Embargo: Friday, 29 April 2011, 10 a.m.

Address by Hansueli Raggenbass, President of the Bank Council, to the General Meeting of Shareholders of the Swiss National Bank, 29 April 2011

Dear Shareholders

Ladies and Gentlemen

Dear Guests

Twenty-one billion Swiss francs. Twenty-one billion Swiss francs was the loss recorded by the Swiss National Bank for the 2010 financial year. This has naturally caused quite a stir, not only among you as shareholders. I would therefore like to use the opportunity today to take a closer look at some of the widely discussed issues in this matter.

The SNB's balance sheet as a reflection of its monetary policy

Rarely in the Swiss National Bank's history of over 100 years have its balance sheet developments caught the public attention as they have in the recent past. This is justified and by no means surprising. After all, the balance sheet reflects the various measures and instruments adopted and used by the SNB in the course of the financial crisis. Remember the exceptionally high demand for liquidity on the part of banks in Switzerland and abroad, which was met by additional Swiss franc repos as well as by newly created US dollar repos and euro/Swiss franc swaps. Or think of the creation of the stabilisation fund at the height of the crisis, and the purchase of Swiss franc bonds issued by domestic borrowers. And, most of all, of course, there were the foreign exchange purchases, with which the SNB countered the threat of deflation.

The SNB's balance sheet has changed over the past four years. Currently, foreign exchange is prominent on the assets side, and the SNB's interest-bearing debt certificates, the SNB Bills, are strong on the liabilities side. Compared to the end of 2006, before the onset of the financial crisis, the balance sheet total has increased by around CHF 160 billion to CHF 270 billion.

Such a marked balance sheet expansion is a new phenomenon. It is, however, not restricted to the Swiss National Bank. Other major central banks have also been forced to expand their balance sheets. Thus, the balance sheets of the European Central Bank, the US Federal Reserve and the Bank of England all doubled or trebled in size over the same period.

As an outside observer, one might wonder why the SNB did not simply prevent or at least limit the growth of its balance sheet. The answer lies in the potential conflict of interest with the SNB's monetary policy and the fact that monetary policy takes priority. If monetary policy measures lead to undesirable effects on the balance sheet, these have to be accepted. As you know, the SNB conducts its monetary policy in order to fulfil its core task, which is to ensure price stability. The primacy of monetary policy also means that, if necessary, the SNB has to assume additional balance sheet risks. In this connection, two conditions must be fulfilled.

First, the balance sheet must be sufficiently robust over the long term to allow for all types of monetary policy measures, including those associated with risks. The SNB ensures this freedom of action by placing great emphasis on setting aside provisions in the longer term. There are, of course, some central banks that actually operate with negative equity capital for a certain period of time and fulfil their mandate all the same. Nevertheless, such a situation would be problematic. The financial and economic crisis has clearly shown how important it is for a central bank to have a robust balance sheet.

Second, the SNB must never be guided by profitability considerations in its monetary policy measures. Allow me to illustrate this, using the example of a change in the key interest rate. A change in monetary policy interest rates has a direct impact on the SNB's interest income and interest expenses, and an indirect impact on the exchange rate and therefore on the valuation of the foreign exchange reserves. In addition, a central bank that gives priority to profit maximisation would have to take certain measures that are contrary to the ensurance of price stability. This example underlines how disastrous it would be if the influence on the SNB's own positions and thus on its profit played even the slightest role in the monetary policy decisions.

At the same time, the SNB may not take measures that would make sense purely from a balance sheet perspective, but would have undesirable monetary policy consequences. This can be exemplified by the exchange rate risk. Whereas private companies or commercial banks can hedge their exchange rate risk at any time through appropriate financial transactions, the SNB can do so only in exceptional cases. This is because hedging the foreign currency risk against the Swiss franc would increase demand for Swiss francs and thus contribute to a strengthening of the Swiss currency. And this can have undesirable effects from a monetary policy point of view.

These examples demonstrate that it would be clearly contrary to the interests of the country as a whole if the SNB were to focus its monetary policy on the achievement of profits or the prevention of losses. In other words, the balance sheet – and with it the SNB's financial results – represent not the aim, but the outcome of its activities.

Profits and losses of the Swiss National Bank

At the end of 2010, the currency reserves – foreign exchange and gold – amounted to more than CHF 250 billion. Bearing this sum in mind, it becomes clear that even a slight percentage change in value leads to valuation gains or losses amounting to billions of francs. These effects can be mitigated to a certain extent by investment policy, including consistent diversification of the foreign exchange reserves. For instance, over ten years there has never been a negative return on the foreign exchange reserves if the changes in the value of the Swiss franc are excluded. However, diversification cannot prevent losses if the Swiss franc appreciates against practically all other investment currencies. And this is exactly what happened to a significant extent last year. The risk, moreover, is not new. There have regularly been periods in the past that saw a strong rise in the Swiss franc.

Even if making a profit is not the objective of the Swiss National Bank, we may still build on the assumption that the SNB does achieve positive returns. Not every single year, but on a long-term average. Interest income, dividends and price gains on investments all contribute to these returns. On average, they exceed the exchange rate losses resulting from the Swiss franc's long-term upward trend.

The SNB's profit distribution

Despite the considerable loss, the SNB will distribute CHF 2.5 billion to the Confederation and the cantons for the past year, and CHF 1.5 million to the shareholders. To make this distribution possible, the Bank Council has cut its allocation to the provisions from roughly CHF 4 billion, as was originally planned, to about CHF 700 million. In doing so, the SNB is taking account both of the exceptional situation on the foreign exchange markets at the end of the year and of the Confederation's and the cantons' need for budgetary planning security.

As you know, the SNB decided in 2009 to raise the annual allocations to its provisions over the following years. The one-off reduction in the annual allocation for 2010 will now delay the planned increase in provisions, but this is justifiable in an exceptional situation. The basic need to increase provisions in the long term, as outlined in my speech last year, remains unchanged. Rather, the events of the past few years have clearly shown how important a robust balance sheet is for a central bank. It gives the SNB the leeway it needs to take all the necessary measures required for the fulfilment of its mandate at any particular time.

At the end of 2010, the SNB's equity capital amounted to around CHF 40 billion, which is equivalent to the level at the beginning of the millennium. At that time, however, the balance sheet was considerably shorter. The SNB is therefore retaining its strategy of reinforcing provisions at a faster rate over the coming years.

What does this mean for future profit distribution? The first thing to remember is that the SNB regularly distributes its entire profit after allocation to the currency reserves. It is obliged to do so in accordance with art. 31 para. 2 of the National Bank Act, which states that one-third of any net profit remaining after the distribution of a dividend shall accrue to the Confederation and two-thirds to the cantons. In other words, the SNB does not retain any profits for other than monetary policy purposes. Any net profit that the SNB does not distribute is invariably allocated to the distribution reserve, which is used to smooth the flow of the amounts distributed year by year. The SNB is in a position to distribute the high amount of CHF 2.5 billion precisely because it had previously achieved a series of very good annual results and thus been able to allocate correspondingly large amounts to the distribution reserve.

As you know, the agreement concerning the profit distribution concluded between the SNB and the Federal Department of Finance will be reviewed in the course of this year. The review takes place against the background of a significantly longer balance sheet. This means that earnings are likely to fluctuate more from year to year than in the past. The results of the past two years give an indication of this. While 2009 closed with a profit of over CHF 10 billion, 2010 ended with a loss of CHF 21 billion. Certainly, there had been earnings fluctuations in the billions before, but in the last ten years this had mostly been due to unexpectedly high profits, which resulted especially from valuation gains on gold. The Swiss Confederation and the cantons thus benefited from a superior level of distribution over the past few years, also by international standards. What is more, this gave rise to high expectations – presumably too high – with regard to the SNB’s long-term distribution potential.

Independence and accountability

Recently, the SNB’s financial result has aroused at least as much interest as its monetary policy. But let me emphasise once again: Achieving a profit is not the core task of the Swiss National Bank. Its mandate is to ensure price stability while taking due account of economic developments. This task was fulfilled in the past year.

In order to enable the SNB to carry out its core task under the best-possible conditions, Swiss legislators granted the Swiss National Bank a high measure of independence from the very beginning. The value of this approach has been demonstrated, as international comparisons reveal an impressive monetary policy track record for independent central banks. Experience shows that an independent central bank is better able to align its policy to the long-term interests of the country as a whole.

The SNB’s independence is not absolute, it is coupled with accountability. The SNB is – rightly – obliged to account for its activities. It has this obligation towards the Federal Council, towards parliament and, last but not least, towards the general public.

The public is affected by the SNB's measures in various ways, which extend well beyond the annual profit distribution to the Confederation and the cantons. Think of tax income and social security spending, both of which depend on the performance of the economy. In the long term, the results of the SNB's financial stability measures have a stronger impact on public finances than the level of profit distribution. This underlines the fact that there can ultimately be no conflict of interest between the SNB and the recipients of its profit distribution.

Ladies and Gentlemen, the Swiss National Bank has been faced with exceptionally difficult challenges over the past four years. It regularly had to take decisions in circumstances of great uncertainty, during the financial crisis and subsequently in the escalating sovereign debt crisis affecting a series of European countries. There are always times in the history of a central bank when its monetary policy is subject to controversy. Nevertheless, central banks should have the freedom to operate independently of everyday politics.

Let me assure you that the Swiss National Bank, in performing its statutory mandate, is guided exclusively by the well-being of the Swiss economy as a whole.

Thank you very much for your attention.