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Andréa M. Maechler

Introductory remarks by Andréa M. Maechler

I would like to start by outlining developments in the financial and foreign exchange markets. I will then make a few comments regarding the SNB policy rate and the replacement of Libor. Finally, I will provide some background information on the SNB's recent decision to join the Network for Greening the Financial System.

Financial and foreign exchange markets

In Q1 2019, the risk markets – especially the equity markets – recovered from the downturn in Q4 2018. This was partly due to the Federal Reserve signalling its willingness to be 'patient' on further interest rate hikes, and partly to the fact that economic data for Q1 2019 painted a more benign picture than the markets had expected at the end of 2018. In April, equity market indices briefly rose to new highs in several countries. In May and early June, many of these indices declined in response to a weaker economic and inflation outlook and, in particular, the abrupt escalation of the trade dispute between the US and major trading partners like China and Mexico. In aggregate, the major equity markets in North America and Europe have gained over 5% since the last news conference in December 2018.

By contrast, over the last six months, yields on government bonds have fallen significantly overall in most advanced economies. Market developments were shaped by the more pessimistic assessment of the economic outlook and expectations that monetary policy could remain expansionary for longer. At the end of May and beginning of June, deteriorating risk sentiment triggered a flight to safe havens and a corresponding decline in government bond yields.

These developments on the equity and bond markets had only a limited effect on the foreign exchange markets. In the major currencies, trading ranges were generally narrow and risk premia low, despite heightened macroeconomic and political risks. Swiss franc volatility also remained moderate. The trade-weighted exchange value of the Swiss franc has barely changed overall since the last news conference, and the currency remains highly valued. The Swiss franc depreciated in April following the postponement of the UK's exit from the EU, however in May, the escalation of the US-China trade dispute and concerns about Italy's budget situation reversed this depreciating trajectory.

The risk of renewed upward pressure on the Swiss franc is high, given the many hotspots around the world. This explains why it still costs more to hedge against Swiss franc appreciation than against Swiss franc depreciation on the options market. The franc thus continues to be in demand as a safe-haven currency and the situation on the foreign exchange market remains fragile. The negative interest rate and the SNB's willingness to intervene in the foreign exchange market as necessary therefore remain essential.

The transition from Libor to SARON

Let me now turn to the SNB policy rate and the transition away from Libor.

As Thomas Jordan has explained in his remarks, we are introducing the SNB policy rate as the future of Libor is uncertain. This adjustment does not entail any change in the SNB's current monetary policy stance.

However, the move away from Libor presents the financial markets, and those operating in them, with a very challenging task. I would like to discuss three aspects of this transition in greater detail: first, the choice of the Swiss Average Rate Overnight (SARON) as the alternative reference rate; second, the importance of using SARON in financial products and developing a liquid, SARON-based yield curve; and third, the issue of how interest payments should be calculated over longer periods.

As regards the first aspect – the choice of a new reference rate: In Switzerland, the National Working Group on Swiss Franc Reference Rates (NWG) recommended SARON as the alternative as early as 2017. Switzerland, like other currency areas, has thus chosen an overnight rate as its preferred alternative to Libor. SARON has been in existence for ten years and, unlike Libor, is based on trades and binding quotes for overnight transactions on the secured Swiss franc money market. This market segment is broader and more liquid than the unsecured money market on which Libor is based.

Moving on to the second aspect – the importance of using SARON more actively in financial products and developing a liquid, SARON-based yield curve: To date, Libor has been widely used in financial products, however market participants are now working hard on transitioning to new, SARON-based products. These include derivatives, especially interest rate swaps, which can be used to hedge against changes in interest rates.[1] A SARON-based interest rate swap market was set up back in 2017. Trading activity in this market remains low, however it is expected to pick up once SARON becomes more widely used in cash products (such as loans, mortgages and capital market instruments) and investment products. The SARON-

[1] An interest rate swap allows a contractually agreed, fixed interest rate (e.g. for a period of five years) to be exchanged periodically for a floating interest rate. The floating interest rate portion of the contract is determined by a reference rate.

based yield curve will then be able to take over the role of the current, Libor-based yield curve. Yield curves are important benchmarks for market participants and serve as the basis for pricing medium and long-term financial products.

And, finally, the third aspect – how should interest payments be calculated for a period of three months, for example? Libor provided a three-month rate which could, among other things, be directly applied to the calculation of interest payments on money market mortgages. If one were to use SARON in such cases, interest payments would theoretically have to be made daily, which is impractical. The NWG has recommended using average SARON values (‘compounding approach’), and has proposed several possible options. Market participants are currently working on implementing this recommendation.

Let me conclude this section by emphasising that SARON is establishing itself as the leading reference rate for financial products. It is the responsibility of market participants to systematically complete the remaining transition work and prepare themselves for the post-Libor era. As they do so, they can draw on the recommendations of the NWG, whose activities the SNB supports. The faster SARON is integrated into financial products, the smoother the replacement of Libor will be. The creation of a liquid, SARON-based yield curve is fundamental as it will enable our money and capital markets to continue running efficiently. This is very important not only for our country’s financial system but also for the transmission of the SNB’s monetary policy.

SNB joins network dedicated to ‘greening the financial system’

To conclude, I would like to say a few words about our decision to join the Central Banks and Supervisors Network for Greening the Financial System (NGFS). As climate change is a global phenomenon, institutional and technical knowledge must be analysed and exchanged globally.

The SNB joined the NGFS, which now comprises 36 central banks and supervisors, in April 2019. The network provides a forum in which members can conduct in-depth analysis and seek answers to some key questions. For instance: What kind of financial risks do climate and environmental threats pose for the finance industry? And could these risks weaken the resilience of the financial system, or indeed affect macroeconomic variables and monetary policy?

The SNB’s goal in joining the NGFS is to engage in dialogue and share knowledge in order to better understand – and anticipate – the potential impact of climate risks.