Jean-Pierre Roth: “A franc remains a franc” – 100 years of National Bank policy in support of monetary stability

Address by Mr Jean-Pierre Roth, Chairman of the Governing Board of the Swiss National Bank and Chairman of the Board of Directors of the Bank for International Settlements, at the official ceremony of the 100th anniversary of the Swiss National Bank, Zurich, 22 June 2007.

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Honoured President of the Swiss Confederation
Honoured Prime Minister of the Principality of Liechtenstein
Honoured members of the federal parliament
Honoured representatives of the cantonal governments
Honoured governors of fellow central banks
Honoured guests

Almost to the day 100 years ago, the Swiss National Bank opened its doors at the head offices in Berne and Zurich and the branch offices in Basel, Geneva and St Gallen. This marked the end of around 16 years of parliamentary work that had followed the acceptance, in 1891, of a constitutional article leading to the establishment of a central note-issuing institution for the whole of Switzerland.

This prolonged process can definitely be explained by the fact that our countrymen, at the end of the 19th century, did not see any urgent need for the establishment of a central bank. In fact, the political debates prior to 1907 mainly focused on questions relating to the organisation of the bank and the distribution of its profits; the regulatory role that the new institution was to assume was hardly touched upon. The new National Bank was expected to gradually take over the activities of the former note-issuing institutions and to bring some welcome order to the payment system. At the time, the value of the Swiss franc was defined in gold and silver, the precious metal content of the coins was fixed accordingly and banknotes could be exchanged for gold.

Nowadays, the SNB’s responsibility in matters of monetary stability is uncontested. In fact, it is explicitly mandated by law to preserve price stability while taking economic developments into account. Moreover, economic theory stresses the special responsibility of central banks in this area. The goals, methods and instruments of monetary policy have thus undergone profound changes. Nevertheless, the principles that have guided our activity over the past century have been remarkably enduring, and this is exemplified by the history of the National Bank.

Pursuit of stability

From the outset, the National Bank recognised that its role as the national note-issuing institution would extend far beyond the harmonisation of payment systems.

The first steps were difficult. During the First World War, the SNB actively participated in financing military expenditures through its loans. This undisciplined lending policy pushed up inflation, thereby contributing to the social unrest of 1918. This sparked a broad debate on the SNB’s responsibility for the massive price rise. These events, along with the subsequent tragedy of German hyperinflation, left a strong mark on the National Bank. It must have been at that time that the SNB fully realised the complexity of its task. In particular, it recognised how important it was to preserve the country’s good monetary health – and this was long before the law made price stability a priority goal within the SNB’s policy.

Since then, and even during the most turbulent phases of the 20th century, the determination to ensure monetary stability has emerged as a guiding principle for the National Bank’s activity. In its quest for stability, the SNB strove to apply the rules of the gold standard consistently, accepting the Federal Council’s decision to devalue the Swiss franc in 1936 reluctantly, as a trial imposed upon it from outside. Also, when Switzerland found itself isolated in the Second World War, the SNB tried to avoid repeating the mistakes made during the First World War so as not to further aggravate an already difficult situation through monetary instability. Preserving domestic stability and maintaining the country’s ability to meet international payments were thus accorded priority. After the War, the new order established at the Bretton Woods conference was intended to ensure international monetary stability. However, this goal was not achieved. In Switzerland, the disequilibrium in the balance of payments became even more exaggerated, and the fight against inflation called for the joint efforts of the Federal Council and the National Bank. In 1973, the National Bank decided to stop intervening on the foreign exchange market and to float the Swiss franc. This measure was also designed to safeguard monetary stability, which was jeopardised by the massive inflow of speculative funds. Maintaining the internal balance in a highly unstable international environment was the main focus of the monetary policy decisions in the years that followed. In Switzerland, price stability has been ensured since 1994, but it was only ten years later that it was also made a statutory goal of our policy.

Central bank autonomy

This constant pursuit of monetary stability would not have been possible if the National Bank had not been able to act independently – an essential advantage – since the day it was founded.

The principle of central bank autonomy is widely recognised nowadays. Price stability can be better ensured if the institution responsible for conducting monetary policy has a clear mandate and can act independently of third-party instructions. This realisation has led to many central banks being granted independence during the last 20 years.

In Switzerland, the debate on the status of the future National Bank took place at the end of the 19th century. In 1897, a project for the establishment of a state bank located in Berne and placed under the direct control of the Federal Department of Finance was adopted by parliament, but the proponents of an independent note-issuing bank to be domiciled in Zurich launched a referendum, and the law was rejected in a popular vote. As a compromise, the legal status of the new central bank was situated somewhere between that of a public and a private sector institution and it was given two head offices, one in Berne and one in Zurich. From the beginning, it thus occupied a special place in Switzerland's political landscape.

This special status has hardly changed over the years. In the 1930s, when devaluations and the abandonment of the gold standard often resulted in tighter government controls over central banks, the National Bank Act remained unchanged. Likewise, at the end of the Second World War, when many central banks were nationalised, the SNB remained a stock company open to private shareholders, and it has maintained this status to this day. Since 1973, following the abolition of fixed exchange rates and the introduction of an autonomous monetary policy, the circumstances under which this principle of independence is implemented have changed progressively. A growing need for transparency vis-à-vis the public and the authorities has emerged. This is why we have developed a strategy of active communication, and our relationship with the federal authorities has been gradually institutionalised. Nowadays, transparency and accountability have become principles of good governance for all independent central banks. In Switzerland, the revised National Bank Act of 2004 obliges the SNB to present an annual accountability report on the execution of its mandate to parliament.

Application of rules

Independence is not merely a theoretical concept, it must be lived constantly. Very early on, the National Bank realised that it could defend its autonomy and strengthen confidence in the Swiss franc by adopting rules of conduct. From the start, it strove to adhere to the rules of the gold standard and maintained this policy until the system of fixed exchange rates collapsed in 1973. With the Swiss franc losing its traditional anchor, the SNB was forced to adopt new rules. This was achieved 18 months later with the publication of annual growth targets for the money supply, a strategy which was pursued until 1999. Since 2000, our interest rate decisions have been based on our medium-term inflation forecast and our definition of price stability, which we consider achieved if annual inflation remains below 2%.

The second constant in the National Bank's activity over the past 100 years has been its adherence to the rules of monetary discipline. This strategy has allowed us, as it did our predecessors, to conduct a coherent monetary policy over all these years while shielding our institution from all kinds of demands, both economic and political.

Willingness to adapt

Given the strong disruptions in the international environment in the past 100 years, pursuing a policy of stability and applying the rules of monetary discipline has not been an easy undertaking. Let us not forget the obstacles we encountered in adhering to the rules of the gold standard and the fixed exchange rate system in times of war or during major international upheavals. Let us also remember the difficulties that money supply targeting caused in the context of financial market deregulation in the past 20 years. Quite often, the implementation of our policy was undermined by a highly unstable international environment. The ability to adapt, therefore, became crucial.

Our predecessors demonstrated this willingness to adapt to new developments time and again, for example, when Switzerland had to be reintegrated in the international system of payments in the post-war period, in the fight against speculative capital inflows in the 1960s, in managing the volatility of the Swiss franc in the 1970s or curbing inflation in the late 1980s. Apparent in all these phases were the same determination to ensure monetary stability, the same commitment to apply rules and the same necessity of having to take an often hostile environment into account. The direction was always clear, but many obstacles had to be overcome along the way.

We are celebrating the 100th anniversary of the establishment of the Swiss National Bank in quite exceptional circumstances. Indeed, Switzerland enjoys great prosperity: We are close to full employment, price stability has been maintained for almost 13 years, and the economic prospects are favourable in almost all respects.

This enviable situation could not have been achieved without our economy striving for greater efficiency or without its ability to take on new challenges and make the most of the international environment. All this has not been easy, neither for the companies nor for the employees.

The good economic situation can also be attributed to the country's sound financial health. National savings are high, the external accounts are solid, and public finances are on the way to recovery.

The National Bank has contributed to this success by ensuring confidence in the Swiss franc – a key factor for the smooth functioning of the economy. As I have pointed out, this commitment is not new, but has been a constant throughout our history. As our predecessors, we are honouring it by following rules that are as clear as possible, while knowing that the uncertain environment in which we operate requires the ability to adapt.

Mistakes have certainly been made in the 100 years of the National Bank's existence. It must be acknowledged, in retrospect, that certain situations were not analysed correctly, that certain decisions were taken too late or were simply inadequate. In some instances, the SNB opted for strictly following the rules rather than searching for solutions that would have been better suited to the realities of the moment.

Nevertheless, the outcome has been positive overall. Switzerland has been spared the monetary problems that afflicted so many other countries. However, the purchasing power of the Swiss franc has not been preserved as successfully as one might have wished. The general price level has increased by an average of 2.5% a year since 1907, although this is still only half a percentage point above the range we now equate with price stability.

Our currency was created in 1850, and the coins of that time were in circulation in 1907, when the National Bank started operations. We still use these coins today for our day-to-day payments. This is tangible proof of our country's monetary stability.

"A franc remains a franc," declared the President of the Swiss Confederation in a radio address one day after the 1936 devaluation, in an endeavour to reassure the Swiss people about the abolition of the gold standard. I am pleased to be able to say today – 100 years after the National Bank started business – that a franc has indeed remained a franc.

All this could not have been achieved if our policy did not enjoy broad support in our country. I would therefore like to conclude by expressing sincere thanks; first of all to the federal and cantonal authorities for the support that they have given us, particularly in difficult times when we had to make unpopular decisions for the sake of monetary stability. Second, I would like to thank the business community for its understanding of our policy, even at times when we assessed the situation differently or when monetary constraints necessitated painful adjustments. And, finally, my thanks go to the Swiss people for their unwavering confidence in our institution and their support for our monetary autonomy over the last 100 years.

May the National Bank continue to enjoy such broad support! Through its actions, it will continue to uphold the trust which has been placed in it thus far.