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Speech given by Mr Jean-Pierre Roth, Chairman of the Governing Board, at the General Meeting of Shareholders of the Swiss National Bank on 17 April 2009

Mr President of the Bank Council

Dear Shareholders

Dear Guests

The financial crisis, which first emerged in August 2007, continued to spread during 2008. From mid-September on, the situation deteriorated sharply. Growing uncertainty about the stability of the financial system gradually paralysed the money market. Most industrialised countries implemented relief packages for banks with the aim of improving their refinancing conditions, cleaning up their balance sheets or strengthening their capital base. In fact, the crisis led to an unprecedented level of government intervention. Far-reaching guarantees were granted, major corporations were put under state control, and a substantial amount of risk was transferred from the private to the public sector.

The difficulty of implementing our monetary policy

The waning ability of the financial markets to function properly posed problems for the implementation of our monetary policy. The prevalent mood of uncertainty created a strong appetite for liquidity, and yet the seizing-up of the interbank market hampered the supply in Swiss francs. In view of these two factors, the Swiss National Bank (SNB) had to resort to some exceptional measures.

From the start, the uncertainty engendered by the financial crisis led to a surge in demand for liquidity by both banks and the public in Switzerland. The distrust characterising interbank relations encouraged certain institutions to stockpile capital. This trend was reinforced by the fact that numerous banks were unable to make a reliable estimate of their own liquidity requirements, particularly in view of the soaring demand for cash on the part of the public. At the end of last year, the total value of banknotes in circulation had risen by 11% and banks had three times as much money on their SNB sight deposit accounts as at the end of 2007.

To satisfy this extraordinary demand, the SNB was obliged to expand its repo operations in terms of volume and maturity, and to inject liquidity into the market through a new channel – that of swap transactions.

Over the past few years, repos have become the standard tool with which we implement our monetary policy. They involve loans to banks denominated in Swiss francs and backed by securities. As a rule, these loans are granted for a term of one week. However, in response to the special needs of the market in 2008, we had to lengthen the term of our loans on several occasions, extending maturity to as much as twelve months. Unlike other central banks, however, we saw no need to expand the range of eligible securities, since we already apply a very liberal policy, accepting top-rated securities denominated not only in Swiss francs, but also in euros, pounds sterling, US dollars and other currencies. In 2008, the average amount of our repos rose by 53% against the year before.

Despite the intensification of our repo operations, tensions on the money market increased throughout the year owing to the ongoing deterioration of the economic and financial environment, and reached their peak in autumn. A particular source of difficulties was the extremely strong demand for Swiss francs coming from eastern European countries, where banks had granted Swiss-franc-denominated loans on a massive scale, refinancing themselves on the money markets. Since these banks have no access to our loans, they found themselves in a delicate position when the Swiss franc money market dried up. The increased demand for Swiss francs contributed to the rise in our interest rates, which we deemed undesirable from a monetary policy perspective.

To satisfy demand from eastern European banks, we sought the support of the European Central Bank (ECB), to which we remitted Swiss francs under a euros against francs swap arrangement. The ECB then transferred these francs to its counterparties. Similar agreements – euros against Swiss francs – were subsequently concluded with the Polish central bank and the Hungarian central bank, enabling them to conduct analogous transactions in their respective countries. Moreover, to ensure a better distribution of francs across the market, the SNB itself engaged in swaps with its counterparties. By the end of 2008, our supply of Swiss francs to three central banks and a certain number of

other banking institutions by means of swap transactions had reached a total of CHF 50 billion.

Thus, the demand for liquidity was considerable across the board. The total amount of our loans more than tripled, climbing from CHF 31 billion at the end of 2007 to CHF 101 billion at the end of 2008. In parallel, as a way of enabling banks to place their liquid means with the SNB in a form other than sight deposits, and of introducing a tool which would allow us to absorb large amounts of liquidity if need be, we issued SNB Bills for the first time on 20 October 2008. By the end of the year, the sum of SNB Bills issued had reached CHF 24.4 billion.

Active Swiss franc liquidity management enabled us to hold the three-month Swiss franc Libor at the level targeted by our monetary policy. I shall return to this point later.

Consolidating UBS

In autumn 2007, the National Bank realised that Switzerland's two big banks would be particularly badly affected by the financial market turbulence. At that point, we intensified our contacts with the Swiss Federal Banking Commission (SFBC) (now the Swiss Financial Market Supervisory Authority FINMA) in order to ensure ongoing monitoring of the situation at these two institutions. From spring 2008 on, in view of UBS's growing vulnerability, we drew up a number of solutions to protect it from the consequences of a large volume of illiquid assets on its balance sheet. In autumn, after the collapse of Lehman Brothers in the US led to liquidity drying up completely on the interbank market, UBS encountered increasing refinancing difficulties and was facing a substantial loss of funds. In the opinion of the SFBC, urgent action was needed to prevent a dramatic worsening of the situation, with potentially very serious consequences for the stability of the entire banking system and for the Swiss economy as a whole.

This was the environment in which we, in close collaboration with the SFBC and the Swiss government, prepared the operation that was announced on 16 October last year.

It is not necessary here to reiterate the details of a transaction that was copiously commented on by the media and is described in our Annual Report. When planning this operation, we were fully aware of the financial risks inherent in the asset portfolio we were taking over. Yet we were convinced that these risks were adequately compensated for

by the conditions under which UBS would participate in any losses and, above all, by the collective benefit derived from the stabilisation of Switzerland's biggest bank. Our decision was thus based solely on considerations regarding the stability of the financial system.

Only in a few years will it be possible to pass definitive judgment on our actions. If, upon completion, the operation proves successful, we might come to wonder whether the support measures were actually necessary. If, by contrast, losses are registered, our conclusion will be that the SNB's operation helped prevent the worst. In any case, whatever the financial outcome, it must be borne in mind that the only motive behind our intervention was to keep the uncertainty with regard to the value of UBS's illiquid assets from destabilising the bank and thereby our financial system and economy.

When public funds are employed to restore financial stability, the rules governing the functioning of markets need to be adapted to ensure that such a situation can never arise again. We therefore strongly supported the SFBC's stance in favour of a gradual strengthening of the big banks' capital levels, of capping their leverage ratios and reforming their compensation systems. In addition, the SNB is currently working together with FINMA to impose more stringent liquidity requirements. As I already pointed out last year, a small country like ours is entitled to define specific conditions under which the systemic risks involved with having two large international banks domiciled on its territory must be limited. The Federal Council and the SFBC clearly recognised this situation and took appropriate preventive measures. For the future, it would also be advisable to examine the expediency of putting into place a legal framework and organisational measures that permit an orderly liquidation of systemically important banks.

The crisis spreads to the real economy

Ultimately, it was inevitable that the financial market crisis would spread to the real economy. And yet the year 2008 began well. Our country was in the midst of solid economic growth and was experiencing a strong inflow of foreign workers. In the first three quarters, year-on-year growth amounted to 2.4%, buttressed by all components of global demand except construction.

At the end of summer, however, the situation turned completely. The faltering international credit markets and the mounting uncertainty caused global trade to plummet and prompted a decline in growth in our export markets; indeed, most of our trading partners actually went into recession. In the fourth quarter of 2008, Switzerland's GDP receded to 1.2% and unemployment, which had reached a low-water mark of 2.5%, started to climb again. In our quarterly assessment of last December, we predicted a 0.5–1% drop in GDP for 2009. In March this year, based on the latest data available, we revised the forecast downwards to a 2.5–3% decline.

The SNB's reaction

In autumn 2008, as I said, we experienced an abrupt downturn of the economic cycle and, owing to plunging commodity prices, a spectacular change in the inflation outlook. Whereas inflation had been at 3.1% in July, price stability was entirely re-established from November onwards.

This reversal forced the SNB to take rapid and decisive measures to ease its monetary policy. In a series of five steps between October 2008 and March 2009, we lowered the target range for the three-month Swiss franc Libor and brought down the market rate from 3% to 0.25%. Thus, by markedly loosening the monetary reins, we aimed to trigger an easing of lending conditions and discourage investment in Swiss francs. The volume of lending in Switzerland continued to rise, albeit at a reduced pace, but credit lines granted to Swiss borrowers were now less used. To date, the state of the bank loan market reflects a drop in demand and a slight tightening of lending conditions in connection with the decline of the economy, rather than an actual credit crunch. On the other hand, we have noted a substantial deterioration in financing conditions for companies on the capital market due to the prevalent mood of uncertainty and the shortage of liquidity. This is why we decided, on 12 March, to intervene in those market segments where the imbalances were most pronounced.

In this delicate phase of worsening credit market conditions, our monetary policy strategy proved to be particularly well chosen. Unlike most other central banks, the SNB has made it its objective to stabilise a market interest rate – the three-month Swiss franc Libor, which serves as a reference for numerous commercial rates – rather than a rate reflecting

central banks' short-term refinancing conditions for commercial banks. By keeping the Libor well under control, we have managed to shelter the Swiss market from the kind of degradation of credit conditions experienced by markets abroad. Thus, the three-month euro Libor, which had generally been 1.5% higher than the three-month Swiss franc Libor, saw its spread widen to 2.2% in 2007 and 2.7% in 2008. Our policy of stabilising the three-month Swiss franc Libor therefore enabled us to at least partly shield the Swiss economy from the repercussions of the international financial crisis.

Unfortunately, the effect of relaxing monetary conditions since last autumn in order to lower the Libor was largely offset by the continuing appreciation of the Swiss franc against the euro. Between October 2008 and March 2009, our currency rose by nearly 10% vis-à-vis the euro, which was particularly inopportune in a phase of rapidly declining inflation rates and the contraction of global demand. On 12 March, to prevent the ongoing appreciation of the franc from neutralising the impact of our policy of lowering interest rates, we decided to buy foreign currencies on the foreign exchange market in conjunction with a further reduction of the Libor, with the aim of avoiding any further appreciation of the Swiss franc against the euro and injecting additional liquidity into the economy. In view of the risk of deflation, decisive action was called for, and we will continue to pursue this strategy for as long as the risk remains.

Therefore, after 15 years of absence, we were obliged to intervene once more in the foreign exchange market. This does not, however, represent any reversal of our traditional strategy, which is to pursue an independent monetary policy aimed at maintaining price stability. It is simply a case of adapting the implementation of this strategy to an environment characterised by interest rates close to zero and a Swiss franc once again in the role of a safe haven. Contrary to certain reactions aired in the media, the action to counter the rise of the Swiss franc against the euro is not a form of competitive devaluation, which would inevitably work against the interests of our country in the long run. Rather, it is a key operational tool which, under the given circumstances, helps us perform our mandate with regard to price stability, in other words to preserve our economy from both inflation and deflation.

The outlook for 2009

The year 2009 will see the steepest decline in Switzerland's GDP since 1975. Exports, normally the driving force of our economy, will continue to be weak, and the lack of confidence in the corporate sector will weigh on investment demand. Moreover, all signs point to a further slackening of consumption in view of growing uncertainty about households' purchasing power. All in all, the outlook for the near future is anything but bright.

Switzerland does not constitute a special case – all industrialised countries are faced with a similar downturn, especially those with high exposure to foreign trade.

All the same, we are confident that we are well equipped to deal with the situation, for several reasons:

- our country has a competitive export sector in terms of both price and technology;
- our companies have posted good results over the past few years and are generally in a healthy financial state;
- unlike other countries, Switzerland did not experience a housing market bubble in recent years;
- our economic structure, built on small and medium-sized enterprises, gives us an edge in terms of flexibility;
- our public finances have been put in order and the country's balance of payments is in a good condition.

All these factors lead us to believe that our economy can rebound once the international economic slide has been halted. The International Monetary Fund is forecasting an upturn in Europe from 2010 onwards in the wake of a recovery expected to begin in the US. In Switzerland, initial signs of stabilisation are appearing here and there, and the decline in GDP should gradually become less steep in the near future. But a true reversal of trend is unlikely to occur before next year and recovery will be a slow process, since the current difficulties are more than just cyclical. They are partly the result of a profound crisis of confidence in the soundness of the financial sector and the future growth potential of the global economy.

Faced with collapsing demand, all countries have adopted expansionist monetary and fiscal policies. Interest rates have been slashed and a number of relief packages involving considerable sums launched, exacerbating the public debt burden. Such strategies are appropriate in times of emergency. Nevertheless, we should always bear in mind that the difficulties confronting us today are in all likelihood the consequence of excessive borrowing and of monetary policies that were too accommodating – two factors that helped derail the international economy. Strange as it may seem, the stimuli used in the battle against recession today are the very ones that were abused in the past.

Moreover, once the economy is back on track, the prime political and economic challenge will be to put in place the corrective measures needed to ensure a more balanced course in future. The subsequent path of growth may not be as steep as it was in the past, but for that it will be all the more sustainable. For our part, we are aware that maintaining price stability in our country over the medium term will require us to re-establish healthy monetary conditions by absorbing excess liquidity in good time. We have both the means and the will to do so.

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The global economy has entered a painful phase of putting its house in order; a phase marked by weak growth and high unemployment. Profoundly embedded as it is in international trade, the Swiss economy cannot escape these difficulties. The SNB reacted swiftly to the deteriorating economic situation, and many people hoped that the monetary policy adopted could shield our country from the turmoil experienced elsewhere. However, it was not in our power to meet these expectations. We did all we could within the framework of our legal mandate. 2009 will be a difficult year for our economy, and the signs are that 2010 will be so too because, even if the downward trend is halted, the under-utilisation of our production resources will still be considerable.

Dear Shareholders

Dear Guests

In such a challenging environment, we shall once again need the support of everyone, in particular our shareholders. We thank you for the unfailing trust you placed in us throughout the year and the interest you have shown in the SNB's activities.