Bruno Gehrig: Review of the Swiss economy: end-of-year media news conference

Introductory remarks by Prof Dr Bruno Gehrig, President of the Swiss National Bank, at the End-of-year Media News Conference, Zurich, 7 December 2001.

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Financial markets characterised by economic slowdown

Development on the financial markets during the current year was characterised by a surprisingly significant weakening of the economy affecting all the major economic regions around the world. The slowdown was most pronounced in the US, but Europe is experiencing a considerable setback in growth as well. Inflationary pressure, already weak, thus eased further. The central banks took advantage of the rapidly increasing flexibility and lowered their key rates, in some cases down to historical lows.

Up until the middle of the year, the prevalent opinion in the financial markets was that - buoyed by the Fed's marked interest rate cuts - the US economy, along with the global economy, would stage a fairly swift recovery from the deterioration in the technology sector and the associated weak investment activity. For this reason, the second quarter was characterised by a recovery on most stock markets, increasing bond yields and a US dollar defying gravity. By mid-year it became clear that the cyclical decline was likely to be more serious and to last longer. This reversal of opinion led to investors gradually becoming more risk averse. Equities portfolios were regrouped and invested in the money market and in bonds. Growing pessimistic sentiment vis-à-vis the economy led to lower capital market yields, declining stock valuations and a weaker US dollar.

The general pattern of activities on the financial markets was and still is characterised by a marked parallelism in price fluctuations. On the one hand, this is a reflection of the synchronisation of the current and expected economic development which has been apparent for several quarters and which in turn leads to parallel monetary policy reactions. On the other hand, the widespread globalisation of capital market processes has considerably intensified - at the expense of country-specific differentiations - the impact of the valuation factors effective worldwide.

The shock of 11 September

The attack of 11 September hit the world economy and the financial markets in a state of instability. It did not trigger any new trends, but magnified developments which were already under way. Business and consumer confidence suffered a severe blow, which further dimmed economic prospects in the US and in Europe. The sudden increase in risk aversion led to drastic corrections on all major stock exchanges and to a veritable flight into the Swiss franc. The record highs the Swiss franc reached on 21 September went in tandem with the stock markets hitting record lows. In response to the rapid and marked appreciation of the Swiss franc, we cut interest rates in an extraordinary move on 24 September. Following this step, and in the course of a broader normalisation of the financial markets, the euro rebounded somewhat vis-à-vis the Swiss franc. Our currency nevertheless remained strong against the euro. At the end of November, it was quoted at 3.5 % above its average rate during the first eight months of the year. The euro-Swiss franc rate was somewhat more volatile as well. Its volatility in additional currencies now stands at about the same level as previously against the D-mark.

On the stock markets, a distinct corrective movement set in even before the end of September. Meanwhile, most stock indices are above the level obtaining on 10 September. Bond yields have increased a little in the last few weeks as well. Both effects can be interpreted as a sign of renewed optimism concerning the economic development in the medium term.

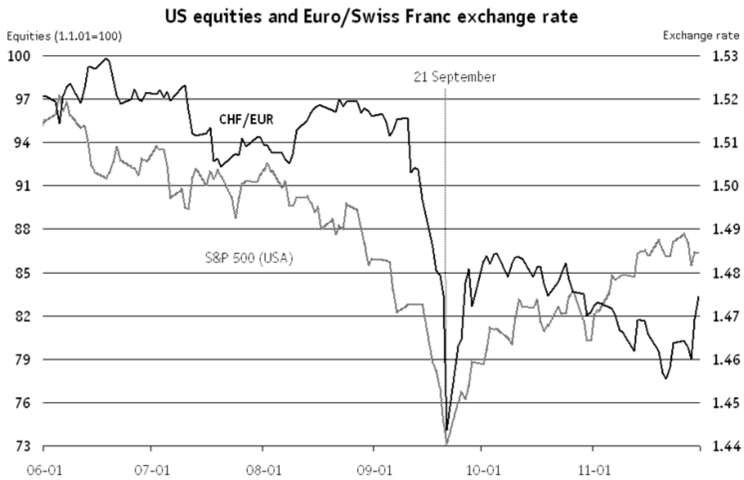
In the days after the terror attacks, the resiliency of the financial system was put to a test never before described or even considered in any emergency plan. Payment transactions in US dollars were affected directly. Faced with the possible breakdown of individual banks and parts of the system which are crucial for carrying out transactions, the Federal Reserve - by way of the discount window - pumped massive amounts of liquidity into the system. On the basis of a swap agreement, the European Central Bank supplied banks in the euro area directly with dollar liquidity. The National Bank was in close touch with the Swiss banks and - should this have been necessary - we would have been in a position to lend support as well. The demand for Swiss franc liquidity also rose sharply. Naturally, we made the necessary amounts available to the full extent. As was to be expected, it became evident that only a part of this liquidity was needed, and we were able to reabsorb it through repo transactions as early as 12 September. On the two days following the attacks, repos totalling approximately Sfr 40 billion were turned over.

The experiences gained in the aftermath of 11 September have shown three things. Firstly, that the financial system - even in this unique and completely unexpected situation - still managed to function relatively smoothly. Different players contributed to this, but it was mainly the banks themselves which supported one another with creative flexibility in the interest of the situation as a whole. Secondly, our repo system enabled us to take the necessary steps without problems. Had we still been dependent on foreign exchange swaps with US dollars, conducting monetary policy under the given conditions would have been eminently more difficult. Thirdly, these experiences prove how vulnerable the highly integrated global financial system really is. They clearly underscore that securing the stability of the financial system must constitute an important part of the role of central banks.

The Swiss franc on the foreign exchange and capital markets

We do not expect that the introduction of euro cash, which is upon us in a little less than a month, will have any significant impact on the financial markets. However, it will be interesting to see if, to what extent, and in what areas people in Switzerland will use the euro as a means of payment. Certain structural effects of the euro have already become evident for quite a while, for example on the primary bond market, where the Swiss franc is losing in weight while the euro capital market is enjoying growing popularity due mainly to its excellent liquidity.

According to the survey conducted by the Bank for International Settlements (BIS) for the trading days of the month of April, the trading volume in international foreign exchange transactions dropped by nearly 20% within three years. Another contributing factor to this development was the advance of electronic trading and the discontinuation of trading between the euro's predecessor currencies. Roughly 6% of all global foreign exchange transactions include the Swiss franc. This share still amounted to 7% three years ago and to just over 8% nine years back. The fact that the Swiss franc has lost relative significance in foreign exchange trading is probably largely attributable to institutional conditions for trading in additional currencies having improved. By far most of the Swiss franc transactions were effected against the US dollar. This currency pair was traded approximately five times as frequently as the Swiss franc-euro pair. This volume ratio, however, is likely to be subject to strong fluctuations depending on specific exchange rate developments. At any rate, the National Bank will be pleased to see the historic, special role played by the Swiss franc as a foreign exchange trading currency continuing to diminish.




International equity markets
(1.1.01=100)
100
85
70
55
11 September
21 September
S&P 500 (USA)
SMI
Euro Stoxx 50
06-01
07-01
08-01
09-01
10-01
11-01