News conference

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SWISS NATIONAL BANK

Berne, 15 December 2016
Andréa M. Maechler

Introductory remarks by Andréa M. Maechler

I will begin by reviewing the situation on the financial markets, before going on to talk about the impact of negative interest on the money and capital markets. I will finish my presentation with a few comments on the progress that has been made in reforming benchmark interest rates.

Situation on the financial markets

Since the last news conference in June, movements on the financial markets have been heavily influenced by two political events: the unexpected outcome of the Brexit vote in June and the US presidential election in November. Both events generated short-term uncertainty among investors. Nevertheless, positive risk sentiment prevailed overall. Leading equity indices in the US, Japan and Europe have recorded price gains since mid-year (cf. chart 1). In the US, all key indices hit new record highs at the beginning of December. In Switzerland, the SMI, however, lagged behind the general trend: it is currently virtually unchanged from its mid-year level. The reason for this is the index’s strong weighting in defensive equities, from the healthcare and consumer goods sector for example. These securities, which tend to benefit less from increasing risk appetite among investors, came under selling pressure as a result of rising interest rates.

On bond markets, high-quality government bond yields have climbed since mid-year (cf. chart 2a). Firstly, economic data bolstered investor confidence in a global economic recovery. Secondly, inflation expectations rose steadily – albeit from a low level – particularly in the UK and the US (cf. chart 2b). This trend was reinforced by the outcome of the US election, which fuelled expectations of a more expansionary fiscal policy and a stronger increase in US government debt. The rise in yields also reflects higher risk premia caused by generally heightened uncertainty surrounding the future course of US fiscal and monetary policy.

Thus, the increase in yields was particularly pronounced in the US. Ten-year US government bonds recently stood at around 2.5%, 1 percentage point up from mid-year. By contrast, yield increases in Japan and Europe were on a smaller scale. Yields on ten-year Swiss Confederation bonds recently stood at –0.1%, half a percentage point up from mid-year. Approximately 60% of outstanding Confederation bonds are currently still generating negative yields, compared with around 95% at the end of June.

The global rise in yields has led to a reduction in the share of negative-yielding government bonds worldwide from over 30% at the end of June to around 20% most recently. Although this trend can be seen as a step towards normalisation on the bond markets, it is important to recognise that higher US yields and the associated appreciation of the US dollar could become a burden for some emerging economies.

On the foreign exchange market, the Swiss franc came under increased upward pressure for a brief period after the Brexit vote. This pressure abated again, not least due to the Swiss National Bank's willingness to intervene on the market. While the pound sterling continued to lose value over the summer months, other key currencies, including the Swiss franc, moved sideways within a narrow range (cf. chart 3). Heightened uncertainty in the run-up to the US presidential election was once again reflected in growing demand for safe-haven currencies on the foreign exchange market, leading to slightly higher Swiss franc exchange rates. Following the US election, the US dollar appreciated on a broad basis. The strengthening of the currency occurred against the backdrop of the rise in US interest rates mentioned earlier. The dollar gained approximately 3% in trade-weighted terms after the election. The recent developments in the US also had an impact on other currency areas. Currencies in emerging economies in particular came under pressure and, as a group, weakened by around 4% against the US dollar.

On a trade-weighted basis, the Swiss franc has changed little from its end-June level. Nevertheless, Swiss franc exchange rates moved in different directions. While appreciating more sharply against the yen than against the euro and pound sterling, the Swiss franc weakened against the US dollar and currencies of commodity-exporting countries. Overall, the Swiss franc is still significantly overvalued. The market environment remains challenging and fraught with global economic and political risks. The SNB therefore continues to monitor events on the foreign exchange markets very closely.

Impact of negative interest on the money and capital markets

Let me now turn to the impact of negative interest on sight deposits at the SNB on the Swiss franc money and capital markets. As you know, since the introduction of the negative interest rate in January 2015, key money market rates such as the three-month Libor have hovered, as intended, around –0.75% (cf. chart 4). The negative interest rate has ensured that the traditional interest rate differential with other currencies has been at least partially restored. On the secured money market – the repo market – interest rates have also stabilised at a lower level. This applies in particular to SARON, the reference rate for call money. Activity on the repo market remains unaffected by negative interest and the very high level of sight deposits. Banks and insurance companies use the market for their short-term liquidity requirements and the efficient management of their collateral holdings. The introduction of the negative interest rate even resulted in an increase in the trading volume on the repo market (cf. chart 5). One reason for this is that repo trades can be conducted in order to use up exemption thresholds.

Yields on Confederation money market debt register claims are below interbank levels (cf. chart 4). This is mainly attributable to relatively high investor demand for safe Swiss franc investments. On the foreign exchange swaps market, where currencies are exchanged on a temporary basis, implied interest rates for Swiss franc investments lie well below –0.75%; this applies in particular to US dollar swaps. The reason for this is abundant Swiss franc liquidity as well as structurally high demand for US dollar funding in the international financial system. These factors lead to a relative oversupply of Swiss francs against the US dollar, which depresses implied Swiss franc interest rates in the foreign exchange swap market. This makes it more expensive for the relevant investors to hold Swiss francs, on top of the negative interest rate of –0.75%.

Yields on long-term Confederation bonds on the capital market likewise fell substantially following the introduction of the negative interest rate. The interest rate rise observed since mid-year on longer-term securities in Switzerland took place in parallel with international interest rate developments. Since, at the same time, money market rates remained stable, this resulted in a slightly steeper yield curve for Swiss franc investments, which also mirrored international developments.

Overall, negative interest is having the expected impact on the money and capital markets and is making it less attractive for investors to hold Swiss francs compared to other currencies.

Reform of benchmark interest rates

To conclude, I would like to talk briefly about ongoing interest rate benchmark reforms. In 2014, the Financial Stability Board (FSB) recommended strengthening the existing global interest rate benchmarks, in particular the Libor. It also called for the development of alternative benchmark rates. The SNB is taking an active part in these reform efforts. It is represented on the relevant committees and plays a supportive role by participating in discussions with market participants, as well as with Swiss and foreign authorities.

Reforms have been implemented at international level, particularly as far as the Libor is concerned. They focus on standardising the interest rate calculation by the panel banks and making it more transaction-based. However, volume in the market segment underlying the Libor remains low.

At national level, the main emphasis is on the replacement of the TOIS fixing.[1] The TOIS fixing is a panel-based reference interest rate for the unsecured call money market and is used

[1] TOIS stands for Tomorrow/Next Overnight Indexed Swap.

for interest rate derivatives. Despite extensive reform efforts, no stable long-term solution has been found. Underlying trading volume continues to be very low and other banks are unwilling to report interest rate conditions. For this reason, the TOIS fixing will be abandoned as of end-2017. SARON, the reference interest rate for secured call money, will be used in its place. SARON was launched by the SNB in cooperation with SIX in 2009. We are confident that it will establish itself as a key Swiss franc reference rate. Further work will be coordinated by a working group comprising financial sector representatives. Key information on this topic is publicly available on the SNB's website.[2]

2 http://www.snb.ch/en/ifor/finmkt/fnmkt_benchm/id/finmkt_reformrates

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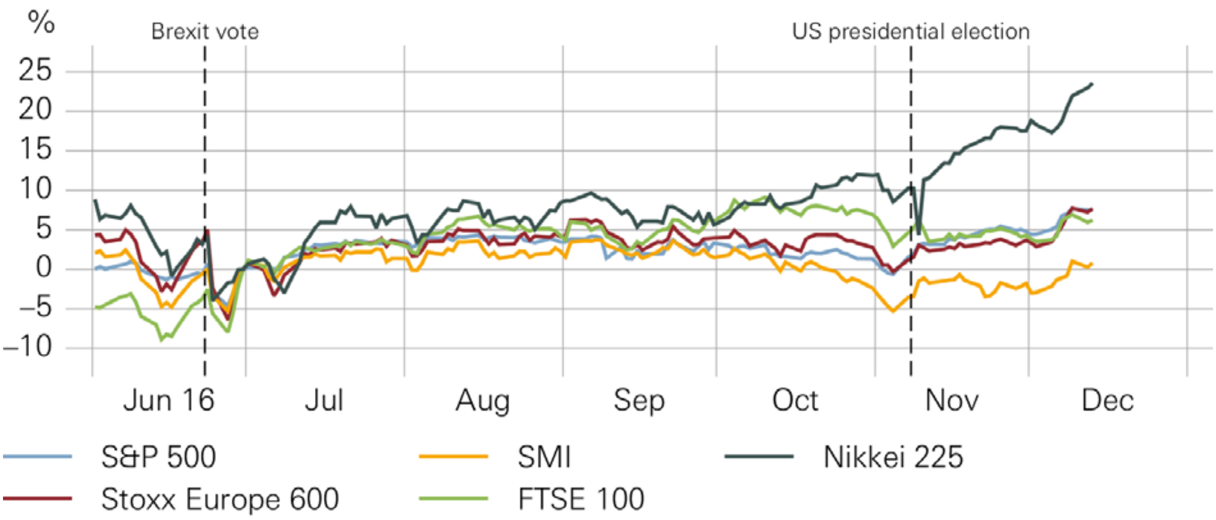
News conference

Slides

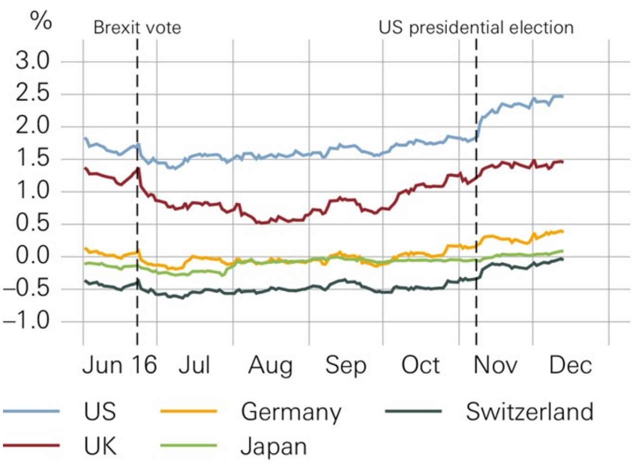
CHART 1: GLOBAL EQUITY MARKETS

Change since end-June in percent



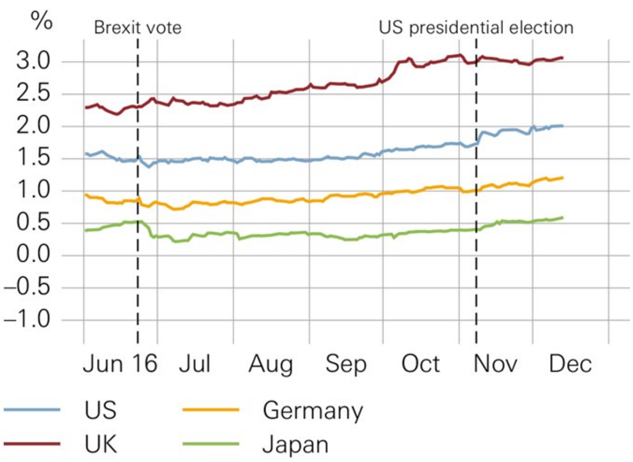
Sources: Bloomberg, SNB

CHART 2A: YIELDS ON GOVERNMENT BONDS (10YR)



Sources: Bloomberg, SNB

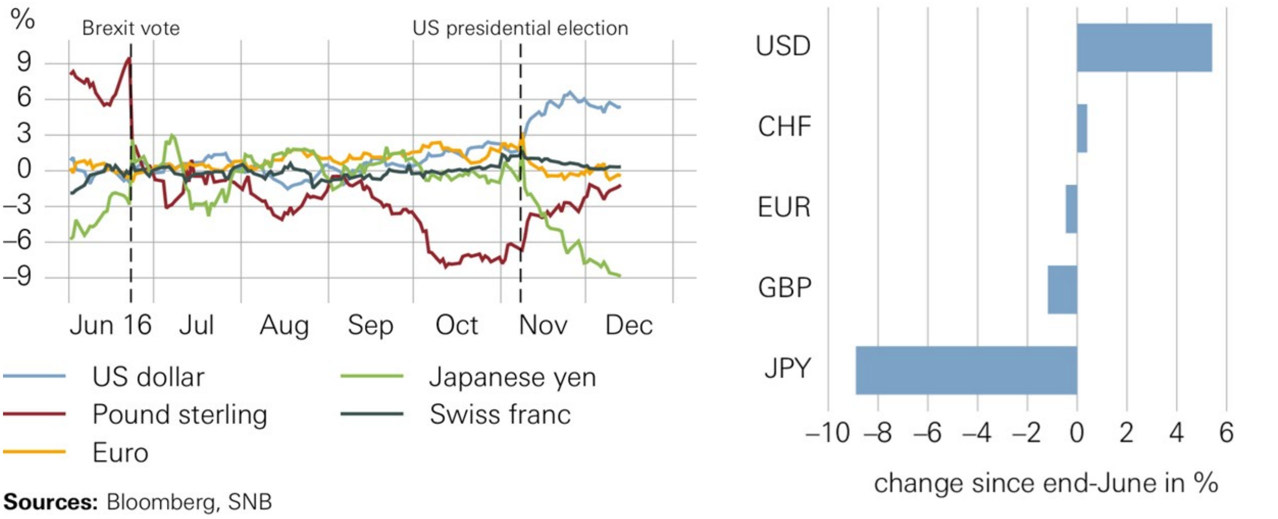
CHART 2B: INFLATION EXPECTATIONS* (10YR)



* Derived from inflation-linked government bonds

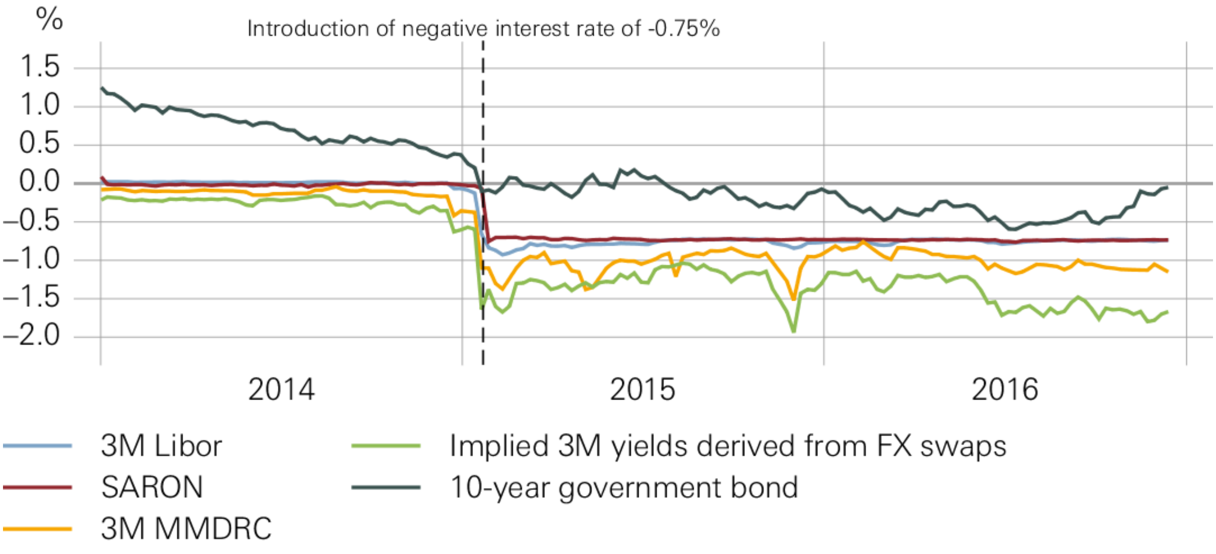
CHART 3: TRADE-WEIGHTED EXCHANGE RATES

Change since end-June in percent



Sources: Bloomberg, SNB

CHART 4: MONEY AND CAPITAL MARKET RATES



Sources: Bloomberg, SNB

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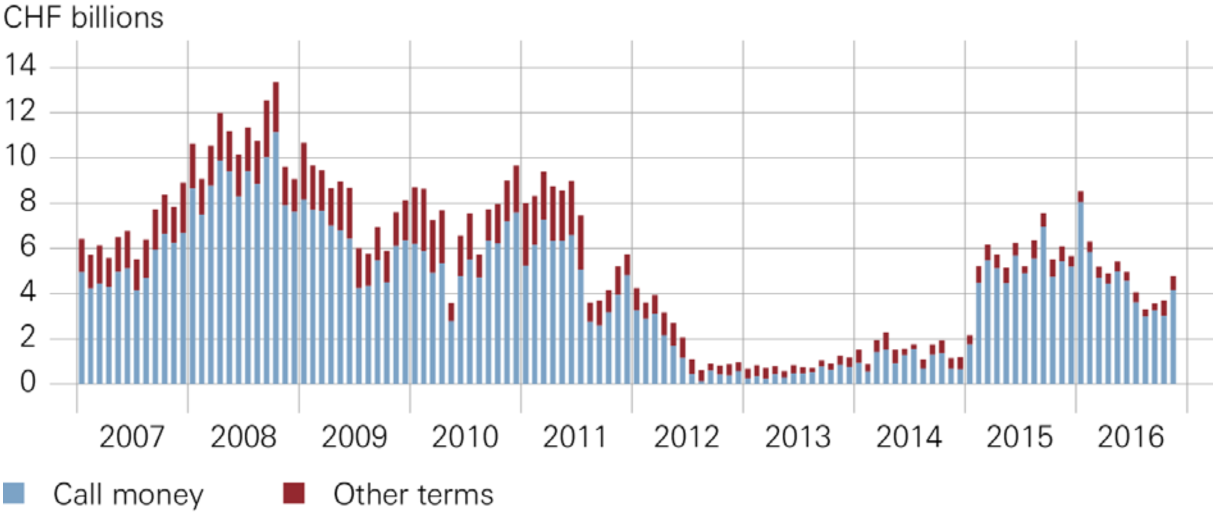
CHART 5: TURNOVER ON THE SWISS FRANC REPO MARKET

Average figures for each period



Sources: SIX, SNB