With its forecast that GDP will grow by 1.5%-2.0% and the average inflation rate will amount to 2%, the National Bank is cautiously optimistic for the Swiss economy in 2008. However, since the summer of 2007, the international environment has taken a clear turn for the worse: Financial markets are in a serious crisis, the major economies are weakening and inflation rates are rising worldwide. This means that the SNB’s monetary policy is facing challenges on several fronts simultaneously.

With regard to economic growth, the SNB is called upon to assess the consequences of the international financial crisis for the Swiss economy as precisely as possible and to analyse their implications for monetary policy correctly and at an early stage. On the inflation front, it must ensure that the measures taken in connection with the financial market crisis do not jeopardise the credibility of a monetary policy geared to long-term price stability or shake established inflation expectations. Finally, the challenge in the money market is two-fold. First, the SNB must try – despite volatile risk premiums and interest rate expectations – to keep the targeted three-month Libor as close as possible to the desired goal. Second, with its operations and its choice of instruments, it must contribute to a well-functioning money market.

Even though there have been several innovations in the area of monetary policy instruments, the SNB’s options in this complex environment are limited, however. In particular, there is no magic bullet with which central banks could restore the lost confidence among market participants. In dealing with the financial market crisis, therefore, banks and other financial market participants must also try to help restore the proper functioning of markets by implementing measures to shore up confidence.