

Jean-Pierre Danthine: Financial stability developments and the delayed new Swiss banknotes

Introductory remarks by Mr Jean-Pierre Danthine, Vice Chairman of the Governing Board of the Swiss National Bank, at the Media News Conference of the Swiss National Bank, Berne, 13 December 2012.

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In my introductory remarks today, I would like to look at the main developments in the area of financial stability since the publication of our *Financial Stability Report* in June of this year. Afterwards, I will talk about the postponement of the new banknote series.

In the area of financial stability, the improvement in the big banks' capital situation is particularly noteworthy. The prevailing uncertainties and the risks for the banking sector as a whole remain considerable, however.

Prevailing risks remain considerable

General economic and financial conditions for the Swiss banking sector remain difficult. On the one hand, the situation in the financial markets has eased since June 2012. This is largely due to various decisions and measures taken by governments and central banks worldwide. On the other hand, the easing of tensions in the financial markets should be interpreted with caution. Should the measures already taken not be effective or should the progress made in restructuring government budgets be slow, we cannot rule out renewed turbulence in the financial markets. The European banking industry is also in a fragile state. Although CDS premia for European banks have been going down in the last few months, their level is still considerably above previous years as well as that of Swiss and US banks. Finally, as my colleague Thomas Jordan has explained, the global economic outlook remains modest. For Europe, in particular, we have revised our short-term forecast downwards again slightly.

For Switzerland, the National Bank is expecting moderate growth. Economic conditions remain comparatively good, which – in conjunction with the low level of interest rates – is boosting the continued strong momentum in the mortgage and real estate markets. I will speak about developments in this market in more detail later on.

To sum up, the risks in the banking environment remain considerable. First, the risk of an escalation of the European debt crisis is not insignificant. Second, imbalances are building up in the Swiss real estate market. This goes hand in hand with an increased risk of significant price corrections in the medium term.

Greater resilience of the big banks

The situation of the big banks has improved since the last news conference, as both institutions have further increased their resilience. This increase was particularly pronounced at Credit Suisse. According to the bank's most recently published data, it increased its holdings of loss-absorbing capital by roughly three-quarters in the second half of 2012. In addition to retaining profits, this increase is mainly attributable to the capital measures announced in July, which have already been implemented to a large extent. In addition, as part of their strategic reorientation, both big banks announced measures which will further enhance their resilience. For instance, both institutions are planning to further expand their loss-absorbing capital, to reduce their risks and, in particular, trim their balance sheets as well as to pursue a policy of dividend restraint.

The National Bank welcomes the increase in the big banks' resilience achieved thus far, as well as the announced measures to further improve their capital situation. The consistent

implementation of these measures is important for two reasons: First, leverage has remained high despite the improvement in the capital situation. Second, the risks in the environment – and thus the associated potential losses for the big banks in the event of a further escalation of the European debt crisis – remain considerable.

Situation at domestically focused banks

I would now like to turn to the situation at domestically focused banks.

The risks associated with the environment in which these banks operate increased during the past six months. Indeed, the isolated signs of a slowdown of growth in the mortgage and real estate markets observed in the second quarter did not materialise in the third quarter. In particular, prices in the different segments of the residential real estate market continued to rise at a sustained pace. At the same time, growth in the mortgage loan volume was still considerably higher than GDP growth. Imbalances have therefore grown.

As far as risk appetite and capitalisation are concerned, the situation of domestically focused banks has not changed significantly during the last six months.

On the one hand, banks' risk appetite has not diminished overall. This is substantiated by the following: First, in the case of new mortgage loans, both the loan-to-value ratios and loan-to-income ratios have remained at a high level. Second, interest rate risk has not declined and remains high. Third, the already low margins on interest income have continued to decrease. There are nevertheless considerable differences from one bank to another, in particular as to how their risk appetite has evolved. Certain banks have reduced their risk-taking significantly during the last quarters, while others have increased their exposure to risk.

On the other hand, average capitalisation for domestically focused banks relative to regulatory requirements is still at a historically high level. However, as the SNB already emphasised in its latest *Financial Stability Report*, the resilience of these banks, as measured by the regulatory capital indicators, is overestimated.

Therefore, six months after being announced, the stricter capital requirements for mortgages and the revision of the self-regulation rules for mortgage lending have not, or not yet, led to a significant trend reversal in mortgage and real estate markets, although there is some anecdotal evidence pointing in that direction. It cannot be ruled out that the impact of these measures has not fully materialised or is simply not yet reflected in the data available. In particular, due to the still exceptionally low interest rates, there is, however, a considerable risk that these imbalances continue to build up, and the risk of an abrupt correction over the medium term keeps increasing.

Under these circumstances, the SNB is carefully monitoring the developments in mortgage and real estate markets. It periodically assesses the necessity to activate the countercyclical capital buffer.

Issuance of the new banknote series in 2015 at the earliest

In February 2012, the National Bank informed the public that the new banknote series would be postponed. Today, I would like to provide some background information on our decision.

The National Bank is committed to putting banknotes into circulation that are state of the art in terms of both their design and their technological aspects. In order to meet this standard, such a project must be launched at an early stage. Integrating and combining security features involving new technologies that have not previously been used for banknotes presents a special challenge. Since the development phase for new security features is very long, launching a new series is likely to take several years for the technical feasibility assessment alone. Certain insights can only be gained during the actual serial production.

The development of the new banknote series began in 2005 with a design competition. In the planning phase for the technical feasibility and during initial production tests in 2010, it became evident that the complexity of the new security features necessitated a postponement of the issue date to autumn 2012. In autumn 2011, during an early phase of the serial production, technical difficulties arose which had not been discernible in the testing phase, whose results were positive. For this reason, the SNB this year decided to conduct a comprehensive re-assessment of the entire project together with the industrial partners producing the new banknote on its behalf. As a result, several mostly technical measures were defined and in some cases have already been implemented. These measures should ensure that the series can go into long-term industrial production.

Owing to the complexity and scope of the necessary work, the first denomination of the series, the CHF 50 note, may be expected in 2015 at the earliest. The SNB will announce the issue date as soon as production of the first banknote denomination has been completed.

Since the National Bank wants to continue meeting the highest quality standards, it has accepted a postponement in the new issue, a decision which was rendered all the easier because the banknotes currently in circulation continue to offer a high standard of security.