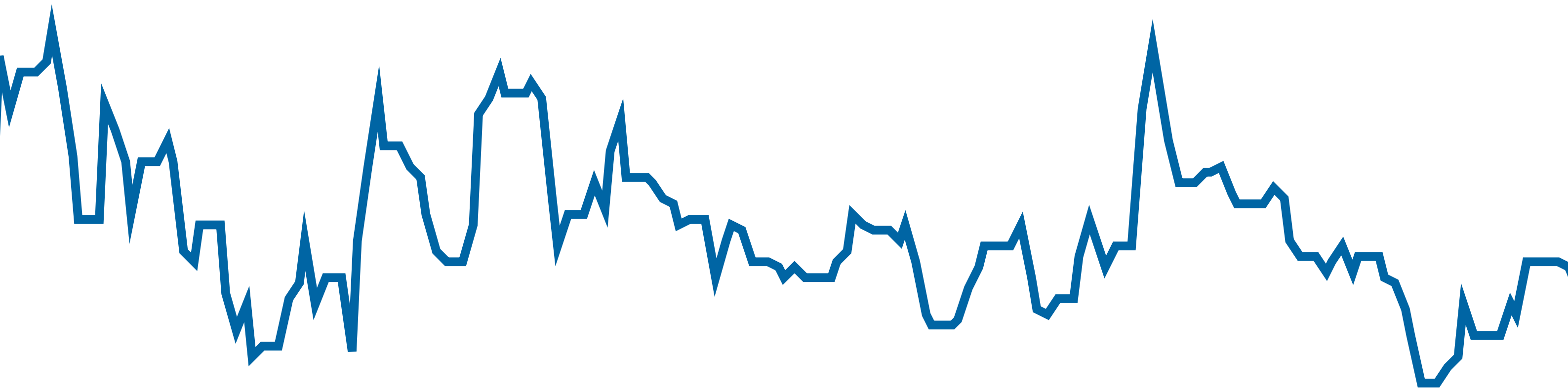
March 2021

Federal Treasury

Activity report 2020



Schweizerische Eidgenossenschaft
Confédération suisse
Confederazione Svizzera
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Swiss Confederation

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The Federal Treasury activity report explains the strategies and results with respect to the Confederation's debt management, liquidity management and foreign exchange management in 2020. It is tailored primarily to the Federal Council, the Finance Delegation, and the Swiss Federal Audit Office. After these bodies have taken note of the report, it is made available to interested members of the public.

Table of contents

Page

Summary **5**

Guidelines and targets **7**

2020 Treasury activity **11**

Developments on the Swiss capital market 11

Funding requirements and liquidity trend 14

Funding in the money market 17

Funding in the capital market 19

Foreign exchange management 26

Presentation and evaluation of the risk situation **29**

Interest rate risk 29

Refinancing risk 32

Forex risk 32

Counterparty risk 33

Outlook **34**

87

billion

in debt is managed by the Federal Treasury. 74 billion of this is market debt (money market debt register claims and bonds)

-0.40

percent

was the interest on the bonds issued in 2020. By issuing long maturities, the federal budget will benefit from these low interest rates in the long term.

9.8

years

is the average term to maturity of the Confederation's market debt.

Summary

The outlook for 2020 indicated little change in terms of economic growth, inflation and expansionary monetary policy on the part of the Swiss National Bank (SNB) and the major central banks. Market participants anticipated another year with a negative SNB policy rate of -0.75% and interest rates trending sideways to slightly higher at record low levels. Meanwhile, the Confederation expected marginally positive results with hardly any discernible funding requirements. For the Federal Treasury, this meant maintaining a minimal issuance program in the money and capital market. Then the outbreak of the COVID-19 pandemic turned many things topsy-turvy.

After a subdued start, the COVID-19 pandemic caused major turbulence in the financial markets in March. Equity prices plummeted in a short period of time, issuing activity on the capital market virtually came to a standstill for several weeks, and yields were extremely volatile. The yield on 10-year Confederation bonds fell steadily from just under -0.5% to -0.8% in the first quarter on the back of initial information on the COVID-19 outbreak and interest rate cuts in the United States. At the beginning of March – shortly before the first lockdown – it was below -0.9%, only to jump to just under -0.2% within a few days. The leading central banks intervened decisively on the financial markets and, as a result, financing conditions on the Swiss capital market likewise returned to normal quickly. Issuing activity picked up again and was even significantly higher than in previous years. Yields moved sideways in a relatively narrow range from May onward. At the end of the year, the yield on 10-year Confederation bonds was back at -0.5%.

Even in these turbulent times, the capital market was always accessible for the Confederation. The Federal Treasury actually succeeded in auctioning a bond in March. Altogether, 17 bonds were reopened at 11 auctions. Including the 29 own tranches sold, the Confederation raised long-term debt of CHF 4.6 billion in nominal terms, with an average maturity of 14.3 years. All transactions were carried out with negative yields. The average yield was -0.4%. Consequently, for the first time in more than a decade, the outstanding volume of Confederation bonds remained constant and did not decrease further.

The COVID-19 pandemic put a great strain on the Confederation, which quickly took measures to cushion the negative consequences of the pandemic. In total, extraordinary expenditure of CHF 31 billion was approved, but only about half of this amount was actually used. This posed a major challenge with a great deal of planning uncertainty for liquidity management. The Federal Treasury responded by doubling its bond program and, above all, by rapidly increasing short-term money market debt register claims from CHF 6 billion to CHF 13 billion. Thanks to the quite substantial liquidity accumulated in previous years, it was nonetheless possible to respond to the heightened funding requirements cautiously and proactively. The issue volume was thus increased gradually and with minimum impact on the market. Ultimately, the additional funding requirements associated with the coronavirus were financed primarily by increasing money market debt register claims by around CHF 7 billion and reducing the liquidity buffer by just over CHF 10 billion. As a result, the Confederation's market debt rose from just over CHF 67 billion to CHF 74 billion.

Owing to the persistently low interest rates and a lack of investment opportunities, disposable funds are placed exclusively with the Swiss National Bank (SNB), like in previous years. As a result, there is virtually no counterparty or credit risk.

In 2019, the Federal Treasury engaged in forward purchases of euro and USD worth approximately CHF 1.3 billion for the 2020 budget year. However, the actual foreign currency requirements were significantly higher and around CHF 0.6 billion in foreign currencies subsequently had to be purchased. Almost half of the substantial additional amount was related to extra COVID-19 procurements. Since the introduction of currency hedging in 1998, a total of around CHF 27 billion in foreign currencies has been purchased within the framework of budgetary transactions, i.e. an average of CHF 1.2 billion per year. In addition, nine new special transactions in EUR, USD and SEK were hedged during the year for the equivalent of some CHF 1.8 billion.

The year 2020 was extremely challenging, especially in terms of liquidity management and issuing activity. Nevertheless, it was possible to continue the deployment work for the new treasury management software. The new software should be rolled out in the course of 2021. Thanks to more extensive digitalization, the implementation of the new software will allow considerable efficiency gains to be achieved in transaction processing and thus a reduction in operational risks.

87

billion

in debt is managed by the Federal Treasury. 74 billion of this is market debt
(money market debt register claims and bonds)

Guidelines and targets

The central Treasury, run by the Federal Finance Administration (FFA), ensures the Confederation's ability to fulfill its payment obligations at all times (Art. 60 para. 1 of the Financial Budget Act). The three main tasks of the Federal Treasury stem from this statutory mandate:

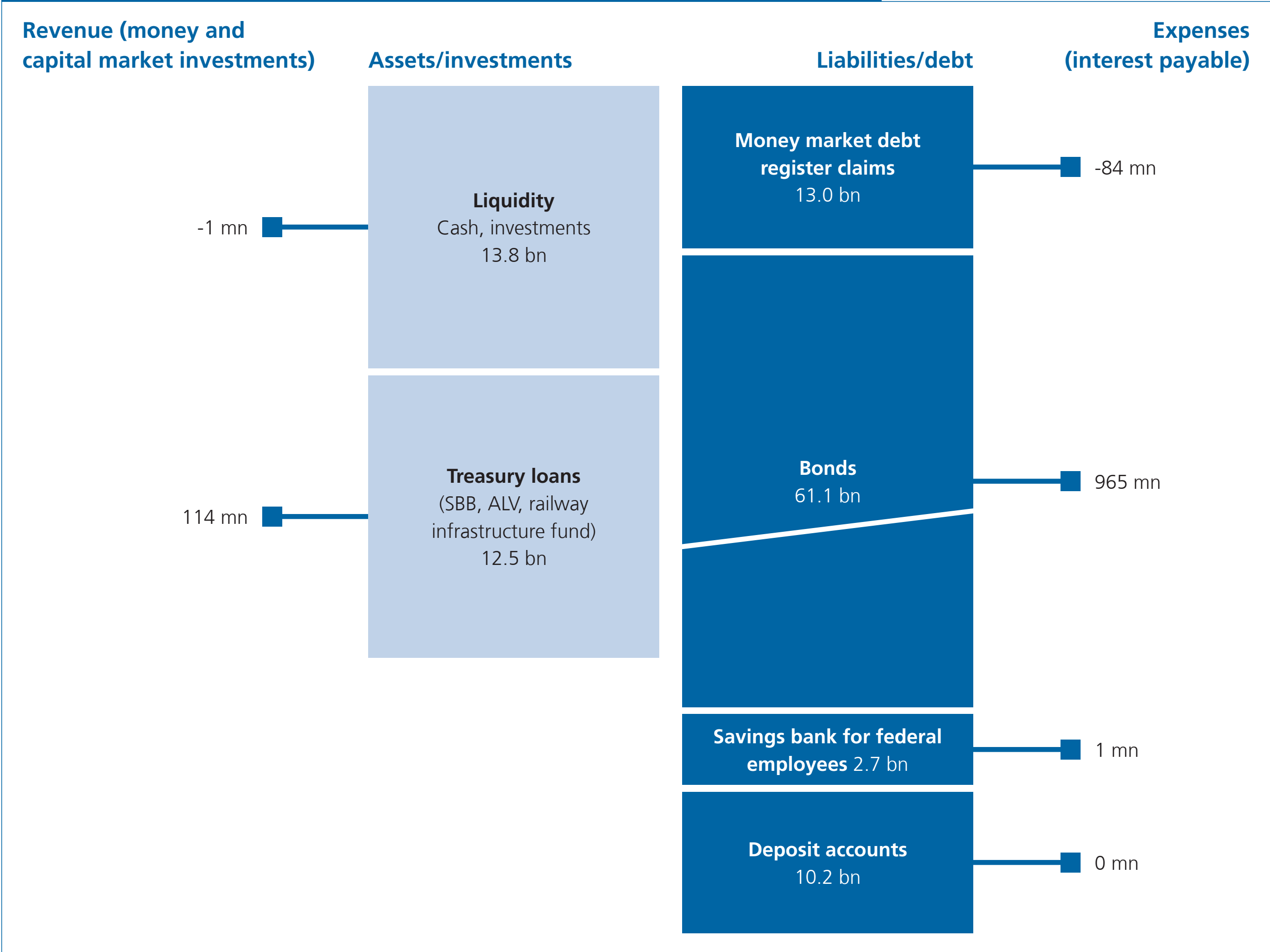
— *Debt management:* coverage of the funding needs by means of funding in the money and capital market at the lowest possible cost and with an acceptable degree of risk

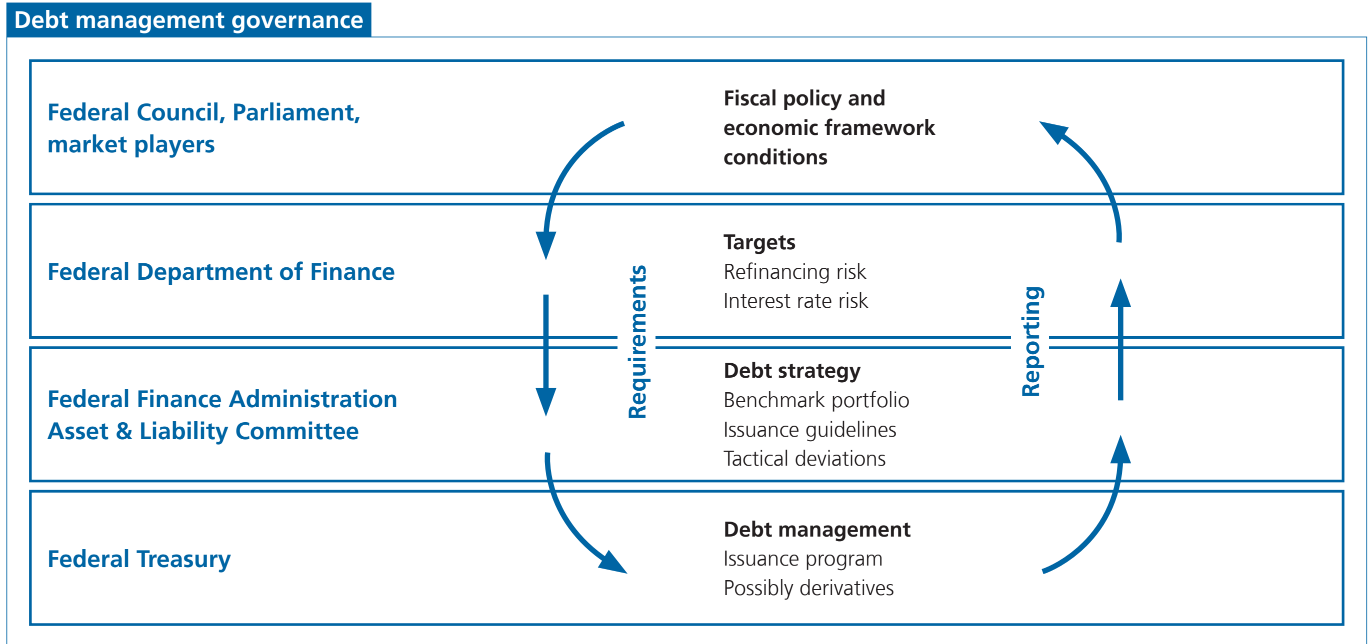
— *Liquidity management:* assurance of an appropriate level of liquidity to even out liquidity fluctuations; low-risk short-term investment of liquidity at usual market interest rates or short-term coverage of liquidity shortfalls

— *Foreign exchange management:* central procurement and management of foreign currencies to ensure planning certainty

The Federal Treasury ensures the Confederation's ability to fulfill its payment obligations at all times

Treasury statement of financial position and its impact on the 2020 federal budget





The Federal Treasury manages a significant proportion of the Confederation's balance sheet. Its activities involve substantial expenditure and receipts. Since the Confederation is a net borrower, this mostly concerns debt management with interest payable.

The Federal Treasury has little leeway regarding the volume of debt, as the funding requirements depend primarily on the development of the federal budget and thus on fiscal policy. Nevertheless, the Federal Treasury's debt management has a significant impact on interest payable: since the interest rates for short maturities are generally lower than those for long ones, the Federal Treasury can reduce the average interest burden by issuing more short-term debt instruments. However, this increases the interest rate and refinancing risk, as the debt needs to be renewed more frequently. Conversely, it can reduce these risks by issuing long-dated instruments, but this leads to higher interest expenditure on average.

The interest rate risk is a relevant variable for fiscal policy, as unexpected changes in interest expenditure affect the leeway for budgeting other expenditure. Consequently, the Federal Treasury has a risk limit which it may not exceed for debt management. This risk budget is part of the FFA's targets in performance management with the new management model for the Federal Administration (NMM). They are agreed with the Department on an annual basis. Within these risk guidelines, the FFA's Asset and Liability Management Committee (ALCO) specifies a debt strategy which the Federal Treasury has to implement with its issuing activity. Monitoring and reporting are carried out by an independent middle office (Risk Control).

Liquidity and foreign exchange management are also associated with risks, which are controlled by the ALCO and monitored by Risk Control.

NMM targets

	Limit	Actual 2019	Actual 2020
Refinancing risk: the FFA helps ensure that the Confederation's refinancing risk is bearable.			
Maturity profile of money and capital market debt under 1 year (%, maximum)	30	16	24
Maturity profile of money and capital market debt under 5 years (%, maximum)	60	39	42
Maturity profile of money and capital market debt under 10 years (%, maximum)	85	63	60
Interest rate risk: the FFA helps ensure that the interest rate risk is bearable for the federal budget in the short and medium term.			
Accumulated interest rate risk for following 4-year periods: additional interest expense that will not be exceeded in 9/10 cases (CHF mn)	500	263	218

Debt management risks
The Confederation is confronted by two inherent risks when managing its debt:

Interest rate risk: in the event of a rise in interest rates, debt has to be issued at a higher rate of interest. This leads to higher interest expenditure, i.e. to a burden for the federal budget. The interest rate risk can be quantified using simulation calculations.

Refinancing risk: as a result of declining creditworthiness on the part of the Confederation or major financial market turmoil, (re)financing in the market could result in higher/unfavorable market interest rates, or, in an extreme situation, could even prove impossible. This could jeopardize the objective of ensuring the Confederation's ability to fulfill its payment obligations. The maturity profile of outstanding debt as well as ratings are key indicators for the refinancing risk.

-0.40

percent

was the interest on the bonds issued in 2020. By issuing long maturities,
the federal budget will benefit from these low interest rates in the long term.

2020 Treasury activity

Developments on the Swiss capital market

In 2020, nothing and no one could escape the COVID-19 pandemic – including the Swiss capital market. After a quiet start, most market observers predicted a year with a slightly brighter global economy and no major movements on the capital markets. Even when the coronavirus became more prevalent after a few weeks, most market participants expected only a short-term dip without a lasting deterioration in the outlook for the global economy. However, from the beginning of February and with the global spread of the virus, this serenity became a thing of the past. Confederation bond yields initially plunged and then surged between early and mid-March following the outbreak of the pandemic. Within a few days, the yield on the 10-year benchmark bond went from around -0.9% to just under -0.2%.

The yield on 10-year Confederation bonds ranged between -0.9% and -0.2%

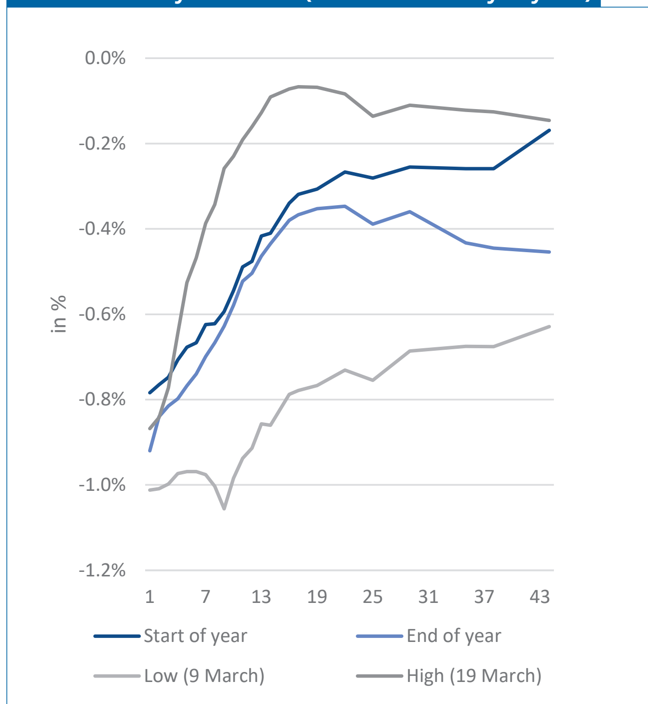
This development reflected market sentiment: in an initial reaction to the outbreak of the new type of virus, government bonds were sought after as safe havens, and yields fell as a result. However, as the virus became a global pandemic, a remarkable phenomenon occurred: even very safe government bonds were sold. One of the reasons for this unusual occurrence during a crisis was that the rapid upheaval on equity markets meant that many investors needed to raise cash very quickly, and that safe government bonds were the easiest to sell because of their comparatively high levels of secondary market liquidity. Accordingly, the considerable selling pressure led to tumbling prices and rising yields. The upheaval on the government bond market – in Switzerland and on all major capital markets – had repercussions for the entire capital market. Corporate bonds and lower-rated bonds were particularly impacted by soaring risk premia. As a result, the Swiss capital market came to a short-term standstill, and there were virtually no new issues for several weeks.

With the help of extensive interventions by the major central banks, it was possible to ensure that companies retained access to the capital market. Subsequently, financing conditions on the Swiss capital market also returned to normal relatively quickly. Yields moved sideways in a fairly narrow range from May onward, and by the end of the year, the yield on 10-year Confederation bonds was -0.5%, the same level as at the beginning of the year. Even though the number of cases was again high during the second wave of the pandemic and although uncertainty about the short- and medium-term economic outlook remained substantial, there was no further turmoil. Since a turnaround on interest rates is not expected, at least in the short term, the upside potential for yields is likely to remain limited going forward. One remarkable effect of the major intervention by the European Central Bank was that German government bond yields were lower than Confederation bond yields for the first time from March onward.

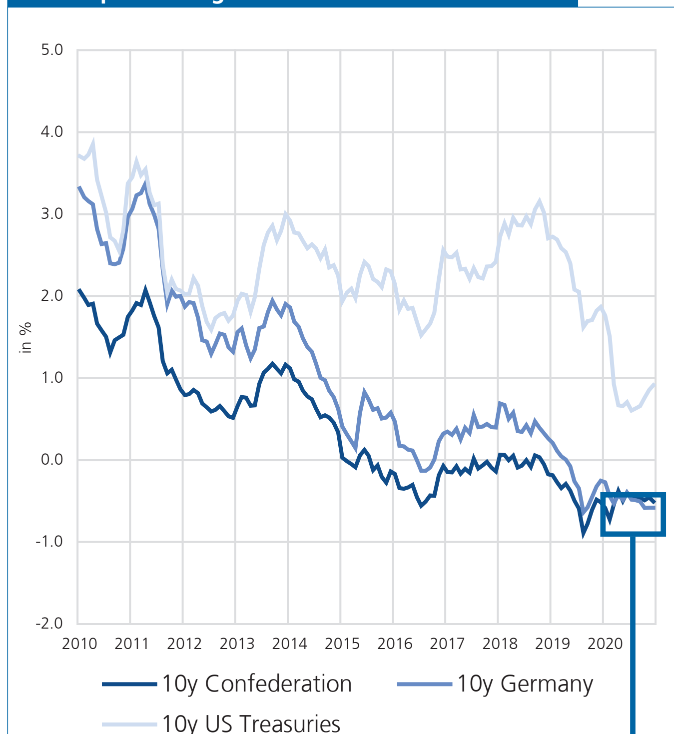
Overall, issuing activity on the Swiss capital market actually increased significantly compared with the previous year in terms of both volume (+25%) and number of issues (+10%). This was due not least to robust growth in the corporate segment, where a large number of companies took advantage of the favorable financing conditions to strengthen their liquidity positions. As shown by the example of Zurich and Geneva airports, even issuers directly affected by the consequences of the pandemic were able to successfully raise funds. In addition to companies, public sector issuers and the Swiss Confederation also made much greater use of the capital market than in the previous five years. With the exception of the brief pause in March, Swiss issuers had access to the markets at all times and actively took advantage of the constant liquidity supply.

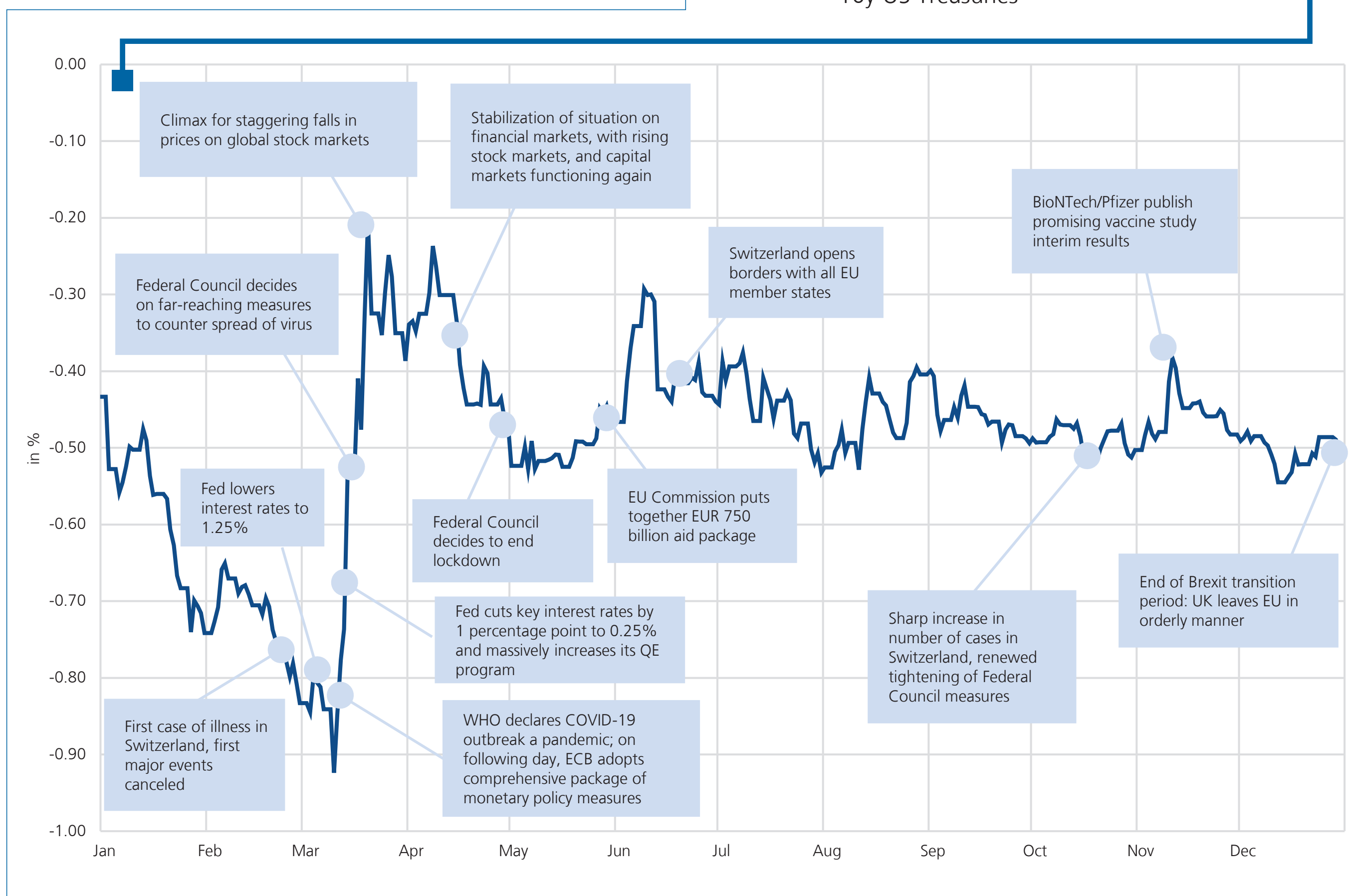
At year-end, a volume of around CHF 538 billion was outstanding on the Swiss capital market. The gap between the domestic and foreign segments widened further in 2020. While the outstanding volume in the domestic segment exceeded the CHF 400 billion mark for the first time, with an outstanding volume of just under CHF 405 billion (+6.1%), the foreign segment (-4.0%, now 132.6 bn) continued the downward trend it started around a decade ago. The two Pfandbrief institutions are still the largest issuers in the domestic segment. Having further increased their market share relative to the previous year, they now account for 35% of the domestic segment. The Confederation's share continued to edge down to around 16% because of its stable bond volume.

Confed. bond yield curve (term to maturity & yield)



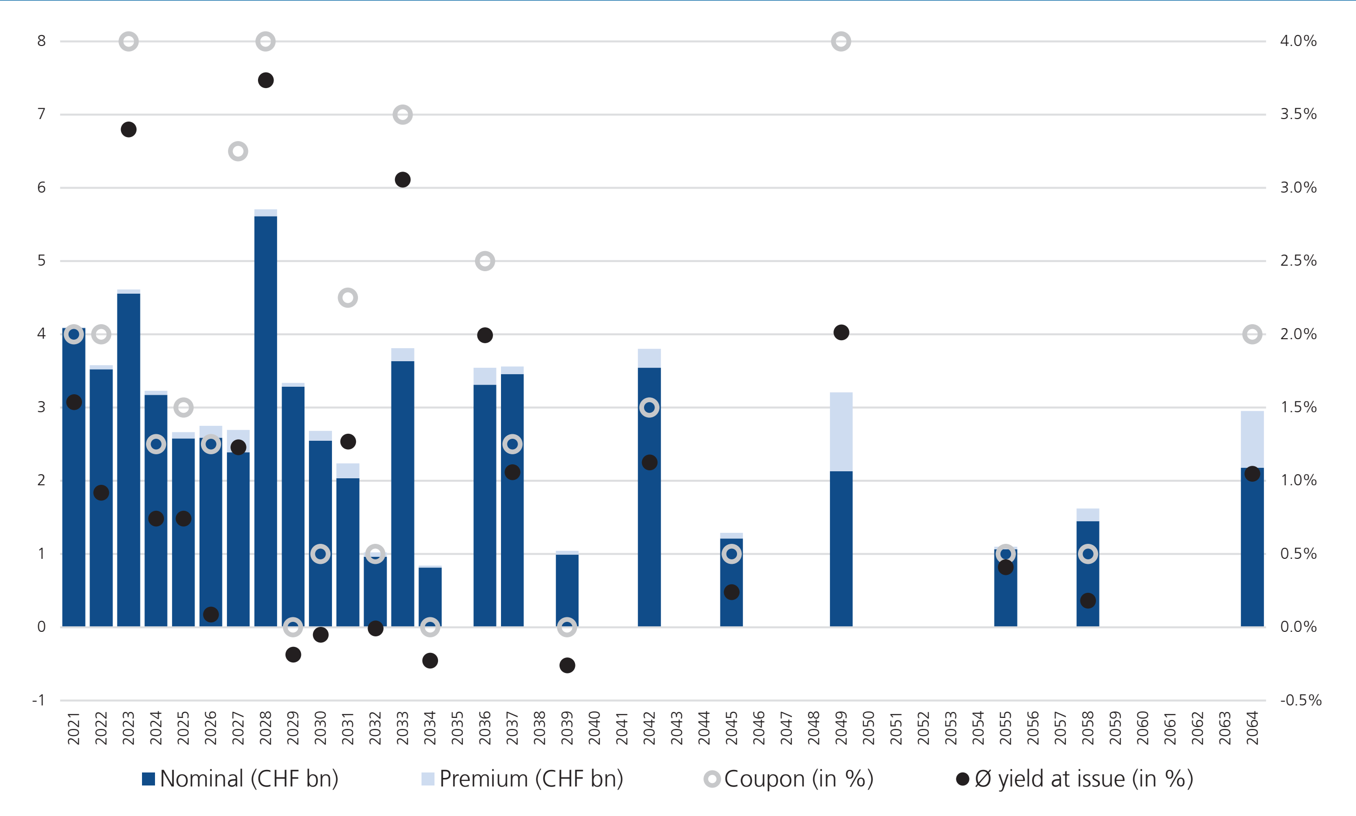
Development of government bond interest rates





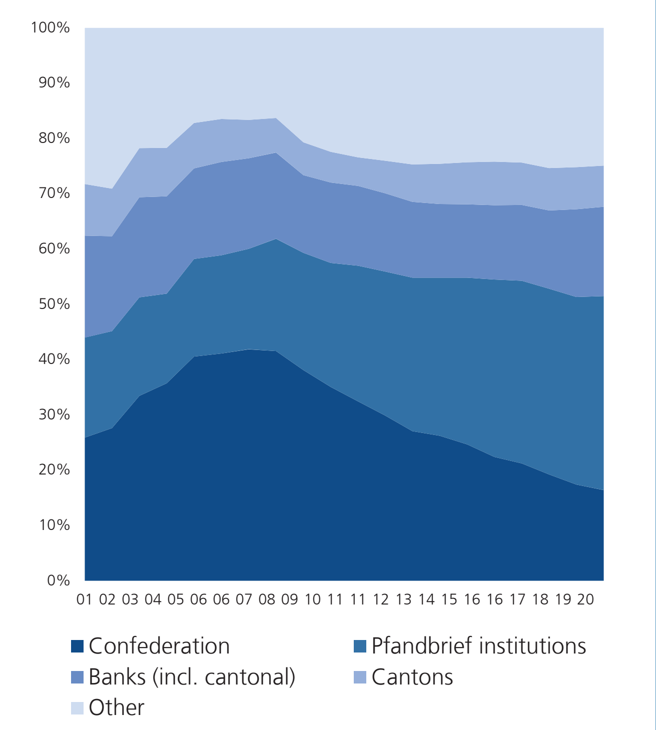
Source: Bloomberg

Confederation bond trading volumes on secondary market



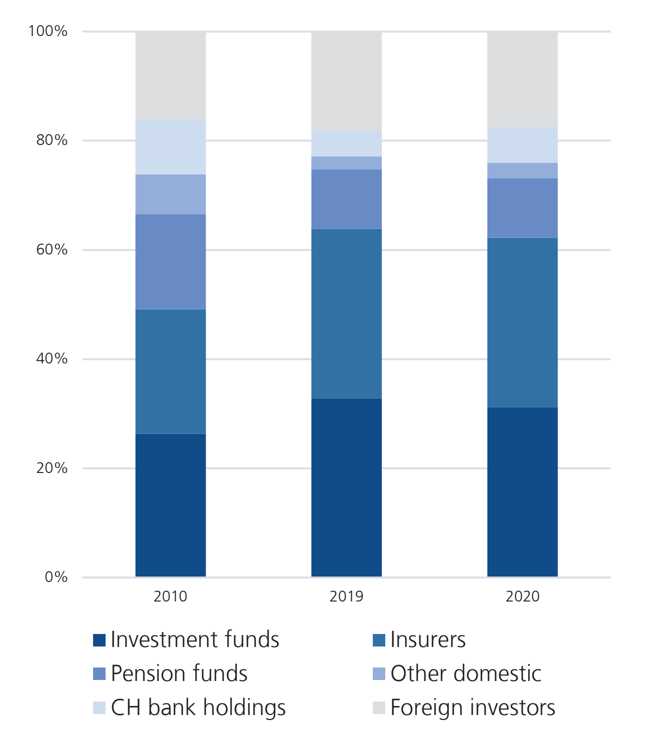
Source: SIX

Outstanding bonds in CHF domestic segment



Source: SIX

Confederation bond investor base



Source: SNB

Funding requirements and liquidity trend

Since the SNB introduced the negative interest rate regime, the Federal Treasury has been confronted by unexpectedly high inflows of funds. Withholding tax in particular has since been used by many players as a means of easing the burden of negative interest rates by delaying the refund of their claims. At the same time, the Federal Treasury has found it increasingly difficult in recent years to offset the high inflow of funds with measures to reduce liquidity without restricting access to the money and capital market. Consequently, the Confederation started 2020 with exceptionally high liquidity of around CHF 23 billion.

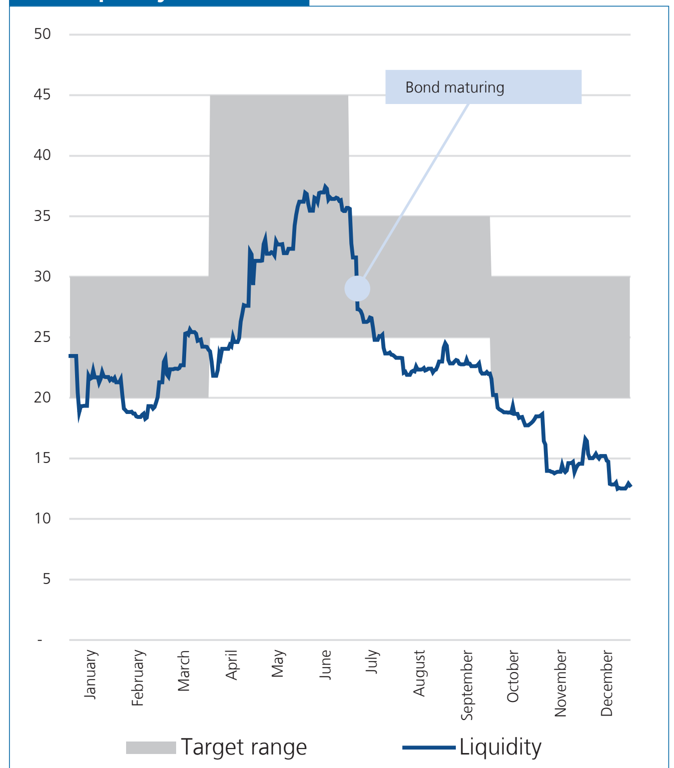
According to the 2020 issuance program published by the Federal Treasury on December 3, 2019, liquidity was to be kept at this high level. Funding requirements of only CHF 2.5 billion were anticipated, and were to be covered exclusively by issuing bonds. Moreover, the volume of outstanding money market debt register claims was to be kept unchanged at approximately CHF 6 billion.

However, due to the COVID-19 pandemic and the measures ordered to cushion the economic impact, this plan quickly became obsolete. By the end of March, the expenditure approved by the Federal Council already totaled more than CHF 20 billion. The Federal Treasury subsequently adjusted the issuance program and informed market participants of the revised plan in a press release at the end of March. The outstanding volume of money market debt register claims was now to be increased from around CHF 6 billion to CHF 12 billion, and the sale of own tranches not yet placed was to be stepped up again.

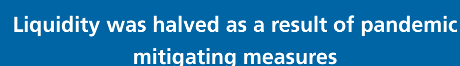
Aggregate net cash flows federal budget in bn

Calculation: daily change in SNB sight deposit account less financing activities

2020 liquidity trend in bn

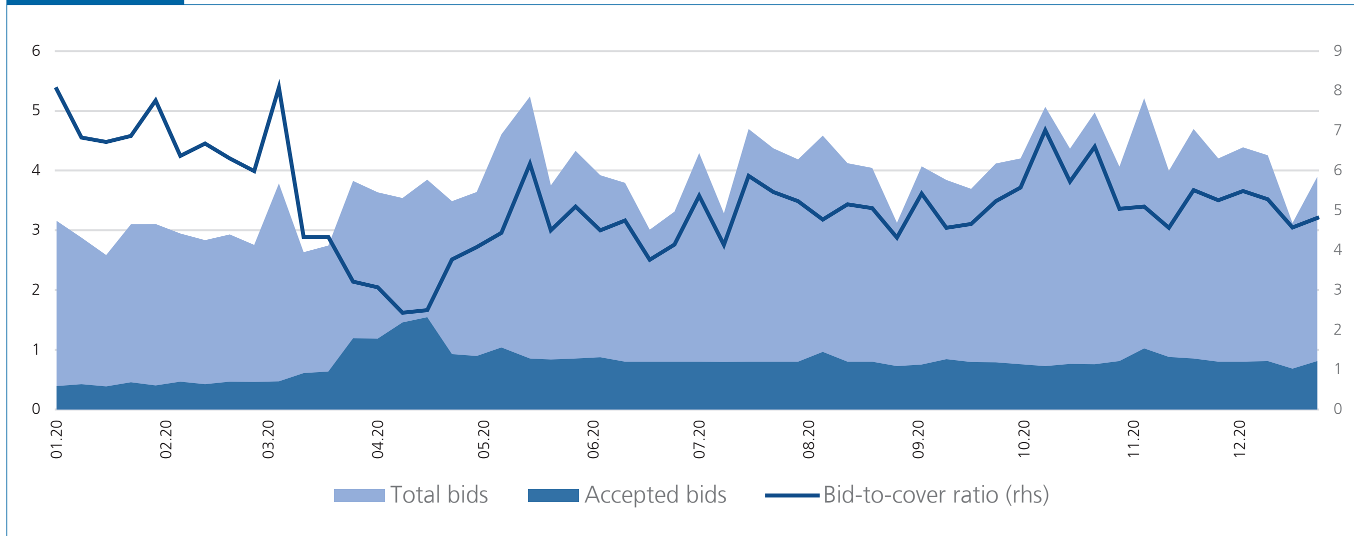


In retrospect, the high level of liquidity proved to be a major advantage in several respects during the crisis. Despite the sudden, unprecedented surge in the Confederation's funding requirements, the Federal Treasury was able to increase borrowing on the money and capital market gradually and thus with minimum impact on the market. Moreover, the funds to ensure the Confederation's ability to fulfill its payment obligations did not have to be raised in advance based on unreliable projected values. Instead, it was possible to align issuing activity with the actual liquidity trend without incurring major liquidity risks. A look at the Confederation's overall fiscal balance shows just how important this was: only about half of the extraordinary expenditure of CHF 31 billion approved in the 2020 budget was ultimately used. Nevertheless, the Confederation's funding requirements reached historic dimensions, with the federal budget alone recording a net cash outflow of over CHF 12 billion. Including financing activities (e.g. bond maturities, interest payments, foreign currency procurement), the Confederation's funding requirements rose to around CHF 22 billion. These were ultimately covered by reducing liquidity by CHF 10 billion, increasing the volume of money market debt register claims by just under CHF 7 billion and placing bonds at a market value of around CHF 5 billion.

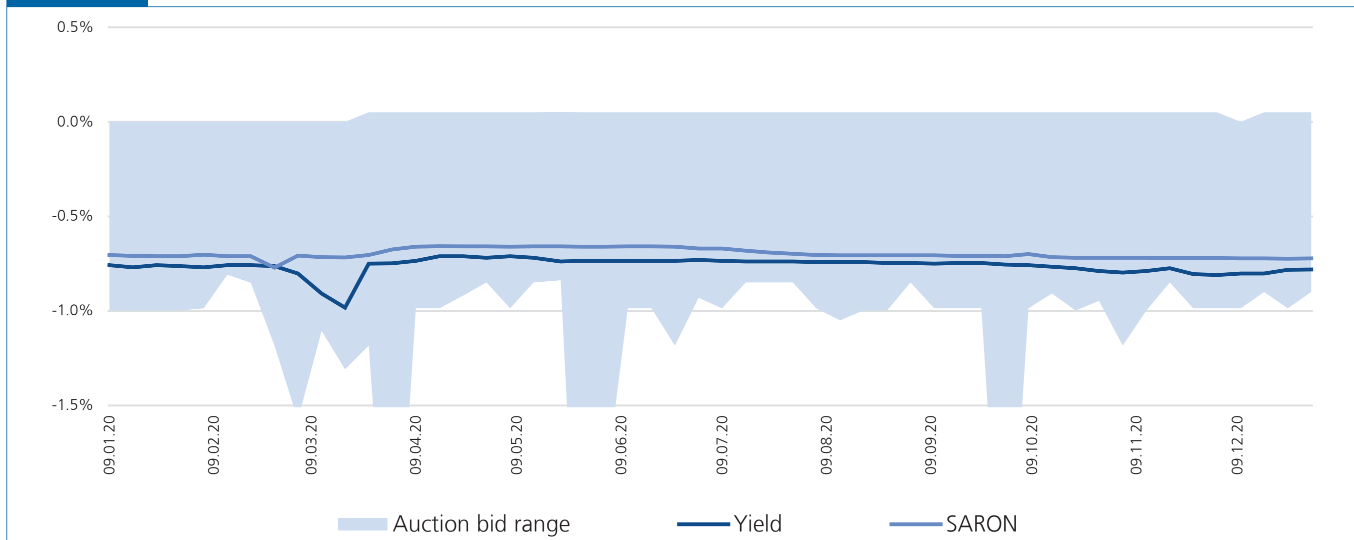


Money market debt register claims

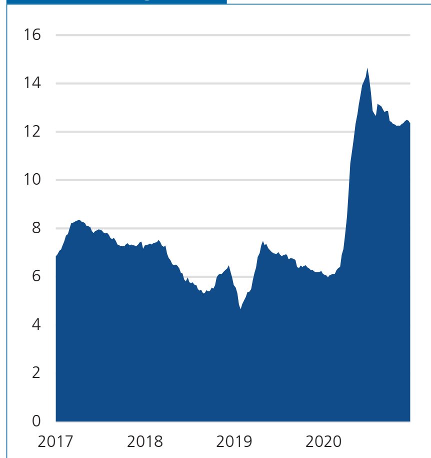
Auctions in bn



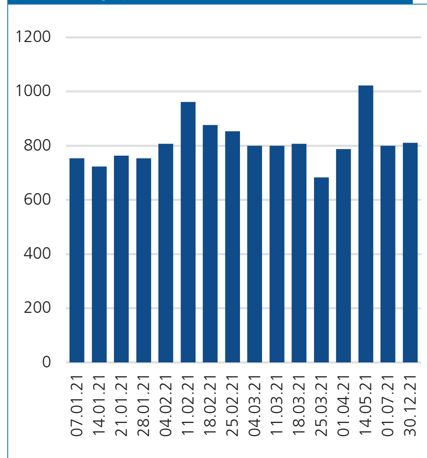
Yields in %



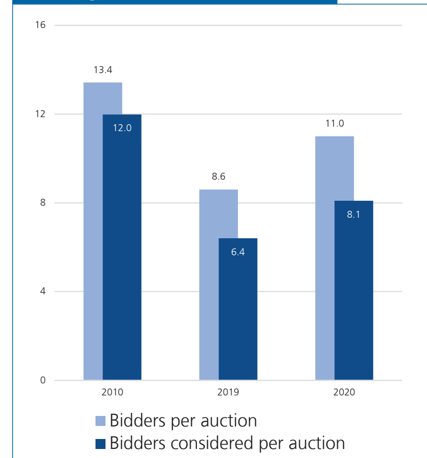
Outstanding in bn



Maturity profile end of 2020 in mn



Average number of bidders



Funding in the money market

Money market debt register claims

Due to their short maturities and weekly auctions, money market debt register claims are ideal for managing the Confederation's short-term liquidity. They are also the first choice for responding to rapidly changing funding needs. Accordingly, the Federal Treasury initially turned to the money market debt register claims program to finance much of the additional COVID-19 expenditure incurred.

As early as mid-March, the Federal Treasury experienced unusually high net cash outflows, which were attributable to lower tax receipts and higher withholding tax refund requests. At the same time, the Federal Council announced an initial multi-billion franc package of measures to cushion the economic impact of the coronavirus pandemic. The Federal Treasury responded to this situation by increasing the volume of money market debt register claims rather quickly: between mid-March and early July, the volume of outstanding money market debt register claims was increased from around CHF 6 billion to over CHF 14 billion.

However, already in the summer it became apparent that the fiscal policy damage would be less severe than initially feared. Following the gradual lifting of the public health measures, a strong economic recovery set in, accompanied by greater momentum for tax receipts. At the same time, the unemployment insurance fund's needs for short-time working compensation were significantly lower than expected. As a result, the Federal Treasury was able to reduce its money market debt register claim issues to a volume of around CHF 12 billion.

Despite the high volume, the average yield on the money market debt register claims issued last year was -0.76%, only a few basis points higher than the corresponding figure for the previous year (-0.84%). This is proof of the high absorbing capacity of the Swiss money market. It was possible to significantly increase auction demand with only minor price concessions, with the result that the 3.8 billion bids submitted per auction on average were almost double the previous year's figure of 2.0 billion. Overall, interest receipts of around CHF 84 million were generated in 2020.

Money market debt register claims

Money market debt register claims (T-bills) are interest-bearing debt instruments that are issued at a discount by the FFA. These are tradable debt register claims entered in a main register kept by SIX SIS Ltd. Money market debt register claims have maturities of three, six and twelve months. A total of 16 money market debt register claims are always outstanding (11 three-month ones, 3 six-month ones and 2 twelve-month ones). The auctions are held weekly on Tuesdays on the platform of SIX Repo Ltd (rate tender with Dutch or single rate allocation procedure). No nominal interest rate is specified in the case of money market debt register claims; the interest is in the form of a discount at the time of issuance. This means that money market debt register claims are normally issued at a price that is less than 100% of the nominal value. Redemption is then at 100%. However, money market debt register claims are currently being issued at a price of more than 100%, i.e. with a discount surcharge, which means a negative interest rate.

The regular issuance of these money market instruments is an important pillar of the Confederation's refinancing. A liquid market for money market debt register claims that functions well enables the Confederation to raise even larger volumes of borrowed capital at favorable conditions at any time.

On average, the Federal Treasury raised 780 million per week at -0.76%

Repo market

As part of its liquidity management, the Federal Treasury may in principle also borrow on the money market or invest surplus funds. However, it has not made use of this possibility since the global financial crisis of 2009. Moreover, short-term investing and financing activities have generally shifted to the secured money market, the so-called repo market. The Federal Treasury has been an official participant in the Swiss repo market since the beginning of 2019. Joining the repo market is important particularly in view of the interest rate environment returning to normal. At that time, the Confederation will also need to participate in the secured money market in order to minimize counterparty and refinancing risk, optimize liquidity management and ensure the Confederation's ability to fulfill its payment obligations at all times.

Repo transactions

Repos (repurchase agreements) are financial transactions in which a lender provides cash to a borrower for a specified period of time in exchange for collateral (e.g. bonds). They essentially consist of two transactions, a spot and a forward transaction. In the first leg, the borrower sells collateral to the lender (spot transaction). At the same time, the parties agree on the repurchase of the collateral at a future date (forward transaction). In a conventional repo transaction, the lender receives interest at the repo rate in addition to the amount lent when the transaction is completed. Repos normally have terms of between one day and 12 months. They are an important component of the interbank market and provide the financial system with liquidity. Moreover, the SNB uses repo trading to implement its monetary policy strategy by keeping the short-term repo rate – the Swiss Average Rate Overnight (SARON) – close to its policy rate. An important feature of repos compared with other financial transactions is the considerable reduction in credit risk achieved through the exchange of collateral. The Federal Treasury joined the repo market at the beginning of 2019.

Funding in the capital market

The issuance calendar published in December 2019 formed the basis for the issuance program in 2020. According to the calendar, a total of CHF 2.5 billion was to be raised at market values on eleven auction dates. After subtracting the CHF 4.6 billion bond maturing in 2020, this plan corresponded to a reduction of CHF 2.1 billion in bonds outstanding. The outbreak of the COVID-19 pandemic turned the plan on its head. The Federal Treasury issued bonds with a face value of CHF 4.6 billion in 2020 through auctions and the sale of own tranches. In addition, around CHF 600 million was earned in premia, as interest rates remained very low. Instead of a substantial reduction, the volume of outstanding Confederation bonds was thus kept constant in nominal terms. Remarkably, this was the first time in more than a decade that outstanding bonds did not decrease significantly. The average yield for all issues (auctions and own tranches) was -0.40%, and the average term to maturity was 14.3 years (2019: -0.12%, 17.5 years).

Auction review

The Federal Treasury conducted a total of eleven auctions in 2020. Both optional auction dates were used. Two bonds were issued at six auctions, and one at each of the remaining five auctions. In contrast to the past ten years, no bonds were newly issued; instead, existing bonds were reopened. This was due to the fact that all maturities up to and including 2034 were already covered and some of the bonds newly issued in recent years still had very low volumes before the year under review.

With the exception of the short end, all maturities were covered. The average term to maturity (interest commitment) of the bonds auctioned was 13.9 years, which was noticeably lower than over the past ten years (2019: 17.5 years). The terms to maturity of the bonds auctioned ranged from 6 to 38 years, evenly distributed across the three maturity segments of 5 to 10 years, 11 to 15 years and over 15 years. The shortening of the term to maturity was due to the fact that the entire yield curve remained consistently in negative territory and was inverted for terms to maturity of more than 20 years. Accordingly, demand for ultra-long bonds was weaker than in previous years, as many institutional investors avoid negative yields wherever possible. Moreover, the Federal Treasury was able to attract a larger investor base with shorter-dated bonds and thereby meet the Confederation's more substantial funding needs.

For the first time, negative yields were achieved on all capital market transactions

Confederation bonds

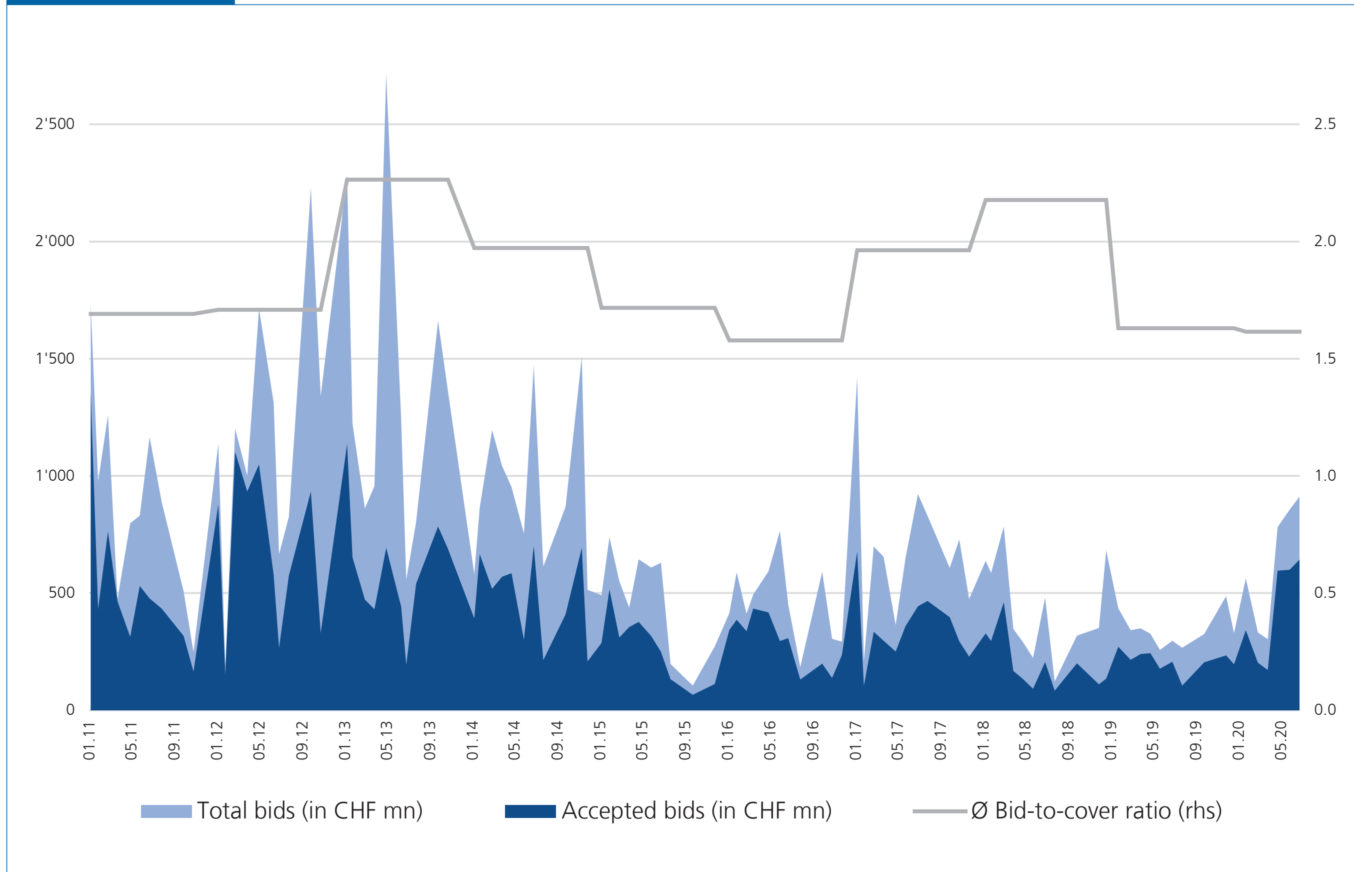
Confederation bonds are the Confederation's most important instrument for covering its long-term funding requirements. The auctions generally take place on the second Wednesday of every month and are carried out on the platform of SIX Repo Ltd: upon issuance, only the nominal interest rate (coupon) and maturity are defined, while the issue amount and issue price (and thus the yield) are determined on the basis of the bids submitted by the platform participants (banks and insurance companies). Like with money market debt register claims, the Federal Treasury allocates the bonds according to the single rate ("Dutch") procedure, i.e. uniformly at the lowest acceptable price. The SNB is responsible for the technical and administrative processing of the auctions.

Confederation bonds are listed on the Swiss stock exchange (SIX Swiss Exchange). The Confederation holds a limited volume of securities as proprietary holdings (first time not yet placed). These so-called own tranches are retained from auctions and if needed can be sold directly on the market between the ordinary auction dates. An overview of the own tranches available can be found on the FFA and SNB websites.

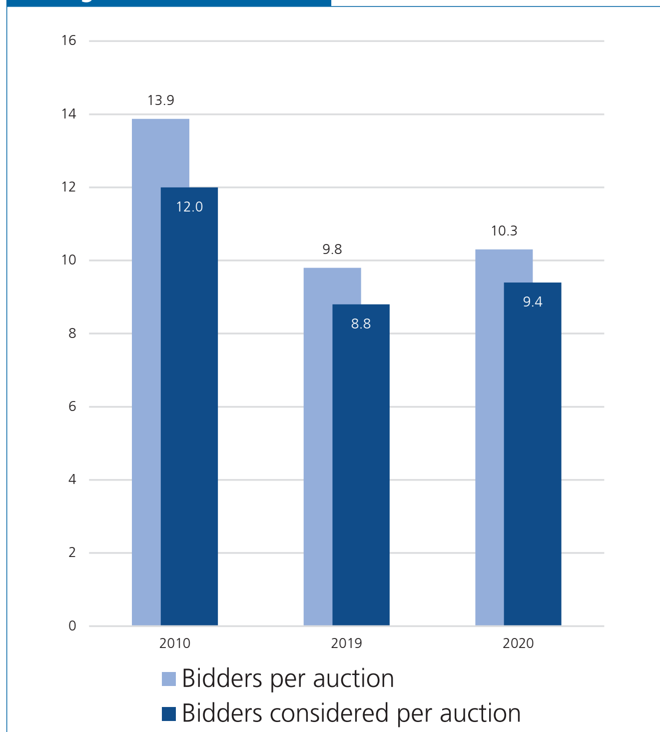
Confederation bonds contain a reopening clause. As a result, a bond can be reopened with several auctions, thereby increasing its liquidity on the secondary market. The outstanding Confederation bonds, with their respective terms to maturity and yields, form the yield curve for government bonds. These yields constitute the risk-free reference interest rates for market participants, which allows for an efficient primary and secondary market not just for bonds, but also for associated interest rate derivatives.

Development of the primary market for Confederation bonds

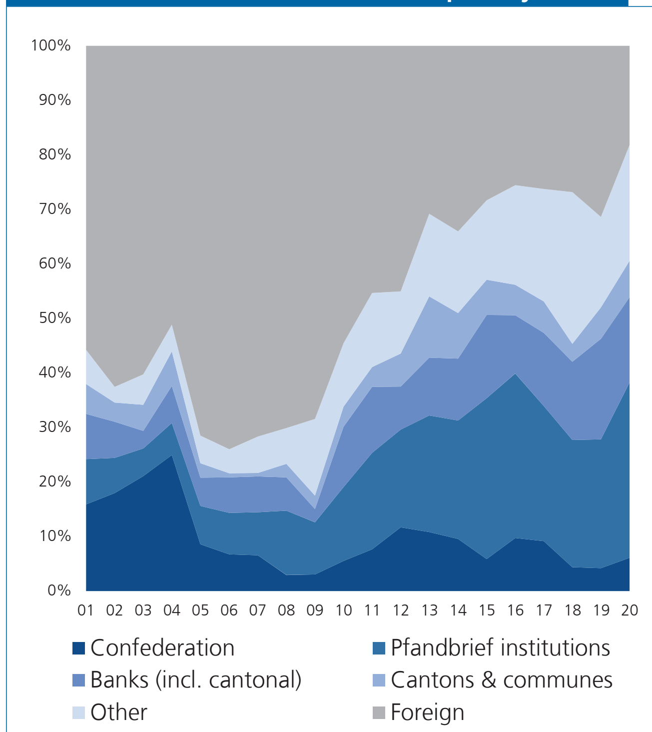
Bids and allocation



Average number of bidders



Share of Confederation bonds on CHF primary market



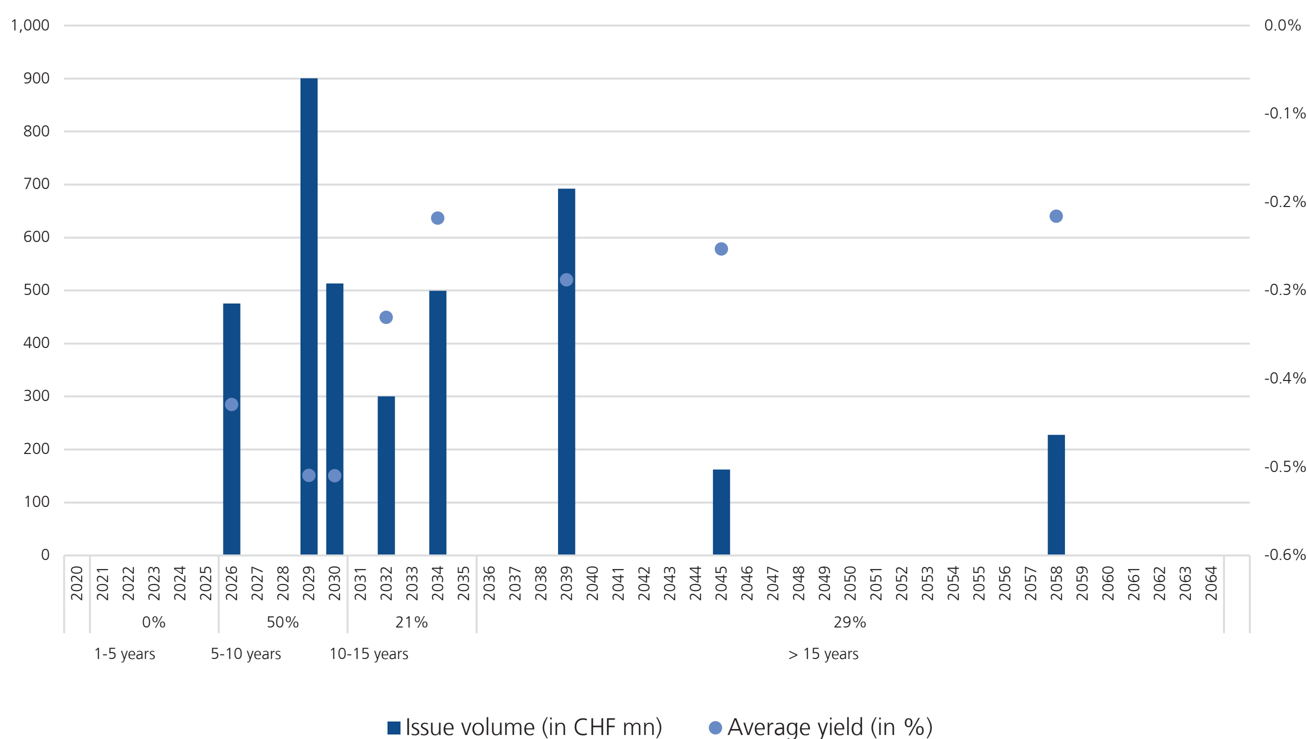
Source: SNB

2020 bond auctions

Auction results

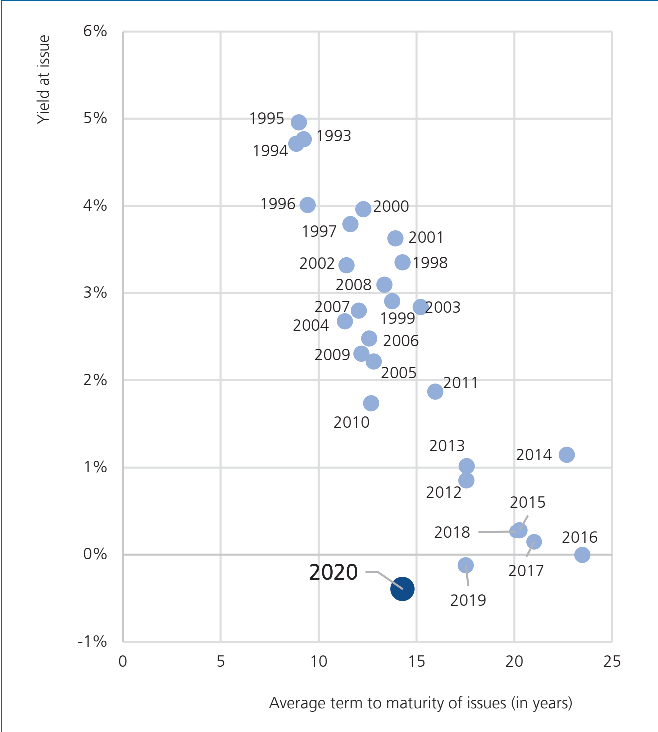
Auction	Issue	Coupon	Maturity	Issue volume (in CHF mn)	Total outstanding (in CHF mn)	Yield	Spread to swap
08.01.2020	Conf. 27.06.18/32	0.500%	27.06.2032	180.0	844.3	-0.456%	-37.1
08.01.2020	Conf. 28.06.17/45	0.500%	28.06.2045	162.1	1160.7	-0.253%	-38.1
12.02.2020	Conf. 27.05.15/30	0.500%	27.05.2030	91.4	2125.0	-0.638%	-32.8
12.02.2020	Conf. 24.07.19/39	0.000%	24.07.2039	112.0	414.6	-0.381%	-35.5
11.03.2020	Conf. 22.06.16/29	0.000%	22.06.2029	171.7	2434.6	-0.804%	-22.4
08.04.2020	Conf. 28.05.14/26	1.250%	28.05.2026	475.6	2537.4	-0.429%	-2.5
08.04.2020	Conf. 27.06.18/32	0.500%	27.06.2032	120.4	964.7	-0.142%	-3.4
13.05.2020	Conf. 22.06.16/29	0.000%	22.06.2029	389.8	2914.4	-0.537%	-9.9
13.05.2020	Conf. 24.07.19/39	0.000%	24.07.2039	209.8	624.4	-0.353%	-11.1
10.06.2020	Conf. 22.06.16/29	0.000%	22.06.2029	338.9	3283.3	-0.328%	-7.0
10.06.2020	Conf. 26.06.19/34	0.000%	26.06.2034	303.7	621.6	-0.141%	-6.6
08.07.2020	Conf. 27.05.15/30	0.500%	27.05.2030	188.2	2313.1	-0.390%	-9.6
08.07.2020	Conf. 24.07.19/39	0.000%	24.07.2039	207.2	831.6	-0.181%	-11.3
09.09.2020	Conf. 26.06.19/34	0.000%	26.06.2034	195.7	817.3	-0.337%	-15.2
14.10.2020	Conf. 24.07.19/39	0.000%	24.07.2039	163.3	994.8	-0.275%	-12.5
11.11.2020	Conf. 30.05.16/58	0.500%	30.05.2058	227.7	1450.9	-0.216%	-15.0
09.12.2020	**Conf. 27.05.15/30**	**0.500%**	**27.05.2030**	**233.6**	**2546.7**	**-0.556%**	**-23.6**
Total				**3770.8**		**-0.377%**	**-14.3**

Maturities and yields

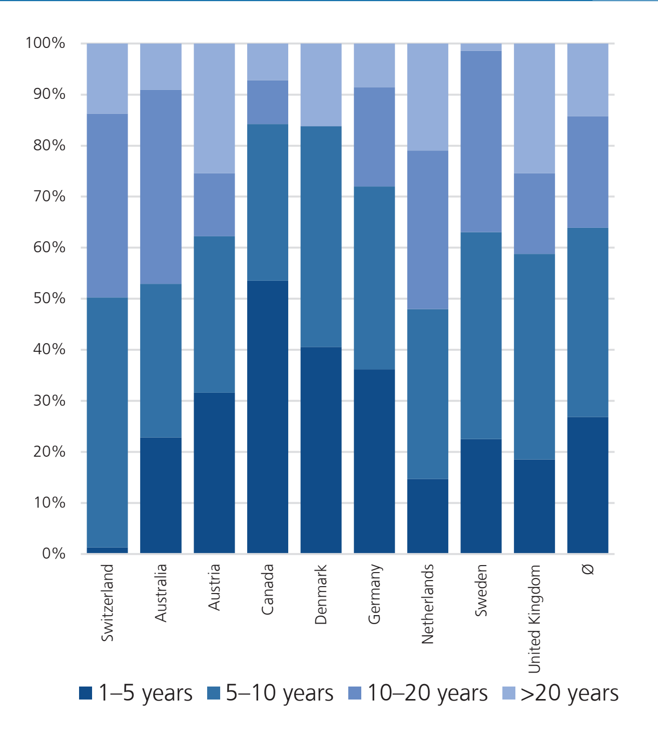


Interest commitment and term to maturity

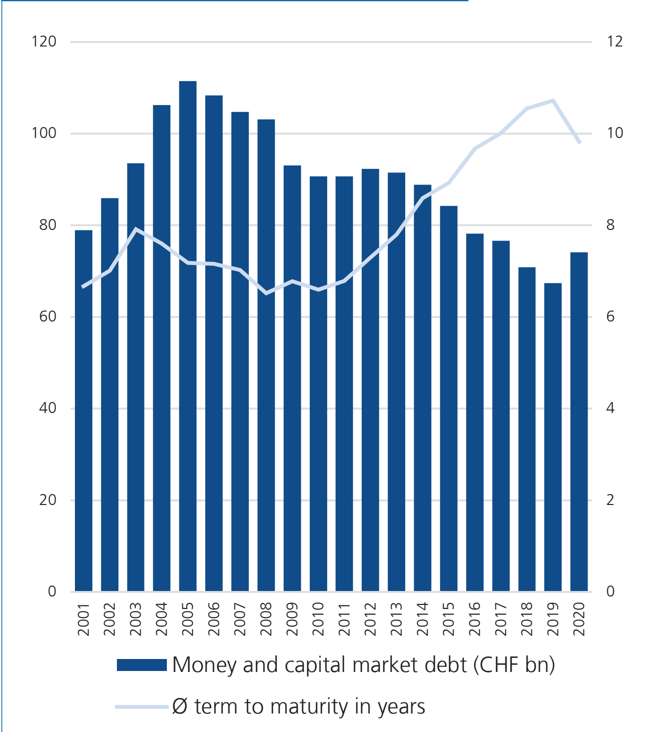
Interest commitment and yield of Confederation bonds



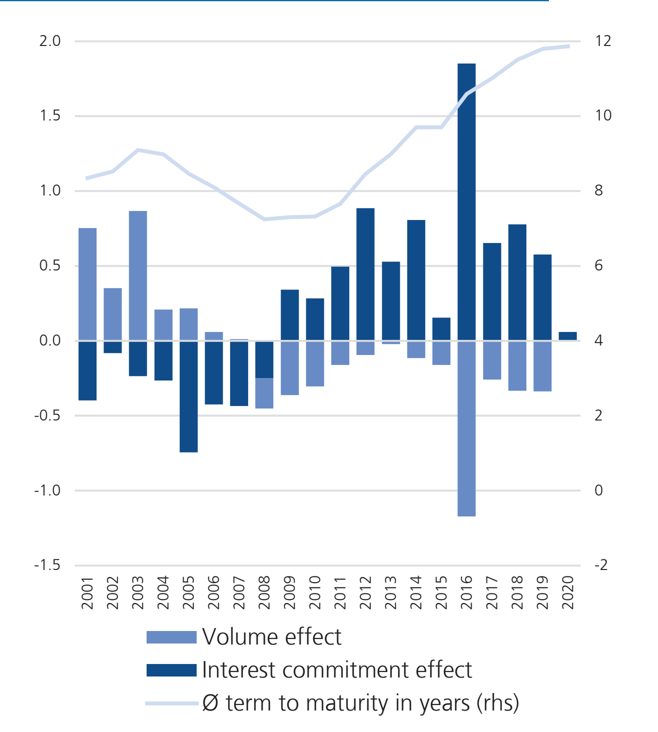
Interest commitment of gov. bonds (issued in 2020)



Term to maturity of federal market debt

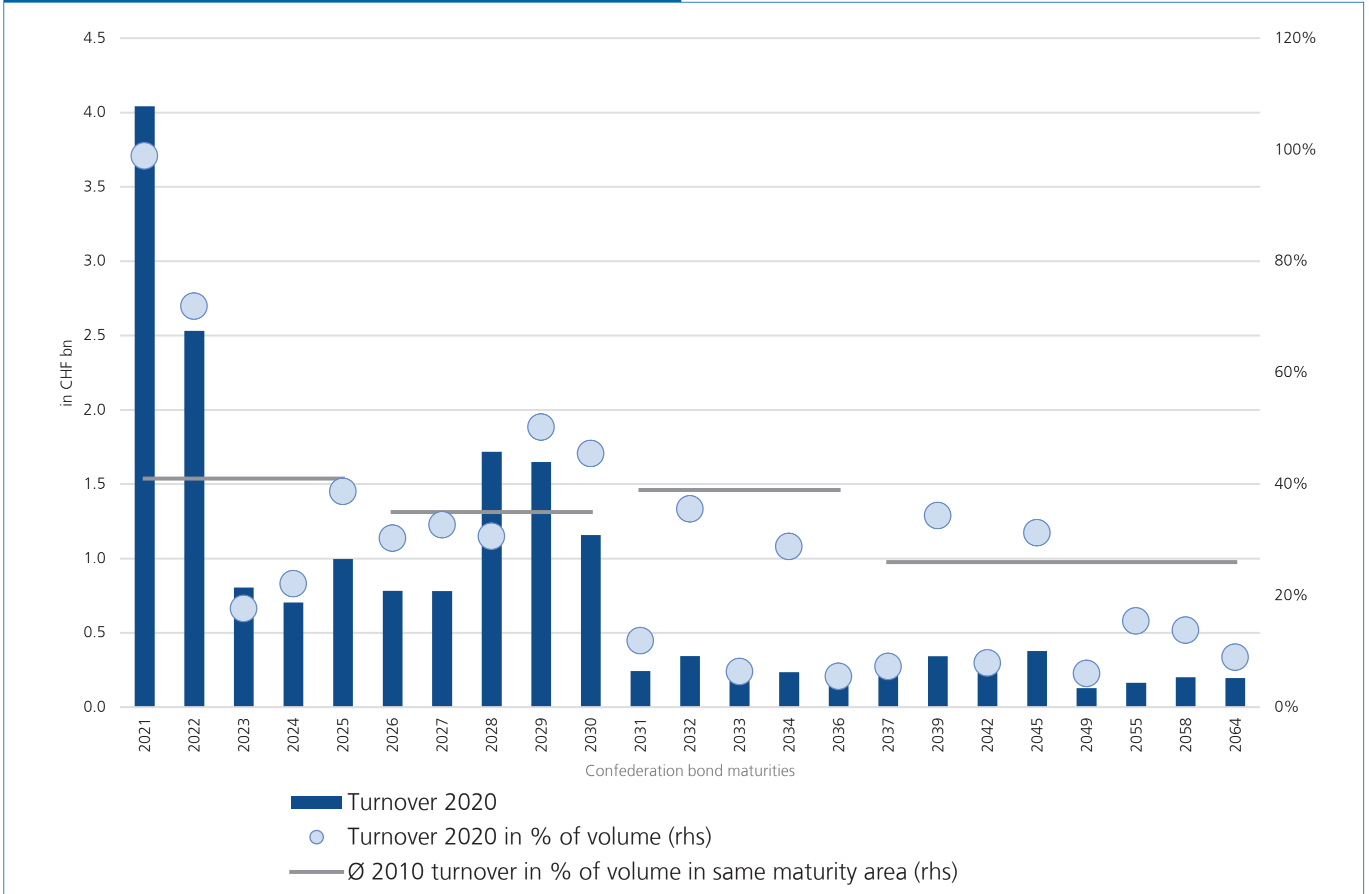


Breakdown of term to maturity change (bonds)

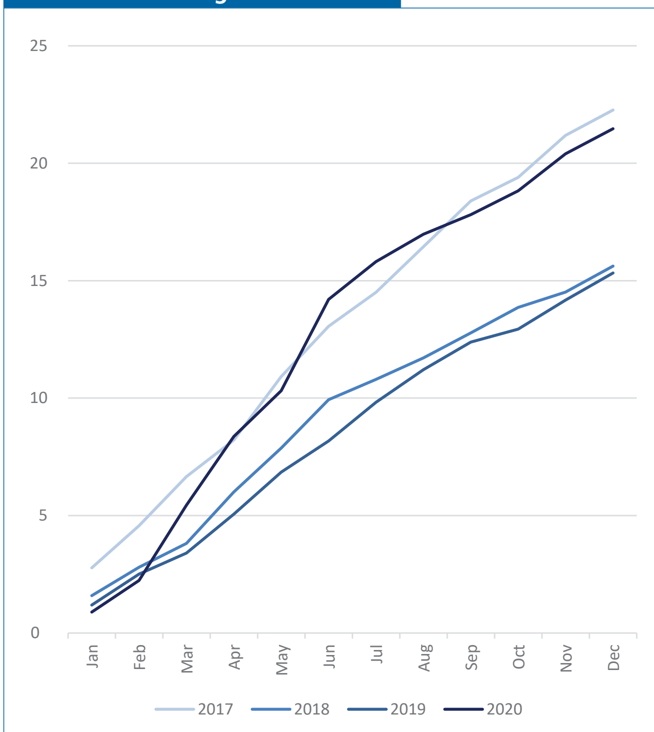


Development of the primary market for Confederation bonds

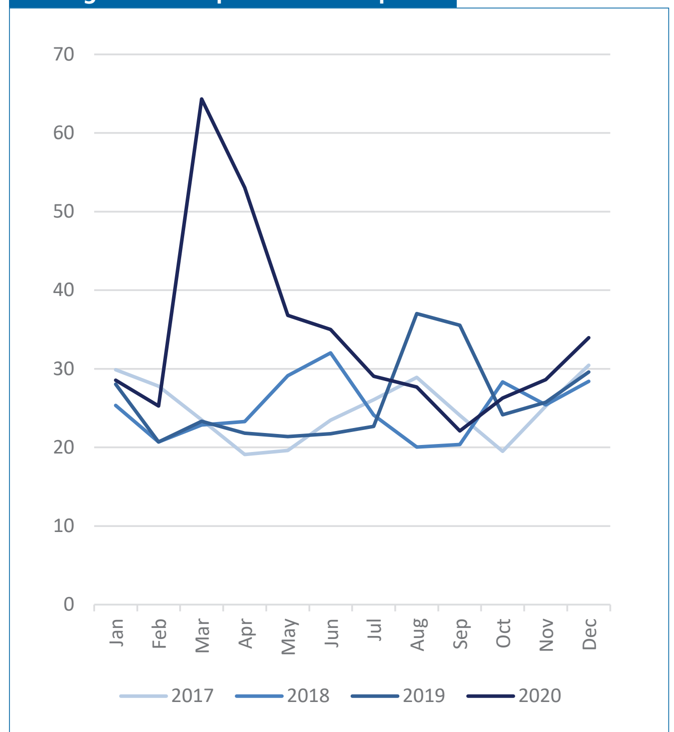
Confederation bond trading volumes on secondary market



Cumulative trading volumes in bn



Average bid-ask spread in basis points



Source: SIX

Issuing principles of the Federal Treasury

1. The Confederation is committed to an efficient Swiss capital market that functions well, thereby ensuring regular and reliable refinancing opportunities. By issuing bonds, it makes sure that the most important maturities of 1 to 13 years are covered with liquid bonds. In the case of extremely long maturities, intermittent anchor points are to be placed on the yield curve with individual bonds.
2. The Confederation's debt portfolio comprises around 20 underlying bonds. There is only one bond per maturity.
3. The issuance program, together with auction dates and the gross and net annual funding requirements, is publicly communicated in December of the previous year.
4. Bond auctions take place on a monthly basis, with a summer break in August. Two dates are optional (usually October and December).
5. A bond with a maximum volume of CHF 4 billion is to mature per year. A minimum volume of CHF 2 billion is sought with the 10-year benchmark bond.
6. If possible, bonds should mature in the months of May to September; new underlying bonds are launched accordingly during this period.
7. Reopenings are possible for all bonds with a term to maturity of more than one year.
8. Pricing at auctions (allocation) is based on the funding requirement, investor demand, absolute interest rates, bid and offer prices, and the swap spread of the underlying bond.
9. Subject to a funding requirement, own tranches can be acquired from the Federal Treasury at any time at market conditions (pricing same as for bond auctions). Maturities that are not (or no longer) covered by auctions in the respective year are preferred.
10. Bonds with a shorter term to maturity can be redeemed within the framework of liquidity management.

The Federal Treasury issued bonds worth CHF 4.1 billion at market prices through auctions (2019: 2.2 bn). The premia of CHF 326 million were high compared with the previous year (2019: 144 mn) and were attributable to two factors: first, unlike in previous years, money was increasingly raised for maturities with a high coupon; second, it was possible to allocate at negative yields in the case of all auctions for the first time. The average volume-weighted auction yield in 2020 was -0.38%, which was even lower than in the previous year (-0.12%), when a negative average yield was achieved for the first time.

Although the interest commitment was lower in a multi-year comparison, the Federal Treasury once again, with the ALCO's approval, deviated significantly from the issuance strategy defined as optimal and took on less interest rate risk than would have been permitted. In this way, the Federal Treasury wishes to ensure that the Confederation can benefit from the low interest rates for a long time, in case they rise again in the medium term. The resulting low interest expenditure enables future budget relief (debt reductions) or the strengthening of other areas of the Federal Administration. Although this incurred a certain term premium, interest expenditure was reduced further. Over the past decade, it has fallen steadily from around CHF 2.5 billion to less than CHF 1 billion. If, however, interest rates were to remain at the current low level in the long term, opportunity costs would arise in the form of lost negative interest rates. The Federal Treasury will return to the optimal strategy if there are concrete indications of the interest rate environment becoming normal again. As a result of the substantially increased public funding needs, governments around the globe started to decrease their term to maturity, resulting in a still higher-than-average interest commitment for Switzerland and a relatively high portion of issues with terms exceeding 15 years.

Overview of the demand structure

Both the number of participants and the number of bidders considered per auction rose somewhat year on year. At around CHF 362 million, average demand measured in terms of total bids submitted was significantly higher than that seen in the years since the introduction of negative interest rates (2019: 204 mn). Several factors are likely to have contributed to the increase in demand despite interest rates remaining very low. Three points in particular are worth mentioning. First, the average term to maturity was a few years shorter, which meant that a broader investor base could be addressed. Second, demand for safe government bonds was supported by the heightened uncertainty regarding the economic consequences of the pandemic. Third, relative to the swap rate, Confederation bonds were at times significantly more favorably priced in the year under review than in previous years.

As both the volume raised and demand were higher, the bid to cover ratio (the ratio of bids to the allocated volume) averaged 1.7 across all bond auctions conducted in 2020, which was only slightly higher than in the previous year (1.6).

Around three quarters of the outstanding Confederation bonds are held by domestic investors: most of these debt securities are held by insurance companies, investment funds and pension funds. Foreign investors hold just under a fifth. Banks' proprietary holdings account for the remaining 5%. This breakdown is virtually unchanged on the previous year.

Greater sale of own tranches

The outbreak of the COVID-19 pandemic and the Confederation's countermeasures to cushion the economic impact led to a need for additional funding. To cover the increased funding needs, the Federal Treasury made greater use of own tranches for the first time in several years. Aside from increased borrowing, the primary objective was to boost the secondary market liquidity of Confederation bond trading. With a total of 29 transactions, own tranches worth CHF 820 million in nominal terms were sold, and premia of CHF 261 million were also generated. The average transaction size was just under CHF 30 million, the volume-weighted yield was -0.49%, and the term to maturity was around 16 years.

As these figures show, this instrument is attractive for both investors and the Federal Treasury. Own tranches enable investors to buy larger volumes than would be possible in the market at market conditions between regular auction dates – especially in maturity segments that are rarely auctioned. From the Federal Treasury's perspective, the instrument offers the advantage of boosting secondary market liquidity and reinforcing its regular market presence. Furthermore, compared with auctions conducted according to the single price procedure, the instrument offers the advantage of allowing individual investors' specific demand to be better absorbed. The benefits of the instrument are reflected in the lower yield combined with a higher term to maturity versus the auctions carried out. Despite these advantages, own tranches are used only to supplement auctions, which remain the primary instrument in the long-term segment, not least because of the greater transparency concerning pricing.

Trend of secondary market liquidity

In accordance with its issuing principles, the Federal Treasury is committed to a well-functioning and efficient capital market. That is why it pays particular attention to the trend of secondary market liquidity for its own bonds. Lower Confederation bond liquidity can adversely affect the Federal Treasury's financing conditions (investors demand a liquidity premium). At the same time, less favorable financing conditions for the Confederation could also impact other parts of the Swiss capital market because of yield spreads. The secondary market liquidity of Confederation bonds had been declining steadily over the past ten years. This was due essentially to the shrinking volume of debt and the associated rarity of bonds. The declining liquidity was reflected in noticeably lower trading volumes and a wider bid-ask spread.

The trend over the past year was largely shaped by the outbreak of the COVID-19 pandemic. In terms of secondary market liquidity, this resulted in contradictory effects. On the one hand, the bid-ask spread widened considerably in March, indicating a decline in liquidity. On the other hand, trading volumes jumped at the same time, indicating higher liquidity. Viewed holistically, the changes were due to the fact that many investors were forced to liquidate their Confederation bond positions. The reasons for this are manifold. Some investors had to rebalance their portfolios due to the substantial losses on equity markets and sell bonds to do so. Others needed to obtain liquid funds as quickly as possible to cover their liabilities. Both of these factors caused Confederation bonds to be sold for that purpose, as their relatively high liquidity made them much easier to trade than other bonds on the Swiss capital market. This selling pressure also explains why the bid-ask spread temporarily increased, despite higher trading volumes. Thanks to substantial monetary and fiscal policy interventions in Switzerland and abroad, the Swiss capital market quickly embarked on a path toward normalization. From the second half of the year onward, conditions were again in line with those at the start of the year.

Foreign exchange management

Since 1998, the Federal Treasury has been managing and systematically hedging the Federal Administration's foreign currency demand. From the FFA's perspective, exchange rate developments generally cannot be predicted. Accordingly, the Federal Treasury pursues a passive approach and does not apply active strategies involving changing exposure to rising and falling exchange rates. Hedging gives the administrative units planning certainty, and overruns of approved credits due to negative forex fluctuations can be avoided. The Federal Treasury distinguishes between budgetary transactions and special transactions.

Budgetary transactions

In the case of budgetary transactions, the administrative units' budgeted euro and USD requirements for the coming year are hedged. Foreign currencies are purchased forward in parallel with the budget process (February to July). The budgeted volumes are purchased on an ongoing basis in batches of 5 to 10 million. By following this approach, an average exchange rate that corresponds to market developments is achieved, i.e. the budget rate more or less corresponds to the average exchange rate for the first two quarters. The FFA makes the purchased foreign currencies available to the administrative units at the exchange rates fixed in the budget.

A total of 647 million euros and USD 612 million was purchased forward in 2019 for the 2020 budget year. The currencies were procured in the first half of 2019 at average rates of 1.12 for CHF/EUR and 0.97 for CHF/USD, respectively. During the hedging phase, the euro reached a high of just under CHF 1.15 in April 2019, but then depreciated continuously and ended the year at CHF 1.09. The average spot rate in 2020 was 1.07 for CHF/EUR, which was much lower than the purchase rate. In retrospect, hedging resulted in opportunity costs of around CHF 41 million. During the year under review, the USD fluctuated between CHF 1.02 and the year-end value of CHF 0.97, while the average spot rate in 2020 was CHF 0.94, which was likewise significantly lower than the purchase rate. USD hedging thus resulted in opportunity costs of approximately CHF 37 million.

The Confederation's measures for combating the pandemic had a major impact on budgetary transactions in 2020. The 647 million euros purchased in 2019 for the budget year had to be increased by another 225 million euros. Almost half of the substantial additional amount was related to the pandemic. Regarding the USD, too, the hedged 612 million had to be increased by a massive 379 million, with COVID-19 measures accounting for just over half of that figure. The subsequent purchases in euros and USD were 3.9 times and 2.6 times, respectively, above the average subsequent purchases for the budget years 2017 to 2019. Despite the high degree of planning uncertainty concerning the COVID-19 measures, a gradual procurement strategy made it possible to avoid over-purchasing.

In the year under review, a total of 436 million euros and USD 686 million was purchased forward for the 2021 budget year, with budget rates of 1.05 for CHF/EUR and 0.95 for CHF/USD.

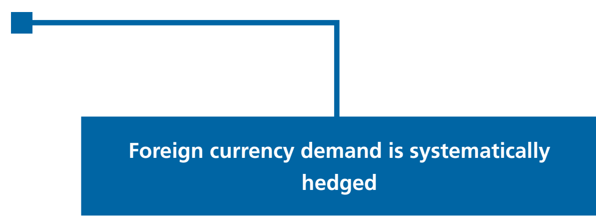
Since the introduction of currency hedging in 1998, around CHF 27 billion in euro and USD has been purchased within the framework of budgetary transactions – in other words, the equivalent of 1.2 billion francs' worth of euro and USD on average each year. Hedging over this period resulted in opportunity costs for the Confederation of around CHF 153 million, or 0.6% of the hedged volume.

Special transactions

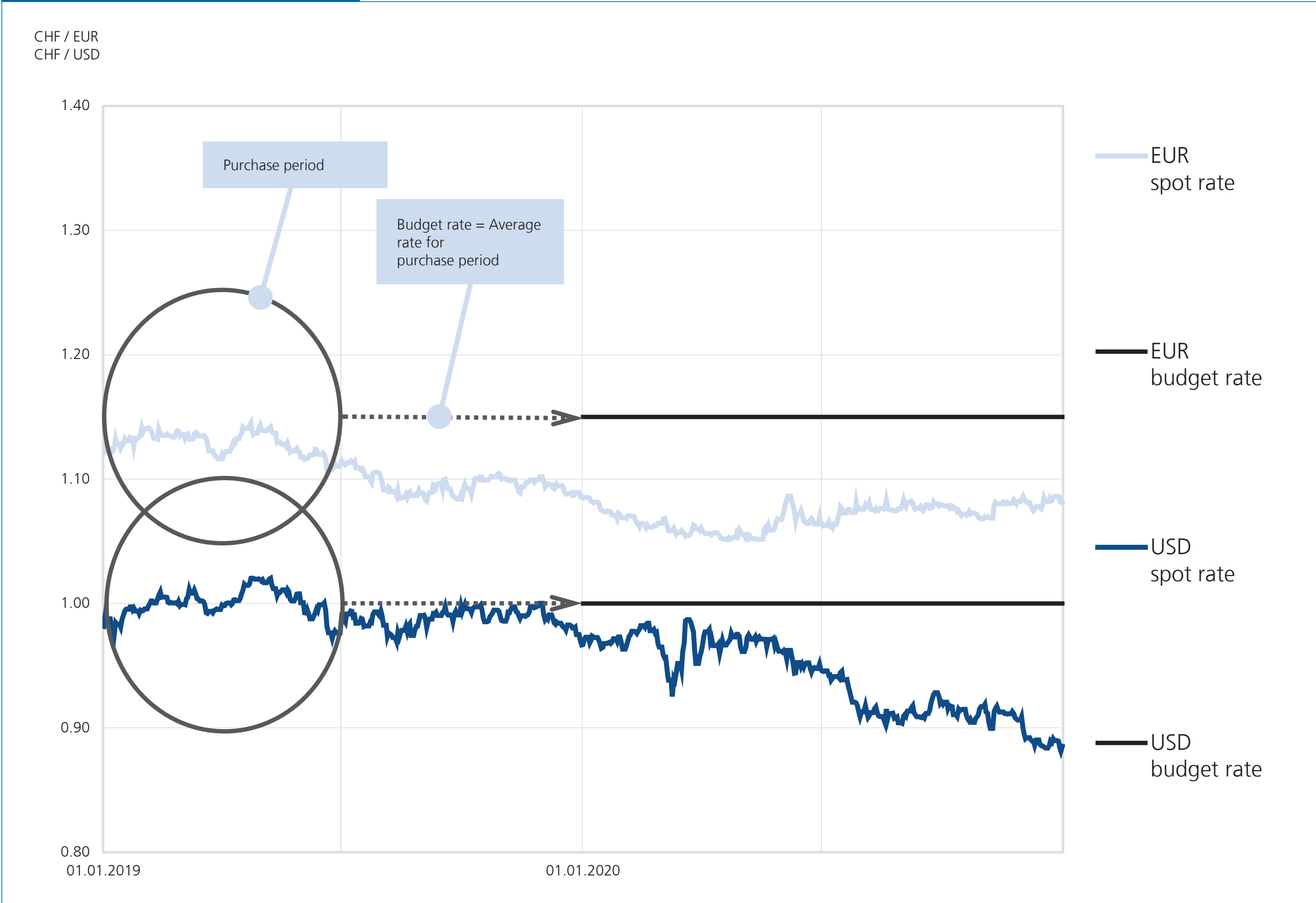
Special transactions are predetermined payments in foreign currencies made over a period of several years within the framework of a credit line. Like the budget requirements, they are fully hedged in a bid not to exceed the CHF amount of the credit line due to negative forex fluctuations and to ensure planning certainty for the administrative units.

During the year under review, nine special transactions amounting to around CHF 1,830 million (EUR 480 mn, SEK 2,474 mn and USD 1,144 mn) were carried out for the areas of defense, development cooperation and space research. As of the end of 2020, a total of 30 forward transactions with an aggregate value of CHF 2.5 billion (euro, USD, NOK and SEK) were open for hedging the special transactions.

Relative to a non-hedging strategy, opportunity costs of around CHF 240 million, or 2.0% of the hedged volume, have accrued for all payments arising from special transactions falling due (2000 to 2020).



Foreign exchange management



Source: Bloomberg

9.8

years

is the average term to maturity of the Confederation's market debt.

Presentation and evaluation of the risk situation

The Confederation's general risk policy is defined by the Federal Council. The Confederation is prepared to assume risks in a controlled and deliberate manner, provided that this is unavoidable for the achievement of objectives or the performance of tasks. Risks should be minimized (instructions on the Confederation's risk policy).

Aside from interest rate and refinancing risks, forex and counterparty risks must also be taken into account by the Federal Treasury when performing its main tasks.

■ Interest rate risk

The interest rate risk for the Federal Treasury is determined by the existing maturity profile and the planned new transactions. It is managed mainly by means of issuing activity. The debt strategy stipulated by the ALCO determines the issuing activity and thus the maturities of new transactions.

Dynamic simulation analyses are used to analyze the effects of various issuance strategies and different interest rate scenarios. A cost-at-risk approach is used to examine the development of interest payable and its fluctuations. Information is thus obtained to optimize the debt strategy from a cost and risk perspective. Moreover, the degree to which interest payable can fluctuate can be estimated, also with regard to the budget and financial plan.

The interest rate risk is closely linked to the refinancing risk. High short-term maturities entail high interest rate and refinancing risks, and long maturities dampen them.

An interest expense projection shows the trend of interest payable under various interest rate scenarios with an unchanged issuance strategy. In the process, the development of debt in accordance with the budget and financial plan is factored in. The interest rate paths from the stochastic simulation are based on an interest rate model that was calibrated for a period with rising interest rates. The mean is derived from this, as are the 10% and 90% quantiles for the development of interest payable.

Analysis of the interest rate risk

The analysis concept pursues both a prospective and a retrospective approach. The prospective approach consists in simulating and analyzing various issuance strategies with different interest rate trends over a period of up to ten years. On the one hand, selected deterministic interest rate scenarios are used. On the other, stochastic interest rate models are also used to generate a large number of interest rate paths. This enables a random distribution of potential interest payable to be calculated for different debt portfolios for a given planning period. This in turn makes it possible to establish average expected interest payable, as well as possible deviations and their probability (cost-at-risk approach). Based on this data, different issuance strategies can be compared with respect to the expected interest payable (cost dimension) and its future fluctuation ranges (risk dimension).

In the retrospective analysis, differently composed debt portfolios are analyzed on the basis of actual interest rate developments and compared with effective interest payable. This means that the issuance strategy followed can be evaluated ex post and measured against other strategies. Moreover, this approach is also suitable for analyzing the different portfolios in typical sub-periods of interest rate development (rise in interest rates, inverted yield curve, etc.) and thereby gaining insights for strategy formulation.

The baseline scenario is derived from macroeconomic assumptions and the corresponding interest rates of the federal government's economic forecasts expert group. A continuation of the very low interest rate environment is expected in the short term, with negative interest rates for short maturities. Interest rates are expected to normalize in the medium term, i.e. it is assumed that they will rise gradually. This scenario with a moderate rise in interest rates serves as a basis and is expanded upon in this analysis. The extreme scenarios include interest rates remaining low (constant interest rates), as well as an exceptionally sharp and rapid rise of 4 percentage points in interest rates (interest rate shock).

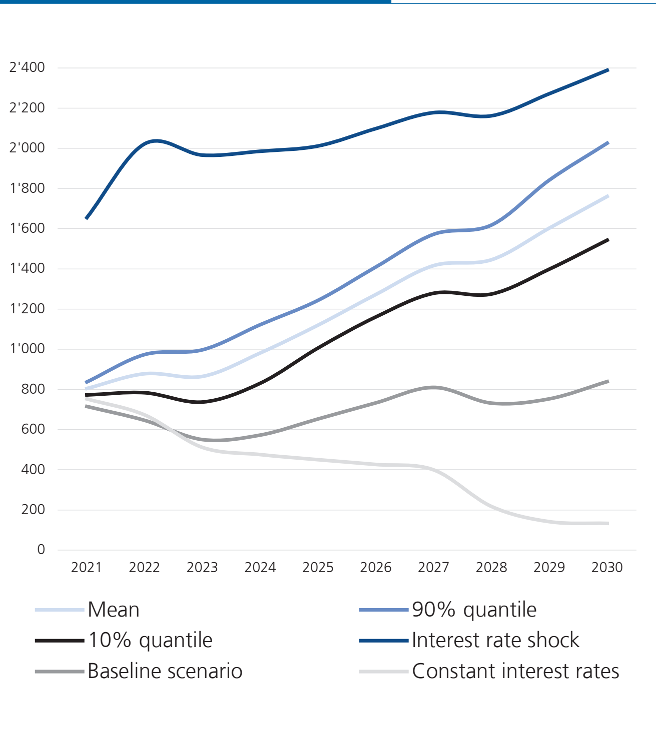
Based on the baseline scenario, the Federal Treasury expects interest payable to fall further over the next four years. Only in the event of an interest rate shock would interest payable rise rapidly. This scenario is unlikely at the moment. In such a case, the additional interest receipts from the investment of liquidity would partly offset the increase in interest payable.

Last year, the utilization of the risk budget increased noticeably, going from CHF 67 million to CHF 343 million at the end of 2020. This was attributable to higher short-term funding (money market debt register claims) and the projected increase in debt, combined with a simultaneous reduction in liquidity.

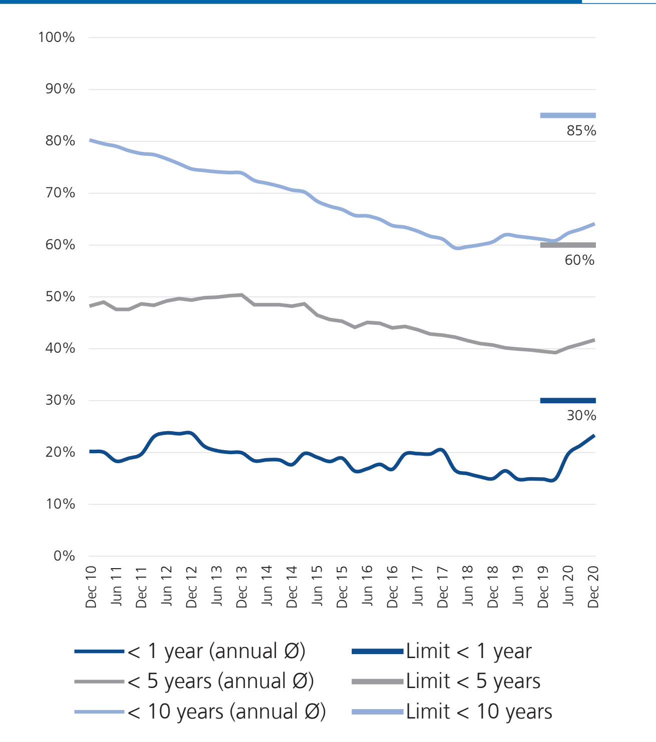
Due to the persistently low interest rate environment and the fact that a normalization of interest rates will not occur until the medium term, the ALCO confirmed the deviation from the issuance strategy defined as optimal (with shorter maturities). In the current environment, even long maturities can be financed at relatively low costs or even with negative yields.

Highest interest rate risk permissible
The cumulated risk budget for interest rate risks is CHF 500 million for four years. This takes into account the Confederation's fiscal policy risk capacity and risk tolerance, i.e. the extent to which an increase in interest expenditure can be offset in another way without radical measures. This means that the fluctuations in interest expense forecast for the budget and financial plan time horizon may deviate from the mean by a maximum of CHF 500 million on a cumulative basis (90% quantile less mean). In the worst case, the corresponding risk can also occur within a year. The annual average for this interest rate risk was CHF 343 million in 2020.

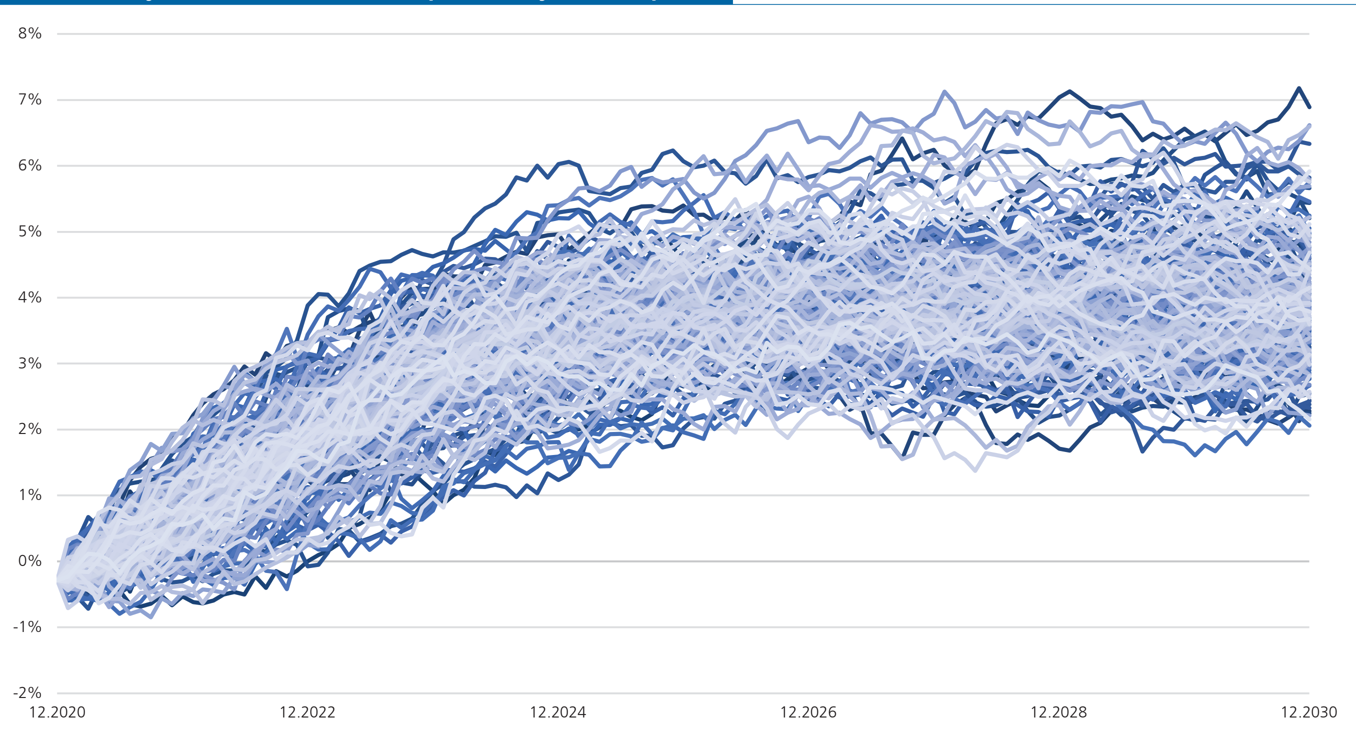
Interest expense projection in mn



Maturity shares of money and capital market debt



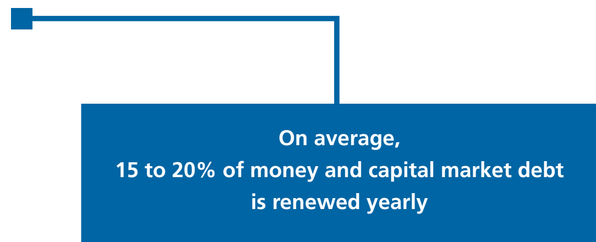
Stochastically simulated interest rate paths (10 years swap rate)



Refinancing risk

The maturity profile of outstanding market debt and the Confederation's rating are important refinancing risk indicators.

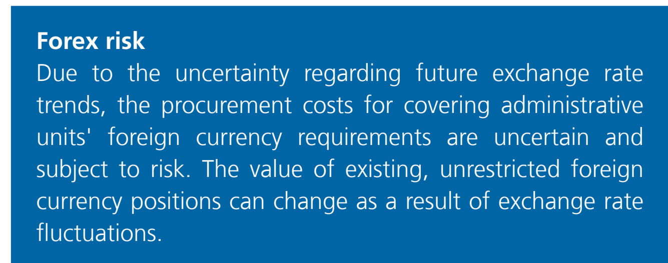
The current maturity profile of money and capital market debt shows a moderate refinancing risk. While the proportion of debt requiring refinancing within the next 12 months relative to total marketable debt rose by around 8 percentage points year on year, it ended the year at 24% and thus remained well below the upper limit of 30%. The limit was, however, reached for a short while during the year. This was due to the fact that, as of the reporting date, two bonds were maturing in less than 12 months, while the volume of money market debt register claims was increased at the same time. Owing to the higher volume of money market debt register claims, the average term to maturity of the debt portfolio has fallen from 10.7 to 9.8 years. The targets (or maximum shares) set out in the service level agreement between the FDF and the FFA are still clearly undershot nevertheless. The maturity structure of the debt portfolio could thus be shortened significantly within these specifications, especially in the case of maturities of more than five years.



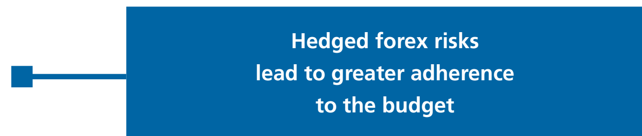
The Confederation's creditworthiness is given the highest rating by all relevant rating agencies. In the wake of the financial crisis, only very few countries maintained this top level of creditworthiness. Even in the case of unfavorable market conditions, the Confederation was able to raise the necessary funds on the money and capital market.

Forex risk

The Federal Treasury purchases foreign currencies for the administrative units. The foreign currency requirements for the budget year for the main currencies of euro and USD and the future payment obligations arising from special transactions that are already known are comprehensively hedged. The primary objective when managing forex risks is thus to ensure adherence to the budget and planning accuracy for expenditure. Overruns of approved credits due to negative forex fluctuations are to be avoided. Since the Confederation constantly has certain foreign currency requirements, it is generally exposed to exchange rate developments.

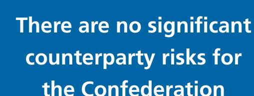


From the FFA's perspective, exchange rate developments essentially cannot be predicted. Accordingly, forex risks are systematically hedged using a passive approach. As a result, the Federal Treasury is not exposed to any substantial forex risks.



Counterparty risk

Counterparty risks for the Confederation arise primarily as a result of short-term deposits (liquidity) and positive replacement values from outstanding currency and interest rate derivatives. These receivables are exposed to default risk. Treasury loans are granted to institutions affiliated with the Confederation and therefore are not part of the counterparty limit system; the amount of the loans is managed by means of treasury agreements. A credit limit concept forms the basis for avoiding losses and risk concentrations. The credit limits are established on the basis of predefined criteria, namely rating, equity, financial strength (in the case of cantons), diversification and instrument type. Risk Control regularly reviews the set counterparty limits and monitors compliance with the limits on a daily basis. The development of permitted counterparties' credit quality is continually reviewed (e.g. rating changes, interim financial statements and other reports). The limits were complied with at all times in 2020.



Liquidity amounted to approximately CHF 14 billion at the end of 2020. It was placed with the SNB (at 0%, including the SNB sight deposit account) and thus carries no risk.

The positive replacement values from outstanding currency and interest rate derivatives fell last year, going from CHF 44 million to reach CHF 32 million at the end of December 2020. On the one hand, longer-term derivative positions (e.g. currency and interest rate hedging instruments) are entered into with counterparties that have signed a "Credit Support Annex" with the FFA. On the other, such transactions are also conducted with cantonal banks which have a state guarantee.

Outlook

The COVID-19 pandemic will remain the dominant issue in 2021. The Federal Treasury will be challenged especially in the areas of liquidity planning and the procurement of debt financing. The Confederation still has a sizeable liquidity buffer, but this is also necessary in view of the considerable planning uncertainty, and it should not be reduced any further. It will no longer be possible to finance additional unforeseen expenditure by reducing liquidity like in 2020. Accordingly, there will be a rise in market debt in 2021.

In view of the heightened uncertainty, the issuance program published in December 2020 was also formulated more openly. For example, the planned volume of money market debt register claims was indicated within a range of CHF 12 billion to CHF 18 billion, corresponding to an increase of around CHF 4 billion. Bonds worth CHF 6.5 billion in nominal terms are to be issued in the monthly auctions. Taking account of bonds maturing in April, the volume of bonds outstanding will increase by CHF 2.4 billion. As a result, some of last year's short-term financing associated with the coronavirus should be shifted into longer-term bonds.

However, the measures proposed by the Federal Council to parliament in February 2021 (in particular measures for hardship cases and short-time working compensation) are likely to significantly increase the federal government's financing requirements. Accordingly, it can be assumed that the issuance program will have to be increased for both money market debt register claims and bonds.

Following the sharp economic downturn of more than -3% last year, the federal government's expert group is anticipating a significant economic recovery and GDP growth of around 3% this year. Although the outlook has brightened with the start of the vaccination campaign, the virus and the associated restrictions are still putting a damper on the Swiss economy. As soon as the epidemiological situation eases, growth should pick up. Nevertheless, there is an extraordinarily high degree of uncertainty. The European and US central banks have signaled that they will maintain their hugely expansionary monetary policy and that there is no end in sight to the extremely low interest rates. Accordingly, the SNB's room for maneuver in terms of monetary policy is likely to remain limited. It is generally expected that Swiss franc interest rates will essentially move sideways and could rise moderately in the second half of the year in the wake of the anticipated economic recovery and, at best, expectations of somewhat rising inflation. Hence, the Federal Treasury will continue to deviate from the optimal issuance strategy from a risk-bearing capacity perspective and issue rather long-dated bonds. However, with the significant expansion of the short-term money market debt register claims program, the available risk budget will again be utilized much more than in previous years. Therefore, short-term debt should be increasingly shifted into long-term liabilities wherever appropriate.

The COVID-19 crisis and greater reliance on working from home have triggered a real surge in digitalization. Following a protracted project and deployment phase, the new treasury management software is finally being rolled out, and the old solution is being replaced, thereby giving another major boost to the digitalization of the Federal Treasury. Processes and controls will be highly automated and manual checks, and activities will be scaled back to a minimum. This will make transaction processing and control more efficient and reduce operational risks.

Aside from further optimization efforts and adjustments, the replacement of the Libor by the new SARON reference interest rate will also be addressed in 2021. This will affect the few interest rate swaps still outstanding and the underlying derivative contracts.