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Bank funding costs: latest developments from a monetary policy perspective

Money Market Event

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Ladies and gentlemen

My colleague Thomas Moser and I are delighted to welcome you to our traditional Money Market Event in Geneva. We are pleased that so many of you have accepted our invitation to attend. Our speech today and the panel discussion that follows will focus on bank funding costs in the Swiss financial market.

Since we last met here a year ago, the SNB has lowered its policy rate by 1 percentage point. The policy rate has thus been cut by a total of 1.75 percentage points since the beginning of 2024, and this has passed through to the relevant market interest rates.[1] Interest rates in the financial and credit markets have fallen accordingly, thereby also reducing interest costs for borrowers in Switzerland.

At the same time, however, we observe that the interest rates at which banks secure funding in the financial market have fallen less sharply than the general level of interest rates. This means that bank funding costs in the financial market have increased relatively speaking, which can affect the pricing and granting of loans.[2]

As the credit markets are one of the channels via which our monetary policy takes effect, we will take a closer look at this phenomenon today. We will focus on two questions: First, what factors explain the higher funding costs? And second, what are the implications for bank lending and the effectiveness of our monetary policy?

The role of funding in the financial markets

Before turning to these questions, let me briefly address the central role played by the funding of loans in the financial markets.

When a bank grants a loan, a claim on the borrower is created on the assets side of the bank's balance sheet. At the same time, it credits the corresponding amount to the borrower's account – on the liabilities side, a customer deposit thus appears as a liability of the bank (cf. chart 1a). As soon as the borrower uses this deposit to make a payment to a customer of another bank, the amount is debited from the borrower's account and credited to the payment recipient's account. This is settled between the banks involved using sight deposits at the SNB. The lending bank transfers liquidity in the form of SNB sight deposits to the payment recipient's bank (cf. chart 1b).

The lending bank must ensure that it has sufficient liquidity to cover all its liabilities – such as those arising from retail payments – at all times. Making sure that it has the liquidity needed to meet its financial obligations is therefore a key issue. To manage its liquidity, the bank must find solid financing for its loans, a process commonly referred to as securing 'funding'. Various sources of funding are available for this purpose:

[1] Cf. Martin and Moser (2024) on the transmission of the policy rate to financial market interest rates.

[2] In this speech, we consistently use the term 'funding costs' to mean a measure expressing the absolute funding rate in relation to the general interest rate level.

- Customer deposits: Short-term sight or savings deposits are normally one of the cheapest sources of funding. Banks can expand their deposit base by adjusting their conditions, for example.
- Money market: Short-term liquidity requirements can be met by borrowing money in the interbank market or from other financial market participants; this enables liquidity to be obtained flexibly and rapidly.
- Capital market: Large volumes of liquidity can be raised for the long term by issuing Pfandbriefe (a type of covered bond) and bank bonds (cf. chart 1c). This enables a bank to manage its liquidity actively and on a long-term basis.[3]

The bank will typically make use of all available sources of funding, seeking to achieve a balanced funding profile that is aligned as well as possible with its business model and prevailing market conditions. We will focus here on funding costs in the money and capital markets.

Determining funding costs

When banks secure funding, they pay investors a specific rate of interest, known as the funding rate. This can be broken down conceptually into the following four components (cf. chart 2):

1. Expected short-term interest rates over the term of the funding.
2. A term premium to compensate for the uncertainty regarding future interest rate and inflation developments.
3. A credit premium for the bank's default risk.[4]
4. A liquidity premium, which reflects both the tradability of the funding instrument and the funding costs of investors arising from balance sheet and investment restrictions, for instance.[5] This means, for example, that if a bank issues a bond and investors' buying capacity is limited, it will have to offer a higher liquidity premium and pay a correspondingly higher funding rate.[6]

In order to determine a bank's funding costs, the bank and instrument-specific premia – i.e. the spreads that the bank has to pay in excess of interest rate expectations and the term premium – are relevant. A common measure of interest rate expectations and the term premium is the swap rate, i.e. the fixed interest rate that derivatives market participants

[3] Other sources of funding are also available, such as the sale of loans to investors (e.g. via securitisation).

[4] The credit premium compensates for the expected default risk and the uncertainty surrounding default risk.

[5] Institutional investors such as pension funds and insurers are subject to various balance sheet and investment restrictions, such as caps on certain asset classes, diversification requirements, as well as credit rating and liquidity requirements.

[6] Cf. Brunnermeier, M. K. and L. H. Pedersen (2009), pp. 2202–2203.

exchange for a variable money market rate such as SARON. As the principal is not exchanged in an interest rate swap, the swap rate does not include either credit or liquidity premia.[7]

The difference between the funding rate and the swap rate thus isolates the instrument-specific credit and liquidity premia. This difference, known as the swap spread, is a common measure of funding costs. The swap spread directly shows the additional funding costs that banks have to bear in excess of interest rate expectations and the term premium. It thus allows a comparison of funding costs over time, across different terms and between different funding instruments (e.g. Pfandbriefe or bank bonds).

How have funding costs developed in recent times? Between mid-2023 and end-2024, swap spreads increased significantly for a range of funding instruments (cf. chart 3). Yields on bonds such as Pfandbriefe thus fell less sharply than swap rates during this period. A similar increase was also observed in the bank bond market and the unsecured money market. Although spreads have recently declined somewhat, they remain elevated.

By way of example, the swap spread on ten-year Pfandbriefe reached more than 40 basis points in the secondary market in November 2024. The ten-year average was around 20 basis points. Latterly standing at around 30 basis points, it is still approximately 10 basis points above the ten-year average.

Explanations for the increase in funding costs

What explains the rise in swap spreads, i.e. in bank funding costs? There are many possible reasons, the relevance of which varies depending on the bank and funding instrument in question. We would like to highlight three key explanations (cf. chart 4): First, the higher yields on foreign government bonds relative to the corresponding swap rates; second, the structural change in the Swiss banking market following the acquisition of Credit Suisse by UBS; and third, developments that have made banks' liquidity management more challenging.

These three factors have led to a higher liquidity premium on funding instruments. Given that the creditworthiness of the Swiss banks and mortgage bond institutions has remained stable, we can practically rule out the rise in the swap spread being attributable to higher credit risk and the associated widening of the credit premium.

Explanation 1: Rise in government bond yields relative to swap rate

Since mid-2023, the swap spreads on foreign government bonds, i.e. their yields relative to the swap rates, have risen significantly (cf. chart 5, left-hand side).[8] This is mainly

[7] Money market rates that are relevant for interest rate swaps (e.g. SARON) reflect average interbank credit risk. As SARON is secured by high-quality liquid assets, the credit risk associated with SARON swaps is negligible.

[8] In the market, the swap spread on government bonds is calculated as the difference between the swap rate and the yield on a government bond with the same term (swap spread = swap rate minus government bond yield). However in this speech, as with the calculation of bank funding costs, we calculate the swap spread on government bonds as the government bond yield minus the swap spread.

attributable to two developments: First, in the context of quantitative tightening (QT), central banks became less active in government bond markets. As a result, important – and not especially price-sensitive – sources of demand were absent. They were replaced by more price-sensitive private investors who could only absorb the supply of government bonds at higher interest rates. Second, an expansion of sovereign debt considerably increased the supply of government bonds abroad, which weighed on prices and pushed up yields.[9]

In Switzerland, the SNB did not sell any Swiss government bonds – and there was no expansion of fiscal deficits.[10] Global interest rate movements were nevertheless reflected in Swiss Confederation bond yields – particularly via interest arbitrage transactions and international portfolio allocations. If, for example, yields on German government bonds rise relative to corresponding Swiss securities, Swiss bonds become less attractive for investors. Demand therefore falls, putting prices under pressure and pushing up yields in the Swiss market.[11]

The spillover effects described here are not limited to the impact of foreign yields on Swiss bonds; they are also felt within the same currency area (cf. chart 5, right-hand side). If the swap spread on government bonds rises, the swap spreads on other bonds – e.g. Pfandbriefe or bank bonds – typically also increase. As a result of this adjustment mechanism, a rise in the swap spreads on foreign government bonds widens the spreads on comparable Swiss franc-denominated government bonds, increasing bank funding costs.

Explanation 2: Structural change in Swiss banking centre

The acquisition of Credit Suisse by UBS in 2023 triggered a structural change, which has also been reflected in the Swiss credit market. Since then, the number of customers entering into new credit relationships with domestically focused banks has increased significantly. One important reason for this was the desire for diversification – many clients that previously did business with both UBS and Credit Suisse sought additional banking relationships to reduce their reliance on a single big bank. Equally, this development may also have occurred in response to more risk-based borrowing conditions for former Credit Suisse customers in the context of the integration process at UBS.[12]

This structural change caused lending to shift towards domestically focused banks (chart 6, left-hand side). In our discussions, market participants emphasised that credit growth at some of these banks had significantly exceeded the rise in customer deposits, increasing their funding needs in the capital market. Unlike the former Credit Suisse, many of the

[9] Cf. BIS (2024).

[10] In order to tighten its monetary policy, the SNB reduced its foreign exchange reserves, which contributed to an increase in the supply of securities denominated in foreign currencies.

[11] Cf. Federal Treasury (2025), p. 11.

[12] Cf. SNB (2025), p. 16. SNB (2025a), p. 31.

domestically focused banks have little or no presence abroad, so their investor base is narrower. This has led to a corresponding rise in domestic funding needs.

Banks' additional funding needs in the Swiss capital market are reflected in the issuance volume of bank bonds and Pfandbriefe (cf. chart 6, right-hand side). This has risen continuously in recent years and is likely to have contributed to the increase in spreads on Pfandbriefe and bank bonds.

Explanation 3: More challenging liquidity management

At the heart of banks' liquidity management is meeting the liquidity coverage ratio (LCR) requirement.[13] This stipulates that financial institutions must hold sufficient high-quality liquid assets (HQLA) to meet their short-term liabilities, even in times of stress. HQLA include banks' sight deposits at the central bank, as well as government bonds and other high-quality liquid securities. In Switzerland, sight deposits make up a large proportion of HQLA.

In recent quarters, three developments have made banks' liquidity management more challenging and have – via a higher liquidity premium – contributed towards a rise in swap spreads.

First, the supply of available HQLA declined because the SNB sold foreign currency until the end of 2023 in the course of tightening monetary policy.[14] These transactions led to a decline in banks' sight deposits held at the SNB, and hence to a decrease in HQLA.[15] In addition, the SNB raised the minimum reserve requirement for banks as of 1 July.[16] Sight deposits to meet this minimum reserve requirement are to be held permanently, even under conditions of stress, and they therefore cannot be counted towards the LCR. As a result, the volume of eligible HQLA decreased.

Second, since January 2024, systemically important banks have been subject to stricter liquidity requirements.[17] These ensure that systemically important banks are more resilient to liquidity shocks, as stipulated by the Banking Act, and have increased their need for HQLA and long-term funding.

Third, the currently comparatively flat yield curve, in which long-term interest rates are barely higher than short-term interest rates, is leading to a situation in which the maturities on the

[13] The Swiss Banking Act in conjunction with the Liquidity Ordinance requires Swiss banks to conduct professional liquidity management. In addition to the short-term liquidity coverage ratio (LCR), the net stable funding ratio (NSFR) must also be complied with. The NSFR limits dependence on short-term funds by requiring stable funding structures for banks' long-term loans.

[14] At the same time – albeit on a smaller scale – the decline in banknotes in circulation, the interest payments by the SNB and the profit distributions to the Confederation and the cantons led to a rise in HQLA in the banking system. The disbursement of emergency liquidity assistance (ELA) also temporarily increased the HQLA. This interplay of factors thus had the opposite effect to foreign currency sales.

[15] By international standards, the sight deposits made available by the SNB, or HQLA, remain very high, even after the SNB's balance sheet reduction. Swiss banks may also make use of options for alternative liquidity approaches (ALA) to meet the LCR requirement in Swiss francs – they may include foreign currency HQLA or additional HQLA in category 2a (Pfandbriefe). These options were specifically created for jurisdictions where, in the absence of the central bank's sight deposits, the supply of HQLA may not be sufficiently large.

[16] Cf. SNB (2024): SNB raises minimum reserve requirement for banks.

[17] Cf. Federal Council (2022): news.admin.ch/en/nsb?id=89132.

liabilities side of banks' balance sheets are tending to shorten. This is because, in such an interest rate environment, investors tend to avoid longer-term investments such as time deposits and bank bonds, preferring short-term sight deposits instead. This maturity shortening with respect to banks' liabilities causes their LCRs to deteriorate.

These developments have led banks to seek more HQLA and to strive for a longer-term funding structure – partly to ensure compliance with liquidity requirements. Furthermore, according to our discussions with market participants, in many cases financial institutions have not wanted to allow their liquidity surpluses to fall; in other words, they have sought to preserve their liquidity buffers. The HQLA surplus in the Swiss banking system is thus comparable to that of 2022 (cf. chart 7).

The increased competition for longer-term funding of HQLA has contributed to upward pressure on liquidity premia and hence also on swap spreads in the funding markets. The increased demand for long-term funding has also been felt in the unsecured money market, where spreads on terms of over 90 days have risen significantly since 2024 (cf. chart 8).

Outlook for funding costs in the Swiss financial market

How do we expect things to develop in the future (cf. chart 9)? The international environment currently suggests that a rapid decline in funding costs is unlikely. It is true that QT by central banks – in other words, the pace at which they are selling securities – has slowed of late.[18] However, a reduction in the spread between government bond yields and the corresponding swap rates is counteracted by high government borrowing needs.[19]

The structural change in the Swiss banking sector resulting from the acquisition of Credit Suisse by UBS is likely to persist for some time. There are signs that adjustment processes are already underway and that not only domestically focused banks but also other market participants, such as foreign banks, are filling the gaps left by Credit Suisse. We also see that many institutions are expanding their range of funding measures, including by raising funds abroad. However, these adjustment processes are demanding and time-consuming.

The SNB's foreign currency sales in 2022 and 2023, the increase in the minimum reserve requirement, as well as stricter liquidity requirements for systemically important banks have had a lasting impact on banks' liquidity management. Here, too, accessing additional sources of funding can help alleviate upward pressure on funding costs.

Indeed, we see that the situation has eased somewhat in recent months, with swap spreads falling in the unsecured money market and the market for Pfandbriefe. This indicates that the aforementioned adjustment processes – such as accessing new sources of funding – are progressing.

[18] Cf., for example, Federal Reserve (2025), p. 5, and Federal Reserve (2025a), p. 37. In October, the Federal Reserve decided to end its QT altogether in December 2025.

[19] In Switzerland, swap spreads on government bonds have declined noticeably this year. One possible reason for this is that investors have increasingly focused on Swiss franc investments as safe havens.

Significance for credit supply and monetary policy

From the SNB's perspective, the key question is: What effects are higher funding costs having on the granting and pricing of bank loans, and will this development influence the impact of our monetary policy?

Let us start by looking at the granting and pricing of loans. For banks, the interest rate margin – the difference between the lending rate and the funding rate – is a significant source of income. An increase in funding costs, i.e. a situation in which the funding rate rises relative to the swap rate, reduces this margin. In order to stabilise it, banks can raise their lending rates in relation to the swap rate.

We have indeed observed a widening in the spread between various lending rates and the swap rates since 2024. The average swap spread for published mortgage rates has risen by around 20 basis points (cf. chart 10).

In addition to steering the interest rate margin, banks must ensure that they comply with regulatory liquidity metrics. They can do this by tightening lending – curbing credit growth in a targeted manner can reduce funding needs.

According to our observations, however, credit growth in Switzerland has remained robust overall. The volume of mortgage lending, which makes up over 85% of total credit volume, is currently growing at a rate of around 3%. This development is in line with our model forecasts. Based on the available data, there is no discernible 'credit crunch' – i.e. no nationwide undersupply of credit.[20]

What does this mean for the SNB's monetary policy? Following our policy rate cuts, both funding and lending rates fell markedly (cf. chart 11, left-hand side), despite rising relative to swap rates. This shows that monetary policy transmission via the credit markets is working.[21] Credit growth has accelerated as a result (cf. chart 11, right-hand side). Our monetary policy easing is thus having the intended effect.

Conclusion

In summary, bank funding costs, as measured by swap spreads, have risen noticeably in recent quarters. The key factors here have been the global increase in swap spreads on government bonds, the structural change in the Swiss banking centre, and various developments that have made banks' liquidity management more challenging.

Despite this rise in funding costs, credit growth in Switzerland remains robust and our monetary policy stimuli are taking effect via the credit markets. The easing of monetary policy since the beginning of 2024 has led to lower financial market and lending rates and a

[20] There are some signs of restraint in complex loan segments and in the case of specific borrowers. Cf. Baeriswyl, Freitag and Ganarin (2025).

[21] In addition to the credit channel, monetary policy takes effect via other channels, such as the exchange rate channel.

pick-up in lending, thereby helping to ensure price stability in Switzerland. Our monetary policy thus remains effective.

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