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Introductory remarks by Andréa M. Maechler

I will begin with a review of developments on the financial markets and look at the status of the Swiss franc. After that I will say a few words about the upcoming transition from Libor to SARON as the new reference interest rate in Switzerland and inform you about progress being made on this front.

Situation on the financial markets

So let me start with developments on the financial markets.

In the second half of the year, sentiment on the financial markets darkened considerably at times, despite the fact that the economic situation in many countries remained sound. Nonetheless, the economic data did weaken slightly in some regions. This caused investors to focus on a number of risks – most notably, ongoing concerns about protectionist tendencies, but also the currency crises unfolding in several emerging economies and Italy's budget dispute with the EU.

As a result, volatility on the financial markets has increased significantly since mid-year (cf. chart 1). This is particularly true of the equity markets, where prices fluctuated substantially at certain points. Thanks to strong economic data and solid corporate earnings growth, US stock exchanges performed better than their counterparts in Europe and the emerging markets (cf. chart 2). Despite suffering sizeable losses in October, the S&P 500 recently closed only moderately lower than it had at the end of June down 3%. In Europe, the Stoxx 600 lost around 9% over the same period. Various factors contributed to the weak performance of European stocks. Economic momentum has weakened of late and corporate earnings growth remained below expectations in the third quarter overall. Moreover, currency turmoil in Turkey and the budget dispute between Italy and the EU weighed on Europe's stock exchanges. In Switzerland, the SMI has managed to gain around 1% since mid-year. This above-average showing was predominantly due to a strong performance in July, which in turn was mainly driven by positive corporate news in the pharmaceutical sector.

On the interest rate markets the picture initially remained mixed due to uneven growth momentum in the major economic regions since mid-2018 (cf. chart 3). In the US, the Federal Reserve confirmed that it intended to maintain its policy of gradual interest rate rises. Against this backdrop, yields in the US continued to rise and the yield on 10-year US Treasuries hit a multi-year high at the beginning of November. This rise in yields receded again in response to another dip in risk sentiment at the beginning of December. Most recently, the yield on 10-year US Treasuries stood at almost 2.9% – close to the level recorded at the end of June. In Europe, on the other hand, yields have been more stable. Yield differentials between US and European government bonds thus also reached a multi-year high in November. Since then, differentials have narrowed again somewhat due to a more pronounced decline in the US. The yield on ten-year Confederation bonds last stood at –0.15%, virtually unchanged versus mid-year.

Let me now turn to the foreign exchange markets. Compared to the turbulent developments on the equity markets, the currencies of the major advanced economies traded within fairly narrow ranges in the second half of the year. On a trade-weighted basis, the US dollar has gained 2.5% since mid-year thanks to a buoyant economy and rising interest rates. The trade-weighted euro, however, lost almost 1% over the same period due to weaker economic momentum in the euro area recently and uncertainty linked to Italy’s budget issues.

The Swiss franc remains vulnerable to changes in risk sentiment on the international financial markets. It strengthened moderately, by 2.5%, in the second half of the year (cf. chart 4). This appreciation is primarily due to the period between August and mid-September, when concerns about emerging markets – and possible consequences for Europe’s finance sector – caused a renewed spike in risk premia on European financial securities. From mid-September, the Swiss franc depreciated again slightly, particularly against the US dollar which has become more attractive to investors due to the greater interest rate advantage. Furthermore, emerging market currencies stabilised noticeably. Overall, developments on the foreign exchange markets show that the situation remains fragile and that the Swiss franc continues to serve as a safe haven in times of heightened uncertainty. Thomas Jordan also referred to this phenomenon in his remarks on exchange rates.

Replacing Libor with SARON

I would now like to update you on the work that is under way to replace Libor with SARON as a reference interest rate. Since the UK Financial Conduct Authority announced nearly a year ago that it would not guarantee the continuation of Libor beyond 2021, this topic has attracted significant public interest. Alternative reference interest rates have now been identified for all currencies in which Libor is used as a reference rate. In Switzerland, the National Working Group on Swiss franc Reference Interest Rates (NWG) is drawing up recommendations to ensure a smooth transition. Many of the leading market participants sit on the NWG, which is co-chaired by the SNB and a representative from the private sector. The SNB principally acts as a facilitator and is responsible for running the secretariat.[1] It also maintains links with international bodies charged with preparing recommendations for reference interest rate reforms and ensuring a well-coordinated transition.

In October 2017, the NWG recommended that the Swiss franc Libor be replaced by the Swiss Average Rate Overnight (SARON) used for overnight transactions in the secured segment. SARON has already gained in importance as a reference interest rate. In the course of 2017, an interest rate curve developed based on swap transactions referencing SARON. Although the outstanding volume is still substantially lower here than on the swap market referencing Libor, increasing use of SARON in loan agreements means that demand for interest rate hedging will rise. The SARON-based curve is therefore set to become increasingly important in the future. This interplay between loan products and interest rate hedging transactions is highly significant for the transition from Libor to SARON.

This year, the NWG has been conducting detailed discussions on the modalities of replacing a longer-term rate like Libor with an overnight rate. In loan agreements, interest periods of three or six months are typically set. When using Libor, the interest payments due are thus fixed at the beginning of the interest period. With SARON, an overnight rate, this is not directly possible. The NWG recommends using the average of realised SARON values for the relevant interest period (e.g. the last three months) as the reference rate. The next step will involve working out various ways of using these averages in financial products such as loan agreements.

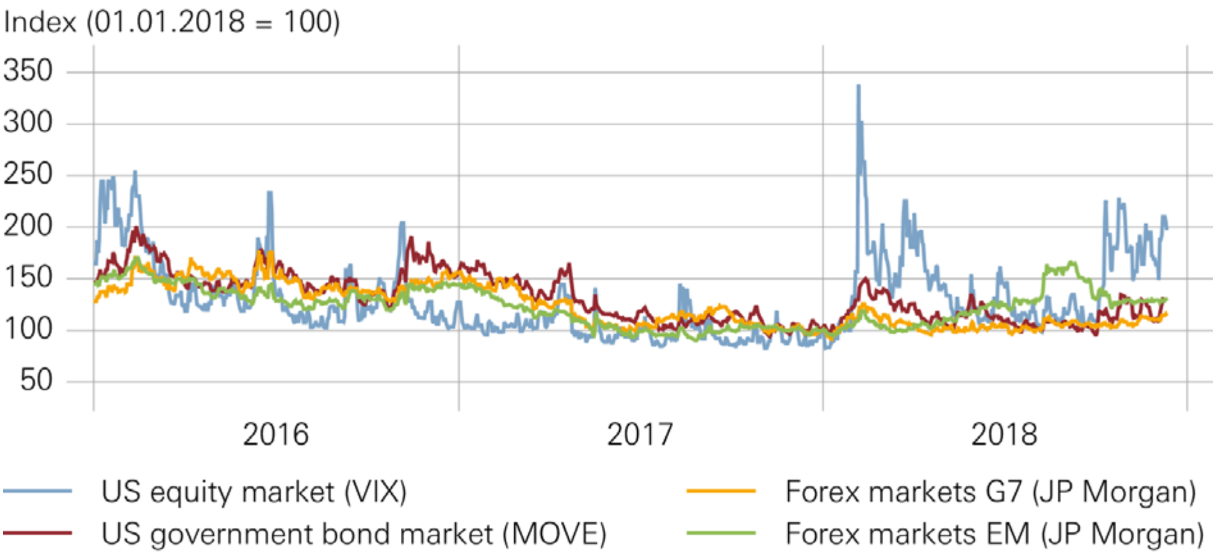
The transition to SARON presents an array of challenges. For the changeover to run smoothly, all market participants must have a thorough understanding of the issues. The recommendations of the NWG play an important role here. However, each market participant is ultimately responsible for preparing its organisation to transition away from Libor and for taking necessary measures in time.

[1] Relevant documents are published on our website: https://www.snb.ch/en/ifor/finmkt/fnmkt_benchm/id/finmkt_reformrates

News conference

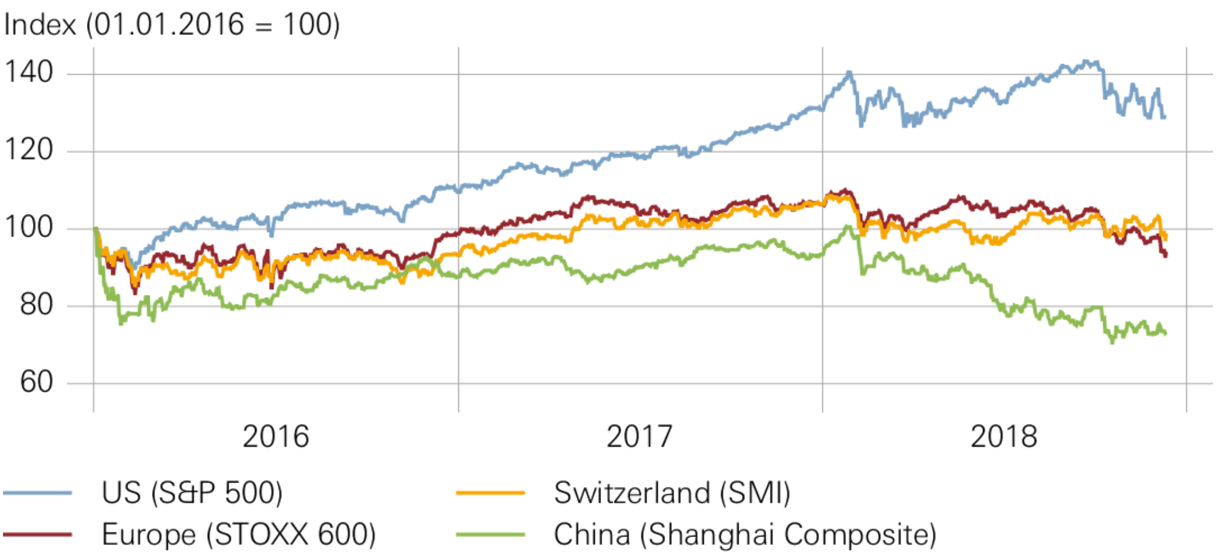
Charts

CHART 1: IMPLIED FINANCIAL MARKET VOLATILITY



Sources: Bloomberg, CBOE, JP Morgan, Merrill Lynch, SNB

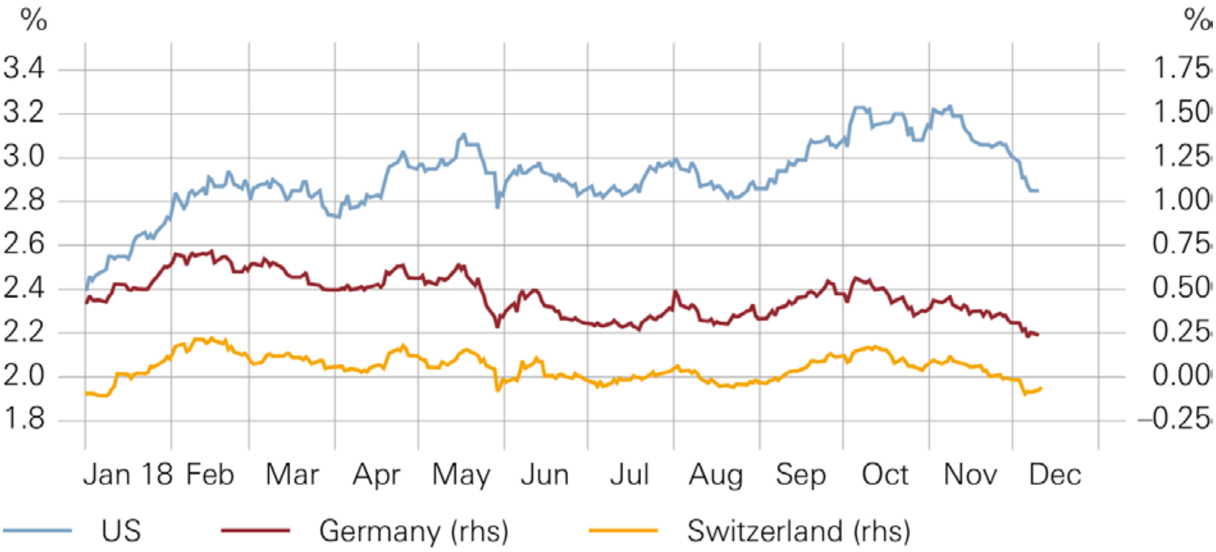
CHART 2: GLOBAL EQUITY MARKETS



Sources: Bloomberg, SNB

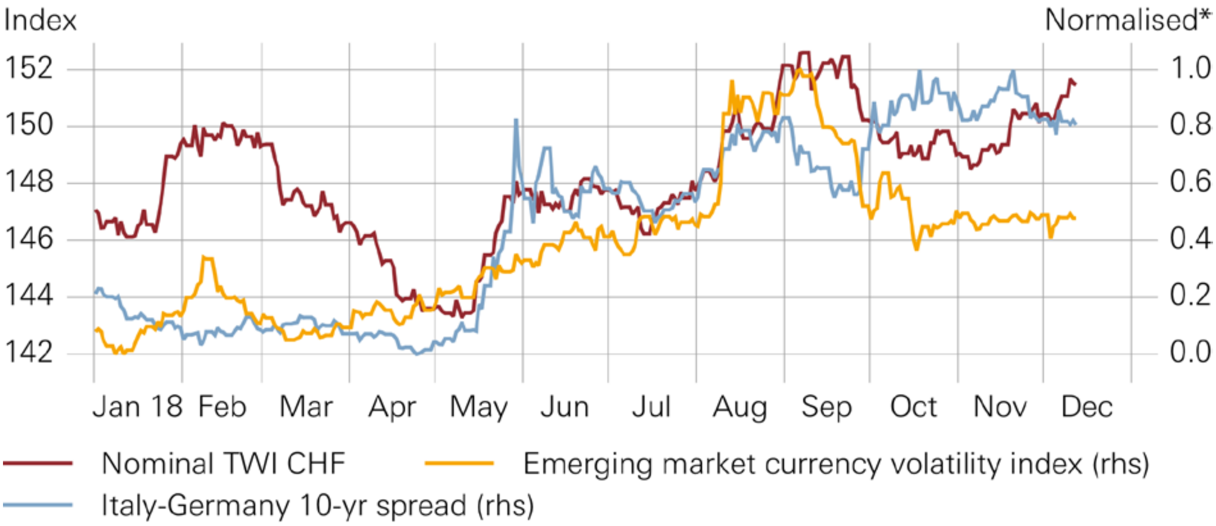
News conference

CHART 3: 10-YEAR GOVERNMENT BOND YIELDS



Sources: SNB, Thomson Reuters Datastream

CHART 4: SWISS FRANC AND SELECTED RISK DRIVERS



* 0 represents the lowest observed value and 1 the highest observed value since the beginning of the year.
Sources: Bloomberg, SNB