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.

Indicators of relevance to the inflation forecast

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.

Review of monetary policy based on 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.

Target range for the three-month Libor

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.

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.

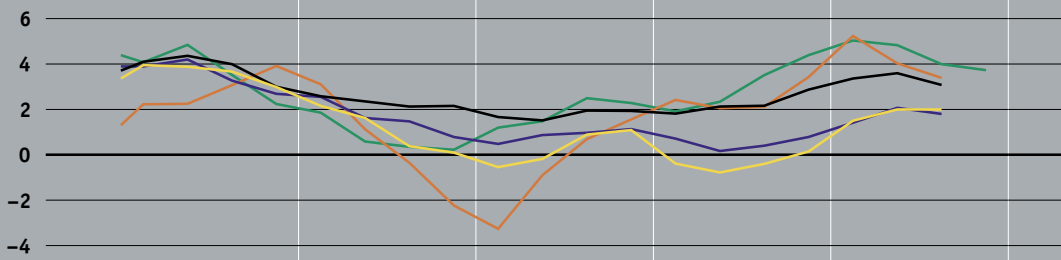
Dynamic Asia

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.

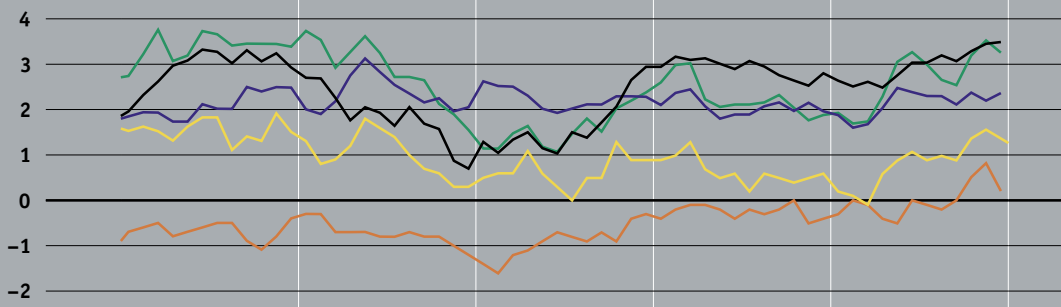
Gross domestic product



United States
Japan
Euro area
United Kingdom
Switzerland

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

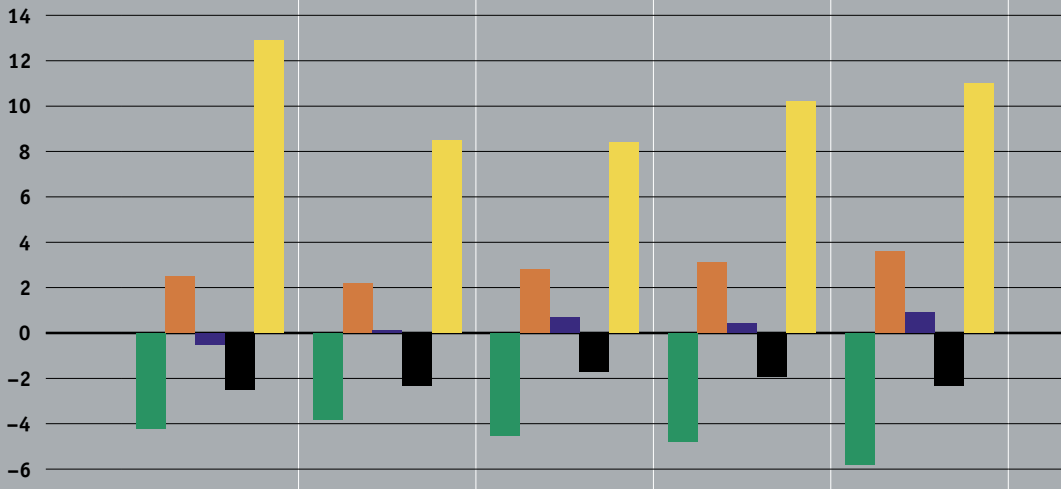
Inflation



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

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.

Gross domestic product and components

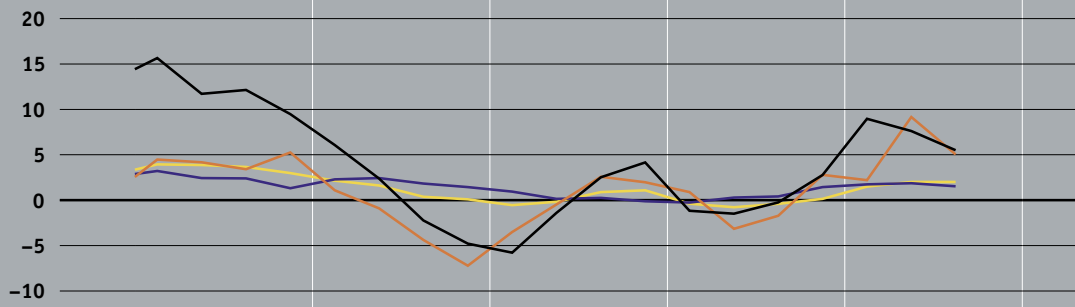
GDP

Private consumption

Investment in fixed assets

Exports

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

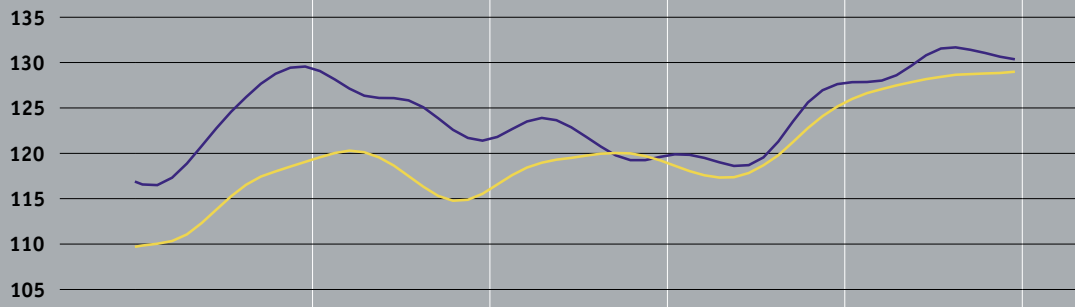


Foreign trade

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

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

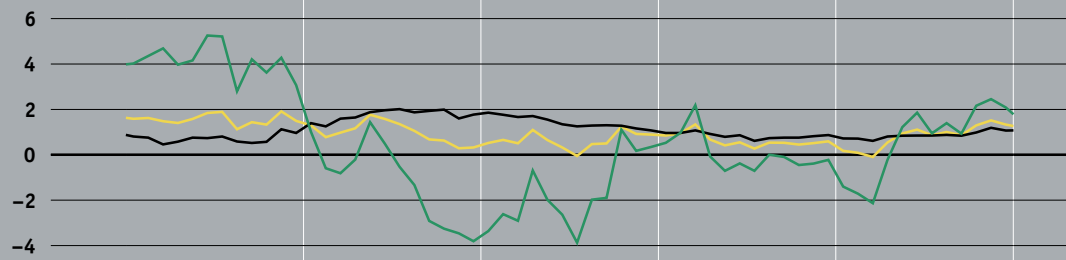
Dearer oil products, housing rents and public services

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

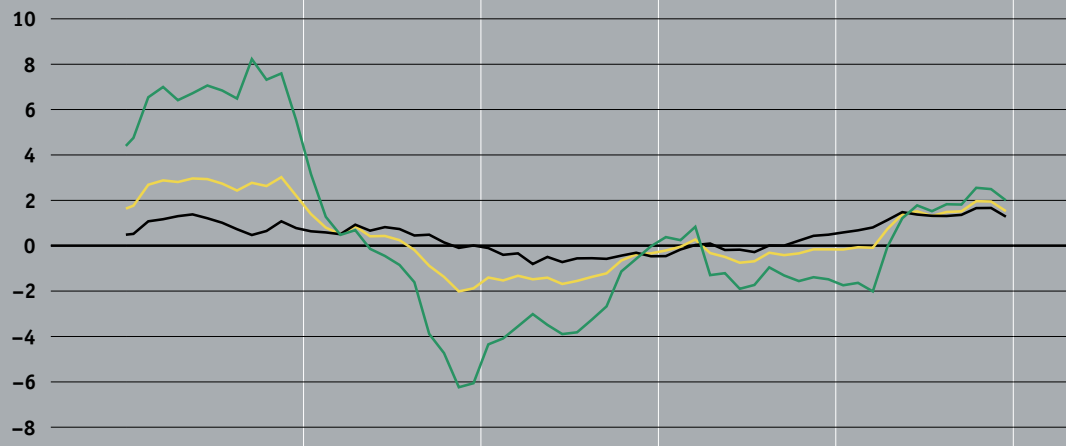
Year-on-year change
in percent
Source: SFSO



Producer and import prices

Producer and import prices
Producer prices
Import prices

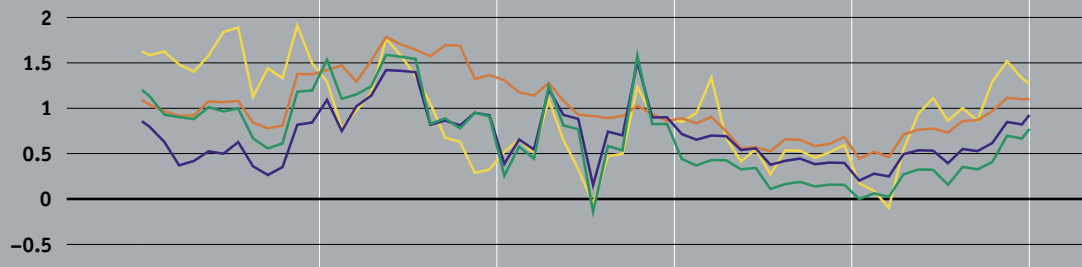
Year-on-year change
in percent
Source: SFSO



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.

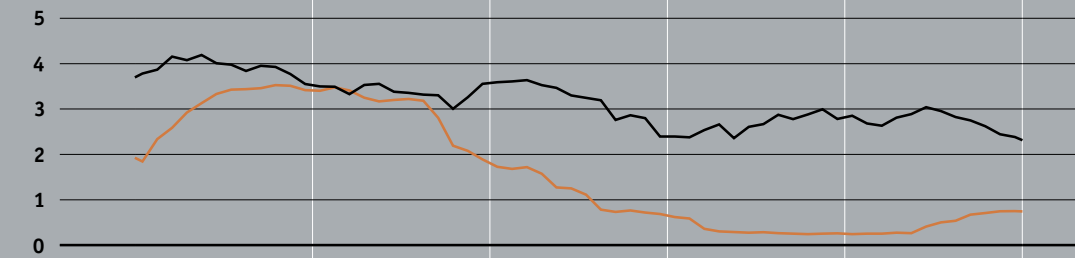
Capital market yields still low

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.

Money and capital market rates

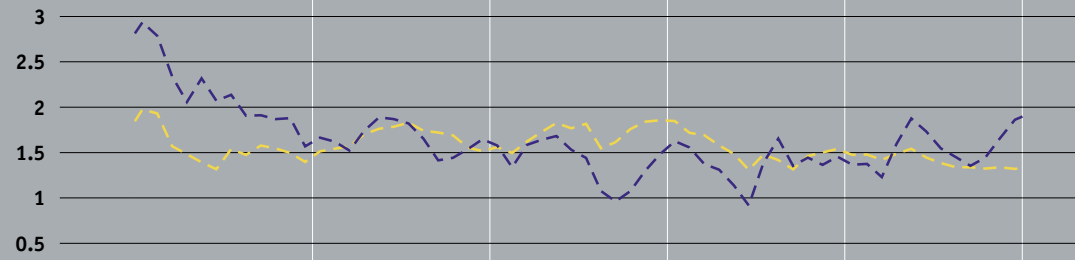


Three-month Libor

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

In percent

Spreads for long-term interest rates

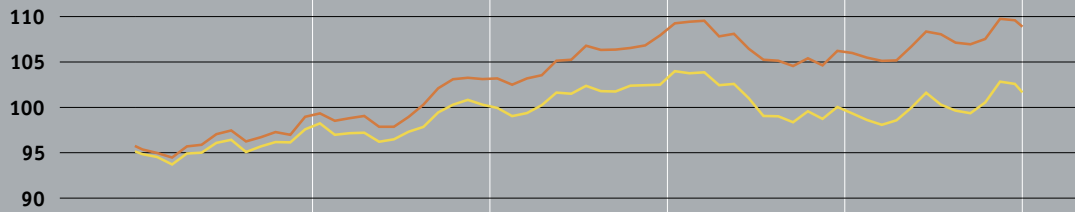


Euro area - Switzerland

United States - Switzerland

Spread in percentage points
Source: BIS

Export-weighted Swiss franc exchange rates

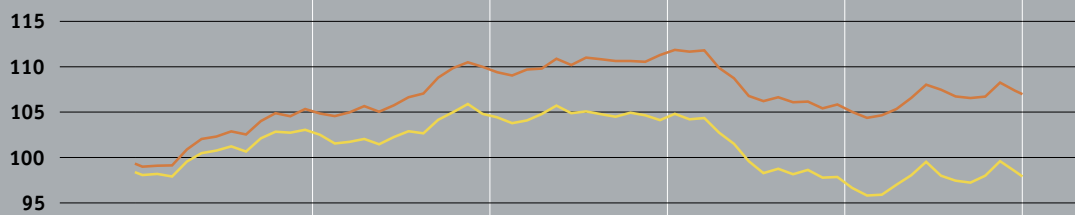


Real

Nominal

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

Export-weighted Swiss franc exchange rates



Real

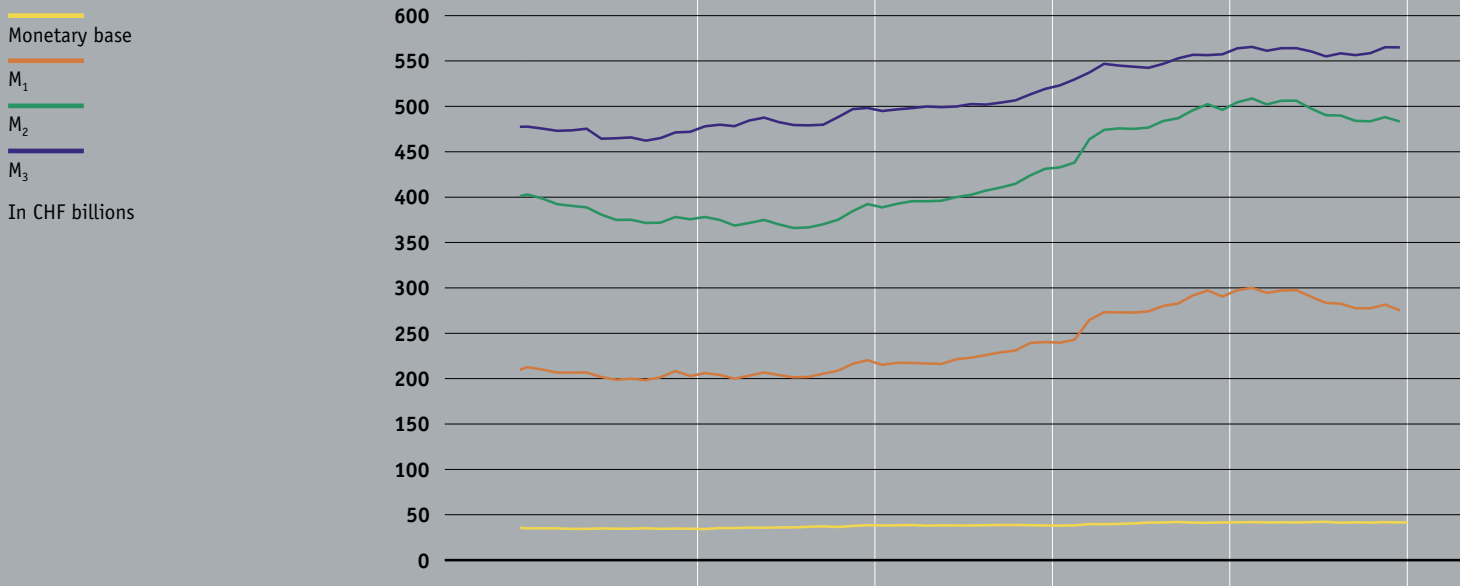
Nominal

16 European trading partners
Index: January 1999 = 100

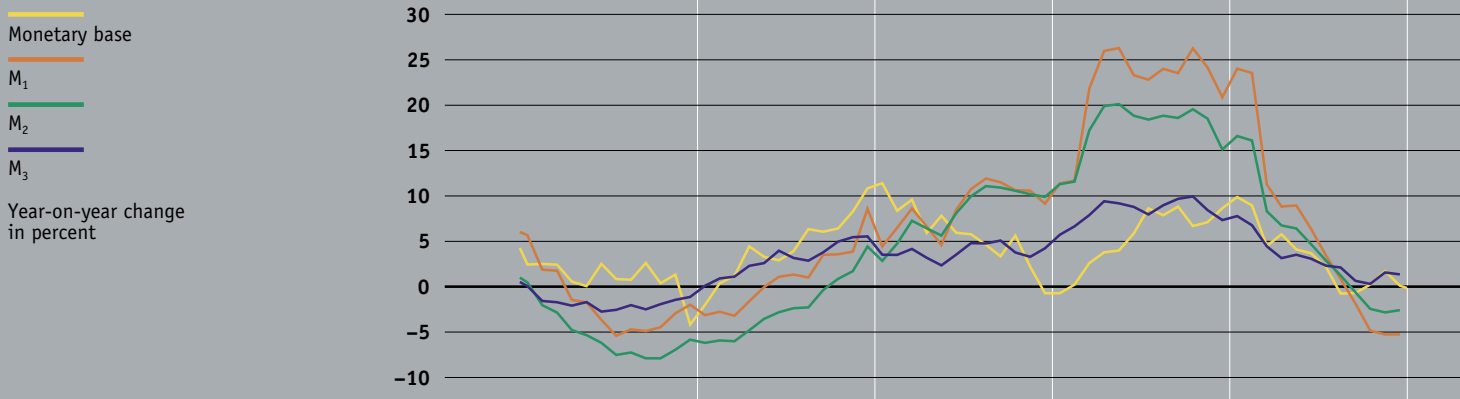
Reduced money overhang

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



Growth rates of monetary aggregates



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.

Three-month Libor

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.

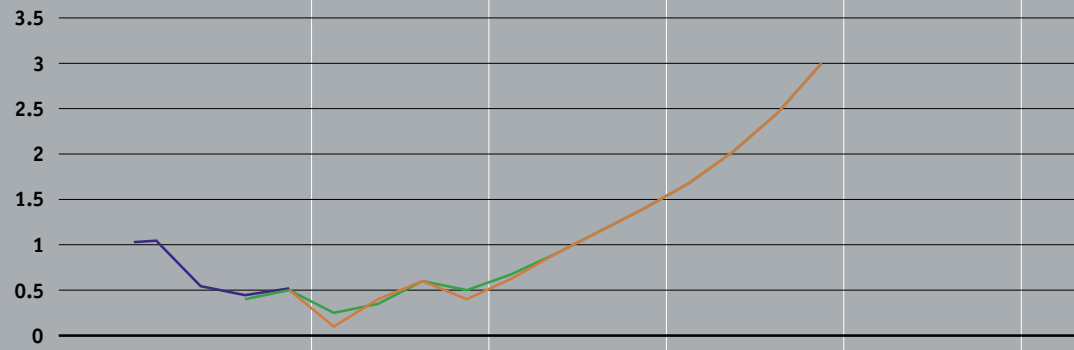
Inflation forecast Q1 2004

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



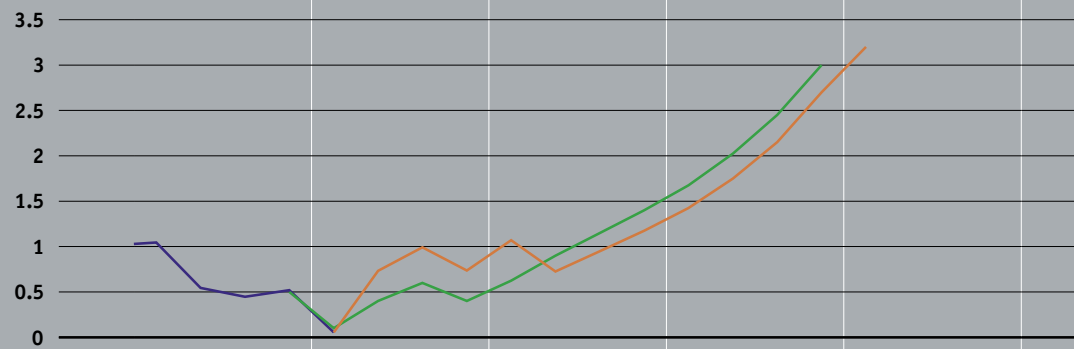
Inflation forecast Q2 2004

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



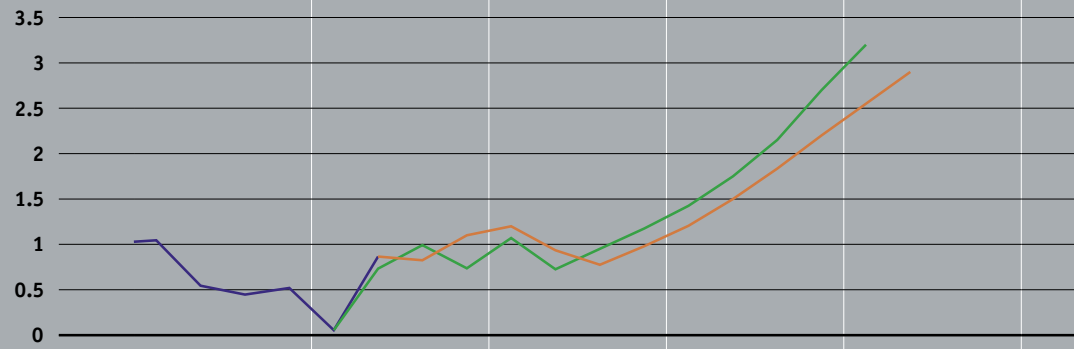
Inflation forecast Q3 2004

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



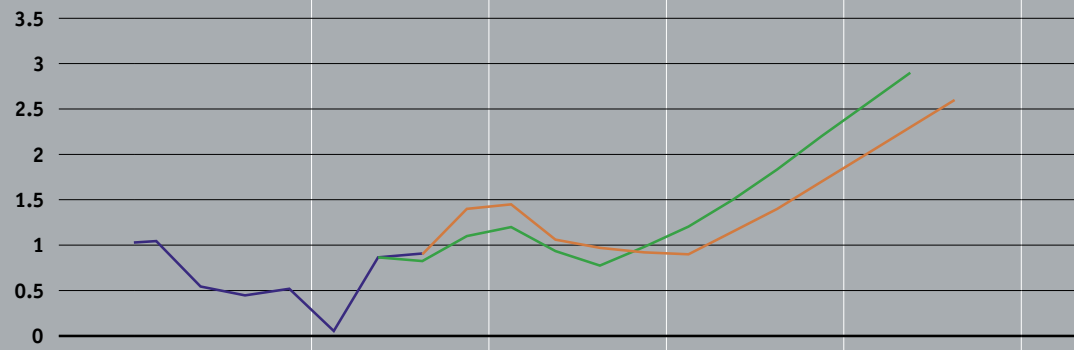
Inflation forecast Q4 2004

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



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.

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.

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.

Monetary policy torn between short and long-term needs

1.5 Statistical activities

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.

Legal basis

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.

Broad cooperation

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).

... with the SFSO

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 SFBC

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 banking statistics committee

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 group of experts on the balance of payments

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 foreign agencies

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.

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

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.

Counterfeits

3.3 Coins

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.

Mandate

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.

Coin circulation and minting

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.

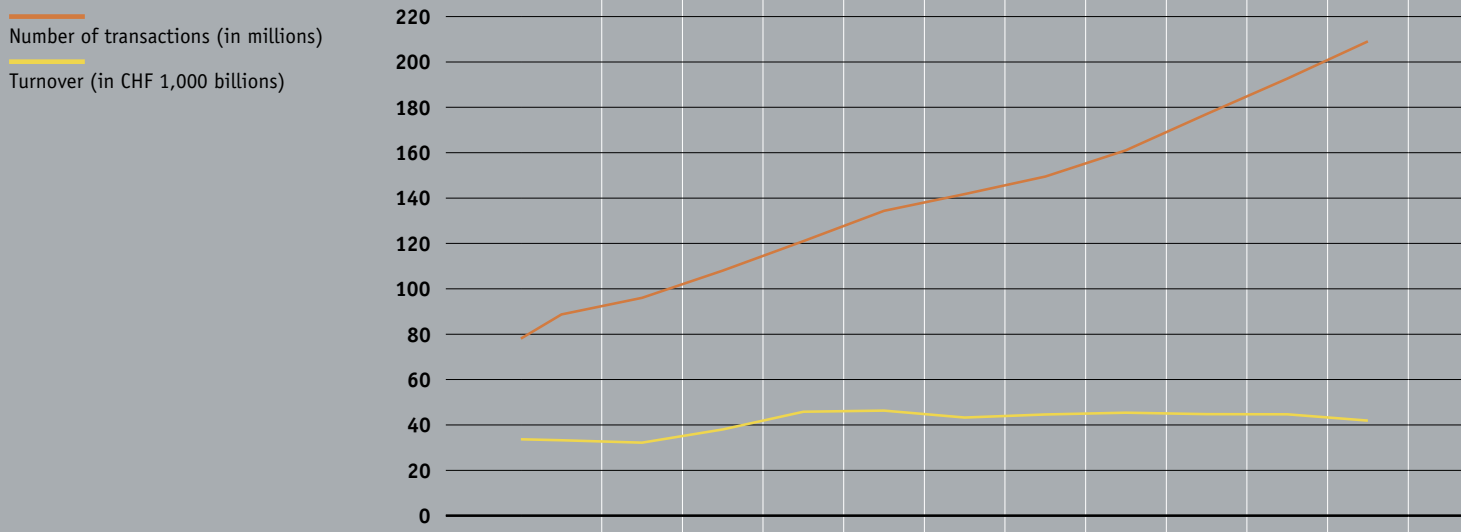
SIC and monetary policy

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



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

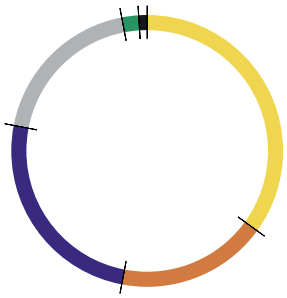
Composition of assets

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.

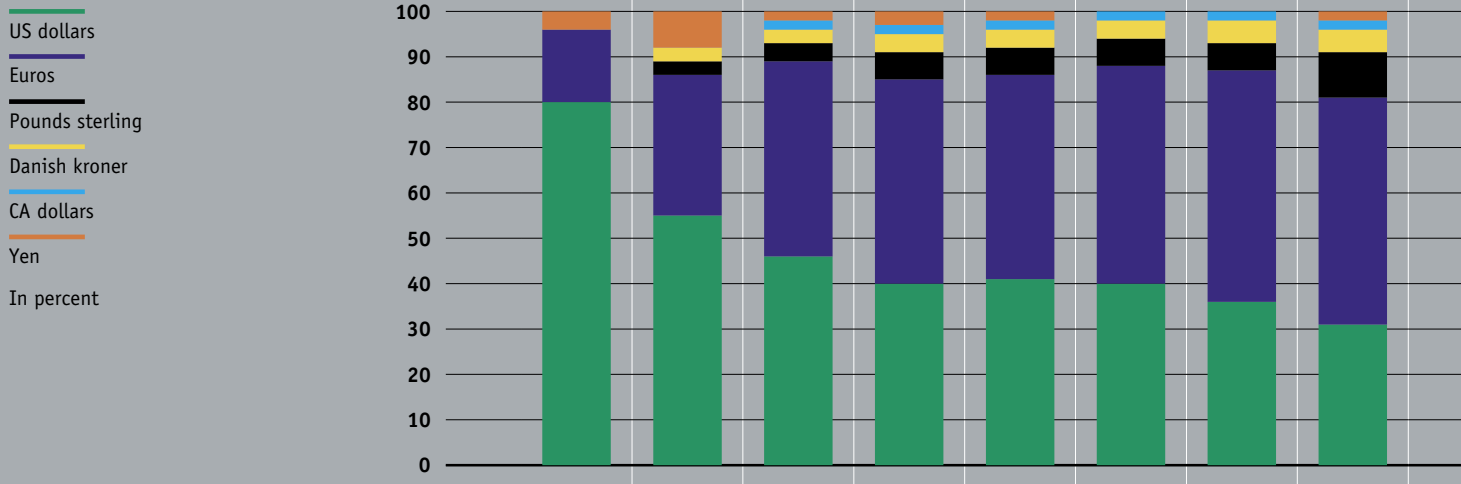
... of monetary Swiss franc investments

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



... of free assets

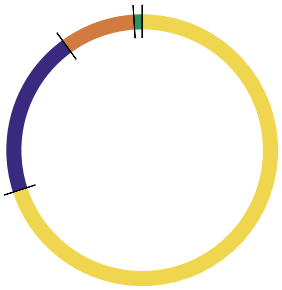
The risk profile of the free assets clearly differed from that of the currency reserves in that overall risk was significantly lower. On the one hand, this is attributable to the fact that there were no monetary policy restrictions imposing a currency allocation which was – from an investment policy 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.

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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.

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.

... and to other countries

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.