such pillar of intellectual respectability. In his 2003 book, "Monetary Regimes and Inflation," Bernholz notes that, of the 29 hyperinflations in history he has been able to chronicle and analyze, 28 occurred in the 20th century following the 1914 destruction of the classical gold standard.

From the department of hope: In monetary affairs, may the 21st century more closely resemble the 19th century than the topsy-turvy 20th.

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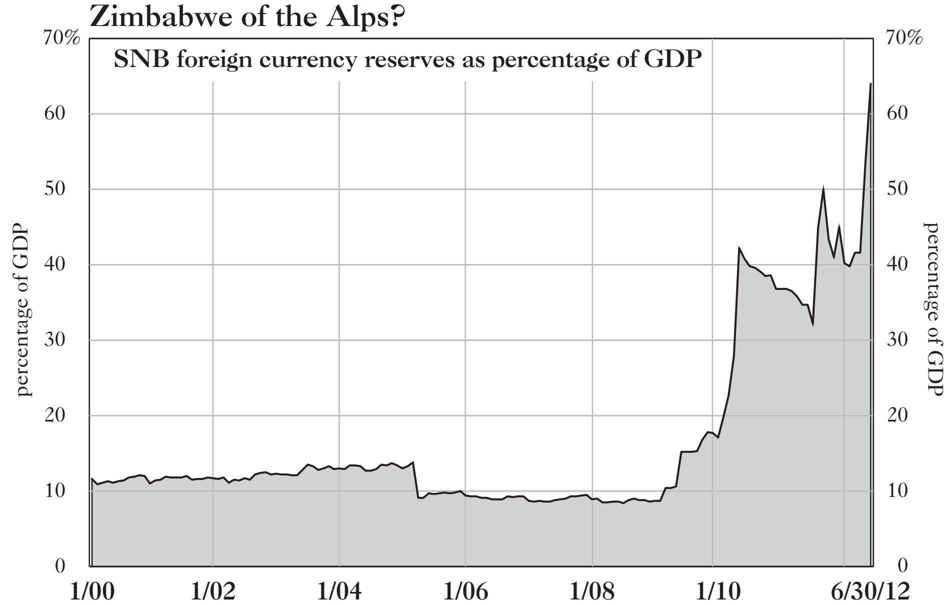
Zimbabwe of the Alps?



sources: Swiss National Bank, International Monetary Fund