EXECUTIVE BOARD MEETING

SM/19/134
Correction 2

June 26, 2019

To: Members of the Executive Board

From: The Secretary

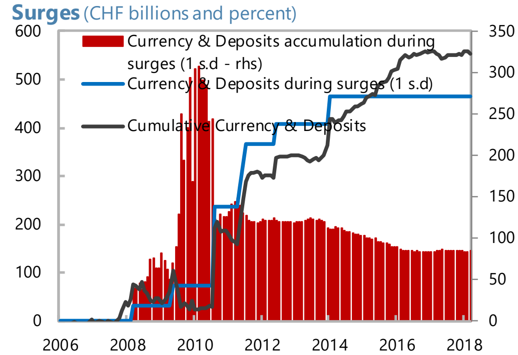
Subject: **Switzerland—Selected Issues**

Board Action:	The attached correction to SM/19/134 (6/4/19) has been provided by the staff:
Factual Errors Not Affecting the Presentation of Staff's Analysis or Views	**Page 14**
Questions:	Ms. van Elkan, EUR (ext. 34763) Ms. Maslova, EUR (ext. 38306)

2011, the SNB introduced an exchange rate floor against the euro, thereby committing to purchase foreign exchange to prevent the franc from strengthening. Removal of the floor in early 2015, even though it was accompanied by the introduction of a negative policy interest rate, saw additional large inflows and led to further accumulation of reserves.

3. The SNB's FX purchases were concentrated into relatively few episodes. Intervention, as proxied by the sum of changes in sight deposits at the SNB and currency in circulation, was especially large in August 2011, and purchases were also sizable around April 2010, June 2012 and January 2015.[3] Around 85 percent of cumulative foreign exchange purchases occurred during inflow surge episodes (defined as monthly purchases that exceeded the mean by 1 standard deviation or more).[4] Unlike some other central banks, intervention occurred mainly in the spot market.

SNB Currency and Deposits Accumulation During Surges (CHF billions and percent)



Sources: SNB; and IMF staff calculations

B. Some Additional Motives for Holding Reserves

4. While the SNB's stock of reserves is a by-product of its constrained monetary policy, there are a number of reasons why it—together with other central banks—may wish to hold reserves. The literature shows that during financial crises, including the GFC, central banks provide substantial emergency liquidity assistance in domestic and foreign currencies (Domanski and others (2014), CGFS (2010), Ghosh and others (2017)). In fact, some advanced and emerging countries pursuing inflation targeting have acquired significant reserves since the GFC, including Sweden, Israel, the Czech Republic and Poland. The two Swiss G-SIBs—which are very large relative to the size of the domestic economy—as well as several domestically-focused banks are active in international financial markets. These financial institutions' own liquid foreign-currency assets should provide the first line of defense during liquidity stress. However, during extreme episodes of market disruption, temporary provision of foreign exchange liquidity by the central bank may be warranted to protect financial stability.

5. Prior to the GFC, the prospect of losing exchange market access and of external-sector crises was perceived to be remote for a reserve-currency country such as Switzerland. However, the onset of the crisis caused the market for US dollars to freeze as risk-averse investors hoarded what was perceived to be *the* global safe asset, while concerns about counterparty risk

[3] The proxy for intervention (sum of changes in sight deposits at the SNB and currency in circulation) excludes passive inflows due to income on reserves and valuation changes, both of which affect the level of international reserves (measured in Swiss francs) on the asset side of the SNB's balance sheet. This measure also does not take into account other changes in the composition of SNB liabilities, which contributed to the surge in sight deposits in August 2011.

[4] As the SNB conducted FX swaps during 2008–12, the cumulative share of purchases (including the first leg of FX swaps) occurring during surge episodes exceeded 100 percent for some time.