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Introductory remarks by Fritz Zurbrügg

In my remarks today, I will present the key findings from the new Financial Stability Report, published this morning by the Swiss National Bank.

Economic environment

Since publication of last year's Financial Stability Report, the economic environment and financial market conditions have improved. The impact of the coronavirus pandemic on the economy has been less severe than assumed under the baseline scenario a year ago. Above all, none of the stress scenarios has actually materialised.

Nevertheless, the Swiss banking sector continues to operate in a challenging economic environment shaped by the pandemic. As my colleague Thomas Jordan has just mentioned, global economic activity has risen further despite a slowdown over the winter months, but remains below its end-2019 level in most countries.

The current economic environment carries various risks for financial stability. First, the economic outlook is still subject to high uncertainty; further deterioration in the economic environment caused, for example, by a worsening of the pandemic situation could negatively affect the quality of banks' credit portfolios. Second, there are signs of asset price overvaluation in a large number of countries; any change in market assessments of the economic outlook or of support measures could lead to substantial price corrections. Third, the historic level of global public and private debt means the credit markets are more vulnerable to income and interest rate shocks.

This last point concerns, on a national level, the mortgage and residential real estate markets in particular. Since publication of last year's Financial Stability Report, mortgage lending has increased moderately, while price growth on the residential real estate market has been strong. The improved economic outlook has reduced the risk of a pandemic-triggered correction in

residential property prices. At the same time, the vulnerability of the mortgage and residential real estate markets has increased, as growth in residential property prices and in mortgage lending volume has been higher than fundamental factors such as income and rents can explain.

In my following remarks, I will start by looking at the two globally active banks, Credit Suisse and UBS. I will then outline our assessment of the situation at the domestically focused banks.

Globally active banks

The two globally active Swiss banks are proving resilient in the current challenging environment. Their profitability in 2020 in fact exceeded the average of recent years. On the one hand, the two banks, like their globally active peers, benefited from the public support measures enacted around the world, and the swift recovery of the financial markets. On the other hand, the diversified income structure of Credit Suisse and UBS is contributing positively to their resilience in the current environment. Thus, although provisions for credit losses have risen significantly in the wake of the pandemic, they remain low by international comparison. This is mainly attributable to the smaller share of credit business relative to the overall balance sheet and to the different loan portfolio composition at the two Swiss banks.

Detracting from this positive picture are the significant losses incurred in Q1 2021 by both banks – but in particular Credit Suisse – on their exposure associated with the US-based hedge fund 'Archegos'.[1] Strong performance in other areas of investment banking and in wealth management helped to absorb these losses. FINMA has opened proceedings against Credit Suisse and ordered various risk-reducing measures to be put in place.

In line with their overall robust profitability during the coronavirus pandemic, Credit Suisse and UBS have improved their capital position since last year's Financial Stability Report. Their regulatory capital ratios have returned to pre-crisis end-2019 levels and fully comply with the Swiss 'too big to fail' (TBTF) regulations.

Market indicators for the two globally active Swiss banks have also improved since the last report. After a strong negative reaction in Q1 2020, CDS premia and stock prices recovered back to pre-crisis levels over the course of the pandemic. However, following the significant losses incurred on its Archegos exposure in Q1 2021, Credit Suisse's CDS premia have increased and its share price has decreased again.

Looking ahead: The two globally active Swiss banks continue to be well placed to face the current challenges and support the real economy. At the same time, however, the loss potential of both banks, as assessed under the SNB's stress scenarios, remains substantial.

[1] While FINMA and Credit Suisse refer to Archegos as a hedge fund, the Federal Reserve Board and others refer to it as a family office. This terminological distinction highlights the fact that, despite acting like a hedge fund in economic terms, Archegos was exempt from registration with the US Securities and Exchange Commission and did not have to disclose its size or leverage.

Furthermore, the pandemic has reminded us that the banking business can be hit by massive shocks and a sharp rise in uncertainty at any time. Finally, as the Archegos case in Q1 2021 illustrates, significant losses may materialise even in the absence of a macroeconomic or system-wide financial shock. All these factors underline that the TBTF capital requirements are necessary for ensuring adequate resilience at the two globally active Swiss banks.

Domestically focused banks

I shall now turn to the domestically focused banks.

Contrary to initial fears, the deterioration in economic conditions did not adversely affect these banks' profitability in 2020. This positive development can be attributed to three factors. First, credit losses have so far remained low thanks to the public support measures. Second, as mentioned earlier, the pandemic has had very little impact to date on the mortgage and real estate markets. Third, the narrowing of domestically focused banks' interest rate margins has slowed considerably despite the renewed decline in mortgage interest rates. As a result, by retaining profits, these banks were able to maintain and even further build up their capital base in 2020.

Thus, the domestically focused banks continue to be able to withstand shocks and, at the same time, to supply the economy with credit. This is especially important in the current situation. First, the after-effects of last year's recession or a renewed deterioration in economic conditions could cause credit losses in the medium term. Second, vulnerabilities in the mortgage and real estate markets as well as the exposure of domestically focused banks to these markets have increased further. This is reflected in the continued growth in mortgage volume at the domestically focused banks, and the increase in affordability risks in 2020.

The SNB's scenario analysis shows that domestically focused banks, in aggregate, would be able to absorb losses under the stress scenarios. However, these simulations also suggest that the capitalisation of certain banks could approach, or even fall below, the regulatory minima.

The SNB continues to monitor developments on the mortgage and real estate markets closely, and regularly reassesses the need for a reactivation of the countercyclical capital buffer.