REUTERS/VALENTIN FLAURAUD

THE TRIALS OF PHILIPP HILDEBRAND

The head of the Swiss National Bank has fought a losing battle with currency markets. Now he's taking on big banks

BY EMMA THOMASSON
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PHILIPP HILDEBRAND LEARNED the value of perseverance at an early age, when as a freestyle champ he narrowly missed qualifying for the 1984 Olympics. It's an experience he's drawn on in a rocky chairmanship of the Swiss National Bank since he took up the post in January 2010.

The 47-year-old former hedge fund manager has faced down calls for his resignation after he risked state funds to try to halt the rise of the Swiss franc last year, an effort which cost the central bank 26.5 billion francs. The currency has since gone on to hit more record highs against the dollar and euro, and such huge foreign exchange losses mean Hildebrand is unlikely to take on markets again in a hurry.

But he has not been cowed. Swimming is a very good learning process for life, points out his former coach Anthony Ulrich. "It's an endurance-oriented sport," he says. "You learn to lose and keep your head above water at the same time."

Central bank heads in post-crisis Europe face many stiff challenges. For his next test, Hildebrand – one of a new generation in Europe taking over as familiar figures like Jean-Claude Trichet, Axel Weber and Nout Wellink move on -- has set his sights on another ambitious target: big banks. Pushing tough plans to force banks like UBS and Credit Suisse to be more prudent than their global rivals, he's made enemies at home. Internationally, he's building an image as a trail-blazing regulator.

"He's one of the best central bankers around," said Charles Wyplosz, economics professor at Geneva's Graduate Institute, who taught with Hildebrand up to 2007. "He is up against two very big Swiss banks. These are some of the most powerful lobbies in the world. That takes a lot of personal courage."

CAN'T BEAT IT: A foreign exchange trader in Tokyo, October 2010. **REUTERS/TORU HANAI**

MARKET FORCES

HILDEBRAND REMEMBERS the start of the financial crisis quite clearly. It was August 2007 and he was on the last day of his summer holidays in the Swiss Alps when his phone rang. It was the SNB's trading desk, calling to tell him global risk premiums had jumped, signalling the start of a liquidity crunch as banks stopped trusting one another. It was also the start of a steep climb for the safe-haven Swiss franc.

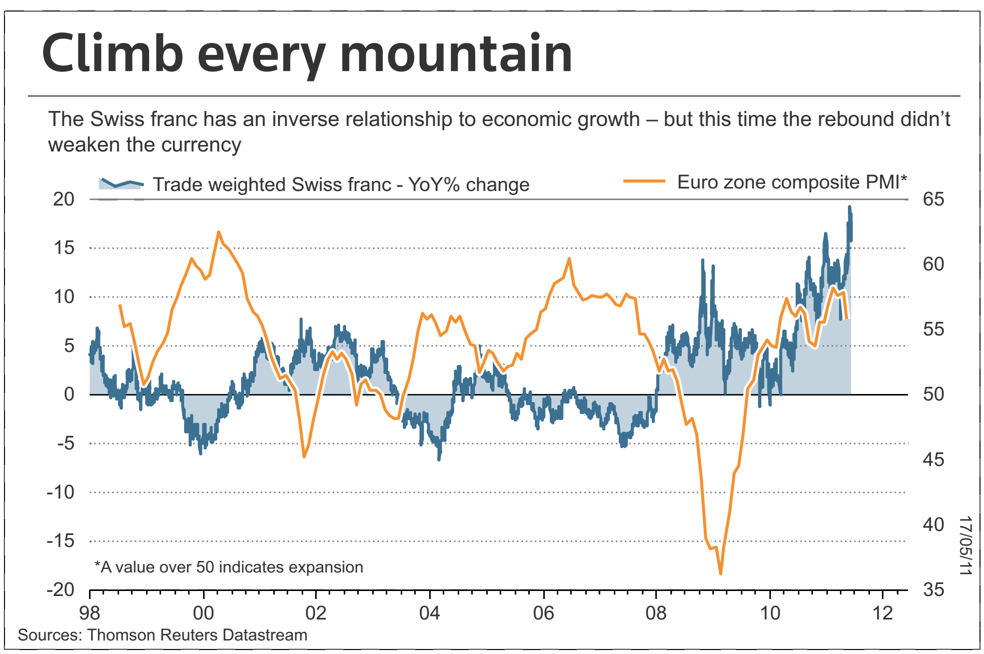
Since then, the world's sixth most traded currency has gained over 20 percent against the dollar and almost 30 percent against the euro. Investors worried about the United States' fast-growing debt and the euro zone's failure to fix its problems have piled in. Swiss manufacturers were already complaining about squeezed profits on exports and having to compete against cheaper imports.

By early 2009, when Hildebrand was vice chairman, the Swiss economy was in its worst recession since World War Two and the SNB had already slashed interest rates to rock bottom. The bank was so concerned about the risk of a deflationary spiral it decided to act, buying euros in the foreign currency markets. That worked, at least for a while, and by December the SNB had decided the economy was on the mend and the currency had stabilised.

Then in January 2010, Philipp Michael Hildebrand took over as the youngest president in the history of the century-old bank. Born in the Swiss capital of Bern, he had studied -- mostly politics and international relations -- in Toronto, Florence, Harvard and Oxford.

Though he was no economist, Hildebrand knew the territory. His first real job had been with the World Economic Forum in Geneva, organising speakers from the financial services industry for its annual talkfest at Davos. They included George Soros, who had made his fortune betting against the Bank of England, and who helped him get a position at New York-based hedge fund Moore Capital Management, which specialised in speculating on interest rate futures and monetary policy.

As a young hedge fund manager, Hildebrand



Reuters graphic/Scott Barber

had in 1996 written a letter to influential Swiss newspaper Finanz und Wirtschaft, demanding that the SNB intervene to weaken an overvalued franc. "The markets are powerful but they often also allow themselves to be led," he asserted at the time. (He declined to comment on the record for this report.)

Scarcely had he settled into his new office at the edge of Lake Zurich -- hanging a favourite black and white photo of childhood idol Mohammed Ali on the wall – when he was called into action. With the franc soaring again during the euro zone debt crisis, to around 1.4 per euro, Hildebrand ordered another round of

"THE SNB WANTED TO MAKE THE BIGGEST SPLASH THEY COULD."

massive interventions. Between February and May 2010, the SNB bought 147 billion francs in foreign currency, about a quarter of Swiss GDP. The markets sensed the SNB's desperation as it tried to move the market in thin Asian trade.

"The SNB wanted to make the biggest splash they could," one trader said. "They wanted to take the speculators out of the game by squeezing their positions." A month later, with the franc still rising, the SNB ditched the policy.

That year the bank booked a 20 billion franc loss, the biggest in its history. It may yet have to suspend an annual payout to local governments, prompting belt-tightening that the wealthy Swiss have so far largely avoided.

It was a hard lesson. "Historically, central bank intervention has a short-term effect but in the long run it always loses," said Geoffrey Baker, managing director and currency strategist at Insch Capital. "Hildebrand seemed to have more market knowledge than most and decided to throw in the towel."

DEUTSCHEMARK PROXY

RETAINING THE HABITS of a hedge fund manager, Hildebrand still rises early to read the papers and keep an eye on the markets on the screen in his office. There he can see that he's up against profound forces and has only limited tools to check them.

The SNB is not the only central bank to have the problem of a strengthening currency. Last September, a bid by the Bank of Japan to weaken the yen failed after its intervention met global opposition: there were warnings of currency wars between rival exporting nations. The combined firepower of the Group of Seven rich nations did succeed in stabilising financial markets in March, when their first joint intervention since 2000 stemmed a sharp rise in the yen in the wake of the earthquake.

But Hildebrand has had no such support. Since last June when he stopped intervening, investors on world markets have pushed the franc even higher. It hit a new record around 1.2004 per euro this week and a new peak against the dollar on June 7, its appreciation fuelled by Switzerland's stability – and a low debt-to-GDP ratio of 53 percent according to the IMF -- as other parts of the world were hit

"MEGALOMANIA OR INCOMPETENCE": Politician Christoph Blocher, pictured in December 2010, has called on Hildebrand to resign. **REUTERS/VALENTIN FLAURAUD**

HOLES IN THE MARKET

ELASTIC DEMAND: Swiss exporters, particular;y cheese and watchmakers, aren't too worried by the franc's strength. **REUTERS/DENIS BALIBOUSE**

BY CATHERINE BOSLEY

BLESSED ARE THE cheesemakers, runs a line from the 1979 Monty Python film, "The Life of Brian". According to Matthias Kunz, you can find blessings even in a soaring currency.

The Swiss franc has surged to record highs since 2007, but Switzerland's foreign cheese sales have climbed around 8 percent for the past two years. Kunz's employer Emmi, the country's biggest dairy exporter, expects revenues to grow again this year. Overall cheese export volumes have been stable since Lehman Brothers went down.

"The positive thing from the forex pressure is it's challenging us to come up with still better ideas, and to keep an even tighter grip on costs and work harder," says Kunz, who heads Emmi's foreign business.

The franc's appreciation has provoked howls from some firms – particularly in metals and machinery and tourism. Some have threatened to move production abroad, and the central bank has cautioned that not all the currency pain has yet been felt.

But exports in the first quarter of 2011 climbed just over 12 percent from a year earlier, and in 2010 Switzerland posted the second-largest trade surplus in its history. "If you look at history, Switzerland has always been able to withstand a stronger franc -- by making radical changes, improving productivity, and going for specialisation," Nestle Chairman Peter Brabeck told the SonntagsZeitung last month.

by revolution and economic crises.

Rabobank market economist Emile Cardon says the SNB could not have predicted Japan's disaster, nor the ongoing weakness of the U.S. economy: "There used to be three safe havens, with the Japanese yen and the U.S. dollar, but after the earthquake and weak U.S. growth, the only remaining safe haven is the Swiss franc."

Already last June, Mansoor Mohi-uddin, chief currency strategist at UBS, was arguing the franc is increasingly seen as a proxy for the old German mark: "Switzerland's currency already acts as an indicator of Germany's economy," he said in a report, noting that 20 percent of Swiss exports go to Germany.

POLITICAL TARGET

WHATEVER THE ECONOMIC reality, the political recriminations for Hildebrand have been torrid, especially from Switzerland's right wing. They said the government should have been more wary of appointing a former hedge fund manager with no qualifications in economics. "How hard is Hildebrand?" Weltwoche weekly wrote. "After a meteoric rise, sceptical voices are increasing. Is the man as hard as the currency which he has to direct through the euro crisis?"

Christoph Blocher, mastermind of the right-wing Swiss People's Party, has kept up the pressure, calling on Hildebrand to resign and likening the losses to the folly that brought Switzerland's biggest bank UBS to its knees. "What the SNB did was megalomania or incompetence. At the beginning of 2010 they thought they could save the euro from collapse," he told Reuters. "Nobody can do that, not even the Americans."

Even SNB insiders and independent economists have been critical. Former SNB chief economist Ulrich Kohli -- who was still at the bank when the first interventions were launched in 2009 -- calls Hildebrand's effort a "total failure and a total waste of money ... It hasn't done anything to stop the Swiss franc appreciating. It's really money thrown out the window. I think he was wrong then and wrong now when it comes to the ability central banks have to manipulate the exchange rate."

Hildebrand himself refuses to admit the interventions were a failure, saying they helped Switzerland become one of the first countries to return to pre-crisis growth levels. "The SNB's policy -- and that includes the foreign exchange purchases -- undoubtedly contributed to this positive outcome," he told SNB shareholders in April.

Nonetheless, he's unlikely to try to weaken the franc again anytime soon, despite new calls from Swiss trade unions warning tens of thousands of jobs are at risk. "They got burned the last time," says Kohli, the former SNB economist. "They used up all the ammunition and the SNB's very much weakened."

"FOLLOW THE SWISS LEAD"

BUT IF HILDEBRAND WAS brought down by the currency struggle, he's not out for the count. The Ali fan has turned his attention to what for him is a much bigger legacy of the crisis: weak banks. His forex intervention involved nearly a quarter of the country's GDP, but Swiss bank assets amount to at least six times the country's economy.

Reuters graphic/Scott Barber

DEJA VU

Being able to raise prices, and being in fast-growing emerging markets, has helped. Swiss watch exports rose by nearly a third in April: China and Hong led the growth.

The Swiss have been here before. The current situation is similar to the 1970s, when inflation elsewhere boosted demand for the franc. Then as now, Switzerland boasted low inflation and joblessness.

Christoph Blocher, a right-wing politician who made his fortune running a chemical company, Ems, said a move out of Switzerland seemed inevitable for his firm in the 1970s. "Back then we exported 30 percent. Today ... we are exporting 96 percent. Switzerland has always been forced by the strong currency to make better and higher-quality products."

Overall, the central bank does see growth slowing this year: to around 2 percent, from 2.6 percent in 2010. But for a developed economy in old Europe, that's not to be sniffed at. Real GDP growth for the euro zone is forecast at 1.5-2.3 percent by the European Central Bank.

"We believe the Swiss franc's strength has lasted too long for negative export growth to be seen as an inevitable consequence," economists at the Swiss bank Sarasin said in a research note in May. "It appears that exports are less susceptible to prices than generally thought."

Tourism has suffered, but warm weather has been partly to blame.

Against this backdrop, it's easy to see why the Swiss central bank's unsuccessful efforts in 2009-10 to restrain the franc provoked such debate.

In an April 18 study of Swiss firms' finance chiefs by Deloitte, 85 percent said the currency's strength would not have a negative effect in the next 12 months. The survey also found 83 percent were against any further actions by the central bank or the government to counteract the currency's rise.

Even so, the prospect of a further rise in the franc still makes Kunz nervous.

"The big question mark is that we don't know how elastic demand is," he said. "When will Mr. and Mrs Mueller in Berlin buy less Appenzeller?"

A BIGGER SPLASH: Swiss bank assets amount to at least six times the size of the country's economy. UBS HQ, vandalised by protesters in January 2009.. **REUTERS/ CHRISTIAN HARTMANN**

Regulators in Europe and the United States are looking to increase the financial buffers banks must build to limit the call they can make on taxpayers if things go wrong. Hildebrand, who is credited with playing a central role in saving UBS from collapse at the height of the crisis, is pushing for new rules to go further than most. UBS and Credit Suisse will have to have a capital buffer nearly three times bigger than their global rivals.

"Follow the Swiss lead to avoid another Lehman," he wrote in the FT last October. He's been praised by the likes of Paul Volcker and Timothy Geithner and, along with Britain's top financial regulator Adair Turner, is seen as an innovator. The banks don't like it. They say high capital cushions will be costly to maintain and crimp lending. Switzerland is crazy to pursue more stringent rules than its global rivals, some say.

In his defence, Hildebrand points to the ultimate arbiter: the market. Swiss bank credit default swaps (CDS) -- a measure of demand for investors seeking insurance against unpaid debts -- have been trading at the lowest spread of all the majors. "It is an interesting observation that the one market indicator that we have about the safety of banks, the CDS contracts, are telling us today that what we are trying to do in Switzerland may not have been so crazy after all," he said at a European Central Bank event in May. "There is nothing wrong with a race to the top. What must be avoided in a global system, with global integrated markets, is a race to the bottom."

BEYOND THE MOUNTAINS

IT'S A LINE HILDEBRAND is pushing even though the domestic heat on him is unlikely to cool soon. As he sweats out the summer in his 3rd floor office, a listed building where air conditioning is banned, a fierce debate is underway over the rules he has championed. Some commentators say Hildebrand's critics have seized on his forex debacle to water down the regulatory aims.

There are party politics to consider. Switzerland goes to the polls in October and Blocher's anti-immigrant, anti-European Union party, now the biggest in Switzerland, looks set to win. Blocher wants parliament to limit the SNB's powers beyond ensuring price stability. There would be no more currency interventions.

"Mr Hildebrand is very isolated in Swiss politics and in the popular mood," said Peter V. Kunz, professor at the Institute for Economic Law at Bern University. "Mr Hildebrand is not your average central banker. He is a very activist, self-assured national banker... Swiss politicians can be very small-minded so an international star generally doesn't go down so well."

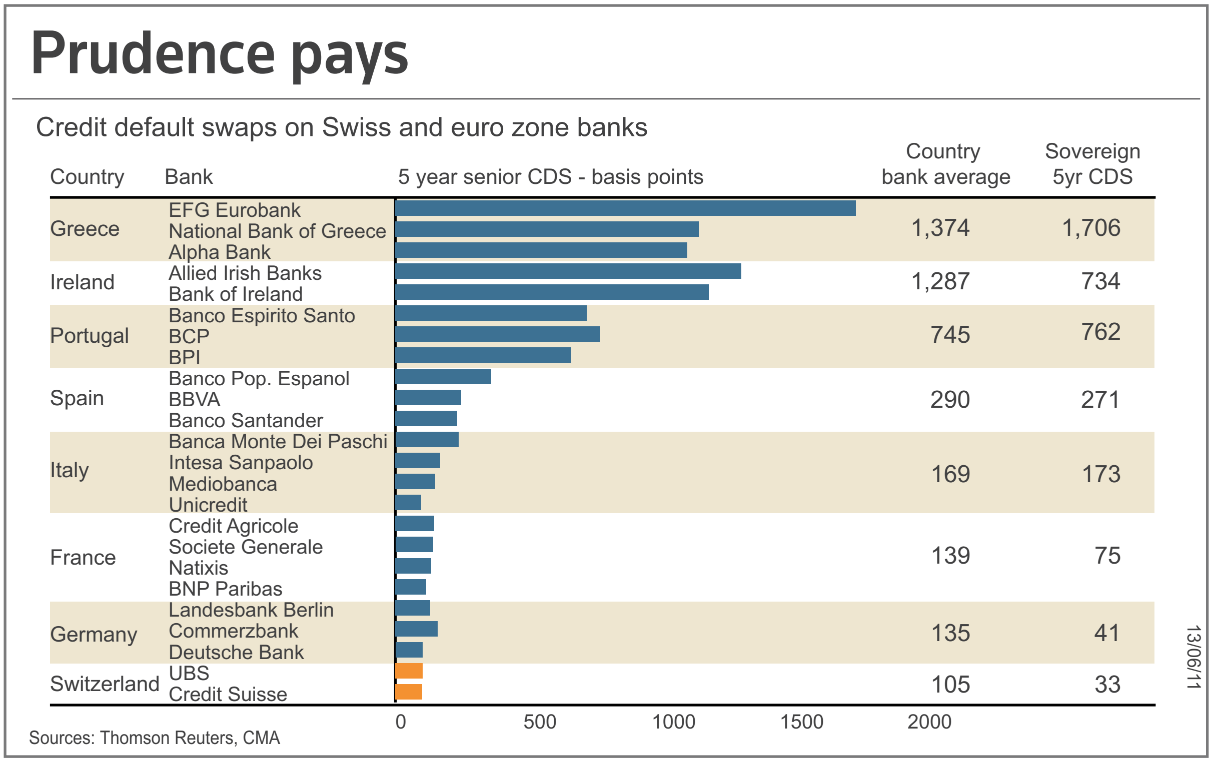
Last year, Hildebrand was the world's highest paid central banker on 833,000 francs, and is rarely seen in anything but an elegant navy blue suit and luxury Breguet watch. Having spent much of his early adult life outside Switzerland, he lacks political allies at home. His towering 1 metre 94 stature gives him an aloof air, and his push for stronger regulations has raised hackles among a cosy Swiss elite more used to backroom deals and a strict code of preserving client secrecy.

He has also been the subject of several glossy magazine profiles, which has jarred with a Swiss preference for modesty, particularly among public officials.

HEAD ABOVE WATER

BUT HIS OPPONENTS would be hard pressed to unseat him. The current term for the SNB's governing board ends in 2015: all three members can be reappointed by the government, and despite the tough talk, no government has yet forced a chairman out. What he lacks in terms of domestic support, Hildebrand more than makes up for on the international stage. He counts among his friends Mario Draghi, the Italian central banker who seems likely to follow Trichet at the head of the European Central Bank, former Brazilian central bank governor Arminio Fraga and Canadian central bank governor Mark Carney, with whom he studied at Oxford.

Hildebrand is already a member of the steering committee of the Financial Stability Board, the global regulatory body. He would make a convincing candidate to replace Draghi as chairman if, as expected, the Italian moves to the ECB. The committee which drew up the Basel III rules is also looking for a replacement chair for Dutch central bank governor Nout Wellink. He could do either job – with both bodies conveniently located just an hour by train from Zurich in Basel -- alongside the SNB post.



Reuters graphic/Scott Barber

If Hildebrand does end up joining the financial industry's global regulatory guard, he would undoubtedly be zealous. When times get tough, he recalls the words of former SNB chairman Fritz Leutwiler, who presided over contested interventions in the turbulent years following the flotation of the franc in 1973. "He always said we are not there to be popular. If you think you can be popular for the whole cycle of a chairmanship then it is the wrong assumption about the job," Hildebrand told Swiss television. "What is a much bigger concern for me are the worries over whether we could stabilise the financial system, concern about the whole economy, where we are going, worries about the risks that are still in the system."

Still, it would be a tall order to convince the world's bankers that keeping your head above water is more important than winning.

(Additional reporting by Catherine Bosley and Martin de Sa'Pinto, Paul Carrel in Frankfurt, Naomi Tajitsu in London; Editing by Sara Ledwith and Simon Robinson))

COVER PHOTO: Philipp Hildebrand President of the Swiss National Bank (SNB) at a news conference in Geneva, June 2010 REUTERS/VALENTIN FLAURAUD

FOR MORE INFORMATION CONTACT:

SIMON ROBINSON,
ENTERPRISE EDITOR, EUROPE, MIDDLE EAST AND AFRICA
simon.robinson@thomsonreuters.com

SARA LEDWITH,
TOP NEWS TEAM
+44 7542 8585
sara.ledwith@thomsonreuters.com

EMMA THOMASSON
BUREAU CHIEF,
SWITZERLAND
Emma.Thomasson@thomsonreuters.com