End-of-year Media News Conference, Zurich, 8 December 2000

Introductory Remarks by Jean-Pierre Roth,
Vice-Chairman of the Governing Board of the Swiss National Bank

Situation on the capital markets

Since our last media news conference in June, the financial markets have been subject to the combined effects of rising oil prices and a gradual slowdown in economic growth. Despite the general acceleration in inflation, long-term interest rates for prime borrowers have remained relatively stable or have even declined slightly. This development indicates that the markets do not expect the oil shock to become a lasting inflationary phenomenon. In Switzerland, the yield on ten-year Confederation bonds has thus fallen from 4% in June to currently 3.75%. On the different markets, the trend in yields on government bonds has also been influenced by special circumstances. In the United States, the federal budget surplus has accelerated the decline in the yield on federal bonds; in the euro area, stagnating long-term interest rates are probably due to the markets' lack of confidence in the European currency.

The generally expected slowdown in economic growth nevertheless had a stronger impact on the financial markets than might have been expected given the weak volatility of long-term government bonds. In fact, it is evident today that the less favourable economic prospects induce investors to adopt a more cautious attitude with respect to risk. On the stock markets, enthusiasm for technology paper has evaporated across the board. In the United States, where the signs of a slowdown are now evident at the end of a period of strong growth, the Nasdaq index has fallen by more than 30% from its summer peak, back to the level in the autumn of 1999. On the other exchanges, the indexes of the new markets have reacted in a similar way. The development on the traditional stock exchanges depended largely on the relative weighting of technology paper in their indexes. In Japan, the steady decline of the Nikkei index mainly reflects the difficulties connected with the recovery of the country's economy.

Investors' reluctance to assume risks also resulted in a considerable widening of spreads between the yield on government securities and that on bonds of private borrowers. On the other side of the Atlantic, in particular a marked deterioration in the financing conditions of enterprises with a poor rating has become observable. The spread to their detriment has reached a record level which surpasses the one witnessed during the financial crisis of 1998.

In the eyes of investors, it is also imperative to be more prudent in the assessment of country risks. Certain emerging economies with a still unsound basis stand to suffer more from a likely slowdown in world growth and an increase in oil prices. The most fragile among them face a deterioration in their financing conditions and attract greater international attention.

Compared with events in the past, the financial markets thus seem to react more quickly and with greater perception to changes in the economic landscape. The extent of the adjustments observed is revealing in this respect. The fact that this volatility has not disturbed investors shows that previous extreme fluctuations could be corrected and that market conditions can be explained by the new assessment of risks.

Gold sales and administration of free assets

The entry into force, at the beginning of May 2000, of the Federal Law on Currency and Payment Instruments has permitted us to start our sales programme for 1,300 tonnes of gold. To date, 160 tonnes have been put on the market, and we intend to sell the same quantity between now and the end of September 2001. Our sales activities are coordinated with those of the central banks which signed the agreement of 26 September 1999.

The Bank for International Settlements has been commissioned to effect the sale of the first 220 tonnes. As our periodic bank returns show, the gold is sold regularly, in small tranches, in order to avoid exerting an undue influence on prices. This procedure has borne fruit: the market has been able to absorb the additional supply without any problems. The average price of our sales amounted to 275.9 $/oz, which is slightly higher than the London fixing, the reference price on the gold market, during this period.

The dollar amounts generated by the gold sales are invested in different financial instruments authorised by the National Bank Law. In this way, a portfolio will gradually be built up which will ultimately be allocated to the objectives to be established by parliament. The final size of the portfolio will depend on two main parameters, i.e. (1) the development of the gold price in Swiss francs, and (2) the yield on investments. When the sales are completed, and based on the current gold price, the portfolio of free assets should amount to approximately Sfr 20 billion.

The possibilities of protecting ourselves against an unfavourable development of the gold price in Swiss francs are limited by the agreement of 26 September 1999, which prohibits us from hedging transactions with respect to the future gold price (expressed in dollars) on the market. We can, however, limit the uncertainties associated with the fluctuations of the dollar against the Swiss franc. Yet, a complete hedge is not warranted for experience has shown that there is a negative correlation between the development of the dollar against the Swiss franc and that of the gold price in dollars; a fall in the dollar price for gold is generally associated with a rise in the dollar against the Swiss franc. The existence of this "natural hedge" has led us to adopt a strategy of a partial hedge for the dollar risk by engaging in forward sales of dollars against Swiss francs in an amount corresponding to approximately a third of the proceeds from gold sales. In this way, we can limit the adverse effects which a depreciation of the dollar would have on future earnings from the sale of gold.

The proceeds from the sale of gold are invested in a bond portfolio with a considerably different composition from that of our foreign exchange reserves. The main reasons for this are twofold. First, even if we do not yet know the future beneficiaries of the free assets, we may nevertheless assume that they will be primarily interested in a portfolio which generates a regular flow of Swiss franc denominated yields. Second, these future beneficiaries will come into possession of their assets within two to three years, and it is essential that, at the time of transfer, the value of the accumulated portfolio will be sufficient to cover the amount to be remitted by the SNB. This is because up to that point in time the SNB must bear all the risks associated with the investments of the proceeds from the gold sales. Safeguarding the interests of the recipients of the ordinary profits of the SNB - the Confederation and the cantons - thus requires that we adopt an investment strategy that is not too aggressive. Approximately 60% of the portfolio is hedged against the exchange rate risk and thus corresponds to an investment in Swiss franc bonds. The balance is invested in Eurobonds (20%), in US dollars (10%) and in bonds denominated in other currencies (10%). The average duration of the portfolio is approximately three years.

The investment profile of the free assets has thus been defined so as to take into account, as far as possible, the needs of future beneficiaries and the probable date on which they will take possession of their assets. Besides, we have taken all the necessary administrative steps to ensure efficient portfolio management:

- The free assets are managed like a separate portfolio whose market value, yield and risk profile are known to us at any time. Nevertheless, since this portfolio does not yet constitute separate assets in the legal sense, it does not figure as such in our balance sheet. The investments are included under various positions on the assets side.
- We have defined reference portfolios with a reference index for every form of investment of free assets. Performance may thus be evaluated continually based on objective criteria.

With these measures, we ensure transparency in the management of the assets not required for the conduct of monetary policy, and this will facilitate their transfer to the future beneficiaries once the legal framework is in place.