News conference

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Introductory remarks by Jean-Pierre Danthine

In my remarks, I would like to examine three topics. First, I will comment on developments in the international financial markets. Then I will briefly address the situation in the Swiss franc money market and the implementation of monetary policy. Finally, I will talk about the management of the foreign exchange reserves.

Developments in the international financial markets

Developments in the international bond, share and foreign exchange markets are mixed and, as before, characterised by relatively high volatility. The relatively favourable global economic developments and the fact that the balance sheets and the liquidity situation of corporations outside the financial industry are in relatively good – in some cases very good – shape are having a positive effect. By contrast, the balance sheets of many governments reflect the consequences of crisis measures and increasing structural debt problems. Thus, in recent quarters, the financial markets have presented a mixed picture. Signs of an improvement in the prevailing mood have been followed by setbacks attributable to the serious impending challenges. At the beginning of the financial crisis, these were mainly concentrated in corporations' balance sheets. Since then, the market has increasingly shifted its focus towards the risks associated with government debt. Such fundamental changes in investor risk assessment influence not just the prices of the affected bonds. They also impact on other investment categories and, therefore, as I will explain later, on the financial markets in general.

Allow me to begin by addressing the most serious developments. The European sovereign debt crisis is far from over. In comparison to last year, it has again worsened. Thus the credit risk premia of euro countries with large debt burdens continued to rise; compared to the previous year's average value, the risk premia have approximately doubled. That the debt problem in the euro area has worsened is apparent not just on the bond markets. On the foreign exchange market, the CHF/EUR exchange rate, in particular, reacted strongly, attaining new all-time high levels. Since, at the same time, the US dollar was still tending lower, the CHF/USD exchange rate also climbed to extreme levels. The weak dollar has to do with doubts about the robustness of the US economy in the wake of diminishing fiscal and monetary policy stimuli, as well as worries about US public debt. Since the Swiss franc also recorded historical exchange rates against other currencies, its value, on a real and trade-weighted basis, is now well above its long-term level.

Investor appetite for bonds considered to be secure helped to push down capital market yields on US, German and Swiss ten-year government bonds to the level last recorded in December 2010 of around 3% (US and Germany) and 1.7% (Switzerland). By contrast, the risk premia for bonds of particularly burdened euro economies – namely those of Greece, Ireland and Portugal – continued to rise. Overall, the risk premia of certain European sovereign borrowers remain very high, and latent threats of contagion continue to exist.

In the global equity and commodity markets, the mood during recent quarters was cautiously positive. In the equity markets, the gratifying corporate results had a strongly supportive effect. In the US, for example, around two-thirds of the most important corporations reported better results than were expected by the market. In the commodity markets, healthy economic conditions – especially in the emerging countries – assisted a continuation of the upward movement, although here, too, price volatility remained high. However, there were also factors weighing on the markets, like the political unrest in North Africa and the Middle East, the catastrophe in Japan and, finally, the indications of a global economic slowdown in the markets.

To summarise, the situation in the international financial markets presents a mixed picture, despite the fact that economic developments are relatively favourable. This reflects the fact that the burden inherited from the economic and financial crisis continues to be very significant.

Implementation of monetary policy

The financial crisis was characterised not least by turbulence on the money market. While uncertainties in the international financial markets persist, the situation in the Swiss franc money market eased last year, and has been very relaxed since the beginning of 2011. The Swiss franc money market is still in a position of structural liquidity surplus vis-à-vis the Swiss National Bank (SNB). Consequently, our focus is on liquidity-absorbing open market operations. Currently, a large proportion of the surplus Swiss franc liquidity is being absorbed through SNB Bills amounting to around CHF 110 billion and daily repo auctions (reverse repos) of around CHF 25 billion. The volume being absorbed has not been increased over recent months. Consequently, the total sight deposits of domestic banks have, at approximately CHF 25 billion, remained almost unchanged. This is a significantly higher level than before the financial crisis. It exceeds the minimum reserve requirements many times over. As a consequence, interest rates on the Swiss franc money market are still close to zero. Despite the fact that interest rates are still very low, the volume of activity on the secured Swiss franc money market remains at a relatively high level. By contrast, the volumes traded on the unsecured Swiss franc money market are still markedly lower than their pre-crisis level. The management of the three-month Libor is, however, not affected by this, and can still be guaranteed.

The management of the foreign exchange reserves

Allow me to conclude with a few words on the management of our foreign exchange reserves.

First, let me stress that the increase in the foreign exchange reserves in 2009 and 2010 was a direct consequence of monetary policy measures. It had nothing to do with the pursuit of investment goals. With interest rates close to zero, the SNB created additional Swiss franc liquidity through foreign exchange market interventions. This prevented the rise in the value of the Swiss franc from leading to what at the time would have been an undesirable tightening of monetary conditions. The foreign exchange reserves therefore surged from around CHF 50 billion at the end of 2008 to a good CHF 200 billion by the end of 2010.

A direct consequence of our much larger balance sheet is the increase in the financial risks associated with our foreign exchange reserves. These risks have materialised in the last 12 months, and have led to significant losses for the SNB. They hold the potential for further losses. Just as the increase in our foreign exchange reserves was determined by the demands of monetary policy under the exceptional circumstances that prevailed in 2009 and 2010, monetary policy considerations will continue to dictate our actions in the future. This means, in particular, that selling our foreign exchange reserves (and buying Swiss francs) is not an option at the moment.

Monetary policy also dictates that our currency risks not be hedged. In effect, hedging the exchange rate risk using derivatives would be equivalent to buying Swiss francs against foreign exchange for forward delivery. The effect of hedging on the market is thus comparable to the direct sale of foreign currency. The only option for the SNB is therefore to diversify its risks as efficiently as possible with a view to limiting the exchange rate, credit and concentration risks of its foreign currency investments. The SNB had already begun diversifying its investments in the late 1990s. The SNB foreign currency investments are considerably more diversified than those of many other countries, with many central banks investing their foreign exchange reserves mainly in US Treasuries, that is, in public debt titles and in dollars. While the SNB also holds the large majority of its portfolio in the form of government securities, it also currently holds as many as 10% of its reserves in equities and 5% in corporate bonds. In order to limit credit risk, the large majority of our public debt holdings have the highest (AAA) or second-highest rating (AA). In effect, our current allocation corresponds to 86% AAA-rated and 13% AA-rated public debt holdings.

The SNB diversification strategy is, however, subject to limits. These spring from the stringent requirements with regard to the security and liquidity of the investments. Many investment markets are too narrow, and do not meet the SNB's liquidity requirements. The SNB's investment universe – and thus its scope for diversification – is therefore limited. The bulk of the worldwide supply of highly rated public debt instruments is denominated in euros and US dollars. It is thus due to the instruments available on the market that the largest part of our foreign currency investments is in euros (55%) and in US dollars (25%). The remainder of our investments is composed of yen (10%), Canadian dollars (4%), pounds sterling (3%) and other currencies (3%).

Finally, taking a general and somewhat longer-term view, the following point should be noted. The SNB's currency reserves are made up of foreign currency investments and gold. In a risk-averse environment, losses tend to occur on foreign currency investments and profits on gold, while in a risk-friendly environment the opposite is true. Consequently, diversification of a portfolio to include gold and foreign currency helps to stabilise earnings over an entire risk cycle.