Media news conference

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Fritz Zurbrügg

Introductory remarks by Fritz Zurbrügg

I will begin today by looking at the situation on the financial markets. Then I will talk briefly about developments in our foreign exchange holdings. I will close with a few comments on the progress that has been made in reforming interest rate benchmarks at both international and national level.

Situation on financial markets

Since our last media news conference in June, the positive risk sentiment on financial markets has been largely maintained, as is evident from the soaring share prices, among other things. In the past few weeks, the key US indices Dow Jones and S&P 500 have reached new record levels, thereby exceeding the peaks attained prior to the global financial crisis. In addition, Japan's Nikkei Index and the most important western European stock exchange indices, including the Swiss SMI, have again recorded significant gains in recent months.

Despite all the euphoria on the stock exchanges, we must not forget that it is not only the improvement in the economic outlook but also the continuation of the very expansionary monetary policy around the world which is behind this positive risk sentiment. In May and June we saw what could happen if expectations of a less expansionary monetary policy course become widespread in the market. At that time, the announcement by the US Federal Reserve of a possible reduction in its bond purchase programme caused share markets to plunge temporarily. The wave of selling did not recede until the beginning of July, when the Federal Reserve, the European Central Bank and the Bank of England reassured markets that key rates would remain at very low levels until the recovery of the individual economies was on a firm foundation.

On bond markets, interest rates continued rising in June and July. Since then, they have largely moved sideways. This applies to US, UK, German and Swiss government bonds, in particular. Until the beginning of September, yields on ten-year Confederation bonds rose to almost 1.2%. They are currently at around 1%, which means that they have increased by

about half a percent year-on-year. Government bonds in the emerging economies were particularly strongly affected by the rise in interest rates, since the expectation of an impending monetary policy normalisation in the US led to significant capital outflows from these countries.

By contrast, risk premia on government bonds for the peripheral euro area economies did not increase very much. Moreover, these risk premia have fallen again in the meantime so that returns on government bonds in the peripheral economies are now in fact lower than at the beginning of the year. This is probably due, not least, to progress in overcoming the crisis as well as encouraging economic data from the euro area. However, investors are still cautious, so that demand is still high for investments seen as safe havens. Consequently, in recent months, the Swiss franc has moved in a narrow range above the minimum exchange rate of CHF 1.20. Nevertheless, in view of the progress in the euro area, many market participants expect that the Swiss franc will depreciate.

Despite this progress, it is still too early for an all-clear. Conditions on financial markets could change again rapidly. In order to counteract possible tensions on financial markets and lessen their potential impact on the economy, six leading central banks including the Swiss National Bank (SNB) converted their reciprocal swap lines into a standing arrangement in October. These swap lines had initially been arranged on a temporary basis at the height of the financial crisis, in order to secure access to liquidity.

Developments in foreign exchange reserves

At the end of September 2013, our holdings of foreign exchange reserves stood at CHF 443 billion. I would now like to make a few comments on income from foreign exchange reserves. I should begin by stressing that monetary policy has priority over investment policy, and that generating income is not the primary objective of investment policy. We are guided, first of all, by the criteria of security and liquidity. The criterion of security covers primarily the reduction of risks such as market, credit and concentration risks. In addition, it is important for us to maintain the real value of the foreign exchange reserves in the long term. Consequently, the long-term return on investment must match the average rate of inflation. If the criteria of security and liquidity are fulfilled, our investment policy aims to achieve an additional return over and above the real maintenance of value.

The return on foreign exchange reserves is made up of current income plus changes in the value of the investments. The income takes the form of interest and dividend payments on the bonds and shareholdings. In view of the current low interest rate environment, these amount to only around 2% of foreign exchange reserves per year. Just like investments that fall due, income is generally reinvested. Therefore, foreign exchange reserves tend to rise even when we do not need to purchase additional foreign exchange.

The other component of returns is changes in the value of foreign exchange reserves. We value all investments at market prices and in Swiss francs. Consequently, changes in the prices of interest-bearing paper and shares as well as exchange rate movements have a direct

impact on the net result for investment. If the Swiss franc strengthens against the investment currencies, this results in a valuation loss on the foreign exchange reserves. The chart shows the net investment result since the first quarter of 2010 for the foreign exchange reserves, as well as for the individual components. The dominant role of exchange rate movements is clearly evident. In the past, too, exchange rate movements have posed by far the greatest risk to our portfolio. Taking a long-term view, exchange rates have been responsible for about 80% of the total risk on the foreign currency reserves.

Reform of interest rate benchmarks

Following last year's revelations that Libor interest rates had been manipulated, various activities to reform the Libor and other interest rate benchmarks are under way. The SNB is involved in these reform activities at both international and national level. The objective is to improve the credibility and acceptance of the existing interest rate benchmarks or, where appropriate, to take steps to ensure the provision of robust alternative interest rate benchmarks.

International efforts are being coordinated by the Financial Stability Board on behalf of the G20 countries. They involve not only central banks and supervisory authorities but also an international group of private sector financial market participants. They are examining, first, the extent to which the existing Libor interest rates fulfil the requirements laid down by securities supervisors last July (the IOSCO standards). Second, they are investigating whether there are alternative interest rate benchmarks which would better meet the needs of the market and the requirements of supervisory authorities in the longer term. Alternatives to the Libor are being developed by the private sector group, which also includes Swiss representatives. The Financial Stability Board plans to present the results of its work in the middle of next year.

At the international level, activities are also under way to regulate the interest rate benchmarks as well as other important reference variables on the financial markets. In London, the Libor is already now subject to a supervisory regime. In Brussels, a bill has been proposed which would regulate all interest rate benchmarks used in the EU. In Switzerland, too, a need for regulatory action is likely to emerge in this area.

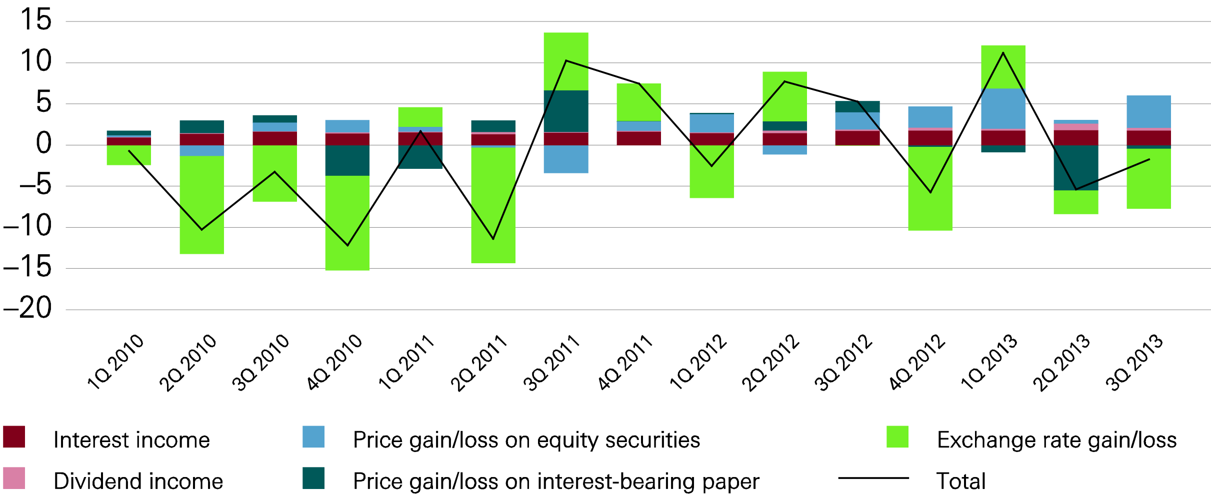
At the national level, the SNB and FINMA are talking to financial market participants about ensuring a more robust construction of the interest rate benchmarks which are fixed in Switzerland. The aim is to widen the data pool and improve the calculation methods, and the focus is on reference interest rates for very short-term Swiss franc transactions, specifically one-day terms. These transactions form the basis for the Swiss franc yield curve. The two benchmarks involved are, first, the TOIS fixing, which is used for interest rate derivatives in the Swiss franc money market, and second, SARON, which serves as the basis for the yield curve on the Swiss franc repo market. Progress has already been achieved on both interest rate benchmarks. Although the level of activity on the money market remains persistently low, they continue to be available to the market as a basis for interest rate transactions in Swiss

francs. However, the Libor retains its position as the most important interest rate benchmark in the money and capital markets.

Chart

NET RESULT FROM FOREIGN CURRENCY POSITIONS

In CHF billions



Source: SNB