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Introductory remarks by Niklaus Blattner

1. Publication of a report on the stability of the financial system

In future, the National Bank will publish a report annually on the stability of the Swiss financial system (Stability Report). The first such report will be included in the June issue of the National Bank's Quarterly Bulletin. From today, the report is available in electronic form on the National Bank's website. The publication forms part of the financial stability reporting by central banks which has become increasingly common in the past few years. This form of reporting reflects the growing significance of system stability.

Confidence in the stability of the financial system is a decisive factor for economic development. It enables decision-makers in the business world to adopt a rational approach to consumption and savings. Furthermore, a stable financial system is a precondition for properly functioning financial markets. It thus creates the environment needed for implementing monetary policy.

The National Bank's Stability Report gives the public an insight into the state of the financial system. It conveys the National Bank's evaluation of the stability of the system and provides indicators that may be used for an in-depth analysis. The report helps to identify potential areas of friction or imbalances that could jeopardise the stability of the system. The National Bank contributes to the stability of the financial system. This includes periodically informing the public on its assessment of the situation.

The key characteristic of a stable financial system is that its components fulfil their function and prove resistant to shocks. The current report concentrates on two main components of the financial system: the banking sector and the financial market infrastructure. Individual banks are only considered if this is relevant for the overall picture. The report is designed as a supplement to the publications of the Federal Banking Commission (FBC). While one of the latter's responsibilities consists in monitoring individual banks (supervision of institutions), the National Bank has the task of overseeing the banking system, including its infrastructure (system supervision).

The first section of the analysis of the banking sector is concerned with risk factors relevant to the system. It contains a description of the macro-economic and stock market environments. The consequences of these risks are then evaluated. Finally, the resilience of the banking sector is assessed. The second section of the report covers the main characteristics and developments of the financial market infrastructure and assesses their effects on system stability.

The situation of the financial system

The Swiss banking sector has proved resistant to the deterioration in the economy and to the collapse of the stock markets in 2002. On the one hand, the banking sector again showed positive results in the past year: despite a marked decline in profits compared with the previous year, earning power is close to the average for the last decade. On the other hand, the sector has maintained its capacity to absorb shocks. The capital ratios of the banking sector at the end of 2002 can be regarded as favourable both in an international and an historical comparison. It must be noted that institutions with considerable losses have introduced significant measures to strengthen their capital adequacy. Finally, no major imbalance was identified as the source of a potential crisis. The Swiss banking system is thus considered to be stable.

The relatively robust results of the banking sector point to the significance of credit business as a source of income. The price collapse on the stock markets has led to a considerable reduction in income from asset management and investment banking and to losses in the banks' own trading portfolios. By contrast, the results from lending business are fairly satisfactory despite the economic slowdown. The growing risks connected with economic stagnation have therefore not impacted perceptibly on the banks' books. A deterioration in the quality of the banks' credit portfolio has so far not been observed.

Nevertheless, two sources of potential tension in the banking system must be emphasised.

First, should the economy remain weak, creditors' financial standing is likely to go from bad to worse, and this would make it necessary for banks to increase their provisions. A massive increase in reserve requirements, however, seems unlikely in view of the cautious credit policy pursued by the banks in recent years. It must also be borne in mind that the easing of monetary policy by the SNB helps to limit the extent and duration of the economic downturn in Switzerland.

Second, the banks do not have unlimited possibilities to improve their income. They have introduced measures to increase their efficiency and to re-position themselves. These measures are designed to arrest the slide in income from trading and asset management business. However, the desired consolidation of income from off-balance-sheet business, which is of such great importance to the banks in Switzerland, would be called into question should the financial market slump persist or become even worse.

The financial market infrastructure relating to the clearing and settlement of payments and of transactions with securities and other financial instruments presents a favourable picture. In this field, the Swiss financial centre operates with the Swiss Interbank Clearing (SIC) payment system and the SECOM securities settlement system, both of which have stood the test over the years and which contribute, by dint of their architecture, to minimising settlement risks. The launching of the international multi-currency payment system Continuous Linked Settlement (CLS) in September 2002 and of the central counterparty SIS x-clear in May 2003 makes it possible to further reduce the risks arising from the settlement of foreign exchange and securities transactions. In addition, organisational and technical measures are constantly taken to enhance the operational reliability of the systems. Overall, the Swiss financial centre has a well-functioning infrastructure, which also compares very favourably as regards security and efficiency with those of other countries.

2. Further improvement in banknote security

Small denominations now also have perforated number

Between October 1995 and October 1998, the Swiss National Bank put the different denominations of the current series of banknotes into circulation. They were phased in one at a time, beginning with the three smaller denominations and finishing with the three large ones. The banknotes in circulation have a large number of security features permitting holders to check whether the notes are genuine.

Today we may say that the security system of this banknote series has stood the test. The number of counterfeits is low in an international comparison. Nevertheless, we should not rest on our laurels. The breakneck speed at which copying technology is developing offers counterfeiters increasingly better and cheaper technological possibilities to reproduce banknotes that look deceptively genuine. We therefore consider it our duty to introduce preventive measures with a view to constantly improving the security of our banknotes.

As a further step towards improving this security system, we have upgraded the three smaller denominations with the perforated number. Only the larger denominations were equipped with this security feature up to now, because at the time the three small denominations were first issued the necessary technology was not yet available. The change relates to the 10-franc, 20-franc and 50-franc notes; the serial numbers of these banknotes start with 00. Thus all banknotes of the current series now bear the same security features.

The perforated number is made up of laser-perforated figures. They can be applied thanks to a technology developed by Orell Füssli Security Printing Ltd, our banknote printers. When held up to the light, the denomination number of the note is seen as a perforated surface. A leaflet on this security feature, which also contains information on five other security features, can be obtained at all National Bank counters and will also be available at most commercial banks and post offices within the next few days.

Banknotes with a small face value bearing a perforated number have already been put into circulation. Concurrently, banknotes without a perforated number are still in circulation. They will stay in circulation until they are worn out and replaced.

3. Normalisation of banknote circulation following completion of the euro launch

From the beginning of 2001 until the end of 2002, the change in the circulation of Swiss franc banknotes, expressed as percentages vis-à-vis the corresponding year-back values, was determined wholly by the introduction of euro cash on 1 January 2002. Based on a growth rate in the value of banknote circulation of approximately 2% at the beginning of 2001, note circulation rose steadily, reaching a peak of close to 12% at the end of January 2002. Subsequently, growth rates declined continuously. The current growth figure for banknote circulation – approximately 2% – again conforms to former rates.

During the launch of the euro, circulation of the US dollar and the pound sterling largely corresponded to Swiss franc circulation.

Annexe

Selected passages from the Stability Report

General operating conditions

Both financial market conditions and the general operating environment for the banking sector deteriorated in 2002. For the first time since the mid-seventies, a downturn on the stock markets, accompanied by high volatility, coincided with a period of economic stagnation. The downtrend on the stock market, which started in mid-2000, continued in 2002 and volatility increased strongly, reaching a relatively high level by the end of 2002. This was accompanied by a rise in yield spreads on the bond market and an increase in the number of bankruptcies. In view of the weakness of the economy, this indicates a general reduction in the credit standing of borrowers.

Profitability

The Swiss banking sector was profitable overall in 2002. However, profits were far lower than in 2001. Moreover, there were major differences in level of profits and profit trends within the sector. Banks whose business is heavily dependent on stock market trends did far worse than those that focus on lending. Should economic stagnation last, the need for risk provisioning will increase, leading to lower profitability at banks that specialise in lending.

Risk factors

To assess the risk factors affecting banks, the SNB uses indicators for three types of risk: credit risk, interest rate risk and market risk. In terms of the proportion of non-performing loans and the level of write-downs and provisions, there was a further decline in credit risk of Swiss banks compared with 2001, bringing this indicator to a low level. Interest rate risk remains low and market risk declined slightly in 2002 compared with 2001. In short, the risk factors in the banking sector therefore declined slightly last year. However, credit risk is expected to rise this year as a result of the poor economic conditions.

Capital adequacy

At year-end 2002 the banks as a whole had a lower equity base than at the end of the previous year. The level of capitalisation is nevertheless adequate overall, and only a few banks have a low level of capital adequacy. Historically and by international standards, Swiss banks can be regarded as well-capitalised.

Market assessment

Market sentiment on the soundness of a bank is reflected in credit ratings, yield spreads and share prices. Although these indicators suggest that the Swiss banking sector is in relatively good shape, its position has deteriorated considerably over the past few years. This trend is mainly due to difficulties at individual banks.