Comment on "The historical origins of the safe haven status of the Swiss franc" by Ernst Baltensperger and Peter Kugler

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The paper by Ernst Baltensperger and Peter Kugler deals with a topic that not only has historical importance, but is also highly relevant to the current debate on how to conduct monetary policy in times of crisis. It asks when the save haven status of the Swiss franc emerged. Has it resulted from recent events, or has it been with us for a longer period of time? The answer the authors give is very clear: the Swiss franc has had safe haven status since World War I. Thus, it is an old story, and given the path dependency of monetary history, it may well continue to be with us for some time.

The paper builds on earlier work by Kugler and Weder (2002, 2005), who investigate the causes of the so-called "Swiss interest island" – the deviation of the Swiss interest rate from the conditions of uncovered interest rate parity – since the end of Bretton Woods. The purpose of the paper is to provide a long-term picture by analyzing interest rates and exchange rates of Switzerland and its most important trading partners. Besides showing that World War I was the threshold, the paper comes up with a number of surprising results that should be explored by future research.

1. The introduction of the Swiss franc in 1850 had no effect on Swiss interest rates. Intuitively, we would expect that the interest rate spread relative to Britain, France and the Netherlands would diminish, but the data do not allow such an interpretation.

2. Relative to the French franc, the Swiss franc became weaker towards the end of the 19th century, not stronger. Again, we would expect the opposite, namely that the maturing of Swiss financial markets led to a process of convergence with France.

3. Perhaps the most interesting result is that prior to 1914 the Swiss franc, while rather a weak currency in normal times, was overvalued in times of uncertainty. This behavior does not reflect a full-fledged safe haven status, but it is remarkable that the demand for Swiss assets increased when international tensions increased even before World War I.

4. As for exchange rates after 1914, the paper for the first time provides a long-term measurement of the average real appreciation relative to the British pound and the US dollar. The appreciation is substantial, at almost 1% per year.

5. Finally, the econometric analysis reveals that exchange rates adjust quite rapidly to deviations from the PPP equilibrium. In contrast, however, prices do not adjust readily to exchange rate disequilibria.

Besides further exploring these issues, future research should address the question of how to enhance the measurement of the safe haven currency status. One possibility is, as the authors have chosen, to investigate the long-term pattern on the basis of yearly data. But this approach has the shortcoming that it is difficult to distinguish between the features of a strong currency and a safe haven currency. Of course, the former is a condition for the latter, but not all strong currencies are automatically safe haven currencies, especially not under a metallic standard. Another possibility would be to focus on crucial periods, for example on the interwar years when the Swiss franc emerged as a safe haven currency, and to use monthly or weekly data that are easily available for the time after 1914.