Thomas Jordan: Monetary policy in the financial markets crisis

Summary of a speech by Mr Thomas Jordan, Member of the Governing Board of the Swiss National Bank, at an event for banks and pension funds, Berne, 2 April 2008.

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

* * *

The origin of the turbulence on the international financial markets which has persisted since August 2007 is mainly to be found in the US housing market. On the one hand, a long period of low USD interest rates had boosted the demand for residential real estate in the US. On the other hand, the structure of the US mortgage market with the associated rapid increase in mortgage debtors with poor credit ratings, and the subsequent securitisation of their mortgages, had proved to be problematic. Between 2001 and 2006, residential real estate prices in the US doubled. At the end of 2006, there was a reversal in the price trend which triggered crises in both the real estate and mortgage markets.

The substantial expansion in sub-prime and Alt-A mortgages, and a deterioration in the credit ratings of debtors within these segments, led to a rise in the level of overdue payments and defaults. As a result, even securities that gave the appearance of being gilt-edged, but were backed by US sub-prime mortgages, lost considerable ground. Since the banks themselves have massive investments in this market, they were obliged to make writedowns which, in some cases, were hefty. There is still uncertainty about the volume of additional bank writedowns that will be needed, so that the situation on the international money markets remains tense.

In this crisis, central banks have reacted fast and flexibly in order to secure the supply of liquidity to banks and counter distortions on the money market. By means of various measures, the Swiss National Bank was able to stabilise the three-month Libor within the target range, thereby keeping fluctuations in the relative restrictiveness of monetary policy low by comparison with other countries.

However, it is not possible to solve the fundamental problems in the banking sector through the flexible deployment of an expanded range of monetary policy instruments; neither can they be resolved by means of coordinated actions on the part of central banks alone. The banks themselves must make a substantial contribution to solving the problems which triggered the current crisis. In this respect, the most urgent matters are transparency with regard to endangered positions and their valuation, increasing the capital base, and improving risk management and control systems.