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Speech given by Mr Jean-Pierre Roth, Chairman of the Governing Board, at the General Meeting of Shareholders of the Swiss National Bank on 27 April 2007

Mr President of the Bank Council

Dear shareholders

Dear guests

One hundred years ago the Swiss National Bank opened its counters and conducted its first transactions. Year for year, the Chairman of the Governing Board has had the privilege of outlining the economic situation to you and setting out the SNB policy approach. It is a great pleasure for me to continue this tradition today, and all the more so in view of the fact that the year 2006 was a particularly favourable one for our economy: Growth accelerated to reach a level higher than the long-term trend, while employment improved, bringing about a gradual reduction in unemployment. Meanwhile, the rise in prices remained restrained and distinctly below the level of 2% that we equate with price stability. Moreover, for the current year, the outlook for growth, employment and monetary stability remain very favourable.

Vigorous foreign trade

The healthy state of the Swiss economy has surprised many observers accustomed to the meagre results of the 1990s and nervous in the wake of the events of the early 2000s. Yet the good results can be explained quite logically, since they arise from a combination of particularly favourable factors.

First, I would like to mention the remarkable ability of the private sector to adapt to the challenges presented by the globalisation of markets. Thanks to reorganisation efforts in the export sector, results in foreign trade have improved substantially. Over the past ten years, our exports have grown by more than 80%, or five times as fast as the gross domestic product. We now run a surplus in goods trading in addition to our traditional surplus in the area of trade in services. The success of strategies geared to quality and high-tech content are demonstrated by the vigorous growth recorded by exports in high added-value areas such as electronics, watchmaking, chemical and pharmaceutical products. Alongside this we should mention the growth in the exports of services, particularly in the areas of finance and tourism. Overall, our net balance from trading in goods and services has increased from CHF 17 billion to CHF 37 billion in 10 years, in other words, from 4.6% to 8.3% of GDP. Clearly, far from threatening our expansion abroad, globalisation has led to an expansion in our markets from which our companies have been able to derive extensive benefits.

The prosperity of our foreign trade depends to a large extent on the good shape of the global economy, whose performance has been very good over the past few years. Recently, signs of weakness have been observed in the US, but a favourable international environment in 2007 can be expected in view of the unchanged vitality of the Asian economy and the recovery of growth in Europe.

In addition to the favourable impetus from the global economy, our exports also benefited from special conditions on the foreign exchange market. The introduction of the euro resulted in a stabilisation of the European monetary scene, and the Swiss franc was sheltered from the speculative disruptions that we have experienced in the past. Nowadays our currency is far less volatile that in the 1990s, and this is certainly beneficial for foreign trade. Moreover, although the dollar has lost ground over recent years, the euro has regained a level comparable to that of 1999. Since Swiss inflation was distinctly lower than that of our main trading partners, the real exchange rate index weighted by our exports to 24 countries has declined by almost 10% over the five last years. The competitive position of our exporters has improved accordingly.

Nevertheless, it would be precipitate to think that the Swiss franc was likely to continue weakening. In many respects, the current situation is paradoxical in view of the fact that currencies from countries where inflation is lowest – the Swiss franc and the Japanese yen – have lost ground to currencies from countries with a less favourable price outlook. Obviously, markets are responding in a short-term manner, as a function of current interest differentials or of expected changes in these differentials, without fully recognising the existing economic fundamentals or fearing the possibility of sudden adjustments in exchange rates. Inevitably, this speculative attitude is risky. History has shown us that reversals on foreign exchange markets often take people by surprise, that periods of strength in the Swiss franc may alternate with periods of weakness, and that the Swiss franc has a tendency to react excessively in times of uncertainty. Therefore, caution is called for. Our exporters need to retain control of their exchange risks even at times of low volatility. After all, nobody would think of doing without fire insurance just because their house had been spared for a number of years.

Domestic demand on the right path

Inevitably, the strong momentum of foreign trade has spilled over into investment and domestic consumption, and especially into employment.

Initially, an improvement in equipment investment and employment results from an increasing level of capacity utilisation. Thus, in manufacturing, the rate of capacity utilisation has been rising steadily since 2002 and has now reached a historical high. The corporate sector, which in 2005 was still hesitant about the soundness of the recovery, held a more favourable view last year. As a result, companies considerably stepped up their investment plans for equipment. At the same time, they created jobs – in particular full-time positions – at a faster rate. This led to a quicker drop in unemployment and the increased use of foreign labour.

Consequently, 2006 was very clearly a year of consolidation in the economic cycle, following the uncertainties of the prior periods. The current outlook represents a continuation of this situation since the order books are well filled and the CEO confidence index remains positive. Thus, the rate of unemployment is likely to continue dropping over the course of the next few months.

One sector that is dependent less on the foreign economic situation and more on the financial environment is the construction sector. Residential construction has benefited strongly from the low interest rates over the past few years. In 2006, 41,000 new dwellings came onto the market or almost double the number in the early 2000s. Demographic developments as well as increasing incomes linked to favourable financing conditions assured a healthy level of demand. Nevertheless, there were initial signs of saturation, and a gradual drop in the mortgage growth rate was evident. Everything points to a further decline in growth momentum for residential construction this year. By contrast, industrial and commercial construction is likely to continue improving.

Growth in employment and income had a favourable impact on household expenditure. Growing at a rate of some 2%, consumption became a driver of the economy, a situation which contrasted to that of past years. The continued decline in unemployment over the months to come is likely to consolidate this picture.

Overall, the Swiss economy recorded real growth of about 3% in 2006. This was the best result since 2000. While enjoying the benefits of healthy demand in both foreign and domestic markets, it was also able to take advantage of the increased flexibility of local production attributable to the fact that the labour market had been opened up to nationals of neighbouring countries – without threatening domestic employment. In the course of the past twelve months, almost 60,000 new jobs have been created – a figure unmatched since 2001 – while the number of jobless has dropped by 22,000.

Restructuring efforts on the part of the corporates, advances in productivity and the increased flexibility in the employment market have created an environment that allows more vigorous growth. Thus, the difficult path of reform and of opening up has yielded its first successes. It is advisable that we continue following this path in order to ensure a sustained and durable increase in our productive potential. This will help us to place our social security institutions on a sound financial basis again and confront the challenges posed by the aging of our population.

Continuing the normalisation of monetary policy

Within this context of an improved economic situation, the SNB last year continued the policy of gradually normalising the interest rates that it has been pursuing since June 2004. At each of our quarterly assessments of the economic and monetary situation, we have concluded that preservation of medium-term price stability demanded that the three-month Libor be adjusted once again, and it has thus been raised by 1.25 percentage points since January 2006.

With average inflation of 1.1%, 2006 was another year of price stability; indeed it was the thirteenth year such year in succession. The current situation remains comfortable due to the fact that the inflation outlook is moderate and last year's drop in oil prices is having a favourable impact on the indices. Nevertheless, we remain cautious since the productive resources in our economy are currently more or less fully employed and the Swiss franc has depreciated on the foreign exchange market – thereby tending to make our imports more expensive. We will continue increasing interest rates to the full extent that is necessary in order to preserve price stability in the medium term.

Risks

Based on the current momentum in the global economy, the outlook for 2007 looks good. Admittedly, there are signs of weakness in the US, but this phenomenon is likely to be temporary. In Europe, the recovery in 2006 was surprisingly strong. A slowdown is now expected, but not a marked downturn in the economy. Consequently, with respect to the economy, the assessment of risks appears relatively favourable for 2007.

Clearly, the price of oil remains a source of concern. The continued growth in the global economy as well as the experience of recent years has shown us how fast the oil market can spiral out of control, given the shortage of surplus production and refining capacity. Consequently, we cannot fully exclude the possibility that the current period of calm is only transitory.

We are currently observing an unusual situation of weak volatility on financial markets and low risk premiums on investments. These two variables can change direction very quickly. Consequently, we must remain on our guard since abrupt movements in financial variables – in stock prices as well as in exchange rates – have an immediate impact on our economy due to its considerable openness to foreign transactions and its relative specialisation in the production of financial services.

A comfortable position, in historical terms

With the Swiss economy close to full employment, the stability of prices secured over a period of several years now and a liberal and open economy making it possible to make full use of monetary policy instruments, the Swiss National Bank currently operates in a comfortable environment. In this year – the year that marks the hundredth anniversary of the establishment of our bank – we should not lose sight of the fact that our predecessors often faced situations that were far more difficult than those we face today.

So it was that, once the problems posed by the establishment of a banknote monopoly had been solved, the youthful SNB was quickly confronted, in 1914, with the problem of financing the military expenditure caused by the First World War and, after the end of hostilities, the difficulties related to normalisation. The social disruption of 1918 and the high level of inflation at the end of the war were bitterly felt and attributed to a failure of monetary management. This setback had a lasting effect on morale at the SNB and accounts to a considerable extent for the orthodoxy of the policies adopted in the decades that followed.

This accounts for the determination with which the SNB worked to restore the rules of the gold standard once peace had returned. The pre-war gold parity was re-established in 1924. However, after a few good years, the economic situation again deteriorated, culminating eventually in the crisis of the 1930s. The devaluation of sterling in 1931, followed by that of the dollar in 1933, were the first episodes in the eventual collapse of the gold standard. In 1936, following the devaluation of the French franc, the Swiss federal authorities were forced, in their turn, to reduce the parity of the Swiss franc.

A few years later, the challenge of administering a war economy again arose. The story of the Second World War, with its doubts, agonies and errors of judgement has been extensively analysed by historians over the past few years. Much reflection has also been carried out on the matter within the Swiss National Bank in order to better understand this difficult period in our own history.

The postwar period was characterised by a fierce determination to start afresh, to avoid the reappearance of the misleading thinking that had led to pre-war protectionism, and to reconstruct the economies that lay in ruins. A phase of intensive work began, with the aim of reorganising the international monetary order. Still isolated, both economically and politically, Switzerland participated in the efforts without becoming a member of the Bretton Woods Institutions. The gradual liberalisation of payments and trade rapidly led to a period of prosperity but also to a situation of disequilibrium in the operation of the international monetary system. Inflation and speculative movements of funds became common features during the 1960s and the monetary arena was disturbed by multiple devaluations, particularly in Europe.

Suspension of gold convertibility for the dollar, in 1971, hailed the collapse of the system of fixed exchange rates that had been put into place after the war. Faced with a massive flow of speculative funds, the SNB was forced to abandon stabilisation of the Swiss franc in 1973. The transition to sustained floating for the Swiss franc was definitely the most important change of direction in the monetary policy strategy pursued by our bank in its hundred years of existence.

Since then, the SNB has had to learn to operate with floating, and to conduct an independent monetary policy. This has not always been easy, since the international environment has often been extremely instable with the result that the Swiss franc has, at times, been heavily overvalued. During the 1980s, a greater degree of monetary discipline emerged and the fight against inflation became gradually more widespread. However, the world monetary order only achieved a certain level of calm towards the end of the 1990s, when the European monetary integration project took form and monetary policies were geared towards the defence of price stability.

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In sketching this rapid portrait of the hundred years of our history, we see how much circumstances have differed from one period to another. It is therefore fitting that we pay tribute to all of our predecessors who – often in difficult circumstances – gave of their best in order that the Swiss National Bank might fulfil its mandate. It was their prudent management of the country's business that sheltered us from the numerous monetary crises that battered so many other European states. It was they, too, whose determination made it possible for the SNB to conduct a monetary policy resolutely geared to stability.

Our generation is deriving immense benefit from this heritage. Due to the courage and sacrifices of those who preceded us, we now reap the benefits of a prosperous economy and a healthy currency.

Our gratitude also extends to the authorities and to the Swiss people. We are appreciative of the confidence placed in us by the Federal Council and by parliament. In guaranteeing our independence, the Federal Constitution gives us the means to act entirely in the interests of monetary stability. The political authorities can count on us using our freedom of action solely in the interests of fulfilling the mandates with which we are entrusted by the legislator.

We are also aware that, despite our efforts to communicate our decisions, the general public often finds them difficult to understand. That is why we truly value the confidence that the public places in us. It helps to sustain us when carrying out the mandate with which we are entrusted under art. 99 of the Federal Constitution, that of conducting a monetary policy that serves the interests of the country as a whole.

Finally, I would also like to thank you, the shareholders of the Swiss National Bank. As representatives of cantons, cantonal banks, collective bodies or Swiss public law institutions, or as individual shareholders, you have faithfully supported the Swiss National Bank since its foundation in 1907. You have remained at its side throughout all the ups and downs of its history and we are grateful for your support.

Your presence is the guarantee of our independence, an essential factor in the success of our efforts to preserve the monetary stability of our country.