Swiss central bank President Thomas Jordan is wondering how to invest his currency reserves as euros pile up at the bank at a record pace.

"The SNB has the same problem as lots of wealth managers," said Ursina Kubli, an economist at Bank Sarasin in Zurich. "Safe assets have become very expensive. So for the time being, they prefer cash over investing."

With Europe’s debt crisis hurting returns on the least risky bonds, the Swiss National Bank is keeping reserves in cash after its policy to cap the franc swelled currency holdings by 50 percent in the four months through June to a record 365 billion francs ($380 billion). Money held at central banks, the International Monetary Fund and the Bank for International Settlements accounted for 72 percent of the gain.

The SNB has been piling up euro holdings to defend the franc ceiling of 1.20 versus the single currency introduced in September 2011. While the central bank previously mainly invested foreign currencies in government bonds of AAA-rated nations, the surge in cash reserves suggests policy makers are finding it more difficult to find the right investments.

The Zurich-based SNB has also seen its cash holdings at other central banks, or sight deposits, surge to 107.6 billion francs in June, compared with an average of 6.4 billion francs in the year through April. In the 15 months through June 2010, when the SNB bought billions of euros to weaken the franc without a ceiling, the average share was near zero.

The fallout from the sovereign debt crisis has left only four of the euro area’s 17 economies the AAA rating from the three major ratings companies. France, the region’s second-biggest economy was stripped of its top credit rating by Standard & Poor’s on Jan. 13, as the company downgraded the debt of nine nations in the currency bloc.

**SNB Reserves**

The SNB’s foreign-exchange holdings amounted to about 60 percent of Swiss gross domestic product at the end of the second quarter. Euros accounted for 60 percent of currency reserves, up from 51 percent three months earlier, reflecting the ongoing battle to keep a lid on the franc. The currency surged about 17 percent to a record against the euro in the six months before the ceiling was introduced.

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The yield on the 10-year German bund fell to a record low 1.13 percent on June 1. Two-year notes returned minus 0.007 percent on Aug. 28, indicating that investors are willing to pay for the privilege of holding the region’s safest securities.

While the euro-area turmoil has pushed up the price of what is perceived as a safe asset, the SNB’s internal guidelines may limit its ability to seek better returns from riskier investments. They require the central bank to have a “substantial part” of its holdings in government bonds to meet “secure investment” standards.

Jordan, 49, said on June 14 that a “large part of our foreign-currency investments are bonds issued by governments of the core euro area with very high quality.” At the end of the second quarter, government bonds in their own currencies and deposits with central banks and the BIS accounted for 85 percent of the SNB’s foreign assets, with 86 percent of all bond holdings rated AAA.

**Dollar Holdings**
"For a risk-averse investor there aren’t too many options at the moment, especially if you are focusing on the euro area," said Peter Schottmueller, a fund manager at Deka Investment GmbH in Frankfurt. "With yields for high-quality government bonds in the euro area very low, it doesn’t matter for the SNB whether they invest in fixed-income securities or keep their money as cash."

The SNB has been selling euros purchased against other currencies in a bid to diversify its portfolio, according to balance-sheet data. Still, its share of currency reserves in dollars fell to 22 percent in the second quarter from 28 percent in March. Yen and Canadian dollar reserves also declined in that period, indicating the pace of swapping euros for foreign currencies has slowed.

‘Wary’ SNB

At the same time, the share of so-called other currencies including Australian dollars and Danish kroner accounted for 3.5 percent of overall reserves at the end of the second quarter, up from 2.9 percent a year earlier. The SNB also added Korean won in the first quarter and Jordan said on June 14 that "additional investment opportunities in the advanced and emerging economies are continually being evaluated."

Linowsky at Credit Suisse said the SNB may maintain its focus on fixed-income securities and keep the share of other currencies limited since it’s not necessarily seeking higher returns. Janwillem Acket, chief economist at Julius Baer Group Ltd. (BAER) in Zurich, agrees.

“The SNB currently seems reluctant to keep the pace of its diversification,” Acket said. “Apparently they are not only wary of investing in euro-denominated assets but also in securities issued in other currencies.”

Maxime Botteron, an economist with Credit Suisse in Zurich, says the SNB will have to cope with its quandary for the foreseeable future.

“If the tensions in the euro area persist and investors keep up pressure on the franc, the SNB will continue to face the problem as to how to manage its rising foreign currency cash holdings for quite a while,” he said.

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