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Speech given by Thomas J. Jordan, Chairman of the Governing Board, to the General Meeting of Shareholders of the Swiss National Bank, 27 April 2012

Mr President of the Bank Council

Dear Shareholders

Dear Guests

Also from a monetary policy perspective, the Swiss National Bank (SNB) has experienced another difficult year. In 2011, the escalation of the European sovereign debt crisis triggered a very substantial appreciation of the Swiss franc. In order to avert major damage to the Swiss economy, and work against the threat of a deflationary trend, the SNB had to react fast with exceptional measures.

I would like to begin by giving you a review of economic developments and monetary policy in 2011. Then I will present our assessment of the international economic outlook and its impact on the Swiss economy. I will also outline the outlook for price stability. I will conclude by explaining the SNB's reflections on current monetary policy. First, let me begin by reviewing the events of last year.

Review of 2011

In terms of the economic cycle, the year 2011 certainly began well. Overall, economic activity was lively, and the situation on the labour market improved further. Despite the appreciation of the Swiss franc in 2010, goods exports were robust during the first few months of the year.

However, in spring 2011, the international economic recovery stalled. This was attributable to several different factors. In major advanced economies, stimuli from fiscal policies diminished. Moreover, in the second quarter in particular, international economic growth suffered from the effects of the Japanese earthquake and tsunami. The destruction of production plants for important intermediate goods for the electronics industry led to substantial supply problems worldwide, which resulted in production losses. Finally, the concerns about fiscal problems in many advanced economies increased. In particular, the risk that the European sovereign debt crisis might escalate hung like a sword of Damocles over the outlook for the entire international economy.

The debt crisis did indeed escalate in the second half of the year. While, initially, it was only the small peripheral states of the euro area that encountered problems because of their high levels of debt, the loss of confidence increasingly affected the larger economies of Europe as well. At the same time, there was growing concern about the stability of European banks.

Given these developments, uncertainty in financial markets increased sharply in the second half of the year. At the same time, the demand for safe-haven investments soared. As we all know, these investments include those in the Swiss franc. The Swiss currency had already gained in value in the second quarter. However, between July and the beginning of August, it appreciated very substantially within a very short period. In August 2011, the Swiss franc reached an all-time high against both the euro and the US dollar, in both nominal and real terms.

Ladies and Gentlemen, in August 2011, the Swiss franc was massively overvalued, according to any yardstick. In addition, in practically the same period, the international economic environment had become noticeably gloomier. This situation presented an acute risk to our economy, as well as carrying the threat of a deflationary trend. Consequently, the SNB reacted fast and announced an unscheduled interest rate reduction on 3 August. In addition, from this moment onwards, it increased the supply of Swiss franc liquidity by a hitherto unprecedented amount, in several steps, with the aim of weakening the Swiss currency.

Overall, the liquidity measures achieved the expected results. They brought about significantly lower interest rates in the Swiss franc money market – interest rates that were, at times, even negative. This tended to weaken the attractiveness of Swiss franc investments. Thus the upward trend of the Swiss franc against the euro was checked for the time being. However, the exchange rate remained very volatile, due to the persistence of negative reports from abroad, and at the end of August the Swiss franc appreciated again. In this market environment, which was extremely uncertain and nervous because of the European debt crisis, the liquidity measures were ultimately insufficient to halt the appreciation of the Swiss franc.

In recognition of this fact, the SNB decided to introduce a measure which was exceptional in every respect. On 6 September, the SNB set a minimum exchange rate of CHF 1.20 per euro. It stated that it would enforce this minimum rate with the utmost determination and was prepared to buy foreign currency in unlimited quantities for this purpose. This policy is still in force, without any restriction.

The impact on the Swiss economy of the deterioration in the international environment as well as the exchange rate movements in July and August had been steadily increasing. Economic activity weakened significantly over the course of 2011 and the pressure on profit margins intensified further in many industries. However, in the past few months there have been growing signs that the economic situation in Switzerland has stabilised as a result of the minimum exchange rate.

Thus the minimum exchange rate of CHF 1.20 per euro has, to date, proved to be effective. It has reduced the very substantial overvaluation of the Swiss franc. Moreover, the extreme exchange rate fluctuations which had been experienced previously have been lessened. This has given business leaders a better basis for planning, thereby clearly limiting the damage inflicted by the appreciation of the Swiss franc on the real economy.

However, apart from the exchange rate, future economic growth in our country will once again depend on developments in the international economy. That is why I will now present to you our assessment of the international economic outlook.

Economic outlook and outlook for price stability

The latest economic statistics suggest that the international economic recovery will continue, although growth rates are likely to be on the low side by comparison with typical recovery phases. The debt reduction process which private households in the US are currently undergoing and the consolidation of government finances in several European countries, in particular, are dampening economic activity in the short term. Nevertheless, the recovery should gradually gain some strength.

However, it is by no means certain that this moderately positive scenario for the international economy will become reality. The international environment continues to be highly uncertain. The European sovereign debt problem still presents the biggest risk. It is unclear whether the measures taken so far will really succeed in defusing the situation permanently. Consequently, the sovereign debt crisis still has the potential to seriously affect the international financial system as well as international economic development.

What does this international environment mean for the Swiss economy? The year 2012 is likely to be another difficult one. At CHF 1.20 against the euro, the Swiss currency is still overvalued and presents major challenges to our economy. Many companies have been forced to reduce their prices, which has lowered their turnover in nominal terms. Companies exposed to international competition, with considerable depth of production in Switzerland, in particular, are facing pressure on their profit margins. An additional factor is the muted outlook for the international economy. Combined with the continued high level of uncertainty with respect to the European debt problem, this is likely to limit the willingness to invest in Switzerland.

However, there are reasons for a certain degree of confidence as far as our economy is concerned. For instance, the low level of interest rates is still having a stimulating effect on the economy. Domestic demand continues to be supported by high immigration. In addition, the repercussions of the high Swiss franc value are not only negative. For example, imported preliminary products for companies and consumer goods for households have become cheaper. Finally, Swiss firms and their employees have made huge efforts to deal with this difficult situation.

Overall, the SNB expects moderate economic growth of close to 1% for the year 2012. This modest economic momentum is likely to be reflected in a moderate increase in unemployment over the course of the next few quarters. The expected economic activity is lower than would be the case for normal capacity utilisation. This means there will be no inflationary pressure from this source. Our conditional inflation forecast of mid-March 2012 shows that there is no risk of inflation in Switzerland in the foreseeable future. The forecast also makes it clear that the threat of a deflationary trend has been kept in check. Inflation rates are only temporarily negative.

Nevertheless, the monetary policy challenges for the SNB remain very considerable. I would now like to go into a little more detail on our reflections on monetary policy, particularly with respect to the minimum exchange rate.

Reflections on Swiss monetary policy

After being announced on 6 September 2011, the minimum exchange rate was rapidly attained. When our press release was issued, at exactly 10 am, the euro was trading at a little over CHF 1.12. Within minutes, the exchange rate exceeded the CHF 1.20 mark. Seen from the outside, this may have created the impression that a minimum exchange rate can simply be generated by pressing a button and that such an exchange rate is a normal monetary policy measure which is straightforward to implement.

That is far from being the case. A minimum exchange rate is an extreme measure, only to be introduced in a situation of massive overvaluation, with the aim of averting the worst developments. It is neither a panacea capable of solving all the problems facing the Swiss economy, nor can it simply be implemented for any desired level, free of any risk. On the contrary. A minimum exchange rate can only be successfully implemented if there is a clear economic justification for its introduction, such as a massive overvaluation resulting from adverse developments on the foreign exchange market. Within the framework of a system of flexible exchange rates, it is also important that it be internationally accepted, and that it is not seen as a competitive depreciation. Finally, a vital element in the successful implementation of such an exchange rate is the central bank’s credibility, in other words, the belief that the central bank will indeed defend the minimum exchange rate, if need be.

Financial markets are constantly changing their assessment of risks. A situation may also occur in which the market decides to test the defence of the minimum exchange rate.

Consequently, the SNB is present in the foreign exchange market at all times and is always prepared to purchase unlimited quantities of euros at CHF 1.20 per euro, in order to enforce the minimum exchange rate. When trading took place at less than CHF 1.20 per euro, it was only for a few seconds and resulted from market idiosyncrasies. Since 6 September, the best rate in the market for the sale of euros against Swiss francs has never fallen below CHF 1.20. The SNB was thus able to successfully enforce the minimum exchange rate even under extremely difficult conditions.

These considerations clearly show that the introduction of a minimum exchange rate is associated with risks. Under certain circumstances, implementing such a rate can lead to a very considerable expansion of foreign currency reserves. The SNB is prepared to bear the risk. Indeed, in summer 2011, the situation had become so acute that, by early September, the SNB felt that there was no longer any alternative to introducing a minimum exchange rate. Doing nothing would have had an extremely negative impact on our economy.

Even at a rate of CHF 1.20 per euro, the Swiss franc remains overvalued. We are acutely aware that considerable challenges still remain for the Swiss economy, despite the minimum exchange rate. One particular reason for this is the fact that the international economy is recovering at only a moderate pace. In addition, there is a very high level of uncertainty in the international environment. An appreciation of the Swiss franc at the current time would again expose Switzerland to considerable risks and, once more, endanger both price stability and the stabilisation of the economy. Given this situation, the SNB will enforce the minimum exchange rate with the utmost determination. If developments in the international economy are worse than foreseen, or if the Swiss franc does not weaken further as expected, renewed downside risks for price stability could emerge. Should the economic outlook and the threat of deflation require it, the SNB is prepared at any time to take further measures.

As you will probably have deduced from this account, seen from today's vantage point, interest rates in Switzerland are likely to remain low for a while yet. This expansionary monetary policy is indispensable from the point of view of the economy as a whole. In that it has significantly reduced the threat to the economy and the threat of a deflationary trend, the current monetary policy is also contributing to financial stability – in the short term. Both a deep recession and a deflationary trend would pose a threat to the banking system.

In the longer term, a period of low interest rates carries the risk that imbalances will build up. In Switzerland, the current low-interest-rate period has now lasted for over three years. We are – in fact – currently observing increasing signs of adverse developments in the Swiss mortgage and real estate market for residential property. The explanatory power of fundamental factors in explaining the developments in residential real estate prices is decreasing steadily, while the volume of mortgage loans in comparison to GDP has never been so high. Should these imbalances increase further, considerable risks to financial stability could emerge.

Given this situation, the SNB has strongly advocated the introduction of a countercyclical capital buffer in Switzerland. This buffer would not be a permanent increase in equity requirements for banks. It is only to be activated temporarily in the event of excessive growth in domestic mortgage lending. As soon as lending growth weakens again, the buffer can be deactivated. An instrument of this kind was examined in detail last year by a working group headed by the Federal Department of Finance, to which both FINMA and the SNB also belonged. The group proposed that the buffer be introduced rapidly so that a suitable instrument would be in place, in case the imbalances in the Swiss mortgage and real estate market increased further.

Concluding remarks

Ladies and Gentlemen, as you will have gathered from my remarks today, the challenges facing the SNB have not diminished. Consequently, it is all the more important that we are able to devote our complete attention to our tasks, now and in the future. The SNB's monetary policy decisions are directed purely and solely at fulfilling its statutory mandate. It is our responsibility to ensure price stability. In doing so, we take account of the development of the economy and make a contribution to the stability of the financial system.

The SNB pursues a monetary policy that serves the interests of the country as a whole, and we fulfil this mandate as an independent central bank. To do this, we continue to rely on the total commitment of our staff, whom I would like to thank – also in the name of my colleague, Jean-Pierre Danthine – for their hard work and their solidarity with the SNB. We thank our shareholders for their continuing support. And we thank you all for taking such a great interest in the activities of the SNB. Finally, we would also like to thank our former colleague and Chairman of the SNB Governing Board, Philipp Hildebrand, for the good collaboration we enjoyed over the years. We very much regret his resignation and the circumstances leading up to it.

Thank you for your attention.