

President's address by Hansueli Raggenbass,  
President of the Bank Council  
to the General Meeting of Shareholders of the  
Swiss National Bank, 25 April 2008

Dear Shareholders

Ladies and Gentlemen

Dear Guests

I would like to start by welcoming you to the hundredth General Meeting of the Swiss National Bank. Not until today's meeting does the series of events marking the SNB centenary finally come to a close. That is why I would like to take this opportunity of reviewing, once again, the eventful history of our central bank. By focusing on 1907, the year when the SNB was founded, as well as 1932, 1957 and 1982, the years of its 25th, 50th and 75th anniversaries, I will outline the kinds of issues and problems faced by the National Bank over the course of the century. To those of you who would like to read up on these matters in more detail, I can wholeheartedly recommend the SNB's commemorative publication.

It is interesting to note that the SNB was faced with particular difficulties not only in the year of its foundation but also in each of its anniversary years. Might this be an unknown correlation that has yet to be discovered by academics? One might almost think so, since the rule that major anniversary years are always years of particular challenge has again – unfortunately – been substantiated this year with the turmoil on the financial markets. The following brief review of the first hundred years should therefore help to place the current difficulties in their historical perspective.

**1907: Panic in New York**

When the SNB opened its doors for the first time on 22 June 1907, it was immediately confronted with the onset of a downturn in the world economy. In the US, share prices had already fallen in March and the decline continued in summer. In autumn, while the newly-founded SNB was still heavily involved in organisational matters such as drawing up regulations, the problems in the US escalated. Eventually a situation of downright panic

broke out on 22 October 1907, triggered by a run on the Knickerbocker Trust Company, which was suspected of having been involved in a huge and unsuccessful copper speculation affair.

Trusts were financial intermediaries that took on similar functions to modern investment banks. Although their field of business was broader than that of banks, they were not obliged to hold as many reserves as banks. Moreover, they were not properly linked into the banks' clearing system, which meant they were unable to obtain liquidity from the system. At that time, there was no central bank in the US which could provide financial institutions with liquidity outside the clearing system. (The Federal Reserve System (Fed) was not founded until 1913–1914. It was established as a reaction to the panic events described here.)

After the trusts, the banks were also affected by the crisis of confidence. A run on the banks could only be averted because they stopped paying out customer deposits. Not until an aid committee headed by banker John Pierpont Morgan mobilised liquidity for the most badly affected banks did public calm again prevail. In early 1908, the situation began to ease.

The events in New York were observed with anxiety by many, including the SNB. At the beginning of November 1907, the Chairman of the Governing Board told the Bank Committee that the international money market was suffering under the "pressure of nervous anxiousness." In New York, he said, the crisis was turning into a panic, Holland had just "gone through a crisis which had considerably weakened the country's stock exchanges and Italy was in the midst of a crisis."

The financial crisis caused interest rates to rise internationally, and Switzerland was unable to escape this trend, although the SNB did not have to increase the discount rate as much as other central banks did. Consequently, the panic in Switzerland was more or less limited to the stock exchange. Although the fall in the value of US securities caused a few small banks in French-speaking Switzerland to close their doors, the impact was less widespread than in other countries, where the real economy was strongly affected. Thus the SNB achieved relatively good results in its first year of business.

### **1932: Great depression and banking crisis**

When the SNB celebrated its 25th anniversary, it found itself confronted with difficulties that made the 1907 panic look like a minor operational incident. The Wall Street crash at the end of October 1929 was the spark that ignited a worldwide economic slump that has gone down in history as the Great Depression.

A series of bank failures (which in Europe had begun in the spring of 1931, in Austria and Germany) accelerated a process that finally led to the collapse of the international monetary and credit system. This was a system that had been established with a great deal of effort after the First World War, but had been set up – to some extent – on faulty foundations. Faced with balance of payments difficulties, important Swiss trading partners were forced to depreciate their currencies and abandon the link to gold. The end of fixed exchange rates based on the gold standard saw the destruction of one of the key foundations upon which the initial phase of economic globalisation in the first half of the 19th century had been based. Most countries imposed additional measures, such as higher customs duties and import restrictions, which further constrained international trade.

For a long time, the SNB hoped that the gold standard would be restored and believed that the export industry would derive only short-term benefits from a devaluation of the Swiss franc. Nowadays, economic historians contend that this assessment was wrong and that earlier devaluation would have accelerated the recovery.

As if the question of an appropriate exchange rate were not difficult enough, the SNB was also faced with a banking crisis at the beginning of the 1930s. However, unlike the panic of 1907, this crisis also affected big banks and cantonal banks rather than just a few small banks. The banks' difficulties were mainly attributable to their foreign business. From 1931, Germany and other countries were no longer able to meet their foreign payment obligations and had to issue foreign debt moratoriums. In addition, they introduced measures for the management of foreign exchange, through which capital transactions were heavily restricted. Since Swiss banks engaged in foreign business had strong commitments in these countries, they encountered major difficulties. Rather like the banks affected by the current sub-prime crisis, they found that, all at once, a substantial part of their assets had become illiquid. Particularly affected by the crisis were the banks that

had allowed themselves to be carried away by the boom in the second half of the 1920s and make excessive commitments, those who had too little experience in these transactions, and those with inadequate reserves.

The largest banks to be affected were the Swiss Volksbank and the Swiss Discount Bank. The SNB feared for the stability of the financial system if these banks went bankrupt, and it promoted efforts to salvage them. In autumn 1931, an Alternate Member of the Governing Board was delegated to the Volksbank's executive management as a restructuring specialist, and the SNB also placed itself at the disposal of the Federal Council, in an advisory capacity. An additional representative of the Governing Board transferred to the Department of Finance and played a major role in drawing up the first Swiss Banking Law of 1934.

In the case of the Swiss Discount Bank, the SNB headed the salvage operation and arranged both private and public bridging loans. In 1932, it promoted the establishment of the *caisse de prêts de la Confédération* (in German: *Eidgenössische Darlehenskasse*, roughly equivalent to Federal loans office) in order to supply illiquid banks with liquidity. The idea was to provide these banks with funds that had not been available before, since the *caisse de prêts* would be able to lend on the basis of assets that could not be accepted by the SNB for legal reasons. Unlike the Volksbank, which was refloated thanks to a massive injection of capital by the Confederation, the Swiss Discount Bank could not ultimately be salvaged, despite the National Bank's considerable efforts. At the end of April 1934, it had to close down. At least the measures that had been taken helped to ensure that the liquidation was orderly and general panic avoided.

### **1957: Concern about the economy and tension on the capital market**

As opposed to the 1930s, the 1950s were times of general prosperity in the US and in most countries of western Europe. This was particularly the case in Switzerland. With its unscathed economy, our country was able to benefit from reconstruction in Europe. However, it was in the SNB's 50th anniversary year, as it happened, that the acutest economic decline of the decade occurred in the US. From January 1957 to April 1958, US industrial production fell by about 14%. In western Europe, the overall balance of payments of countries that were in surplus and those that were in deficit drifted strongly apart, lead-

ing to tensions on foreign exchange markets. France suffered from high rates of inflation, balance of payments deficits and declining foreign currency reserves. Consequently, it was forced to depreciate its currency, thereby – as the SNB noted in its Annual Report – “triggering a wave of unrest and nervousness that caught up a number of additional European currencies in a web of rumours and speculation about upcoming exchange rate adjustments.”

In Switzerland, signs of economic overheating were becoming evident at the beginning of 1957. Saving lagged behind investment, forcing banks to turn down numerous loan applications. The shortage of capital was also manifested in a persistent increase in interest rates for new loans. Despite the improvement in conditions, numerous issues proved to be an outright failure due to the fact that institutional investors' funds were too firmly tied up in mortgages. Consequently, the head of SNB Department III felt himself called upon to point out, in a meeting of the Bank Committee, that “a reasonable relationship between lending and borrowing business must be maintained.”

In May, the SNB came to the conclusion that it would have to deploy “its last weapon in the battle against the impending overheating of the economy” and increased the discount rate for the first time in 21 years. The fact that it raised the rate by an entire percentage point shows how serious it judged the situation to be.

In autumn 1957, the future looked grim. In the US, the stock exchange index had dropped 20% below its record level, while in Switzerland it was 26% down. In view of this tumble, the head of Department III asked himself “whether this development on the stock exchange, as in 1929, did not presage a more serious economic crisis.” Luckily this conjecture did not come to fruition, and the US economy, stimulated by monetary and fiscal policy, was already on the road to recovery by the following year. In Europe, there was a sustained improvement in the exchange rate situation, so that the western European countries were able to move forward to currency convertibility at the end of 1958. In Switzerland, inflation began to decline.

### **1982: Reduction in inflation and debt crisis**

By 1982, when the SNB celebrated its 75th anniversary, the foundations upon which monetary policy was based were entirely different to those of the former major anniversa-

ries. In 1973, the Bretton Woods system of fixed exchange rates had collapsed and the SNB had become one of the pathbreaking central banks running a monetarist policy committed to managing the supply of money. Liberated from the fetters of fixed exchange rates, it was – for the first time – free to manage the supply of money as well as inflation. Now, however, it was faced with the problem of strong short-term exchange rate fluctuations. In 1978, the Swiss franc appreciated so much against the German mark that the SNB temporarily replaced its money supply objective by an exchange rate objective. However, the necessary interventions on the foreign exchange markets resulted in a substantial expansion of the money supply and subsequently to high rates of inflation.

Bringing down inflation was not easy in view of the difficult international environment, and hardly had the consumer price index in Switzerland begun to drop when the SNB found itself confronted with new problems, as the international debt crisis broke out. In August 1982, the Mexican Minister of Finance stated that his country's foreign currency reserves were exhausted and the country was no longer able to service its debts. The background to this crisis, which enveloped first Mexico, then Brazil, and subsequently further South American as well as Asian countries, was a combination of excessive indebtedness, a massive increase in US interest rates in connection with the fight against inflation, and falling commodity prices. The crisis was dangerous, not just for the overindebted developing and emerging countries but also for the industrialised economies, since, at the end of the 1970s, their banks had engaged in large-scale lending to the emerging countries. In view of their high equity levels and "relatively conservative business policies," the SNB Governing Board did not believe that there would be any serious consequences for the Swiss banks. Nevertheless, it took the precaution of presenting the Bank Committee with a plan to be followed in the event of an acute liquidity crisis. It took years before the debt crisis was resolved, and a solution was only found by means of close cooperation between the central banks, the International Monetary Fund (IMF), the Bank for International Settlements (BIS) and the commercial banks. The main contribution of the SNB to these measures aimed at protecting the international financial system was to provide guarantees for BIS bridging loans. The idea of these loans was to allow these countries to service their loans until such time as an agreement with the IMF could be concluded.

Ladies and Gentlemen, we cannot assume that there is any specific mechanism ensuring that the National Bank will always be confronted with particularly difficult situations in its major anniversary years. We should also realise that these years were not the only difficult ones for the SNB. However, I think that by examining the challenges faced by our central bank on these special occasions we derive a good sample of the range of SNB activities. We see that, in addition to securing the internal and external stability of the currency, the National Bank has also had to cope with the consequences of international turmoil emanating from financial and economic crises. As the central bank of a small open economy, it needed to pay attention to the stability of the financial system from very early on – long before it was explicitly entrusted with this task in the 2004 revision of the National Bank Act.

Even if the SNB has occasionally been guilty of mistakes or misjudgements in the course of its history, it is with a certain sense of pride that we can state today that, all in all, it has mastered its tasks well and preserved our country from serious economic damage. I have no doubt that this is also the case now, and will continue to be so in the future.