Interest rates

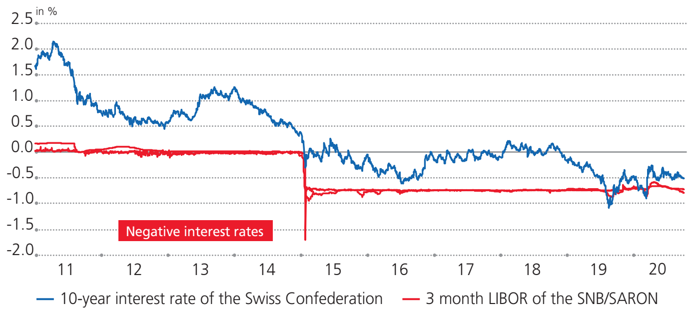
October 2020

Evolution & outlook

New normal

Interest rate markets on both sides of the Atlantic remained calm in September. The month saw a decline in volatility and sovereign bonds recorded a drop in yield of around 10 basis points in Switzerland. Despite the increase in Covid cases throughout Europe and the resurgence of tighter precautionary measures, investors remained calm and risk premiums for peripheral countries narrowed further, a result of the **"new normal" of unconventional monetary policies. Liquidity injections and zero or even negative interest rates are set to last.**

Key interest rates



Source: Thomson Reuters Datastream

In Switzerland, the **State Secretariat for Economic Affairs published revised GDP figures** which are now aligned with international standards and, above all, will more accurately measure the country's economic activity. As a result of these changes, the GDP now shows a decline of 7.3% in the second quarter compared to a decline of 8.2% prior to the alignment. At the risk of repeating ourselves, **Switzerland is doing well and proving resilient in this unprecedented crisis** thanks to the structure of its economy. **And yet, the Swiss franc is not becoming a safe haven**. Although the SNB intervened to stabilise the foreign exchange market, the amount of reserves did not skyrocket, in contrast to what was observed during the eurozone crisis in 2011-2012. In fact, since last June, foreign exchange reserves have stabilised. **The Swiss franc remained stable against the euro in September but continued to appreciate against the dollar**. After the liquidity crisis in March, the fall in US interest rates triggered a depreciation of the dollar, which came to an end in September. Due to the narrowing of the interest rate differential with Europe, **the attractiveness of the US dollar** has diminished and it should approach its fundamental value within our investment horizon.

For its part, the ECB has begun reviewing its monetary policy strategy. Christine Lagarde's initial comments seem to suggest an easing of the inflation target. **Like the Fed, the ECB could allow inflation to exceed the 2% target**. The ECB has also stressed the importance of a policy-mix; an effective interaction between monetary and fiscal policies is, in part, a prerequisite for achieving the objectives.

The Swiss consumer price index stabilised in September, with annual inflation now standing at -0.8% due to the opposing movements of its components. Prices for tourism-related services (travel, air transport and hotels) continued to fall, while the prices of other goods, such as certain fruits and clothing, rose. **Inflation is expected be remain volatile this year**, but control of the Swiss franc and the stabilisation of imported prices, particularly energy prices, will help the return to inflation targets thanks to underlying forces.

Outlook for the interest rate and mortgage yield curve

Money and bond markets remained calm in September. Uncertainties about the evolution of the pandemic or the approach of the US elections did not disrupt the pricing of bonds. The central banks - SNB, Fed and ECB - have left their key interest rates unchanged and asset purchases are acting as a stabiliser. The central banks are absorbing the abundant supply by buying bonds. In fact, the issue of bonds is accelerating, particularly by governments anxious to revive their economies, and central banks are absorbing a large part of this new debt to provide liquidity. **US, European and Swiss interest rates are expected to remain low** and the spread between German and Swiss rates should remain very narrow. Therefore, no imminent change in the mortgage yield curve.

The strong Swiss franc and low interest rates are likely to persist at least for the foreseeable future.

Interest rates 3 months	30.09.2020	3 months	12 months
Switzerland	-0.78	-0.75	-0.75
Euro	-0.49	-0.50	-0.50
USA	0.23	0.25	0.25
10-year interest rate			
Switzerland	-0.50	-0.50	-0.30
Euro	-0.52	-0.50	-0.20
USA	0.68	0.80	1.10

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