



Berne, 12 December 2019
Andréa M. Maechler

Introductory remarks by Andréa M. Maechler

I would like to begin by reviewing developments on the global financial markets, paying special attention to the situation on the Swiss franc money market. I will also brief you on how preparations to replace Libor are progressing. After this, I will address the importance of climate risks for the SNB's investment policy. I will close with a few remarks about the SNB's involvement in the new Innovation Hub being set up by the Bank for International Settlements.

Situation on the financial markets

Economic concerns and political uncertainty have shaped developments on the global financial and foreign exchange markets in recent months. For instance, the tug of war in the US-China trade dispute weighed on investors' risk sentiment, especially in the third quarter. Interest rates declined significantly around the world during this phase. Yield curves flattened markedly. In some countries, long-term interest rates even dropped below the level of short-term rates. The yield on ten-year Confederation bonds fell to a historic low of -1.1% in August (cf. chart 1).

Investor sentiment picked up again from September against a backdrop of monetary policy easing by the US Federal Reserve and the European Central Bank and somewhat more favourable economic data. The equity markets benefited in particular from reduced trade tensions in October, with some of the major share indices reaching new highs in November. The Swiss Market Index (SMI) has gained almost 5% since mid-year, recently surpassing the 2007 peak by over 12% (cf. chart 2).

In this environment, interest rates recovered slightly from their lows and yield curves also steepened again. However, yields on government bonds issued by countries considered safe by investors have mostly been below mid-year levels of late; around 28% of government debt



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worldwide is still trading at negative yields. In Switzerland, the yield on 10-year Confederation bonds recently stood at -0.5% , approximately the same level as in mid-2019.

Overall, uncertainty dominated the financial markets – a fact that was also reflected in foreign exchange market prices. Weaker economic data weighed particularly heavily on the euro, which has depreciated by some 2.5% in trade-weighted terms since the end of June. On the other hand, currencies considered safe havens by the markets were able to appreciate in this environment. The Japanese yen and the Swiss franc have gained slightly since mid-year; the franc thus remains highly valued. The situation on the foreign exchange markets is still fragile (cf. chart 3).

Money market developments

Let me now turn to developments in the Swiss franc money market. Thomas Jordan has already mentioned the adjustments we have made to the way we calculate exemption thresholds for the negative interest rate. These changes came into effect on 1 November. Since then, many banks have been benefiting from higher exemption thresholds and have an incentive to take on liquidity via the money market.

As expected, this demand for liquidity led to higher trading volumes and a slight rise in SARON and other short-term repo rates in the week following the introduction of the new calculation basis (cf. chart 4). The SNB was active in the repo market from time to time in order to keep SARON close to the SNB policy rate.

The Swiss franc repo market functioned smoothly throughout the transition, not least thanks to the state-of-the-art and reliable money market infrastructure. The SNB trades using the same infrastructure as the banks on the interbank market. This is particularly helpful as it ensures that the SNB's operations are highly effective.

Transitioning from Libor to SARON

SARON is currently establishing itself as the leading reference interest rate for financial products in Swiss francs and is replacing Libor. As you know, the UK's financial regulator will only be supporting Libor until the end of 2021, so it is important that the transition process on the market take place now. Over the last few years, the National Working Group on Swiss Franc Reference Rates (NWG) has put forward recommendations on how to proceed with replacing Libor. Market participants must now act decisively to implement these recommendations.

A SARON-based swap market is especially important for the financial markets. Swap markets are used to hedge interest rate risk (e.g. in mortgages); the associated transactions produce a swap curve, which serves as a benchmark for pricing and valuing bonds and loans. To date, however, trading – and hence liquidity – in SARON swaps has been low. This will change once more SARON-based cash products become available. The successful transitioning away from Libor therefore hinges on the development of such products.

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In order for SARON to be used as the reference rate for cash products, a longer-term interest rate must be calculated from the daily rate. As early as 2018, the NWG recommended various options for calculating an average interest rate based on realised SARON values. This approach, known as compounding, is also gaining traction abroad. A wide range of options for calculating such average rates has been proposed and evaluated. At its latest meeting, the NWG was more specific and narrowed down its set of recommended options.¹ As a result, market participants can now begin embedding the compounding approach in products such as mortgages.

In addition to new SARON-based cash products, solutions must be found for existing Libor-based products. Ideally, these will be replaced by new, SARON-based contracts. At the very least, the existing contracts must be furnished with fallback clauses, which will come into effect when Libor is no longer available as a reference rate.

I should stress that it is evident that the Swiss franc Libor will cease to exist. The stage has been set for the transition to SARON, and it is now up to market participants to use the time until the end of 2021 to complete the work that remains to be done. A successful transition from Libor to SARON is crucial for the smooth functioning of the Swiss franc money and capital markets.

Importance of climate risks for the SNB's investment policy

I would now like to say a few words about the importance of climate risks for the SNB's investment policy. Let me start by summarising this policy. Our asset management is governed by the primacy of monetary policy. In applying its investment policy, the SNB has two main objectives. The first is to ensure that the balance sheet can be used for monetary policy purposes at any time. In particular, the SNB must be in a position to expand or shrink its balance sheet if needed. The second objective is to preserve the value of currency reserves in the long term. A high degree of asset liquidity and diversification is required to ensure sufficient room for manoeuvre in the implementation of monetary policy. As the SNB does not pursue any strategic or structural objectives with its investments, it seeks to achieve the broadest possible market coverage in managing its assets.

So what do climate risks mean for the SNB's investment policy? In the context of investment policy, climate risks are not fundamentally different from other financial risks – they too can trigger or amplify market fluctuations, which influence the attractiveness of certain assets. By opting for broad coverage of entire markets, the SNB takes into account the complexity of the many different risks. We regularly review changes in the risk landscape and factor them into our investment policy where necessary. Furthermore, as an investor the SNB has long had in place a clear set of exclusion criteria for companies that violate Switzerland's fundamental norms and values. For instance, it does not invest in companies that systematically cause

¹ Relevant documents are available on the SNB website: https://www.snb.ch/en/ifor/finmkt/finmkt_benchm/id/finmkt_reformrates

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severe environmental damage. Given the monetary policy requirements of our mandate, we are convinced that the approach we have chosen is appropriate.

Foundation of the BIS Innovation Hub

In October, the SNB announced that it was collaborating with the Bank for International Settlements (BIS) to establish the BIS Innovation Hub Centre in Switzerland. This Hub Centre, which is scheduled to commence operations at the beginning of 2020 alongside the Hub Centres in Hong Kong and Singapore, will initially focus on two projects.

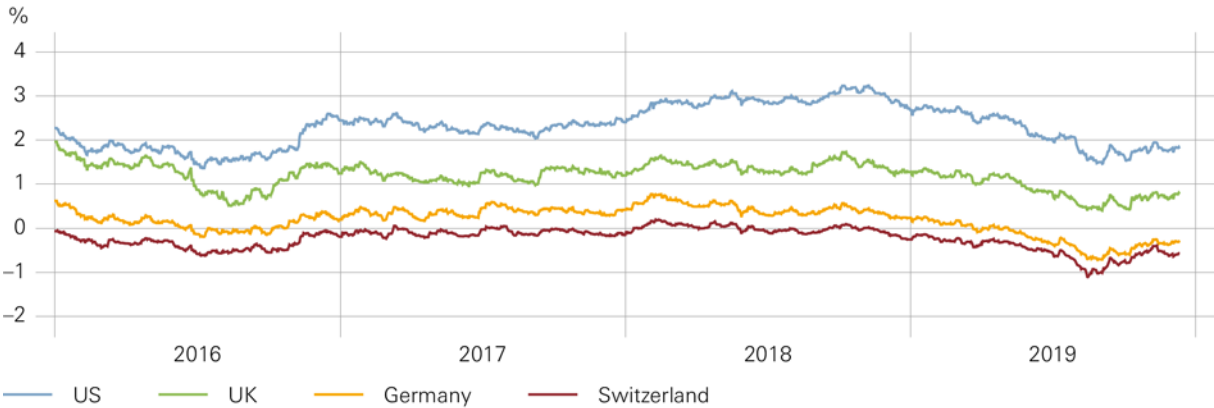
The first will examine the integration of central bank money into a distributed ledger technology infrastructure, with a view to facilitating the settlement of tokenised assets between financial institutions. With respect to integrating digital central bank money, the focus is on two options: an SNB-issued digital token for financial institutions ('wholesale central bank digital currency') and an interface with the Swiss Interbank Clearing payment system. The project will be carried out as part of a collaboration between the SNB and SIX Digital Exchange in the form of a proof of concept.

The second project will address the growing demands placed on central banks to be able to track and monitor fast-paced electronic markets. We are convinced that the work of the new BIS Innovation Hub will make an important contribution to central banks' understanding of developments in the fintech area.

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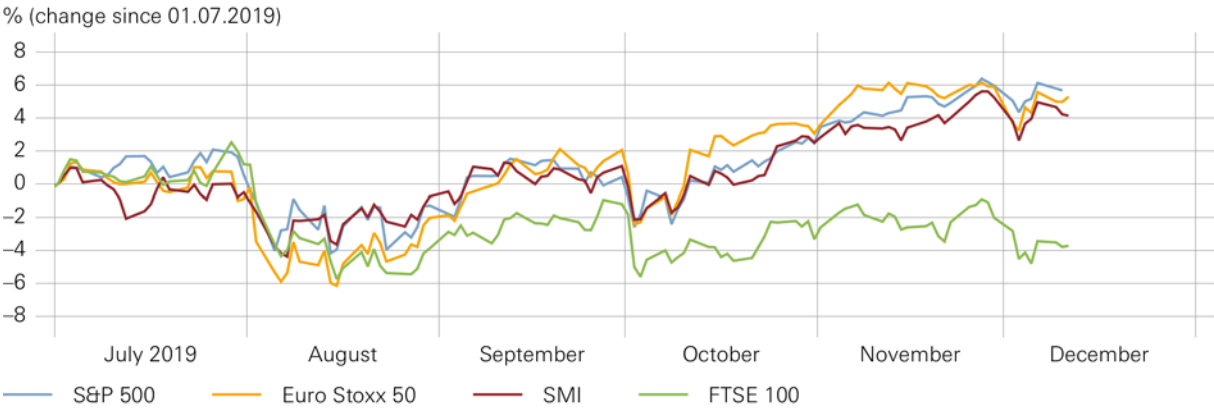
Charts

CHART 1: 10-YEAR GOVERNMENT BOND YIELDS



Sources: SNB, Bloomberg

CHART 2: GLOBAL EQUITY MARKETS

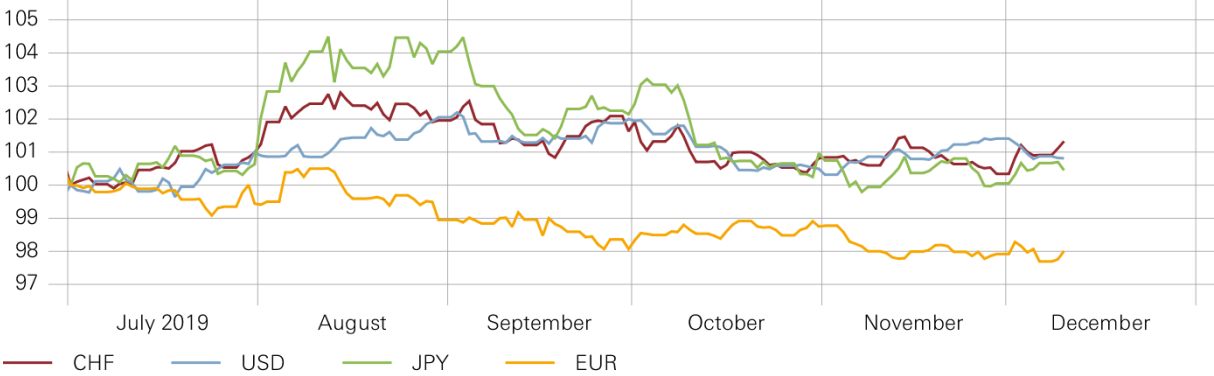


Sources: SNB, Bloomberg

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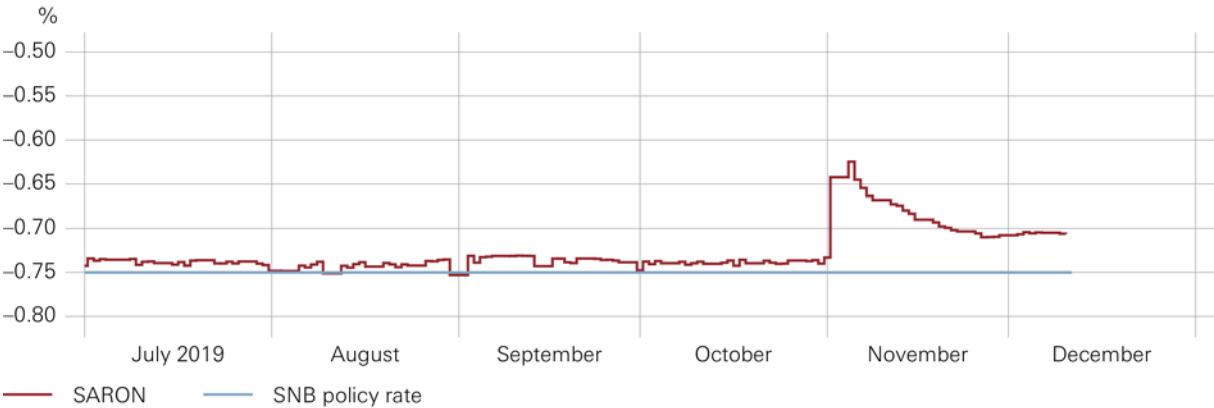
CHART 3: TRADE-WEIGHTED EXCHANGE RATES (NOMINAL)

(01.07.2019 = 100)



Sources: SNB, Bloomberg

CHART 4: SNB POLICY RATE AND SARON



Source: SNB