SCHWEIZERISCHE NATIONALBANK
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SWISS NATIONAL BANK

Berne, 11 December 2014
Fritz Zurbrügg

Introductory remarks by Fritz Zurbrügg

In my remarks, I will begin by talking about developments on financial markets since the middle of the year. Then I will speak about the various reform efforts in the area of interest rate and foreign exchange benchmarks.

Developments on the financial markets

After a lengthy period of calm, volatility has increased slightly on the financial markets since the middle of the year. In addition, investors' appetite for risk has dipped at times, and the risk markets have suffered temporary setbacks. Thus we have observed two waves of selling on the stock markets over the past few months (cf. chart 1). At the end of July, the European stock markets, in particular, were affected, while those in the US and the emerging economies proved more resilient. The second, more serious wave of selling set in at the end of September, making a significant impact on the major non-European markets as well. The main trigger for both waves was unexpectedly weak economic data in the core economies of the euro area and Japan. To some extent, this negative effect was aggravated by geopolitical tensions.

However, chart 1 also shows that these waves of selling were relatively short-lived. A number of share indices, including the S&P 500 in the US and the SPI in Switzerland, rapidly made good their losses and have in fact attained new highs in the meantime. Important share indices within the euro area, such as the Euro Stoxx 50, have also been able to recoup their losses, and their most recent levels roughly matched those of mid-year. Apart from the continued recovery of the economy in the US and the predominantly sound corporate profits on both sides of the Atlantic, the fact that central banks in the euro area, Japan and China have eased their monetary policies is likely to have played an important role in this regard.

Looking at interest rates, yields on government bonds have continued to decline. This is partly a reflection of low inflation and the decline in inflation expectations in the major advanced economies. The fall in yields has been particularly marked in the euro area, where investors are expecting further monetary policy easing measures. Accordingly, yields on ten-year German government bonds have come down by more than 50 basis points since the end of June, while the yields on comparable US government bonds have declined by some 30 basis points. In the same period, yields on ten-year Swiss Confederation bonds have decreased by around 35 basis points, most recently hitting a historical low of about 0.3%.

Foreign exchange markets have been significantly affected by the relative strength of economic developments in the US and the correspondingly higher interest rate expectations. Since the end of June, the trade-weighted US dollar has risen by nearly 10%. By contrast, the trade-weighted euro has lost over 3.5%, while the yen has lost almost 12% of its value. Chart 2 shows that, since the middle of the year, the strength of the US dollar has also made itself felt with respect to the Swiss franc. However, the chart also shows that the Swiss franc has become stronger against the euro over the past few months. It is likely that this is mainly due to two factors. On the one hand, the disappointing path of the euro area economy, and the further easing in monetary policy associated with this, have been responsible for a weakening in the euro. On the other, the pressure on the Swiss franc has reflected the strong demand for safe investments, particularly in periods of increased geopolitical tension. Since mid-year, the trade-weighted Swiss franc exchange rate has barely changed overall. Thus, the Swiss franc is still high.

Reform efforts in the area of interest rate and foreign exchange benchmarks

This brings me to the progress that has been made in reforming interest rate and foreign exchange benchmarks. In recent years, revelations of manipulations have undermined the credibility of these benchmarks. At international level, the Financial Stability Board (FSB) is coordinating the reform efforts. At the same time, country-specific reforms are being implemented at national level. In Switzerland, responsibility for benchmarks lies, in principle, with the private sector and these benchmarks are not regulated. Nevertheless, the SNB is particularly interested that benchmarks for interest rates and exchange rates should be credible, since they are important for well-functioning financial markets and for the implementation of monetary policy. That is why the SNB has supported reform efforts in the area of benchmarks by taking part in various national and international working groups. I have reported here on these efforts on several occasions. The FSB has published two final reports since our last media news conference, so this provides me with a good opportunity to draw some initial conclusions.

Benchmarks for interest rates

As regards benchmark interest rates, the final report recommends pursuing two main approaches in the future. First, existing interest rate benchmarks should be further improved. Second, efforts should be made to develop alternative benchmark interest rates. Thus the two-pronged approach for the future envisages, alongside improved Libor interest rates which would still be based on unsecured money market transactions, the emergence of more benchmark interest rates related to repo transactions or other near risk-free transactions.

The FSB's final report states that significant progress has already been achieved with the Libor rates. However, not all of the requirements set by the securities regulators (IOSCO standards)[1] have so far been met. In particular, it still remains unclear whether the markets upon which the interest rates are based are sufficiently liquid. A certain level of liquidity is needed to ensure robust benchmark rates, i.e. rates based on a sufficiently large number of transactions. The Libor administrator, ICE Benchmark Administration (IBA), reacted to the FSB report by announcing further improvements to ensure that the Libor rates would become better established through the use of actual transactions. Such actual transactions will be used either directly, for calculating the Libor rates, or indirectly, for underpinning the contributions. In this context, the inclusion of short-term loans to large customers or money market instruments, in addition to interbank market transactions, is being examined as a future possibility.

In order to assess the FSB proposals, surveys are being conducted to collect data in the currency areas concerned. The SNB conducted such a survey at the beginning of summer for Switzerland, collecting data on bank transactions on the interbank market and with large customers, as well as on trade in money market instruments. More than 50 domestic and foreign banks took part in the survey. The results confirmed that the small number of actual transactions on the money market currently constitutes a problem for the creation of robust benchmark interest rates. Consequently, it seems improbable that a pure transactions-based approach could be implemented for the Swiss franc. This is also the case if other transaction types and additional instruments are taken into account. For this reason, the Swiss franc Libor will continue to be based mainly on contributions by participating banks.

As I mentioned before, in addition to improvements in the existing Libor interest rates, the FSB also proposes that alternative benchmark interest rates be developed. In Switzerland, alternative interest rates for very short-term Swiss franc transactions already exist. An example of these on the secured money market is SARON,[2] which is the basis for the interest rate curve on the Swiss franc repo market. On the unsecured market we have the TOIS[3] fixing, which is related to transactions in the area of call money and is used for interest rate derivatives. However, reforms were also necessary for the TOIS fixing. Consequently, new standards have been in place since 1 October. These are in line with international requirements and have resulted in a number of enhancements, including improvements to supervisory structures and codes of conduct. For these benchmark rates, too, the underlying transaction volume is currently very low.

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[1] IOSCO is the International Organization of Securities Commissions.

[2] Swiss Average Rate Overnight.

[3] Tomorrow/Next Overnight Indexed Swap.

Foreign exchange benchmarks

I will now turn my attention to benchmarks on the foreign exchange market. On the international financial markets, currencies are traded around the clock. There are no final rates for any given day. Given this situation, benchmarks on the foreign exchange market provide numerous investors, such as investment funds or asset managers, with a basis which they can use for uniform valuation of their portfolios. One of the best-known benchmarks is the WM/Reuters fix, which is set daily at 4.00 pm, London time; it is calculated as the median of actual foreign exchange transactions conducted within the period of one minute.

The FSB working group took on the task of investigating the way in which these benchmarks were fixed and recommending ways to improve them. The group's work was independent of simultaneous investigations into foreign market manipulation by supervisory authorities in a number of different countries, which resulted in the imposition of fines in November.

The final report presented at the end of September found that – unlike the situation for benchmark interest rates – liquidity in the foreign exchange market was high and therefore provided an adequate breadth of data for calculating benchmarks. However, the problem for benchmark fixing in this area stems from a different source, namely the fact that trading orders become heavily concentrated shortly ahead of the fixing time. This gives traders opportunities to manipulate the price of the fixing to their own advantage. In order to eliminate these opportunities, the working group is proposing that the fixing window be widened, thereby broadening the range of data sources. In addition, the group also recommends various code of conduct guidelines for fixing orders. What is particularly important is to ensure that banks do not share information with each other about customer orders before the fixing. The SNB supports the recommendations contained in the report by the working group. It is now up to the private sector, first and foremost, to implement these recommendations.

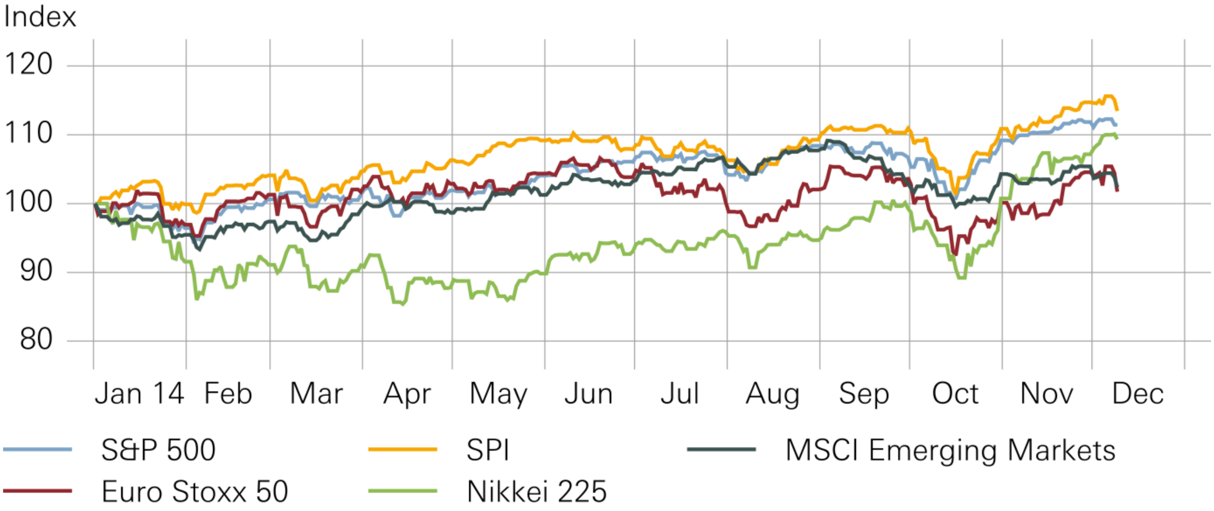
The reforms carried out so far, with regard to both interest rate benchmarks and foreign exchange benchmarks, are steps in the right direction. The SNB will carefully monitor implementation of the reform proposals for foreign exchange benchmarks and provide support, if necessary. In the case of interest rate benchmarks, the FSB's work will continue with the further participation of the SNB.

Media News Conference

Charts

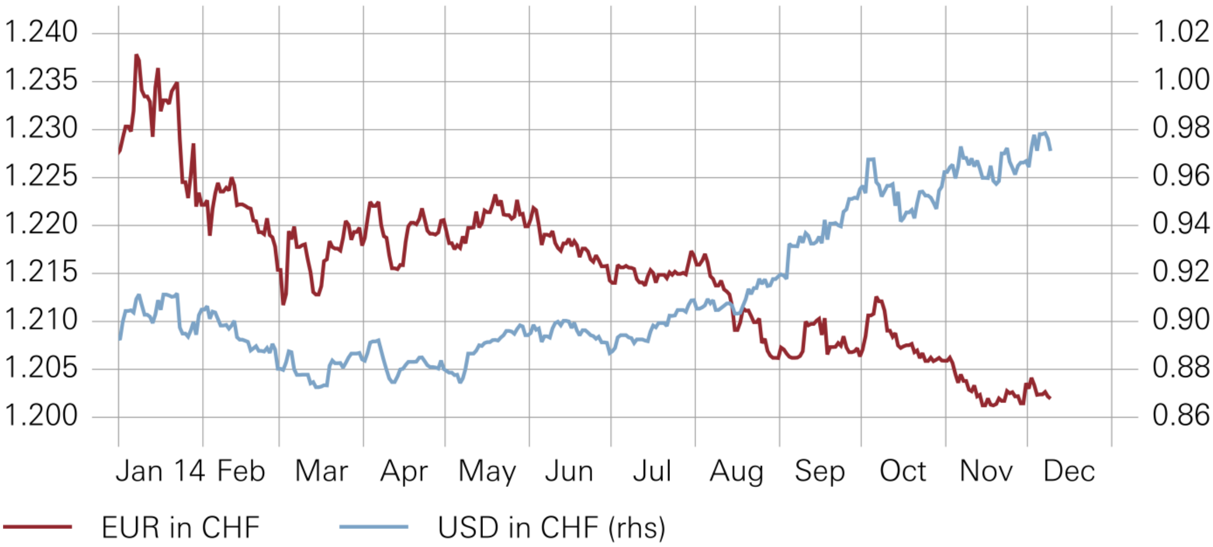
CHART 1: STOCK MARKETS

Beginning of period = 100



Sources: SNB, Bloomberg

CHART 2: EXCHANGE RATES



Sources: SNB, Bloomberg