Interview with Jean-Pierre Roth

Conducted by Alessandro Pedrazzini
and Dr. Reto Foellmi

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Profile:
Jean-Pierre Roth was Chairman of the Swiss National Bank's Governing Board from 2001 to 2009, during which time he also served as the Swiss Governor of the International Monetary Fund. From 2006 to 2009, he was also Chairman of the Board of Directors of the Bank of International Settlements in Basel. Jean-Pierre Roth was elected as President of the Banque cantonale de Genève and member of the Board of Swiss Re and of Nestlé in 2010. He currently serves on the Board of the Swatch Group, the Arab Bank, and MKS Switzerland.

Alessandro Pedrazzini: I would like to start by asking you to briefly introduce yourself to our readers. In particular, what is the professional achievement you are most proud of and why?

Jean-Pierre Roth: Well, I'm a pure product of central banking and monetary studies. I received my PhD in 1976 at the Graduate Institute of Geneva in monetary economics and then went to MIT for a year to work with Rudi Dornbusch[1].
After that, I taught at the University of Geneva during the sabbatical year of prof Alexandre Swoboda[2]. Following these experiences, I found myself without a job. That's when the Swiss National Bank asked me to join their Research Department in Zurich. I said yes, started in 1979 at the Swiss National Bank and left the Swiss National Bank thirty years later. In between, I had the occasion to work in all possible departments of the Bank, such as the Research, Gold, and Bank Note Departments. I was also in charge of the SNB's headquarters in Bern before moving to Zurich to head the operations of the foreign exchange and domestic money market. I once again moved to Bern to serve as Vice Chairman of the Board but later returned to Zurich as Chairman of the Board. At that point, I knew all the possible activities of central banking.
As Vice-Chairman, I am very proud to have been able to conduct the reform of the Swiss National Bank's article in the Swiss Constitution. The previous article was still reflecting a fixed exchange rate regime. I also worked on the full revision of the SNB's law, which had to be adjusted to a flexible exchange rate regime and a new mandate in financial stability. As an economist, it was a fantastic opportunity to reshape the activity of the Central Bank. When the law passed in 2002, I had to implement it in order to reform the governance and decision-making processes within the Bank. That was also a fascinating issue for me because I could use everything that I had learned in terms of decision-making processes and central bank independence.

Alessandro Pedrazzini: The SNB's funds are attracting more and more political desires (for example for the financing of the social insurances AVS/AHV, the climate shift, debts related to COVID). What can the SNB best do in your opinion to defend and protect its independence?

Jean-Pierre Roth: The point is not that of a central bank distributing profits. This is normal. But the problem starts when the profits are linked to a certain political objective or a political mandate. For example, I was firmly against the 2006 Cosa Initiative [3] because linking the activity of the Central Bank to the financing of social security is extremely dangerous for the independence of the Central Bank. As Chairman of the SNB, I tried to convince all political parties to never support that initiative. We knew that there would be huge political pressure to adjust our policies in order to produce more profits. Central Bank profits should be distributed fully to the Government and for the national budget. It is up to the Parliament and Gov-

[1] Rudiger "Rudi" Dornbusch was a macroeconomist who was noted for his contributions to international economic policy design. He not only tutored a generation of leading economists and policymakers, such as Paul Krugman, but also gave economics one of its most important breakthroughs in the modern era by stating that exchange rates reflect future expectations.

[2] Alexandre Swoboda served on the Swiss National Bank's Council from 1997 to 2009. From 1998 to 2000 he was the Senior Policy Advisor in the IMF's Research Department and is an occasional consultant to private financial, governmental and international institutions (including the IMF, the World Bank, and the Swiss National Bank).

[3] The people's initiative for "National Bank profits for the Old Age and Survivors' Insurance Fund (AHV/AVS)", better known as the Cosa initiative, which was put to the vote on 24 September 2006, demanded that the National Bank's future profits be allocated to the AHV/AVS. Both the Federal Council and the Swiss Parliament rejected the initiative, as did the Swiss National Bank.

ernment to decide what will be the use of this money.

Alessandro Pedrazzini: I would like to touch upon your time at the SNB. You took up this position in 2001 and left in 2009. This is a time frame that is, in a way, sandwiched between two periods of economic turbulence but also punctuated by several years of prosperous growth. How did you manage to restore public confidence in the Swiss Banking sector and shore up the Swiss economy during these years?

Jean-Pierre Roth: Well, the point for us was not to defend the reputation of the banking sector. Our role was to maintain confidence in the monetary system, in the Swiss Franc, and in financial stability. That's a goal that goes beyond just the reputation of the banks and the bankers. Our concern was stability in the monetary system. In that regard, 2007 was an incredible exercise. I remember when the crisis started, on August 26th, 2007. The markets had totally dried up and the interbank market, which keeps money moving around the globe, had frozen completely, largely due to fear of the unknown. On that day, I was in a Board meeting in Zurich. We had started at 8:30 o'clock and one of the guys in charge of the markets had come in saying that markets had gone into panic mode. All banks wanted to accumulate as much liquidity as possible and no bank was ready to give any liquidity to other participants in the market. After ten minutes of discussion all three board members around the table agreed that we had to give unlimited liquidity to the market. From that day, the strategy of liquidity created on demand became widely adopted. If there was any need for liquidity in the market, the Central Bank would provide that. What was especially interesting on that day was that the situation was the same in Frankfurt, in London, and all central banks implemented this same strategy. I'm telling this story to you because, in many speeches, people ask me how it was possible for central banks to coordinate policy on that day so quickly. The reality is that we never spoke to each other, but we all had in mind the crisis of the 1930s, which was exacerbated by central banks failing to support the market. We all had the same kind of theory in mind and were all ready to react exactly in the same way and at the same time.

Reto Foellmi: Coordination, in this case, was therefore a common understanding of the benefits of stabilization policy. The danger of too much liquidity is quite low in these phases of turmoil. People often think of the dangers of having too much liquidity in the market, which of course is not the short-term danger in my view, but the long run danger. However, in the short run, central banks have to provide liquidity as there is no alternative.

Jean-Pierre Roth: In fact, where is the problem with too much liquidity on the supply side if there is too much liquidity demand and no imbalance between supply and demand? Today, there is an unlimited preference for liquidity, to a point that we are almost in a liquidity trap. The problem will come when the demand for liquidity will start to change and credit prices will accelerate. But as long as the demand for liquidity is almost unlimited, like nowadays, there is no risk for price stability.

Reto Foellmi: Unless it feeds into the credit demand as you mentioned.

Alessandro Pedrazzini: The SNB was praised for being successful in steering away from issues that other central banks created with monetary policies that were too loose and that inflated asset bubbles. What do you believe was key to not having an over-heating real estate market?

Jean-Pierre Roth: The Swiss National Bank did exactly the same as other central banks. We didn't go through quantitative easing. If you look at the development of money in Switzerland's monetary system, you see exactly the same picture as in the Eurozone or in the U.S: an explosion of liquidity in our economy. Quantitative easing is the Bank buying assets from the market such as bonds, or foreign currency denominated assets, the strategy adopted by the SNB. The SNB didn't buy bonds or equities, but it started to buy foreign exchange, which had the same impact on the monetary system. If you look at the expansion of the monetary base in Switzerland, or in the Eurozone, you see that it was much larger in Switzerland than in the Eurozone or even the U.S although we were not conducting any quantitative easing in the real sense of the term.

Alessandro Pedrazzini: Developments over the past few years have led some states to question their reliance on the U.S Dollar. One reason is that since most of the trade takes place in U.S Dollars, emerging economies like the BRICS (Brazil, Russia, India, China and South Africa) are unhappy that their economies are so directly affected by the monetary policy of the U.S. To what extent do you believe that the domination of the U.S Dollar as a global currency reserve is being challenged today?

Jean-Pierre Roth: Look at the development of the Euro. The Euro was supposed to have an important international role when it was launched twenty years ago. Today, it still has a limited role as a vehicle currency all over the world. The Dollar is still the number one currency. I doubt that this will change in the future with only one exception: cryptocurrencies. I can tell you that I'm really surprised to see that central banks have been so patient, so inactive in regard to the development of cryptocurrencies because cryptocurrencies are a risk for money laundering and escape all kinds of controls. Interestingly, the U.S started to react only when it had the feeling that the U.S Dollar's position worldwide could be put at risk by cryptocurrencies. But I don't think that the U.S believes that the Euro is a strong enough competitor to the U.S Dollar as an instrument for the international payment system.

Alessandro Pedrazzini: Some argue that reintroducing the Gold Standard would stabilize the global monetary system, provide a reference point for the U.S Dollar, and curb inflation. How do you see the role of gold today?

Jean-Pierre Roth: In the past, the Gold Standard has been a major topic of discussion. Thirty years ago, there were people saying that we should move back to gold. There was even a gold commission evaluating a possible return to the Gold Standard. As a monetary theory, the Gold Standard system is really fascinating because you have an integrated mechanism of adjustment. If you lose your gold, you have to reduce the money in circulation and if you accumulate gold, you have to increase the quantity of money in circulation. Therefore, there is a direct link between the balance of payments system and monetary policy. There was no room for any political decision. With today's flexible exchange rates, there is no more link between the balance of payments and domestic monetary policy. Since the 2007 crisis, we decide whether we want to intervene in the foreign exchange market, whether we want to change the interest rate, and we are not bound by any monetary rule such as the Gold Standard.

I remember saying, at an IMF Board meeting in 2007, that Switzerland was going to intervene in the financial markets because the strength of the Swiss Franc was totally artificial. It had nothing to do with our economy, but with the safe-haven reaction of the markets. Jean-Claude Trichet [4] passed me a small note around the table. It said (Translation from French): "Jean-Pierre, you cannot say such things. The Swiss Franc is an international currency that has to respect the strictest rules. We have a floating exchange rate, and you are not allowed to intervene in the markets". 2007 was a turning point! Since my appointment as Chairman in 2001 and, until 2007, we never intervened once in the financial markets, never. It was pure flexible exchange rate. We changed policy after the crisis of 2007-2008 and moved to this kind of "dirty floating".

Alessandro Pedrazzini: Do you see currency wars between central banks evolving in the future?

Jean-Pierre Roth: A central bank must only say what the markets should hear. That is, "we will stick to our present policy, and we have no intention to change". Maybe, on the next day, it might decide to follow a different path. In communication, it cannot be other than fully black or fully white. There are no currency wars officially because no central bank has the right to use foreign exchange as an instrument for domestic monetary policy. But in fact, they all do. For example, when Draghi decided to lower interest rates to zero in the Eurozone and even in negative territory, it was because he wanted to weaken the Euro with respect to the U.S Dollar and stimulate the Eurozone economy. The SNB's policy of maintaining price stability also uses foreign exchange as an instrument because of its direct impact on the price level domestically. You can, of course, monitor price development in Switzerland with the foreign exchange market. In general, central banks never mention that they care about foreign exchange. But in fact, they all have an eye on it, which can in some cases be considered as "currency war".

Alessandro Pedrazzini: Higher inflation has already forced several countries to raise interest rates including Brazil, Hungary, Mexico, and Russia. Do you believe that emerging markets are in good enough shape to withstand a sooner-than-expected withdrawal of stimulus from the U.S Federal Reserve?

Jean-Pierre Roth: Each country has a different situation, a different level of inflation. Therefore, it's difficult to comment on that, but what you see

[4] Jean-Claude Trichet is a French economist who served as President of the European Central Bank from 2003 to 2011. Before his assumption of the presidency, he served as Governor of the Bank of France from 1993 to 2003 under presidents François Mitterrand and Jacques Chirac.

around us is what has already happened in the U.S, Eurozone, and Switzerland. At the moment, the exit strategy is a very difficult exercise. To be frank, I do not see any major central bank with a clear vision of an exit strategy, vis-à-vis the policy implemented over the last ten years, because they all fear to take the unpleasant step of announcing higher interest rates. Can you imagine Christine Lagarde saying that the ECB is going to raise interest rates? The point is that they are really still trapped in the present situation and there is no clear exit strategy yet.

Alessandro Pedrazzini: How do you think central banks should communicate a raise in interest rates versus a taper of asset purchases?

Jean-Pierre Roth: They will probably do it step-by-step, by slowing down unconventional policies and reducing asset purchases on the market and so on. But I suspect that most of them will just wait for their neighbors to start. The European Central Bank could wait for the U.S to start raising rates. It's easier to do it if your neighbor is doing it first. Probably, the U.S will start as it clearly has a leading role.

Alessandro Pedrazzini: Why do you think that's the case (that central banks wait for other central banks to act)?

Jean-Pierre Roth: If the ECB sees the U.S raising interest rates, it would be easier to also raise interest rates because of the limited impact on foreign exchange. Think of the SNB if the ECB raises interest rates. It would be happy to eliminate negative interest rates. The SNB has an incentive to not move independently because it does not want the Swiss Franc to strengthen too much vis-a-vis the Euro. Therefore, it might wait for the European Central Bank to move first in order to also make a move without suffering the impact of interest rate differential. But maybe Switzerland will decide to go by itself. Who knows?

Reto Foellmi: I agree that central bank policy actions are linked to each other because of the impact of real exchange rates, particularly for Switzerland. However, do you think an exit strategy for Switzerland is necessary now?

Jean-Pierre Roth: Take the case of Switzerland and the Eurozone. Should the SNB follow the ECB or not if they both are in the same business cycle? The SNB knows that if it moves first, then that will have an impact on the Swiss Franc. The question is whether Switzerland would be able to absorb the impact on the Swiss Franc. Of course, the current communication of the SNB is still the same: The Swiss Franc is too strong. Today, though, there are more and more articles in the press saying that the Swiss Franc is at a very normal level: there's no-over appreciation of the Swiss Franc anymore. This question will never be debated publicly by the Bank. A central bank uses its black and white communication policy. Therefore, the SNB could very well communicate that the Swiss Franc is overvalued and change its stance on the next day. A central bank with doubts destabilizes the markets.

Alessandro Pedrazzini: How do you assess the current economic climate and what do you see as the challenges for central banks moving forward?

Jean-Pierre Roth: Well, I think that what is different now from the pre-2007 era is that there is a profound crisis of confidence. Today's unlimited preference for liquidity is also a sign that people are not sure exactly what the future will be. There is a lack of confidence in the system, in the capacity of monetary authorities to manage the situation, and in international cooperation. If we had more clarity about the future, we would start to invest, and the demand for credit would accelerate again because the price of credit is almost zero. People think of what could happen in the next two, three years, but they do not see any more what will come long-term. This is related not only to public policy, but also to environmental strategy. If central banks want to stimulate the economy, they cannot lower interest rates. Public policy should be to create more confidence in the future development of the economy, because there is already enough money and credit in the system.

In Switzerland, we also have doubts about the future of our pension system. People start to save more because they see that their pension funds are not giving them the level of pension that they were expecting due to zero or even negative interest rates. Therefore, they start to save again. In fact, if you look at how much of your wage bill is put aside for your pension, it is 20 to 25% of the labor cost, including employer contribution. You are forced to save 25% each month, which is huge. If you think that 25% of the labor cost is bringing you such a limited pension, you also start to save more in order to complement what you will miss out on. Draghi said that lowering interest rates would stimulate the economy, but in fact it can also push people to save more because they do not know what the future will be. Pushing with low interest monetary policy is not possible anymore. You have to create more visibility into the future.

Alessandro Pedrazzini: What were the consequences of the introduction of the euro (1999) on the Swiss Franc and on the effectiveness of Swiss monetary policy during your time at the SNB? And what were the effects of this new international monetary order on countries outside the dollar-euro block more generally?

Jean-Pierre Roth: It was both one of the best and worse things to happen to Switzerland's monetary system. The SNB knew that a crisis occurring in Italy or France would cause huge capital inflows and pressure on the Swiss Franc, German Mark, and Dutch Guilder. Therefore, on the one hand, it was good news for Switzerland to have all of these currencies replaced with a common, more stable currency. On the other hand though, if instability did occur in the Euro currency market, Switzerland would suffer as a result of the crisis faced by the entire community of European nations at the same time, which could prove extremely damageable.