97th Annual Report

SCHWEIZERISCHE NATIONALBANK
BANQUE NATIONALE SUISSE
BANCA NAZIONALE SVIZZERA
BANCA NAZIUNALA SVIZRA
SWISS NATIONAL BANK

2004

Goals and responsibilities of the Swiss National Bank

Mandate

The Swiss National Bank conducts the country's monetary policy as an independent central bank. In so doing, it creates an appropriate environment for economic growth. The National Bank is obliged by Constitution and statute to act in accordance with the interests of the country as a whole. Its primary goal is to ensure price stability, while taking due account of economic developments.

Price stability

Price stability is an important precondition for growth and prosperity. Inflation and deflation are inhibiting factors for the decisions of consumers and producers; they disrupt economic development and put the economically weak at a disadvantage. The National Bank equates price stability with a rise in the national consumer price index of less than 2% per annum. Monetary policy decisions are made on the basis of an inflation forecast and implemented via the steering of the three-month Libor.

Cash supply and distribution

The National Bank is entrusted with the note-issuing privilege. It supplies the economy with banknotes that meet high standards with respect to quality and security. It is also charged by the Confederation with the task of coin distribution.

Cashless payment transactions

In the field of cashless payment transactions, the National Bank provides services for high-value payments between banks. These are settled in the Swiss Interbank Clearing (SIC) system via sight deposit accounts held with the SNB.

Investment of currency reserves

The National Bank manages the currency reserves. These engender confidence in the Swiss franc, help prevent and overcome crises, and may be utilised for interventions in the foreign exchange market.

Financial system stability

Within the framework of its task to ensure the stability of the financial system, the National Bank analyses and takes into account sources of risk emanating from the financial system. It oversees the systemically important payment and securities settlement systems and helps to shape the operating framework for the financial sector.

Tasks on behalf of the Confederation

The National Bank acts as banker to the Confederation and, together with the federal authorities, participates in international monetary cooperation.

Statistics

The National Bank compiles statistical data, particularly with regard to banking activity and financial market development.

Swiss National Bank
97th Annual Report 2004

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Preface

Ladies and Gentlemen

According to art. 7 para. 2 of the National Bank Act (NBA), which entered into force on 1 May 2004, the National Bank is obliged to report to the Federal Assembly each year on the fulfilment of its tasks as defined in art. 5 NBA. Furthermore, the SNB is required – pursuant to art. 7 para. 1 NBA – to submit its Business and Financial Report to the Federal Council for approval, before handing it, together with the Audit Board's report, to the General Meeting of Shareholders for subsequent approval.

The first part of the 97th Annual Report of the National Bank comprises the Accountability Report to the Federal Assembly (pp. 6–66). The Accountability Report is submitted to the Federal Council and the General Meeting of Shareholders for information purposes only, and does not require their approval. It details the National Bank's fulfilment of its statutory mandate – in particular the conduct of monetary policy – and also describes economic and monetary developments in the year under review.

The Business Report, for the attention of the Federal Council and General Meeting of Shareholders, deals with the organisational and operational development of the National Bank and its business activity, and includes the Financial Report, which contains the income statement, balance sheet and notes (pp. 68–150).

From an organisational and operational perspective, the implementation of the new NBA played a pivotal role in the year under review. This required the drafting and passing of the SNB's legal basis (National Bank Ordinance, Organisation Regulations, Terms of Business, Guidelines on Monetary Policy Instruments, Investment Policy Guidelines and other internal regulations). It also involved the election and appointment of the new Bank Council (reduced to eleven members), its four committees and the new Audit Board. In addition, the Enlarged Governing Board, consisting of the three members of the Governing Board and their three deputies, commenced its activities. It is responsible for the operational management of the National Bank, while the conduct of monetary policy remains the mandate of the Governing Board. Furthermore, investment policy was adjusted to suit the extended legal scope. Finally, the National Bank's new mandate with regard to the stability of the financial system needed to be defined.

The sale of the 1,300 tonnes of gold no longer required for monetary policy purposes was pursued as planned in the year under review, and will be completed by spring 2005. The political debate on the appropriation of the proceeds from the sale of these gold reserves continued throughout the year. The National Council and the Council of States were unable to agree on a joint bill. After the Council of States' decision on 16 December – for the second time – not to consider the bill, the Federal Council decided on 2 February 2005 to distribute the gold proceeds pursuant to the existing law, with one-third going to the Confederation and two-thirds to the cantons. The proceeds will be distributed in spring 2005, based on the financial results for 2004.

The SNB's financial results for 2004 registered a distributable profit of CHF 20.7 billion, as compared with CHF 2.3 billion a year earlier. This profit refers to the amount after the planned increase of the provisions prescribed in the NBA. Under the terms of the current profit distribution agreements, a total of CHF 24 billion will be distributed to the Confederation and the cantons for the 2004 financial year. The surplus for future distributions is thus reduced in the balance sheet by CHF 3.3 billion to CHF 6.9 billion.

We wish to thank the bank authorities as well as our employees for their valuable support over the past year.

Berne and Zurich, 25 February 2005

Hansueli Raggenbass
President of the Bank Council

Jean-Pierre Roth
Chairman of the Governing Board

Accountability Report for the Federal Assembly

On 15 February 2005, the Governing Board of the Swiss National Bank submitted its 2004 Accountability Report to the Federal Assembly in accordance with art. 7 para. 2 of the National Bank Act of 3 October 2003. The following Accountability Report is provided to the Federal Council and the General Meeting of Shareholders for information purposes only, and does not require their approval.

Summary

In accordance with art. 7 para. 2 of the new National Bank Act (NBA), which entered into force on 1 May 2004, the Swiss National Bank (SNB) is required to report to the Federal Assembly each year on the fulfilment of its mandate. The present report is structured in line with art. 5 NBA, with a separate chapter reporting on each of the eight tasks listed in the legislation.

Despite the entry into force of the totally revised NBA, the National Bank performed the customary activities of a central bank in 2004. It instituted a reversal of its monetary policy, however, and the legislative reforms resulted in substantial adjustments to the instruments used by the National Bank and to its organisational structure.

Monetary policy

(1) The new NBA defines the National Bank's monetary policy mandate more precisely than was previously the case. Monetary policy must be conducted in the interests of the country as a whole and must ensure price stability. In doing so, it shall take due account of economic developments. The monetary policy concept consists of three elements: the definition of price stability, a medium-term inflation forecast and an operational target range for the targeted money market rate.

Developments in global economic growth – the basis for the inflation forecast – were decidedly favourable in the first half of the year. Strong growth stimuli emanated from the US and the emerging Asian industrialised economies, and this helped to boost regions like Japan and Europe that were suffering from weak domestic demand. As the year went on, however, the rise in the price of oil and the depreciation of the dollar slowed down the expansion around the world, though not in the US.

The Swiss economy succeeded in shaking off the recession and stagnation which had dogged it in the two preceding years. Growth was broad-based and slightly exceeded the economy's potential, thus reducing excess capacity. At 1.8%, however, growth was lower than it had been in previous upswings. Owing to higher prices for oil, housing rents and public services, consumer price inflation rose from 0.6% in 2003 to 0.8% in 2004. The Swiss franc – though initially stable – was driven upwards towards the end of the year by the dollar's weakness.

Monetary policy had to be adapted in line with these developments. In the four preceding years, the National Bank had cut its reference interest rate, the three-month Libor, in several steps, ultimately bringing it down to 0.25%. In view of the economic stabilisation, the SNB raised the target range in two increments of 0.25 percentage points each in June and September. These actions, and the fact that rates were left unchanged in the first and fourth quarters of the year, illustrate the conflicting demands impinging on monetary policy. Whereas the long-term view favoured a restrictive stance, the resurgence of fears about economic growth in the autumn called for caution. The National Bank's interest rate moves reflected a normalisation; as price stability was not in jeopardy, however, it continued at the same time to pursue a relaxed policy aimed at supporting economic growth.

Liquidity supply

(2) Maintaining an adequate supply of liquidity to the money market goes hand in hand with the implementation of monetary policy. Based on the list of permissible central bank transactions that was expanded under the new NBA, the National Bank issued Guidelines on Monetary Policy Instruments effective as of 25 March 2004 along with a number of Instruction Sheets aimed at its counterparties. The Guidelines describe the instruments and procedures for the implementation of monetary policy, as well as the collateral that is eligible for monetary policy transactions. For the first time, the National Bank also specifies the conditions under which it is willing to grant emergency liquidity assistance. As was already the case, liquidity is supplied by way of various facilities based almost exclusively on repo transactions.

Cash supply and distribution

(3) The National Bank is entrusted with the note-issuing privilege. It supplies high-quality and highly secure banknotes to the economy via the banks and postal service. It is also charged by the Swiss Confederation with the task of coin distribution. In 2004, it focused on maintaining the quality of banknotes and of cash transactions, gaining initial experience with cash deposits held with third parties, further developing security features, taking precautionary measures to prevent counterfeiting, and initiating preparations for a possible new series of banknotes.

Payment systems

(4) In the area of cashless payments, the National Bank is mandated to facilitate and secure the functioning of the appropriate systems. It holds accounts on behalf of the banks, and it runs and monitors the Swiss Interbank Clearing (SIC) system, through which Swiss franc interbank payments are settled. The task of overseeing the payment and securities settlement systems as laid down in the new NBA primarily concerns the definition of this function in the National Bank Ordinance (NBO) and the actual determination of the systemically important systems on that basis.

Currency reserves

(5) The National Bank manages Switzerland's currency reserves. In doing so, the Governing Board – which is responsible for the investment of the National Bank's assets – bases its decisions on three criteria: security, liquidity and return. On 27 May 2004, the National Bank issued Investment Policy Guidelines that take account of the expanded possibilities provided by the new NBA. They define the scope available to the SNB for its investment activities by setting out the investment principles and instruments, as well as the investment and risk control process to be observed. Given that previous legal restrictions on investment categories and borrowers no longer applied, the National Bank took the opportunity to enhance its risk/return profile. Its portfolio continued to focus on the most liquid currencies and markets and on borrowers with the highest credit ratings. The investment universe was expanded to include foreign corporate bonds.

Financial system stability

(6) The National Bank is mandated to contribute to the stability of the financial system. A stable financial system is essential to the successful conduct of monetary policy and to properly functioning financial markets. The National Bank sought to identify potential risks at an early stage and help to create an environment that is conducive to stability. In its annual Financial Stability Report, it analysed the banking system and the financial market infrastructure from the point of view of security. It cooperated closely with domestic and international supervisory bodies, both bilaterally and on committees such as the Basel Committee on Banking Supervision.

Monetary cooperation

(7) The National Bank participates in international monetary cooperation. In 2004, as in previous years, it did so mainly through the International Monetary Fund (IMF), the Group of Ten (G-10) and the Bank for International Settlements (BIS). In the case of the IMF and the G-10, it participates in collaboration with the Federal Council. The IMF, which works to promote stable monetary conditions worldwide and support free trade and payment flows internationally, and on whose Executive Board Switzerland has a seat, concerned itself mainly with overseeing the member countries in respect of preventing or resolving crises, its role in poorer nations and the Fund's financial situation. Technical assistance by the National Bank focused on the countries in its IMF constituency. This assistance included central bank management training, the preparation of monetary policy decisions, the introduction and administration of banknotes, and the investment of currency reserves.

Banker to the Confederation

(8) The National Bank provides the Swiss Confederation with banking services in the areas of payment transactions and liquidity and securities management. As the new NBA states that these services are no longer provided free of charge, details of compensation and of the services provided are set out in an agreement with the Federal Finance Administration.

1 Monetary policy

Overview

After the years 2001 to 2003, which had been shaped by declining interest rates, 2004 saw an interest rate reversal in the money market. In retrospect, the year under review was characterised by economic recovery and a normalisation of monetary policy. Price stability was maintained at all times.

This chapter will look more closely at monetary policy decisions and the basis on which they are made, both in terms of the legal and conceptual framework and the economic and monetary background. Section 1.1 will discuss the legal basis underlying the National Bank's monetary policy, its mandate and its strategy in terms of monetary policy. Sections 1.2 and 1.3 will examine economic developments in Switzerland and abroad. Section 1.4 will review the implementation of monetary policy in 2004 and the Governing Board's decisions taken at the four quarterly assessments on the basis of information available at the time. Finally, section 1.5 will discuss the new legal basis for the National Bank's statistical activities and its implementation.

1.1 Monetary policy concept

Constitutional and legal mandate

Art. 99 of the Federal Constitution (FC) entrusts the National Bank, as an independent central bank, with the conduct of monetary policy in the interests of the country as a whole. The constitutional mandate is explained in greater detail in art. 5 para. 1 of the revised NBA, which came into force on 1 May 2004. This article requires the National Bank to ensure price stability. In doing so, it shall take due account of economic developments. The SNB is required to resolve as best as possible any conflicts arising between the objective of price stability and the development of the economy, while taking into consideration the interests of the country as a whole and giving priority to price stability. The mention of "interests of the country as a whole" underscores the requirement of the National Bank to gear its policy to the needs of the Swiss economy as a whole rather than to the interests of individual regions or industries.

Significance of price stability

Price stability is an important condition for the smooth functioning of the economy, as both inflation and deflation disrupt economic development, hinder decision-making by consumers and producers, and generate high social costs. By keeping prices stable, monetary policy creates a favourable framework in which the economy can fully exploit its production potential. Consequently, price stability contributes to prosperity.

Origins of inflation and deflation

The aim of the National Bank's monetary policy must be to ensure medium to long-term price stability. In other words, it has to prevent both inflation and deflation. Both economic theory and experience show that a substantial excess or shortage of liquidity over a lengthy period of time is the principal cause of inflationary or deflationary phases. For this reason, inflation or deflation can ultimately be attributed to monetary policy. It would be wrong, however, to attempt to use monetary policy to counteract short-term deviations from price stability, as the impact of monetary policy on the economy and on prices is subject to considerable time lags and uncertainty. Moreover, its influence on the development of the real economy is only temporary.

Appropriate monetary environment

To secure price stability in the medium and long term, the National Bank must provide an appropriate monetary environment. If interest rates are too low for a lengthy period, the supply of money and credit to the economy is too high, thus triggering an inordinate demand for goods and services. Although this boosts production initially, bottlenecks occur in the course of time and overall economic capacity is stretched, thus causing prices to rise. By contrast, if interest rates are too high for a lengthy period, this reduces the supply of money and credit to the economy and, consequently, leads to a demand shortage. Prices for goods and services fall, thus also hampering economic growth.

Due consideration of the economic situation

A country's economy is subject to numerous domestic and foreign influences. These cause fluctuations in the business cycle, which in turn either lessen or increase the pressure on prices. Such fluctuations are inevitable. Being aimed at medium to long-term price stability, however, the National Bank's monetary policy does help to limit them. The SNB thus has to take due consideration of the economic situation when formulating its policy. It would be wrong, however, to expect it to be able to fine-tune the development of the economy. Time lags and the impact of monetary policy on the business cycle and prices are subject to considerable uncertainty. Moreover, the National Bank has to operate in a highly diverse range of situations.

Demand and inflation

The most common cause of a general rise or fall in inflation is when demand for goods and services does not develop in line with the economy's production capacity. Such situations are caused, for example, by unforeseen fluctuations in the international economy, persistent exchange rate distortions, serious budget imbalances or inappropriate money supply levels in the past. Upward pressure on prices eases in phases when production capacity is not fully utilised and increases in phases of economic overheating. The National Bank will thus tend to ease monetary policy in the former case and tighten it in the latter. Monetary policy that is geared to restoring price stability has a corrective influence on aggregate demand and thus helps to regulate the development of the economy. The SNB's policy must then be aimed at gradually restoring price stability.

Supply and inflation

The situation is more complex when the price level rises owing to a fall-off in supply, thus increasing production costs. A continuous rise in the oil price is an example of such a shock. Under these circumstances, monetary policy must seek to ensure that the higher costs do not trigger a wage-price spiral that results in an inflationary process, nor unduly impair the economy. A strategy aimed at the rapid restoration of price stability might trigger adverse influences on the business cycle and employment.

Monetary policy concept

The National Bank needs indicators to determine whether or not its monetary policy is appropriate for its price stability objective. It bases its decisions on a broad range of real and monetary indicators. The monetary policy concept in force since the beginning of 2000 consists of three elements: the definition of price stability, a medium-term inflation forecast and an operational target range for the National Bank's chosen reference interest rate, the three-month London Interbank Offered Rate (Libor) for Swiss francs, which is the economically most significant money market rate for Swiss franc investments.

Definition of price stability

The National Bank equates price stability with a rise in the national consumer price index (CPI) of less than 2% per annum. Prior to the revision of the CPI in 2000, actual inflation was overstated by about 0.5–0.6 percentage points owing to measuring errors. It is probable that the new price index, too, is subject to imprecision. In particular, it is not possible to properly account for price rises that reflect qualitative improvements in goods and services. The CPI will probably continue to slightly overstate the actual level of inflation. It is thus reasonable to equate price stability (measured by the CPI) with a slightly positive inflation rate.

Possible overstepping of price stability threshold

While the National Bank would combat an inflation rate that persistently exceeded the 2% level, there are situations in which it would allow this threshold to be temporarily breached. In a small open economy, exceptional situations with sharp exchange rate fluctuations could arise, causing the inflation rate to overstep the price stability threshold in the short term. Marked price rises for imported goods, such as oil, can also result in a temporary breach of price stability. It is not possible – or necessary – for the central bank to prevent this. Similar situations may arise in response to major increases in taxation.

Quarterly publication of inflation forecast

At its quarterly assessments, the National Bank publishes a forecast on the development of inflation over the three subsequent years. The period of three years corresponds more or less to the time required for the complete transmission of monetary stimuli. Forecasts over such a long time horizon are, however, fraught with considerable uncertainties. By publishing a medium to long-term forecast, the National Bank emphasises the need to adopt a forward-looking stance and to react at an early stage to any inflationary or deflationary threats. The inflation forecast is based on a scenario for the development of the global economy. Moreover, the inflation forecast is prepared on the assumption that the three-month Libor will remain constant over the forecasting period. The inflation forecast thus maps the future development of prices against the background of a specific world economic scenario and unchanged monetary policy environment in Switzerland. It cannot therefore be compared with forecasts of other institutions which incorporate expected monetary policy responses.

The National Bank prepares its inflation forecast based on various indicators. Their impact on the development of prices is subject to different time lags. The supply of money, as reflected in changes in the monetary aggregates, takes effect mainly towards the end of the forecasting horizon. In the medium term, the economic prospects play a key role. In the shorter term, factors such as the exchange rate, prices of raw materials (oil), administered prices and value-added tax rates are of significance. In its report on monetary policy, the National Bank regularly issues statements on the development of the principal indicators factored into its inflation forecast. In various issues of its Quarterly Report, moreover, the SNB has published details of the models it uses to forecast inflation.

Indicators of relevance to the inflation forecast

If the inflation forecast indicates a deviation from price stability, monetary policy needs to be reviewed. Should inflation threaten to exceed 2%, the National Bank would consider tightening its monetary policy. Conversely, it would loosen the monetary reins if there were a danger of deflation. The National Bank does not, however, react mechanically to the inflation forecast. To determine the scale and timing of its response, it also takes account of the general economic situation.

Review of monetary policy based on the inflation forecast

The National Bank implements its monetary policy by influencing the interest rate level in the money market. It fixes a target range for the three-month Libor and publishes it regularly. As a rule, this range extends over one percentage point. The SNB performs quarterly assessments at which it reviews its monetary policy. If circumstances so require, it also adjusts the target range for the three-month Libor between these regular assessments. It publishes the reasons for any such changes in a press release issued on the day the decision is made.

Target range for the three-month Libor

1.2 International economic developments

Gratifying start to the year

The outlook for the world economy looked decidedly positive at the beginning of 2004. In the second half of 2003, global economic growth was running at nearly 6% per annum – the highest rate recorded in four years. Boosted by highly expansionary monetary and fiscal policies, the US economy in particular provided major stimuli. The emerging Asian industrialised countries also contributed to the sharp rise in demand. Thanks to expanding global trade, even countries previously dogged by distinctly sluggish economic conditions started to see their economies recover. This was mainly true of Japan and – to a lesser extent – Europe.

Strong growth in the US

In March, strong global economic growth prompted the National Bank to upwardly revise its international economic scenarios for both 2004 and 2005. The US economy in particular showed impressive momentum. This was reflected in, among other things, a steep rise in manufacturing activity, which reached a twenty-year peak at the beginning of 2004. The strong growth was mainly attributable to consumer spending, with US households benefiting not only from federal tax cuts, but also from historically low mortgage rates and the increasing value of real estate. Alongside private households, companies also contributed to the upturn through strong investment activity, particularly in the IT sector. The fall in the price of many IT assets, accentuated by high overcapacity and further productivity gains, had a stimulating effect. The economy was additionally boosted by high military spending as a result of the US intervention in Iraq and by sharp rises in spending on homeland security.

Dynamic Asia

The Asian economy also exhibited a dynamic trend. The investment boom in China generated significant stimuli for the global economy beyond the region's boundaries. In Japan, the export sector enjoyed a recovery, followed by domestic demand. In contrast to the 1990s, the economic recovery was no longer based one-sidedly on an increase in government spending.

Tentative recovery in the euro area

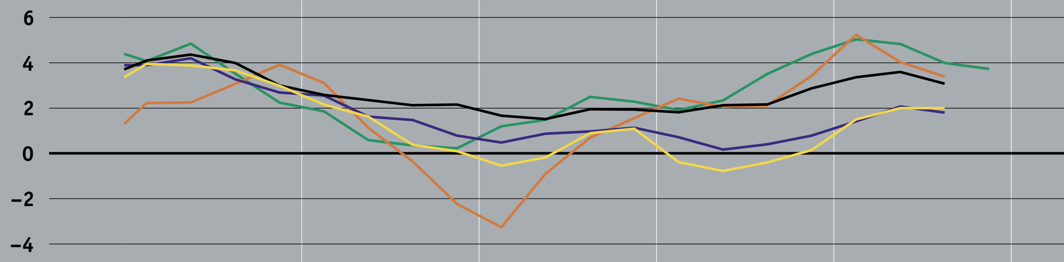
By contrast, the economic recovery in the euro area was rather tentative. The revival in the first half of the year was largely due to higher foreign demand. Despite the impressive improvement in the business climate, companies held back with investments and expenditure by private households rose only marginally. Several factors may have contributed to the weak trend in consumer spending. Low growth in employment and high jobless rates are likely to have damaged consumer confidence. In some countries, such as Germany in particular, consumer sentiment may have been depressed by announcements of structural reforms affecting the labour market and the healthcare and pension systems.

2000 2001 2002 2003 2004

Gross domestic product

United States
Japan
Euro area
United Kingdom
Switzerland

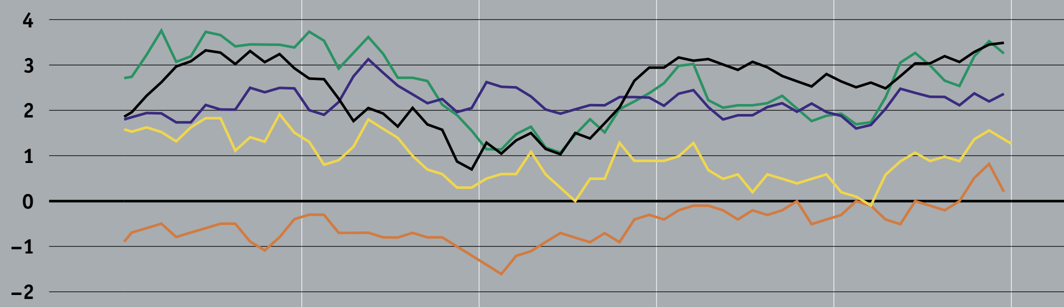
Year-on-year change
in percent, in real terms
Source: OECD



Inflation

United States
Japan
Euro area
United Kingdom
Switzerland

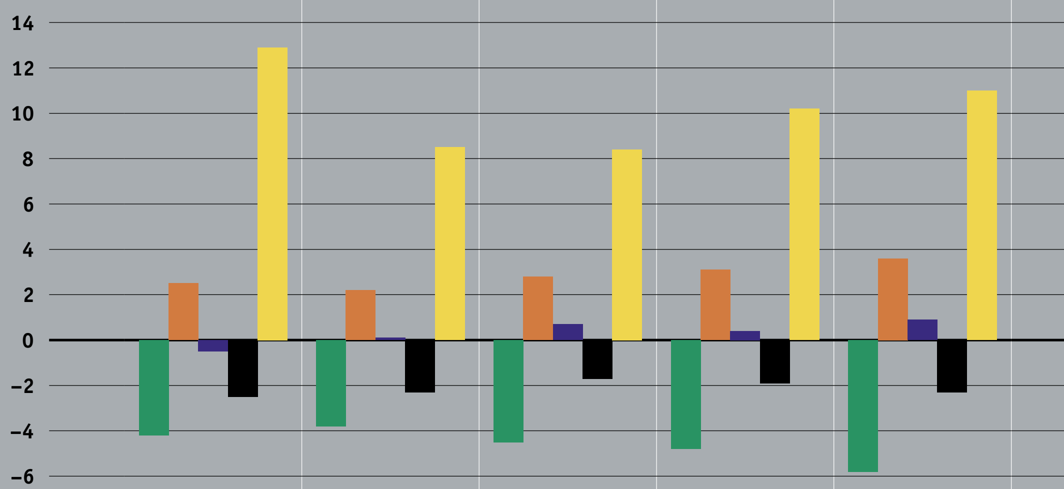
In percent
Source: OECD



Current account balance

United States
Japan
Euro area
United Kingdom
Switzerland

Net balance in percent
of GDP
Source: OECD



2000 2001 2002 2003 2004

Sharp rises in raw material prices

The strong global economic growth was accompanied by sharp rises in raw material prices. Steel and oil prices increased especially sharply. In the case of oil, the price hikes were further exacerbated by the political instability in the Middle East. The first six months of 2004 saw the price of oil climb from USD 30 to USD 38 per barrel (Brent crude), before reaching an all-time high of USD 52 in October.

Inflation subdued

A combination of economic recovery and higher oil prices led to a rise in inflation rates worldwide, although in most countries the rise was dampened by continuing overcapacity. This at least dispelled the anxieties over deflation, which in 2003 had still led many to fear that central bank interest rates would approach the zero lower bound.

Interest rate hikes by the Fed

Given the low risk of inflation, most central banks maintained their expansionary monetary policies. In the first half of the year, real short-term interest rates in the US, the euro area and Japan remained close to or below zero. From June onwards, once the US economic recovery had gained strength, the US Federal Reserve (Fed) began raising its interest rates, thus adopting a more neutral monetary policy stance. Proceeding cautiously, by the end of the year it had increased its key interest rate (the federal funds rate) from 1% to 2.25% in five 0.25 percentage point steps.

ECB reference rate unchanged

By contrast, the European Central Bank (ECB) left its reference rate unchanged at 2%. The ECB had previously relaxed its monetary policy less than the Fed. Of greater importance were, however, the persisting fragility of aggregate demand in the euro area and the marked appreciation of the euro against the US dollar, which tended to have a dampening effect on the economy. Between the fourth quarter of 2003 and the fourth quarter of 2004, the euro rose by 9% against the dollar, having already appreciated by 20% in 2003.

Growth slowdown in autumn

The gratifying international economic trend in the first half of the year was followed by a more sober mood in the autumn. Most of Switzerland's key trading partners, with the exception of the US, saw a significant decline in economic growth over the summer months. This was probably due in large part to the massive rise in oil prices, although it is difficult to quantify the extent to which it slowed down business activity. In autumn 2004, signs that the economic recovery in Europe was faltering prompted the National Bank to make a slight downward adjustment to its economic scenario for the euro area for 2005.

1.3 Economic developments in Switzerland

Upturn in the second half of 2003

With the global business climate generally upbeat, 2004 started off on a promising note for the Swiss economy. The second half of 2003 saw real gross domestic product (GDP) embark on a 2% growth trajectory, with strong export demand from the US and Asia acting as a major stimulus.

Strong export growth

In the first few months of 2004, exports remained the main engine of growth. Even exports to the euro area picked up, although trends differed from country to country. Around mid-year, export momentum slowed, mainly owing to weaker demand from Asia and the new EU countries. The National Bank interpreted this as a temporary slowdown and expected to see a revival in the second half of the year. The revival did materialise, but exports to Germany and France in particular continued to make sluggish progress.

Higher capacity utilisation

Thanks to strong foreign demand, capacity utilisation in industry improved rapidly and by mid-year was back at its long-term average of 84%. Discussions between the SNB's delegates for regional economic contacts and companies from a range of industries also confirmed that the order situation had improved significantly and that capacity was once again being well utilised. Companies' earnings recovered and this, in conjunction with the consistently low level of interest rates, stimulated investment activity. Initially, the increase mainly related to demand for industrial machinery and precision instruments. Towards mid-year, there was also a rise in demand for IT assets, which had dropped particularly sharply during the previous period of weakness.

Construction underpins the economy

Another important pillar of the economic recovery was construction investment. An upturn in building activity helped to stabilise construction prices, which in previous years had been squeezed by fierce competition. However, this acceleration was due almost entirely to higher demand for housing, fuelled in turn by historically low mortgage rates. By contrast, demand for commercial premises, and in particular office space, remained slack. This segment was still beset by a great deal of excess capacity. Construction in the public sector continued to suffer from cost-cutting pressure at government agencies.

Consumer spending subdued

The beginning of the year also saw a revival in consumer spending. The increasingly upbeat consumer sentiment was mainly reflected in rising sales of consumer durables such as home furnishings and household appliances, for which there was considerable pent-up demand. From mid-year onwards, however, the improvement in consumer sentiment and consumer demand lost momentum appreciably. This was probably due mainly to the persisting uncertainty in the labour market, but the sharp rise in oil prices is also likely to have played a part.

Gross domestic product and components
Year-on-year change in real terms in percent

	2000	2001	2002	2003	2004[1]
Private consumption	2.3	2.0	0.3	0.5	1.7
Government consumption	2.6	4.2	3.2	1.4	1.3
Investment in fixed assets	4.3	–3.1	0.3	–0.3	5.6
Construction	2.7	–3.4	2.2	1.8	3.8
Equipment	5.5	–2.9	–1.1	–2.0	6.9
Domestic demand	**2.1**	**2.3**	**–0.8**	**0.2**	**1.4**
Exports of goods and services	12.1	0.2	–0.2	0.0	7.3
Aggregate demand	**5.2**	**1.7**	**–0.6**	**0.1**	**3.3**
Imports of goods and services	9.6	3.2	–2.8	1.4	6.5
Gross domestic product	**3.6**	**1.0**	**0.3**	**–0.4**	**1.8**

Sources: SFSO, seco

1 Average from Q1–Q3

Broad-based yet moderate economic growth

Overall in 2004, the Swiss economy succeeded in shaking off the recession and stagnation which had overshadowed the two preceding years. Economic growth was broad-based and above its potential, thus reducing excess capacity. At an estimated 1.8%, however, growth was moderate in comparison with previous upswing phases. This can be ascribed in no small part to the sluggish economic development in the euro area.

Only modest rise in employment

The moderate economic growth did not leave the labour market unscathed. At the beginning of the year, a series of indicators, such as the trend of job vacancies, pointed to a gradual rise in employment. In the months that followed, however, this trend began to falter and employment increased only minimally, with the year-on-year rise coming to just 0.2% in the third quarter. Until the end of the year, the unemployment rate (3.8%) and the proportion of job seekers (5.6%) remained at the levels of mid-2003.

Cautious recruitment

One reason why conditions in the labour market remained difficult was presumably the persisting uncertainty over the strength and duration of the economic upturn. This uncertainty, which was fuelled not least by the massive increase in the price of oil, led to a great deal of caution in the recruitment of staff. A further factor was that 2001 and 2002 only saw a slight decrease in employment in comparison with the trend in real GDP, which meant that companies still had adequate staffing levels.

Growth set to continue in 2005

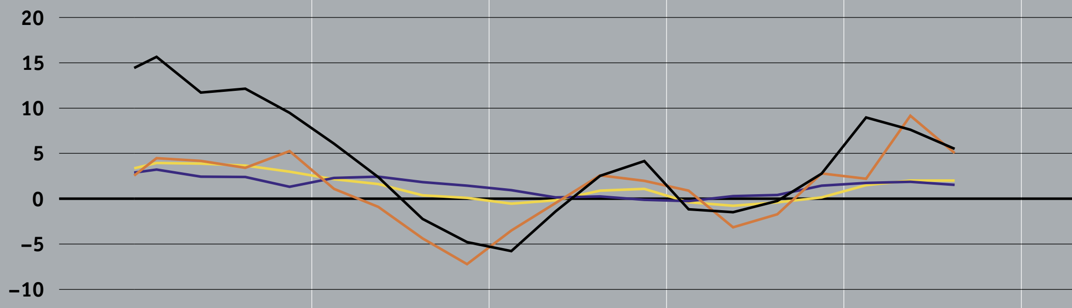
Although global economic growth forecasts were generally revised downward slightly in autumn 2004, the outlook for 2005 remains favourable. The National Bank anticipates a GDP growth rate of 1.5% to 2% for Switzerland, i.e. roughly the same as in 2004. Employment should increase at a slightly stronger pace than in the previous year, with staffing resources gradually becoming tighter. Export growth should continue, and corporate investment activity is likely to rise further. The outlook for consumer spending also gives grounds for confidence. However, much depends on whether the coming year sees the recovery in the labour market as forecast.

2000 2001 2002 2003 2004

Gross domestic product and components

GDP
Private consumption
Investment in fixed assets
Exports

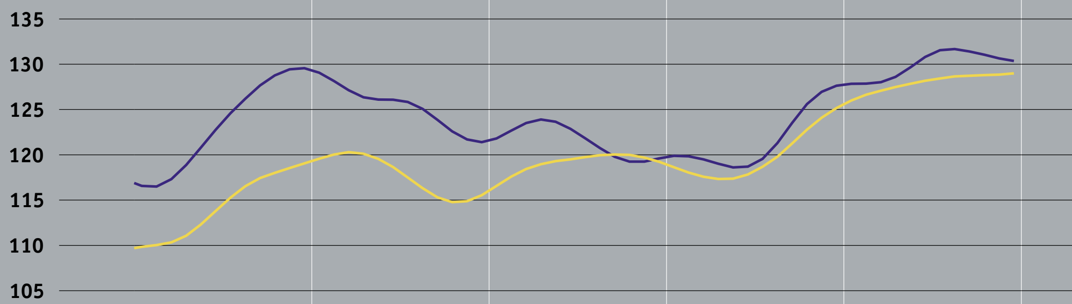
Year-on-year change
in percent, in real terms
Source: seco



Foreign trade

Imports
Exports

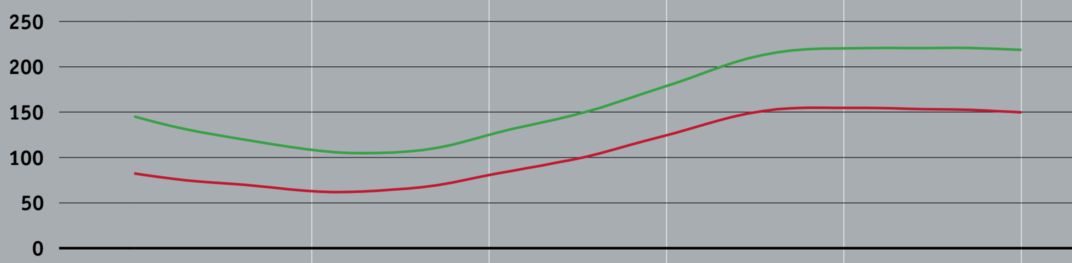
Volume, seasonally adjusted,
and smoothed
Index: 1997 = 100
Source: Federal Customs Administration



Labour market

Unemployed persons
Job seekers

In thousands,
seasonally adjusted,
and smoothed
Source: seco



2000 2001 2002 2003 2004

Price trend in 2004

The economic revival in 2004 was also reflected in the general price trend. The inflation stimuli generated by import and producer prices on downstream consumer prices strengthened during the course of the year. Whereas in the first quarter import prices were still 1.8% lower than a year previously, by the fourth quarter they were up 2.3% on the year-earlier level as a result of increases in the price of petroleum and metal products. Over the same period, annual producer-price inflation increased by 0.8 percentage points to 1.5%. Prices of goods destined for the domestic market rose considerably faster than export prices.

Moderate rise in consumer prices

The trend was much the same at consumer level, with inflation measured by the national consumer price index rising from just 0.1% in the first quarter to 1.4% in the fourth quarter. This brought the average rate of consumer price inflation for 2004 as a whole to 0.8%, as against 0.6% the previous year.

National consumer price index and components
Year-on-year change in percent

	2003	2004	2004 Q1	Q2	Q3	Q4
Overall CPI	**0.6**	**0.8**	**0.1**	**0.9**	**0.9**	**1.4**
Domestic goods and services	0.8	0.9	0.7	0.8	0.9	1.1
Goods	0.6	0.5	0.9	0.7	0.3	0.1
Services	0.9	1.0	0.6	0.9	1.1	1.4
Private services (excluding rents)	1.0	0.6	0.4	0.6	0.6	0.8
Rents	0.3	1.2	0.6	0.9	1.4	1.9
Public services	2.1	1.9	1.4	2.1	2.0	2.2
Foreign goods and services	0.0	0.6	–1.8	0.9	1.1	2.2
Excluding oil products	–0.5	–0.8	–1.3	–0.5	–0.9	–0.6
Oil products	3.2	9.3	–4.5	10.3	12.7	19.2
Core inflation (SNB)	0.7	0.8	0.5	0.8	0.8	1.1
Core inflation 1 (SFSO)	0.5	0.5	0.2	0.5	0.5	0.8
Core inflation 2 (SFSO)	0.3	0.3	0.0	0.3	0.3	0.6

Sources: SFSO, SNB

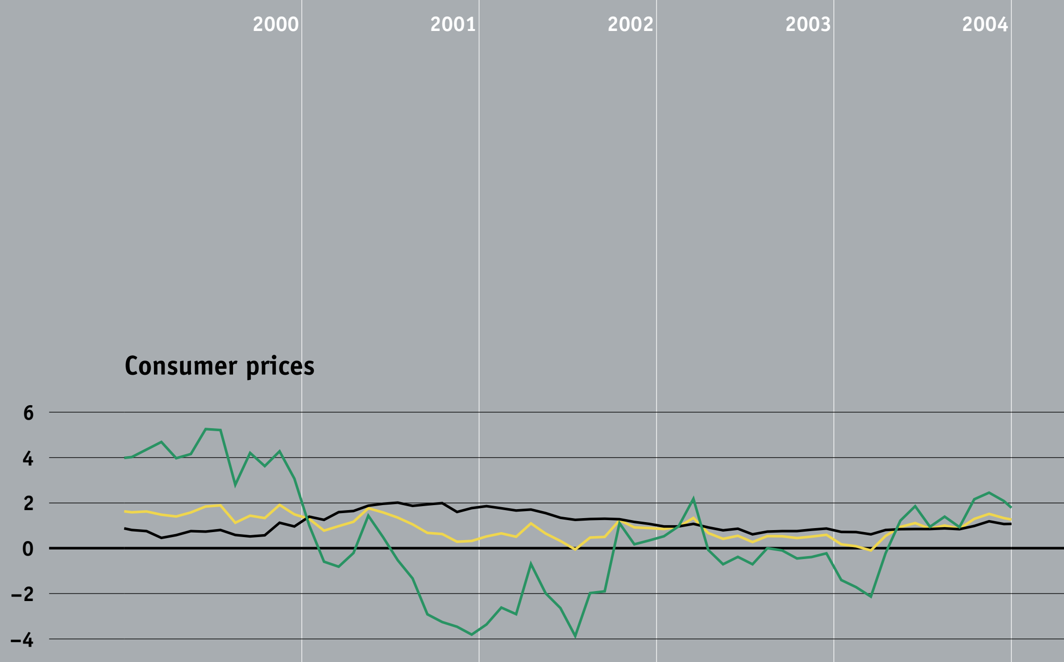
Dearer oil products, housing rents and public services

The trend in prices was essentially driven by three forces. Firstly, there were sharp rises in the price of oil products (fuel and heating oil), with the fourth quarter seeing an 19.2% increase versus the previous year. Secondly, there was an upward movement in housing rents, which account for just under 20% of the basket of commodities forming the basis for the consumer price index. By the fourth quarter, rents had risen to 1.9%, from 0.6% at the beginning of the year. At 2.2%, prices of public services also increased quite substantially. By contrast, the rise in prices for other private services edged up only slightly. In the case of domestic goods, prices actually declined significantly to stand at just 0.1% at the end of the year. Throughout the year, prices of imported goods (excluding oil products) were below their year-back levels. Averaged over the year, they declined by 0.8%. Falls in the price of electronic equipment in particular had a major impact.

Consumer prices

Consumer prices
Domestic goods
Imported goods

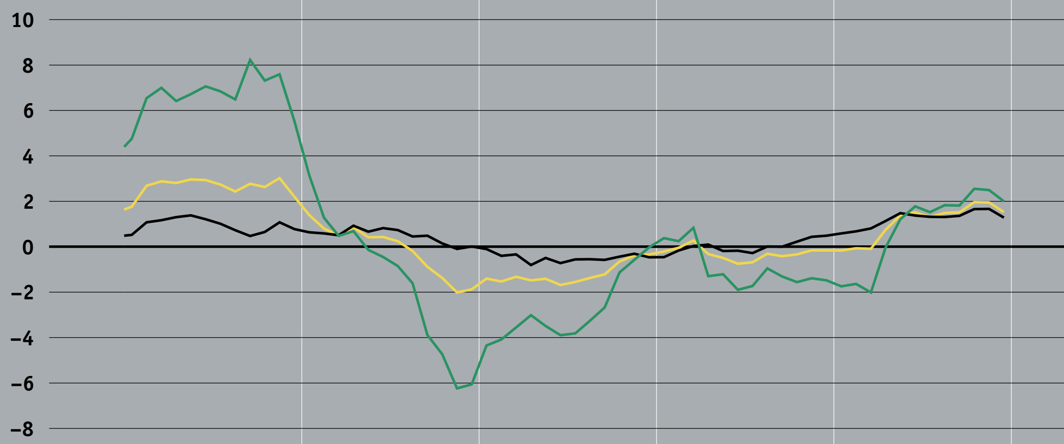
Year-on-year change
in percent
Source: SFSO



Producer and import prices

Producer and import prices
Producer prices
Import prices

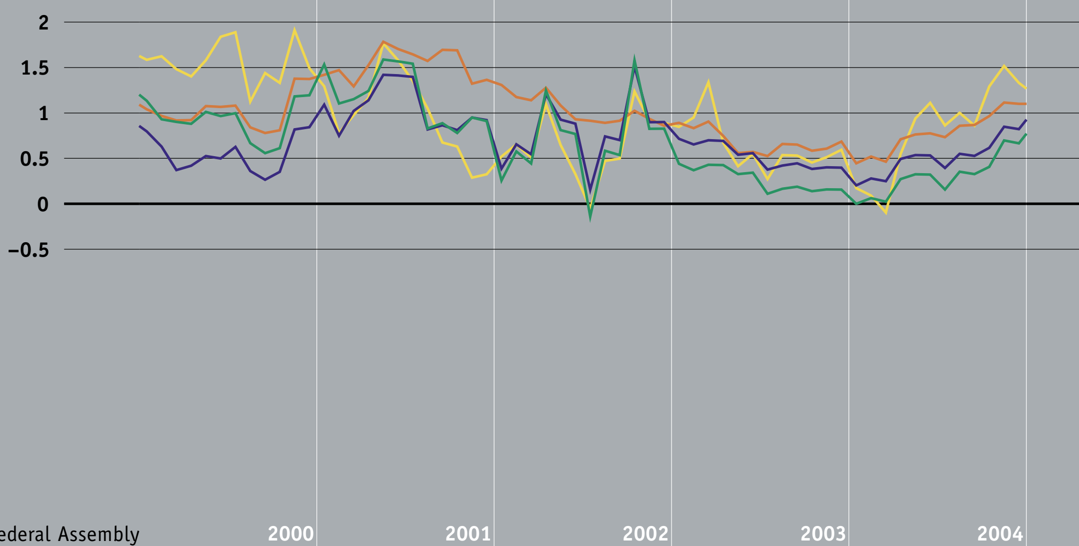
Year-on-year change
in percent
Source: SFSO



Core inflation

Consumer prices
Core inflation (SNB)
Core inflation 1 (SFSO)
Core inflation 2 (SFSO)

Year-on-year change
in percent
Sources: SFSO, SNB



Slightly higher core inflation

The increase in the general inflationary trend was also reflected in the figures for core inflation, which should give an indication of the long-term inflation development. The core inflation rate computed by the National Bank – which for any given period excludes the 15% of goods with the highest annual price variation and the 15% of goods with the lowest annual price variation from the basket of commodities forming the basis for the consumer price index – rose from 0.5% in the first quarter to 1.1% in the fourth quarter. The core inflation rates calculated by the Swiss Federal Statistical Office (SFSO), which exclude the same goods from the basket of commodities in each period, also signalled a slightly rising inflationary trend. In the fourth quarter, the rates came to 0.8% and 0.6% respectively.

Money market rates

In the first quarter, the three-month Libor remained stable at close to 0.25%. In the second quarter, the three-month rate began to rise, reaching an average value of 0.32%. In the third quarter, it averaged 0.57%, and by November it had been adjusted to 0.75%. The three-month Libor remained roughly at this level until the end of the year.

Capital market yields still low

Whereas yields on Swiss Confederation bonds were still falling at the beginning of the year, they rose significantly in the spring. Between March and June, the yield on the ten-year Swiss Confederation bond climbed 50 basis points to 3%. This rise was most apparent in the case of maturities of less than ten years. Capital market yields in the longer maturities remained stable, however, indicating that inflation expectations were unchanged for the long term. When the global economic outlook deteriorated over the summer months, the ten-year spot interest rate on Swiss Confederation bonds declined to 2.4%. These developments coincided with the sharp rise in oil prices.

Pronounced weakness of the dollar

Up until the autumn, the Swiss franc's nominal exchange rate against the euro and the US dollar moved within a relatively narrow bandwidth. The real export-weighted Swiss franc also failed to exhibit a clear trend. Although it showed a slight tendency to weakness at the beginning of the year, the franc gained ground against the euro in the spring as the latter softened against the dollar. The dollar's recovery after a phase of weakness lasting almost three years stemmed from expectations of interest rate rises in the US, coupled with rises in US capital market yields in line with the country's robust economic growth. However, in mid-October the dollar began to lose value. At the end of November, it slipped to a new record low against the euro and reached its lowest level since 1995 against the Swiss franc. The franc also appreciated against the euro, though to a much lesser extent.

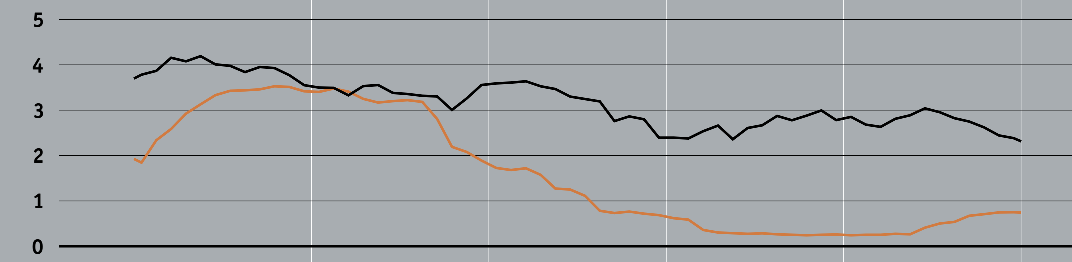
2000 2001 2002 2003 2004

Three-month Libor

Yield on ten-year
Swiss Confederation bonds
(spot interest rate)

In percent

Money and capital market rates

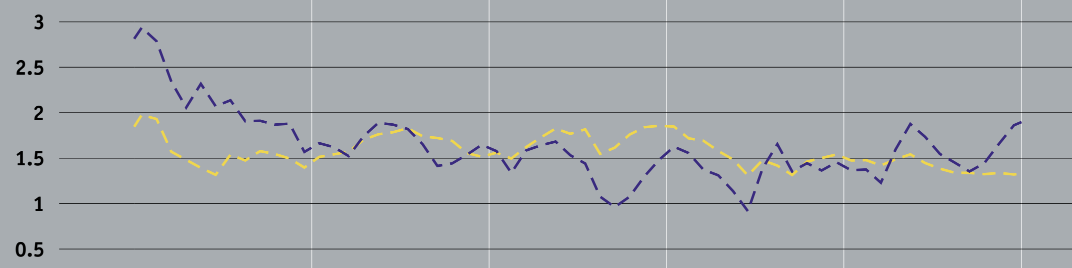


Euro area - Switzerland

United States - Switzerland

Spread in percentage points
Source: BIS

Spreads for long-term interest rates

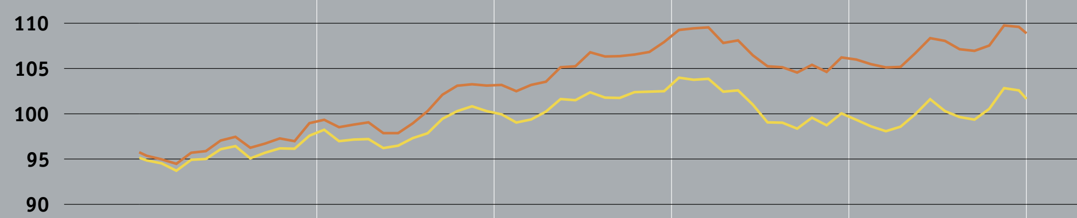


Real

Nominal

24 trading partners
(US included)
Index: January 1999 = 100

Export-weighted Swiss franc exchange rates

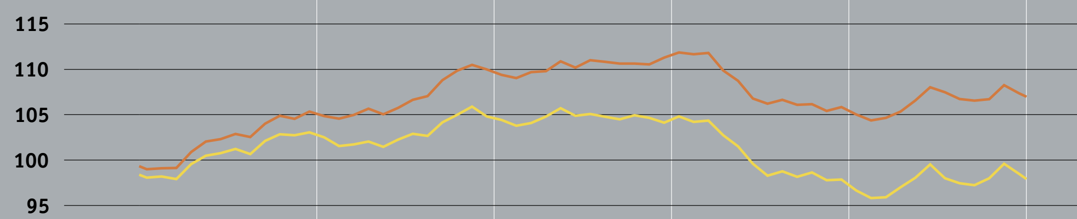


Real

Nominal

16 European trading partners
Index: January 1999 = 100

Export-weighted Swiss franc exchange rates



2000 2001 2002 2003 2004

Reduced money overhang

The monetary aggregates expanded in line with the National Bank's highly expansionary monetary policy in place since 2001. The reduction of the three-month Libor from 0.75% to 0.25% in March 2003 sparked an increase in money growth. The negative money gap for M3 registered in 2001 and 2002 gave way to an overhang at the beginning of 2003. A money overhang is a situation in which more money is available at a specific interest rate level than is required to finance economic activities. In 2004, the monetary aggregates continued to grow year-on-year, although at a slower pace. In comparison with the corresponding year-back period, M1 and M2 began to contract in the summer, however, while M3 stagnated. After peaking in the first quarter of 2004, the money overhang declined. Among the factors which contributed to this decline were the two interest rate hikes in June and September 2004. Nevertheless, there was still a liquidity surplus at the end of 2004. Unless monetary policy is subsequently corrected, a money overhang can drive up prices over time.

Level of monetary aggregates

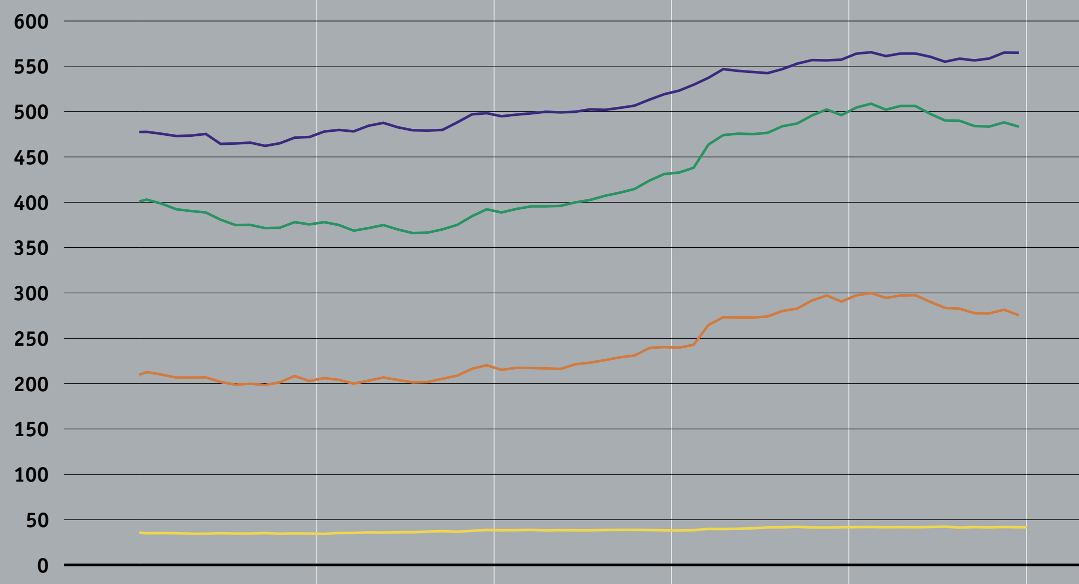
Monetary base

M_1

M_2

M_3

In CHF billions



Growth rates of monetary aggregates

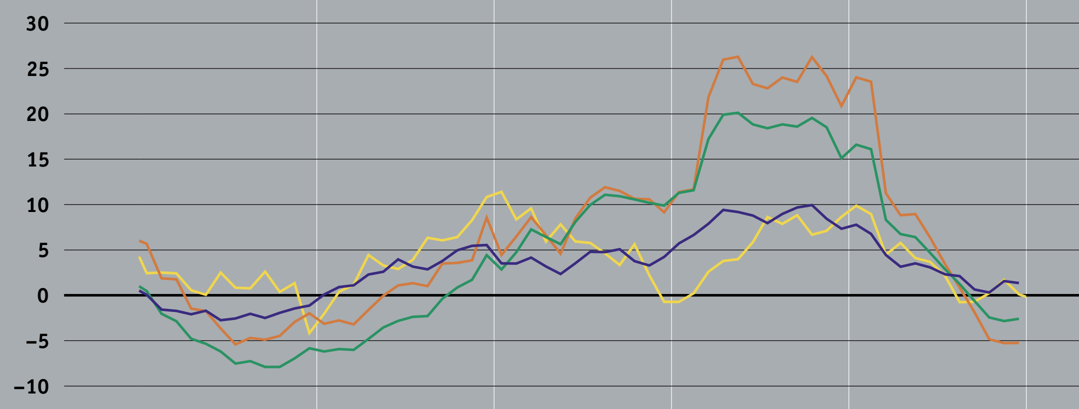
Monetary base

M_1

M_2

M_3

Year-on-year change
in percent



1.4 Monetary policy decisions

Four times a year – in March, June, September and December – the National Bank's Governing Board conducts a regular assessment of the monetary policy situation. Each of these assessments results in an interest rate decision. In certain situations, interest rate changes are also effected between the regular assessments. In the past year, however, this was not the case.

Initial situation: quarterly assessment of 12 December 2003

At the quarterly assessment in December 2003, the National Bank assumed that the Swiss economy would see increasingly broad-based growth of 1.5–2% in 2004. On the assumption that the three-month Libor would remain constant at 0.25% for the next three years, it forecast annual average inflation rates of 0.4% for 2004, 1.0% for 2005 and 2.3% for 2006. While pointing out that the economic upswing was not yet completely guaranteed, the Governing Board left the target range for the three-month Libor unchanged at 0.0–0.75%, with a targeted rate of 0.25%. As the closure of the output gap, which had been negative since mid-2001, approached, however, inflationary pressure was expected to increase as of mid-2005. It became clear that the extremely expansionary monetary policy pursued in the preceding two years would have to be gradually corrected. For the time being, however, the interest rate range was left unchanged.

Quarterly assessment of 18 March 2004

At the March 2004 assessment, it was confirmed that the economic upswing had gained momentum during the winter. While the data pointed to strong growth in the US, the recovery in Europe was still fraught with uncertainties. The financial markets, too, remained sceptical about the upswing's sustainability, as was evidenced by their expectations of an unchanged monetary policy.

The inflation forecast issued in March largely corresponded to the December 2003 forecast. Based on the assumption that the three-month Libor would remain at 0.25% for the next three years, the 2004 inflation rate was put at less than 0.5% (disregarding minor fluctuations due to baseline effects). From the beginning of 2005 onwards, expansionary monetary policy coupled with the predicted closure of the output gap resulted in considerable dynamism in the price trend. The forecast for mid-2005 reached 1% and that for mid-2006 went up to 2%, rising to 3% towards the end of 2006. Consequently, it had to be expected that an unchanged monetary policy would result in a breach of price stability.

The outlook for the economic upswing in Switzerland had improved, and an early closure of the output gap was expected. Moreover, the economy's liquidity overhang had widened again. As a result, the forecast rise in the inflation trend moved closer. Even so, the time did not yet appear ripe for an adjustment of monetary policy: the economic recovery at home and abroad was still too shaky. It was important not to jeopardise the upswing in Switzerland with an over-hasty changeover to a more restrictive monetary policy. If the National Bank had raised interest rates at this point, the Swiss franc would have come under upward pressure. The Governing Board thus decided to retain the strongly expansionary monetary policy. It left the target range for the three-month Libor at 0.0–0.75% (a level that had remained unchanged since 6 March 2003), and targeted a rate of 0.25%. In doing so, however, the National Bank indicated that it would not be able to continue its highly expansionary policy indefinitely without endangering price stability. It thus announced that it would have to adjust its policy as soon as the economic upswing was clearly confirmed.

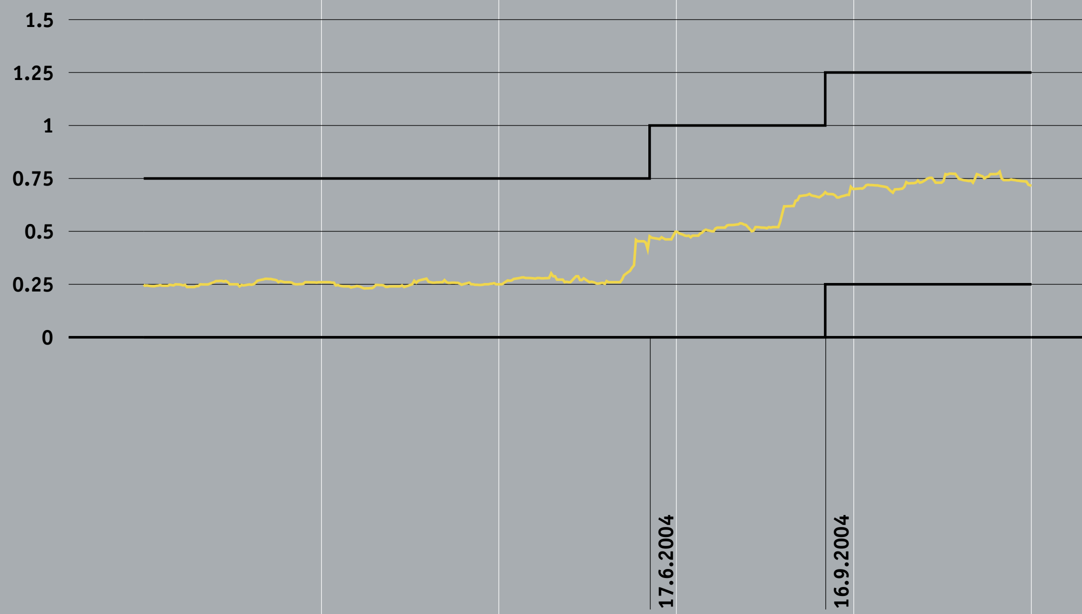
Q4 2003 Q1 2004 Q2 Q3 Q4

Three-month Libor

Three-month Libor

Target range

Daily quotations, in percent



Q4 2003 Q1 2004 Q2 Q3 Q4

Quarterly assessment of 17 June 2004

At the June assessment, it was found that the prospects of a sustained improvement in the business climate had become more tangible. The National Bank was still expecting GDP to grow by 1.5% to 2%, but was now looking at the upper end of this range. The factors which it had cited as a reason for adhering to an unchanged monetary policy stance in March had changed. The world economy appeared considerably more robust. In the US, the upswing was now underpinned by a brisker labour market and a marked improvement in order intake. The economic situation was improving in Europe, too. In Switzerland, a retrospective assessment of the economic situation looked more positive following the revision of statistical data, which indicated that the upswing had already been in progress for a year. Moreover, leading economic indicators suggested that growth would accelerate in the second half of 2004. The historically low interest rate levels and the continuing growth in the money supply mirrored a highly expansionary monetary policy stance. The financial markets were anticipating a rise in the three-month Libor by 25 basis points. The absence of any change in bond yields at the long end of the market implied that long-term inflation expectations had remained unchanged. Meanwhile, yields on short to medium-term debt securities rose. The anticipation of a rate increase reflected in these yields substantially boosted the Swiss franc's exchange rate against the euro prior to the quarterly assessment scheduled for June.

As both the Swiss and international economies developed in line with the expectations voiced at the March 2004 assessment, the inflation outlook was practically identical with that of the previous quarter, both for the medium and long term. Compared with March, the time at which expansionary monetary policy would start to have marked effects on inflation moved closer again: less than a year remained until the reversal of the inflation trend. Given this background, the Governing Board decided on 17 June 2004 to raise the interest rate target range by 0.25 percentage points to 0.0–1.0% and to keep the three-month Libor in the middle of this range (i. e. around 0.5%) until further notice.

The new inflation forecast, which was based on a steady three-month Libor of 0.5%, showed a slightly higher inflation rate in the near term, due mainly to the unexpectedly sharp rise in prices of oil products. From mid-2005 onwards, the analysis revealed an acceleration of future inflation owing to the anticipated closure of the output gap and the excessive supply of liquidity. Towards the middle of 2006, the predicted annual inflation rate exceeded the 2% price stability threshold, easily topping 3% by the end of the forecasting horizon.

2003 2004 2005 2006 2007

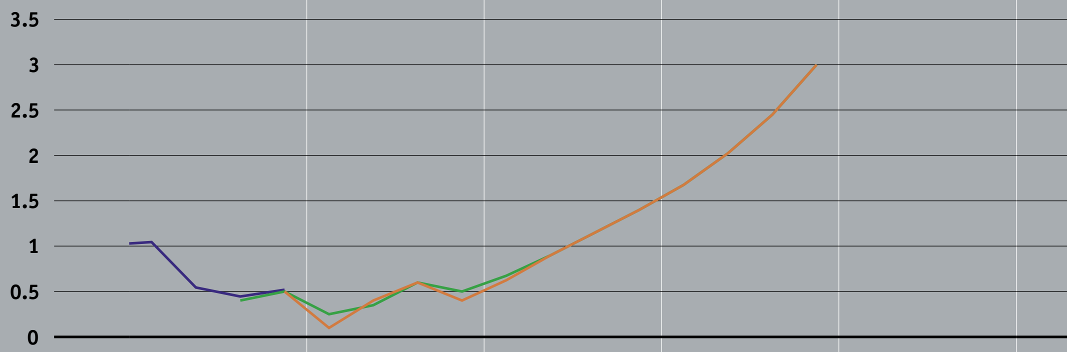
Inflation forecast Q1 2004

Inflation

December 2003 forecast:
three-month Libor 0.25%

March 2004 forecast:
three-month Libor 0.25%

Change in the national consumer price index from previous year, in percent



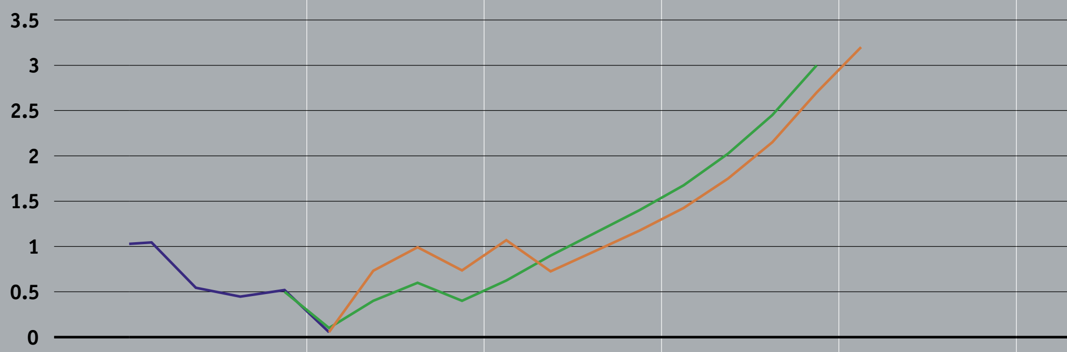
Inflation forecast Q2 2004

Inflation

March 2004 forecast:
three-month Libor 0.25%

June 2004 forecast:
three-month Libor 0.5%

Change in the national consumer price index from previous year, in percent



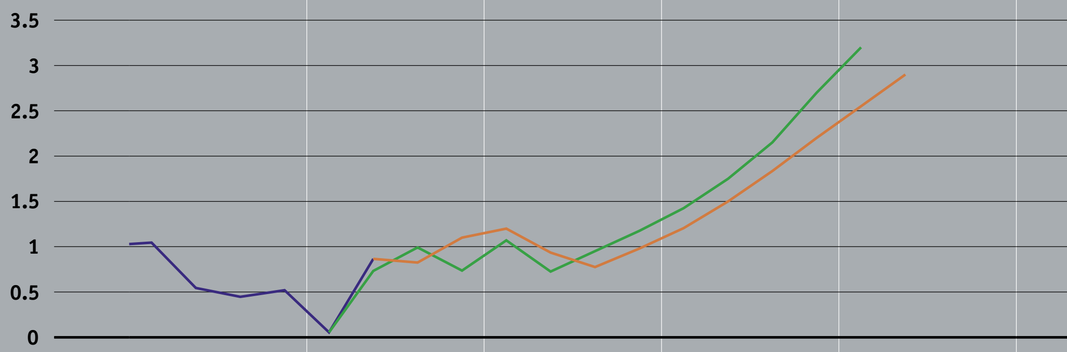
Inflation forecast Q3 2004

Inflation

June 2004 forecast:
three-month Libor 0.5%

September 2004 forecast:
three-month Libor 0.75%

Change in the national consumer price index from previous year, in percent



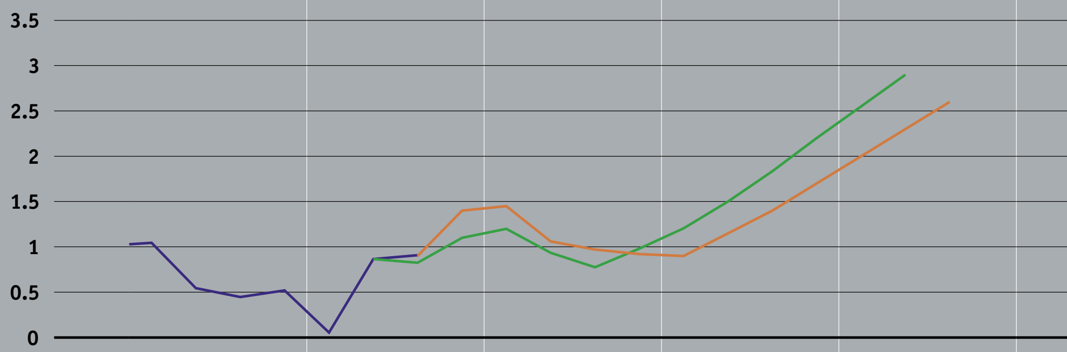
Inflation forecast Q4 2004

Inflation

September 2004 forecast:
three-month Libor 0.75%

December 2004 forecast:
three-month Libor 0.75%

Change in the national consumer price index from previous year, in percent



2003 2004 2005 2006 2007

Quarterly assessment of 16 September 2004

The US economic data incorporated into the September assessment had worsened slightly during the summer. In Europe, the trend appeared to be steadier. Germany and France, the two largest economies, were expanding after having slowed down growth in the euro area in 2003. The Swiss economy, too, continued to recover – albeit at a rather slower pace than before. The oil price remained on its previous steep upward trajectory, and annual inflation rose to approximately 1%. As in the lead-up to the June assessment, the three-month Libor showed signs of rising beyond the mid-point in the target range towards the end of August. The financial markets were evidently expecting the September assessment to result in an interest rate hike. The Swiss franc weakened against the euro, even though the June increase in interest rates had narrowed the spread versus the higher yields on euro investments. Other indicators confirmed the impression that monetary policy was highly expansionary. In particular, real short-term interest rates were still negative despite the raising of the target range, and the monetary aggregates still pointed to an ample liquidity supply.

The September analysis of the inflation outlook resulted in two changes from the June outlook. Up to mid-2005, forecast inflation was above the June figure due to the rise in the price of oil. In the longer term, slightly lower inflation potential was expected – this was ascribed to a reduction in the liquidity overhang. The medium-term inflation outlook was the same as in the previous quarters, reflecting the fact that economic developments had not changed. On the whole, the analysis of inflation prospects pointed to a rising inflation trend towards the end of 2005, leading to a permanent overshooting of the 2% mark in the course of 2006.

Despite the mild slowdown in business activity and the slight easing of longer-term inflationary pressure by comparison with the previous quarter's predictions, monetary policy was still too expansionary. In light of the longer-term inflation forecast, the Governing Board decided at its assessment on 16 September 2004 to raise the target range for the three-month Libor by a further 0.25 percentage points to 0.25–1.25%. A three-month rate in the middle of this band (i.e. approximately 0.75%) was targeted. This second interest rate increase in 2004 confirmed the National Bank's basic confidence in a continuation of Switzerland's economic upswing. Even after this second interest rate adjustment, the three-month Libor was low by historical standards, a sign of a clearly expansionary monetary policy.

Quarterly assessment of 16 December 2004

Global economic growth had decelerated slightly since mid-2004. While this was due in particular to the surge in oil prices, the economic slowdown in Asia was also a contributing factor. In the EU, the weakening of the dollar created an additional burden. In the US, by contrast, economic growth remained sound. According to National Bank's estimates, Swiss GDP grew by close to 2% on average in 2004. The SNB assumed that the economic upswing would continue in 2005. Given the slightly dimmer outlook for the global economy, however, it was thought that the upswing was unlikely to strengthen further, with real GDP growth put at around 1.5% to 2%. The price of oil (Brent crude) reached a peak of USD 52 at the end of October. Under the impact of the higher oil prices, the annual inflation rate rose up to 1.5% in November. However, the last assessment of 2004 was dominated less by oil prices than by the heavily weakened US dollar. Between mid-October, when the dollar's decline accelerated, and mid-December, the US currency had lost 8% against the Swiss franc. In November, the real appreciation of the Swiss franc against the currencies of Switzerland's 24 most important export markets – essentially North America and Europe – came to 2.5% year-on-year. This real appreciation against the currencies of Switzerland's key trading partners, which was modest compared with the Swiss franc's nominal appreciation against the dollar, was attributable not only to Switzerland's lower inflation rates but also to the stable relationship between the euro and the franc. Overall, the real appreciation of the Swiss franc resulted in a more restrictive monetary environment, which had a dampening effect on inflation.

Based on an unchanged three-month Libor of 0.75%, December's inflation forecast featured three changes compared with the September forecast. Firstly, it forecast higher inflation in 2005. This reflected the renewed upsurge in the cost of oil products. Secondly, it predicted a weaker rise in inflation in 2006. The reason was the later-than-expected closure of the output gap owing to an anticipated cyclical slowdown. Finally, lower inflationary pressure was also predicted over the longer term. This was due to the continuing reduction in the liquidity surplus, which had begun in the summer.

A combination of the slowdown in growth momentum, the marked weakening of the dollar and the decline in surplus liquidity had led to a reduction in the anticipated inflationary pressure, thus reducing the need for a further rise in interest rates. The Governing Board therefore decided to leave the target range for the three-month Libor unchanged at 0.25–1.25% and to keep the three-month rate in the middle of this range at 0.75%. Consequently, monetary policy remained expansionary. However, the SNB pointed out that the interest rate normalisation phase begun in June was not yet over, considering that the forecast predicted a rise in inflation over the medium term.

Monetary policy challenges in 2004

The interest rate decisions taken at the 2004 quarterly assessments reflect the conflicting demands impinging on monetary policy. On the one hand, monetary policy was highly expansionary by historical standards – despite the interest rate rises implemented. On the other hand, various imponderables complicated monetary policy decisions. While the March assessment was overshadowed by uncertainty over the sustainability of the economic recovery, the rise in oil prices led to an increasing risk of a deterioration in the domestic and international economic outlook. In the autumn, the sharp depreciation of the dollar made the assessment of the economic situation even more difficult.

Rise in oil prices as particular problem

One of the crucial issues affecting monetary policy in 2004 was the substantial rise in oil prices, which began in the spring. The National Bank's June inflation forecast was still based on the premise that oil prices would ease in the near term. In its September forecast, the SNB was still assuming that oil prices would soon fall, albeit not to the level prior to the increase. Whereas the two interest rate hikes in June and September were motivated by the state of the economy and the excessive money supply, the sharp rise in oil prices – which increased inflationary pressure in the near term – did not prompt an interest rate move. There were three reasons to refrain from interest rate adjustments in response to firming oil prices. Firstly, it would be wrong to try to stabilise oil-price-related fluctuations in the price level by raising interest rates. Experience has shown that a monetary policy which seeks – by way of interest rate increases – to prevent oil price rises from having an impact on the price level can significantly reinforce the adverse effect of such rises on the economy. Secondly, any attempt to compensate for an oil-price-related economic slowdown by cutting interest rates would be misguided. It would merely increase the risk of a wage-price spiral. The greater the already existing liquidity surplus, the greater the likelihood of such second-round effects. Thirdly, the National Bank's assumption that the higher oil prices were short-lived suggested that any inflationary impact of these prices would gradually recede of its own accord.

Monetary policy torn between short and long-term needs

In retrospect, monetary policy in 2004 was shaped by the contrasting implications of short and long-term views. While the long-term perspective made a tightening of monetary policy appear desirable, uncertainties over the future course of the economy militated more in favour of a measured pace. The monetary policy stance adopted by the National Bank in 2004 was the result of having to strike a balance between these two considerations. On the one hand, the SNB's interest rate decisions continued a very relaxed monetary policy that was designed to support the economy. On the other hand, however, they were the first steps towards a normalisation of the interest rate level.

1.5 Statistical activities

Legal basis

The entry into force of the new NBA and NBO on 1 May 2004 placed the statistical activities of the National Bank on a uniform legal footing. The National Bank's powers in collecting statistical data are designed to help it fulfil its statutory tasks. They are invaluable for the conduct of monetary policy, but are also useful for the oversight of payment and securities settlement systems, for maintaining the stability of the financial system, for preparing the balance of payments and statistics on the international investment position, for international monetary cooperation and for the data analysis by international organisations. The National Bank collects the statistical data required for these tasks. Art. 4 NBO stipulates the principle that the National Bank must limit the number and type of the surveys to what is strictly necessary. It seeks in particular to minimise the demands placed on those required to provide information.

Purpose of statistical activities

Banks, stock exchanges, securities dealers, fund management companies of Swiss investment funds and representatives of foreign investment funds are obliged to provide the National Bank with statistical data on their activities (art. 15 para. 1 NBA). Where necessary to analyse trends in the financial markets, to obtain an overview of payment transactions or to prepare the balance of payments or the statistics on Switzerland's international investment position, the National Bank may collect statistical data from other private individuals or legal entities on their business activities. This applies in particular to insurance companies, occupational pension institutions, investment and holding companies, as well as to operators of payment and securities settlement systems such as the postal service (art. 15 para. 2 NBA).

Confidentiality and exchange of data

The National Bank must maintain confidentiality with respect to the data collected. It must publish the data it collects in the form of statistics. To maintain confidentiality, the data is aggregated (art. 16 NBA). The National Bank may exchange the data collected with the competent supervisory authorities of the Swiss financial market (art. 16 para. 4 NBA).

Surveys and database

The National Bank manages a database containing 1.5 million time series, and publishes the results of its surveys. Statistical information is made available primarily in the Monthly Statistical Bulletin, in the Monthly Bulletin on Banking Statistics and in "Die Banken in der Schweiz" (statistical yearbook of banks in Switzerland). These publications are supplemented by reports on Switzerland's balance of payments, the international investment position and direct investment. All publications are also accessible on the internet (www.snb.ch).

New surveys

In mid-2004, the National Bank began a one-year trial involving the collection of data on the terms and conditions of new loans extended to companies (lending rate statistics). The data includes such details as the loan amount, loan interest rate and loan maturity, as well as information on collateral and borrower attributes. The National Bank can use this data to analyse the effects of its interest rate decisions on the banks' lending activities.

Under an agreement with PostFinance, the latter will regularly provide the National Bank with data on its business performance – comprising monthly balance sheets and an annual income statement. The survey of investment funds was revised in line with trends in the funds business and was prepared for introduction next year.

Preparatory work for financial accounts

In collaboration with the SFSO, the National Bank continued with the preparatory work for the production of financial accounts for Switzerland. These financial accounts will show the flows of funds between different sectors of the economy. They will provide information that is invaluable for monetary policy as well as close a major gap in the system of national accounts. This will also enable Switzerland to meet a requirement under the bilateral statistical agreement with the EU.

In compiling statistical data, the National Bank cooperates with the competent federal government bodies, notably the SFSO and the Swiss Federal Banking Commission (SFBC), the competent authorities of other countries and international organisations (art. 14 para. 2 NBA). With regard to organisational and procedural issues, and when introducing new surveys or modifying existing ones, the reporting institutions – together with their associations – are given the opportunity to comment (art. 7 NBO).

Broad cooperation

On the basis of art. 16 NBA, the National Bank concluded an agreement with the SFSO concerning reciprocal exchanges of data in selected areas of economic statistics. The agreement is reviewed annually.

… with the SFSO

An agreement was reached with the SFBC on reciprocal exchanges of data in the financial sector. Under the agreement, information from the banks, which is primarily of supervisory relevance, flows from the National Bank to the Banking Commission. The National Bank will thus serve as a "data hub" between the banks and the SFBC.

… with the SFBC

The National Bank is advised on the content of its banking surveys by the banking statistics committee (art. 7 NBO). The committee comprises representatives of the Swiss commercial banks, the Swiss Bankers' Association, the SFBC and the Liechtenstein banks.

… with the banking statistics committee

A group of experts under the direction of the National Bank participate in drawing up the balance of payments. This group comprises representatives from industry, the insurance sector, various federal agencies and the Swiss Institute for Business Cycle Research at the Swiss Federal Institute of Technology.

… with the group of experts on the balance of payments

The National Bank cooperates closely with the Bank for International Settlements (BIS), the Organisation for Economic Cooperation and Development (OECD), the Statistical Office of the European Communities (Eurostat), and the International Monetary Fund (IMF). This cooperation is aimed at harmonising statistical survey methods and analyses.

… with foreign agencies

2 Supplying the money market with liquidity

Mandate

One of the tasks of the National Bank is to provide the Swiss franc money market with liquidity (art. 5 para. 2 (a) National Bank Act (NBA)). The transactions that the National Bank can carry out with financial market participants are listed in art. 9 NBA. Based on art. 9 para. 1 (e) NBA, the SNB also acts as lender of last resort.

Guidelines on monetary policy instruments

The "Guidelines of the Swiss National Bank on Monetary Policy Instruments" of 25 March 2004 put art. 9 NBA into more concrete terms and describe the instruments and procedures used by the National Bank for the implementation of its monetary policy. They also define the conditions under which these transactions are concluded and what securities can be used as collateral for monetary policy operations with the National Bank. For its transactions, the National Bank accepts securities in selected currencies that fulfil certain liquidity and credit-rating criteria. Basically, all banks domiciled in Switzerland and internationally active banks abroad that meet the conditions stipulated by the National Bank are accepted as SNB counterparties. The Guidelines are supplemented by five Instruction Sheets issued by the National Bank and are primarily aimed at the counterparties. Since May 2004, the SNB has been publishing a weekly report containing important monetary policy data.

2.1 Regular instruments for steering the money market

Repos as main financing instrument

All regular monetary policy instruments of the National Bank, with the exception of Lombard advances, are based on repo transactions. In a repo transaction, the cash taker sells securities to the cash provider. At the same time, it enters into an agreement to repurchase securities of the same type and amount from the cash provider at a later point in time. The cash taker pays interest (repo rate) for the duration of the transaction. From an economic perspective, a repo is a secured loan.

Main financing and liquidity-absorbing operations

The purpose of the National Bank's main financing operations is to provide the banking system with liquidity, while that of liquidity absorbing operations is to withdraw surplus liquidity from the system.

Where main financing operations are concerned, transactions are concluded by way of auction. The auctions in turn are conducted by volume tender – in other words, the National Bank's counterparties request a certain amount of liquidity at a fixed price (repo rate). The repo rate, the size of the individual operations and their maturities depend on monetary policy requirements. The maturity of repo transactions varies from a day (overnight) to several weeks. In exceptional circumstances, contracts may run for several months. The National Bank sets the maturities of repo transactions in such a way that the commercial banks have to request liquidity on an almost daily basis in order to achieve the average level of sight deposits necessary to meet the minimum reserve requirements in a reporting period.

Fine-tuning operations

Fine-tuning operations are used to offset both the undesired impact of external factors on liquidity supply as well as sharp fluctuations in short-term money market rates. Fine-tuning is carried out via bilateral repo transactions that are concluded when necessary, the conditions for which may vary from those used for main financing operations.

Intraday facility

During the day, the National Bank provides its counterparties with interest-free liquidity (intraday liquidity) through repo transactions so as to facilitate the settlement of payment transactions via Swiss Interbank Clearing (SIC) and foreign exchange transactions via Continuous Linked Settlement (CLS), the multilateral payment system. The cash amounts received must be repaid by the end of the same bank working day at the latest. Consequently, these funds are not included when evaluating compliance with liquidity requirements under banking law or with minimum reserve requirements.

Liquidity-shortage financing facility

The National Bank provides a liquidity-shortage financing facility to bridge unexpected, short-term liquidity bottlenecks. The interest rate for liquidity provided through this facility is two percentage points above the call money rate. The reference rate is the Overnight Repo Index (SNB) for the previous bank working day. The interest premium is intended to prevent commercial banks from using the facility as a permanent source of refinancing.

At present, two instruments are available: conventional Lombard advances and special-rate repo transactions. By the end of 2005, however, Lombard advances will be completely replaced by special-rate repo transactions. During the transition phase, the Lombard rate will correspond to the special-rate. The precondition for concluding special-rate repo transactions is that a limit be granted by the National Bank and that this limit be covered by collateral eligible for SNB repos. The limit determines the maximum amount of liquidity that a counterparty may obtain, and it is utilised in the form of an overnight repo transaction. The securities are held by the counterparty in a Custody Cover Account "SNB" at SIS.

2.2 Liquidity supply with the different facilities

Instruments for money market operations in CHF billions

	2003 Holding Average	Turnover	2004 Holding Average	Turnover
Repo transactions				
Main financing and fine-tuning operations	23.55	1 017.90	22.31	1 087.15
Maturities of				
less than 1 week	1.44	236.39	0.48	95.42
1 week	8.38	436.40	16.06	852.12
2 weeks	11.12	286.41	4.42	115.59
3 weeks	2.29	39.81	1.07	13.52
Other	0.32	18.89	0.28	10.50
Liquidity-absorbing operations	0.00	0.00	0.00	0.00
Intraday facility	5.97	1 489.23	6.19	1 584.13
Liquidity-shortage financing facility	0.02	4.03	0.00	0.52

Repo transactions in detail

In 2004, the average volume of the National Bank's repo transactions still outstanding at the end of the day fell by CHF 1.2 billion to CHF 22.3 billion. The decline is due in particular to the lower level of the Swiss Confederation's balances at the National Bank.

Up until June 2004, the National Bank offered liquidity to banks at a stable repo rate of 0.11%. Parallel to the increase in the target range for the three-month Libor in June and September 2004, the National Bank also raised its repo rates. These rates varied – as they did before the policy of keeping interest rates close to zero percent – according to monetary policy requirements and the situation in the money market. In December, the National Bank's repo rates fluctuated between 0.50% and 0.56%.

Unlike the volume of outstanding repo transactions, the turnover – in other words the sum of all repo transactions concluded by the National Bank – climbed in 2004 by CHF 69.3 billion to CHF 1,087.2 billion. This was due to the fact that a greater number of these transactions were concluded with shorter maturities. At CHF 852.1 billion, the turnover of repo transactions with a one-week maturity was almost twice that of the year-earlier level. By contrast, the turnover of transactions with other maturities fell back.

Banks' daily demand for liquidity at the repo auctions of the National Bank fluctuated in 2004 between CHF 0.9 billion and CHF 68.6 billion, with the average being CHF 24.0 billion. The amount of liquidity allocated seesawed between CHF 0.9 billion and CHF 10.4 billion, with the annual average amounting to CHF 3.9 billion. The allocation rate moved between 5% and 100%.

Compared with the previous year, the average degree of use of the intraday facility by banks rose in 2004 from CHF 6.0 billion to CHF 6.2 billion.

As in 2003, the liquidity-shortage financing facility used to bridge unexpected liquidity bottlenecks was only occasionally called upon in 2004.

2.3 Further monetary policy instruments

In addition to the regular monetary policy instruments, the National Bank also has further instruments at its disposal, as per art. 9 para. 1 NBA: foreign exchange spot and forward transactions, foreign exchange swaps, the issuance of its own interest-bearing debt certificates, and the purchase and sale of securities in Swiss francs. It can also create, purchase or sell derivatives on receivables, securities, precious metals and currency pairs. In the 1980s and 1990s, foreign exchange swaps were the principle monetary policy instrument of the National Bank. Since 2000, however, they are only used by way of exception. Own interest-bearing debt certificates can be issued to absorb surplus liquidity. In exceptional cases, the National Bank influences long-term interest rates by purchasing or selling securities in Swiss francs. These instruments were rarely used in 2004.

2.4 Emergency liquidity assistance

Liquidity assistance conditions

Within the context of emergency liquidity supply, the National Bank can provide emergency liquidity assistance to one or more domestic banks if they are no longer able to refinance their operations in the market. This facility is subject to the following conditions: the bank or group of banks requiring credit must be of systemic importance for the stability of the financial system, the bank in question must be solvent, and finally, sufficient collateral must be provided at all times to cover the liquidity assistance.

Systemic importance of financial institutions

A bank or group of banks is of systemic importance if its inability to pay would seriously impair the functioning of the Swiss financial system, or major parts thereof, and have a negative impact on the economy. To assess the solvency of a bank or group of banks, the National Bank obtains an opinion from the Swiss Federal Banking Commission (SFBC). The National Bank determines what collateral is sufficient. Emergency liquidity assistance may also be provided in foreign currencies.

In 2004, such assistance was not required – neither by a bank nor group of banks.

2.5 Cash liquidity and minimum reserves

Liquidity volumes in 2004

In 2004 (20.12.2003 to 19.12.2004), the required cash liquidity funds amounted to CHF 8.4 billion on average, while available funds totalled an average of CHF 11.5 billion. Consequently, the annual average of surplus liquidity stood at CHF 3.1 billion, which corresponded to a liquidity ratio of 137%.

New minimum reserve regulation

With the entry into force of the new NBA on 1 May 2004, the cash liquidity provisions – which had been based on the Banking Act – were replaced by the minimum reserve regulation in the new NBA (arts. 17, 18, 22). This regulation entered into effect on 1 January 2005. The purpose of minimum reserves is to secure a minimum level of demand for base money, thus fulfilling a monetary policy objective. Given this change, amendments needed to be made to the existing provisions on cash liquidity, both with regard to eligible assets and relevant liabilities. Eligible assets in Swiss francs now comprise only coins in circulation, banknotes and sight deposits held at the National Bank. Assets no longer eligible are PostFinance credit balances as well as credit balances at one of the clearing centres recognised by the SFBC. The principal changes to the relevant liabilities concern those liabilities vis-à-vis banks, on the one hand (minimum reserves must now be held only on liabilities vis-à-vis banks not subject to minimum reserve requirements), and money market paper and medium-term notes, for which minimum reserves must now be held, on the other hand. If a bank fails to fulfil the minimum reserve requirement, it has to pay the National Bank interest on the shortfall for a period of 30 days. The interest rate is three percentage points higher than the one-month Libor for Swiss franc investments averaged over the respective reporting period.

3 Ensuring the supply of cash

3.1 Cash transactions

Mandate

According to art. 5 para. 2 (b) of the National Bank Act (NBA), the National Bank shall guarantee the supply and distribution of cash in Switzerland. In conjunction with the commercial banks, their jointly operated organisations and Swiss Post, the National Bank ensures an efficient and secure payment system.

Role of the SNB

The National Bank deals with the head and regional offices of the commercial banks, Swiss Post and Swiss Federal Railways (SBB). It offsets seasonal fluctuations in the demand for banknotes and replaces notes that are unfit for circulation. The role of retailer, which also includes the immediate redistribution of cash, is assumed by commercial banks, Swiss Post and cash processing operators.

Cash deposit facilities

Since 2003, cash processing operators have been able to request cash deposit facilities at the National Bank. These facilities are banknote and coin stocks which the National Bank sets up with third parties, while still retaining ownership. The third parties use the holdings in these facilities, exchanging cash for their sight deposits at the SNB. One year after the first cash deposit facility was set up, the National Bank recorded a drop both in its own number of incoming and outgoing banknotes and in the number of transports made by the operators of cash deposit facilities. Consequently, the supply and distribution of cash have become more efficient.

Turnover of offices

In 2004, the National Bank's offices registered currency turnover amounting to CHF 124.4 billion, as compared with CHF 132.2 billion a year earlier. They received 407 million banknotes (previous year: 425 million). The value of incoming coins stood at CHF 289.2 million (previous year: CHF 275.3 million), their weight at 1,498 tonnes (previous year: 1,414 tonnes). The National Bank examined a proportion of the coins received with regard to quantity, quality and authenticity.

Turnover of agencies

The agencies' turnover stabilised in the year under review at a level of CHF 14.3 billion, compared with CHF 14.1 billion a year earlier. Agencies are cash distribution services operated by cantonal banks on behalf of the National Bank. They are responsible for the distribution and redemption of cash in their region. In order to do this, the agencies have access to cash belonging to the National Bank. In previous years, the reorganisation of Swiss Post and the emergence of cash processing operators led to a steady decline in the agencies' turnover. Despite the diminishing importance of its agency network, the National Bank is still interested in its maintenance.

Turnover of domestic correspondents

The National Bank can grant banks the authority to act as correspondents in areas in which it itself is not active. Together with the post offices, these banks perform local cash redistribution transactions. The domestic correspondents supplied 2.6 million banknotes (previous year: CHF 3.8 million). Turnover in this category is also highly dependent on the activity of the cash processing operators.

3.2 Banknotes

Mandate

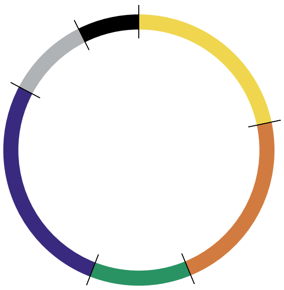
Pursuant to art. 7 of the Federal Act on Currency and Payment Instruments (CPIA), the National Bank shall issue banknotes commensurate with demand for payment purposes and take back any banknotes which are worn, damaged or no longer needed. It also determines the denomination and design of the notes. Particular attention is paid to the security of the notes. Given the speed at which counterfeiting technology is advancing, it has become absolutely essential that the security features on the banknotes be continuously checked and, if necessary, adjusted, as was the case for example with the perforated number (known as Microperf) on the small notes. New security features are developed in close cooperation with third parties. This applies in particular to the long-term project on the introduction of a new banknote series, for which initial preparatory steps were taken in 2004.

Banknote circulation

In 2004, banknote circulation averaged CHF 36.2 billion (previous year: CHF 35.7 billion). This increase is primarily attributable to a corresponding development in the 1,000-franc notes. This denomination is generally held as a store of value. The number of notes in circulation in 2004 amounted to 271.9 million on average (previous year: 269.3 million). The rise is attributable to GDP growth, the replacement of the 200-franc note with the 20-franc note in ATMs, and the increasing demand for 10-franc notes.

Issue and disposal

In 2004, the National Bank put 108.6 million (previous year: 120 million) freshly printed banknotes with a face value of CHF 8.7 billion into circulation (previous year: 8.6 billion), and destroyed 112.7 million (previous year: 115.2 million) damaged or recalled notes with a nominal value of CHF 8.2 billion (previous year: 9.0 billion).



Banknotes in circulation
Denominations (in millions)

CHF 10s: 59

CHF 20s: 60

CHF 50s: 33

CHF 100s: 73

CHF 200s: 27

CHF 1,000s: 20

Annual average

Counterfeits

In the period under review, roughly 3,000 banknotes were confiscated in Switzerland; the National Bank's offices alone discovered 244 counterfeits (previous year: 190). By international standards, 12 seized counterfeit notes per million of Swiss franc notes in circulation is rather low. Moreover, the counterfeits are by and large of poor quality.

3.3 Coins

Mandate

The National Bank is entrusted by the Swiss Confederation with the task of coin circulation. Its role is defined in art. 5 CPIA. In essence, the SNB must put the number of coins required for payment purposes into circulation and take back those coins that are surplus to requirements – without restriction and against reimbursement of the nominal value. The National Bank's coinage services are not remunerated, as these constitute part of the mandate to supply the country with cash.

Coin circulation and minting

At CHF 2.4 billion (previous year: CHF 2.3 billion), average coin circulation in 2004 almost equalled the year-earlier level. The number and denomination of coins in circulation depend greatly on the degree of coin machine usage.

In 2004, demand for new coins amounted to 32 million units (previous year: 39.5 million), with a nominal value of approximately CHF 10.5 million (previous year: CHF 13.7 million). A large proportion of these coins replace those taken out of the country by tourists.

4 Securing cashless payment systems

Mandate

In accordance with art. 5 para. 2 (c) of the National Bank Act (NBA), the National Bank shall facilitate and secure the operation of cashless payment systems.

4.1 Facilitating cashless payment transactions

Bodies responsible for the cashless payment system

The National Bank plays a vital role not only where cash is concerned, but also in cashless payment transactions. As defined in art. 9 NBA, the National Bank may keep interest-bearing and non-interest-bearing accounts for banks and other financial market participants. Payments in these accounts are settled via Swiss Interbank Clearing (SIC). SIC is what is known as a real-time gross settlement system. While it is run and monitored by the National Bank, SIC is operated by Swiss Interbank Clearing AG – a subsidiary of Telekurs Group – on behalf of the National Bank. Telekurs Group, in turn, is a joint venture among Swiss banks.

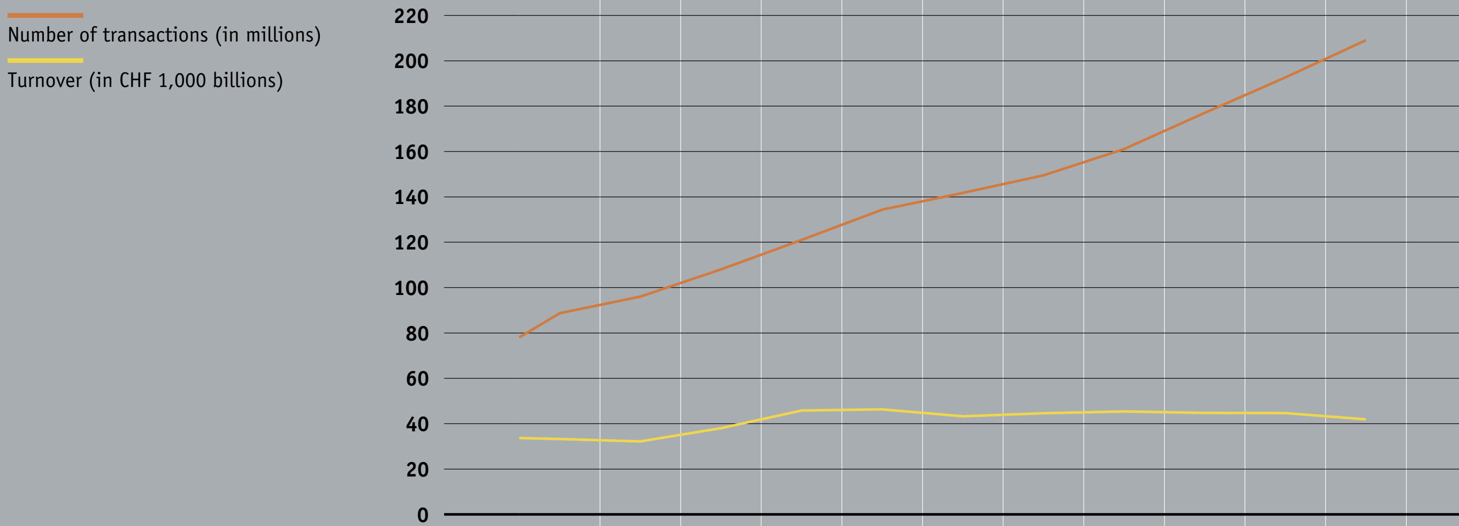
SIC and monetary policy

The National Bank settles its monetary policy transactions via SIC. The monetary policy instruments are designed to be transacted through SIC. This means that institutions wishing to effect repo transactions with the National Bank, for example, must be connected to SIC. The daily transaction volume in SIC resulting from monetary policy-based money market transactions amounts to roughly CHF 10 billion.

Facilitating and securing payment transactions

The National Bank fulfils its statutory mandate of facilitating and securing cashless payment transactions by performing operational functions in SIC. It opens the new value date and transfers the necessary funds from the banks' sight deposit accounts held at the National Bank to the appropriate SIC clearing accounts. SIC AG uses these accounts to settle payments electronically. Over the course of the day, the National Bank monitors operations and supplies the system with sufficient liquidity. To this end, it grants intraday loans to the commercial banks when necessary. It then closes the value day by transferring the balances from the SIC clearing accounts back to the sight deposit accounts at the National Bank. The National Bank is also responsible for the administrative tasks. It handles applications for sight deposit accounts, which, once opened, entitle account holders to participate in SIC. In addition, the National Bank is responsible for crisis management. In 2004, it had to summon the crisis management committee on one occasion, following a failure during data transfer.

Transactions and turnover in Swiss Interbank Clearing per year



1994 1995 1996 1997 1998 1999 2000 2001 2002 2003 2004

Conceptual issues

The National Bank influences the development of the SIC system on a conceptual level. It approves in the last instance changes and enhancements to the transaction process operated by SIC AG. Furthermore, National Bank employees are active in numerous technical working groups. These bodies support the Board of Directors of SIC AG in the decision-making process by dealing with the operation and development of payment system applications, drawing up technical, administrative and procedural documentation for the payment systems, and defining new functionalities and services, among other things. In 2004, these bodies dealt primarily with security issues, standardisation and harmonisation problems in connection with the globalisation of the financial markets, and the automation of payment procedures.

Key figures on SIC

At the end of 2004, 306 participants were connected to SIC, as compared with 307 the previous year. In 2004, a total of 816,000 payments amounting to CHF 163 billion were settled each day. On peak days, however, SIC processed over 2.2 million transactions totalling roughly CHF 273 billion. The average amount per transaction was approximately CHF 200,000 – the downward trend of the past few years thus prevailed. Bank clients are using the retail payment application DTA (data exchange carrier) at SIC AG less and less frequently to process their retail payments, such as wage and pension payments or payments to suppliers. Instead, they settle these transactions directly via their own banks, which process the payments individually via SIC rather than in batches. The volume of transactions settled via the retail payment application in 2004 amounted to CHF 229.2 billion, compared with CHF 269.5 billion the previous year. At present, roughly 85% of all transactions settled in SIC are smaller than CHF 5,000 (low-value payments). Payments greater than CHF 1 million (high-value payments) account for just slightly more than 1%. The situation with regards to volume is the other way around: high-value payments account for approximately 95% of the turnover, low-value payments for only 0.5%. The turnover resulting from National Bank transactions amounts to roughly 15%.

Key figures on SIC

	2000	2001	2002	2003	2004
Transactions (in thousands)					
Daily average	595	644	705	768	816
Highest daily value of the year	1 821	2 078	1 874	2 145	2 215
Volume (in CHF billions)					
Daily average	178	182	180	178	163
Highest daily value of the year	291	274	270	284	273
Amount per transactions (in CHF thousands)	299	282	253	232	200
Average liquidity (in CHF millions)					
Sight deposits at the end of the day	3 336	3 339	3 327	4 811	5 339
Intraday liquidity	2 074	2 566	3 897	5 972	6 188

4.2 Oversight of payment and securities settlement systems

Focus on systemically important payment and securities settlement systems

The NBA (art. 5 para. 2 (c) and arts. 19–21) obliges the National Bank to oversee systems for the clearing and settlement of payments (payment systems) and transactions involving financial instruments, in particular securities (securities settlement systems). Furthermore, the National Bank is authorised to demand that minimum requirements be fulfilled with respect to the operation of systemically important payment and securities settlement systems. It thus focuses on those systems from which risks for the stability of the financial system may emanate.

Regulation of details in the NBO

The National Bank Ordinance (NBO) entered into force on 1 May 2004 together with the NBA. In arts. 18–39, the NBO details system oversight, namely the criteria determining which payment and securities settlement systems are systemically important, the minimum requirements demanded of these systems, and the review of compliance with the minimum requirements and procedures.

Risk mitigation with minimum requirements

The essence of the NBO provisions relevant to system oversight are the minimum requirements listed in arts. 22–34 – these aim primarily to minimise credit, liquidity and operational risks. The said requirements include provisions on the corporate governance of the system operator, as well as on contractual foundations, system regulations and procedures, access, and IT security. The minimum requirements are based largely on international standards – namely the "Core Principles for Systemically Important Payment Systems" and the "Recommendations for Securities Settlement Systems" – which were published by the BIS Committee on Payment and Settlement Systems (CPSS) and by CPSS in association with the Technical Committee of the International Organization for Securities Commission (IOSCO) respectively.

Comprehensive information and reporting obligation of system operators

In order for the National Bank to be able to review compliance with the minimum requirements, the operators are bound by a comprehensive information and reporting obligation (arts. 35–36 NBO). In particular, they are required to provide the National Bank with information on all the necessary areas and grant it full authority to inspect the infrastructures on site. They must also submit certain reports and statistics periodically.

Disclosure obligation in determining relevant systems

Determining which payment and securities settlement systems are of systemic importance is significant insofar as these systems are the only ones required to fulfil the minimum requirements of the National Bank. All systems subject to the disclosure obligation were evaluated. This obligation applies both to operators of payment systems that settle payments in excess of CHF 25 billion per financial year, as well as to all operators of securities settlement systems. After the NBA entered into effect, the following system operators registered within the three-month notification period: Swiss Interbank Clearing AG for the payment systems Swiss Interbank Clearing (SIC); the data carrier exchange (DTA) and the direct debit procedure (LSV); SIS SegaInterSettle AG for the securities settlement system SECOM; SIS x-clear AG for the central counterparty x-clear; CLS Bank International for the multicurrency payment system Continuous Linked Settlement (CLS); and PostFinance for various services related to retail payments. In addition, the euroSIC clearing system operated by Swiss Euro Clearing Bank (SECB) was also evaluated.

Evaluation using different criteria

The evaluation was carried out in accordance with the criteria listed in art. 20 NBO. These criteria were specified further and weighted according to their importance. The following factors were given particular priority: the types of transactions that are cleared or settled through the system, the type and number of links existing between a system and other payment and securities settlement systems, and the possibility of switching at short notice to the system of another operator.

SIC, x-clear, SECOM and CLS rated as systemically important systems

The following four systems were categorised as systemically important: SIC, x-clear, SECOM and CLS. The first three – SIC, x-clear and SECOM – belong to the Swiss Value Chain and, together with the electronic stock exchange SWX, form the core of Switzerland's financial market infrastructure. These systems are used almost exclusively for clearing and settling financial market transactions. Participants include various financial intermediaries with an important role to play in the Swiss financial market. Operational problems occurring in one of these systems, and causing liquidity shortages among participants as a result, could have a negative impact on the functioning of the other connected systems. With the exception of x-clear, the payments transacted in these systems are so large that a system failure would be enough to jeopardise the economy's supply of liquidity. Moreover, if a system malfunctions – particularly where SIC and SECOM are concerned – no alternative systems exist for the settlement of payments or securities transactions. The systemic importance of x-clear is primarily attributable to the concentration of various counterparty risks.

CLS is a global system enabling the settlement of foreign exchange transactions. At the end of 2004, transactions were settled in 15 different currencies according to the payment-versus-payment principle. The New York-based operator of CLS was exempted from compliance with the minimum requirements as the system is already adequately overseen by the Federal Reserve Bank of New York and because the exchange of information with the National Bank runs smoothly.

CLS exempt from minimum requirements

The remaining systems that were evaluated – DTA, LSV, euroSIC and PostFinance – were classified as not systemically important. These systems predominantly settle retail payments. While the transaction volumes are very high, the actual amounts processed are relatively low. Although the transactions cleared via DTA and LSV are settled in SIC, they nonetheless have no major influence on the high-value payments systems, neither with regard to operational problems nor participants' liquidity bottlenecks. The same applies to PostFinance, which is also connected directly to SIC for certain payments. Moreover, with these systems, it is possible to switch at short notice to other retail payment systems. In consideration of these facts, it can therefore be assumed that these systems pose no threat to the supply of liquidity to the financial sector.

Not systemically important retail payment systems

The Swiss Federal Banking Commission (SFBC), which was consulted by the National Bank in accordance with the procedure laid down in the NBO with regard to compliance with minimum requirements, endorsed the SNB's classification into systemically important and not systemically important payment and securities settlement systems.

Cooperation with the SFBC

Swiss-based operators of securities settlement systems – SIS SegaInterSettle AG and SIS x-clear AG – also have the status of a bank and are thus subject to supervision by the SFBC. Given that the provisions in the Banking Act and the minimum requirements stipulated in the NBO are partly similar in content, the SFBC and the National Bank discussed ways of delimiting the respective competencies and providing an efficient exchange of information in an effort to avoid overlaps.

Cooperation with authorities abroad is necessary also in the case of internationally active system operators. Where CLS is concerned, the National Bank participates in an international supervision framework, which in addition to the Federal Reserve Bank of New York, includes all central banks whose currency transactions are settled via CLS Bank International in New York. In July 2004, the National Bank, together with the European Central Bank (ECB) and the UK Financial Services Authority (FSA), signed a "Memorandum of Understanding on Coordination and Cooperation for the Supervision and Oversight of x-clear". As a result, x-clear was granted the status of Recognised Overseas Clearing House (ROCH) in the UK.

Cooperation with authorities abroad

5 Investment of assets

5.1 Basic principles

Mandate

Under art. 5 para. 2 of the National Bank Act (NBA), the National Bank is responsible for managing the currency reserves. Asset management is governed by the primacy of monetary policy and must be implemented according to the criteria of liquidity, security and return. Within these parameters, investments are to be made in line with the principles of modern asset management. Diversification of investment aims at achieving an adequate risk/return profile. In view of the extended investment possibilities under the new NBA, the National Bank issued Investment Policy Guidelines on 27 May 2004. These define the scope of investment activity as well as the investment and risk control process to be followed.

Monetary assets

The National Bank's assets essentially consist of foreign currency reserves, gold reserves and financial assets in Swiss francs (securities and claims from repo transactions). They fulfil important monetary policy functions. Their composition is determined mainly by the established monetary order and the requirements of monetary policy. Part of the assets, including claims from repo transactions, serve directly for implementing monetary policy. By concluding repo transactions, the National Bank purchases securities from commercial banks on a temporary basis and supplies liquidity in the form of base money. By setting the terms for these repo transactions, the SNB influences the interest rate level on the money market. Swiss franc assets are supplemented by a bond portfolio in Swiss francs. The National Bank holds currency reserves – in the form of foreign currency and gold – in order to have room for manoeuvre in monetary policy at any time. Currency reserves serve to prevent and overcome possible crises.

Free assets

In addition to these assets necessary for monetary policy, the National Bank also manages the proceeds from the sale of the surplus gold reserves. These proceeds are managed separately, but are not shown separately in the balance sheet as they do not constitute separate assets in the legal sense.

5.2 Investment and risk control process

Responsibilities of Bank Council and Risk Committee

Within the framework of the new NBA, the National Bank's mandate in the area of asset management was described in detail and the competencies defined. The Governing Board decides on the composition of the currency reserves and the investment of other assets. The Bank Council is responsible for the integral oversight of the investment and risk control process. It assesses the principles of the process and monitors compliance with them. A Risk Committee composed of three members of the Bank Council supports the Bank Council in this task. In particular, the Risk Committee monitors the SNB's risk management. Risk reporting is carried out by the competent organisational unit which reports directly to the Governing Board and the Bank Council's Risk Committee. To avoid conflicts of interest, the responsibilities for monetary policy and investment policy operations are largely separated – to the extent possible – on the operational level.

... Governing Board

The Governing Board defines the requirements with regard to security and liquidity of the investments as well as the eligible currencies, investment categories, instruments and debtors. It generally decides on the investment strategy once a year. The investment strategy encompasses the allocation of total assets to the different portfolios and guidelines for their management, in particular the allocation to different currencies and investment categories. Furthermore, part of the strategy is the leeway for active management on the operational level.

... Investment Committee and Portfolio Management

On the operational level, an internal Investment Committee determines the tactical allocation. Within the prescribed range, it adjusts the currency allocations, duration or the allocation to the different investment categories to changing market conditions. Finally, the individual portfolios are managed by the portfolio managers. The majority of investments are managed by internal portfolio managers. External asset managers are used in order to get access to investment categories such as US mortgage-backed securities in an efficient manner. For comparison purposes with internal portfolio management, other mandates are outsourced.

... Risk Management

The investment strategy is based on the quantitative specifications as to risk tolerance and liquidity of the investments, and on comprehensive risk/return analyses. Risk management and risk limitation is carried out by means of a system using reference portfolios, guidelines and limits. All relevant financial risks on investments are continuously compiled, assessed and monitored. Risk measurement is based on standard risk indicators and procedures. While market risk is mainly assessed by means of sensitivity and Value-at-Risk (VaR) analyses, credit risk is appraised using information from major rating agencies. Risk indicators are aggregated over all investments. Compliance with all the key guidelines and limits is monitored on a daily basis. A quarterly risk report to the attention of the Governing Board and the Bank Council's Risk Committee documents the results of risk management activities.

5.3 Development of the asset structure

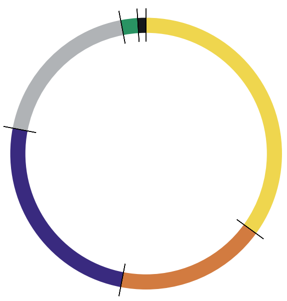
Composition of assets

The National Bank manages currency reserves of a little over CHF 60 billion, two-thirds of which are held in foreign currency investments and one-third in gold. In addition to this are approximately 30 billion Swiss franc assets in the form of balances from repo transactions and bond investments in the domestic capital market. The currency reserves and Swiss franc assets combine to make up the monetary assets. The free assets consist of the proceeds from the sale of the surplus gold reserves and the remainder of gold still to be sold. At the end of the year, free assets totalled approximately CHF 22 billion.

At the end of 2004, investments of monetary assets and free assets consisted of government bonds and bonds of quasi-governmental institutions, international institutions, local authorities, financial institutions and other companies. In addition, time deposits were placed with banks and gold lending transactions were concluded. Exchange rate and interest rate risks were also managed by derivative instruments, such as interest rate swaps, interest rate and bond futures, and foreign currency forward transactions.

Broader investment spectrum

With the NBA in force since May 2004, former legal restrictions regarding eligible investment categories and debtors were dispensed with. This opened up the possibility to broaden the investment universe, thus improving the risk/return profile of investments. Against this background, the National Bank added corporate bonds to its asset mix and lowered the required minimum rating for bond investments from A to BBB, which corresponds with the lowest investment grade category. To reduce any potential conflicts of interest from the start, only corporate bonds of foreign issuers are held.



Structure of National Bank assets
In percent

Foreign exchange reserves 35

Monetary gold reserves 18

Monetary Swiss franc assets 25

Free assets 19

Monetary institutions 2

Other assets 1

Total: CHF 117 billion
End of 2004

Investment structure at the end of 2004

	Foreign exchange reserves	Monetary CHF portfolio	Free assets
Currency allocation, incl. hedge positions			
Swiss francs	–	100.0%	51.0%
US dollars	30.9%	–	6.4%
Euros	50.0%	–	24.9%
Pounds sterling	9.8%	–	8.0%
Other (Yen, Canadian dollars, Danish kroner)	9.3%	–	9.7%
Investment categories			
Money market investments	2.4%	–	2.4%
Government bonds[1]	68.1%	48.5%	65.4%
Other bonds[2]	29.5%	51.5%	32.2%
Shares	0.0%	–	–
Risk indicators			
Duration of bonds (years)	5.1	4.8	4.0
Value-at-Risk (1 year, 95%) in CHF billions	2.3	0.1	0.5

1 Government bonds in their own respective currencies, and – in the case of Swiss franc investments – bonds issued by Swiss cantons and municipalities.

2 Government bonds in foreign currencies, bonds issued by foreign local authorities and supranational organisations, US mortgage-backed securities (MBS), Pfandbriefe, corporate bonds, etc.

Further diversification

Owing to the expansion of the investment universe, an enhanced diversification of investments was initiated in 2004. The share of government bonds as part of the monetary and free assets was reduced to less than 70% in favour of bonds of other debtors. The National Bank started holding corporate bonds, which accounted for approximately 4% of both the foreign exchange reserves and the free assets. In the case of the foreign exchange reserves, the reduction of the US dollar share in favour of other currencies – initiated in 1997 – continued. Duration of the investments of free assets was increased from three to four years.

5.4 Investment risk profile

Risk profile

The main risk on investments is market risk, i.e. currency, gold price and interest rate risks. They are primarily managed by diversification. The National Bank counters liquidity risk by holding a large part of its investments in the world's most liquid currencies and markets. In addition, it also takes some credit risk. Compared with the market risk, this is insignificant, however.

... of currency reserves

Adding corporate bonds to the currency reserves and increasing the credit risk tolerance enhanced the degree of portfolio diversification. The reduction of the dollar share also has a positive effect from a risk/return perspective. This is because the currency risk of the dollar against the franc is higher than the respective currency risk of the euro and pound sterling. With the duration of five years, the interest risk profile of the foreign exchange reserves remained unchanged. The price of gold and the US dollar exchange rate were still the dominant risk factors of currency reserves. By contrast, interest rate and credit risks contributed only marginally to the overall risk.

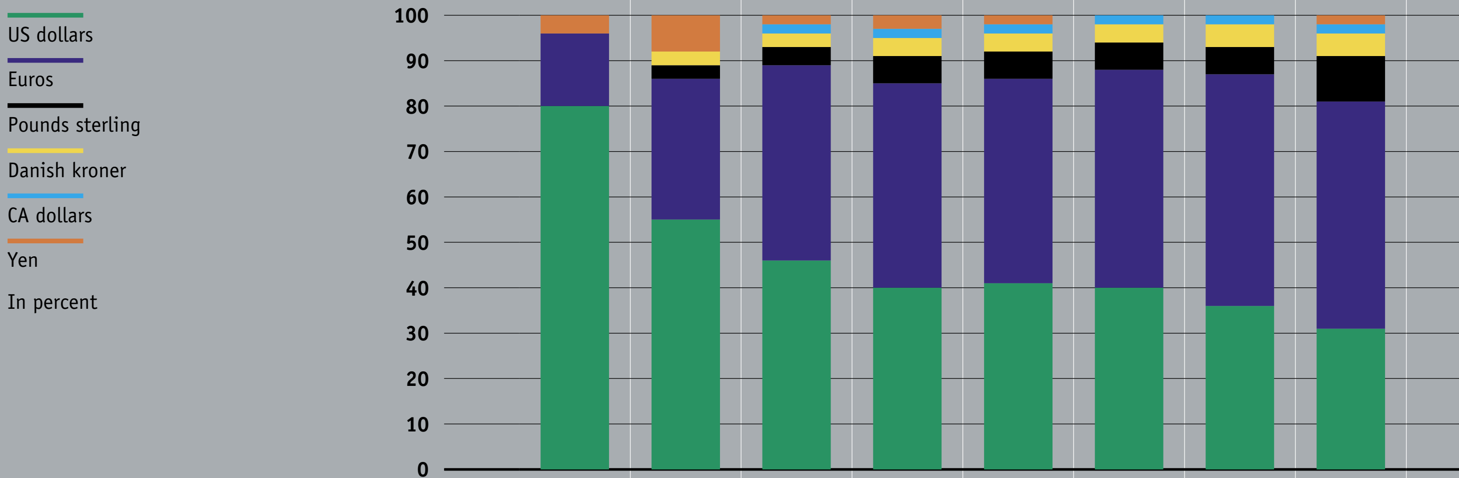
... of monetary Swiss franc investments

The monetary Swiss franc securities are managed passively. The maturity and credit structure largely corresponds with that of the Swiss Bond Index. Duration at year-end was 4.8 years. Monetary policy repo transactions are not actively managed and – since the claims are secured by collateral – are practically free of any credit risk. These collateralised securities are valued daily, and shortfall is covered immediately. Given the extremely short maturity, there is also no interest rate risk.

... of gold

Save for gold lending, monetary gold was not actively managed. A maximum of roughly one quarter of this gold is available for gold lending. At the end of 2004, approximately 130 tonnes of gold had been lent to different financial institutions against remuneration.

Currency breakdown of foreign exchange reserves



1997 1998 1999 2000 2001 2002 2003 2004

… of free assets

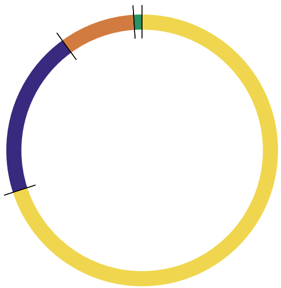
The risk profile of the free assets clearly differed from that of the currency reserves in that overall risk was significantly lower. On the one hand, this is attributable to the fact that there were no monetary policy restrictions imposing a currency allocation which was – from an investment policy viewpoint – suboptimal. The currency risk could thus be kept much lower. On the other hand, other risks were entered into only cautiously so as not to jeopardise the substance for a transfer to the future beneficiaries. The risks attached to gold holdings earmarked for future sale were indirectly reduced as well. This was accomplished by hedging 35% of the expected proceeds in US dollars – right from the beginning of the gold sales – by concluding foreign currency forward transactions. Gold held as free assets amounted to 64 tonnes at the end of the year. Gold sales will be completed in spring 2005. Of the investments made in 2004, secondary currencies and the euro were weighted somewhat higher to the detriment of the Swiss franc. The Swiss franc share stood at 50% at year-end. However, only 10% of the investments were actually held in Swiss franc bonds; the majority of investments were made in liquid markets and denominated in euros and US dollars, with the currency risk partially hedged. Consequently, the market risk of these hedged investments was roughly comparable with that of direct Swiss franc investments.

Credit risks

The National Bank was exposed to credit risks by purchasing bonds from different debtors and debtor categories. Moreover, credit risks vis-à-vis banks existed in the form of time deposits, replacement values of derivatives, and gold lending. Even though credit risk tolerance has been somewhat higher since 2004, claims of the SNB had a very high average rating. Overall, 70% of all investments had an AAA rating, the highest possible rating. The lowest still eligible rating category is BBB. This rating category accounted for approximately 1% of investments.

Overall risk

The overall risk of investments can be estimated – among other methods – with the VaR analysis. This indicator is applied both to the total assets and to all sub-portfolios. It shows the loss which will not be exceeded in the course of 12 months with a probability of 95%. The VaR for monetary assets was CHF 4.8 billion at the end of the year, for the investment of free assets approximately CHF 500 million.



Rating allocation
In percent

AAA 70

AA 20

A 9

BBB 1

End of 2004

5.5 Investment performance

The National Bank's investment performance is calculated across all asset categories (foreign currency assets, gold, Swiss franc assets including repo transactions). It amounted in 2004 to 0.9%, i.e. below the long-term return expectations. Gold and exchange rate losses in particular contributed to the below-average result. While the decline in interest rates resulted in capital gains for most currencies, they were narrowed by the exchange rate losses. The comparatively low level of interest rates in all investment currencies also gave rise to lower interest earnings. The return on investments of free assets was better than that on foreign exchange reserves. This can be attributed to the fact that these investments had a lower exposure to currency risk and therefore suffered only minor exchange rate losses. The gold price in Swiss francs slid over the course of the year by a little over 3%; the rise in the gold price in US dollars was quashed by the dollar's weakness.

Return on investments in Swiss francs

	Foreign exchange reserves	Monetary gold	Monetary CHF portfolio	Investments of free assets
1999	9.7%	–	0.7%	–
2000	5.8%	–3.1%	3.3%	4.2%
2001	5.2%	5.3%	4.3%	4.4%
2002	0.4%	3.4%	10.0%	5.2%
2003	3.0%	9.1%	1.4%	4.0%
2004	2.3%	–3.1%	3.8%	2.6%

The return on investment comprises direct income (interest), realised price gains and losses, and unrealised price changes on holdings. Return on free assets refers to the invested proceeds from gold sales, but not to the remaining gold holdings. The management of these proceeds began in May 2000. The return for 2000, therefore, is the result as of May.

6 Contribution to financial system stability

Mandate

Pursuant to art. 5 para. 2 (e) of the National Bank Act (NBA), the National Bank shall contribute to the stability of the financial system.

Stability as important condition

A stable financial system inspires confidence in a balanced economic development and helps consumers, savers and investors to make long-term decisions. It is also a prerequisite for properly functioning financial markets and is thus one of the necessary conditions for the successful implementation of monetary policy. The National Bank makes every effort to identify any potential risks to the stability of the financial system at an early stage. It also plays an active role in creating an operational environment that promotes stability. To this end, the National Bank continued its close collaboration with the Swiss Federal Banking Commission (SFBC) and other federal offices in 2004.

6.1 Assessment of financial system stability

Analysis of the banking sector

In June 2004, the National Bank published its second Financial Stability Report. The report looked at developments in the banking sector and in the financial market infrastructure with regard to stability. Individual banks are only considered if this is relevant for the overall assessment.

Banks' increased resilience

According to the report, the banking sector was able to significantly boost its profits in 2003, despite the changeable macroeconomic environment. This increase led to a distinct rise in capital, thus improving the resilience of the banking sector. No major imbalances which might trigger a crisis were identified. Consequently, the Swiss banking system was considered stable. The two most unfavourable scenarios which could potentially occur – an economic downturn and an unexpectedly sharp increase in interest rates – failed to materialise.

Secure and efficient market infrastructure

With regard to payment and securities settlement systems, the report concluded that the Swiss financial sector has a financial market infrastructure that compares very favourably in terms of security and efficiency with those of other countries. The report points out, in particular, the extent to which two more recent newcomers to the infrastructure – the central counterparty SIS x-clear and the global system for foreign exchange settlements CLS – contribute positively to the stability of the financial system.

6.2 New Basel Capital Accord

SNB supports Basel II

On an international level, the National Bank, as a member of the Basel Committee on Banking Supervision, continued to participate in the revision of the Basel Capital Accord. In June 2004, the central bank governors and the heads of the banking supervisory bodies of the Group of Ten (G-10) countries approved the new Capital Accord (Basel II). This is based on three elements or "pillars": minimum capital adequacy requirements which in some cases permit banks to apply an internal ratings-based approach to measure risk exposure, the monitoring of banks' capital adequacy strategies by the national supervisory authorities, and the creation of conditions for market discipline. The National Bank supports the direction in which Basel II is headed. Well-funded and risk-adequate amounts of capital strengthen the stability of the banking system. They protect banks from solvency problems and thus also from confidence crises that may lead to liquidity shortages. Furthermore, only well-capitalised banks can effectively fulfil their macroeconomic task of granting credit, also in difficult economic times.

SNB's role in implementation

In autumn 2003, a working group lead-managed by the SFBC began the implementation of the new Capital Accord in the Swiss banking regulatory framework. The National Bank, together with the commercial banks and auditing companies, participates in this task, concentrating on areas related to the stability of the banking system and the smooth functioning of the credit market. During the course of 2004, the working group drew up draft documents for the ordinances and circulars concerning the new capital adequacy requirements. For the advanced calculation method of capital adequacy requirements, Swiss standards are based strongly on the new Capital Accord. Considerable differences still remain, however, with regard to the standard approach, particularly in relation to risk weighting. With both methods, Swiss capital adequacy ratios are likely to continue to remain higher than the international standard. The drafts of the ordinances and circulars will be submitted for consultation sometime in 2005 and will be passed at the beginning of 2006. The new capital adequacy regulation should then enter into force at the end of 2006.

6.3 Reform of securities legislation

Reform of act on securities held with intermediaries

The National Bank actively supported the efforts undertaken to reform the act governing securities held with financial intermediaries. It headed a working group set up in 2003 by the Federal Department of Finance (FDF), which concluded its work to a draft legislation on the custody and transfer of uncertificated securities (Uncertificated Securities Act) in 2004. This act updates the legal basis for the safekeeping of securities by financial intermediaries, the transfer of such securities, and for the creation of related security rights. It aims to protect the investors' ownership rights, but also seeks to contribute to the stability of the financial system. In addition, ratification of the Hague Securities Convention should also give the private international law on securities held with intermediaries a new legal foundation. The FDF is carrying out a consultation on the draft until the beginning of 2005.

Harmonisation of act on securities held with intermediaries

Finally, the National Bank supports a project run by the Rome-based International Institute for the Unification of Private Law (Unidroit) on the material harmonisation of the law on securities held with intermediaries, which aims to ensure integration between the national legal systems on cross-border safekeeping measures. A group of experts appointed by Unidroit held a week-long conference in the Study Center Gerzensee.

6.4 Legislation relevant to the financial market

Involvement in FINMA Expert Commission

The National Bank continued its participation in the FINMA Expert Commission headed by Professor Ulrich Zimmerli, which formulated a draft legislation on the integration of financial market supervision. In 2003, the Zimmerli Expert Commission proposed the creation of a Federal Financial Market Supervisory Authority (FINMA). In 2004, activities concentrated on the system of sanctions as well as the expanded prudential supervision of foreign exchange traders, introducing brokers and independent asset managers. The National Bank is in favour of an effective system of sanctions. Moreover, it opposed intentions to burden FINMA with tasks that need not necessarily be performed by the future supervisory authority.

7 Involvement in international monetary cooperation

Mandate

Art. 5 para. 3 of the National Bank Act (NBA) stipulates that the National Bank shall participate in international monetary cooperation.

Participation in different institutions

On an international level, the National Bank primarily works together with the International Monetary Fund (IMF), the Group of Ten (G-10), the Bank for International Settlements (BIS) and the Organisation for Economic Cooperation and Development (OECD). It also provides technical assistance.

7.1 Participation in the International Monetary Fund

Participation in the IMF

Switzerland has been a member of the IMF since 1992. The IMF works to promote stable monetary conditions worldwide and support free trade and payment flows internationally. As an open economy with a globally important financial sector, Switzerland shares these aims.

IMF Board of Governors and Executive Board

The Chairman of the National Bank has a seat on the Board of Governors of the IMF, the Fund's highest decision-making body, while the Head of the Federal Department of Finance (FDF) leads the Swiss delegation that takes part in the IMF meetings. Switzerland holds one of the 24 seats on the Executive Board, the IMF's most important operational body. In this function, it represents one constituency, which also includes Azerbaijan, the Kyrgyz Republic, Poland, Serbia and Montenegro, Tajikistan, Turkmenistan and Uzbekistan, and actively participates in formulating IMF policy. The Swiss seat on the Executive Board is held alternately by a representative of the National Bank and the FDF. The National Bank and the FDF determine Switzerland's policy in the IMF and support the Swiss executive director in his activities.

Important activities of the Executive Board in 2004

In addition to its surveillance of the economic situation in member countries (crisis prevention), the Executive Board's activities in 2004 also addressed crisis management, the IMF's role in poorer nations and the Fund's financial situation. The Executive Board confirmed that the IMF has made significant progress in its surveillance activity in recent years. In terms of crisis management, it devoted particular attention to its members with a lending programme, notably Argentina, Brazil and Turkey, as the three largest IMF borrowers. It also continued its debate on the structure of lending policies and lending facilities, emphasising the necessity to comply with the existing regulations when granting large financing packages. With regard to the IMF's role in poorer countries, the Executive Board focused on fund provision and debt sustainability issues. In its assessment of the IMF's financial situation, the Executive Board ascertained that the IMF has sufficient funds, also in the medium term.

SNB finances reserve position

The IMF finances its activities with the member countries' quotas, i.e. capital subscriptions. Total quotas in the IMF in Special Drawing Rights (SDR) amount to 213 billion (approx. CHF 370 billion), with Switzerland's quota coming to SDR 3,458.5 million (roughly CHF 6,050 million). The portion of the Swiss quota used by the IMF – the reserve position – is financed by the National Bank. It represents a currency reserve for the National Bank and may be used by it at any time. At the end of 2004, Switzerland's reserve position amounted to SDR 1,153.9 million, compared with SDR 1,386.4 million at the end of 2003. At the end of 2004, one SDR was equivalent to CHF 1.758. This figure is calculated on the basis of weighted exchange rates for the US dollar, euro, yen and pound sterling.

SNB finances PRGF and interim PRGF

The National Bank also finances the Swiss contribution to the loan account of the Poverty Reduction and Growth Facility (PRGF). The PRGF funds in which Switzerland participates with a loan commitment of SDR 151.7 million were drawn completely by the end of 2001. Owing to the fact that the PRGF could not be established as a self-supporting facility before 2005, interim financing (interim PRGF) was necessary. Switzerland contributes SDR 250 million towards the capital of the interim PRGF. This amount is provided by the National Bank. The Swiss Confederation guarantees the National Bank the timely repayment of both the PRGF and interim PRGF loans, including interest payments.

7.2 Participation in the Group of Ten

Report on the IMF's financial position

The National Bank participates in meetings of the finance ministers and central bank governors of the G-10 countries and in various working groups. In 2004, G-10 devoted itself primarily to the IMF's financial situation, in particular to the risks facing the Fund and to the possibilities to hold such risks in check.

Collective action clauses

Finance ministers and central bank governors were also satisfied to see that the use of collective action clauses for sovereign bond issues promoted by the G-10 has become standard market practice in the space of just a few years. Such clauses should facilitate a restructuring of sovereign debt in the event of default.

7.3 Cooperation with the Bank for International Settlements

BIS bodies

The central bank governors of industrialised countries and emerging economies meet every two months at the BIS for an exchange of information. In addition, the National Bank participates in the four standing committees of the BIS: the Basel Committee on Banking Supervision, the Committee on Payment and Settlement Systems, the Committee on the Global Financial System, and the Markets Committee.

Basel Committee on Banking Supervision

The Basel Committee on Banking Supervision serves as a platform for regular cooperation in banking supervision matters. Its tasks are described in more detail in the chapter on the National Bank's contribution to the stability of the financial system.

Committee on Payment and Settlement Systems

The Committee on Payment and Settlement Systems (CPSS) monitors and analyses the developments in national and international payment and securities settlement systems. The CPSS issued two reports in 2004. The first report provides an overview of the use of electronic money and innovative payment instruments in more than 90 countries. The second report, which was drawn up in collaboration with the Technical Committee of the International Organization of Securities Commissions (IOSCO), contains 15 recommendations to central counterparty operators.

Committee on the Global Financial System

The Committee on the Global Financial System (CGFS) monitors and examines international financial markets and draws up recommendations to support central banks in the fulfilment of their responsibilities with regard to the stability of the financial system. The CGFS published a report in 2004 on the importance of foreign direct investment in the financial sectors of emerging economies. The report shows that the sharp increase in such direct investment played a crucial role in the integration of emerging economies into the global financial system, and that this integration was considerably advantageous for the financial sectors of the countries in question.

Markets Committee

The Markets Committee serves as a discussion forum for the G-10 central bank staff members responsible for financial market operations. The discussions addressed the developments in the foreign exchange and other financial markets, as well as the impact of individual events on the overall functioning of these markets.

7.4 Participation in the OECD

Switzerland is a member of the OECD and participates in committees set up to promote the development of economic relations, particularly among industrialised countries. The National Bank, together with the Federal Administration, represents Switzerland in this capacity. The Economic Policy Committee (EPC), its Working Parties WP1 and WP3, and their working groups deal with global economic issues on a political and scientific level. The Committee on Financial Markets (CMF) discusses current developments and structural problems in international financial markets. Within the context of the annual OECD examination of Switzerland (Examen Suisse), the OECD's country survey on Switzerland is discussed in detail.

7.5 Monetary assistance loans

Monetary Assistance Act in force

The Federal Act and Federal Decree on International Monetary Assistance (Monetary Assistance Act and Decree) entered into effect on 1 October 2004, thereby replacing the Federal Decree on Switzerland's cooperation in international monetary measures.

No new loans

No new monetary assistance loans were extended in 2004. One balance-of-payments loan remained outstanding at the end of the year – EUR 14.3 million to Bulgaria, expiring in 2007.

7.6 Technical assistance

Technical assistance

The National Bank fosters good relations with the central banks of the countries in its IMF constituency, as listed in 7.1. Thanks to their support, Switzerland is able to head a constituency in the IMF; its seat in the Executive Board gives it added influence. The National Bank primarily provides the central banks of these countries with technical assistance, with a particular focus on the transfer of central bank-specific knowledge. The SNB provides no financial support.

The National Bank has been assisting the National Bank of the Azerbaijan Republic since 2002 in the introduction of a new banknote series and advising it on the implementation of monetary policy. Work was continued on these projects in 2004. In addition, the National Bank of the Azerbaijan Republic and the Central Bank of Montenegro received technical assistance for the investment of reserve assets. An already existing project in this area was pursued further with the Central Bank of Serbia. The National Bank of the Kyrgyz Republic continued to receive technical support in the areas of cash management and central bank management training. A project assisting in the preparation of monetary policy decisions was launched for the National Bank of Tajikistan.

... to countries in its IMF constituency

Furthermore, topic-related technical assistance was simultaneously provided in 2004 to several countries. In a seminar on cash, representatives of Azerbaijan, the Kyrgyz Republic and Tajikistan, together with representatives of four other countries, familiarised themselves with the challenges involved in issuing and handling banknotes. In May 2004, the National Bank of Poland and the SNB organised a conference in Warsaw on exchange rate regimes and monetary policies. The seminar addressed in particular the participants from central banks whose countries are members of the Swiss constituency at the IMF, as well as other countries of the former Soviet Union and Southeast Europe. The aim was to involve these nations in academic discourse and to promote cooperation between their central banks.

... and to other countries

Outside of the Swiss constituency within the Bretton Woods institutions, the National Bank advised the central banks of Kazakhstan and Mexico on issues regarding planning and budgeting.

8 Banking services for the Confederation

Mandate

Based on art. 5 para. 4 and art. 11 of the National Bank Act (NBA), the National Bank shall provide banking services to the Swiss Confederation.

Remuneration for banking services

The services will be provided by the National Bank for an adequate compensation. However, the services shall be provided free of charge if they facilitate the implementation of monetary policy. Remunerable services include payment transactions, liquidity management and custody of securities. The details of the services provided and the remuneration were laid down in agreements concluded between the Federal Finance Administration and the National Bank.

Liquidity management

Up until the end of 2004, the Confederation held its liquid funds in the form of sight deposits or short-term time deposits at the National Bank. In the event of liquidity shortages, the National Bank arranged money market loans from banks for the Confederation. The National Bank pays interest at market rates on time deposits held with it by the Confederation, while sight deposits are interest bearing up to a certain level. Swiss Post places its liquid funds directly in the money market.

Issuing activity

In 2004, the National Bank issued money market debt register claims (MMDRC) and bonds on behalf of the Confederation. A total of CHF 41.8 billion MMDRCs were subscribed, of which CHF 39.5 billion were allocated. Swiss Confederation bonds amounting to CHF 16.1 billion were subscribed, CHF 11.1 billion of which were allocated.

Swiss Confederation bonds and money market debt register claims

	2000	2001	2002	2003	2004
Number of issues[1]					
MMDRC	52	52	52	53	52
Swiss Confederation bonds	14	14	15	20	25
Total subscribed in CHF billions					
MMDRC	62.7	53.0	54.7	57.8	41.8
Swiss Confederation bonds[2]	15.6	12.6	9.9	18.7	16.1
Total allocated in CHF billions					
MMDRC	42.4	39.7	40.6	40.1	39.5
Swiss Confederation bonds[2]	9.3	7.5	8.4	14.9	11.1
Outstanding at year-end in CHF billions					
MMDRC	13.4	11.5	12.4	10.7	12.0
Swiss Confederation bonds[3]	54.1	62.1	70.2	82.6	88.7

1 By payment date

2 Excluding the Confederation's own tranches

3 Including own tranches placed in the market by the Confederation

The National Bank settled certain domestic and international payments of the Confederation. It also kept the Federal Debt Register – until its discontinuation at the end of October – and managed securities holdings and valuables on behalf of federal offices and associated enterprises.

Business Report

1 Legal framework

1.1 Entry into force of the new National Bank Act

NBA effective as of 1 May

On 24 March 2004, the Federal Council enacted the totally revised National Bank Act (NBA) with effect from 1 May 2004 after the statutory period for a referendum had expired at the end of January 2004 and no referendum had been instituted (cf. 96th Annual Report, p. 45).

Price stability, independence and accountability

The new NBA sets out in detail the National Bank's constitutional mandate. It makes price stability the SNB's primary goal – one which must be ensured while taking due account of the development of the economy – and defines the SNB's tasks in a more transparent manner. It defines the National Bank's independence and includes a formal accountability obligation to the Federal Council, Parliament and the public. An integral part of this accountability is the submission of a yearly report to the Federal Assembly on the fulfilment of the National Bank's tasks. The new NBA also extends the SNB's scope of business, making it considerably more flexible. In addition, the National Bank's monetary policy powers have been restructured and now include the authority to oversee the payment and securities settlement systems. The determination of the SNB's profits is now also regulated by law, whereas the rules governing the distribution of profits have essentially remained unchanged.

Simplified structure of bank bodies

A more streamlined structure of the National Bank's bodies became effective with the entry into force of the new NBA. This included a reduction of the Bank Council to eleven members. The Federal Council had already appointed six members of the new Bank Council and re-elected its previous president on 11 February 2004. The remaining five members were elected by the National Bank's General Meeting of Shareholders on 30 April 2004.

Revision of Banking Ordinance

At the same time as the new NBA entered into effect, the Federal Council amended the Ordinance to the Banking Act (Banking Ordinance). This was a necessary step, as the existing provisions on the cash liquidity of banks, which had been governed by the Banking Act, were replaced by a modern minimum reserve regulation in the NBA.

1.2 New National Bank Ordinance

Governing Board's implementation provisions

In view of the entry into force of the new NBA, the Governing Board issued implementation provisions in an Ordinance to the National Bank Act (National Bank Ordinance, NBO) on 18 March 2004 on the SNB's authority to compile statistics, on the minimum reserve requirements, and on the oversight of payment and securities settlement systems.

The NBO is published in the Official Compilation of Federal Laws and Decrees (AS 2004 2033), the Classified Compilation of the Federal Law (SR 951.131) and on the internet (www.snb.ch).

... on the compilation of statistics

In the chapter "Statistical surveys", the NBO defines the principles of data collection as well as the rights and obligations of institutions and companies required to submit data. The collection of statistical data must adhere to the principles of necessity and reasonableness. The coverage and frequency of statistical surveys as well as the parties required to report statistical data are described in the annexes to the NBO. The National Bank issues technical instructions on the form of reporting. All individuals involved in the conduct of surveys are obliged to treat the collected data confidentially.

... on minimum reserves

The "Minimum reserves" chapter of the NBO determines the form and manner of the banks' minimum reserve requirement. The purpose of minimum reserves is to secure a minimum level of demand for base money, thus fulfilling a monetary policy objective. The implementation provisions in the NBO closely follow the cash liquidity provisions previously contained in the Banking Ordinance. In particular, the applicable cash liquidity ratio of 2.5% remains unchanged. To give banks sufficient time to make the necessary adjustments to their information systems, the implementation provisions on minimum reserves and the (associated) amendments to the Banking Ordinance relating to liquidity did not enter into force until 1 January 2005.

... on system oversight

The chapter "Oversight of payment and securities settlement systems" of the NBO describes the minimum requirements for systemically important payment and securities settlement systems, from which risks for the stability of the financial system may emanate. These requirements are based on international standards. The NBO also governs the way in which the fulfilment of minimum requirements is assessed. To enable the National Bank to identify systems that could jeopardise system stability, all securities settlement systems and payment systems with a transaction volume of at least CHF 25 billion per annum are subject to an extended disclosure obligation.

1.3 New Organisation Regulations of the National Bank

Issued by Bank Council

On 14 May 2004, the new Bank Council held its constituent meeting, during which it passed the new Regulations on the Organisation of the Swiss National Bank (Organisation Regulations) as prescribed in the NBA. These were subsequently approved by the Federal Council on 23 June 2004.

Basic internal rules

The Organisation Regulations constitute the National Bank's basic internal rules. They lay down the basic features of the SNB's organisational structure, stipulate the procedure of the General Meeting of Shareholders, define the tasks and powers of the Bank Council, Governing Board and Enlarged Governing Board, and contain procedural, abstention and resignation regulations for the Bank Council. They also form the basis for the issuance of further regulations by the Bank Council. They are published in the Official Compilation of Federal Laws and Decrees (AS 2004 3389), the Classified Compilation of the Federal Law (SR 951.153), and on the internet (www.snb.ch). Compared with the former business regulations for the bodies of the National Bank, there are two key amendments that warrant particular mention.

Special Bank Council committees

The Organisation Regulations stipulate that the Bank Council shall appoint four committees. An Audit Committee shall support the Bank Council in supervising financial accounting and financial reporting. It shall also assess the effectiveness of the internal control system and supervise the activity of external and internal auditors. A Risk Committee shall support the Bank Council in overseeing risk management and the investment process, and shall also assess internal risk controlling. The Compensation Committee shall assist the Bank Council in determining the principles of the National Bank's compensation and salary policy and submit proposals to the Bank Council for fixing the salaries of the members of the Governing Board and their deputies. Finally, in the event of vacancies, a Nomination Committee shall prepare proposals for the election of Governing Board members and their deputies and submit these to the Bank Council. Each committee shall comprise two to three members of the Bank Council.

Two management boards

The Organisation Regulations divide the activities of the Governing Board, the supreme management and executive body, between two bodies. While the Governing Board will continue to be responsible for the core tasks necessary for monetary policy and to represent the National Bank externally, the Enlarged Governing Board – comprising the three Governing Board members and their three deputies (who were also elected by the Federal Council) – will assume the operational management of the SNB, which includes internal directives, financial planning and budgeting, as well as human resources and infrastructure-related decisions. The Governing Board, however, retains responsibility and the duty of accountability.

1.4 Federal Act on International Monetary Assistance

Monetary Assistance Act effective as of 1 October

On 19 March 2004, the Federal Parliament adopted the Federal Act on International Monetary Assistance (Monetary Assistance Act). A day earlier, the Federal Assembly had issued the Federal Decree on International Monetary Assistance (Monetary Assistance Decree). As no referendum had been sought within the statutory period expiring at the beginning of July 2004, the Federal Council put the Monetary Assistance Act and Decree into effect on 1 October 2004.

Broad legal basis

The entry into force of the new Monetary Assistance Act has established a broad legal basis for Switzerland's financing obligations within the context of international monetary cooperation. This includes providing multilateral aid in the event of disruptions to the international monetary system, participating in special funds of the International Monetary Fund (IMF), and granting bilateral loans to countries with which Switzerland has especially close ties in terms of economic and monetary policy. If the National Bank finances loans – something that is ruled out for bilateral financial assistance granted to individual countries – the Swiss Confederation guarantees their timely repayment (cf. 96th Annual Report, p. 46).

Credit facility for systemic aid and bilateral financial assistance

The Monetary Assistance Decree contains a credit ceiling (credit facility) of CHF 2,500 million for the financing of aid operations in the event of disruptions to the international monetary system and for bilateral financial assistance to individual countries. The Federal Assembly will continue to be responsible for approving special guarantee credits for Switzerland's participation in special funds of the IMF. Deviating from the Federal Council's bill, the Federal Parliament restricted the Monetary Assistance Decree to a five-year term and obliged the Federal Council to report annually on the appropriation of funds.

1.5 Appropriation of 1,300 tonnes of National Bank gold

Federal Council bill

With its Message of 20 August 2003, the Federal Council requested the Federal Parliament to have the National Bank's assets that are no longer required for monetary policy (1,300 tonnes of gold) managed by a separate fund, with one-third of the real income to be distributed to the Confederation and two-thirds to the cantons over a period of 30 years. At the same time, the Federal Council recommended the Parliament to reject the people's initiative "National Bank profits for the Old Age and Survivors' Insurance Fund (AHV/AVS)", which was launched by the Swiss committee promoting the security of the AHV/AVS (Kosa) and which aimed to allocate the SNB's future profits to the AHV/AVS – minus an annual amount of CHF 1 billion to be distributed to the cantons (cf. 96th Annual Report, p. 47).

National Council's counter-proposal

In the summer session, the National Council – as the primary council – dealt with both bills. It decided to allocate two-thirds of the real income from the sales proceeds of the surplus gold reserves to the AHV/AVS and one-third to the cantons. It then submitted a counter-proposal to the people's initiative, recommending that the SNB's profits be split equally between the AHV/AVS and the cantons. The National Bank, which had also been heard by the deliberating committee, argued resolutely against linking the SNB's profits with the financing of a social institution, as the resulting pressure to generate as high a profit distribution as possible could hinder it in its task to pursue an independent monetary policy.

Non-consideration by Council of States

In the autumn session, the Council of States decided not to consider the Federal Council's proposal to create a constitutional basis for the preservation of the asset value of the proceeds from the sale of the surplus gold reserves. With this move, the Council of States not only rejected the new distribution formula for the real income from the gold assets put forward by the National Council, it also stated that the existing law (art. 99 para. 4 Federal Constitution (FC) in conjunction with arts. 30–31 NBA) should be applied; i.e. that one-third of the proceeds from the sale of the surplus gold reserves be distributed to the Confederation, and two-thirds to the cantons. The decision was based on the consideration that the revaluation gain resulting from the market valuation of the gold is also distributable profit as defined in the NBA. In addition, the Council of States rejected the people's AHV/AVS initiative without a counter-proposal.

Bill fails in Parliament

In the December session, the National Council initially adhered to its earlier resolution to consider the bill on the appropriation of surplus gold reserves. It also stood firm with regard to its counter-proposal to the people's AHV/AVS initiative. However, a day later – on 16 December 2004 – the Council of States confirmed its decision not to consider the bill. It endorsed a distribution pursuant to current legislation. It thus became clear that there would be no majority in Parliament supporting an appropriation formula for the surplus gold which deviates from the applicable constitutional provision.

Federal Council decision

The failure of the bill on the appropriation of the gold in Parliament led to a Federal Council decision being taken on 2 February 2005, which stipulated that the National Bank's gold reserves no longer required for monetary policy be distributed in accordance with the existing law, namely two-thirds to the cantons and one-third to the Confederation. This issue had already been addressed on 22 December 2004, when the Federal Department of Finance (FDF) published the report of a technical working group, in which the National Bank was also represented, discussing various aspects of a possible transfer of assets to the countervalue of 1,300 tonnes of gold from the SNB to the Confederation and cantons. The report suggested that the free assets could be distributed within a three-month period without monetary policy being affected.

2 Organisation and tasks

Management and oversight

The National Bank's management and executive body is the Governing Board. It is primarily responsible for monetary policy, asset investment strategy and international monetary cooperation. The Governing Board enjoys a high degree of independence in fulfilling its monetary policy mandate. The Enlarged Governing Board, which was created in accordance with the new NBA, consists of the three members of the Governing Board and their three deputies. It is responsible for the operational management of the National Bank. The Bank Council oversees the business activity.

Structure

The National Bank has two seats: one in Berne and one in Zurich. It is divided into three Departments. The organisational units of Departments I and III are, for the most part, located in Zurich; those of Department II, primarily in Berne. Each of the three Departments of the SNB is headed by one member of the Governing Board. In order to ensure the supply and distribution of cash, the National Bank also has branches in Geneva and Lugano. As with the head offices and branches, four representative offices – located in Basel, Lausanne, Lucerne and St Gallen – are responsible for monitoring regional economic developments. Furthermore, the SNB has 16 agencies, which are operated by cantonal banks, for the receipt and distribution of banknotes and coins.

Monetary policy

The National Bank's principal task is to pursue a monetary policy serving the interests of the country as a whole. The organisational unit Economic Affairs in Department I provides the basis for monetary policy decisions. It analyses the economic situation in Switzerland and abroad and produces the inflation forecast. Regional economic observers support Economic Affairs in its analysis of economic developments in Switzerland. The Financial Market Operations unit of Department III implements monetary policy by carrying out transactions in the financial markets. It also steers the three-month Libor.

Asset management

The management and investment of gold, foreign currency reserves and Swiss franc bonds are the responsibility of the units Asset Management and Financial Market Operations in Department III. Investment strategy and risk control are dealt with by the eponymous unit, also in Department III.

Cash transactions

The tasks relating to cash transactions fall within the domain of the Cash unit in Department II. The National Bank issues banknotes and puts the coins minted by the Confederation into circulation via its network of bank offices. It ensures that the quality of currency in circulation is kept at a high level by checking the cash returned to it and by disposing both of counterfeits and of banknotes and coins that no longer meet requirements.

Cashless payment transactions

Conceptual and technical issues arising with regard to cashless payment transactions are dealt with by Financial Stability and Oversight in Department II as well as the units Banking Operations and Information Technology in Department III. The Banking Operations unit also runs the real-time gross settlement system SIC.

Financial system stability

The Financial Stability and Oversight unit in Department II is responsible for contributing to the stability of the financial system and overseeing the systemically important payment and securities settlement systems.

Banker to the Confederation

Acting as the bank of the Confederation is a function performed by the units Banking Operations and Financial Market Operations of Department III. These units settle domestic and foreign payments, participate in issuing money market debt register claims and bonds, and assist the Confederation in safekeeping its securities. They also effect money market and foreign exchange transactions on behalf of the Confederation.

International monetary cooperation

The International Affairs unit of Department I deals with the international aspects of monetary policy and technical assistance.

Statistics

The Statistics unit of Department I is responsible for compiling various statistical data, notably banking statistics and the balance of payments.

Central services

The central services are divided between the three Departments. The Secretariat General, Legal Services, Human Resources, Communications, and Premises belong to Department I. Department II includes Central Accounting, Controlling, and Security. Department III is responsible for Information Technology. The Internal Auditors unit reports to the Bank Council.

3 Corporate Governance

General principles

The National Bank is a special statute joint-stock company that is administered with the cooperation and under the supervision of the Confederation. Its organisational structure and responsibilities are governed by the National Bank Act of 3 October 2003 (NBA and SR 951.11 (Classified Compilation of the Federal Law)) and the Regulations on the Organisation of the Swiss National Bank of 14 May 2004 (Organisation Regulations and SR 951.153; both available at www.snb.ch). At the National Bank, statutes and regulations fulfil the function of articles of association. The SNB has a share capital totalling CHF 25 million. This is paid up in full (art. 25 NBA), after having been reduced by CHF 25 million as of 1 May 2004 (forgoing of the non-paid-up part of the share capital; art. 57 NBA).

Bodies and responsibilities

The corporate bodies of the National Bank are the General Meeting of Shareholders, the Bank Council, the Governing Board and the Audit Board. The Bank Council oversees and controls the conduct of business of the National Bank (art. 42 NBA). Six of its members are elected by the Federal Council; the remaining five are appointed by the General Meeting of Shareholders (art. 39 NBA). The Bank Council set up an Audit Committee, a Risk Committee, a Compensation Committee and a Nomination Committee, each including two to three Bank Council members (arts. 11–14 Organisation Regulations and cf. p. 138 of this Annual Report). The Governing Board is the management and executive body (art. 46 NBA); its three members are appointed for a six-year term by the Federal Council upon recommendation of the Bank Council (art. 43 NBA). The operational management of the National Bank is the responsibility of the Enlarged Governing Board, which is composed of the three Governing Board members and their deputies (arts. 21–24 Organisation Regulations). The Audit Board examines whether the bookkeeping and the annual accounts (Financial Report) as well as the proposal for the allocation of the net profit comply with the statutory requirements. Furthermore, it is entitled to inspect at any time all aspects of the National Bank's business (art. 48 NBA). It is elected for a term of one year by the General Meeting of Shareholders (art. 47 NBA). The auditors must meet special professional requirements pursuant to art. 727b of the Swiss Code of Obligations (SCO), and they must be independent of the Bank Council, the Governing Board and the controlling shareholders (art. 47 NBA).

Shareholders' rights

The rights of the shareholders are also embodied in the NBA; company law is applied merely complementarily (art. 2 NBA). As the National Bank fulfils a public mandate and is administered with the cooperation and under the supervision of the Confederation, the shareholders' rights are restricted as compared with a joint-stock company under private law. Shareholders who do not belong to the public-law sector may not cast more than 100 votes for their own and for represented shares (art. 26 para. 2 NBA). Shareholders may be represented at the Shareholders' Meeting only by other shareholders (art. 37 NBA). Only five of the eleven members of the Bank Council are elected by the General Meeting of Shareholders (art. 39 NBA). The right to a dividend is limited to 6% of the paid-up capital (art. 31 para. 1 NBA); the remaining distributable profit goes to the Confederation and the cantons (art. 31 para. 2 NBA). The Business and Financial Report must be approved by the Federal Council, before being submitted to the General Meeting of Shareholders (art. 7 para. 1 NBA). Other provisions deviating from company law concern the passing of resolutions (art. 38 NBA), the agenda and the convention of the Shareholders' Meeting (art. 35 NBA). Agenda items with proposals from shareholders must be signed by at least 20 shareholders and be submitted to the President of the Bank Council in writing in due time before the invitation is sent out (art. 35 para. 2 NBA).

Remuneration and affiliations of bodies

The remuneration of the National Bank's bodies is determined in regulations drawn up by the Bank Council (art. 42 para. 2 (j) NBA). The affiliations of the members of the bodies are recorded in the supervisory and management bodies list (cf. p. 139).

The remuneration of the Bank Council consists of a fixed annual salary plus an attendance allowance, while the members of the Governing Board receive a salary plus a lump-sum compensation for representation expenses. The remuneration of the members of the Bank Council and the Governing Board currently in office breaks down as follows:

	2004 CHF millions	**2003** CHF millions	**Change** CHF millions
Members of the Bank Council	0.659[2]	0.447[1]	+0.212
of which for the President of the Bank Council	0.114	0.082	+0.032
of which for the Vice-President of the Bank Council	0.054	0.041	+0.013
Three members of the Governing Board	1.736	1.736	–
of which for the Chairman of the Governing Board	0.592	0.592	–
of which for the Vice-Chairman of the Governing Board	0.572	0.572	–

1 40 members of the Bank Council, ten of whom are members of the Bank Committee.

2 With the new NBA, which entered into force on 1 May 2004, the number of Bank Council members was reduced to elevenC members.

In the period under review, the National Bank did not make any severance payments to former members of the Bank Council or the Governing Board. The SNB does not pay any performance-linked remuneration. In particular, there are no share or option programmes for members of the Governing Board or Bank Council. The National Bank does not grant any loans to governing bodies.

No National Bank shares were held by members of the Governing Board and Bank Council as at 31 December 2004.

The members and the substitute members of the Auditing Committee received remuneration totalling CHF 20,141 for outlays and attendance fees in the 2004 financial year. The Auditing Committee was dissolved with the entry into force of the new NBA and replaced by an external Audit Board (PricewaterhouseCoopers in 2004). The chief auditor has been in office since the 2004 financial year.

During this period, mandates were entrusted to Pricewaterhouse-Coopers AG (statutory auditing mandate), KPMG and Compass AG (IT audit). Fees totalled CHF 171,084 and CHF 93,832 respectively. In addition, consultancy fees in the amount of CHF 43,457 were paid to PricewaterhouseCoopers AG.

Notifications to shareholders are, in principle, communicated by post to the address listed in the share register and published in the Swiss Official Gazette of Commerce (art. 28 NBA). Shareholders do not receive any information not also made available to the public (cf. pp. 146–148). Information for shareholders can be found on the National Bank's website (www.snb.ch/e/snb/aktionaer/aktionaer.html). The deadlines for the submission of proposals and the registration of shareholders for participation in the General Meeting of Shareholders are also published at this address.

Information of shareholders

The registered shares of the National Bank are traded on the stock market. A total of 53.45% of the shares are held by cantons and cantonal banks; the remaining shares are owned primarily by private individuals (cf. p. 125). The major shareholders at the end of 2004 were the Canton of Berne with 6.6% (6,630 shares), Fritz Aeschbach, Monaco, with 6.3% (6,282 shares), and the Canton of Zurich with 5.2% (5,200 shares). The Confederation is not a shareholder.

Listed registered shares

The National Bank is not structured as a group.

4 Personnel, resources and bank management

4.1 Human resources

Number of employees and turnover

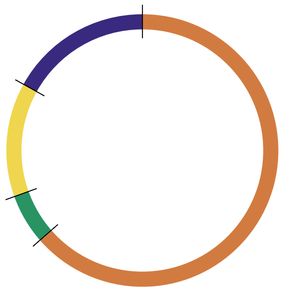
At the end of 2004, the National Bank's staff numbered 656 persons (including 22 apprentices). It thus exceeded the previous year's level by four persons (including two apprentices). Converted into full-time equivalent jobs, the number of employees rose from 607.9 to 611.3. The number of part-time employees decreased by 4 to 150, corresponding to a part-time rate of 22.9%. Personnel turnover was up from 3.9% a year earlier to 4.9%. This was mainly the result of 20 jobs being relocated from Berne to Zurich.

Recruitment of foreign nationals

With the entry into force of the new National Bank Act (NBA), it became possible for the first time to recruit staff from abroad. In particular, the National Bank now has the opportunity to hire highly qualified foreign specialists. However, positions on the Enlarged Governing Board can still only be occupied by Swiss citizens.

Management

In mid-2004, new management principles were introduced in the National Bank. Applied bank-wide, they form the basis for conscious management decisions and for the methodical further development of the corresponding skills within the SNB. Moreover, basic management training was made compulsory for prospective managerial staff, as were systematic advanced management courses for experienced executives.



Human Resources
Number of employees

Full-time, men 417

Part-time, men 39

Full-time, women 89

Part-time, women 111

Total: 656
End of 2004

4.2 Resources

Planning and budgeting process

The National Bank revised its planning and budgeting process in 2004. Thanks to the new planning process, which links the elements of strategy, planning and budget, the operational management of the SNB has been enhanced to optimally suit the respective organisational function. Strategic principles describe the development guidelines, forming a bank-wide strategy. New regulations on the delegation of responsibilities and on budget authority were introduced. Furthermore, the establishment of the new bodies responsible for the operational management – i.e. the Enlarged Governing Board and the Board of Deputies – has strengthened the management coordination.

Property management

The National Bank holds real estate for operational requirements only, rather than for investment purposes.

The two renovation projects at the Zurich head office have progressed according to plan and within budget, and quality standards were complied with. In the main building at Börsenstrasse 15, the second phase – the renovation of the cashier's office, the security gate and the mezzanine floor – was concluded, and operations there were started in November. The construction preparations for the third and final phase, the conversion of the three office floors, has progressed to such a stage that work can be commenced in the second quarter of 2005. The comprehensive renovation of the premises at Nüschelerstrasse 22 began at the end of June. The premises should be ready for occupation in May 2005. Planning of the related large-scale relocation of offices at the Zurich head office is under way.

Environmental management: target period for 2003–2008

The environmental performance evaluation published in the 2004 reporting year is the first assessment in the new target period covering 2003–2008. The National Bank's impact on the environment (measured in eco indicator points) was slightly higher overall in 2003. This was primarily due to the increase in air travel caused by the growing internationalisation of the National Bank's activities. The demolition waste resulting from the renovation work at the main building in Zurich, too, temporarily contributed to the higher impact on the environment. Electricity consumption, by contrast, was reduced by 2%, heat consumption by 15% and water consumption by 14%. In an external audit carried out for the first time, the auditing company gave the National Bank good marks for meeting the targets set in the ecological charter.

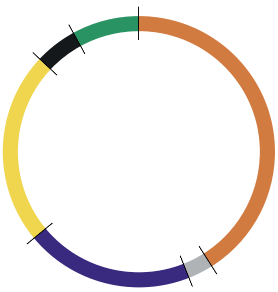
Developments in information technology

In the period under review, the IT infrastructure, which has been comprehensively updated in recent years, and the new applications continued to be consolidated and gradually enhanced. The entire central application for foreign currency investments was replaced. In document management, the focus was on electronic solutions. Measures to ensure secure and reliable operations of the IT systems continued to absorb a substantial proportion of the available IT resources. Preparations were initiated for enhancing the technical facilities for secure communication (telephony, firewalls) with external parties.

Stable shares of costs

The bulk of the National Bank's total operating costs were incurred by the position *cash transactions* (41%). These include the costs of producing banknotes and the costs arising in connection with banknote and coin circulation. The costs relating to *cashless payment transactions* remained stable year-on-year at 3% of total operating costs. This position includes the services of the National Bank in interbank payment transactions and in the field of payment transactions on behalf of other central banks and international organisations.

The position *asset management,* which comprises the costs relating to foreign exchange, money market, securities, gold and Lombard business, and the management of financial investments and gold holdings, declined slightly, amounting to 20% of total operating costs. The item *monetary policy,* which includes the costs involved in planning and formulating monetary policy as well as the costs for compiling statistics, rose slightly year-on-year to account for a 23% share. *Services for the Confederation* and *services for third parties* both remained unchanged from the previous year at 5% and 8% of total costs respectively. *Services for third parties* comprise the SNB's contribution to the Study Center Gerzensee, expenses for international cooperation (notably with the IMF) and technical assistance to foreign central banks.



Cost units
In percent

Cash transactions 41

Cashless payment transactions 3

Asset management 20

Monetary policy 23

Services
for the Confederation 5

Services
for third parties 8

4.3 Bank authorities, Regional Economic Councils and management

Reorganisation of bodies

In connection with the reorganisation of the bodies under the new NBA, i.e. the termination of their mandates, all members of the Bank Council, the Local Committees and the Auditing Committee retired from their functions with effect from the date of the General Meeting of Shareholders on 30 April 2004. The National Bank thanks all of them for their – in some cases long-standing – valuable services.

Pursuant to arts. 39, 42 and 47 of the new NBA, the Bank Council is now composed of eleven members; the president, the vice-president and four other members are appointed by the Federal Council, while five members are elected by the Shareholders' Meeting. The Local Committee as a statutory body was abolished; the Bank Council appoints Regional Economic Councils, which are, however, not statutory bodies. Instead of electing the Auditing Committee, the General Meeting of Shareholders must appoint an Audit Board on an annual basis.

Bank Council

On 11 February and 30 April 2004 respectively, the Federal Council and the General Meeting of Shareholders elected the persons listed on p. 138 to the Bank Council. The following persons were elected for the first time:

Konrad Hummler, Teufen, Managing Partner of Wegelin & Co., Private Bankers

Marina Masoni, Lugano, Member of the Cantonal Government and Head of the Department of Finance and Economic Affairs of the Canton of Ticino

Fritz Studer, Meggen

Eveline Widmer-Schlumpf, Felsberg, Member of the Cantonal Government and Head of the Finance and Military Department of the Canton of Graubünden

Audit Board

The General Meeting of Shareholders on 30 April 2004 elected PricewaterhouseCoopers AG, Zurich, as the Audit Board for the 2004/2005 term of office.

Proposal to the General Meeting of Shareholders

The Bank Council proposes to the General Meeting of Shareholders on 29 April 2005 that PricewaterhouseCoopers AG, Zurich, be reelected.

The composition of the Bank Council remains unchanged.

Regional Economic Councils

On 3 December 2004, the Bank Council decided to rename the economic regions of the National Bank with effect from 1 January 2005 as follows:

Former name	New name
Basel Region	Region Northwestern Switzerland
Berne Region	Region Mittelland
Geneva Region	Region Geneva
Lausanne Region	Region Vaud-Valais
Lugano Region	Region Ticino
Lucerne Region	Region Central Switzerland
St Gallen Region	Region Eastern Switzerland
Zurich Region	Region Zurich

With effect from the date of the General Meeting of Shareholders on 29 April 2005, the following members will resign from their positions:

Willy Egeli, Chairman of the Regional Economic Council Eastern Switzerland
Silvia Huber-Meier, Chairwoman of the Regional Economic Council Zurich
Rolf Mehr, Chairman of the Regional Economic Council Vaud-Valais

The National Bank thanks them for their services.

On 14 May 2004, the Bank Council appointed those members of the former Local Committees who stood for election to the corresponding Regional Economic Councils (cf. list on p. 140). On 14 May and 3 December 2004, it supplemented and enlarged several of the Regional Economic Councils by making the following appointments:

Northwestern Switzerland

Hans Büttiker, Dornach, CEO of EBM (as of 14 May 2004)
Matthys Dolder, Bienne-Benken, CEO of Dolder AG (as of 14 May 2004)
Gabriele Gabrielli, Möriken, Member of the Executive Committee of ABB Switzerland Ltd (as of the Shareholders' Meeting on 29 April 2005)

Central Switzerland

Xaver Sigrist, Lucerne, President and CEO of Anliker AG Bauunternehmung (as of 14 May 2004)
David Dean, Volketswil, CEO of Bossard AG (as of the Shareholders' Meeting on 29 April 2005)

Mittelland

André Haemmerli, La Chaux-de-Fonds, General Manager of Johnson & Johnson (as of the Shareholders' Meeting on 29 April 2005)

Eastern Switzerland

Christoph Leemann, St Gallen, Chairman and CEO of Union Holding AG (as of the Shareholders' Meeting on 29 April 2005)
Eliano Ramelli, Trogen, Partner and Vice-President of the Board of Directors of Abacus Research AG (as of the Shareholders' Meeting on 29 April 2005)

Vaud-Valais

Jean-Jacques Miauton, Epalinges, CEO of Gétaz Romang Holding SA (as of the Shareholders' Meeting on 29 April 2005)

Zurich

Milan Prenosil, Kilchberg, Chairman of the Board of Confiserie Sprüngli AG (as of the Shareholders' Meeting on 29 April 2005)

At the end of June 2004,
Erich Spörndli, Director, Deputy Head of Department III, retired. For 15 years, he served the National Bank with his expertise and provided significant contributions to the SNB, first as Head of Economic Studies and later as Head of Monetary Operations. We thank him for his commitment.

Upon proposal of the Bank Council, the Federal Council appointed
Thomas J. Jordan, former Head of Research in Department I, as his successor as of 1 July 2004.

On 30 June 2004,
Peter Klauser relinquished his function as Deputy Head of Department I. He will continue to carry out his duties as Head of Legal and Administrative Affairs. With his decision, Peter Klauser freed the way for the introduction of the new management structure, which provides for only one deputy head in each Department as stipulated in the new Organisation Regulations approved by the Federal Council on 23 June 2004. The Governing Board thanks Mr Klauser for his decision.

The Bank Council elected
Hans Peter Biland as Director and Head of Information Technology with effect from 1 February and 1 April 2005 respectively.

5 Business performance

5.1 Financial result

Summary

The annual result of the Swiss National Bank was shaped by the write-back of the provisions for the assignment of free assets in the amount of CHF 21,113 million. Not including this one-off transaction, the annual result amounted to CHF 500 million. This result, which fell significantly short of the year-earlier figure, was mainly due to lower foreign exchange rates and the lower price of gold. These developments led to significant valuation losses on gold holdings and foreign currency investments. After the allocation to provisions for currency reserves, a distributable annual profit of CHF 20,728 million resulted.

The profit distribution for 2004 totals CHF 24,015 million and thus clearly surpasses the distributable annual profit. The shortfall is offset by non-distributed profits from previous years. This reduces the distribution reserve by a total of CHF 3,287 million to CHF 6,948 million.

Gold price on the decrease

The net result from gold depends primarily on the development of the price of gold. At the beginning of the year, the gold price stood at almost CHF 16,600 per kilogram. Following its year's peak of CHF 17,500 per kilogram in mid-April, a trend reversal set in during the second quarter, lasting until mid-June. Subsequently, the gold price rose again steadily until the end of 2004, but it did not reach the level seen at the beginning of the year. The price decline of approximately CHF 640 per kilogram resulted in a loss of CHF 901 million.

Declining interest rate level abroad

The net result from foreign currency investments hinges on current interest earnings, exchange rate developments in the investment currencies and changes in the market price of investment instruments. Interest rates in the markets in which the National Bank invests fell slightly until the beginning of April. This trend was reversed by a substantial rise in the interest rate level lasting until the end of June. The second half of the year was marked by another decline in interest rates in all investment currencies. At the end of 2004, interest rates in all currencies – with the exception of the US dollar and the Canadian dollar – were somewhat lower than at the beginning of the year. These developments resulted mostly in capital gains for the National Bank. Interest income and capital gains totalled CHF 3,204 million.

The foreign exchange rates of significance to the National Bank declined during the financial year. The decreases were moderate with the exception of the US dollar. During the first nine months, the greenback hovered around the CHF 1.26 mark before depreciating sharply in the last quarter, losing roughly 10% of its value compared with the beginning of the year. Foreign exchange rate movements resulted in a CHF 1,990 million loss for the National Bank. The income from foreign currency investments amounted to CHF 1,191 million in total.

Weaker foreign exchange rates

The interest rates in the Swiss capital market developed similarly to those in the foreign markets. The interest rate decline in the first quarter was followed by an increase in the second quarter. In the second half of the year, the downward trend set in again. The interest rate level fell slightly year-on-year. The corresponding capital gains were modest. The net result from Swiss franc investments to the amount of CHF 304 million is thus largely made up of the interest income from securities and repo transactions in Swiss francs.

Decline in Swiss franc interest rates

Operating expenses comprise general overheads, personnel and banknote expenses, and depreciation on tangible assets. At CHF 214 million, operating expenses were 4% lower than a year earlier.

Slightly lower operating expenses

On 16 December 2004, the Council of States decided – for the second time – not to consider the Federal Council's bill on the appropriation of the surplus gold reserves. It was thus obvious that there could be no parliamentary majority to support an appropriation formula for the surplus gold that deviates from the applicable constitutional provision (cf. pp. 73–74). The Council of States clearly stated that it expects the gold reserves no longer required by the National Bank to be distributed as profit based on the applicable legal provisions. It was to be assumed, therefore, that another gold appropriation bill from the Federal Council would be just as unsuccessful in gaining the support of a majority in Parliament. This assessment was confirmed on 2 February 2005, when the Federal Council decided that the gold assets with the countervalue of 1,300 tonnes of gold would be distributed to the Confederation (one-third) and the cantons (two-thirds). With this decision, the Council of States' non-consideration of December 2004 became effective.

Write-back of the provisions for the assignment of free assets

Consequently, there is no basis for further retaining the free assets with a view to assigning them to a third party. The existing law, which stipulates that the earnings not required to build up currency reserves are to be distributed as profit (art. 30 para. 2 NBA), must be applied. The Bank Council and the Governing Board are of the opinion that it is not justified to maintain the former provisions for the assignment of free assets. The provisions for the assignment of free assets, consisting of the proceeds from gold sales realised to date, the market value of the as yet unsold portion of gold and the net result from hedging transactions for the sales proceeds in US dollars, were written back in the income statement at the end of 2004.

Annual result

Prior to the increase in provisions which are stipulated in the National Bank Act, the annual result was CHF 21,613 million.

5.2 Provisions prescribed in the National Bank Act

Purpose

The National Bank does not distribute its entire annual result, as it is obliged by the NBA to set aside provisions from its earnings surplus to build up currency reserves. These reserves allow the National Bank to intervene in the market should the Swiss franc become excessively weak. The currency reserves also make Switzerland's economy less vulnerable to international crises and thereby engender confidence in the Swiss franc. The need for foreign exchange reserves is growing in tandem with the size and international integration of the Swiss economy.

Moreover, the provisions for currency reserves have a general reserve function and cover the market, credit and liquidity risks to which the National Bank's assets are exposed.

Targeted level

In accordance with art. 30 para. 1 NBA and the profit distribution agreement of 5 April 2002, the provisions formed on the liabilities side of the balance sheet for the purpose of building up currency reserves are increased in step with the growth of nominal gross domestic product (GDP). The targeted percentage rise is based on the average GDP growth over the past five years. This avoids the need for subsequent corrections and prevents large fluctuations from year to year.

Development of targeted level

	Growth in nominal GDP[1] In percent (average period)[2]	Annual allocation CHF millions	New targeted level[3] CHF millions
2000	2.0 (1994–1998)	522.7	26 655.4
2001	2.6 (1995–1999)	682.4	27 337.8
2002	3.3 (1996–2000)	902.1	28 239.9
2003	2.3 (1997–2001)	829.3	36 886.7[4]
2004	2.4 (1998–2002)	885.3	37 841.0[5]
2005	2.1 (1999–2003)	794.7	38 635.7

1 Until 2002: nominal gross national product (GNP).

2 The data is revised on a continuous basis. The growth rates shown in the table thus differ slightly from the latest available data.

3 After the allocation of the reporting year.

4 Including CHF 7,817.5 million from the integration of the provisions for market and liquidity risks on gold on 1 January 2003 (cf. 96th Annual Report 2003, pp. 105–106).

5 Including CHF 69.0 million from the transfer of the reserve fund on 1 May 2004 pursuant to art. 57 para. 2 NBA.

Reporting of provisions in the previous balance sheet

Previously, these provisions were covered by two balance sheet positions, i.e. provisions for market, credit and liquidity risks and provisions for operating risks. In order to achieve a steady flow of payments, profit was distributed by means of the provisions for market, credit and liquidity risks, which therefore also included the surplus provisions for future profit distributions. Any changes in the provisions were shown in the income statement.

Reporting of provisions in the new balance sheet

With the entry into force of the new NBA on 1 May 2004 and two new guidelines of Swiss GAAP FER (Generally Accepted Accounting Principles issued by the Foundation for Accounting and Reporting Recommendations), the reporting method for the provisions shown in the National Bank's Financial Report was revised. The two provision items used to build up adequate currency reserves were merged and renamed *provisions for currency reserves.* This new name was chosen to express the purpose of these provisions, which is to ensure the growth of the currency reserves on the assets side. The surplus provisions for future profit distributions were transferred to a distribution reserve. Consequently, the provisions for currency reserves now correspond to the targeted level. Both the allocation to the provisions for currency reserves and the changes in the distribution reserve are now shown in the appropriation of profit. The restatement (cf. pp. 107–109) provides more detailed information.

Allocation from the 2004 annual result

This year's increase in the targeted level of provisions amounts to CHF 885 million in accordance with the average growth in GDP during the 1998–2002 period, which was 2.4% in nominal terms. The allocation from the 2004 annual result is made as part of the profit appropriation and must be approved by the General Meeting of Shareholders.

Distributable annual profit

Pursuant to art. 30 para. 2 NBA, the distributable annual profit corresponds to the earnings remaining after the provisions for currency reserves are set aside. After the allocation to the provisions, a distributable annual profit of CHF 20,728 million resulted for 2004.

5.3 Profit distribution

Profit distribution agreements

The National Bank's profit distribution is laid down in art. 31 NBA. Since the 2003 financial year, the amount of the annual profit distribution to the Confederation and the cantons has been determined by two agreements concluded between the National Bank and the Federal Department of Finance. In the 2004 financial year, the special agreement on the distribution of the proceeds from the sale of 1,300 tonnes of gold applies in addition.

Main agreement

The main agreement on the distribution of profit concluded on 5 April 2002 stipulated that – in order to achieve a steady flow of payments in the medium term – distributions to the Confederation and the cantons would be fixed at CHF 2.5 billion per year for the period 2003–2012 on the basis of an earnings forecast. This agreement relates to the current profits earned by the National Bank on its monetary assets and to the reduction in surplus provisions.

Supplementary agreement

The supplementary agreement concluded on 12 June 2003 mainly relates to the income accruing on the National Bank's free assets. According to this agreement, the National Bank has – since spring 2004 and until such time as different legislation enters into force – distributed one-third of this income to the Confederation and two-thirds to the cantons. As the gold sales progress, the annual distribution will grow from CHF 300 million in spring 2004 to CHF 400 million in spring 2005. Under the agreement on the distribution of the proceeds from the sale of 1,300 tonnes of gold, this supplementary agreement will become null and void following the distribution of CHF 400 million for the 2004 financial year.

Agreement on the distribution of the gold proceeds

The agreement concluded on 25 February 2005 concerns the distribution of the countervalue of the 1,300 tonnes of gold no longer required for monetary policy purposes. The amount of the one-off distribution corresponds to the proceeds from the sale of 1,235.9 tonnes of gold, the market value of the as yet unsold 64.1 tonnes of gold and the net result from hedging transactions for the sales proceeds in US dollars as at 31 December 2004. The distributable amount totals CHF 21,113.2 million.

2004 profit distribution

The profit distribution for the 2004 financial year will total CHF 24.0 billion: CHF 21.1 billion will be distributed under the special agreement on the distribution of the proceeds from the sale of 1,300 tonnes of gold, CHF 2.5 billion under the 2002 main agreement, and CHF 0.4 billion according to the 2003 supplementary agreement on the distribution of income on free assets. Dividend payments amount to CHF 1.5 million.

Distribution reserve

For the payment of this year's profit distribution, CHF 3.3 billion must be drawn from the distribution reserve, which is thus reduced to CHF 6.9 billion.

Development of profit distribution and distribution reserve

	Residual surplus prior to distribution CHF millions	Profit distribution CHF millions	Residual surplus for future distributions CHF millions
2000	14 205.1	1 500.0	12 705.1
2001	14 881.0	1 500.0	13 381.0
2002	13 240.4	2 500.0	10 740.4
2003	13 047.0	2 800.0	10 247.0[1]

	Distribution reserve prior to distribution CHF millions	Distributable annual profit CHF millions	Profit distribution CHF millions	Distribution reserve after distribution CHF millions
2004	10 235.5[1]	20 727.6	24 014.7	6 948.4

1 Cf. transfer of the residual surplus for future distributions to the distribution reserve, p. 126, Item no. 26.

5.4 Share capital and reserve fund

Reduction of the share capital

With the entry into force of the new NBA, the share capital was reduced to the paid-up amount and the reserve fund was liquidated.

Previously, the share capital amounted to CHF 50 million, only half of which was paid up, however. Given today's balance sheet total and considerable provisions, the share capital no longer carries any economic significance. When the new NBA came into force, the share capital was thus reduced to the paid-up amount of CHF 25 million and the non-paid-up amount was waived. As a consequence, the nominal value of one (now fully paid-up) share was lowered to CHF 250.

Liquidation of the reserve fund

The reserve fund created under the previous NBA served to cover any capital stock losses. Each year, CHF 1 million was added to the reserve fund. After the profit appropriation of the 2003 financial year, the fund had totalled CHF 69 million (cf. pp. 98–99). With the entry into force of the new NBA, the reserve fund was transferred to the provisions prescribed in the Act (pursuant to art. 57 para. 2 NBA).

Financial Report

1 Income statement and appropriation of profit for 2004

In CHF millions

	Item no. in Notes	2004	2003	Change
Net result from gold	01	–900.7	2 615.1	–3 515.8
Net result from foreign currency investments	02	1 191.2	1 526.3	–335.1
Net result from Swiss franc investments	03	304.4	125.2	+179.2
Net result from other assets	04	22.4	14.3	+8.1
Gross income		**617.3**	**4 280.9**	**–3 663.6**
Banknote expenses		–41.8	–45.2	+3.4
Personnel expenses	05, 06	–99.7	–98.4	–1.3
General overheads	07	–45.6	–55.3	+9.6
Depreciation on tangible assets	15	–26.6	–25.1	–1.5
Net income		**403.6**	**4 057.0**	**–3 653.4**
Allocated to (–)/released from (+) provisions for the assignment of free assets		96.0	–912.4	+1 008.4
Write-back of the provisions for the assignment of free assets		21 113.2	–	+21 113.2
Annual result		**21 612.9**	**3 144.6**	**+18 468.3**
Allocation to provisions for currency reserves		–885.3	–829.3	–56.0
Distributable annual profit		**20 727.6**	**2 315.3**	**+18 412.3**
Allocated to (–)/released from (+) the distribution reserve		3 287.1	493.0	+2 794.2
Total distribution of profit		**24 014.7**	**2 808.3**	**+21 206.4**
of which				
Payment of a dividend of 6%		1.5	1.5	–
Additional appropriations of profit under the former NBA			6.8	–6.8
Ordinary distribution of profit to the Confederation and to the cantons (Agreement of 5 April 2002)		2 500.0	2 500.0	–
Supplementary distribution to the Confederation and to the cantons (Agreement of 12 June 2003)		400.0	300.0	+100.0
Distribution of the proceeds from the sale of 1,300 tonnes of gold (Agreement of 25 February 2005)		21 113.2		+21 113.2

2 Balance sheet as at 31 December 2004

In CHF millions

Assets	Item no. in Notes	31.12.2004	31.12.2003	Change
Gold holdings	08	19 485.8	23 217.3	–3 731.5
Claims from gold transactions	09	2 153.4	3 910.7	–1 757.3
Foreign currency investments	10, 31	60 708.0	56 311.7	+4 396.3
Reserve position in the IMF	11	2 035.1	2 561.9	–526.8
International payment instruments	29	80.1	45.8	+34.3
Monetary assistance loans	12, 29	291.3	327.2	–35.9
Claims from repo transactions in Swiss francs	28	24 502.7	27 097.7	–2 594.9
Lombard advances	28	6.6	0.8	+5.8
Claims against domestic correspondents		11.8	36.8	–25.0
Swiss franc securities	13	7 393.6	7 657.9	–264.3
Banknote stocks	14	144.0	147.0	–3.0
Tangible assets	15	393.3	385.3	+8.0
Participations	16, 30	96.7	88.6	+8.1
Sundry assets	17, 32	606.3	983.9	–377.6
Non-paid-up share capital	25	–	25.0	–25.0
		117 908.8	122 797.7	–4 888.9

Liabilities	Item no. in Notes	31.12.2004	31.12.2003	Change
Banknotes in circulation	18	39 719.3	40 544.0	–824.7
Sight deposits of domestic banks		6 541.7	7 186.6	–644.9
Liabilities towards the Confederation	19	2 154.8	2 853.1	–698.3
Sight deposits of foreign banks and institutions		329.4	486.0	–156.6
Other sight liabilities	20	165.0	153.4	+11.6
Liabilities from Swiss franc repo transactions		–	–	–
Foreign currency liabilities	21	0.5	130.5	–129.9
Sundry liabilities	22, 32	160.9	174.8	–13.9
Provisions for the assignment of free assets	23	–	21 209.3	–21 209.3
Provisions for operating risks	24	8.1	11.5	–3.4
Provisions for currency reserves		36 955.7	36 057.4	+898.3
Share capital	25	25.0	50.0	–25.0
Reserve fund		–	68.0	–68.0
Distribution reserve	26	10 235.5	10 728.5	–493.0
Annual result[1]		21 612.9	3 144.6	+18 468.3
		117 908.8	122 797.7	–4 888.9

1 Before allocation to provisions for currency reserves.

3 Changes in equity capital

In CHF millions

	Share capital	Non-paid-up share capital
Equity capital as at 1 January 2003	**50.0**	**–25.0**
Result from change in accounting principles[1]		
Equity capital as at 1 January 2003 (after restatement)	**50.0**	**–25.0**
Endowment of provisions for currency reserves pursuant to the NBA		
Released from distribution reserve		
Allocation to reserve fund		
Distribution of dividends to the shareholders		
Per capita distribution to the cantons		
Profit distribution to the Confederation and to the cantons		
Annual result of the year under review		
Equity capital as at 31 December 2003 (before appropriation of profit)	**50.0**	**–25.0**
Equity capital as at 1 January 2004	**50.0**	**–25.0**
Endowment of provisions for currency reserves pursuant to the NBA		
Released from distribution reserve		
Allocation to reserve fund		
Distribution of dividends to the shareholders		
Per capita distribution to the cantons		
Profit distribution to the Confederation and to the cantons		
Reduction of nominal value	–25.0	25.0
Liquidation of reserve fund		
Annual result of the year under review		
Equity capital as at 31 December 2004 (after appropriation of profit)	**25.0**	**–**
Proposed appropriation of profit		
Endowment of provisions for currency reserves pursuant to the NBA		
Released from distribution reserve		
Distribution of dividends to the shareholders		
Profit distribution to the Confederation and to the cantons		
Distribution of the proceeds from the sale of 1,300 tonnes of gold		
Equity capital after appropriation of profit	**25.0**	**–**

1 Cf. pp. 107–109.

Reserve fund	Provisions for currency reserves	Distribution reserve	Annual result (net profit)	Total
67.0	**–**	**–**	**2 508.7**	**2 600.7**
	35 155.3	12 967.1	–1 336.5	46 785.9
67.0	**35 155.3**	**12 967.1**	**1 172.2**	**49 386.6**
	902.1		–902.1	
		–2 238.6	2 238.6	
1.0			–1.0	
			–1.5	–1.5
			–6.2	–6.2
			–2 500.0	–2 500.0
			3 144.6	3 144.6
68.0	**36 057.4**	**10 728.5**	**3 144.6**	**50 023.5**
68.0	**36 057.4**	**10 728.5**	**3 144.6**	**50 023.5**
	829.3		–829.3	
		–493.0	493.0	
1.0			–1.0	
			–1.5	–1.5
			–5.8	–5.8
			–2 800.0	–2 800.0
–69.0	69.0			
			+21 612.9	+21 612.9
–	**36 955.7**	**10 235.5**	**21 612.9**	**68 829.1**
	885.3		–885.3	
		–3 287.1	+3 287.1	
			–1.5	–1.5
			–2 900.0	–2 900.0
			–21 113.2	–21 113.2
–	**37 841.0**	**6 948.4**	**–**	**44 814.4**

4 Notes to the accounts as at 31 December 2004

4.1 Accounting and valuation principles

General

General principles

The present Financial Report has been drawn up in accordance with the provisions of the National Bank Act (NBA), the Swiss Code of Obligations (SCO) and – with due account being taken of circumstances specific to the National Bank – in compliance with the Swiss GAAP FER accounting principles. The Financial Report gives a true and fair view of the financial position, the results of operations and the cash flows in accordance with the Swiss GAAP FER.

As a company listed in the main segment of the Swiss stock exchange SWX, the National Bank would be obliged to present its accounts in accordance with the International Financial Reporting Standards (IFRS). Citing art. 27 NBA, the National Bank requested to be exempted from this obligation. By letter of 5 November 2004, the SWX granted the exempt status.

Changes from previous year

Reporting and allocation of the provisions defined in the NBA were adjusted upon entry into force of the new NBA and the first-time application of the Swiss GAAP FER 23 (provisions) and 24 (equity capital). In so doing, the names of the provisions were changed as well. These adjustments were made to take effect retroactively as of 1 January 2003 and are shown in the restatement (cf. pp. 107–109).

The income statement was streamlined by combining several positions previously shown separately. In addition, two positions were reallocated. *Interest expenses* – previously a separate item – are now included in the *net result from foreign currency investments* and in the *net result from Swiss franc investments,* respectively. *Commission expenses,* which were previously included in *general overheads,* have been reallocated to *net results from other assets,* i.e. *net result from foreign currency investments* and *net result from Swiss franc investments.*

Cash flow statement

The National Bank does not prepare a cash flow statement. Since the National Bank can autonomously create money as a central bank, such a statement is not meaningful.

Interim reporting

The National Bank has so far not published interim results. As from the 2005 financial year, it shall publish quarterly results.

Segment information

The National Bank operates exclusively as a central bank. For this reason, the Financial Report does not include any segment information.

Consolidated financial report

The National Bank does not hold any participating material interests which are subject to consolidation according to FER 2. For this reason, the Annual Report does not include a consolidated financial report.

Recording of transactions

All business transactions are recorded on the day the transaction is concluded (trade day accounting). However, they are only posted on the value date. Transactions completed as of the balance-sheet date with a value date in the future are stated under off-balance-sheet business.

Expenses are recognised in the financial year in which they are incurred, and income in the financial year in which it is earned.

Accrual reporting

Pursuant to art. 8 NBA, the National Bank is exempt from profit taxes. Tax exemption applies to both direct federal taxes and cantonal and municipal taxes.

Profit tax

Shareholders of the National Bank have very limited rights; for this reason they cannot exert any influence on financial and operative decisions. No essential transactions are concluded with members of the SNB's executive bodies or the Bank Council.

Transactions with related parties

Balance sheet and income statement

Gold and negotiable financial instruments are stated in the balance sheet at market value or fair value. Tangible assets are stated at their acquisition cost less required depreciation. Other items are stated at their nominal value inclusive of accrued interest. Foreign currency items are translated at year-end rates. Income and expenses in foreign currency are translated at the exchange rates applicable at the time the income/expenses was/were posted to the accounts.

Summary

Physical gold holdings, consisting of gold bars and gold coins, are stored at various locations in Switzerland and abroad. These holdings are stated at market value. Valuation gains and losses are reported in *net result from gold*.

Gold holdings

The management of the National Bank's investment portfolio includes lending a part of its gold holdings to first-class domestic and foreign financial institutions. The National Bank receives interest on the gold loaned. Gold lending transactions are effected on a secured and unsecured basis with maturities of up to five years. Since the gold price risk remains with the National Bank, gold lent is not booked out of the balance sheet, but merely reclassified and stated as *claims from gold transactions*. *Claims from gold transactions* are stated at market value inclusive of accrued interest. The valuation result and interest are stated in *net result from gold*.

Claims from gold transactions

In *foreign currency investments,* negotiable securities (money market paper and bonds) and assets (sight deposit accounts, call money, time deposits and repos) are denominated in foreign currency. Securities, which make up the bulk of the foreign currency investments, are stated at market value inclusive of accrued interest. The assets are stated at their nominal value inclusive of accrued interest. Gains and losses from revaluation at market value, interest earnings and exchange rate gains and losses are stated in *net result from foreign currency investments*.

Foreign currency investments

Securities lending

Securities lending transactions are concluded as part of the management of foreign currency investments. The SNB loans securities from its own portfolio and, in exchange for collateral securities, it receives interest on the securities loaned. Loaned securities remain in the *foreign currency investments* position and are disclosed in the notes to the accounts. Interest income from securities lending is stated in *net result from foreign currency investments.* The National Bank does not engage in securities borrowing.

Reserve position in the IMF

The reserve position in the International Monetary Fund (IMF) comprises the Swiss quota less the IMF's sight balances at the National Bank. The quota is Switzerland's portion of the IMF capital financed by the National Bank. It is held in the form of Special Drawing Rights (SDRs), which are the IMF's currency. A part of the quota was not transferred to the IMF, but paid into a sight deposit account. The IMF can dispose of these assets for its transactions at any time. The income from interest on the reserve position as well as the exchange rate gains and losses from revaluation of the Special Drawing Rights are stated in *net result from foreign currency investments.*

International payment instruments

Claims from two-way arrangements with the IMF are stated in *international payment instruments.* The National Bank has committed itself to purchase up to SDR 400 million against foreign currency. These sight deposits attract interest at market conditions. Interest earnings and exchange rate gains and losses are stated in *net result from foreign currency investments.*

Monetary assistance loans

In the context of international cooperation, Switzerland may participate in the IMF's internationally coordinated balance-of-payments aid in the form of a credit tranche or by granting bilateral monetary assistance loans to countries with balance-of-payments problems. In addition to one bilateral monetary assistance loan, currently outstanding claims include those under the Poverty Reduction and Growth Facility (PRGF). The latter is a fiduciary fund administered by the IMF which finances long-term loans at reduced interest rates to poor developing countries. The Confederation guarantees the interest and principal repayments both on the bilateral loans and on Switzerland's participation in the PRGF credit account. These loans are stated at their nominal value inclusive of accrued interest. Interest earnings and exchange rate gains and losses are stated in *net result from foreign currency investments.*

Claims and liabilities from repo transactions in Swiss francs

Repo transactions in Swiss francs are the National Bank's major monetary policy instrument. Repo transactions are used to provide the banking system with liquidity or to withdraw liquidity from it. Claims from repo transactions are fully backed by securities from the SNB General Collateral Basket. Claims and liabilities from repo transactions are stated at their nominal value inclusive of accrued interest. Interest earnings and expenses are stated in *net result from Swiss franc investments.*

Lombard advances

Lombard loans are used by the banks to bridge unforeseeable liquidity shortfalls in the short term. These claims attract interest at the call money rate plus 200 basis points. They are stated at their nominal value inclusive of accrued interest. Interest earnings are stated in *net result from Swiss franc investments.*

Claims against domestic correspondents

Domestic correspondents perform local cash redistribution transactions and cover the cash requirements of federal agencies and enterprises associated with the Federal Government (Swiss Post and Swiss Federal Railways). This results in short-term claims of the National Bank which attract interest at the call money rate. They are stated at their nominal value inclusive of accrued interest. Interest earnings are stated in *net result from Swiss franc investments.*

Swiss franc securities

Swiss franc securities are made up exclusively of negotiable bonds. They are stated at their nominal value inclusive of accrued interest. Valuation gains/losses and interest earnings are stated in *net result from Swiss franc investments.*

Banknote stocks

Freshly printed banknotes which have never been put into circulation are capitalised at their acquisition cost and stated in *banknote stocks.* At the time a banknote first enters into circulation, its acquisition cost is charged to *banknote expenses.*

Tangible assets

Tangible assets comprise real estate (including land), conversions, immovables under construction, and sundry tangible assets. Software, as the only intangible asset, is also included in tangible assets. For materiality reasons, intangible assets are not shown separately in the balance sheet, but are only disclosed in the notes to the accounts. Day-to-day maintenance expenses for real estate and sundry tangible assets are stated in *general overheads.* Investments of less than CHF 1,000 are also charged directly to *general overheads.* Tangible assets are stated at their acquisition cost less required depreciation and value adjustments. Depreciation is always carried out on a straight-line basis. Profits and losses from the sale of tangible assets are stated in *net results from other assets.*

Participations

Minority interests in excess of 20% qualify as an associated company and are valued according to the equity method. The remaining minority interests in companies in which the National Bank exercises no material influence or non-essential majority interests are valued at acquisition cost less required value adjustments. The entire income from participations is stated in *net results from other assets.*

Derivative financial instruments

The National Bank uses foreign currency forward transactions, futures and interest rate swaps to manage its currency reserves and free assets. All derivative financial instruments are stated at fair value. Market values are applied, if available. If no market values are available, fair value is established in accordance with recognised financial mathematical methods. Valuation changes are recorded in the income statement and shown in *net result from foreign currency investments*. Unrealised gains and losses (gross replacement values) are stated in *sundry assets* or *sundry liabilities*.

Accrued expenses and deferred income

The National Bank does not state accrued expenses and deferred income as separate positions in its balance sheet. For materiality reasons, they are reported in *sundry assets* or *sundry liabilities* and are disclosed in the notes to the accounts.

Banknotes in circulation

The position *banknotes in circulation* shows the nominal value of all banknotes held by the public and by the banks, including recalled, still exchangeable notes from previous series.

Sight deposits of domestic banks

Sight deposits of domestic banks in Swiss francs form the basis on which the National Bank controls monetary policy. They also facilitate cashless payments within Switzerland. These sight deposits are non-interest-bearing accounts which are stated at their nominal value.

Liabilities towards the Confederation

The National Bank holds a sight deposit account for the Confederation which bears interest at the call money rate for amounts up to a maximum of CHF 600 million. Moreover, the Confederation may place time deposits with the National Bank at market rates. The liabilities towards the Confederation are stated at their nominal value inclusive of accrued interest. Interest expenses are recorded in *net result from Swiss franc investments*.

Sight deposits of foreign banks and institutions

The National Bank holds sight deposit accounts for foreign banks and institutions which facilitate payment transactions in Swiss francs. These sight deposits do not bear interest and are stated at their nominal value.

Other sight liabilities

Sight deposits of non-banks, accounts held by active and retired staff members and pension funds of the SNB, as well as liabilities in the form of bank cheques drawn on the National Bank but not yet cashed are stated in *other sight liabilities* at their nominal value inclusive of accrued interest. Interest expenses are stated in *net result from Swiss franc investments*.

Foreign currency liabilities comprise liabilities towards the Confederation and repo transactions related to the management of foreign currency investments. They are stated at their nominal value inclusive of accrued interest. Interest expenses and exchange rate gains and losses are stated in *foreign currency investments*.

Foreign currency liabilities

The provisions for the assignment of free assets reflect the fact that an amount of gold initially totalling 1,300 tonnes is no longer required for monetary purposes. The provisions are based on the proceeds from gold sales, the market value of the as yet unsold gold and the realised results from hedging transactions for the sales proceeds denominated in US dollars.

Provisions for the assignment of free assets

Following the decision of the Council of States and the Federal Council to distribute 1,300 tonnes of gold in accordance with the current law, an assignment to third parties is no longer applicable. For this reason, the provision was written back as at 31 December 2004.

Provisions for operating risks include reorganisation and other provisions pursuant to FER 23. Reorganisation provisions are financial obligations to staff members taking early retirement as a result of reorganisation.

Provisions for operating risks

Art. 30 para. 1 NBA stipulates that the National Bank shall set up provisions permitting it to maintain the currency reserves at a level necessary for monetary policy. In so doing, it shall take into account the development of the Swiss economy. Under the profit distribution agreement of 5 April 2002, the provisions for currency reserves shall expand in step with the growth in nominal gross domestic product. These special law provisions are equity-like in nature and are incorporated in the table "Changes in equity capital". The allocation is made as a part of the profit appropriation.

Provisions for currency reserves

With the exception of the dividend which – pursuant to the NBA – shall not exceed 6%, the Confederation and the cantons are entitled to the total remaining profit after adequate provisions for currency reserves. To achieve a steady flow of payments in the medium term, the profit distributions are fixed in advance in an agreement concluded between the Confederation and the National Bank. The distribution reserve contains the as yet non-distributed profits. The currently valid agreement provides for a continuous reduction of as yet non-distributed profits until 2012.

Distribution reserve

All employees are insured under defined benefit pension plans according to Swiss GAAP FER 16. The National Bank does not activate excess cover. Any shortfall in cover is stated as a liability.

Pension fund

Off-balance-sheet business

Contingent liabilities

Contingent liabilities are obligations entered into as a result of contracts, laws or implied actions. A resultant future outflow of funds is possible, but will probably not materialise. The maximum amount owed from contingent liabilities is stated in the notes under off-balance-sheet business.

Fiduciary business

Fiduciary transactions encompass investments which the National Bank makes in its own name but on the basis of a written contract exclusively for the account and at the risk of the Confederation. These transactions are shown in the notes at market value under off-balance-sheet business.

Irrevocable undertakings

Irrevocable undertakings include credit arrangements the National Bank has granted to the IMF in the context of international cooperation and credit lines for banks in the form of liquidity-shortage financing facilities (Lombard advances and special-rate repos). The maximum of resulting liabilities are stated in the notes under off-balance-sheet business.

4.2 Foreign currency exchange rates and gold price

	31.12.2004 CHF	**31.12.2003** CHF	**Change** In percent
1 US dollar (USD)	1.13	1.24	–8.9
1 euro (EUR)	1.54	1.56	–1.3
1 British pound (GBP)	2.18	2.20	–0.9
100 Danish kroner (DKK)	20.74	20.93	–0.9
1 Canadian dollar (CAD)	0.94	0.96	–2.1
1 Special Drawing Right (SDR)	1.76	1.85	–4.9
1 kilogram of gold	15 939.44	16 580.81	–3.9

4.3 Result from changes in the accounting principles (restatement)

With the entry into force of the new NBA and the two new guidelines Swiss GAAP FER 23 (provisions) and 24 (equity capital), reporting and allocation of the provisions defined in the NBA have been adjusted. This is because these provisions do not meet the criteria defined in Swiss GAAP FER 23 but are equity-like in nature.

Provisions in the previous balance sheet

Provisions stipulated in the NBA, provisions for market, credit and liquidity risks and provisions for general operating risks have so far been recognised as liabilities. The provisions comprised the targeted level, rising in step with gross domestic product, and the surplus which serves to achieve a steady flow of future profit distributions. Any changes in these provisions were shown in the income statement.

Provisions in the new balance sheet

The targeted level is shown as provisions for currency reserves and the surplus provisions have been transferred to the newly set up distribution reserve. Both positions are included in the equity capital. As a result, allocation to provisions for currency reserves is not made in the income statement at year-end but in the profit appropriation in the subsequent spring. The difference between distributable profit and planned distribution of profit is taken to the distribution reserve.

Restatements

The table below is a restatement of the provisions in the balance sheet retroactively as at 1 January 2003. In a first step, the annual result of the 2002 financial year was adjusted for the changes in the provisions shown in the balance sheet. This took into account that changes in provisions are no longer shown in the income statement at year-end but in the appropriation of profits. In a second step, the two provision positions were grouped together and reallocated to provisions for currency reserves and the distribution reserve.

Restatement of provisions and equity capital as at 1 January 2003

	Liabilities Provisions for market, credit and liquidity risks CHF millions	Provisions for operating risks CHF millions	Provisions due to reorganisation CHF millions
Position as at 1 January 2003[1]	**46 335.9**	**461.9**	**–**
Restated annual result			
Restatement of release of provisions for market, credit and liquidity risks affecting the income statement	1 734.5		
Restatement of release of provisions for market and liquidity risks on gold affecting the income statement	–398.0		
Restated provisions			
Transfer of reorganisation provisions		–11.9	11.9
Transfer of provisions for general operating risks	450.0	–450.0	
Transfer of targeted amount to provisions for currency reserves	–35 155.3		
Transfer of surplus provisions to the distribution reserve	–12 967.1		
Position as at 1 January 2003 before appropriation of profit	**–**	**–**	**11.9**
Total effect of change in accounting principles	**–46 335.9**	**–461.9**	**11.9**

1 After transfer of the provisions for market and liquidity risks on gold; cf. 96th Annual Report 2003, p. 106.

Restated net income and annual result for 2003

	2003 before restatement[1] CHF millions	Restatement CHF millions	2003 after restatement[2] CHF millions
Net income	**4 057.0**	**–**	**4 057.0**
Allocated to (–)/released from (+) provisions for			
the assignment of free assets	–912.4		–912.4
market, credit and liquidity risks[3]	–336.3	336.3	–
Annual result	**2 808.3**	**336.3**	**3 144.6**

1 Income statement for 2003, cf. 96th Annual Report, p. 85.

2 Previous year's figures from the income statement in the present Financial Report (cf. p. 95).

3 Adjusted allocation to the provisions specified in the NBA. This allocation is now made as a part of the profit appropriation.

Equity capital						
Share capital	Non-paid-up share capital	Legal reserves	Provisions for currency reserves	Distribution reserve	Annual result (net profit)	Total equity capital
CHF millions	CHF millions	CHF millions	CHF millions	CHF millions	CHF millions	CHF millions
50.0	**–25.0**	**67.0**			**2 508.7**	**2 600.7**
					–1 734.5	
					398.0	
			35 155.3			
				12 967.1		
50.0	**–25.0**	**67.0**	**35 155.3**	**12 967.1**	**1 172.2**	**49 386.6**
–	**–**	**–**	**35 155.3**	**12 967.1**	**–1 336.5**	**–**

4.4 Notes to the income statement and balance sheet

Item no. 01

Net result from gold

Breakdown by type	2004 CHF millions	2003 CHF millions	Change CHF millions
Net result from changes in market value	–927.6	2 248.0	–3 175.6
Interest income from gold lending transactions	22.8	32.9	–10.2
Net result from hedging transactions	4.2	334.2	–330.1
Total	–900.7	2 615.1	–3 515.8

The loss from changes in market value was due to the fall in the gold price by about CHF 640 per kilogram. In the previous year, the sharp rise in the gold price had resulted in large gains in market value.

The lower interest income from gold lending transactions was mainly due to the lower volume of business.

Despite the sharp fall in the US dollar exchange rate, the forward foreign exchange transactions (forward sale of US dollars) used to hedge the USD-denominated gold sale proceeds only yielded a small profit in the year under review. This is because the volume of hedging transactions fell substantially in line with gold sales.

Breakdown by origin	2004 CHF millions	2003 CHF millions	Change CHF millions
Net result from monetary gold	–804.7	1 702.8	–2 507.4
Net result from gold held as free assets	–96.0	912.4	–1 008.4
Total	–900.7	2 615.1	–3 515.8

Item no. 02

Net result from foreign currency investments

Breakdown by type	2004 CHF millions	2003 CHF millions	Change CHF millions
Interest and capital gain/loss	3 203.6	1 746.1	+1 457.5
Interest expenses	–12.5	–7.9	–4.6
Exchange rate gain/loss	–1 989.5	–201.8	–1 787.7
Asset management and safe custody account fees	–10.4	–10.2	–0.2
Total	1 191.2	1 526.3	–335.1

All investment currencies except the US and Canadian dollars saw interest rates fall in the past year. This resulted in capital gains. In the previous year, a rise in interest rates had resulted in capital losses in most of the relevant markets.

Breakdown by origin	**2004** CHF millions	**2003** CHF millions	**Change** CHF millions
Foreign currency investments	1 282.5	1 543.1	–260.6
Reserve position in the IMF	–70.6	–16.3	–54.3
International payment instruments	0.6	6.2	–5.6
Monetary assistance loans	–8.8	1.2	–10.0
Foreign currency liabilities	–12.5	–7.9	–4.6
Total	1 191.2	1 526.3	–335.1

Breakdown by currency	**2004** CHF millions	**2003** CHF millions	**Change** CHF millions
USD	–615.0	–1 528.5	+913.6
EUR	1 575.6	2 650.9	–1 075.2
GBP	156.4	42.6	+113.8
DKK	179.0	239.9	–60.9
CAD	54.1	142.7	–88.6
SDR	–79.1	–11.0	–68.0
Other	–79.9	–10.2	–69.7
Total	1 191.2	1 526.3	–335.1

Exchange rate losses reduced the investment result in all currencies. As in the previous year, these exceeded the result prior to exchange rate effects in the case of US dollars and Special Drawing Rights, thus producing a net loss. In all other currencies, there was a net gain on the investments despite losses on conversion of foreign currency amounts into Swiss francs.

Breakdown of exchange rate gain/loss by currency	2004 CHF millions	2003 CHF millions	Change CHF millions
USD	–1 293.2	–1 877.6	+584.4
EUR	–313.5	1 537.4	–1 850.9
GBP	–157.2	–35.2	–122.0
DKK	–11.2	144.6	–155.7
CAD	–23.7	85.2	–108.9
SDR	–121.2	–56.0	–65.1
Other	–69.5	0.0	–69.6
Total	–1 989.5	–201.8	–1 787.7

Item no. 03

Net result from Swiss franc investments

Breakdown by type	2004 CHF millions	2003 CHF millions	Change CHF millions
Interest and capital gain/loss	327.2	146.8	+180.3
Interest expenses	–19.4	–18.2	–1.3
Trading and safe custody account fees	–3.3	–3.5	+0.2
Total	304.4	125.2	+179.2

Breakdown by origin	2004 CHF millions	2003 CHF millions	Change CHF millions
Swiss franc securities	265.1	101.0	+164.1
Swiss franc repo transactions	58.7	42.1	+16.6
Other assets	0.1	0.3	–0.2
Liabilities towards the Confederation	–13.0	–12.0	–1.0
Other sight liabilities	–6.4	–6.2	–0.3
Total	304.4	125.2	+179.2

Net result from other assets

Item no. 04

	2004 CHF millions	2003 CHF millions	Change CHF millions
Commission income	16.3	18.2	–1.9
Commission expenses	–15.5	–17.8	+2.3
Income from participations	17.1	8.5	+8.6
Income from real estate	3.7	4.6	–0.9
Other ordinary income	0.7	0.8	–0.1
Total	22.4	14.3	+8.1

The commission income and expenses stated here originate from business with third parties. The bulk of these commissions arose from services performed in connection with the National Bank's function as paying agent for new issues, coupon payments and redemptions of Confederation bonds.

Income from real estate stems from the letting of Bank-owned premises not currently used for its own purposes.

Personnel expenses

Item no. 05

	2004 CHF millions	2003 CHF millions	Change CHF millions
Wages, salaries and allowances	78.3	74.0	+4.3
Social insurance	15.4	15.8	–0.4
Other personnel expenses	6.0	8.5	–2.5
Total	99.7	98.4	+1.3

Item no. 06

Employee benefit obligations

All employees are insured under defined benefit pension plans according to Swiss GAAP FER 16. The pension plans comprise two staff pension fund schemes. Both the SNB and its employees contribute to the schemes. Employees contribute 8% of their insured salary and the SNB 16%.

Pension benefits are calculated annually by an independent insurance expert in accordance with the projected unit credit method, which is based on the insured salary most recently paid. Insured benefits comprise the retirement pension, benefits on disability or death, and benefits for surviving dependents.

Basis for calculation	**2004** In percent	**2003** In percent
Discount rate	4.0	4.0
Projected long-term investment yield	4.5	4.5
Projected salary development	2.5	2.5
Projected pension development	1.5	1.5

Difference	**2004** CHF millions	**2003** CHF millions
Employee benefit obligations	–587.6	–570.0
Pension fund assets	662.0	637.0
Excess (not capitalised)	74.4	67.0

Employee benefit expenses	**2004** CHF millions	**2003** CHF millions
Employee pension entitlements acquired	13.1	11.8
Interest on future pension entitlements	23.5	21.6
Projected income from pension fund assets	–26.5	–25.5
Employee contributions	–4.7	–4.7
Imputed net pension expense	5.4	3.2
Employee benefit expenses posted (employer contributions)	9.9	10.0
Imputed net pension expense	–5.4	–3.2
Prepaid benefit expenses not stated in the balance sheet	4.5	6.8

General overheads

Item no. 07

	2004 CHF millions	2003 CHF millions	Change CHF millions
Premises	9.0	10.3	–1.3
Maintenance of mobile tangible assets and software	8.5	8.4	+0.1
Consulting and other third-party support	3.7	10.0	–6.3
Administrative expenses	11.9	12.2	–0.3
Operating contributions	6.6	7.8	–1.2
Other general overheads	5.9	6.4	–0.5
Total	45.6	55.3	–9.6

The operating grants include a contribution of CHF 6.2 million (2003: CHF 7.3 million) towards Study Center Gerzensee. The Study Center, which is a National Bank foundation, organises courses for employees of foreign central banks plus international conferences on academic topics and courses for doctoral students of Swiss universities.

Gold

Item no. 08

Breakdown by type	2004 Tonnes	 CHF millions	2003 Tonnes	 CHF millions
Gold ingots	1 047.3	16 693.3	1 225.1	20 312.5
Gold coins	175.2	2 792.5	175.2	2 904.9
Total	1 222.5	19 485.8	1 400.3	23 217.3

Breakdown by purpose	2004 Tonnes	 CHF millions	2003 Tonnes	 CHF millions
Monetary gold	1 158.4	18 463.5	1 057.1	17 527.9
Gold from free assets	64.1	1 022.3	343.1	5 689.5
Total	1 222.5	19 485.8	1 400.3	23 217.3

Free assets: Gold sales per annum	**Amount sold**	**Sales proceeds**[1]	**Average price**
	Tonnes	CHF millions	CHF
2000	170.8	2 589.9	15 167
2001	220.8	3 252.8	14 730
2002	281.9	4 376.0	15 524
2003	283.4	4 458.8	15 733
2004	279.0	4 567.6	16 372
Total	1 235.9	19 245.2	15 572

1 Excluding net result from headging transactions.

Of the original total of 1,300 tonnes of gold no longer required for monetary purposes, 64.1 tonnes remain available for sale in 2005 (cf. p. 91).

Item no. 09

Claims from gold transactions

	2004		**2003**	
	Tonnes	CHF millions	Tonnes	CHF millions
Claims from unsecured gold lending	31.9	514.6	128.9	2 146.2
Claims from secured gold lending[1]	99.8	1 637.4	104.0	1 762.5
Claims on metal accounts	0.1	1.4	0.1	1.9
Total	131.8	2 153.4	233.0	3 910.7

1 Secured by the deposit of first-class securities with a market value of CHF 1,865.9 million (2003: 1,887.9 million).

Foreign currency investments

Breakdown by investment type	**2004** CHF millions	**2003** CHF millions	**Change** CHF millions
Sight deposits and call money	1 201.4	1 074.5	+126.9
Time deposits	362.6	2 416.4	–2 053.8
Claims from repo transactions	–	1 774.9	–1 774.9
Money market paper	2 680.3	2 627.2	+53.1
Bonds[1]	56 463.7	48 418.7	+8 045.0
Total	60 708.0	56 311.7	+4 396.3

1 Of which CHF 320.3 million (2003: CHF 118.9 million) lent under securities lending operations.

Breakdown by borrower category	**2004** CHF millions	**2003** CHF millions	**Change** CHF millions
Governments	45 546.8	46 438.9	–892.1
Monetary institutions[1]	1 919.7	1 417.2	+502.4
Corporations	13 241.5	8 455.5[2]	+4 786.0
Total	60 708.0	56 311.7	+4 396.3

1 The debtor category *monetary institutions* refers to investments at the Bank for International Settlements (BIS), at central banks and in securities of multilateral development banks.

2 Banks only.

Breakdown by currency[1]	**2004** CHF millions	**2003** CHF millions	**Change** CHF millions
USD	20 405.0	20 406.0	–1.0
EUR	28 854.9	29 320.2	–465.3
GBP	6 944.8	3 078.6	+3 866.2
DKK	3 130.5	2 360.4	+770.2
CAD	1 371.8	1 144.2	+227.6
Other	1.0	2.3	–1.3
Total	60 708.0	56 311.7	+4 396.3

1 The breakdown by currency refers to basic investments and does not take foreign exchange derivatives into account. For a breakdown of currency positions including foreign exchange derivatives, see the breakdown of assets by currency on p. 131.

Item no. 11

Reserve position in the IMF

	2004 CHF millions	2003 CHF millions	Change CHF millions
Swiss quota in the IMF[1]	6 080.7	6 390.7	–310.0[2]
./. less IMF's Swiss franc sight balances at the National Bank	–4 045.6	–3 828.8	–216.8
Total	2 035.1	2 561.9	–526.8

1 This quota amounts to SDR 3,458.5 million.

2 Change due entirely to exchange rates.

Item no. 12

Monetary assistance loans

	2004 CHF millions	2003 CHF millions	Change CHF millions
Bilateral loan to Bulgaria	22.2	22.4	–0.2
PRGF credit facility	193.7	243.8	–50.1
Interim PRGF credit facility	75.4	61.0	+14.4
Total	291.3	327.2	–35.9

The change in the PRGF (Poverty Reduction and Growth Facility) is due to the IMF's repayment of the loan and to currency valuation effects. Since 2002, the IMF has exhausted all loan commitments under the PRGF.

The change in the *interim PRGF credit facility* item is due to currency valuation effects and to increased borrowing by the IMF. Outstanding commitments were down from CHF 401.5 million in 2003 to CHF 364.8 million (cf. p. 128, Item no. 29).

Swiss franc securities

Item no. 13

Breakdown by borrower category	2004 CHF millions	2003 CHF millions	Change CHF millions
Governments	4 368.0	4 141.6	+226.3
Corporations	3 025.6	3 516.2	–490.6
Total	7 393.6	7 657.9	–264.3

Breakdown of the *Governments* borrower category	2004 CHF millions	2003 CHF millions	Change CHF millions
Swiss Confederation	2 249.4	2 060.1	+189.3
Cantons	862.4	785.0	+77.4
Municipalities	417.4	358.2	+59.2
Foreign states	838.8	938.4	–99.6
Total	4 368.0	4 141.6	+226.3

Breakdown of the *Corporations* borrower category	2004 CHF millions	2003 CHF millions	Change CHF millions
Domestic banks	137.7	173.1	–35.4
Domestic mortgage bond institutions	1 063.2	1 336.6	–273.4
Other domestic corporations	126.4	132.8[1]	–6.4
Foreign corporations	1 698.2	1 873.7[2]	–175.5
Total	3 025.6	3 516.2	–490.6

1 International organisations headquartered in Switzerland.

2 Banks and international organisations.

Item no. 14

Banknote stocks

	2004 CHF millions	2003 CHF millions	Change CHF millions
Position as at 1 January	147.0	149.9	–2.9
Additions	37.4	41.5	–4.1
Disposals	–40.4	–44.4	–4.0
Position as at 31 December	144.0	147.0	–3.0

Item no. 15

Schedule of assets in CHF millions

	Real estate[1]	Specific conversion work	Assets under construction[2]	Software	Sundry tangible assets[3]	Total
Period of depreciation	100 years	10 years	No depreciation	3 years	3–12 years	
Historical cost						
1 January 2004	326.1	44.7	6.4	25.3	71.2	473.8
Additions	0.0	4.3	17.6	6.2	6.7	34.7
Disposals	–	–0.1	–	–7.5	–9.9	17.5
Reclassified	–	–	–	–	–	
31 December 2004	326.2	48.9	24.0	24.0	68.0	491.1
Cumulative value adjustments						
1 January 2004	18.8	12.0		9.4	48.2	88.5
Additions	3.3	4.6		8.8	9.9	26.6
Disposals	–	–0.1		–7.5	–9.8	17.4
Reclassified	–	–		–	–	
31 December 2004	22.1	16.5		10.7	48.3	97.6
Net book values						
1 January 2004	307.3	32.7	6.4	15.9	23.0	385.3
31 December 2004	304.0	32.3	24.0	13.3	19.7	393.3

1 Fire insurance value: CHF 362.6 million (2003: CHF 339.8 million).

2 Remodelling work at Zurich office.

3 Relates primarily to IT hardware, machinery, equipment, furnishings and vehicles; fire insurance value: CHF 83.3 million (2003: CHF 82.5 million).

Participations (not consolidated) in CHF millions

Item no. 16

	Percentage held	Book value at 1 Jan. 2004	Investments	Divestments	Changes in value	Book value at 31 Dec. 2004
Orell Füssli[1]	33%	27.0	–	–	8.1	35.1
BIS[2]	3%	60.9	–	–	–	60.9
Others		0.6	–	0.0	–	0.6
Total		88.6				96.7

1 Orell Füssli Holding Ltd, whose subsidiary Orell Füssli Security Documents Ltd produces Switzerland's banknotes.

2 The interest in the Bank for International Settlements (BIS) is held by reason of collaboration on monetary policy.

Sundry assets

Item no. 17

	2004 CHF millions	2003 CHF millions	Change CHF millions
Coins[1]	266.4	290.2	–23.8
Foreign notes	0.7	0.6	+0.1
Other accounts receivable	19.6	20.9	–1.2
Prepayments and accrued income	3.2	3.6	–0.3
Cheques and bills of exchange (collection business)	0.3	0.5	–0.2
Positive gross replacement values[2]	316.1	668.2	–352.1
Total	606.3	983.9	–377.6

1 Coins comprise the coins and commemorative coins acquired from Swissmint which are placed in circulation by the National Bank.

2 Positive gross replacement values correspond to unrealised gains on derivative financial instruments and on outstanding spot transactions. By far the greater part of this Item is derived from foreign currency forward transactions concluded to hedge currency risks on the free assets (cf. p. 130, Item no. 32).

Item no. 18

Banknotes in circulation

	2004 CHF millions	2003 CHF millions	Change CHF millions
8th issue	37 852.9	38 482.0	–629.1
6th issue[1]	1 866.3	2 062.0	–195.7
Total	39 719.3	40 544.0	–824.7

1 Exchangeable at the National Bank until 30 April 2020.

Item no. 19

Liabilities towards the Confederation

	2004 CHF millions	2003 CHF millions	Change CHF millions
Sight liabilities	54.3	452.6	–398.3
Term liabilities	2 100.5	2 400.5	–300.0
Total	2 154.8	2 853.1	–698.3

Item no. 20

Other sight liabilities

	2004 CHF millions	2003 CHF millions	Change CHF millions
Sight deposits of non-banks	20.5	13.4	+7.2
Deposit accounts[1]	144.0	138.4	+5.6
Cheque liabilities[2]	0.5	1.6	–1.1
Total	165.0	153.4	+11.6

1 These mainly comprise accounts of active and retired employees, and liabilities towards SNB pension funds (CHF 16.2 million; 2003: CHF 16.8 million).

2 Bank cheques drawn on the National Bank but not yet cashed.

Foreign currency liabilities

Item no. 21

	2004 CHF millions	2003 CHF millions	Change CHF millions
Sight liabilities towards the Confederation	0.5	0.5	–
Liabilities from repo transactions[1]	–	130.0	–130.0
Total	0.5	130.5	–130.0

1 Relating to the management of foreign currency investments.

Other liabilities

Item no. 22

	2004 CHF millions	2003 CHF millions	Change CHF millions
Other liabilities	10.8	12.6	–1.8
Accrued liabilities and deferred income	5.3	3.0	+2.3
Negative gross replacement values[1]	144.7	159.2	–14.5
Total	160.9	174.8	–13.9

1 Negative gross replacement values correspond to unrealised losses on derivative financial instruments and on outstanding spot transactions. By far the greater part of this item is derived from foreign currency forward transactions concluded to hedge currency risks on the free assets (cf. p. 130, Item no. 32).

Provisions for the assignment of free assets

Item no. 23

Changes	2004 CHF millions	2003 CHF millions
Book value as at 1 January	21 209.3	20 296.9
Allocated to provisions		912.4[1]
Released from provisions	–96.0[1]	
Write-back as at 31 December as per agreement 25 February 2005	–21 113.2	
Book value as at 31 December	–	21 209.3

1 Corresponds to the net gain/loss from gold in the free assets (cf. p. 110, Item no. 01).

The provision for the assignment of free assets comprises the proceeds from gold sales realised to date, the accrued net result from the hedging transactions and the anticipated proceeds of future gold sales. The latter depends on the market value of the gold not yet sold. Owing to the development of the gold price during the year, the anticipated value of the gold assigned declined by CHF 96 million.

Composition before dissolution	**2004**		**2003**	
	Tonnes	CHF millions	Tonnes	CHF millions
Cumulative proceeds from gold sales	1 235.9	19 245.2	956.9	14 677.6
Market value of the as yet unsold portion of gold from the free assets	64.1	1 022.6[1]	343.1	5 690.4[1]
Cumulative net result from hedging transactions		845.5		841.3
Total (position as at 31 December before liquidation)	1 300.0	21 113.2	1 300.0	21 209.3

1 Including gross replacement values of gold sales not yet performed as at the balance sheet date.

Owing to the Federal Council's decision to distribute the countervalue of the 1,300 tonnes of gold to the Confederation and the cantons, the Council of States' decision not to intervene in this matter became effective. Consequently, the provision was written back as at 31 December 2004 and carried as income (cf. pp. 87–88).

The calculation of the distribution was based on the provision of CHF 21,113.2 million as at 31 December 2004, i.e. in accordance with the definition stated at the outset. Any difference remaining on completion of the sales will be reflected in the Financial Report for 2005.

Provisions for operating risks

Item no. 24

	Provisions due to reorganisation CHF millions	Other provisions CHF millions	Total CHF millions
Book value as at 1 January 2003	11.9	–	11.9
Formation	3.2	–	3.2
Release	–3.5	–	–3.5
Write-back	–	–	–
Book value as at 31 December 2003	11.5	–	11.5
Book value as at 1 January 2004	11.5	–	11.5
Formation	0.7	0.7	1.3
Release	–4.5	–	–4.5
Write-back	–0.2	–	–0.2
Book value as at 31 December 2004	7.5	0.7	8.1

Share capital

Item no. 25

The share capital of the National Bank totals CHF 25 million. It is divided into 100,000 registered shares of CHF 250 each.

In the 2004 financial year, the Bank Committee, and afterwards the Secretariat General acting on behalf of the Bank Council, authorised the transfer of 21,912 (previous year: 4,403) shares to new holders. The number of registered shareholders declined by 146.

At year-end the shares were distributed as follows:

	Number of shares	In percentage of shares registered
2,395 private shareholders with a total of	**34 851**	**39**[1]
of whom 2,057 shareholders with 1–10 shares each		
of whom 312 shareholders with 11–100 shares each		
of whom 13 shareholders with 101–200 shares each		
of whom 13 shareholders with over 200 shares each		
81 public-sector shareholders with a total of	**54 494**	**61**
of whom 26 cantons with a total of	38 981	
of whom 24 cantonal banks with a total of	14 473	
of whom 31 other public authorities and institutions with a total of	1 040	
Total 2,476 shareholders with a total of	**89 345**[2]	**100**
Registration applications pending or outstanding for	10 655	
Total shares	**100 000**	

1 10.5% are legal entities and 28.5% private individuals.

2 2,810 shares are in foreign ownership.

At year-end, the price of the National Bank share was CHF 1,000, having risen from CHF 997 at the beginning of the year (at that time the price reflected a non paid-up portion of the share capital).

Major shareholders	Number of shares		Percentage held	
	2004	Year-on-year change	2004	Year-on-year change
Canton of Berne	6 630	–	6.63	–
Fritz Aeschbach-Müller, Monaco	6 232	[1]	6.23	[1]
Canton of Zurich	5 200	–	5.20	–

1 Previous year's holding was not subject to a reporting obligation.

Item no. 26

Transfer of the residual surplus for future distributions to the distribution reserve

	CHF millions
Residual surplus prior to distribution for financial year 2003[1]	13 047.0
Distribution to Confederation and cantons in spring 2004	–2 800.0
Residual surplus for future distributions[1]	10 247.0
Release of reorganisation provisions	–11.5
Distribution reserve as at 31 December 2004 (before appropriation of profit for 2004)	10 235.5

1 Cf. 96th Annual Report 2003, p. 109.

To date, the reorganisation provisions were included in the provisions stipulated in the NBA. Since they were not surplus provisions as specified in the new NBA, they have been transferred to provisions for operating risks rather than to the distribution reserve (cf. p. 125, Item no. 24).

4.5 Notes regarding off-balance-sheet business

Contingent liabilities

Item no. 27

	2004 CHF millions	2003 CHF millions	Change CHF millions
Documentary credits[1]	1.8	2.6	–0.8
Other contingent liabilities	0.5	1.5	–1.0

1 Chiefly in connection with development aid provided by the Confederation (covered by balances earmarked for this purpose).

Irrevocable undertakings

Item no. 28

Undrawn credit lines provided to banks under the liquidity-shortage financing facilities	2004 CHF millions	2003 CHF millions	Change CHF millions
Lombard advances	6 551.4	9 407.5	–2 856.1
Special-rate repo	3 170.5	–	+3 170.5
Total	9 721.9	9 407.5	+314.4

Lombard advances	2004 CHF millions	2003 CHF millions	Change CHF millions
Credit lines	6 558.0	9 408.3	–2 850.3
of which drawn down	6.6	0.8	+5.8
of which not yet drawn down	6 551.4	9 407.5	–2 856.1

Special-rate repo	2004 CHF millions	2003 CHF millions	Change CHF millions
Credit lines	3 170.5	–	+3 170.5
of which drawn down	–	–	–
of which not yet drawn down	3 170.5	–	+3 170.5

Item no. 29

Undrawn credit lines provided to IMF	2004 CHF millions	2003 CHF millions	Change CHF millions
Two-way arrangement	623.3	693.4	–70.1
Interim PRGF	364.8	401.5	–36.7
General Arrangements to Borrow (GAB) and New Arrangements to Borrow (NAB)	2 707.6	2 845.6	–138.0
Total	3 695.7	3 940.5	–244.8

Two-way arrangement[1]	2004 CHF millions	2003 CHF millions	Change CHF millions
Credit undertaking	703.3	739.1	–35.8[2]
of which drawn down	80.0	45.7	+34.3
of which not yet drawn down	623.3	693.4	–70.1

1 National Bank undertaking to purchase Special Drawing Rights against currency up to the agreed maximum of SDR 400 million or to return the Special Drawing Rights in exchange for currency.

2 Change due entirely to exchange rates.

Interim PRGF[1]	2004 CHF millions	2003 CHF millions	Change CHF millions
Credit undertaking	439.5	462.0	–22.5[2]
of which drawn down	74.7	60.4	+14.3
of which not yet drawn down	364.8	401.5	–36.7

1 Limited-term credit undertaking to the IMF's trust fund amounting to SDR 250 million (cf. p. 118, Item no. 12) with federally guaranteed repayment of principal and payment of interest.

2 Change due entirely to exchange rates.

General Arrangements to Borrow (GAB) and New Arrangements to Borrow (NAB)[1]	2004 CHF millions	2003 CHF millions	Change CHF millions
Credit undertaking	2 707.6	2 845.6	–138.0[2]
of which drawn down	–	–	–
of which not yet drawn down	2 707.6	2 845.6	–138.0

1 Credit lines totalling SDR 1,540 million (of which a maximum of SDR 1,020 million in the context of the GAB) in favour of the IMF for special cases, without a federal guarantee.

2 Change due entirely to exchange rates.

Other obligations not carried on the balance sheet

Item no. 30

	2004 CHF millions	2003 CHF millions	Change CHF millions
Additional funding obligation BIS[1]	105.5	110.9	–5.4[2]
Liabilities from long-term rental, maintenance and leasing contracts	26.2	28.1	–1.9

1 The BIS shares are 25% paid up. The additional funding obligation is stated in Special Drawing Rights.

2 Change due entirely to exchange rates.

Assets pledged or assigned as collateral for own liabilities

Item no. 31

Foreign currency investments	2004 CHF millions	2003 CHF millions	Change CHF millions
USD	16.3	163.5	–147.1
EUR	77.4	87.7	–10.3
GBP	–	11.9	–11.9
Total[1]	93.7	263.2	–169.4

1 Collateral lodged in connection with repo and futures transactions.

Item no. 32

Outstanding derivative financial instruments

	Contract value	Gross replacement value	
	CHF millions	CHF millions Positive	CHF millions Negative
Interest rate instruments	**14 757.6**	**18.3**	**22.1**
Forward contracts[1]	10 648.4	1.5	1.3
Interest rate swaps	3 552.4	16.2	20.5
Futures	556.9	0.6	0.3
Foreign exchange	**16 850.1**	**297.5**	**122.6**
Forward contracts[1]	16 850.1	297.5	122.6
Precious metals	**472.3**	**0.3**	**0.1**
Forward contracts[2]	472.3	0.3	0.1
Total as at end of 2004	**32 080.0**	**316.1**	**144.7**
Total as at end of 2003	65 742.9	668.2	159.2

1 Including spot transactions with value date in the new year.

2 From spot sales and gold lending transactions with value date in the new year.

Item no. 33

Fiduciary investments

	2004	2003	Change
	CHF millions	CHF millions	CHF millions
Fiduciary investments of the Confederation	745.3	550.2	195.1

4.6 Assets by currency as at 31 December 2004

In CHF millions

The following table gives a breakdown of the National Bank's assets by currency. Foreign exchange derivatives were included on the basis of the assets stated in the balance sheet. These are made up of claims and liabilities from forward foreign exchange transactions.

	CHF	Gold	USD	EUR	Other	Total
Gold		19 485.8				19 485.8
Claims from gold transactions		2 100.3	53.1			2 153.4
Foreign currency investments			20 405.0	28 854.9	11 448.1	60 708.0
Reserve position in the IMF					2 035.1	2 035.1
International payment instruments					80.1	80.1
Monetary assistance loans				22.2	269.1	291.3
Sundry assets	33 155.1					33 155.1
Total assets as per balance sheet	**33 155.1**	**21 586.1**	**20 458.1**	**28 877.1**	**13 832.4**	**117 908.8**
Foreign exchange derivatives	9 043.4		–6 574.0	–2 843.9	374.5	
Total assets incl. foreign exchange derivatives as at end of 2004	**42 198.5**	**21 586.1**	**13 884.1**	**26 033.1**	**14 206.9**	**117 908.8**
As at end of 2003	45 705.6	27 080.7	13 954.3	29 342.6	6 714.3	122 797.7

Proposals of the Bank Council

Proposals of the Bank Council to the General Meeting of Shareholders

At its meeting of 25 February 2005, the Bank Council accepted the 97th Annual Report consisting of the 2004 Business and Financial Report presented by the Governing Board for submission to the Federal Council and the General Meeting of Shareholders.

On 11 March 2005, the Federal Council approved the Business and Financial Report pursuant to art. 7 para. 1 NBA. The Audit Board signed its report on 25 February 2005.

The Bank Council presents the following proposals to the General Meeting of Shareholders[1]:

1. that the Business and Financial Report be approved;
2. that the annual result (net profit) of CHF 21,612,884,596.50 be appropriated as follows:

Appropriation of profit	**2004** CHF millions
Annual result (net profit pursuant to art. 36 NBA)	21 612.9
Allocation to provisions for currency reserves (art. 30 para. 1 NBA)	–885.3
Distributable annual profit (art. 30 para. 2 NBA)	**20 727.6**
Release from distribution reserve	3 287.1
Total distribution of profit (art. 31 NBA)	**24 014.7**
Payment of a dividend of 6%	–1.5
Ordinary distribution to the Confederation and to the cantons[2]	–2 500.0
Supplementary distribution to the Confederation and to the cantons[3]	–400.0
Distribution of the proceeds from the sale of 1,300 tonnes of gold[4]	–21 113.2
Balance after appropriation of profit	**–**

3. that the Bank Council be granted discharge.

1 The proposal concerning the election of the Audit Board can be found on p. 83.

2 Agreement on the distribution of profit of 5 April 2002.

3 Supplementary agreement on the distribution of income on the SNB's free assets of 12 June 2003.

4 Agreement on the distribution of the proceeds from the sale of 1,300 tonnes of gold of 25 February 2005.

Report of the Audit Board

Report of the Audit Board to the General Meeting of Shareholders

As statutory auditors, we have audited the accounting records and the financial statements (balance sheet, income statement and notes/pages 94 to 131) of Swiss National Bank for the year ended 31 December 2004.

These financial statements are the responsibility of the Bank Council. Our responsibility is to express an opinion on these financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with auditing standards promulgated by the Swiss profession, which require that an audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the financial statements. We have also assessed the accounting principles used, significant estimates made and the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accounting records and financial statements give a true and fair view of the financial position, the results of operations and the cash flows in accordance with the Swiss GAAP FER. We should, however, point out the particular features (explained in the notes to the accounts) of accounting methods used by the Swiss National Bank as Switzerland's central bank and note-issuing institution.

We further confirm that the books of account and the annual financial statements as well as the proposals for the appropriation of the annual profit comply with the provisions of the National Bank Act and the Swiss Code of Obligations.

We recommend that the financial statements submitted to you be approved.

PricewaterhouseCoopers AG

Peter Ochsner **Yvonne Staub**

Zurich, 25 February 2005

Selected information

1 Chronicle of monetary events in 2004

March

On 18 March, the Governing Board passes the new Ordinance on the National Bank Act, which comes into effect on 1 May (cf. p. 70).

On 18 March, the Governing Board decides at its quarterly assessment to leave the target range for the three-month Libor at 0.0–0.75% (cf. p. 26).

On 19 March, the two chambers of Parliament approve the Federal Act on International Monetary Assistance, which the Federal Council enacts together with the Federal Decree on International Monetary Assistance with effect from 1 October 2004 (cf. p. 72).

On 24 March, the Federal Council enacts the totally revised National Bank Act (NBA) with effect from 1 May (cf. p. 69).

May

On 14 May, the new Bank Council holds its constituent meeting and passes the new Organisation Regulations, which are approved by the Federal Council on 23 June (cf. p. 71).

June

On 17 June, the Governing Board at its quarterly assessment raises the target range for the three-month Libor with immediate effect by 0.25 percentage points to 0.0–1.0%. For the time being, the three-month Libor is to be kept in the middle of the target range at around 0.5%. After this step, the interest rate target range again exhibits a spread of 100 bp (cf. p. 28).

September

On 16 September, the Governing Board at its quarterly assessment raises the target range for the three-month Libor with immediate effect by 0.25 percentage points to 0.25–1.25%. For the time being, the three-month Libor is to be kept in the middle of the target range at around 0.75% (cf. p. 30).

December

On 16 December, the Council of States decides for the second time not to deal with the Federal Council's bill regarding the appropriation of the surplus gold reserves (cf. p. 73).

On 16 December, the Governing Board at its quarterly assessment leaves the target range for the three-month Libor at 0.25–1.25%. For the time being, the three-month Libor is to be kept in the middle of the target range at around 0.75% (cf. p. 31).

2 Supervisory and management bodies, Regional Economic Councils

(As at January 2005)

Bank Council

(2004–2008 term of office)

Hansueli Raggenbass, Kesswil, Attorney-at-law, President[1]

Ruth Lüthi, Fribourg, Member of the Cantonal Government and Head of the Health and Social Welfare Department of the Canton of Fribourg, Vice-President[1]

* Ueli Forster, St Gallen, Chairman of the Board of Directors of Forster Rohner Ltd[1]

* Serge Gaillard, Bolligen, Executive Secretary of the Swiss Federation of Trade Unions[3]

Konrad Hummler, Teufen, Managing Partner of Wegelin & Co., Private Bankers[3]

* Armin Jans, Zug, Professor of Economics at the Zurich University of Applied Sciences, Winterthur[2]

* Franz Marty, Goldau[2]

Marina Masoni, Lugano, Member of the Cantonal Government and Head of the Department of Finance and Economic Affairs of the Canton of Ticino

Fritz Studer, Meggen[2]

* Alexandre Swoboda, Geneva, Professor at the Graduate Institute of International Studies[3]

Eveline Widmer-Schlumpf, Felsberg, Member of the Cantonal Government and Head of the Finance and Military Department of the Canton of Graubünden

* Elected by the General Meeting of Shareholders.

1 Member of the Compensation Committee.

2 Member of the Audit Committee.

3 Member of the Risk Committee.

Further relevant affiliations of the Bank Council members

Hansueli Raggenbass
- Chairman of the Board of the Health Care Organisation SWICA, Winterthur, and associated companies
- Member of the Board of Oerlikon Contraves, Zurich

Ruth Lüthi
- None

Ueli Forster
- Chairman of the Swiss Business Federation (economiesuisse)
- Deputy Chairman and Lead Director of the Board of Directors of Helvetia Patria Group, St Gallen

Serge Gaillard
- None

Konrad Hummler
- Chairman of the Board of Telsonic Holding AG, Bronschhofen
- Member of the Board of Christian Fischbacher Co. AG and CF Holding AG, St Gallen
- Member of the Board of Finansbank (Suisse) SA, Geneva
- Member of the Board of Habib Bank AG, Zurich
- Member of the Board of Neue Zürcher Zeitung AG, Zurich
- Member of the Board of Private Client Bank, Zurich

Armin Jans
- Vice-President of Schweizerischer Mieterinnen- und Mieterverband Deutschschweiz (Swiss German Association of Tenants)
- Member of the Bank Board of Zuger Kantonalbank, Zug

Franz Marty
- Chairman of the Board of the Swiss Union of Raiffeisen Banks, St Gallen

Marina Masoni
- Member of the Board of the Compensation Fund of the Old Age and Survivors' Insurance scheme (AHV/AVS), Geneva

Fritz Studer
- Member of the Board of Luzerner Kantonalbank, Lucerne
- Chairman of the Board of Sarna Kunststoffholding AG, Sarnen

Alexandre Swoboda
- Member of the Board of LB InterFinanz AG, Zurich
- Member of the Board of ABD Capital SA, Geneva

Eveline Widmer-Schlumpf
- None

Audit Board
(2004/2005 term of office)

PricewaterhouseCoopers AG, Zurich

Regional Economic Councils
(2004–2008 term of office)

Geneva	Charles Seydoux, Choulex, Director of DMB SA, Chairman
	Raymond Léchaire, Bussigny, Director and Head of Sales Area Coop Romandie
	Claude-Daniel Proellochs, Neuchâtel, General Manager and Chairman of the Board of Vacheron Constantin SA, Branch of Richemont International SA
Mittelland	Jean-François Rime, Bulle, National Councillor, Chairman of the Board of Despond SA, Chairman
	Edgar Geiser, Brügg/BE, Senior Vice-President and Chief Financial Officer, Member of the Executive Board of Swatch Group Ltd
	Oscar A. Kambly, Trubschachen, President of the Board of Kambly SA, Spécialités de Biscuits Suisses
Northwestern Switzerland	Bruno Sidler, Binningen, President of the Executive Board and CEO of Panalpina Management Ltd, Chairman
	Hans Büttiker, Dornach, CEO of EBM
	Matthys Dolder, Bienne-Benken, CEO of Dolder AG
Eastern Switzerland	Willy Egeli, Wittenbach, Chairman of the Board and Managing Director of Egeli AG, Chairman
	Charles Peter, Uzwil, CEO, President and Managing Director of Benninger AG
	Urs Kienberger, Sils-Maria, Director and Chairman of the Board of Hotel Waldhaus Sils
Ticino	Franz Bernasconi, Genestrerio, President and General Manager of Precicast SA, Chairman
	Olimpio Pini, Sorengo, Director of Pini & Associati, Ingegneri Consulenti SA
	Giancarlo Bordoni, Viganello, Chairman of the Board of Oleificio Sabo SA
Vaud-Valais	Rolf Mehr, St-Prex, Managing Director and CEO of Vaudoise Insurance Holding, Chairman
	Gérard Beytrison, Conthey, Delegate of the Board of Orgamol SA
	Bernard Rüeger, Féchy, General Manager of Rüeger SA

Ruth Pedrazzetti-Weibel, Lucerne, Hotel Manager, Hotel Continental-Park, Chairwoman	Central Switzerland
Werner Steinegger, Schwyz, Chairman of the Board of Celfa AG	
Xaver Sigrist, Lucerne, President and CEO of Anliker AG Bauunternehmung	

Silvia Huber-Meier, Lengnau/AG, Managing Director of Domaco Dr. med. Aufdermaur AG, Chairwoman	Zurich
Reto H. Müller, Dietikon, Chairman of the Board and CEO of Helbling Holding SA	
Hans R. Rüegg, Rüti/ZH, Chairman of the Board and CEO of Baumann Springs Ltd	

Governing Board	Jean-Pierre Roth, Chairman, Zurich
	Niklaus Blattner, Vice-Chairman, Berne
	Philipp M. Hildebrand, Member, Zurich

Enlarged Governing Board	Jean-Pierre Roth, Chairman
	Niklaus Blattner, Vice-Chairman
	Philipp M. Hildebrand
	Ulrich Kohli
	Thomas Wiedmer
	Thomas J. Jordan

Secretariat General	Peter Schöpf, Secretary General, Director, Zurich

Department I

Head of Department	Jean-Pierre Roth, Chairman of the Governing Board
Deputy Head	Ulrich Kohli, Alternate Member of the Governing Board, Chief Economist
International Affairs	Ulrich Kohli, Alternate Member of the Governing Board, Chief Economist
Economic Affairs	Michel Peytrignet, Director
Legal and Administrative Affairs	Peter Klauser, Director

Department II

Head of Department	Niklaus Blattner, Vice-Chairman of the Governing Board
Deputy Head	Thomas Wiedmer, Alternate Member of the Governing Board, Chief Financial Officer
Finance and Controlling	Thomas Wiedmer, Alternate Member of the Governing Board, Chief Financial Officer
Cash	Roland Tornare, Chief Cashier of the Bank, Director
Financial Stability and Oversight	Daniel Heller, Director

Department III

Head of Department	Philipp M. Hildebrand, Member of the Governing Board
Deputy Head	Thomas J. Jordan, Alternate Member of the Governing Board, Chief Investment Officer
Financial Market Operations	Thomas J. Jordan, Alternate Member of the Governing Board, Chief Investment Officer
Asset Management	Thomas Stucki, Director
Investment Strategy and Risk Control	Dewet Moser, Director
Banking Operations	Daniel Wettstein, Director
Information Technology	Rudolf Hug, Director (until 31 March 2005) Hans Peter Biland, Director (as of 1 April 2005)

3 Organisational chart

- **General Meeting of Shareholders**
  - **Audit Board**
- **Bank Council**
  - **Internal Auditors**
- **Governing Board**
  - **Secretariat General**
- **Enlarged Governing Board**

Department I Zurich

- **Human Resources**
- **Communications**
- **Regional Economic Relations**
- **International Affairs**
  - International Research and Technical Assistance
  - International Monetary Relations
- **Economic Affairs**
  - Research
  - Economic Analysis
  - Statistics
  - Library
- **Legal and Administrative Affairs**
  - Legal Services
  - Pension Fund
  - Premises, Technical Services

Department II Berne

- **Management Support**
- **Security**
- **Finance and Controlling**
  - Central Accounting
  - Controlling
  - Premises, Technical Services
- **Cash**
  - Administration
  - Storage
  - Processing
  - Technical Services
  - Cashier's Offices Berne, Geneva, Lugano, Zurich

Department III Zurich

Financial Stability and Oversight

- Financial Stability
- Financial Market Infrastructure

Financial Market Operations

- Money Market and Foreign Exchange
- Financial Market Analysis

Asset Management

Investment Strategy and Risk Control

Banking Operations

- Payments
- Back Office
- Support

Information Technology

- Banking Applications
- Statistics Applications
- Office Automation and Operations Applications
- Technical Services
- IT Operations Zurich
- IT Operations Berne

4 Publications

The printed publications are available on the internet: www.snb.ch

Annual Report	The Annual Report is published in April in German, French, Italian, and English. Free of charge
Reports on the balance of payments, the international investment position and direct investment	The "Swiss Balance of Payments" provides comments on the development of the balance of payments and is published once a year as a supplement to the Monthly Statistical Bulletin. The report on Switzerland's international investment position provides comments on the development of foreign assets, foreign liabilities and Switzerland's net investment position. It is published once a year as a supplement to the December issue of the Monthly Statistical Bulletin. The report on direct investment provides comments on the development of Switzerland's direct investment abroad and foreign direct investment in Switzerland. It is published once a year as a supplement to the December issue of the Monthly Statistical Bulletin. The reports are available in German, French and English (English version only on the internet). Free of charge
Financial Stability Report	The Financial Stability Report assesses the stability of Switzerland's banking sector. It is published once a year in June. The publication is in English and contains summaries in German and French. Free of charge
Quarterly Bulletin	The Quarterly Bulletin includes the Monetary Policy Report used for the quarterly assessment of the Governing Board. Furthermore, articles on topical central bank policy issues and abstracts of the SNB's Economic Studies and Working Papers are published. The Quarterly Bulletin also contains the speeches delivered at the General Meeting of Shareholders and the chronicle of monetary events. The Quarterly Bulletin is available in German, French and English (English version only on the internet). Subscription rate: CHF 25* per year (outside Switzerland CHF 30); for subscribers of the Monthly Statistical Bulletin: CHF 15* per year (outside Switzerland CHF 20)

Swiss National Bank Economic Studies/ Swiss National Bank Working Papers

In the two series "Swiss National Bank Economic Studies" and "Swiss National Bank Working Papers", economic contributions are published at irregular intervals. They are available in one language only (German, French or English).

Free of charge

Monthly Statistical Bulletin/Monthly Bulletin of Banking Statistics

The Monthly Statistical Bulletin contains graphs and tables on key Swiss and international economic figures (available in German and French; English only on the internet). The Monthly Bulletin of Banking Statistics contains detailed banking statistics (available in German and French). The latest issue together with machine-readable data is available on the internet under Publications; Monthly Bulletin of Banking Statistics. A printed version is published every quarter (free of charge as a supplement to the Monthly Statistical Bulletin).

Subscription rate: CHF 40* per year (outside Switzerland CHF 80)

Statistical yearbook of the Swiss banks

The statistical yearbook of the Swiss banks ("Die Banken in der Schweiz") provides commented source material on the structure and development of the banking sector in Switzerland. It is compiled mainly from data contained in the year-end statistics of the National Bank. The yearbook is published in mid-year in German and French.

Price: CHF 20 *

Money and monetary policy

The publication "Money and monetary policy" provides an introduction into the financial world and monetary policy for teaching purposes. It was published as part of the teaching aid series "Bildung und Wirtschaft"(no. 2000/1) of the association "Jugend und Wirtschaft" (available in German, French, Italian and English).

Free of charge

The Swiss National Bank in brief

The brochure "The Swiss National Bank in brief" describes in concise form (approximately 30 pages) the monetary policy concept, major tasks, and the organisation and legal basis of the National Bank's activity. The brochure is available in German, French, Italian and English.

Free of charge

Information tools for schools and the interested public	The brochure “What is money really about?” describes the activity of the National Bank in simple terms. It is an ideal teaching aid for intermediate and higher grades.
	The brochure “The Swiss National Bank and that vital commodity: money” provides information on the National Bank and its tasks. It is suitable as a teaching aid for the higher grades and for vocational training and generally appeals to people interested in the National Bank.
	The glossary “An “A to Z” of the Swiss National Bank” explains important terms from the world of the National Bank and money.
	The website www.snb.ch, “The world of the National Bank” conveys the contents of the above-mentioned brochures in a form adapted to the internet.
	The short film “The National Bank and money” (available on DVD or VHS) illustrates the characteristics of money.
	The short film “The National Bank and its monetary policy” (available on DVD or VHS) illustrates how the National Bank conducts monetary policy on a daily basis and explains the principles of monetary policy.
	All information tools are available in German, French, Italian and English.
	Free of charge

Obtainable from:	Annual Report: Swiss National Bank, Secretariat General, Bundesplatz 1, CH-3003 Berne
	Telephone +41 31 327 02 11, e-mail: library@snb.ch
	All other publications (subscriptions and individual issues):
	Swiss National Bank, Library, Fraumünsterstrasse 8, P.O. Box, CH-8022 Zurich,
	Telephone +41 44 631 32 84, e-mail: library@snb.ch

*All rates include 2.4% VAT.

5 Addresses

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Agencies

The Swiss National Bank maintains agencies operated by cantonal banks in Altdorf, Appenzell, Basel, Bienne, Chur, Fribourg, Glarus, Liestal, Lucerne, Sarnen, Schaffhausen, Schwyz, Sion, Stans, Thun and Zug.

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6 Rounding conventions and abbreviations

Rounded figures

The figures in the income statement, balance sheet and tables are rounded; the total may therefore deviate from the sum of individual items.

The figures 0 and 0.0 are rounded values representing less than half of the unit used, yet greater than zero (rounded zero).

A dash (–) in place of a number stands for zero (absolute zero).

Abbreviations

ARR	Swiss Accounting and Reporting Recommendations (Swiss GAAP FER)
art.	Article
AS	Official Compilation of Federal Laws and Decrees
BIS	Bank for International Settlements
CAD	Canadian dollar
CHF	Swiss franc
CPI	Consumer price index
DKK	Danish krone
EUR	Euro
FC	Federal Constitution
FDF	Federal Department of Finance
Fed	US Federal Reserve
G-10	Group of Ten
GAAP	Generally Accepted Accounting Principles
GBP	Pound sterling
IMF	International Monetary Fund
Libor	London Interbank Offered Rate
NBA	National Bank Act
NBO	National Bank Ordinance
OECD	Organisation for Economic Cooperation and Development
para.	Paragraph
SDR	Special Drawing Rights
seco	State Secretariat for Economic Affairs
SFBC	Swiss Federal Banking Commission
SFSO	Swiss Federal Statistical Office
SIC	Swiss Interbank Clearing
SNB	Swiss National Bank
SR	Classified Compilation of the Federal Law
USD	US dollar

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