News conference

Berne, 18 June 2009

Introductory remarks by Thomas Jordan

Around the world, the effects of the financial crisis on the implementation of monetary policy and the composition of central banks' balance sheets are becoming more and more apparent. On the one hand, conventional monetary policy has all but exhausted its options, and unconventional measures are being increasingly used. On the other hand, some central banks are having to manage the illiquid assets which they took over in an effort to stabilise the banking system. Both of these situations also apply to the Swiss National Bank. Therefore, after giving a brief assessment of the developments in the international financial markets, I will turn my attention to the unconventional monetary policy measures being taken by the SNB. I will then move on to discuss the SNB StabFund. To conclude, I will look at the risks facing the SNB that are associated with these activities.

Situation in the international financial markets

Although the first few weeks of the year saw stock markets around the globe experiencing their lowest levels in many years, the surprisingly positive results from the US banking sector in mid-March prompted a turnaround in market sentiment. Stock markets have since been recording strong price gains. Other financial market segments also saw a significant recovery.

As a result, the downward spiral, which was triggered by the collapse of Lehman Brothers last September and which, for a short while, even threatened to bring the global financial system crashing down, has come to halt. After having climbed to unsustainable highs in recent years, the prices of many investments fell to extremely low levels during the turmoil this past winter. The rapid recovery in the financial markets since March must also be partly regarded as a correction of previous excesses. Furthermore, the extremely expansionary monetary policy being pursued worldwide is likely to have also contributed to calming the situation.

However, the recovery in the financial markets should not conceal the fact that uncertainty is still high. How sustainable the shift in market sentiment really is remains to be seen. The risk of suffering a setback remains correspondingly high.

The SNB's unconventional monetary policy measures

At our quarterly assessment in March, we were confronted by the need to once again significantly expand our monetary policy. Since the repo rates were already practically at zero, we had to resort to unconventional monetary policy measures. We decided to conclude longer-term repo transactions on the one hand, and to purchase foreign currencies and Swiss franc bonds on the other. By simultaneously intervening in the money, foreign exchange and capital markets when necessary, a strong and broad-based monetary policy impact can be generated, without leading to any major distortions in the markets concerned. Allow me here to add a few remarks on our foreign currency and bond purchases.

Purchase of foreign currency

The aim of our buying foreign currency is to prevent an appreciation of the Swiss franc against the euro. This is the key component of our unconventional monetary policy. It is important to emphasise that we do not engage in foreign exchange interventions in order to bring about a depreciation of the Swiss franc, but to prevent any further appreciation of the franc in its role as a safe haven currency. Therefore, the reproach we occasionally hear that the SNB's policy is encouraging an international depreciation race is unjustified. A look at exchange rate movements shows a clear appreciation of the Swiss franc during the course of the financial market crisis (cf. chart 1). So there can be no question of the SNB conducting a beggar-thy-neighbour policy.

We give ourselves a great deal of latitude with regard to our foreign exchange interventions. There is no fixed threshold beyond which we become active; we simply decide in accordance with the situation at hand. And markets should not become used to a certain level of intervention. We feel that this approach promises the highest possible impact, which in turn will allow us to phase out the strategy more easily when the time comes. Furthermore, we do not comment on the volume of our foreign currency purchases.

The purchases of foreign currency have fulfilled their purpose – and with these I am referring to our first unilateral interventions in the foreign exchange market since 1992. The appreciation of the Swiss franc against the euro, which is particularly dangerous for the Swiss real economy in this crisis, has been halted, and the volatility of the EUR/CHF exchange rate has eased considerably (cf. chart 2).

If necessary, we will continue to intervene in the foreign exchange market to prevent an appreciation of the Swiss franc against the euro. The SNB occupies a strong position in this regard. With interest rates at the zero bound and our policy of quantitative easing, we have an advantage over market participants who are expecting an appreciation of the Swiss franc. For our interventions, we neither have to take a specific rate of interest into account nor neutralise the expansion of money supply.

Purchase of Swiss franc bonds

With the purchase of Swiss franc bonds issued by private domestic borrowers, we want to lower the risk premia in the capital market and, in so doing, make it easier for private issuers to raise capital. Depending on the situation, we try to achieve the greatest possible impact on risk premia and capital market liquidity while deploying the least amount of capital. We do not want to give individual companies preferential treatment, instead we wish to ease the refinancing of companies in Switzerland overall.

By also purchasing in the primary market, we are directly promoting the raising of new capital. Initially, we restricted our purchases to mortgage bonds (*Pfandbriefe*). Since the beginning of April, however, we have also been buying corporate bonds. In both of these segments, we hope to achieve the greatest impact on the market as a whole. In principle, we buy only marketable bonds and pay market prices. Apart from the mortgage bonds, we did not buy any bonds issued by financial institutes. As of mid-June, our total purchases amounted to around CHF 2.5 billion in mortgage bonds and roughly CHF 300 million in corporate bonds. For the time being, we plan to continue purchasing selectively. As regards volume, we have set no restrictions.

The bond purchases also seem to have fulfilled their purpose. Risk premia have come down significantly (cf. chart 3). That said, we were able to benefit from the favourable mood in the financial markets. The fact that, in the past few weeks, several issuers found their way back to the issues market for the first time in a long time is further proof of the effectiveness of our strategy.

SNB StabFund

Developments in the market since the UBS package of measures was announced show that the transfer of illiquid assets from UBS to the SNB StabFund was both appropriate and absolutely necessary. Had these assets remained on UBS's books and been valued at market price, the bank's existence would have been seriously threatened these last few months.

The transfer of assets was concluded at the beginning of April. Ultimately, the total volume of assets transferred amounted to USD 38.7 billion, where the purchase price was roughly USD 1 billion below the book value of the assets at UBS at the end of September 2008. In addition, a substantial portion of the amount transferred includes liabilities in the form of derivatives which currently do not need to be financed by the SNB. The initial financing of the StabFund was therefore considerably lower than the purchase price. It comprised the SNB's loan to the StabFund totalling USD 26.6 billion and UBS's equity contribution in the value of USD 3.9 billion.

The fund's portfolio contains several thousand positions. Table 1 gives an overview of the portfolio and the different investment segments. The portfolio management concept is based on a long-term risk/return assessment. For assets where the cash flow is expected to exceed the current market price, we are mainly pursuing a hold-to-maturity strategy.

For assets where this is not the case, we will sell if the opportunity arises. The objective of our portfolio management is to repay the SNB's loan in full if at all possible.

Market developments to date have impacted strongly on the StabFund's assets. As it stands, most of the assets do not have to be entered in the balance sheet at market value. Rather, they only have to be written down if the balance sheet value is no longer considered sustainable based on the results of an impairment test. However, despite this method of stating assets in the balance sheet at amortised cost, the StabFund had already used up its equity capital by the end of March. Up until that point, it had been necessary to make value adjustments amounting to roughly USD 5 billion. Nonetheless, it still looks as though the StabFund will ultimately be able to pay back the loan. This is because, on the one hand, markets can recover; the positive turn of events in April and May corroborates this. On the other hand, the assets have been generating relatively robust cash flows until now.

Owing to interest payments and loan repayments, the SNB loan has already been reduced considerably. By mid-May, it came to only USD 23.7 billion. In addition, the original size of the StabFund has declined by around USD 6.7 billion as a result of sales, maturities and the closing out of derivatives positions. In mid-May, the size of the StabFund, as valued at amortised cost, was just roughly USD 32 billion, of which around USD 4 billion comprised contingent liabilities from derivatives. The performance of the stabilisation fund's assets is due to be reassessed at the end of the second quarter.

Approximately 80% of the SNB's loan to the StabFund is denominated in US dollars. Originally, the SNB fully refinanced the dollar loan via the existing swap facility with the Federal Reserve. Now, less than 20% is refinanced thus, accounting at this stage for only about USD 3 billion. By contrast, the outstanding volume in SNB USD Bills – launched in February 2009 to refinance the SNB loan to the StabFund – is already at USD 15 billion. In addition to these short-term financing operations, the SNB concluded long-term deposit transactions amounting to USD 4 billion. We plan to further reduce the use of the swap facility with the Federal Reserve.

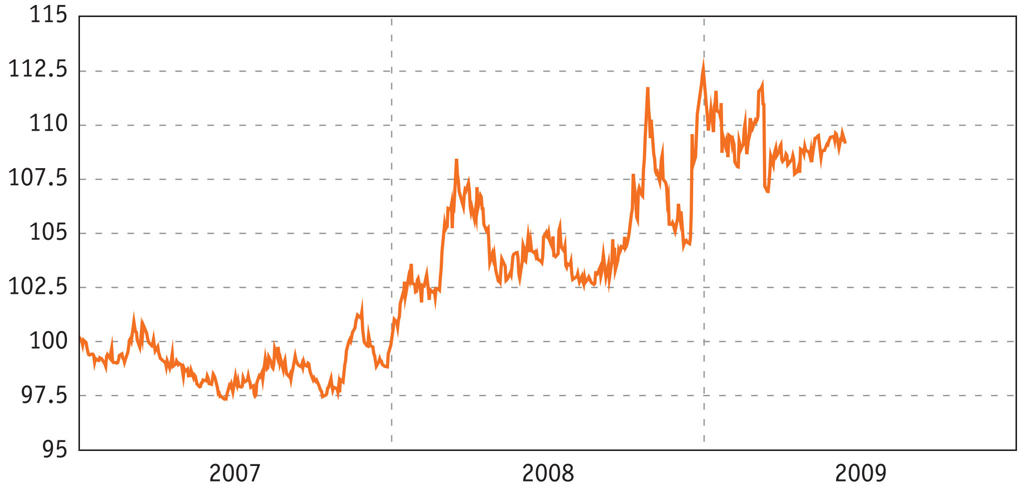
Risks

The risks facing the SNB as a result of its commitment in the StabFund are substantial, yet owing to the bank's strong balance sheet, these risks can be absorbed. I would particularly like to emphasise that the SNB's commitment is actually considerably lower than the USD 60 billion which still gets quoted by the public quite often. The SNB does not consider its loan to the stabilisation fund as a hindrance – either to its risk capability or its monetary policy latitude. The unconventional measures also pose additional risks to the SNB's balance sheet in the form of interest rate, currency and credit risks. However, our analyses show that, in terms of the consolidated balance sheet, these risks are relatively low.

The SNB is well aware of the fact that the unconventional monetary policy measures pose not only balance sheet risks, but also a whole series of other risks, including the difficulties connected with correctly assessing the monetary policy impact and with finding the best way to phase out the unconventional measures. As with the StabFund, we are convinced that – here too – we must take these risks in order to be able to avert other, even greater risks. Extraordinary times call for extraordinary measures. The financial market crisis has confirmed our belief that the SNB must have a strong capital base and a broad range of monetary policy instrument to ensure its capacity to act at all times.

Chart 1. Effective exchange rate for Swiss franc

— Export-weighted against 24 trading partners, nominal, 1.2007=100



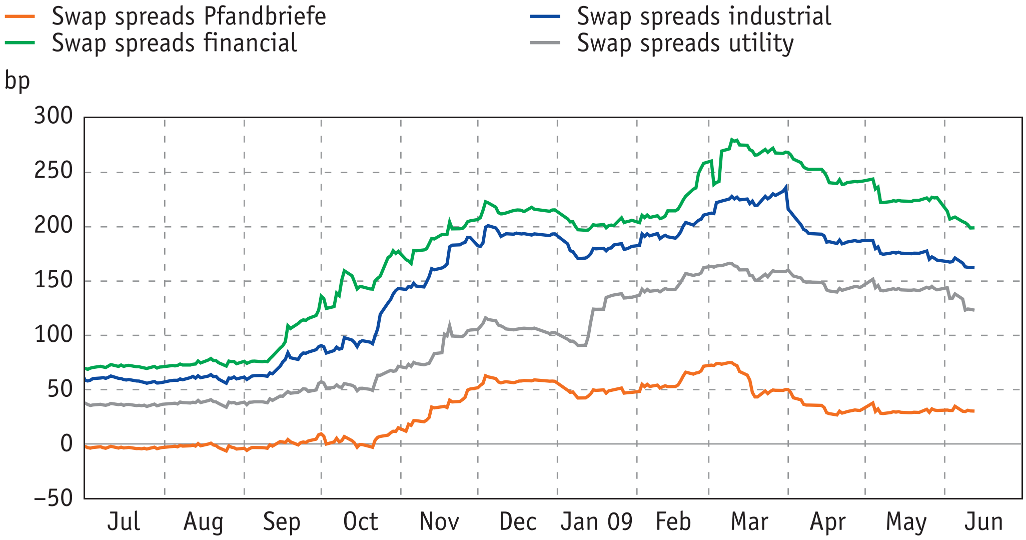
Source: SNB Markets Analysis Platform

Chart 2. EUR/CHF and exchange rate volatility

— Implied volatility EUR/CHF 3M — EUR/CHF (rhs)

Sources: SNB Markets Analysis Platform, Bloomberg

Chart 3. Swap spreads



Sources: SNB Markets Analysis Platform, Credit Suisse

Table 1. StabFund investments at transfer prices (as at 30.9.2008)	
Total for US	**25.5**
RMBS	9.6
Residential loans	0.6
CMBS	4.4
Commercial real estate loans	2.4
ABS consumer	2.0
ABS other	1.8
CDO	3.2
Corporates	0.5
Student loans (loans and ABS)	0.9
Total for Europe	**12.9**
RMBS	5.4
Residential loans	0.6
CMBS	2.2
Commercial real estate loans	0.5
ABS other	1.3
CDO	2.9
Total for Japan	**0.3**
Commercial real estate loans	0.3
Total investments	**38.7**