Niklaus Blattner: System stability and monetary policy

Summary of a speech by Mr Niklaus Blattner, Vice-Chairman of the Governing Board of the Swiss National Bank, at the University of Berne, Berne, 31 January 2006.

The complete speech can be found in German on the Swiss National Bank's website (www.snb.ch).

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For a number of years the Swiss National Bank (SNB) has been devoting considerable attention to the interaction between system stability and monetary policy. The aim is to arrive at an assessment of the current situation. The results obtained so far have been very useful, but there is still work to be done in implementing them and developing them further.

Our point of departure is an analysis comparable to that presented in the 2005 Annual Report of the Bank for International Settlements (BIS). From basic research papers published by the BIS we can conclude that, where financial systems are liberalised, a monetary policy that responds exclusively to short-term risks to price stability will promote the elasticity of economic systems. Only if monetary policy also responds to cumulative disequilibria in financial markets can this elasticity be limited. A monetary policy response of this kind can be achieved through coordination with macroprudential and microprudential instruments.

With this in mind, we turn to the activities of the SNB. The primary objective of the National Bank's monetary policy and its contribution to the stability of the financial system is to supply the economy with liquidity. These two elements are interlocked, thereby taking account of the insights reached in international discussion in this area. The SNB supplies the economy with liquidity first and foremost through money market operations, but also, under certain circumstances, through its function as lender of last resort. Emergency liquidity assistance is only provided if the stability of the system is severely jeopardised. The SNB guards against this situation by helping to ensure a well-functioning liquidity supply. It facilitates and secures the operation of cashless payment systems, regulates and monitors both the payment and the securities settlement systems and works to ensure that these systems are crisis-proof. In addition, it continually oversees and analyses developments in the financial system and collaborates closely with the Swiss Federal Banking Commission (SFBC), the banking supervisory body.

Currently, there are three questions that direct the SNB's use of information on the stability of the financial system when it makes monetary policy decisions. The first question is whether monetary policy – as an instrument for ensuring price stability – can be improved by including information on banking system stability? The second question works the other way round: Can monetary policy influence the stability of the banking industry? And – if the answer to this second question is yes – the third (normative) question is whether monetary policy should be used to increase stability in the banking industry.

While the answers to the first two questions are in the affirmative, the response to the third is negative. Apart from monetary policy, the SNB has other ways of contributing to system stability. The law clearly specifies that the instrument of monetary policy is directed at ensuring price stability. In other words, using monetary policy to promote the stability of the banking system while accepting the possibility that the objective of price stability might not be fulfilled, would be inadmissible. What is more, any gain in the stability of the banking system at the cost of price stability would be temporary, at best. Experience has shown that, in the long term, the absence of inflation is a necessary pre-condition for stable banking systems.

Finally, the paper points out that the SNB is already including system stability considerations in its monetary policy decision-making process, and is examining the possibility of utilising synergies between system stability and monetary policy more extensively.

Naturally, there are many more challenges with respect to the relationships between system stability and monetary policy. One of these challenges is liquidity management at commercial banks. It is apparent that liquidity standards that are desirable in terms of the public interest may be more exacting than those pursued by banks in their own private interests. Like other central banks, the SNB is currently looking more closely at the examination of existing liquidity standards. In this area, it is working with the SFBC and engaging with the central banks and supervisory authorities of other important international financial centres in information-exchange and opinion-building activities.