Thomas Jordan: Low interest rates – blessing or curse?

Summary of a speech by Mr Thomas Jordan, Member of the Governing Board of the Swiss National Bank, at the Delegiertenversammlung des HEV Schweiz, Säntis, 19 June 2009.

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

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Monetary policy uses low interest rates to try and stimulate demand as a way of combating the economic crisis. The property market is an important transmission channel in this regard, as low mortgage rates provide direct relief to home owners and tenants in the form of lower interest payments and rents. This provides households with greater room for manoeuvre in consumption and investment. This in turn boosts overall economic demand and economic growth.

However, despite these direct positive effects, a low level of interest rates can also pose medium-term risks for the stability of the Swiss property market, and hence the financial system. The past has repeatedly shown that prolonged periods of low interest rates can lead to speculation on property markets, and to declining standards in mortgage lending.

The challenge in today's difficult environment is how to boost the economy through low interest rates without creating medium-term risks for the stability of the financial system and the property market. Responsible behaviour on the part of home owners, combined with bank discipline when granting loans, can contain these risks. Households should buy property only if they would also be able to afford it if interest rates increased. Moreover, they should finance their house purchase with a sufficient proportion of equity. Equity acts as a cushion, absorbing movements in property prices. In addition, banks should use discipline in lending practices, even in an environment of low interest rates. The prime considerations when granting loans should be the observance of maximum loan-to-value ratios and a conservative valuation of property.