Speech

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Monetary policy in the interests of the country as a whole

111th Ordinary General Meeting of Shareholders
of the Swiss National Bank

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Swiss National Bank
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Mr President of the Bank Council
Dear Shareholders
Dear Guests

A warm welcome to you all to our Annual General Meeting. Engaging with the general public across Switzerland is very important for us. It therefore gives me great pleasure to speak before you here today, and I hope I will have the opportunity to talk with as many of our shareholders as possible over refreshments afterwards.

In my position as Chairman of the Swiss National Bank's Governing Board, I receive a lot of correspondence from people throughout our country. In one such letter, the owner of a family business in northwestern Switzerland described how she had struggled for years to hold on to customers, only to have to now close down anyway as the strength of the franc has made competition from neighbouring countries simply too great. In another letter someone wrote that despite his having had to pay ever higher pension fund contributions over the past 15 years, there has been no increase in his projected retirement savings. In fact, they have even declined. He attributes this to what he refers to as 'minus interest'.

Ladies and Gentlemen, letters such as these give us a picture of the key issues of the day for people in Switzerland, and how their lives are affected by specific economic circumstances. We always find this informative. However, the SNB's monetary policy can never be focused solely on individual needs and concerns. Instead it must serve the interests of the country as a whole. And unfortunately, you can't have your cake and eat it, as the saying goes. Or in the case of the two letters I quoted, you can't have higher interest rates and a weaker Swiss franc at the same time.

The SNB bases its monetary policy on careful consideration of its impact on the overall economy. For some four years now, we have centred on two key elements: the negative interest rate and our willingness to intervene in the foreign exchange market as necessary.

The first of these in particular is a very unusual concept for many of our fellow citizens, and this is also reflected in the correspondence we receive. Some say that it runs contrary to economic logic, and creates major problems for savers and pension funds.

Against the current backdrop, both the negative interest rate and our willingness to intervene in the foreign exchange market as necessary remain essential, however. This is the only way we can maintain the interest rate and exchange rate conditions in Switzerland that are necessary for us to perform our task of ensuring price stability while taking due account of economic developments. We would not charge negative interest if we did not regard this as being absolutely crucial for us in fulfilling our mandate.

It is of great importance to us for the Swiss people to understand why our current monetary policy is appropriate in its full context, and what impact it has for Switzerland as a whole.

Protracted decline in global interest rates

To explain to you why the negative interest rate is necessary, I need to take a broader perspective and look back at the past quarter of a century. The level of interest rates has fallen markedly worldwide over this period. Chart 1 shows that the nominal yields on 10-year government bonds in Switzerland, Germany and the US have been declining since the 1990s. There are various factors behind this downward movement.

The first of these is the success central banks have had in their efforts to combat inflation. After the negative experiences with high inflation rates in the 1970s and 1980s, at the beginning of the 1990s many central banks started striving to achieve price stability. Inflation subsequently fell, and so too did the rates of interest on savings accounts and financial market yields. After all, if the money on a savings account retains its value thanks to inflation being lower, the interest no longer needs to compensate for any erosion in value. Lower inflation and the attendant decline in the level of nominal interest rates are essentially a positive development for households and companies alike.

A second explanation is the decline in real rates, that is to say nominal rates of interest adjusted for inflation. Chart 2 shows 10-year government bond yields in Switzerland, Germany and the US adjusted for consumer price inflation in those countries. The decline in real interest rates worldwide is attributable to various reasons that have been studied and analysed extensively. In simple terms, we can for example say that the demographic shift has played a key role, with an ageing population tending to save more in light of longer life expectancy. Moreover, the slowdown in productivity growth is curbing the potential return on real investment, thus diminishing the appeal of investments in fixed assets such as factories and equipment. If intentions with regard to saving outstrip investment plans, the real rate of interest has to come down to restore the equilibrium between supply and demand for capital.

Monetary policy amid low interest rates

What does the lower level of interest rates worldwide mean when it comes to conventional monetary policy? If interest rates are already low, monetary policy is less able to respond to shocks. If the economy and inflation weaken, a central bank will normally stimulate economic activity by lowering interest rates. This mitigates the slowdown and stabilises prices. If interest rates are already low, however, a central bank only has a few moves at its disposal before rates reach zero. And once that happens, conventional monetary policy ends.

The restrictions on the latitude of conventional monetary policy are even more pronounced in the case of Switzerland. Indeed, our country has traditionally been known for its political and economic stability, and the Swiss franc is thus viewed by investors as being particularly safe. In return for this security, they are prepared to hold investments in Swiss francs at lower rates of interest than they would in other currencies. This has in the past led to interest rates in Switzerland generally being lower than in other countries. Therefore if monetary policy needed to be eased, the starting point for interest rate cuts was correspondingly lower here than elsewhere.

Monetary policy reaction to the major economic crisis

Ladies and Gentlemen, the global financial and economic crisis broke out eleven years ago, and was followed by a marked decline in economic output and inflation. At that time, the SNB had to switch to an expansionary monetary policy stance in order to fulfil its mandate. We initially responded with conventional measures, and quickly lowered interest rates to virtually zero.

The global financial crisis was swiftly followed by the sovereign debt crisis in the euro area. The attendant uncertainty on the financial markets bolstered demand for the Swiss franc as a safe haven, thus putting appreciation pressure on our currency. To counter these upward forces, we had no option but to resort to unconventional means. We intervened on the foreign exchange market, and in September 2011 introduced a minimum exchange rate against the euro.

From mid-2014 onwards, the international monetary policy environment began to change. On the one hand there were increasingly clearer signs that the US was about to adopt a tightening stance, whereas in the euro area a loosening of monetary policy was becoming more and more likely. The euro subsequently depreciated markedly against the major currencies. As a result, by the beginning of 2015 the minimum exchange rate was no longer sustainable. To retain control over our monetary policy, we therefore decided in January 2015 to change tack.

In that exceptional situation, we had to weigh up the pros and cons of using alternative unconventional instruments. It became apparent that we would have to lower interest rates below zero given that various other central banks had already done so. This was the only way we could limit the appeal of the Swiss franc. When we discontinued the minimum exchange rate, we thus also imposed negative interest of –0.75% on banks' sight deposits held at the SNB. This then brought the level of interest rates in Switzerland back down below that in other countries. Coupled with our willingness to intervene in the foreign exchange market as necessary, the negative interest rate has taken the pressure off the Swiss franc and prevented a sharp drop in inflation.

Broad impact on the economy

All in all, the Swiss economy got off relatively lightly compared with other countries in the difficult years following the global financial crisis – and this despite the fact that, as a small open economy with a large financial sector, we were hit hard by the shocks. This can be mainly attributed to two factors. First of these was the remarkable flexibility of Swiss companies and workers, which made it possible to increase efficiency, develop new products, and tap into new markets. Coupled with this, the SNB's unconventional monetary policy substantially cushioned the blow of external shocks. The real trade-weighted exchange rate of the Swiss franc has thus remained fairly stable since September 2011. Were it not for the negative interest rate and the extensive interventions by the SNB, Switzerland would today be facing a different economic reality. The franc would have become much stronger, inflation would have fallen well below zero, growth would have slowed abruptly and unemployment would have risen markedly.

For us there is thus no question that the negative interest rate was significant in helping Switzerland emerge from a difficult period in good shape. And it is still making an essential contribution to ensuring that our economy continues to fare well today, despite the array of uncertainties worldwide.

But how exactly does negative interest work? Negative interest rates take effect on an economy in a very similar way to a monetary policy with positive rates. Having interest rates slightly below zero does not mean the world has been turned on its head, nor does it run contrary to economic logic.

Introducing the negative interest rate has on the one hand influenced the financing conditions in the economy. This has been to the benefit of companies, households and the public sector alike. Meanwhile, it also has an effect via the exchange rate, and this is particularly important for us as a small open economy. Charging negative interest reduces the appeal of Swiss franc investments compared with investments in other currencies, and thus plays a significant role in keeping the appreciation pressure on our currency in check. This in turn supports economic activity and is essential for price stability in the current situation. Exchange rates are, of course, also influenced by other factors. However, the comparison between yields on Swiss franc investments and those in other currencies is always an important criterion for investors when deciding which currency to invest in.

Knock-on effects of low interest rates

That being said, the low level of interest rates does also pose challenges and there are knock-on effects. Savers in Switzerland are worried about their savings which are yielding barely any interest. Pension funds and life insurers are facing difficulties in meeting their contractually agreed obligations owing to the low level of capital market interest rates. And banks are concerned about their profitability since they are generating less interest income from their lending business. The low interest rate environment is also bolstering momentum on the real estate markets.

However, with all of these problems it is not so much the negative interest rate itself that is a major factor, but rather the exceptionally low level of interest rates that has prevailed worldwide for years, and which I referred to at the beginning of my speech. These challenges did not appear only when the SNB started charging negative interest, but rather reflect the protracted decline in global interest rates. In the current situation, interest rates would remain low even if we were to stop charging negative interest, and the knock-on effects would thus also persist.

Safeguarding Switzerland

Ladies and Gentlemen, would the citizens of Switzerland be better off if the SNB did not impose its negative interest rate? Allow me to play through a brief scenario in this regard. What would happen if we were to simply stop charging negative interest in the current environment?

Dispensing with the negative interest rate would have a substantial impact on the Swiss economy. Swiss short-term interest rates would again be higher than in other countries, which would clearly increase the attractiveness of Swiss franc investments. This is turn would cause the franc to appreciate, which would be detrimental to economic momentum in Switzerland and would see unemployment rise and inflation pushed into negative territory.

If we stopped charging negative interest, would that at least be beneficial for savers, pension funds, life insurers and banks? The marked weakening in the economy would cast a pall over the earnings prospects of Swiss companies, and Swiss equities would come under pressure. Although short-term interest rates in Switzerland would no longer be negative, there would be little change in capital market interest rates owing to the deterioration in the economic outlook. All in all, the level of interest rates would thus remain low, and so too would the yields on long-term Swiss franc bonds. Ultimately, there would be scarcely any significant improvement for savers, pension funds, life insurers and banks.

The same goes for the real estate market. Although its momentum would be curbed somewhat if we were to cease charging negative interest, there would be little change in the low level of interest rates and the impact would therefore be limited. In the current situation, the risks to financial stability must be addressed with focused macroprudential measures. This will then curb demand for mortgages and real estate and strengthen banks' resilience.

Ladies and Gentlemen, abandoning the negative interest rate in the current environment would weigh heavily on the Swiss economy. This would not help either savers or pension funds, nor would it be beneficial for financial stability. In other words, as things stand at present, removing the negative interest rate would not be in the interests of our country as a whole.

Focusing on the big picture

We introduced the negative interest rate after careful consideration of the advantages and disadvantages. We continually assess its effectiveness, and objectively analyse the costs and benefits.

Global economic activity has weakened in recent months. Although GDP growth is likely to pick up again somewhat after stagnating in the second half of 2018, the inflation outlook for this year and next is subdued. In addition to this, given the economic and political uncertainty in many countries, the situation on the financial and foreign exchange markets remains fragile.

Against the current backdrop, our unconventional monetary policy with the negative interest rate and our willingness to intervene in the foreign exchange market as necessary remains both essential and appropriate. And this is in part also because it does not attach greater weight to any individual issues over others, and is instead at all times focused on the interests of Switzerland as a whole.

The negative interest rate has its place among the instruments at the SNB’s disposal, which include conventional and unconventional measures alike. It is incumbent on us to use the instruments best suited to tackling the situation at hand. However, I would like to stress one thing: I am convinced that we will at some point return to positive interest rates. I cannot tell you now when exactly that will be. This will hinge on developments in inflation, growth and exchange rates going forward.

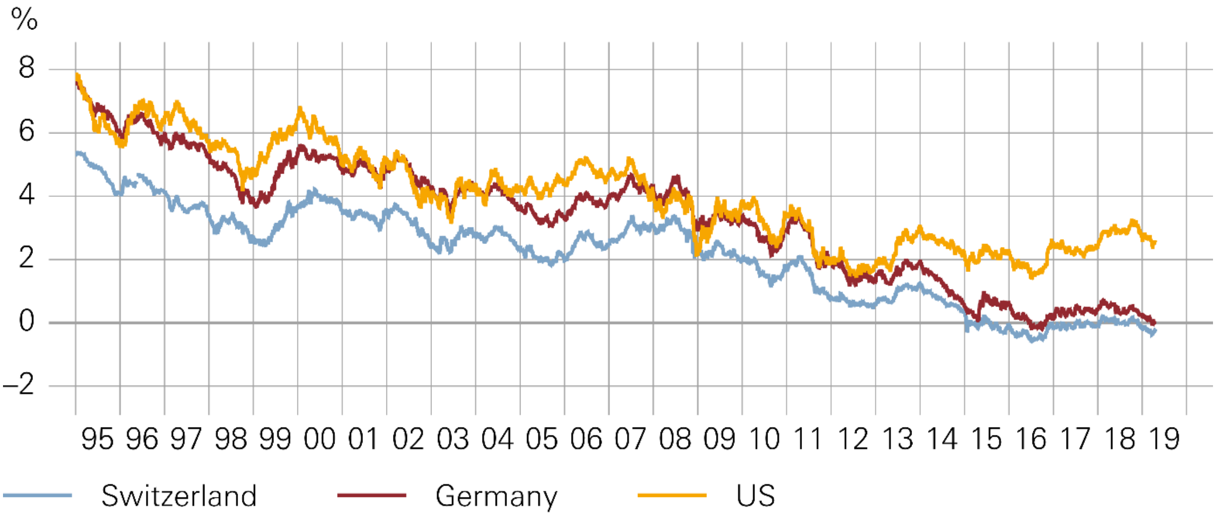
Ladies and Gentlemen, allow me to conclude by taking this opportunity, also on behalf of my Governing Board colleagues Fritz Zurbrügg and Andréa Maechler, to thank our employees for their hard work and dedication. Our gratitude also goes to you, our shareholders, for your loyalty to the SNB and your faithful support. Thanks also to our young guests from the Cantonal School of Graubünden for their interest in monetary policy and the SNB.

I would like to thank you all for your attention, and I look forward to talking with as many of you as possible over refreshments later.

Chart 1

INTERNATIONAL LONG-TERM NOMINAL INTEREST RATES

10-year government bond yields

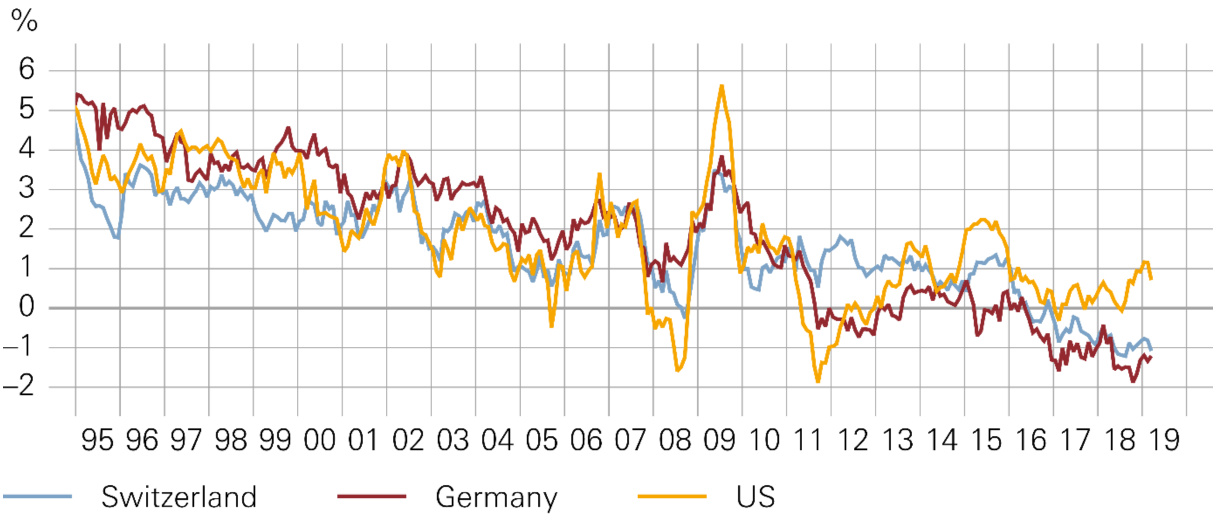


Sources: SNB, Thomson Reuters Datastream

Chart 2

INTERNATIONAL LONG-TERM REAL INTEREST RATES

10-year government bond yields minus consumer price inflation



Sources: SNB, Thomson Reuters Datastream