Interest rates

July 2019

Evolution & outlook

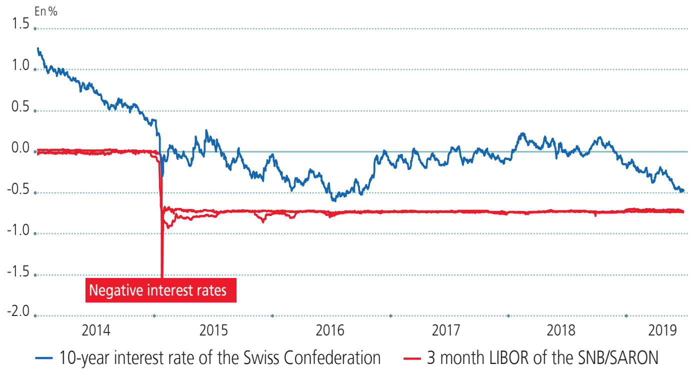
Interest rates move downward contrary to our expectations: when sentiment prevails over fundamentals.

During the month of June, bond investors continued to hang on the words of both monetary and political authorities. The various meetings of the ECB, the Fed and the SNB activated investors and pushed their expectations to extremes; they not only tried to lip-read but also to mind-read. The much-anticipated G20 meeting on the last weekend of June was attended mainly by stock market investors. In this environment, bond markets performed well in all market segments, including government, corporate and emerging market debt. The notion of risk or risk protection was definitely not the driving force behind performance. All maturities of the yield curve followed suit and this time it was not long maturities that triggered the largest decline. In fact, it was the shorter maturities that attracted investors, as they are more representative of expectations of monetary policy change.

Bond markets have a reputation for understanding the economic environment with fairly accurate insight. Since June, they have endorsed the hypothesis of significant rate cuts by the US Federal Reserve to tackle the accumulated risks on manufacturing activity, fuelled by trade tensions. Global monetary policymakers are able to respond to difficult times by opening their arsenal of instruments, but they have not deemed it necessary yet. Throughout our Western economies, domestic growth continues to fuel activity and job creation, a source of private consumer spending. This conflicting context makes it difficult to meet market demand that is more influenced by the environment than business activity; **sentiment predominates in the market and drives asset prices, sometimes disconnected from their intrinsic value, which is about fundamentals.**

In Switzerland, in particular, economic indicators do not corroborate this bond sentiment. The appreciation of the Swiss franc is undoubtedly the main factor explaining this. The SNB addressed this problem by increasing its foreign exchange account. International risks therefore weigh on the outlook for manufacturing exposed to exports and on the Swiss franc. Investors are again finding refuge in the Swiss franc, especially Swiss residents who are repatriating their investments. This repatriation movement had disappeared by 2011 but started again in 2018 and intensified at the beginning of this year. In this environment, it is difficult to assess the impact of the non-renewal of the Swiss stock market equivalence on July 1 on investments and financial flows necessary to ease pressure on the Swiss franc.

Key interest rates



Source: Thomson Reuters Datastream

Outlook for the interest rate and mortgage yield curve

Consumer price inflation, the main indicator of the SNB's price stability objective, rose by 0.3% over the month, which also drove prices excluding energy and food. The result on annual inflation remains low at 0.6% but the monthly rate reveals a domestic dynamic well underway, limiting deflation fears with the recent increase.

The fall in Swiss interest rates to their lowest levels since the introduction of negative rates seems to contradict a potential normalisation of monetary policy. However, both the ECB and the SNB have taken a step that the bond markets have blindly ignored; their recent initiative has separated the so-called interbank market rates (Euribor and Libor) from the deposit rates offered by the two central banks; one has raised the rates on special TLTRO conditions by 10 basis points, the other has created an SNB reference rate independent of the Libor rate and its boundaries. The differential between credit and deposit rates could once again be restored, signalling a path towards normalisation. Regardless of these marginal aspects for economic operators, the environment of negative rates is not about to disappear and hopes of emerging from negative interest rates in 2020 are postponed. For the time being, mortgage financing conditions remain attractive, although the prospect of strengthening macro-prudential policies should not be overlooked, particularly for real estate professionals in need of credit.

Interest rates 3 months	30/06/2019	3 months	12 months
Switzerland	-0.73	-0.70	-0.50
Euro	-0.35	-0.30	0.25
USA	2.32	2.50	2.50
10-year interest rates			
Switzerland	-0.48	-0.40	0.20
Euro	-0.32	-0.10	0.40
USA	2.00	2.20	2.70

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