

Philipp Hildebrand: The virtues of flexible financial markets - a central banking perspective

Summary of a speech by Mr Philipp Hildebrand, Member of the Governing Board of the Swiss National Bank, at the CFA Institute Annual Conference, Zurich, 22 May 2006.

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

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Summary

Rapid technological change and market liberalization have been the driving forces behind the remarkable evolution of global financial markets over the past three decades. The consequences of this development include a geographic rearrangement of global capital markets, a fast pace of product innovation and changes in the nature and composition of financial market participants.

The benefits associated with today's flexible financial markets are manifold. Financial markets have become much more efficient in allocating capital. New products enable a better distribution of risks and the liquefaction of previously illiquid assets. They have also increased market transparency. As a result, modern financial markets facilitated innovation and likely enhanced economic growth. Moreover, they have contributed to make economies more resilient to shocks.

These extensive benefits notwithstanding, modern financial market also entails new risks. These risks tend to elicit calls for increasingly far-reaching regulation. While some regulation may indeed be required to guarantee the integrity of financial markets, the threshold for such regulation should be set high. Regulation should only be considered if the objective is abundantly clear and if there is overwhelming evidence that market participants lack the incentives or the capability to adequately manage these risks themselves. Rather than seeking regulation, market participants, central banks and regulators should focus on strengthening an already active dialogue with the aim of furthering our understanding of new types of risk associated with modern financial markets.