News conference

Berne, 14 June 2007

Introductory remarks by Thomas Jordan

In my remarks, I would like to address three topics. First, I will speak about the adjustments in the composition of our currency reserves. Then, I would like to comment on the Swiss Interbank Clearing (SIC) payment system and its twenty years of existence. At the end, I will say a few words about developments in the financial markets.

1. Adjustments in the composition of currency reserves

The Swiss National Bank is adjusting the composition of its currency reserves. Before the end of September 2009 it will sell 250 tonnes of gold and increase its foreign exchange reserves by a corresponding amount. The overall level of currency reserves will remain unchanged.

The gold sales fall within the bounds set by the second Gold Agreement of 8 March 2004, in which the central banks of the Eurosystem, plus the Sveriges Riksbank and the Swiss National Bank, agreed to limit their gold sales over a period of five years, beginning on 28 September 2004. The Gold Agreement specifies that annual sales by all signatories may not exceed 500 tonnes and that the total sales volume over this period shall not amount to more than 2,500 tonnes. For the gold sales it was planning, the SNB was allocated a quota not claimed by other central banks that were party to the agreement of 2004. The SNB has chosen an approach for its gold sales that will avoid market unrest, with regular sales transactions.

The Swiss National Bank holds currency reserves in the form of foreign currency and gold, thereby ensuring that it has room for manoeuvre in its monetary policy at all times. As a result of the sharp rise in the price of gold, the proportion of the currency reserves held as gold has increased by about a quarter since mid 2005, from 33% to the current level of 42%. The purpose of the SNB's gold sales is to rebalance the composition of currency reserves with respect to its monetary policy requirements. Moreover, by reducing its gold reserves and increasing its foreign exchange reserves, the overall risk on SNB assets will decline. Once the sales have been completed, the Swiss National Bank's gold holdings will amount to some 1,040 tonnes.

2. Swiss Interbank Clearing (SIC) to celebrate its 20th anniversary

Over the next few days, the Swiss Interbank Clearing System SIC will celebrate its 20th anniversary. In 1987, the introduction of the SIC payment system represented a revolution

for Swiss payment transactions. SIC was one of the first payment systems in the world of the type known as Real Time Gross Settlement (RTGS).

Before the introduction of SIC, payments in Switzerland were first offset against each other through a system of eight clearing houses. The net positions were then settled through the banks' sight deposits at the SNB. This system was extremely cumbersome, costly and fraught with large credit and systemic risks. In SIC by contrast, all payments are settled individually and directly via sight deposits at the SNB. Thus, the payments are final and irrevocable – just like cash payments. SIC is extremely efficient and has drastically reduced credit and systemic risks. It is one of the most secure and cost-effective systems in the world.

Nowadays, SIC forms the backbone of Switzerland's payment system. Not only interbank payment transactions, but also payment transactions between PostFinance and banks as well as cashless retail payment transactions are essentially carried out via SIC. In addition, the international foreign currency settlement system, Continuous Linked Settlement (CLS), is linked to SIC. SIC, together with the trading platforms of SWX/Eurex and the securities settlement system SECOM of SIS, forms the Swiss Value Chain, Switzerland's integrated financial market infrastructure. The SIC payment system is of utmost importance for financial stability and the implementation of the SNB's monetary policy. Our monetary policy instruments are tailored to the palette of integrated SIC functions within the framework of the Swiss Value Chain.

Initially, the SIC turnover in terms of value amounted to CHF 100 billion per working day; it currently stands at CHF 180 billion. The number of transactions, however, has increased far more markedly. One year after the SIC launch, approximately 130,000 transactions were processed each day. Now, twenty years later, an average of 1.3 billion – i.e. ten times more – transactions are carried out per working day. The growth trend for SIC looks set to continue its upward path. The rise in turnover and transactions depends largely on economic growth, technical innovations in payment instruments and developments in the Swiss financial centre.

The SNB has partially outsourced its SIC operations. SIC AG, a Telekurs Group company, is responsible for technical operations and for further development of the system. The SNB steers the liquidity in the SIC system, sets the conditions for participation and is responsible for crisis management. Cooperation between SIC AG and the SNB is excellent. The SNB would like to congratulate SIC AG and Telekurs Group on this anniversary and thank them for the outstanding quality of their work.

The boards of directors of SWX Group, SIS Group and Telekurs Group have recently signed a declaration of intent regarding the merger of their companies, with the goal of founding a Swiss financial centre infrastructure holding company. SIC AG, or rather Telekurs Group, would be part of this holding company. The SNB is affected by this development in different ways. On the one hand, we are a direct contractual partner of all three companies involved. On the other hand, it is our task to oversee the systemically relevant

payments and securities settlement systems. The Swiss Value Chain, run by the three companies, is of vital importance for the implementation of monetary policy. There is no alternative infrastructure for our monetary policy operations. Therefore, we will keep a very close watch on further developments in this area.

3. Developments in the financial markets

The positive underlying sentiment in the international financial markets remained largely unchanged in the first half of 2007, despite some turbulence in the stock markets, which was rather strong at times, and some difficulties in the US sub-prime mortgage market.

On 27 February, after a correction in the Chinese stock market, major falls in share prices were recorded worldwide. The price decline temporarily gave rise to fears that the current bull market, which has lasted for many years now, could come to an end. After only a few days, however, the markets returned to normal. A few weeks later, most share indices had already compensated the losses (figure 1). A further correction has occurred in the past few days. However, despite this turbulence, the rise in implicit volatilities – a measure of expected uncertainty – has been relatively insignificant and short-lived in historical terms. Implicit volatilities are still at a very low level (figure 2). In addition, interest premiums on credit risks both for companies and emerging economies remain low, although yields on long-term government bonds have increased markedly since the beginning of March.

As in the case of the financial market turbulence of May 2006, the latest correction on the stock market has been negotiated without any major difficulties. The positive underlying sentiment in the markets and the appetite for high-risk investments remained for the most part unabated. Not least, this is probably attributable to the extensive investment requirements worldwide and the associated high level of liquidity on the part of the investors. This large requirement for high-risk investments originates from the dynamic growth rate that has prevailed for some time now, a high savings ratio worldwide, the globalisation and liberalisation of the financial markets as well as the increasingly professionalised asset management by private, government and institutional investors.

The durability of the valuation of high-risk investments is extremely difficult to assess, since valuations depend on subjective expectations of future earnings, discount rates and volatilities. The latest turbulence is a salutary reminder of the risks, however. In the past, risk premiums at levels lower than ever recorded before, rapidly rising prices for many high-risk investment categories and hectic activity in the area of company acquisitions have been signs of developments that were not sustainable in the long run. Therefore, market participants should not allow themselves to be distracted by the short-lived nature of financial market setbacks so far and simply extrapolate the favourable market trends of the past few years into the future.

The steady rise in the prices of high-risk investments, the low risk premiums and low volatilities might possibly even have an influence on the external value of the Swiss franc. Let me comment on this statement in a little more detail.

In international currency portfolios, the Swiss franc has always been a safe haven currency. In the past, this was reflected in the fact that the Swiss franc rose against other investments when the situation was uncertain. Thus, the Swiss franc took on a kind of insurance function and many investors held Swiss franc investments to protect themselves against political and economic crises.

Just as the Swiss franc is particularly attractive as a safe haven in stormy conditions, there is little interest in the Swiss franc when the weather is calm. Due to the very low level of risk awareness and risk aversion at present, the demand generated for hedging and thus for Swiss francs is weak. However, in the past, phases of calm weather in foreign exchange markets were repeatedly interspersed with stormy periods. Therefore, financial market participants and other market players with exchange rate exposures should remain aware of the exchange rate risks they are incurring.

Figure 1. Stock markets (December 2005=100)

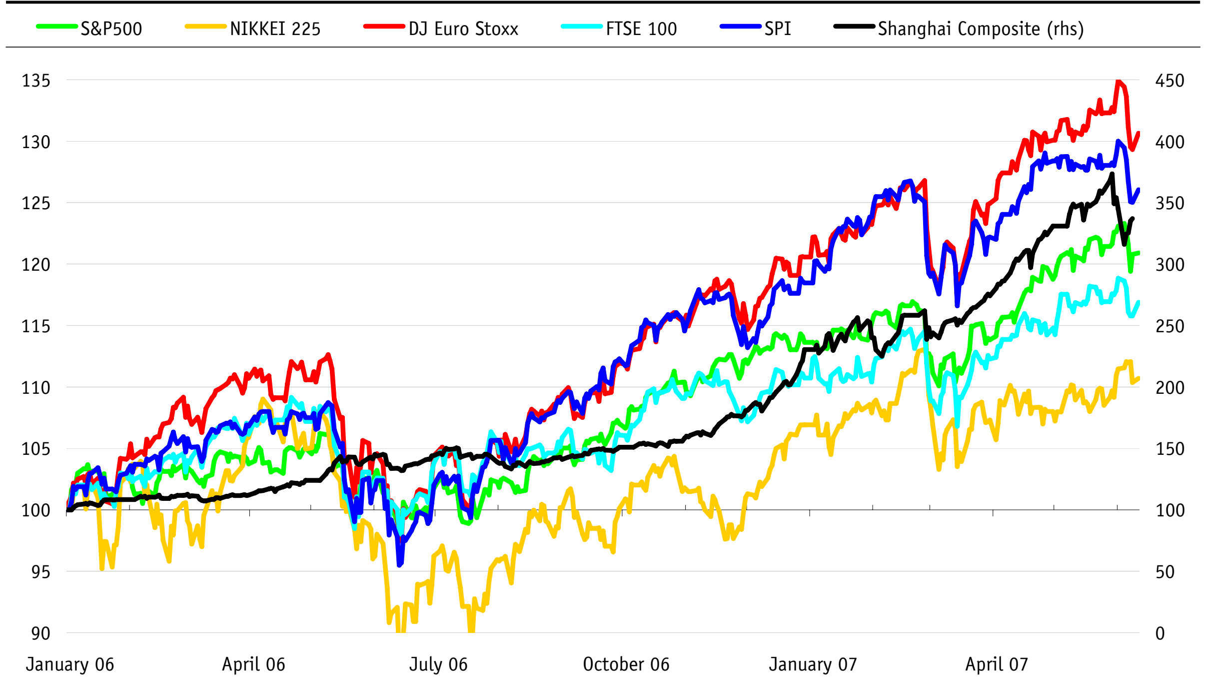

Figure 2. Implicit volatilities