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President's address by Mr Hansueli Raggenbass, President of the Bank Council, at the General Meeting of Shareholders of the Swiss National Bank on 29 April 2005

Dear Shareholders

Dear Guests

Ladies and Gentlemen

I will begin my address today with a look at the 2004 annual result, before moving on to say a few words about the volatility of the earnings and the long-term return expectations. To conclude, I will briefly review the impact of the new National Bank Act.

Please allow me now to make a few remarks on the 2004 financial statements.

2004 Financial Report

Gross income

As you are aware, the provisions for the assignment of free assets, which correspond to the proceeds from the sale of the 1,300 tonnes of gold, were written back and released for distribution. The unusually high annual result for 2004 of CHF 21.6 billion must be regarded in this context.

In fact, the gross income came to only CHF 0.6 billion, which is considerably lower than the previous year's result of CHF 4.3 billion. The decline is primarily attributable to the influence of the valuation of gold in Swiss francs. In 2003, the gold price had increased by almost 9% and had led to valuation gains of CHF 2.2 billion. While the price of gold initially climbed further in the first quarter of 2004, it ended up losing around 4% year-on-year. This fall was reflected in the income statement, with valuation losses of just under CHF 1 billion.

Approximately half the balance sheet total is invested in foreign currency, mostly in euros and US dollars. The gain or loss on these investments depends strongly on the fluctuations in interest rates and exchange rates. In 2004, it amounted to CHF 1.2 billion, which was roughly 20% below the year-earlier level. In most markets in which the National Bank invested, the interest rate level dropped last year. This resulted in rising bond prices, which in turn led to valuation gains in the National Bank's investment portfolio. At more than CHF 3 billion, investment performance before exchange rate influences was quite gratifying. Foreign exchange rate movements narrowed this result significantly, however. At the end of 2004, exchange rates for foreign currency holdings were lower across the board compared with the previous year and resulted in valuation losses to the value of CHF 2 billion. Dropping by nearly 9%, the US dollar exhibited an especially pronounced decline.

Swiss franc investments contributed CHF 0.3 billion to the gross result. The Swiss franc bond portfolio accounted for most of this amount. As was already the case in 2003, the income from repo transactions was comparatively modest. Although the National Bank pushed up the repo rates slightly both in June and September, they were still a very low level – of around 0.6% – at the end of the year.

Declining operating expenses

Operating expenses decreased by approximately CHF 10 million to just over CHF 200 million. Banknote expenses and general overheads registered a marked decline, while personnel expenses increased by around 1%. The reason for the drop in banknote expenses was that, compared with the previous year, far fewer banknotes needed to be taken out of circulation and replaced.

Distribution of the proceeds from the gold sales

As announced, the proceeds from the sale of the 1,300 tonnes of gold are to be distributed from the 2004 annual result, with one-third going to the Confederation and two-thirds to the cantons. To this effect, a special distribution agreement was concluded between the Federal Department of Finance and the Swiss National Bank. The proceeds amount to a little more than CHF 21.1 billion.

After the Council of States' decision on 16 December 2004 not to consider the bill on the appropriation of the surplus gold reserves, it was to be assumed that there could be no majority in Parliament supporting another such bill from the Federal Council. Given the Federal Council's decision of 2 February 2005 to distribute the gold assets to the Confederation and the cantons, the Council of State's non-consideration of December 2004 became effective. The Bank Council and the Governing Board of the National Bank decided therefore that the continued retention of the SNB's gold assets was no longer justifiable. The swift distribution of these assets will release the National Bank of its dual role as a monetary policy authority and an asset manager for the state.

Mr Jean-Pierre Roth, Chairman of the Governing Board, will go into the details in his address.

Ordinary distribution of profit

I would now like to move on to discuss a change to the Financial Report. This change concerns the treatment of the provisions which permit the National Bank to maintain the currency reserves at a level necessary for monetary policy. These provisions are made up of retained profits. In accordance with the law, the required level of provisions is determined by economic growth in Switzerland. Furthermore, in the second half of the 1990s, considerable additional provisions accumulated owing to the National Bank's excellent earnings power. These have been steadily reduced since the 2003 financial year. In this year's accounts, the targeted level of provisions and the surplus provisions are being reported for the first time as two separate positions. In so doing, the National Bank is presenting the required level of provisions and the distributable amount in a transparent manner.

This time last year, I pointed out that the distribution of profit is a long-term issue which causes the National Bank a certain degree of concern. Nothing has changed in the meantime. On the contrary: in 2004, the National Bank generated a gross income of CHF 0.6 billion. After taking into consideration the operating expenses and the release from the provisions for the assignment of free assets, and after the deduction of the CHF 0.9 billion needed to reach the targeted level of provisions, the result was a loss of CHF 0.4 billion. In order to cover this loss and carry out the agreed distribution of CHF 2.9 billion to the Confederation and cantons, a total of CHF 3.3 billion had to be released from the distribution reserve, which is the new term to refer to surplus provisions. Following this release, the total in the distribution reserve is now just under 7 billion. In other words, it is now only double the amount being released this year! The 2004 financial result reflects this clearly: the current profit distribution considerably exceeds the National Bank's profit potential. When budgeting its expenses, the public sector should not come to expect distributions of this size, but should be prepared to receive lower distributions in the future. The current agreement, which is valid until the 2012 financial year, will be reviewed after five years, namely in 2007. Given the circumstances already mentioned, an adjustment of the annual profit distribution could then become necessary.

Allow me now to move on to the earnings fluctuations and prospects.

Earnings fluctuations and prospects

The results of the past 15 years show that the National Bank's earnings can fluctuate dramatically. The annual results – not including extraordinary income – seesawed between minus 1.6 billion Swiss francs in 1995 and plus 6.4 billion in 1996. Bear in mind that the gold reserves were valued up until 1999 at the then applicable statutory parity rate. Market-driven changes to the gold price have thus only been reflected in the annual result since 2000. Had the gold reserves been valued at market price already at an earlier date, the annual fluctuations in earnings would have been far greater, namely between minus 11.1 billion francs in 1990 and plus 10.8 billion in 1996. Not only that, the reported earnings would have been generally lower, as the gold price in Swiss francs declined during this period.

Since the 1997 revision of the National Bank Act and the suspension of the official gold parity in 2000, the National Bank has been better able to manage its assets. Owing to the targeted diversification of foreign exchange reserves, the dependency on the US dollar was reduced in particular. At the same time, the development of more long-term bond investments led to an increase in the earnings potential. With the revision of the National Bank Act in 2003, the investment provisions were extensively liberalised, with the result that the yield potential of investments was strengthened yet a little further.

This notwithstanding, the return on the National Bank's assets is likely to remain relatively moderate and earnings fluctuations comparatively strong. This is both due to the fact that the nominal yield level in the markets is currently quite low, and that, where asset management is concerned, monetary policy always has priority over income considerations. First and foremost, the National Bank's assets must fulfil monetary policy functions. Swiss franc investments are used primarily for the conduct of monetary policy and are hence largely made up of money market investments. Likewise, the currency reserves – in the form of foreign exchange and gold – held by the National Bank do not serve in the first instance as a source of income, but rather help prevent and overcome crises. Given the primacy of monetary policy, the National Bank does not use just any method to hedge against risks to its assets – particularly those to gold and foreign exchange reserves. It also means that when it comes to selecting its investment instruments, the Bank weights criteria such as security and liquidity more heavily than return.

The return perspectives of the National Bank depend on its asset level and the yield potential of its investments. With the distribution of the proceeds from the gold sales, the assets will contract by CHF 21.1 billion. The reduction of the distribution reserve by almost CHF 7 billion as part of the regular profit distribution will cut the income-yielding assets yet further. Above-average yields on bond investments are not anticipated in the foreseeable future. Interest rates are so low globally, that they are bound to increase sooner or later. However, a rise in interest rates would initially lead to capital losses on the National Bank's bond investments. The fluctuations in the gold price and exchange rates, which continue to have the strongest influence on the National Bank's earnings, cannot be forecast with any degree of reliability.

Overall, the National Bank anticipates a nominal yield of slightly less than 3% on its assets in the longer term. However, after operating expenses and the legally prescribed allocation of provisions, an annual distributable income of just below CHF 1 billion is all that is likely to remain. In addition, relatively large fluctuations in earnings can also be expected going forward. Alone the normal spread of the annual yield has to be estimated at between minus 2% to plus 7%. Depending on how the financial markets perform, yield spreads are likely to be even greater. Fluctuations in earnings should thus continue to remain comparatively sharp.

I would now like to take a look at the impact of the new National Bank Act.

New National Bank Act

As you know, the new National Bank Act entered into force one year ago – on 1 May 2004. It brought with it a whole range of changes for the National Bank. These primarily concern the detailed formulation of the central bank mandate, the definition of independence and duty of accountability, and the extension of autonomy in monetary and investment policy activities.

The new Act did not change anything about the National Bank's legal form – which is that of a special statute joint-stock company. The legal structure underpins the Bank's constitutional independence in an institutional sense.

However, the new Act now also reflects the current legal situation of private listed stock companies. In this regard, the share capital – which, given the National Bank's much higher balance sheet total and its level of provisions today, is no longer significant as a risk-bearing element – was reduced to the paid-up amount of CHF 25 million. The nominal value of one SNB share has consequently now been reduced from CHF 500 to CHF 250.

In this context, the Bank Council decided in spring 2004 to completely waive the issue of share certificates in the future. In the meantime, the so-called registered share model – where the shares are not printed – has become established at the SNB. Numerous shareholders have availed themselves of the opportunity to have their value rights held free of charge by the National Bank.

The new Act has also simplified the structure of the Bank's bodies. For instance, the number of bodies was lowered from seven to four: the General Meeting of Shareholders, the Bank Council, the Governing Board and the Audit Board. Also, the Bank Council, which is responsible for overseeing the business activity, was reduced from forty to eleven members. In line with corporate governance, the Bank Council also appointed four committees from its members. An Audit Committee supports the Bank Council in supervising financial accounting and financial reporting. It also supervises the activity of the external and internal auditors. A Risk Committee supports the Bank Council in overseeing the investment process and risk management. A Compensation Committee assists the Bank Council in determining the principles of the National Bank's compensation and salary policy. And finally, a Nomination Committee prepares proposals for the election of Governing Board members and their deputies and submits these to the Bank Council and the Federal Council.

The new Act thus provides the National Bank with a modern statutory basis. Corporate governance was strengthened and the relationship between management and supervision improved. In my opinion, the new structure of the Bank's bodies and the new procedures have proved highly successful.

Concluding remarks

To conclude, I would like to express my sincere thanks to the Governing Board and the staff of the National Bank for their competent and dedicated service.