Niklaus Blattner: Recent financial and economic developments in Switzerland

Introductory remarks by Mr Niklaus Blattner, Vice-Chairman of the Governing Board of the Swiss National Bank, at the half-yearly media news conference, Geneva, 17 June 2004.

* * *

The new National Bank Act obliges the Swiss National Bank to *contribute to the stability of the financial system*. In performing this task, the National Bank focuses on the stability of the banking sector and of the financial market infrastructure. Implementation rests on three pillars: first, regular analysis and assessment of the banking system (referred to as “macroprudential oversight of the banking sector”); second, oversight of systemically important payment and securities settlement systems (referred to as “system oversight”); and third, if preventive oversight is not adequate, crisis management measures.

Today I will be talking mainly about the first and second areas of our activities with reference to the *Financial Stability Report 2004*. You have already received this document (subject to an embargo). I will also talk about emergency liquidity assistance, which is one of the instruments used to deal with crisis situations. And I will draw your attention to another publication appearing today: the summary of the 2003 statistical yearbook “*The Banks in Switzerland*”. While this statistical publication focuses on reporting, the Financial Stability Report ventures into the domain of analysis and evaluation.

Macroprudential oversight of the banking sector

The Swiss National Bank follows developments in the banking sector from the macroprudential angle. This task complements those performed by the Swiss Federal Banking Commission (SFBC), which oversees the individual banks (microprudential oversight). The Financial Stability Report takes account of this division of tasks. The National Bank limits its evaluation of the Swiss banking sector’s stability by focusing on trends observable at the levels of the banking system, the financial markets and the macroeconomic environment. It only focuses on individual banks when this is necessary in order to make an overall assessment. The main purpose of the Financial Stability Report is to allow the National Bank to highlight any stresses or imbalances that could pose an immediate or longer-term threat to system stability.

We evaluate the stability of the banking sector in two steps. First we analyse the development of the risk factors in the macroeconomic environment and on the financial markets. Then we evaluate the banking system’s robustness in the face of these risk factors. To do this, we consider profitability, the risks entered into and the capital adequacy of the banking sector. To complete our analysis, we use newly developed models that quantify both the stress to which the banking sector is subjected and its correlation with the macroeconomic environment. The main characteristics and conclusions drawn from these models are published for the first time today. The models will be presented in detail in a series of SNB publications.

The analysis presented in the Financial Stability Report indicates that the banking sector is stable. In 2003 it was able to raise its profits substantially in spite of a mixed macroeconomic and financial environment. Thanks to these profits, banks were able to bolster their capital significantly, thus enhancing their capacity to absorb shocks. The resulting capital ratios in the banking sector are high both in historical terms and by international standards. This impression of pronounced robustness in the Swiss banking sector is corroborated by the relatively low level (in historical terms) of the stress indicator. This is a new indicator calculated as a synthesis of different stress symptoms. The indicator considers in particular the capital ratios, profits, share prices and risk premiums on bonds in the Swiss banking sector.

As far as the outlook is concerned, we believe that the macroeconomic environment and the financial markets do not present any significant threat to the stability of the Swiss banking system. The forecasts for 2004 point to a rebound in economic growth in Switzerland and the European Union along with a continuing upswing in the United States. Moreover, the rise in prices on the Swiss real estate market has remained moderate by both historical and international standards. It is thus unlikely that this market will see any abrupt downward adjustment - traditionally a major stress factor for the banking sector. And finally, the available indicators suggest that the major global banking sectors are also relatively robust. At present, therefore, the risk of contagion - i.e. of a crisis having repercussions on Switzerland - is remote.

Two sources of potential stress should, however, be mentioned. First, a slowdown in the economy - which, though unlikely, is still conceivable - could have negative repercussions on the quality of loan portfolios and on stockmarket prices. Second, in the more likely event of a sustained economic upswing, a sharper-than-expected rise in interest rates could also worsen the quality of loan portfolios by increasing the interest burden on households and companies more than expected. Analysis of the various scenarios suggests that sufficient capital is available in the Swiss banking sector to withstand even a substantial deterioration in the economic or stockmarket climate or a sharp rise in interest rates. Nevertheless, some banks have announced that they now have an increased appetite for risk. A general rise in risk acceptance would render the banking sector more sensitive to deteriorations in the macroeconomic or stockmarket environment.

System oversight

At the media conference in December last year, I reported in detail on the background to system oversight, i.e. the oversight of payment and securities settlement systems. Today I am limiting myself - given the recent publication of the Financial Stability Report - to a briefing on the current situation.

The day on which the new National Bank Act took effect - 1 May 2004 - also saw the entry into force of the new National Bank Ordinance. Among other things, the Ordinance contains the implementation provisions for system oversight. In particular, these set out the minimum requirements for systemically important financial market infrastructure and the principles of ongoing system oversight by the National Bank.

The task for the next few months will be to determine which payment and securities settlement systems are to be classed as systemically important. Then we will have to define the practical modalities that are best suited for implementing ongoing system oversight as effectively and efficiently as possible.

Oversight is focused on infrastructure that is vital for the Swiss financial centre, i.e. especially those systems which together constitute the *Swiss value chain*. In addition to Swiss Exchange SWX, which will remain under the supervision not of the National Bank but of the SFBC, this infrastructure consists primarily of the payment system *Swiss Interbank Clearing (SIC)*, the securities settlement system *SECOM* and the central counterparty *x-clear*. The first talks have been held with representatives of these systems to establish the implementation of system oversight. Investigations over the next few months will clarify whether other systems are also to be subject to oversight. By the end of July, all payment and securities settlement systems in Switzerland must report to the National Bank.

As mentioned earlier, system oversight was not the product of a crisis. This can also be seen from the new Financial Stability Report, which examines specific aspects of the current financial market infrastructure and gives them a clean bill of health. The aim of system oversight is to ensure that the high levels of safety and efficiency which characterise the market infrastructure of the Swiss financial centre are safeguarded for the future.

Emergency liquidity assistance: a means of overcoming crises

The National Bank is not only active in prevention - i.e. in the macroprudential oversight of the banking sector and in the oversight of the payment and securities settlement systems (system oversight) - but also contributes actively to overcoming crises.

In a crisis, the National Bank - like any other central bank - is primarily responsible for maintaining liquidity. On the one hand, it can do this by ensuring that the market is amply supplied with liquidity. And on the other hand, as lender of last resort (LOLR) it can also provide *emergency liquidity assistance* to individual banks that are illiquid but still solvent. Here too we adopt internationally accepted procedures.

Many central banks still prefer not to inform the commercial banks in too much detail about their role as LOLR. Quite understandably, they want to prevent the banks from being lulled into a false sense of security. The jargon term for this is “constructive ambiguity”. By contrast, the Swiss National Bank has opted - after carefully weighing up the moral hazard implications of its conduct - to communicate its terms to the banks both clearly and well in advance. The modalities are described in the *Guidelines of* *the Swiss National Bank on Monetary Policy Instruments of 30 April 2004*. To receive an LOLR credit, a bank must on the one hand be systemically relevant and, on the other hand, be solvent and able to furnish sufficient collateral. Without collateral, the National Bank cannot grant any credit. This fundamental principle is enshrined in the National Bank Act. By disclosing our terms to the banks in advance, we are eliminating any possible misinterpretation of the liquidity risks and helping to ensure that preparations are in place for a liquidity crisis which can never be ruled out altogether. This is what we refer to as “constructive clarity”.

Conclusion

To sum up, I would like to reiterate that the situation of the Swiss financial system is stable. However, this gratifying conclusion should not allow us to rest on our laurels. Maintaining a stable financial system in the long term calls for constant efforts to prevent and cope with crises. While this challenge must primarily be met by the private sector, the authorities can, should and must support its efforts.

Financial Stability Report 2004 (424 kb)