

Macroprudential Policy Making in Practice: The Swiss Experience

Jean-Pierre Danthine

PSE and CEPR

LSE - March 6, 2017

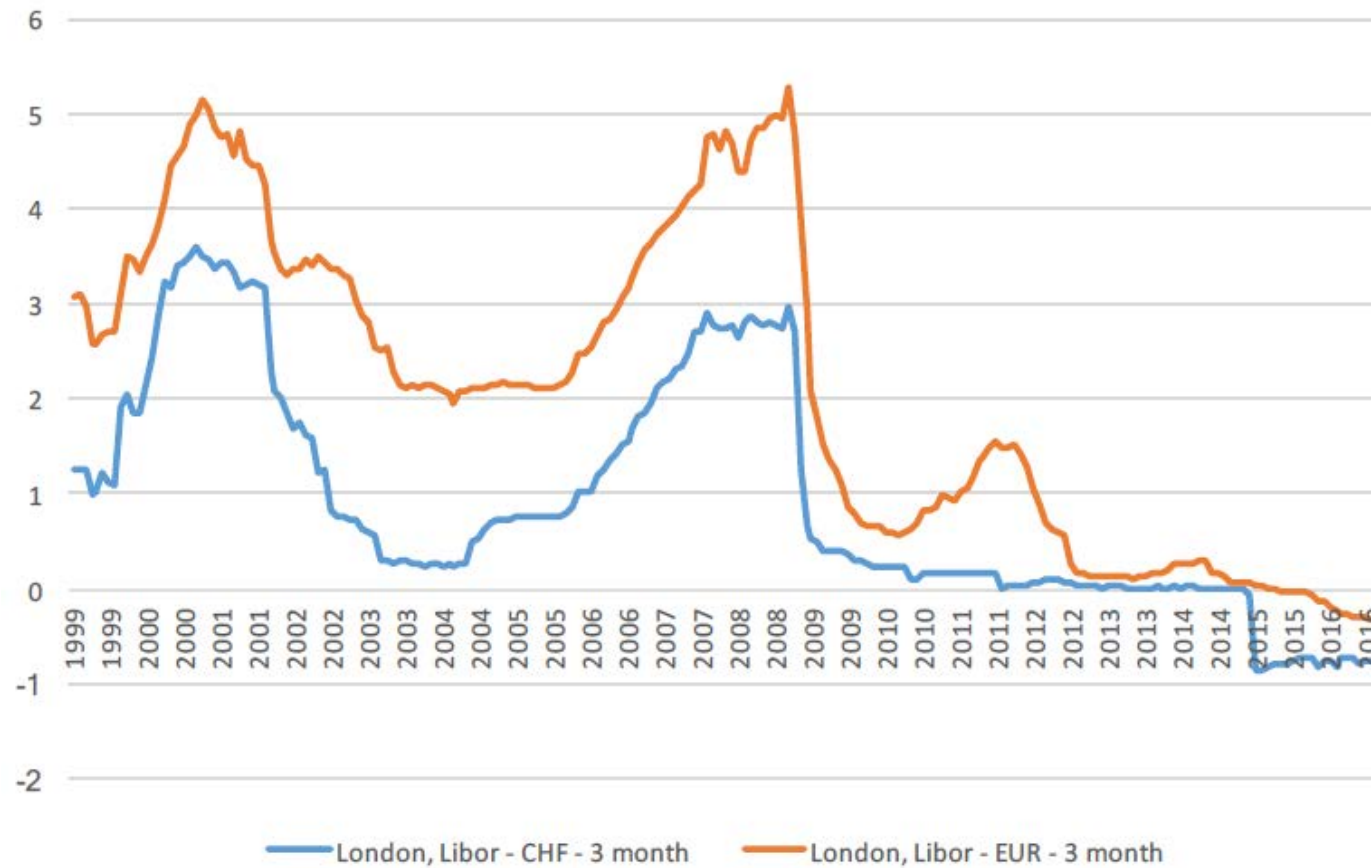
Switzerland

- SOE with a safe haven currency: the key element of context is not within our control
- Financial stability risks are exclusively home-made
 - External capital flows present an ER and MP challenge - little interaction with financial stability issues
- Two financial stability issues
 - A bubbly real estate market
 - Two SIBs, very large relative to the economy

Roadmap

- Elements of context: the safe haven challenge
- The housing market situation and its perception: a bubble? Or 'Here and now', it is different?
- The institutional set-up and the 2012-15 policy response
- A dynamics under control?
- The design of the CCB
- Issue #2: UBS & CS

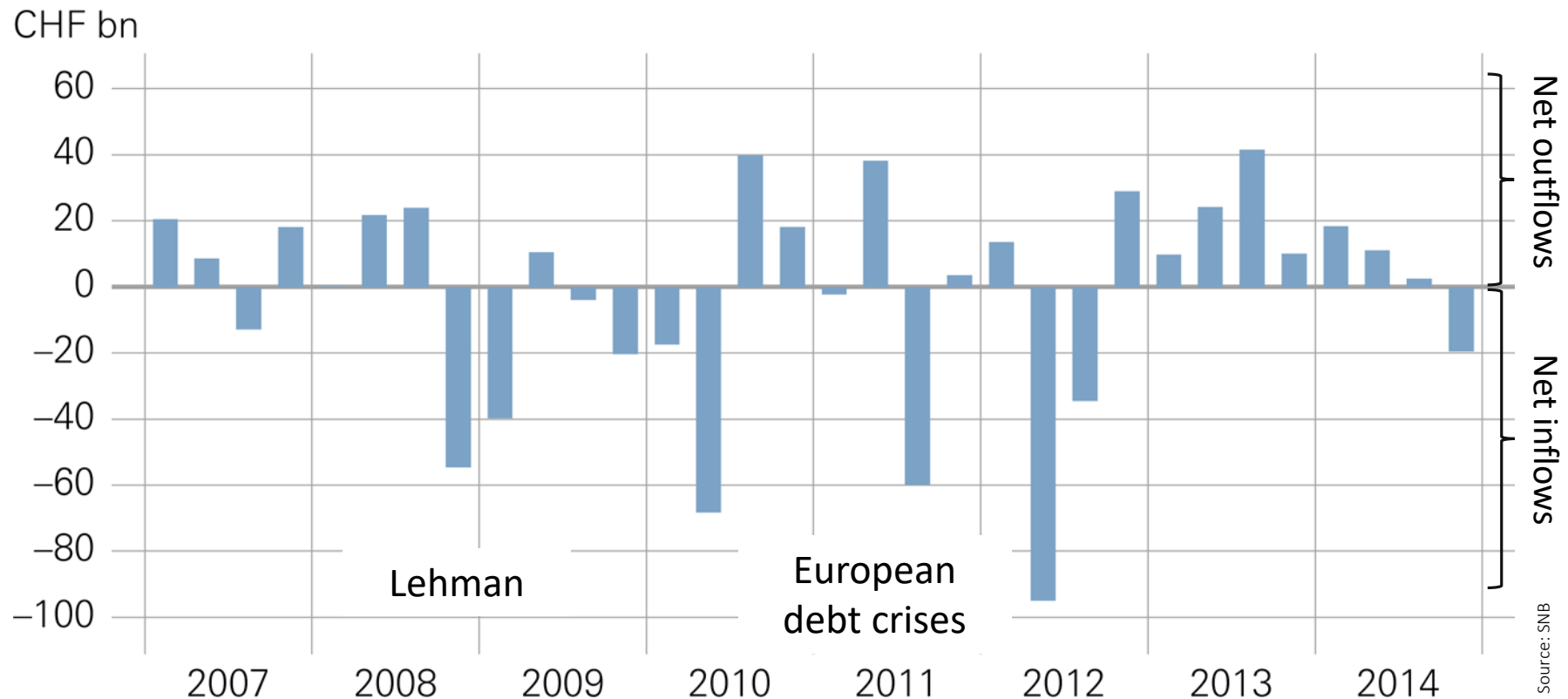
The corollary of a safe haven currency



Financial crisis: safe haven induced net inflows of private capital

SWITZERLAND: PRIVATE CAPITAL FLOWS, NET

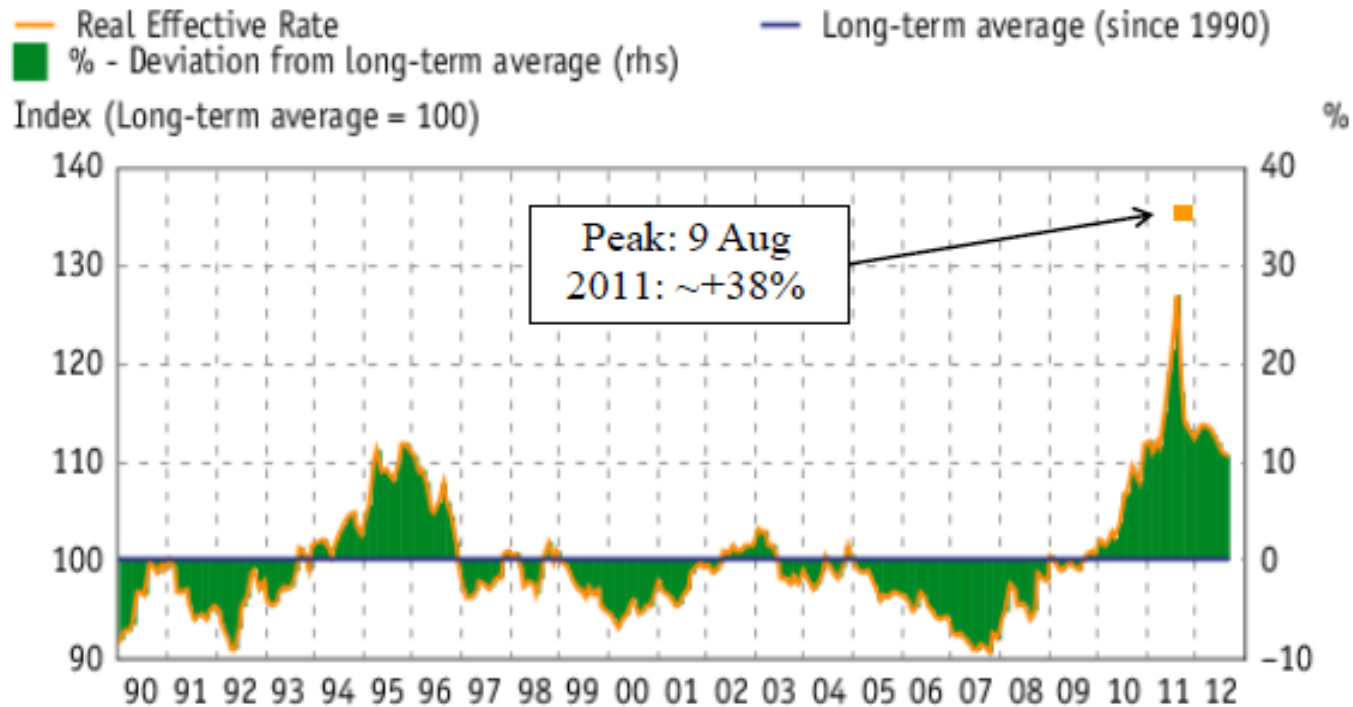
Swiss financial account (excluding reserves and derivatives)



Leaning against the wind? An impossible dream

CHF effective exchange rate

Trade weighted 27 CTY, real



Sources: SNB Markets Analysis Platform, BIS

19.09.2012 11:14:30

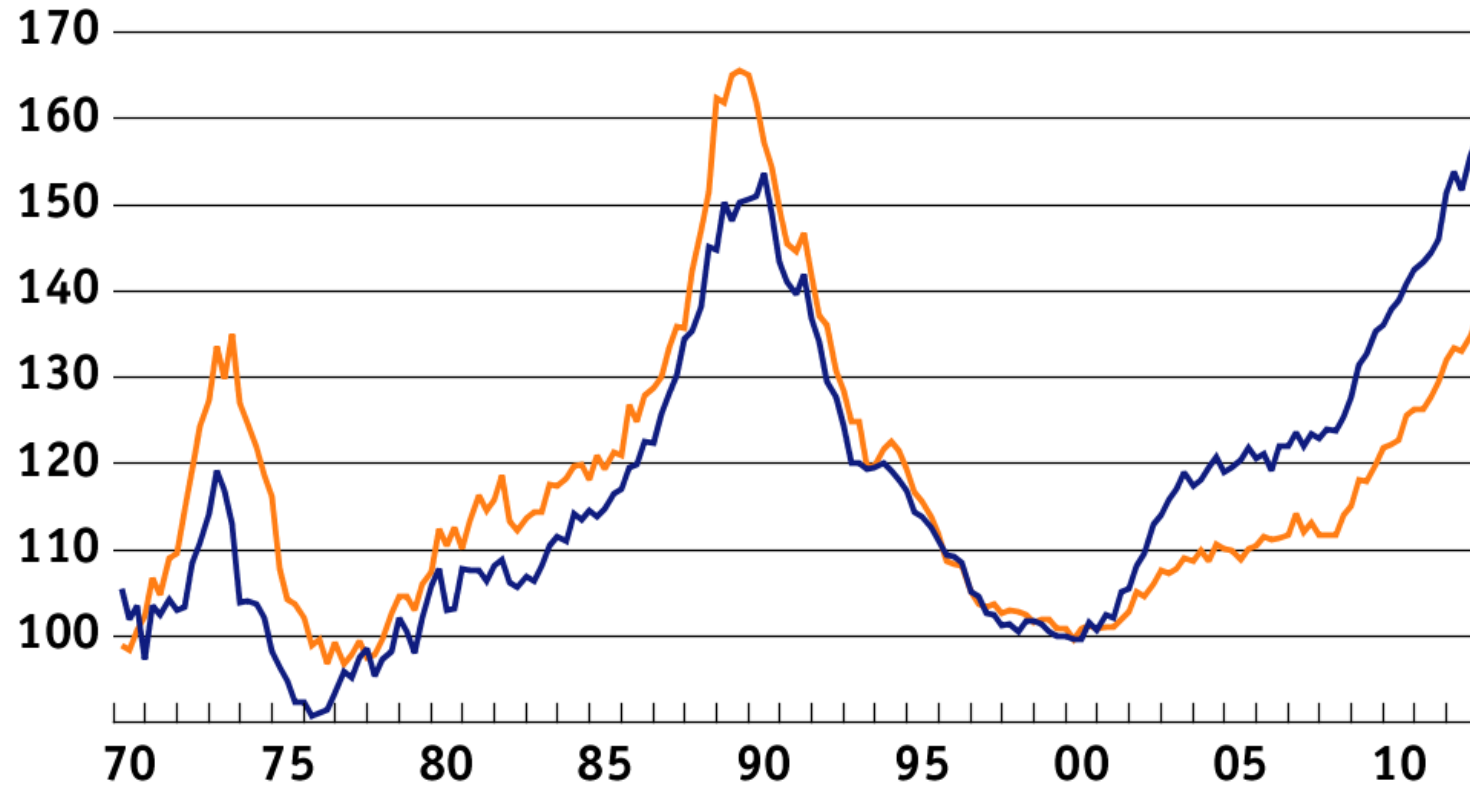
Roadmap

- Elements of context: the safe haven challenge
- The housing market situation and its perception: a bubble? Or 'This time (in CH) is different?'
- The institutional set-up and the 2012-15 policy response
- A dynamics under control?
- The design of the CCB
- Issue #2: UBS & CS

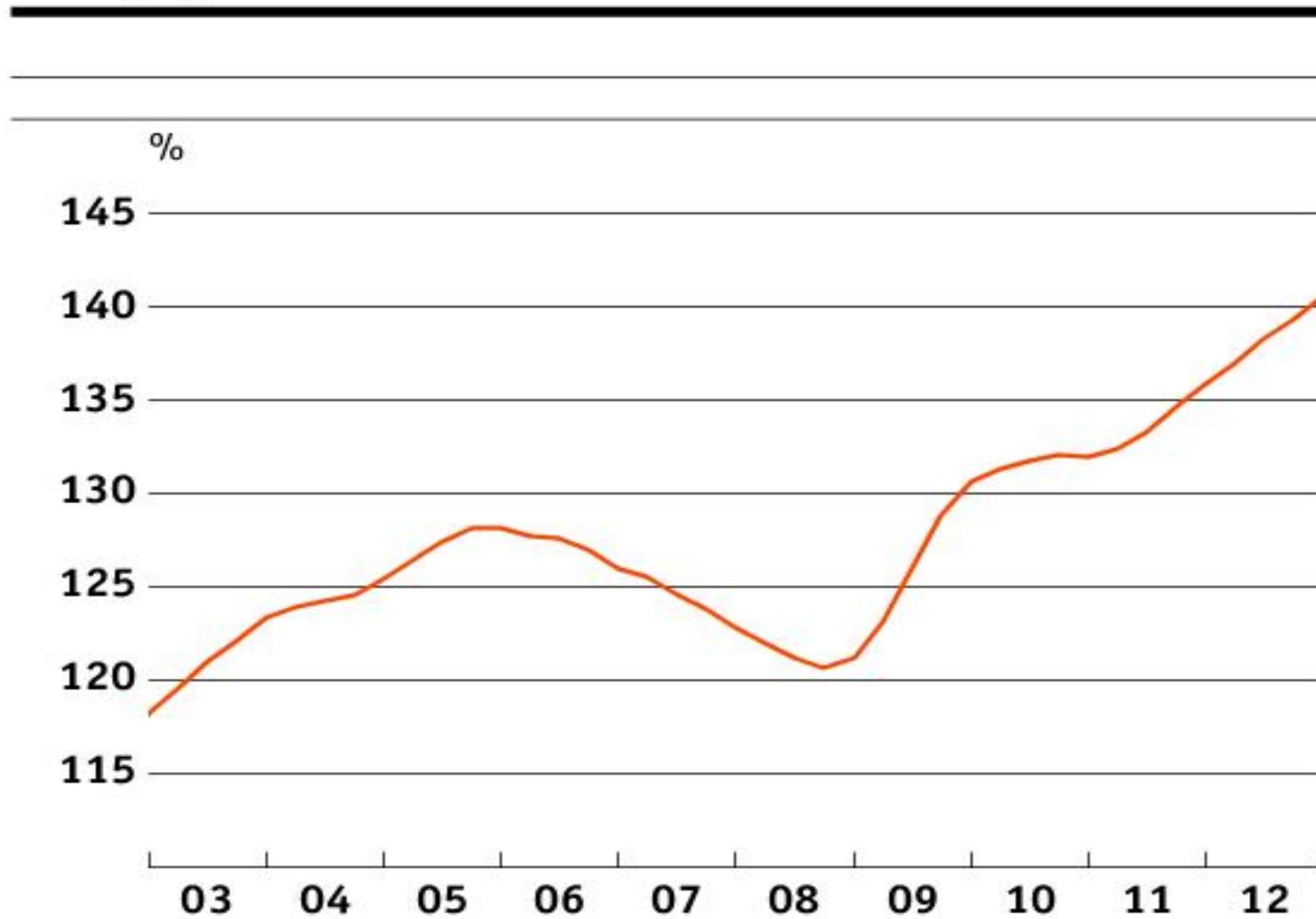
Swiss real estate price indices

Asking prices (Q1/2000 = 100)

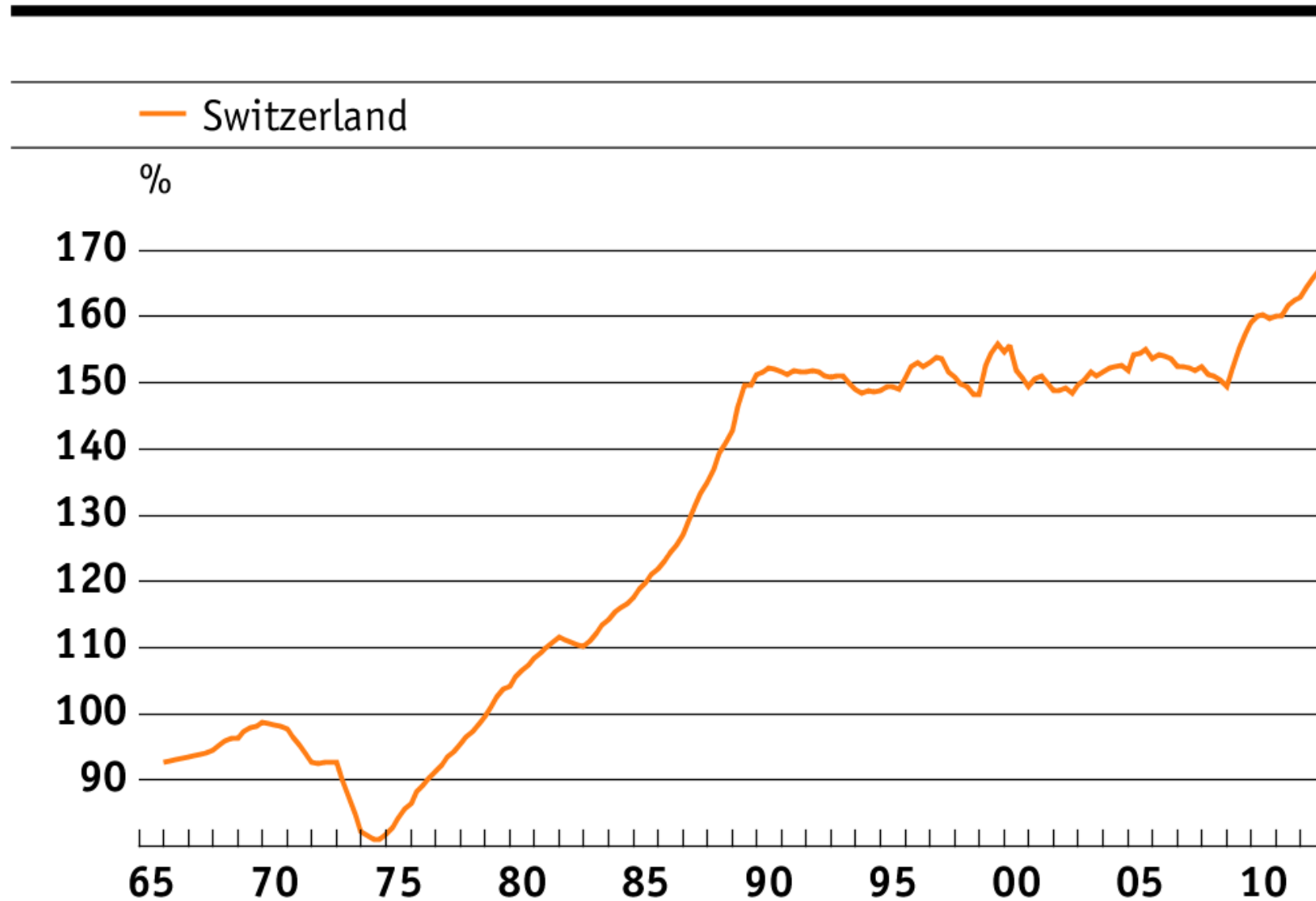
— single-family houses — Owner-occupied apartments



Mortgages-to-GDP



Domestic credit-to-GDP

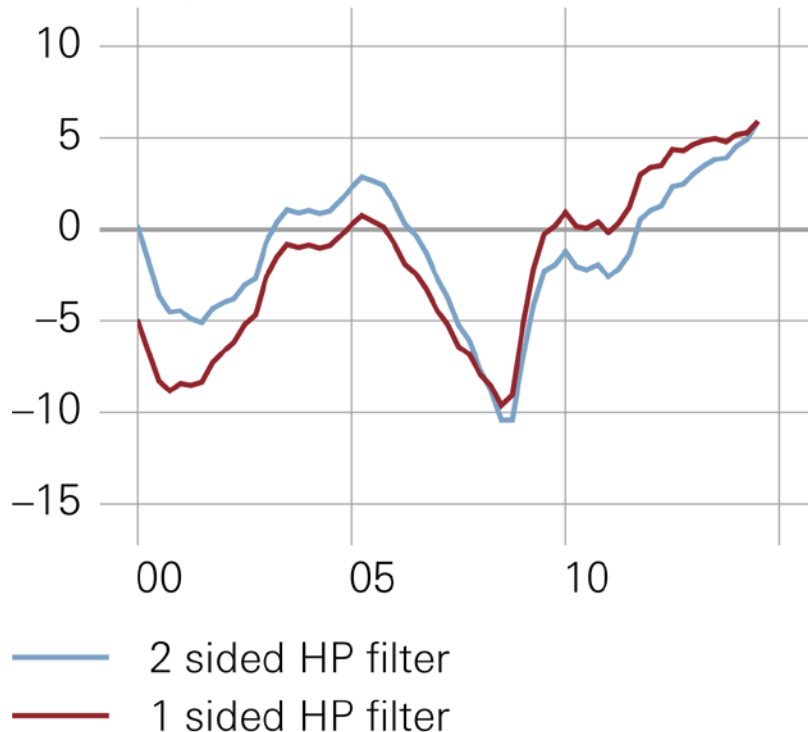


Assessment: Significant imbalances according to standard indicators

MORTGAGES-TO-GDP: GAP

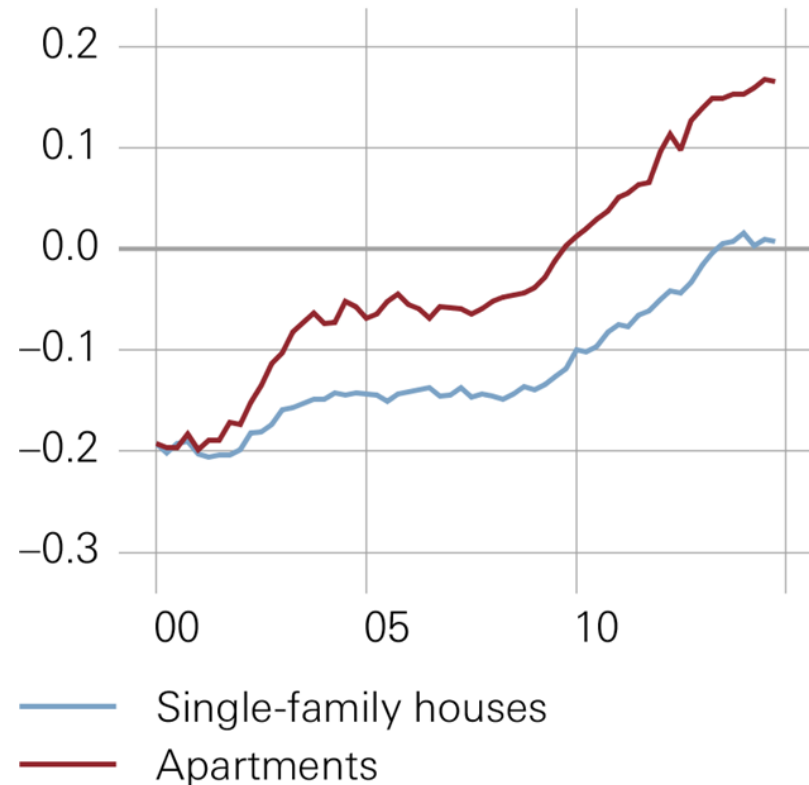
BIS reference indicator

percentage points



PRICE-TO-RENT: ASKING PRICES

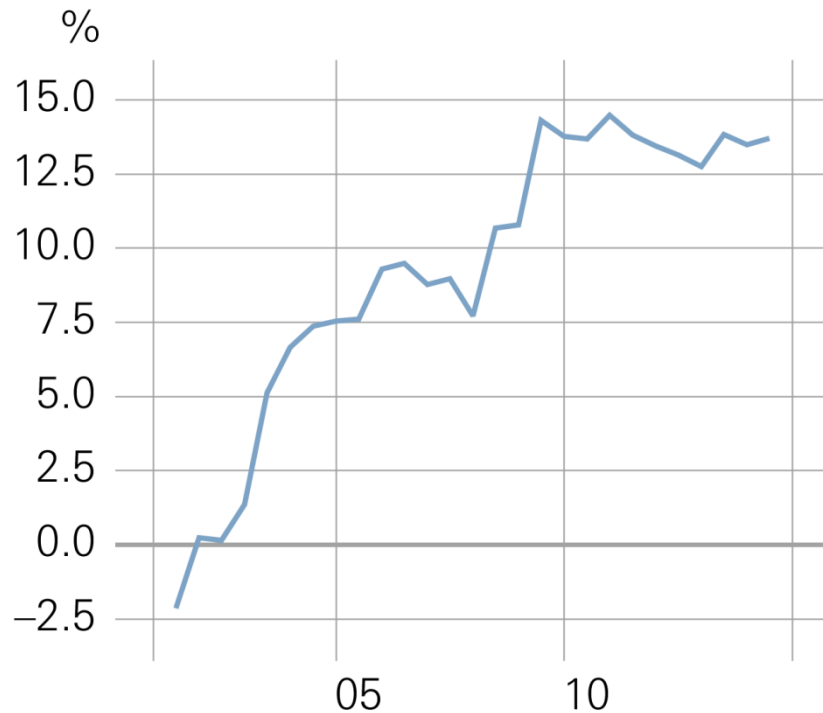
Deviation from long term average



...and high risk appetite by lenders

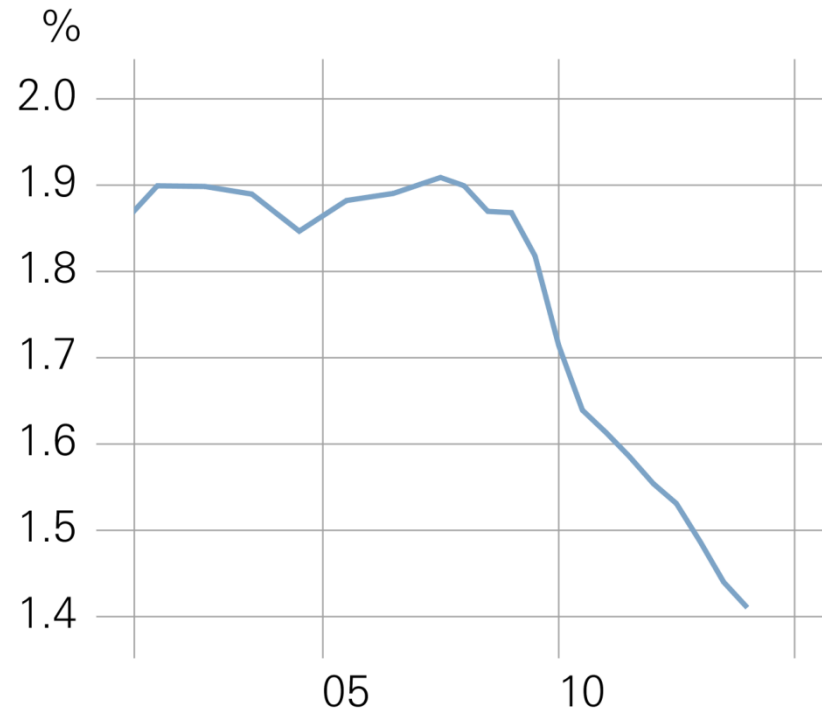
INTEREST RATE RISK

NPV losses relative to capital for +200bp, domestically oriented banks



INTEREST RATE MARGIN

Weighted average, semi-annual data, domestically oriented banks

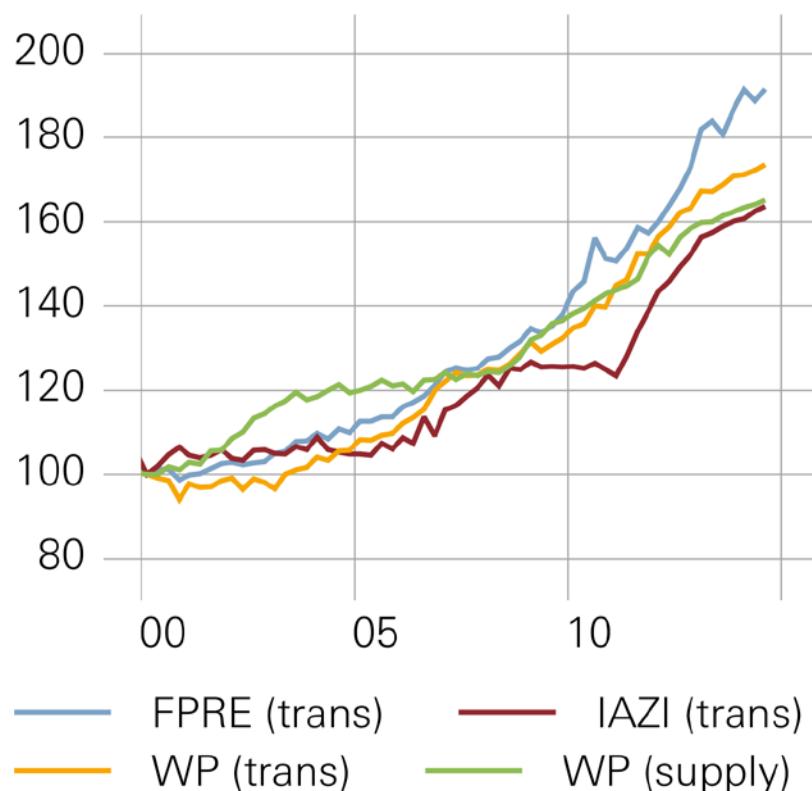


Sources: SNB, Finma

But is it a bubble?

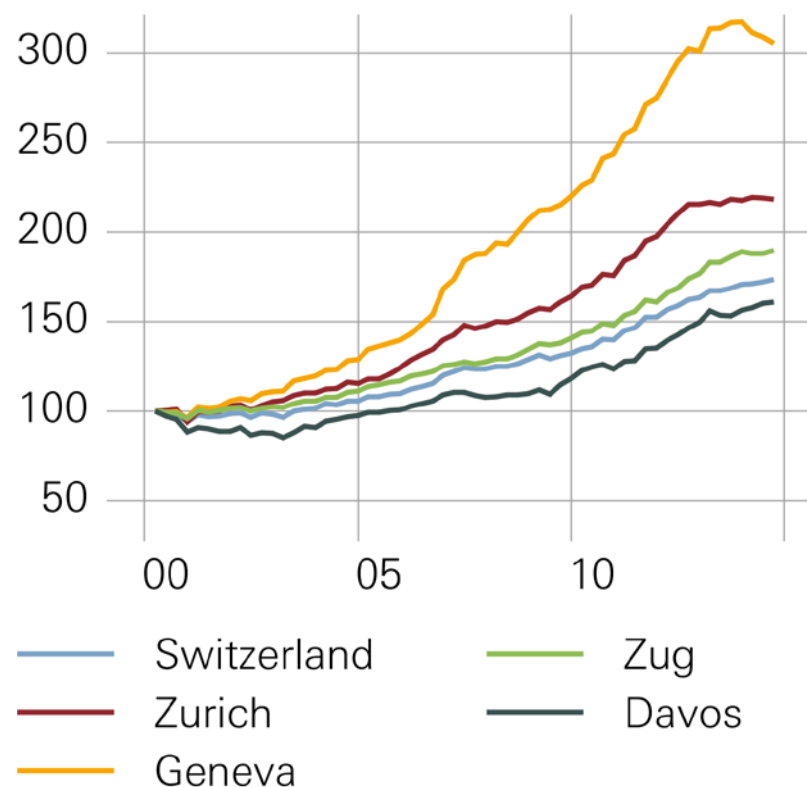
APARTMENT PRICE INDICES

In real terms, Q1/2000 = 100



REGIONAL HOTSPOTS

Apartments: real transaction prices

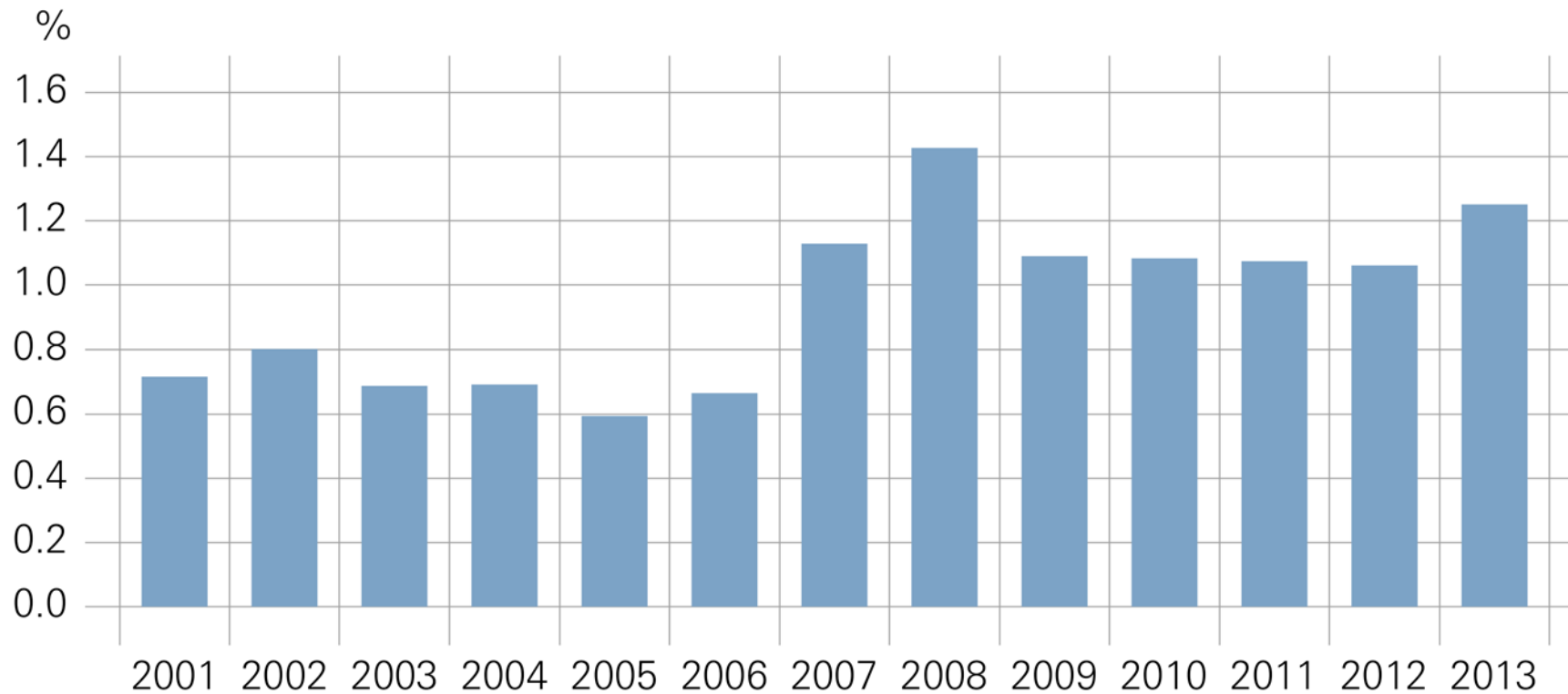


Sources: FSO, Fahrländer Partner, IAZI, Wüest & Partner

...strong housing demand...

POPULATION GROWTH

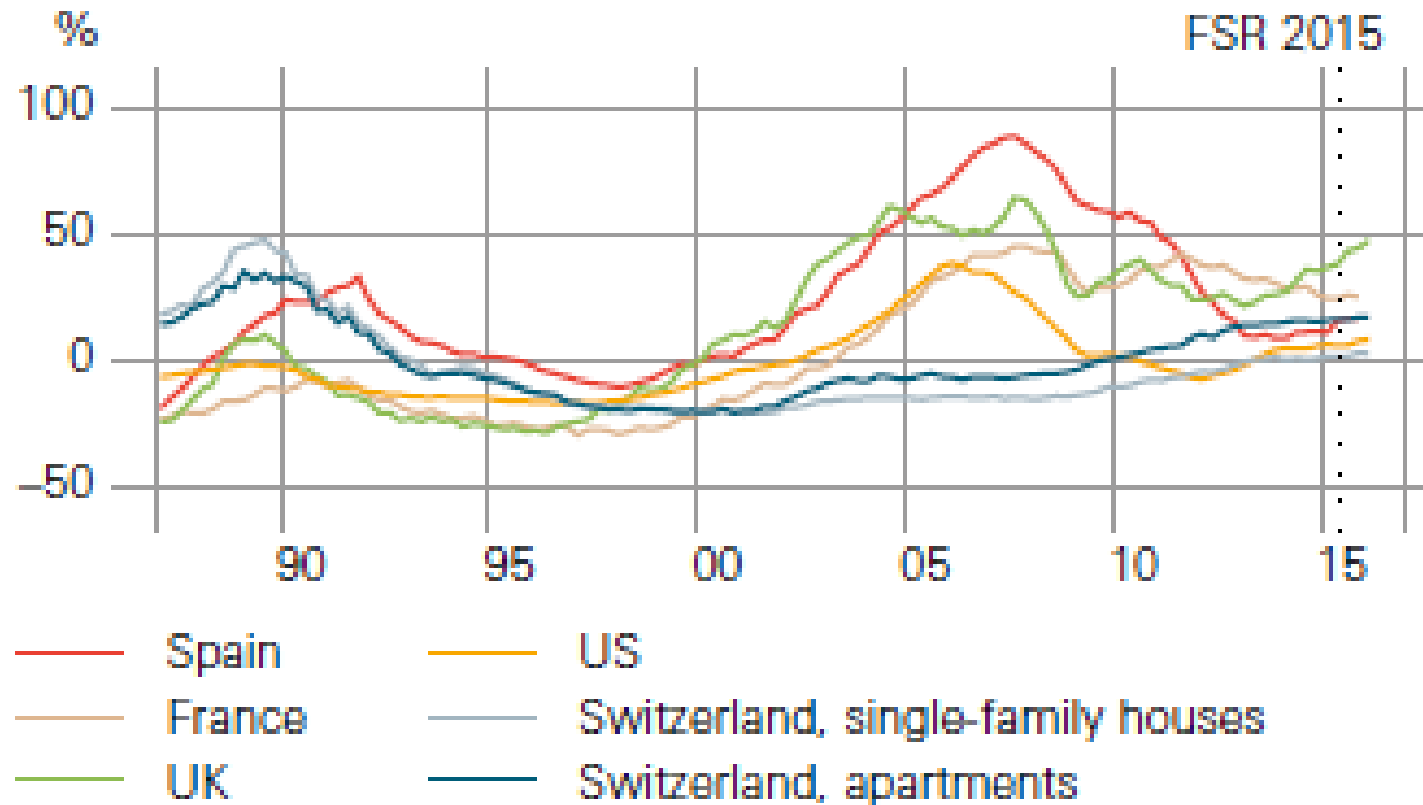
annual change



Source: FSO

PRICE-TO-RENT RATIO: DEVIATION FROM LONG-TERM AVERAGE

Chart 9



* The average is calculated over the period from 1970 to 2015, or over the period for which data are available. For Switzerland, asking prices are used.

Sources: BIS, OECD, SFSO, Thomson Reuters Datastream, Wüest & Partner

Roadmap

- Elements of context: the safe haven challenge
- The housing market situation and its perception: a bubble? Or 'Here and now', it is different?
- **The institutional set-up and the 2012-15 policy response**
- A dynamics under control?
- The design of the CCB
- Issue #2: UBS & CS

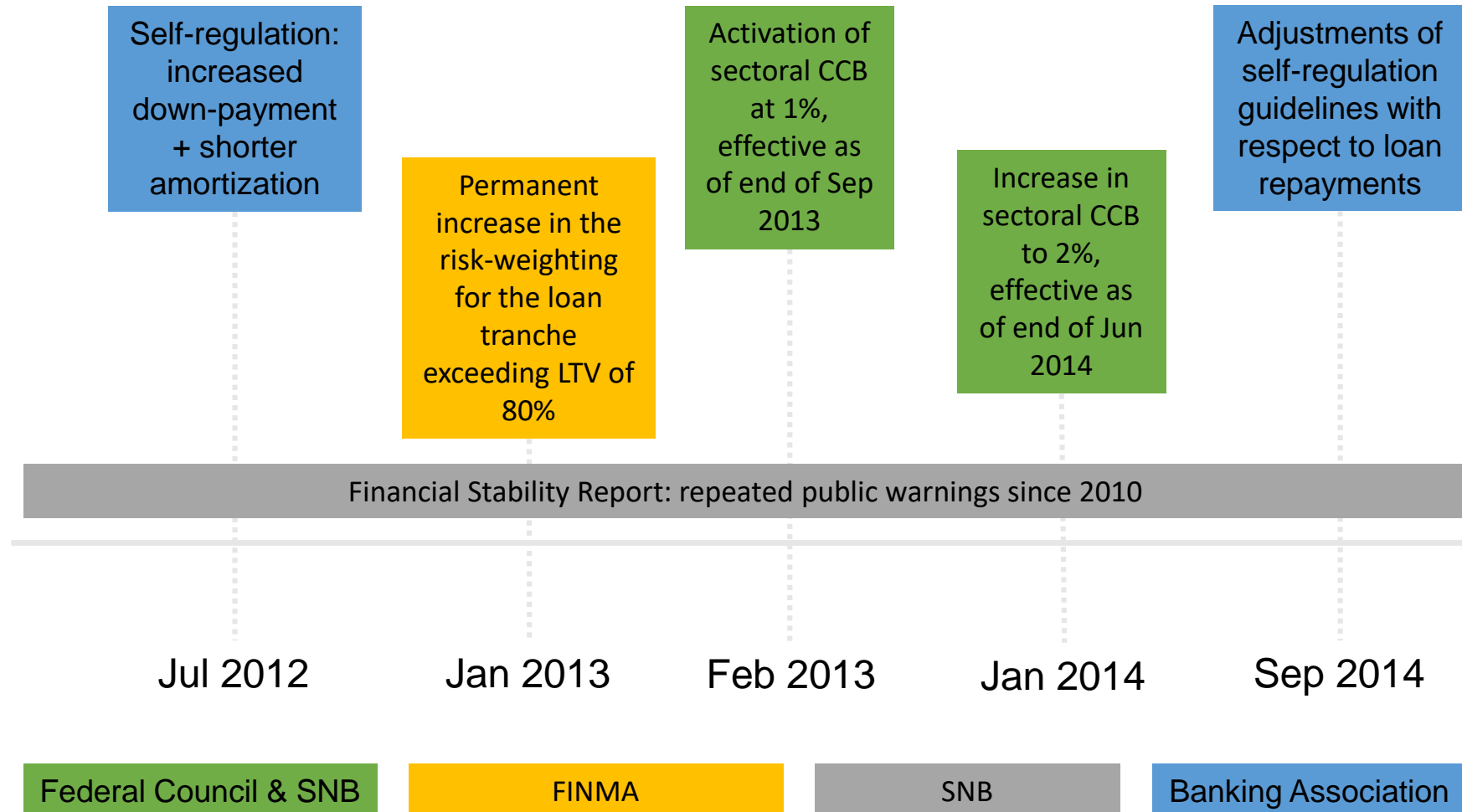
Institutional set-up

- No single macroprudential authority or Financial Stability Board
 - Division of responsibilities
 - Central bank (SNB) the only institution with an explicit financial stability mandate (“contribute”)
- SNB’s instruments
 - Communication/moral suasion
 - Crisis management – liquidity support
 - Regulatory framework: input/expertise, but no formal mandate
 - NEW: CCB: formal responsibility, but no decision taking power

Division of responsibilities – the CCB

- SNB *proposes* activation, modification and deactivation of the CCB
- Federal Council *decides* upon SNB proposition after *consultation* of the financial market supervisory authority
- Procedure
 - The SNB conducts a quarterly assessment of the developments in the mortgage and real estate markets
 - If the SNB determines that it is necessary to activate or adjust the level of the buffer, the SNB submits an official proposal to the Federal Council
 - FINMA supervises the implementation of the CCB at individual bank level

A pragmatic multipronged approach



Roadmap

- Elements of context: the safe haven challenge
- The housing market situation and its perception: a bubble? Or 'Here and now', it is different?
- The institutional set-up and the 2012-15 policy response
- **A dynamics under control?**
- The design of the CCB
- Issue #2: UBS & CS

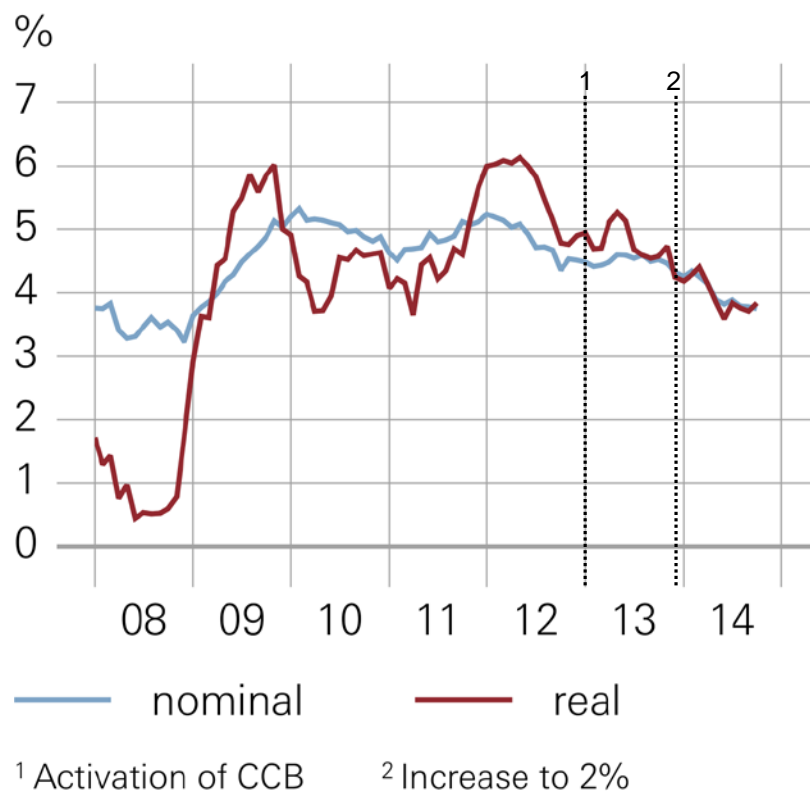
Effectiveness – the evidence (I)

- Activation and increase of CCB: Banks responded by increasing capital, making them more resilient
- Difficult to assess whether mortgage lending is directly affected
 - No counterfactual
 - Impact of individual measures cannot be assessed
 - CCB: may impact lending – depends on size/design
 - Self-regulation: down-payment rule likely to impact demand for housing

Effectiveness – the evidence (II)

MORTGAGE GROWTH

Annual growth rate, monthly data



REAL ESTATE PRICE GROWTH

asking price indices, real annual rates

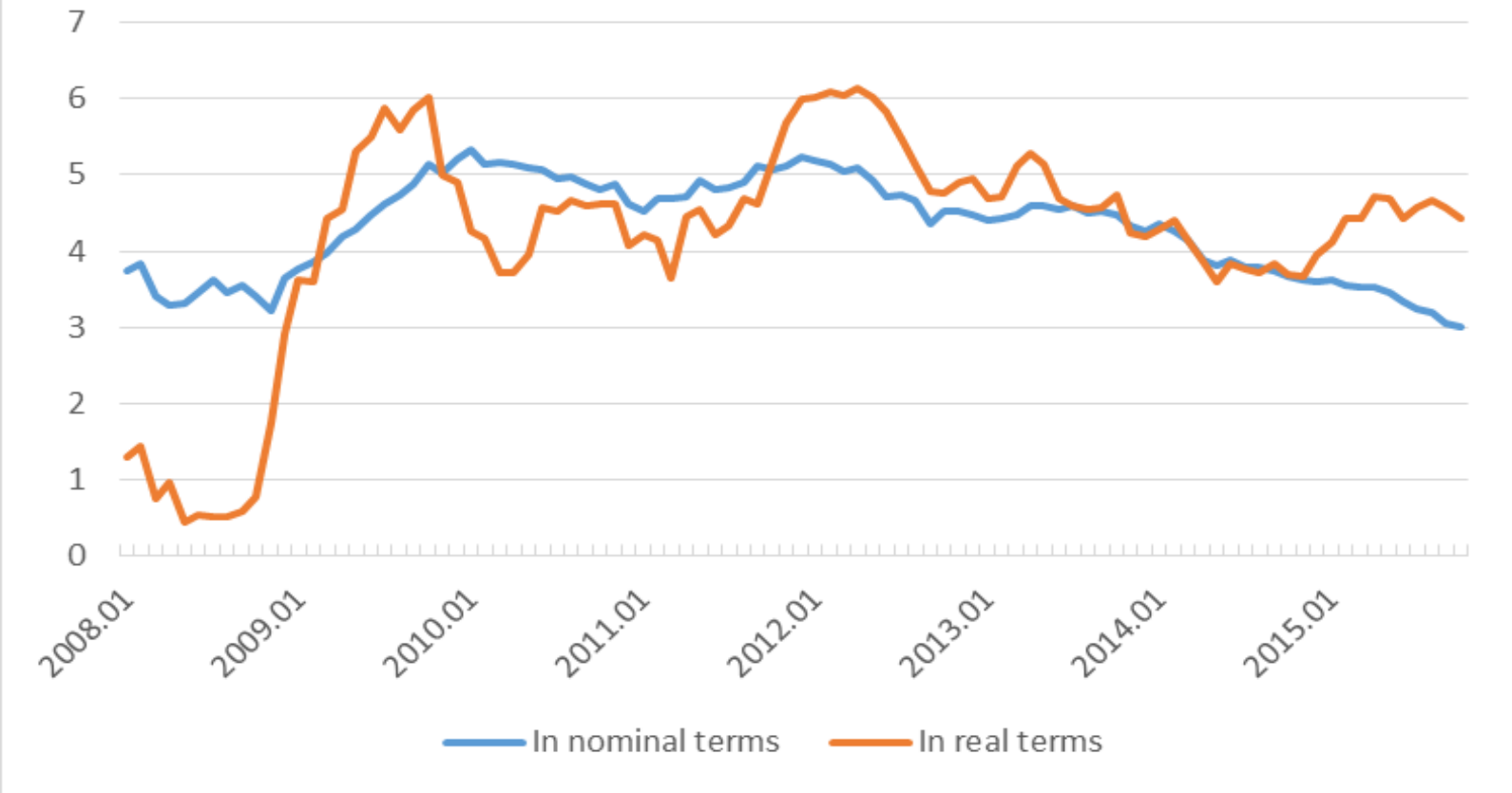


Sources: SNB, Wüest & Partner

Mortgage credit volumes

Annual growth rates, monthly data

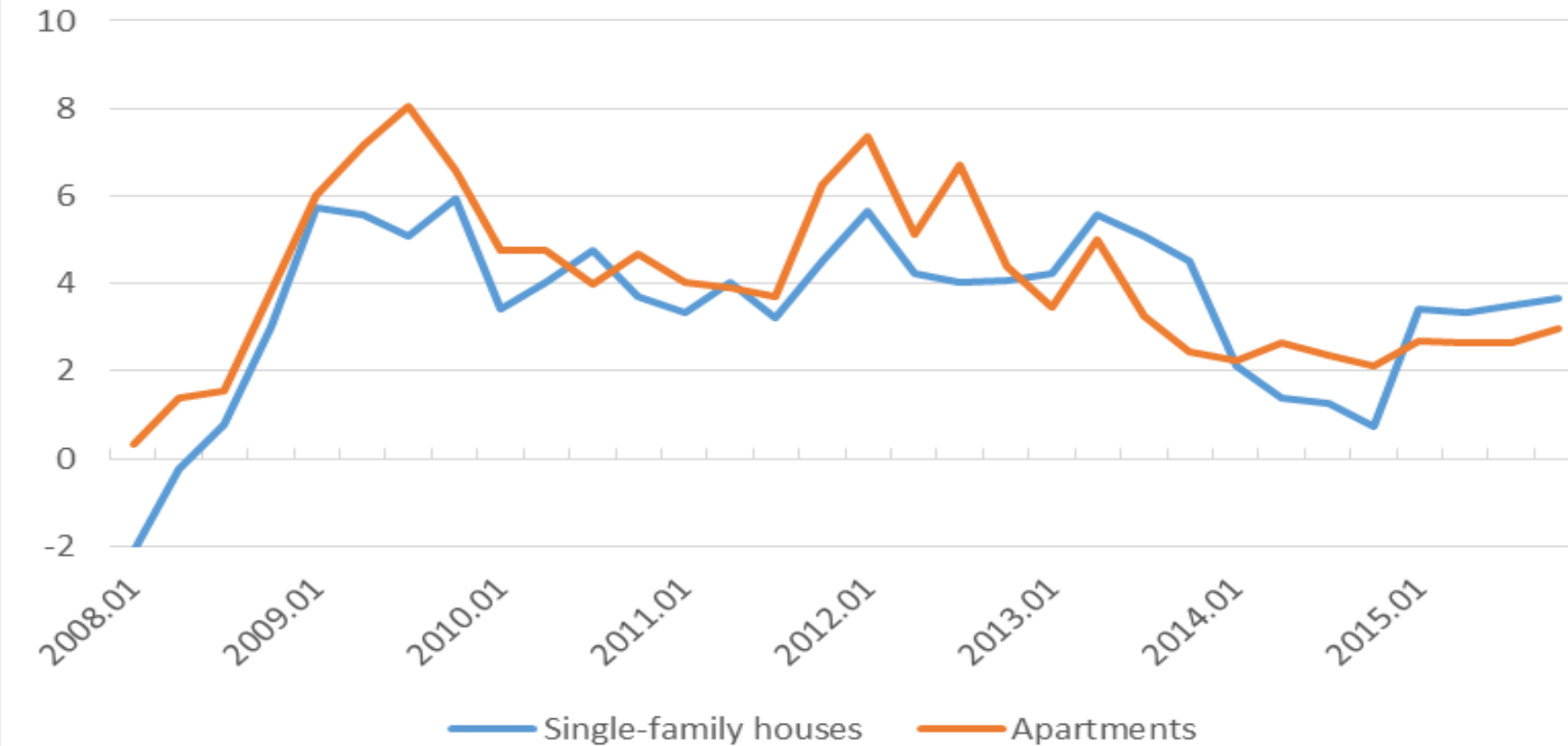
Source: SNB



Real estate price growth

Asking price indices, in real terms: Annual growth rates, quarterly data

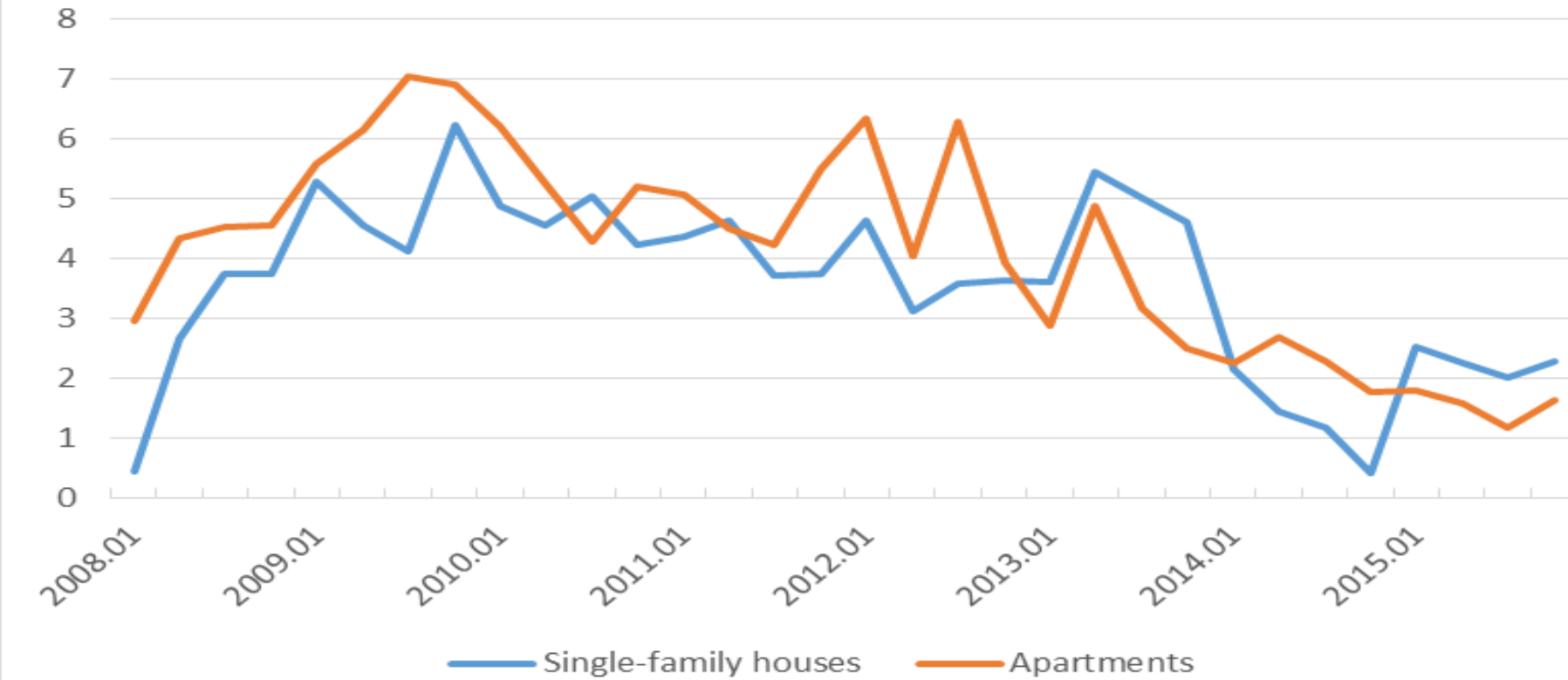
Sources: Wüest&Partner, SNB



Real estate price growth

Asking price indices, in nominal terms: Annual growth rates, quarterly data

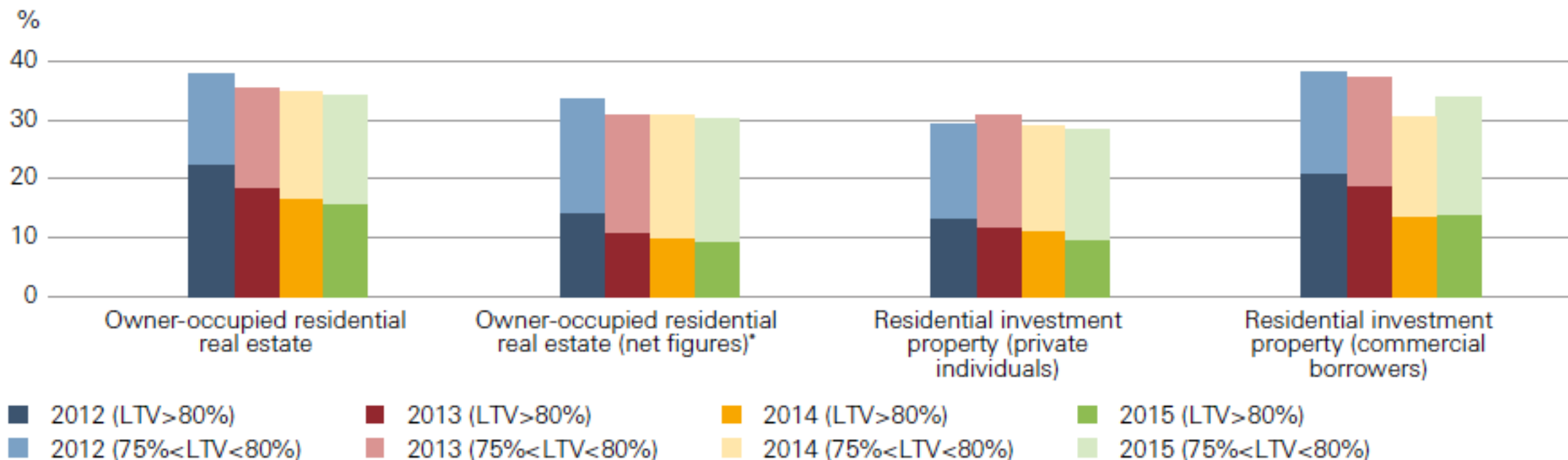
Sources: Wüest&Partner, SNB



LOAN-TO-VALUE: NEW MORTGAGES

Proportion of new loans with LTV over 80% and between 75% and 80%

Chart 14



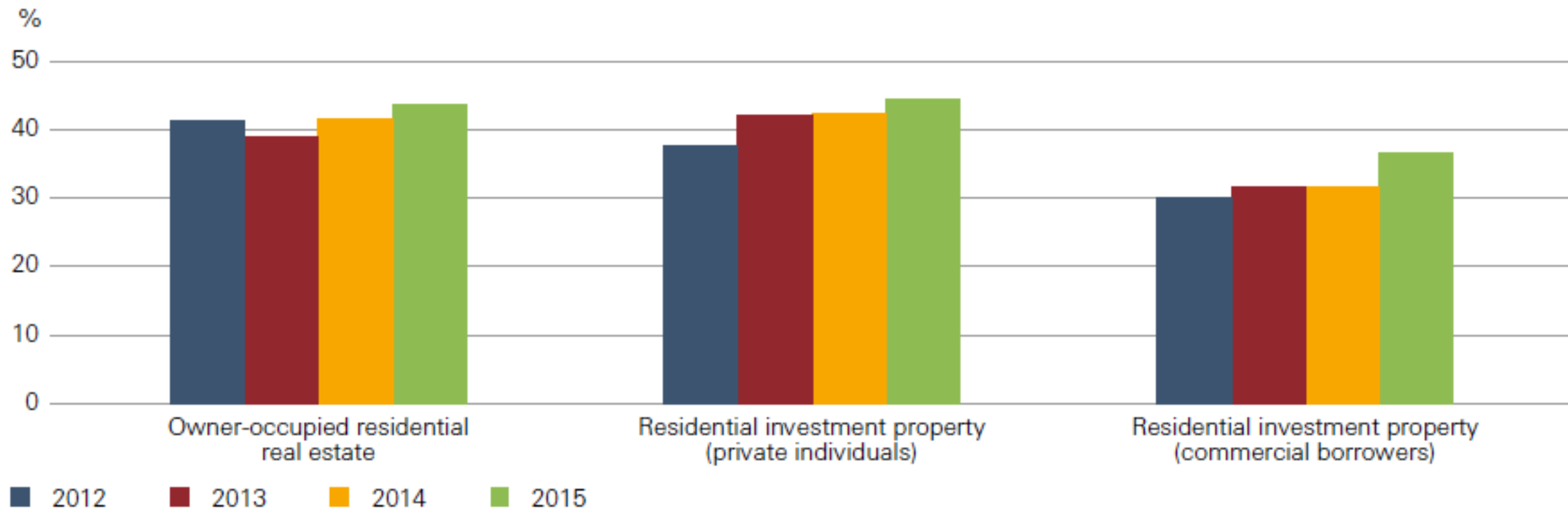
* When calculating net figures, pledges from pillar 2 and 3a pension funds used as part of the scheme to encourage home ownership are counted as additional collateral in the LTV calculation.

Source: SNB

LOAN-TO-INCOME: NEW MORTGAGES

Proportion where imputed costs exceed one-third of income (owner-occ.) or rents (inv. prop.) at an interest rate of 5%

Chart 15

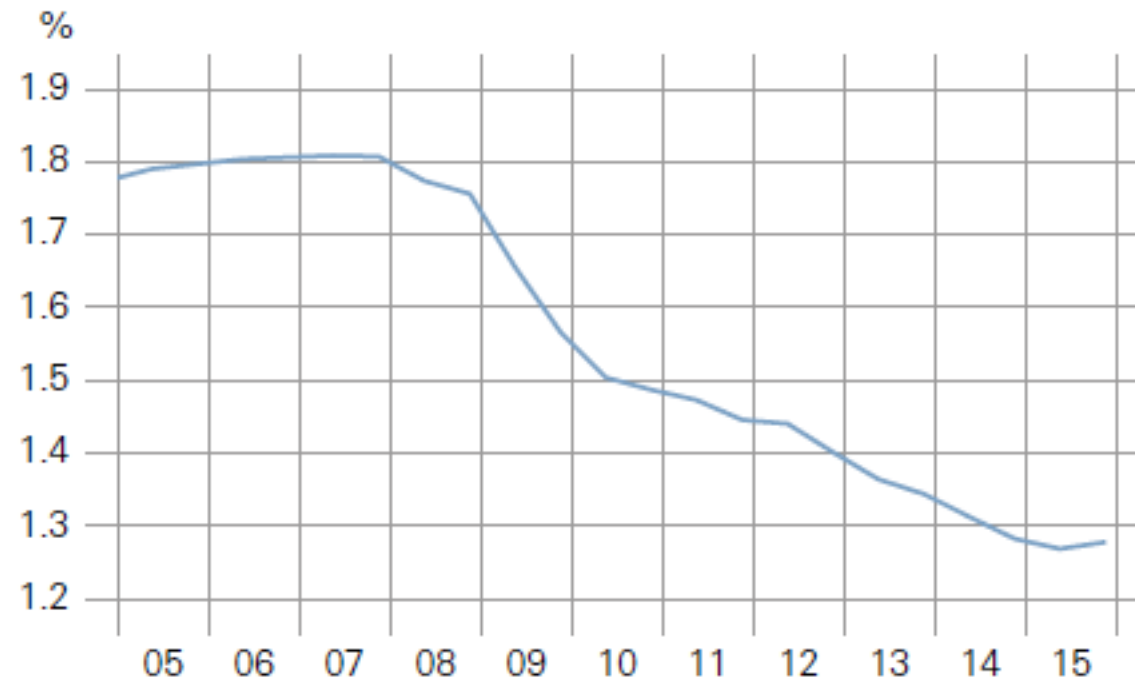


Source: SNB

INTEREST RATE MARGIN OF DOMESTICALLY FOCUSED COMMERCIAL BANKS

Weighted average

Chart 16

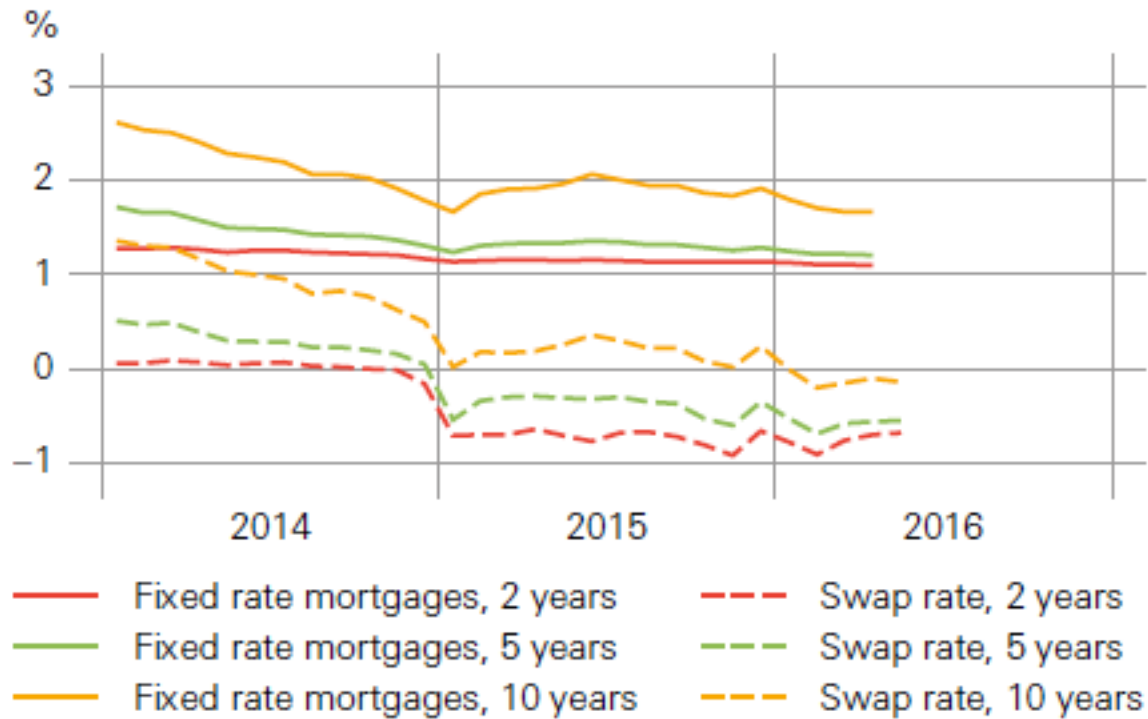


Sources: FINMA, SNB

PUBLISHED INTEREST RATES ON NEW FIXED RATE MORTGAGES AND SWAP RATES

Equally weighted average

Chart 17

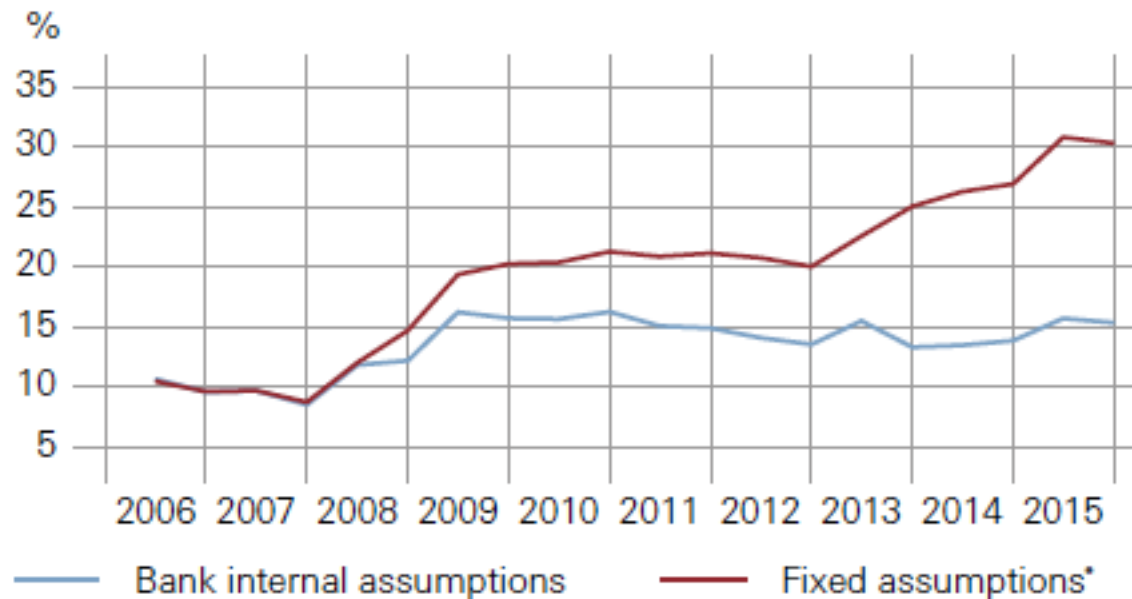


Sources: Bloomberg, SNB (ZISA survey)

INTEREST RATE RISK OF DOMESTICALLY FOCUSED COMMERCIAL BANKS

Losses in NPV with 200 bp interest rate rise and different replication assumptions; as percentage of Tier 1 capital

Chart 18



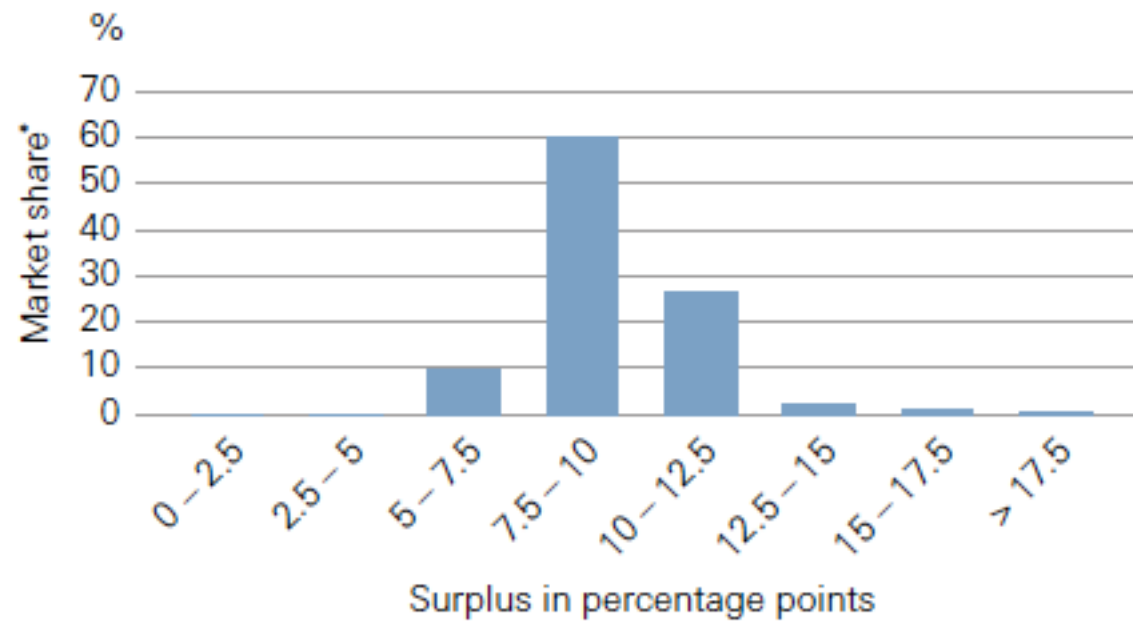
* Assumed repricing maturities of 1.5 years for savings deposits and variable rate mortgage claims, and of 15 days for sight deposits.

Sources: FINMA, SNB

RISK-WEIGHTED CAPITAL RATIOS OF DOMESTICALLY FOCUSED COMMERCIAL BANKS

Capital surplus with respect to the Basel III 8% minimum requirement for risk-weighted total capital ratios

Chart 19



* Share of domestically focused banks' total leverage ratio exposure.
Sources: FINMA, SNB

Roadmap

- Elements of context: the safe haven challenge
- The housing market situation and its perception: a bubble? Or 'Here and now', it is different?
- The institutional set-up and the 2012-15 policy response
- A dynamics under control?
- **The design of the CCB**
- Issue #2: UBS & CS

Basic characteristics of Swiss CCB

- The CCB can be applied on a broad basis or to exposures to specific sectors
- The maximum level of the CCB is set at 2.5% of total domestic RWA
 - On aggregate, mortgage credit amount to about 50% of domestic RWA
- Banks are given between 3 and 12 months to fulfill the requirements, depending on assessment of the situation
 - Transition period at first activation: 8 months
 - Transition period for the increase: 5 months
- First experience regarding the frequency of CCB decisions: one decision per year is realistic

CCB decision-making process: A ‘guided discretion’ approach

- The approach combines a rule component...
 - Mechanical guidance built on 4 key indicators
- ...with a discretionary component
 - The mechanical guidance can be ‘overruled’ based on an analysis of additional (“secondary”) indicators
 - Discretion important given the substantial uncertainty and complexity of measuring imbalances in the credit market

Key indicators

- The key indicators play a major role in the decision regarding turning the CCB on/off and regarding its size
- SNB relies on a combination of mortgage credit variables and residential real estate price indicators
- Pragmatism needed: only limited experience with indicators to assess position on the financial cycle
 - Calibration is, necessarily, based on **one crisis only**

Additional indicators

- Monitored on a regular basis to provide information used as part of the discretionary decision making process
- The greater the heterogeneity among the key indicators, the more weight is put on the discretionary component
- Additional indicators include
 - Indicators of bank risk
 - Alternative measures of credit conditions and real estate prices
 - Measures of general economic conditions
 - Soft indicators: qualitative survey data from SNB's regional network

Financial stability: the Swiss lesson

- In the restricted context of the Swiss economy
- A stable financial system is not an impossible dream
- It is a matter of political will
- Build on the conviction that there is a need to act
- And the readiness to accept paying the price of precaution when knowledge is limited

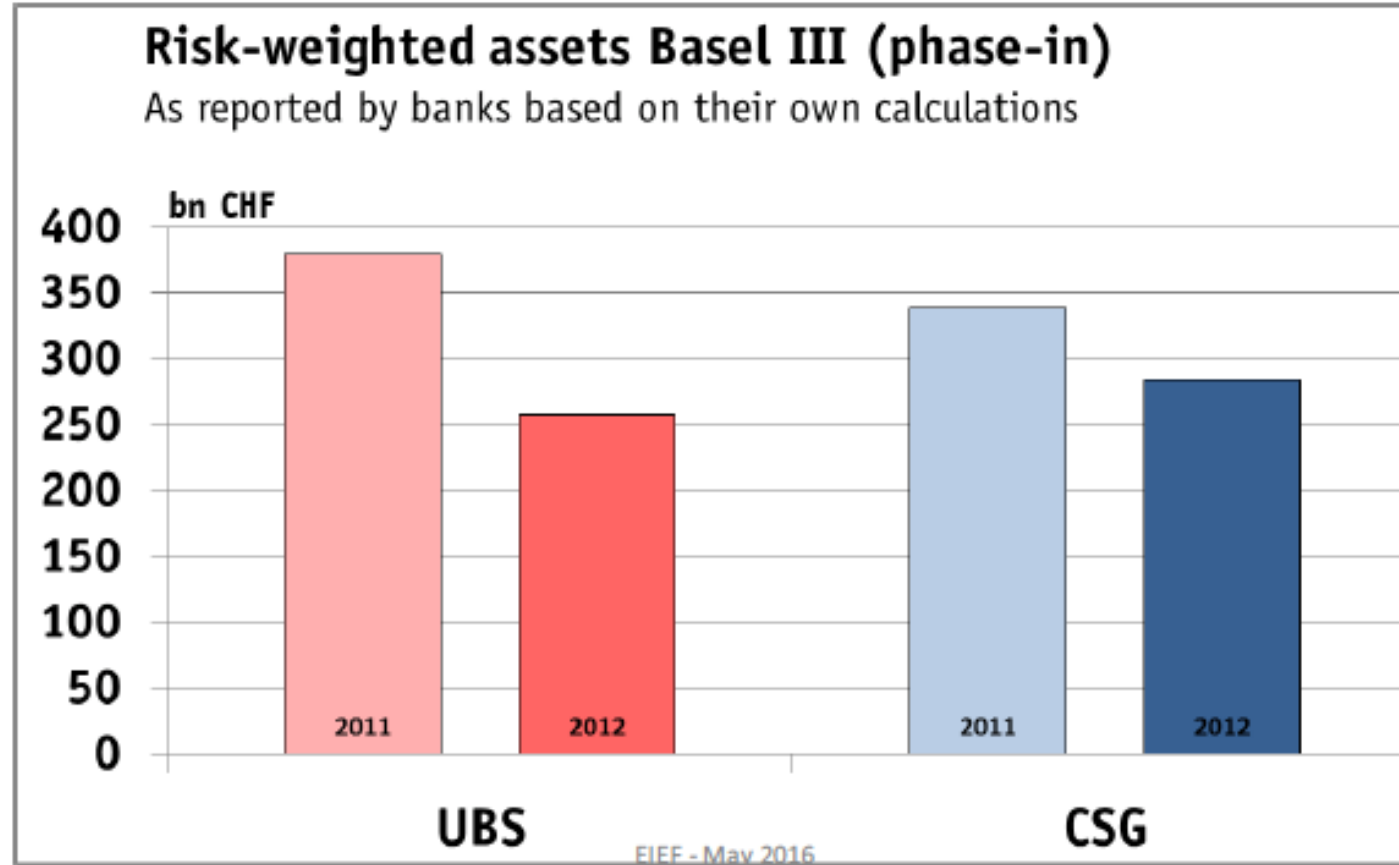
Roadmap

- Elements of context: the safe haven challenge
- The housing market situation and its perception: a bubble? Or 'Here and now', it is different?
- The institutional set-up and the 2012-15 policy response
- The design of the CCB
- A dynamics under control?
- **Issue #2: UBS & CS**

Financial Stability Problem #2: UBS & CS

- TBTF but also Too Big to Save
- Make them safe to fail
- At the forefront since 2009 (largely under the impulse of the SNB) but slowed down by the international environment
- Capital and liquidity requirements with ‘Swiss Finish’
 - RWA up to 19% with progressive component (including Cocos)
 - Leverage ratio of 5%
 - Liquidity requirements “Swiss regime” in effect since 2012
 - TLAC
 - Limits to internal models
 - Living wills (both banks are now Holding company and have separate Swiss entities)

A measure of success ...



A closing Window?

- Strong resistance, internal and external
- Ferocious lobbying