Accountability Report for the Federal Assembly

On 21 February 2007, the Governing Board of the Swiss National Bank submitted its 2006 Accountability Report to the Federal Assembly in accordance with art. 7 para. 2 of the National Bank Act. The following Accountability Report is submitted 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 National Bank Act (NBA), the Swiss National Bank (SNB) submits an annual accountability report to the Federal Assembly in which it outlines how it has fulfilled its mandate. This report on the year 2006 is structured in line with art. 5 NBA, with a separate section devoted to each of the eight tasks listed there.

Monetary policy

(1) Monetary policy must serve the interests of the country as a whole. It must ensure price stability, while taking due account of economic developments. Monetary policy has an impact on production and prices with a considerable time lag. Consequently, monetary policy is directed at future rather than current inflation. 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.

In 2006, the global economy was experiencing the third year of a powerful upsurge. While the US was losing economic momentum, Europe was gaining ground and Asia continued to expand. Oil prices shot up, only to sink back to their original level. Inflation was not unaffected by these developments, but nevertheless remained largely under control.

In Switzerland, too, the recovery was strong. It began with exports and then moved into domestic sales and industrial products. While there was little activity on the labour market in the early stages, the utilisation of technical capacities reached unusually high levels. The initial hesitation with respect to equipment investment disappeared, and consumer confidence firmed. The only area in which momentum declined was investment in construction, which had seen lively activity for a number of years. Employment increased in the form of higher participation and through migration.

Within this context of economic recovery, the SNB continued its process of monetary policy normalisation. It increased the target range for the three-month Libor in four equal steps to 1.5–2.5%. The increases were moderate and carried out at regular intervals. Despite the rise in oil prices in the middle of the year, the recovery proceeded steadily and the outlook for inflation remained unchanged, permitting the SNB to gradually tighten the monetary policy reins. This approach was intended to ensure price stability in the medium term while taking the best possible account of the economic situation.

Liquidity supply

(2) The Swiss National Bank provides the money market with liquidity. It thereby implements monetary policy and acts as lender of last resort when necessary. The NBA sets out the admissible central bank transactions, while the Guidelines on Monetary Policy Instruments specify the instruments and procedures, the eligible securities as well as the conditions for lending of last resort. The supply of money was ensured through a range of instruments which are based on repo transactions. Within the context of monetary policy normalisation, repo rates were increased from 0.73% to 1.90%, and average sight deposits at the end of the day rose by CHF 0.4 billion to CHF 5.2 billion.

Cash supply and distribution

(3) The Swiss National Bank holds the note-issuing privilege. Through the banks and the postal service, it supplies the economy with banknotes and coins, the latter on behalf of the Swiss Confederation. In 2006, it again focused on maintaining the quality of banknotes and of cash transactions, on further developing security features and on precautionary measures to prevent counterfeiting. As part of the project to develop a future series of banknotes, the content, design and production technology aspects of the previous year's winning designs were advanced further. At the end of the year, the Lugano cash office was closed.

Payment systems

(4) In the area of cashless payments, the Swiss National Bank is mandated to facilitate and secure the functioning of the appropriate systems. It operates accounts for the banks, guides the SIC interbank payment system and oversees payment and securities settlement systems. In 2006, for the first time, the SNB required system operators to provide their own estimates on compliance with the minimum requirements. In addition, it judged a fifth system operator to be systemically important and included it in its oversight activities.

(5) The Swiss National Bank manages Switzerland's currency reserves. Currency reserves serve to prevent and overcome potential crises. Asset management is governed by the primacy of monetary policy and is carried out according to the criteria of security, liquidity and performance. Guidelines laid down by the Governing Board define the investment principles and investment instruments as well as the investment and risk control processes. Investments, most of them in foreign exchange, gold and Swiss franc claims from repo transactions, remained focused on liquid currencies and investment markets, and on the highest credit ratings. The investment universe and portfolio breakdown was almost unchanged. Earnings exceeded long-term return expectations. Once again, gold was particularly outstanding. However, it also bears the greatest risk.

Currency reserves

(6) The Swiss National Bank is charged with helping to secure the stability of the financial system. Monetary policy depends on a stable financial system and well-functioning financial markets in order to achieve its goals. At the same time, good monetary policy is an important prerequisite for the stability of the financial system. The SNB seeks to identify potential risks at an early stage and to create an environment that is conducive to stability. In its Financial Stability Report, the SNB judged the banking system and financial market infrastructure to be stable. It took part in preparatory work for the implementation of the new Basel Capital Accord (Basel II) in the Basel Committee, and was a member of the Swiss Federal Banking Commission (SFBC) working group which translated Basel II into Swiss banking regulations. The SNB also contributed to the reform of securities legislation.

Financial system stability

(7) The Swiss National Bank participates in international monetary cooperation activities. Important bodies are the International Monetary Fund (IMF), the Group of Ten (G10), the Bank for International Settlements (BIS) and the Organisation for Economic Cooperation and Development (OECD). The main activities of the IMF were the surveillance of member states and the reform of quotas and voting rights. The IMF introduced multilateral consultations with systemically important countries and economic blocs, and planned a liquidity instrument for emerging markets that pursue a sound economic policy but are still vulnerable in the area of foreign trade. The BIS committees in which the SNB participates were concerned with banking supervision, payment transactions, the global financial system and financial markets. SNB technical assistance focused on the countries that belong to its IMF constituency.

Monetary cooperation

(8) The Swiss National Bank provides the Swiss Confederation with banking services in the areas of payment transactions as well as liquidity and securities management. In 2006, the SNB issued money market debt register claims and bonds for a total value of CHF 51.7 billion and carried out 150,000 payment transactions on behalf of the Confederation.

Banker to the Confederation

1 Monetary policy

Overview

Favourable conditions prevailed in the domestic and global economies in 2006. The Swiss National Bank maintained the normalisation of its monetary policy, lifting the target range for the three-month Libor (money market rate for three-month investments in Swiss francs) at each of its quarterly monetary policy assessments in 2006. Price stability was assured.

Section 1.1 presents the legal basis underlying the SNB's monetary policy, its mandate and its monetary policy strategy. Sections 1.2 and 1.3 examine economic developments in Switzerland and abroad. Section 1.4 reviews monetary policy in 2006 and discusses the Governing Board's decisions, placing them in the context within which they were made. Finally, section 1.5 is devoted to SNB activities in the field of statistics.

1.1 Monetary policy approach

Constitutional and legal mandate

The Federal Constitution entrusts the Swiss National Bank, as an independent central bank, with the conduct of monetary policy in the interests of the country as a whole (art. 99 FC). The mandate is explained in detail in the National Bank Act (art. 5 para. 1), which requires the SNB to ensure price stability and, in so doing, to take due account of economic developments.

The SNB is thus charged with resolving in the best general interests any conflicts arising between the objective of price stability and business cycle considerations, giving priority to price stability. The requirement to act in the 'interests of the country as a whole' requires the National Bank to gear its policy to the needs of the Swiss economy as a whole rather than the interests of individual regions or industries.

Significance of price stability

Price stability contributes to economic growth. Stable prices are an important prerequisite for the smooth functioning of the economy, as both inflation and deflation impede decision-making by consumers and producers, and generate high social costs.

The aim of the SNB's monetary policy is to ensure price stability in the medium and long term; in other words, it strives to prevent both sustained inflation and deflation. Short-term price fluctuations, however, cannot be counteracted by monetary policy. By keeping prices stable, monetary policy creates an environment in which the economy can exploit its production potential.

To secure price stability, the SNB must provide appropriate monetary conditions. 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 production capacity is stretched, thus causing a rise in the level of prices. Conversely, 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 shortage of aggregate demand. This has a dampening effect on the prices of goods and services.

Taking economic activity into account

The economy is subject to numerous domestic and foreign shocks. These cause fluctuations in the business cycle which generate pressures on prices that are more or less pronounced. Such fluctuations are inevitable. Although monetary policy is medium and long-term in nature, it can help to limit these fluctuations. In this sense, the National Bank also takes the economic development into account when formulating its monetary policy.

The SNB faces highly diverse situations. The most common cause of inflationary or deflationary phases is when aggregate demand for goods and services does not develop in line with the economy's production capacity. Such situations can arise, for example, as a result of unforeseen fluctuations in the international economy, persistent exchange rate distortions, serious government budget problems or inappropriate money supply levels in the past. Inflationary pressures increase in phases of economic overheating and decrease in phases when production capacity is not fully utilised. The National Bank will thus tend to tighten monetary policy in the first case and ease it in the latter. Consequently, monetary policy that is geared to price stability has a corrective influence on aggregate demand and thus helps to smooth economic activity. The SNB's strategy must therefore aim at gradually restoring price stability.

The situation is more complex when prices rise owing to shocks that drive up corporate costs and curb production. A continuous rise in the oil price is an example of such a shock. Under such circumstances, monetary policy must make sure that the higher production costs do not result in an inflationary spiral. It should also see to it that the companies affected by the shocks are not excessively disadvantaged. A too hasty restoration of price stability might have adverse effects on the business cycle and employment.

Even though the SNB takes economic developments into consideration when formulating its monetary policy, it cannot be expected to fine-tune them. There are too many uncertainties regarding the cause and duration of the shocks that impair economic performance, the transmission mechanisms, the time lag that elapses before monetary policy affects the business cycle and prices, and the extent of its impact.

Monetary policy approach

The monetary policy in force since 2000 consists of the following three elements: (1) a definition of price stability, (2) a medium-term inflation forecast, and (3) a target range for a reference interest rate, the three-month Libor (London Interbank Offered Rate) for Swiss francs – an operational level element.

Definition of price stability

The Swiss National Bank equates price stability with a rise in the national consumer price index (CPI) of less than 2% per annum. In so doing, it takes account of the fact that not every price movement is necessarily inflationary in nature. Furthermore, it believes that inflation cannot be measured accurately. Measurement problems arise, for example, when the quality of goods and services improves. Such changes are not properly accounted for in the CPI; as a result, the measured level of inflation will tend to be slightly overstated.

Quarterly publication of inflation forecast

The SNB reviews its monetary policy on a regular basis to ensure that it is appropriate for the maintenance of price stability. With this in mind, it publishes a quarterly forecast of the development of inflation over the three subsequent years. The period of three years corresponds more or less to the time required for the transmission of monetary stimuli to the economy. Forecasts over such a long time horizon are, however, fraught with considerable uncertainties. By publishing a medium to long-term forecast, the SNB emphasises the need to adopt a forward-looking stance and to react at an early stage to any inflationary or deflationary threats.

The SNB's inflation forecast is based on a scenario for global economic developments and on the assumption that the Libor will remain constant over the entire forecasting period. The forecast thus maps the future development of prices based on a specific world economic scenario and an unchanged monetary policy in Switzerland. For this reason, it is not directly comparable with forecasts incorporating expected monetary policy decisions.

Indicators of relevance to the inflation forecast

In the medium and long term, price developments depend decisively on the supply of money. The monetary aggregates and loans thus hold a relatively important position among the many indicators employed in the various quantitative models used for forecasting inflation over the next two to three years. For shorter-term inflation forecasts, other indicators relating, for instance, to economic activity, exchange rates or oil prices, are generally of greater importance.

The SNB regularly issues statements on the development of the principal monetary policy indicators factored into its inflation forecast. It has provided details of the models it uses in several of its publications.

If the inflation forecast indicates a deviation from the level of inflation that the SNB equates with price stability, monetary policy needs to be adjusted. Should inflation threaten to exceed 2% permanently, the SNB 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 its inflation forecast; it takes account of the general economic situation in its decisions on monetary policy measures.

Review of monetary policy based on the inflation forecast

If inflation temporarily exceeds the 2% ceiling in extraordinary circumstances, for example following a sudden massive rise in oil prices or strong exchange rate fluctuations, monetary policy does not necessarily need to be adjusted. The same applies to short-term deflationary pressures.

The SNB implements its monetary policy by influencing the interest rate level in the money market. It fixes a target range for the three-month Libor, which is the most important interest rate for short-term Swiss franc investments, and publishes it regularly. As a rule, this target range extends over one percentage point, and the SNB generally aims to keep the Libor in the middle of the range.

Target range for three-month Libor

The SNB undertakes quarterly economic and monetary assessments at which it reviews its monetary policy. It sets out the reasons for its decisions in a press release. If circumstances so require, it will also adjust the target range for the three-month Libor between these quarterly assessments.

1.2 International economic developments

The global economy grew strongly in 2006, achieving a growth rate of around 5% for the third year in a row. Furthermore, this development was more balanced than in previous years, since the regional growth differentials dissipated over the course of the year.

Strong global growth and fewer regional disparities

In Europe, the rate of expansion exceeded the potential growth rate for the first time since 2000, while a correction in the US real estate sector led to a slowdown in the economy over the course of the year. Once again, the principal emerging economies of Asia (China, Hong Kong, Singapore, South Korea and Taiwan) experienced rapid growth and continued to transmit major stimuli to the global economy.

The performance of the global economy in the first six months of the year is all the more remarkable in view of the extreme volatility of oil prices in this period, as well as the sharp increase in metal prices. The barrel price for crude oil exploded from USD 57 to over USD 75 between December 2005 and the beginning of August 2006. It then dropped to about USD 60 and subsequently fluctuated around that level. The decline in the price of oil was mainly due to a relaxation in the level of world political tension, a high level of stocks, a mild hurricane season in the Atlantic and – probably – the slowdown in the US economy.

Moderate global inflation

In 2006, inflation was restrained and most price fluctuations were attributable to volatility in oil prices. Although the first half of the year saw a surge in inflation, inflationary pressure gave way markedly in the second half of the year due to the fall in oil prices.

Year-on-year, US inflation thus dropped from 4% in the second quarter to 1.9% in the fourth quarter. However, core inflation (which factors out energy and food prices) continued to rise for most of the year. In the third quarter it reached 2.8%, its highest level since 2001. In the Euro area, inflation amounted to 2.5% in the second quarter. Subsequently, it fell back a little to end the year below 2%. In Japan, high energy prices, the soft yen and the reduction of excess capacity were factors contributing to the gradual end of the deflationary period. From May onwards, figures for inflation were back in the positive zone.

Gradual slowdown in US economy

In 2006, economic activity in the US was occasionally a little uneven. Although, at 3.4%, GDP growth was comparable to that of 2005, the figure for the previous year had in fact been distorted by the hurricanes that hit the United States in the autumn of that year. Bearing this in mind, a progressive slowdown in the economy may be observed, with growth slipping below its long-term potential. This fall-off largely reflects the correction in the real estate market, which held back growth by an average of one percentage point in the second, third and fourth quarters. It also arose out of a dip in spending on consumer durables, which was partly attributable to the rise in fuel prices. Finally, the normalisation in monetary conditions had a dampening effect on equipment investment.

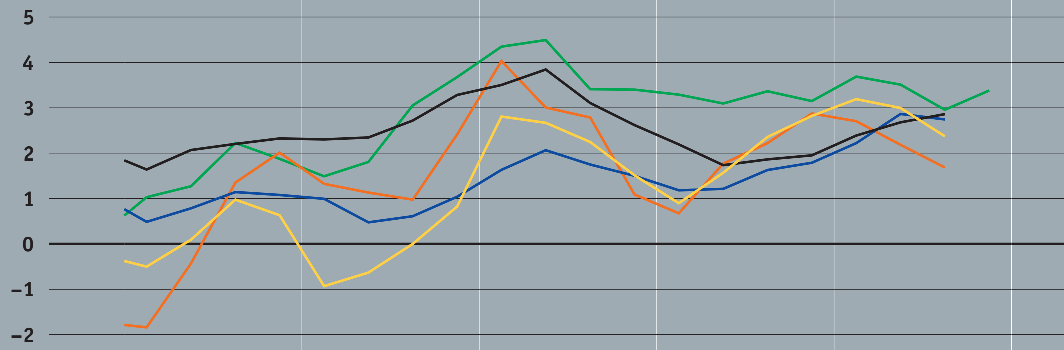
Since the adjustments in the real estate market did not really spread into other sectors, the overall economic situation remained sound. Household consumption of services, non-residential construction and government sector spending all contributed to growth. In addition, the net contribution of foreign trade improved. As a result of the healthy state of the economy, unemployment fell to 4.5% at the end of the year. This was the lowest rate of unemployment recorded since May 2001. Historical comparisons show this rate to be below the level of full employment. This situation contributed to a rise in salaries.

2002 2003 2004 2005 2006

Gross domestic product

United States
Japan
Euro area
United Kingdom
Switzerland

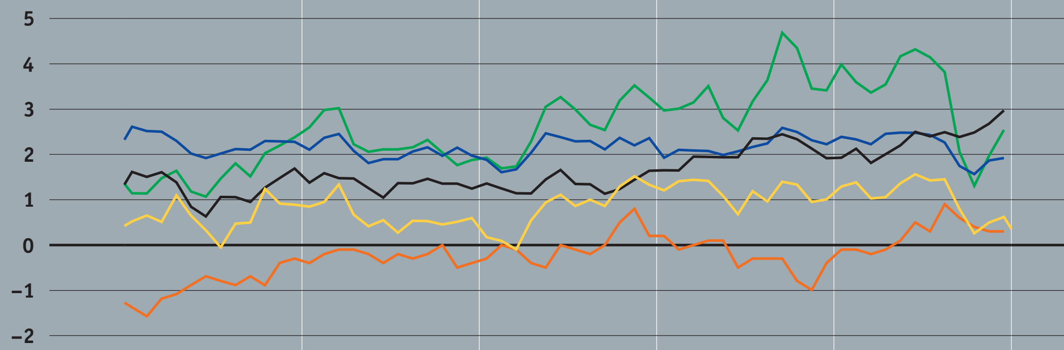
Year-on-year change
in percent, in real terms
Sources:
Thomson Datastream, SECO



Inflation

United States
Japan
Euro area
United Kingdom
Switzerland

In percent
Sources:
Thomson Datastream, SFSO



2002 2003 2004 2005 2006

Strengthening European demand

In the first six months of 2006, economic activity in Europe increased, with the momentum of foreign trade passing through into the domestic economy. Growth soared to 4% in the third quarter – the highest level for six years. Well-filled order books spurred companies to extend their production capacity, thereby increasing expenditure on equipment investment. However, the increase in consumer spending was tentative as compared to previous recoveries. Due to the economic upswing, more jobs were created and unemployment continued the descent begun in 2005, dropping below 8% in the second quarter.

Germany made a substantial contribution to the European recovery with its 2.7% GDP growth as against an average of only 1.1% since 2000. Furthermore, a better equilibrium was achieved in the area of demand, with exports – which had constituted the main engine of growth over the past few years – receiving increasing support from domestic demand. Thus, after many years of restructuring, companies began investing again from the beginning of 2006. Household consumption, traditionally a weak link in the chain, recorded an increase which was due, in particular, to the upcoming three percentage point hike in VAT on 1 January 2007. Moreover, Germany's competitive strength was confirmed, with exports remaining dynamic throughout the year. The economic upswing improved the situation in the labour market, and new jobs with obligatory social security deductions were created. The government deficit also declined as a result of the recovery, dropping below the level of 3% of GDP for the first time since 2001.

Unabated vitality in emerging Asian economies

Once again, in 2006, the main emerging economies of Asia recorded extremely vigorous growth. The Chinese economy, in particular, achieved growth of over 10%. Nevertheless, indications of a slowdown became evident in investment and industrial production during the second half of the year, due in particular to the implementation of more restrictive credit policies. Foreign trade also remained very lively, supporting the economies of the entire region.

Sustained recovery in Japan

Japan's growth appears to have moved into a sustained phase in 2006. The uptrend in the economy continued, giving the country the longest expansionary period it has known since the Second World War. Corporate investment soared, attaining two-figure growth rates over the year as a whole. This economic recovery is partly attributable to restructuring in the past, partly to substantial growth in profits and partly to a global environment favouring exports. Japanese exports have also benefited from the weakness of the yen. At the same time, however, consumption has remained feeble, with households playing a waiting game as salary increases have failed to ensue despite a marked improvement in the employment situation.

Further normalisation of monetary conditions

Monetary conditions varied from one country to another, reflecting their differing positions in the business cycle. In June, the Fed interrupted its gradual tightening of the monetary reins, having raised the federal funds rate by four additional steps of 25 basis points each between January and June. The rate was finally established at 5.25%. This was justified by the good performance of the economy and a relatively high level of core inflation.

In the euro area, the European Central Bank (ECB) decided to maintain the policy of progressively increasing its key rate which it had initiated in December 2005, in view of the strength of the economy and the fact that growth rates for monetary aggregates and loans remained high. As a result, its main key rate rose from 2.25% to 3.5% during the course of 2006.

In March, due to favourable developments in the area of both prices and the business cycle, the Bank of Japan was able to put an end to the quantitative monetary policy introduced five years previously. In addition, in July, it lifted the rate of interest for the first time in six years, increasing its overnight rate to 0.25% and then keeping it at this level for the rest of the year.

Favourable growth outlook for 2007 ...

The global growth outlook remains favourable overall, and in 2007 the major economies should return to growth rates close to their long-term equilibrium.

The correction in the US real estate market is gradually tapering off, and therefore the US economy is likely to remain robust. The good financial situation of companies along with the high level of capacity utilisation in manufacturing will probably shore up investment. In the euro area, more restrictive fiscal policies in both Germany and Italy could lead to a slowdown in economic activity in the first half of 2007, and this could dampen domestic demand. However, this effect may be partially offset by the improvement in employment as well as monetary conditions that remain accommodative. In Asia, the growth outlook also remains favourable. Japan, in particular, is benefiting from the vitality of the global environment, and its exports are likely to remain strong while domestic demand should strengthen on the back of the improvement in the labour market.

... but not without risks

The main risk casting its shadow over this outlook relates to the US economy, where the correction in the real estate sector could be more severe than was expected and then spill over into consumption. Another rise in the price of oil is a second risk that cannot be entirely discounted. Over the past few years, it has become evident how quickly the situation on this market – always very stretched – can spiral out of control due to the shortage of surplus production and refining capacity. Finally, the imbalances in current accounts continue to represent a major risk due to the fact that, if there were a rapid correction in these imbalances, the global economy could be destabilised.

1.3 Economic developments in Switzerland

In 2006, the Swiss economy was in much better shape overall than had been expected at the end of the previous year.

Favourable conditions at the start of the year

At the beginning of 2006, the outlook was bright. Estimated GDP at the end of 2005 showed growth to be above potential. Moreover, the initial leading indicators for 2006 suggested that this trend would continue for the first few months of the year. For manufacturing, in particular, the corporate outlook improved and the level of new orders continued increasing.

Still signs of weakness

Nevertheless, certain macroeconomic indicators suggested that the recovery did not embrace all sectors and that, consequently, it was still a little fragile at the beginning of the year. First of all, equipment investment was advancing only moderately as compared with production. This delay was striking as the level of capital utilisation in manufacturing was at a historically high level. Second, there had been scarcely any improvement in the labour market and unemployment had remained virtually unchanged for some considerable time. Given this situation, consumer confidence was low, and the rate of growth in consumption was below the long-term average.

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

	2002	2003	2004	2005	2006[1]
Private consumption	–0.0	0.8	1.5	1.3	1.9
Consumption by government and social security schemes	1.7	2.6	–0.8	–1.6	–0.6
Investment in fixed assets	0.3	–1.4	4.5	3.2	3.6
Construction	2.2	1.8	3.9	3.5	–0.3
Equipment	–1.2	–3.9	4.9	2.9	7.1
Domestic demand	**–0.5**	**0.4**	**1.5**	**1.1**	**2.0**
Exports of goods and services	–0.7	–0.4	8.4	6.4	9.6
Aggregate demand	**–0.5**	**0.1**	**3.7**	**2.9**	**4.6**
Imports of goods and services	–2.6	1.0	7.4	5.3	8.9
Gross domestic products	**0.3**	**–0.2**	**2.3**	**1.9**	**2.8**

1 Average of first three quarters of 2006

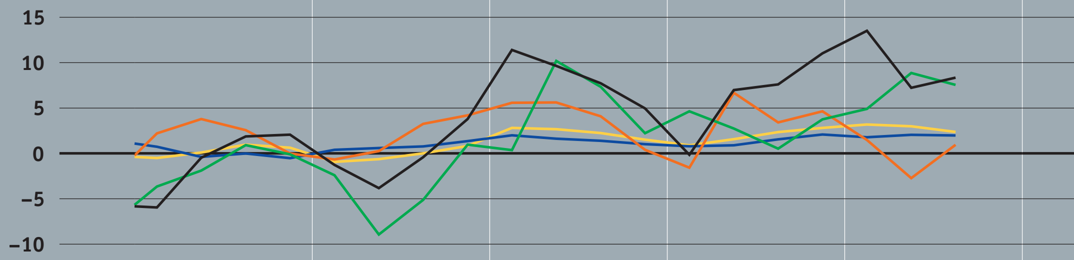
Sources: SFSO, SECO

2002 2003 2004 2005 2006

Gross domestic product and components

GDP
Private consumption
Investment in construction
Investment in equipment
Exports

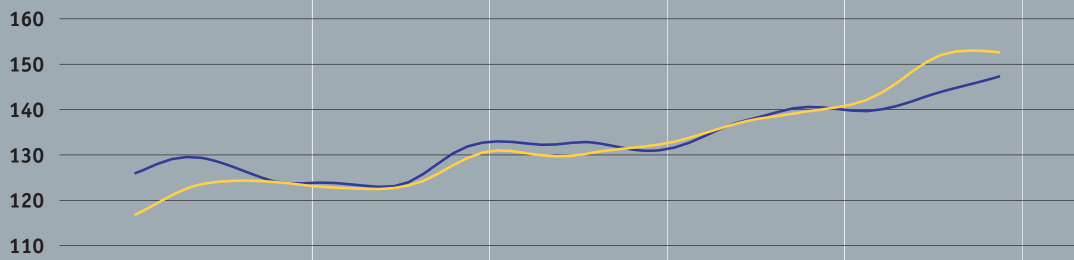
Year-on-year change
in percent, in real terms
Source: SECO



Foreign trade

Imports
Exports

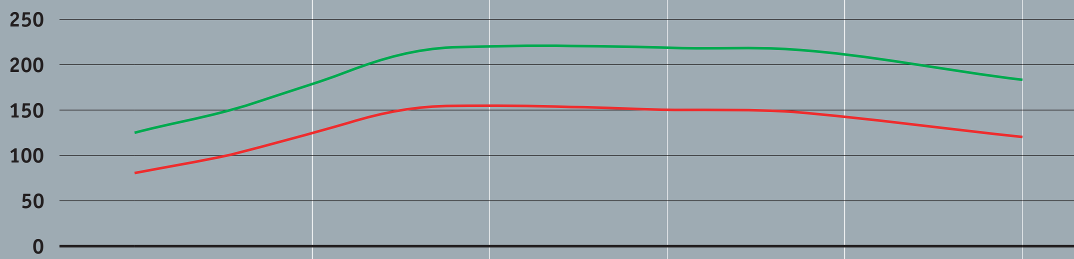
Volume, seasonally adjusted
and smoothed
Index: 1997 = 100
Source:
Federal Customs Administration



Labour market

Unemployed persons
Job seekers

In thousands,
seasonally adjusted
and smoothed
Source: SECO



2002 2003 2004 2005 2006

Exports remain vigorous

During the initial months of 2006, exports to the US and Asia of goods as well as financial services and tourism remained robust. Moreover, exports to the European Union grew in the first quarter, with the main accent on equipment goods, thereby supporting manufacturing. This strength was maintained in the second quarter thanks in particular to the outstanding economic performance of Germany, which is Switzerland's main trading partner. Also, the weakening in the Swiss franc against the euro in the second half of the year had a favourable impact on exports towards the end of the year.

Rapid growth in equipment investment

Alongside the healthy business activity recorded in manufacturing, equipment investment also grew strongly in the first half of the year. This development was supported by favourable conditions, including low interest rates and an auspicious growth outlook. In the area of imports, equipment goods also played an important role.

In the second half of the year, the capital stock was better adapted to production, indicating that the short-fall in production was being made up. Nevertheless, the rate of utilisation of capital maintained its upward trend. To some extent, this can be explained by the fact that, even after an investment has been made, it can take several months before the new equipment is being fully utilised in the production process.

Slower growth in construction investment

As opposed to equipment investment, growth in construction investment dropped back during the course of the year. To a large extent, this was due to a downturn in the growth of residential construction after three years of rapid advances. In the year as a whole, the number of new dwellings exceeded 41,000, which was the highest number since 1996. The demand for new dwellings – created mainly by higher income and favourable interest rates – was largely met. The fact that movement in average real estate prices was no more than moderate suggests that supply and demand followed similar paths. Construction of commercial premises recorded positive growth figures in line with the economy in general.

Consumption at a high level

The growth in employment had a favourable impact on consumption. On the one hand, the fall in the rate of unemployment led to an improvement in the consumption climate while, on the other hand, salary increases resulted in greater household purchasing power. Consequently, consumption rose gradually throughout the year. New car sales rose strongly at the start of the year, followed subsequently by retail sales. The number of overnight stays in Switzerland, an important indicator for the consumption of services, grew throughout the year.

Although GDP was clearly growing, the situation in the labour market remained unclear for quite some time. In manufacturing and construction, employment improved markedly, but in the services sector it remained anaemic despite clear signs of recovery in certain industries, in particular those associated with financial services. Given that more than four jobs in five can be attributed to the service sector, this meant that, overall, there was little job creation. Consequently, substantial job creation could be expected for the quarters ahead. The presumption that the figures could have been underestimated was confirmed when the Swiss Federal Statistical Office (SFSO) published its data on employment in the third quarter, together with an upward revision in the figures for the entire year. According to the new figures, in the second half of the year there was no longer any major discrepancy between the production level and the number of persons employed.

Clear improvement in employment situation

In 2006, however, the drop in unemployment was somewhat disappointing. The seasonally adjusted rate of unemployment edged down from 3.6% in January to 3.1% in December while the rate of job seekers declined to 4.7%. In addition to unemployed persons, this latter indicator includes people looking for jobs who are either temporarily engaged in employment or training programmes, or who receive temporary earnings.

... with only modest drop in unemployment so far

Nevertheless, the Swiss participation rate rose substantially and the flow of workers entering Switzerland from the European Union increased. Thus, it appears that the relationship between job creation and unemployment has shifted over the past few years.

Labour market

	2001	2002	2003	2004	2005	2006
Employment in terms of full-time equivalents[1,2]	1.9	–0.2	–1.3	–0.4	–0.2	0.8
Unemployment rate in percent	1.7	2.5	3.7	3.9	3.8	3.3
Number of job seekers in percent	2.8	3.8	5.2	5.6	5.5	5.0
Swiss nominal wage index[1]	2.5	1.8	1.4	0.9	1.0	–
Total wage bill index, nominal[1,2,3]	2.2	5.4	1.5	0.7	2.6	3.2

1 Year-on-year change in percent
2 Average of first three quarters of 2006
3 Wage contributions to AHV/AVS
Sources: AHV/AVS, SFSO, SECO

Real salary levels rising

With the increasing demand in the labour market, substantial salary increases have been observed. Using salary-based contributions to the Old Age and Survivors' Insurance Fund (AHV/AVS), it is possible to calculate a figure close to the total wage bill concept used in the national accounts. The average real wage per full-time equivalent job can be calculated on the basis of this total wage bill. In the first three quarters of the year, this figure rose by 2%.

The Swiss wage index compiled by the SFSO in fact indicates a slight decline in real salaries in the first half of the year. However, this index excludes changes to the structure of employment as well as bonus payments, thereby underestimating the increase in salary levels.

Optimistic outlook for the economy in 2007

At the end of 2006, growth prospects for the new year remained good. At its press conference on 14 December 2006, the SNB forecast GDP growth of about 2% for 2007. Although the SNB expected the expansion in exports to slow gradually in line with the economies of our main trading partners, both equipment investment and employment were likely to grow substantially. By contrast, a restrained growth path was forecast for investment in construction and continued strong growth in consumption, which was likely to support economic growth.

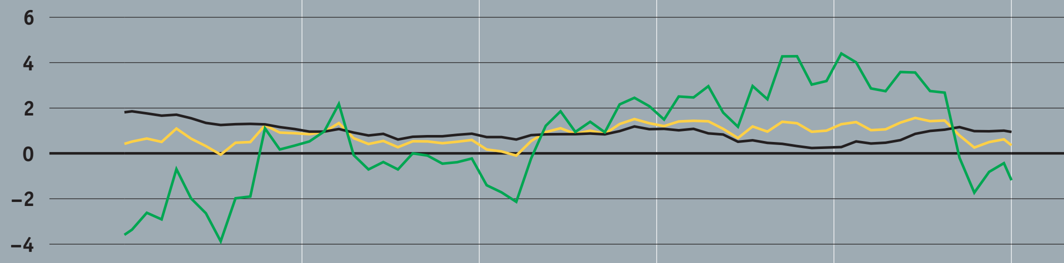
National consumer price index and components
Year-on-year change in percent

	2005	2005	2006 Q1	Q2	Q3	Q4
Overall CPI	**1.2**	**1.1**	**1.2**	**1.3**	**1.2**	**0.5**
Domestic goods and services	0.6	0.8	0.4	0.6	1.1	1.0
Goods	–0.4	–0.2	–0.2	–0.3	–0.1	–0.1
Services	1.0	1.1	0.6	0.9	1.4	1.3
Private services (excluding rents)	0.5	0.4	–0.1	0.2	0.9	0.7
Rents	1.4	2.0	1.5	2.1	2.2	2.2
Public services	1.5	1.2	0.9	1.0	1.3	1.4
Imported goods and services	2.7	1.9	3.8	3.3	1.7	–1.0
Excluding oil products	–0.3	0.4	0.3	0.3	0.6	0.2
Oil products	18.5	9.3	21.4	18.1	7.7	–6.3
Core inflation						
Core inflation (SNB)	0.8	1.0	0.7	1.1	1.1	0.9
Core inflation 1 (SFSO)	0.5	0.6	0.4	0.6	0.8	0.7
Core inflation 2 (SFSO)	0.3	0.7	0.2	0.6	0.9	1.0

Sources: SFSO, SNB

2002 2003 2004 2005 2006

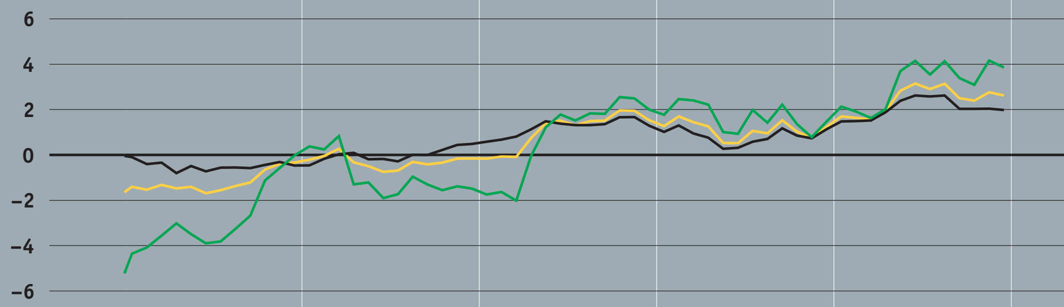
Consumer prices



Consumer prices
Domestic goods
Imported goods

Year-on-year change in percent
Source: SFSO

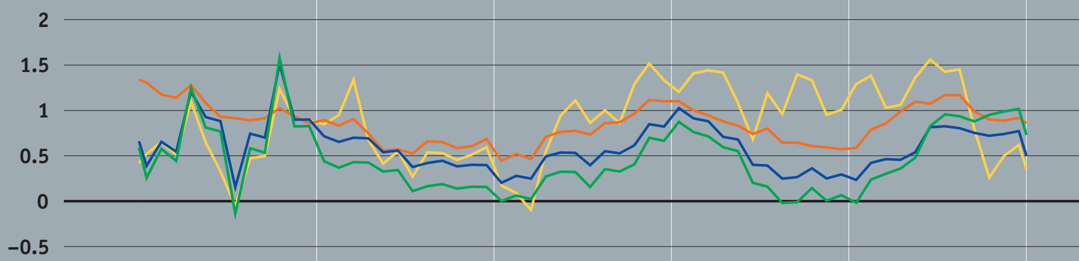
Producer and import prices



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

2002 2003 2004 2005 2006

Inflation under control

In 2006, movements in price indices were strongly influenced by fluctuations in oil prices. The year-on-year increase in import prices rose from 2.1% in January to 4.1% in August, while that for production prices was up from 1.5% to 2.6% over the same period. From September to December, growth in import prices slowed to 3.9%, while the increase in production prices was down to 2%.

Until August, the consumer price index (CPI) remained relatively stable within a band of 1–1.6%. In the first half of the year, the downward price pressure on Swiss goods as well as the stagnation in the prices of private services slowed down overall inflation. In addition, the prices of imported drugs dropped from April onwards, after the conclusion of an agreement between the pharmaceutical industry and the government. The decline in oil prices in autumn led to a substantial decline in inflation, which fell to 0.6% in December.

The easing off in inflation towards the end of the year was broad-based. Having risen from 0.6% in January to 1.2% in August, the SNB measure of core inflation, which excludes the strongest price fluctuations, subsequently declined, amounting to 0.9% in December. It reflected subdued inflationary trends in 2006.

Gradual upward movement in Libor

The Libor began 2006 at around 1% and held that level until mid-February. With financial markets anticipating another 25 basis point increase at the monetary policy assessment in March, the Libor then embarked on a gradual upward climb in advance of the decision of the Governing Board. On 16 March 2006, the SNB increased the target range, thereby confirming market expectations. At the three following monetary assessments in 2006, the Libor followed the same pattern, rising gradually on each occasion. Following the last increase in the target range to 1.5–2.5% in December 2006, the Libor stood at 2%, i.e. the middle of the new target range.

Return on investment slightly higher

Long-term interest rates, as well as yields on Confederation bonds, experienced a substantial correction in the first half of 2006, climbing from 2% at the end of 2005 to virtually 3% in mid-2006. Subsequently, yields on Confederation bonds declined gradually to end the year at about 2.5%. Consequently, they rose only 50 basis points in 2006.

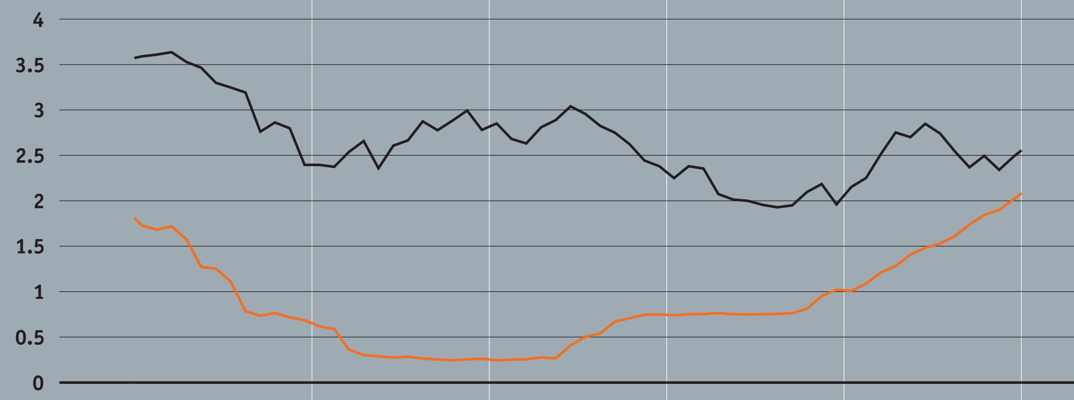
2002 2003 2004 2005 2006

Money and capital market rates

Three-month Libor

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

In percent

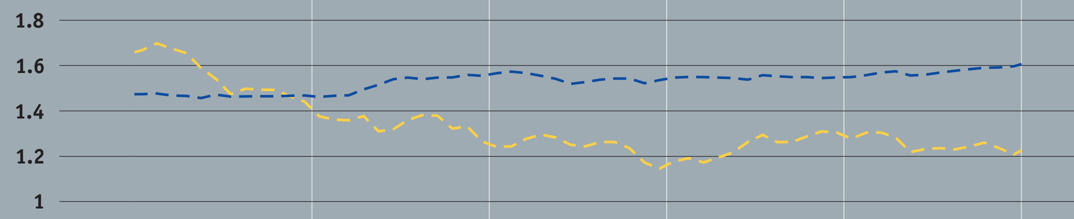


Exchange rates

CHF/USD

CHF/EUR

Nominal

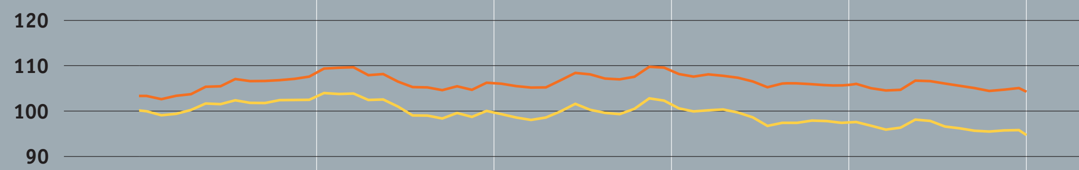


Export-weighted Swiss franc exchange rates

Real

Nominal

24 trading partners
Index: January 1999 = 100



2002 2003 2004 2005 2006

Swiss franc weakens against euro

Although the exchange rate of the Swiss franc against the euro fluctuated within a relatively narrow margin of CHF/EUR 1.54–1.60, the year 2006 saw a continued appreciation of the euro against the Swiss franc. This phenomenon was particularly marked towards the end of the year.

Swiss franc strengthens against US dollar

By contrast, in 2006 the US dollar lost all it had gained in the year before. Following a relatively stable period when it fluctuated around the CHF/USD 1.30 mark, it depreciated in the second six months to end the year slightly below CHF/USD 1.20. Following a temporary improvement in the wake of the Fed's normalisation of interest rates, the downward movement in the Swiss franc exchange rate against the US dollar – a trend which has been observed for many years now – appeared to have established itself once more.

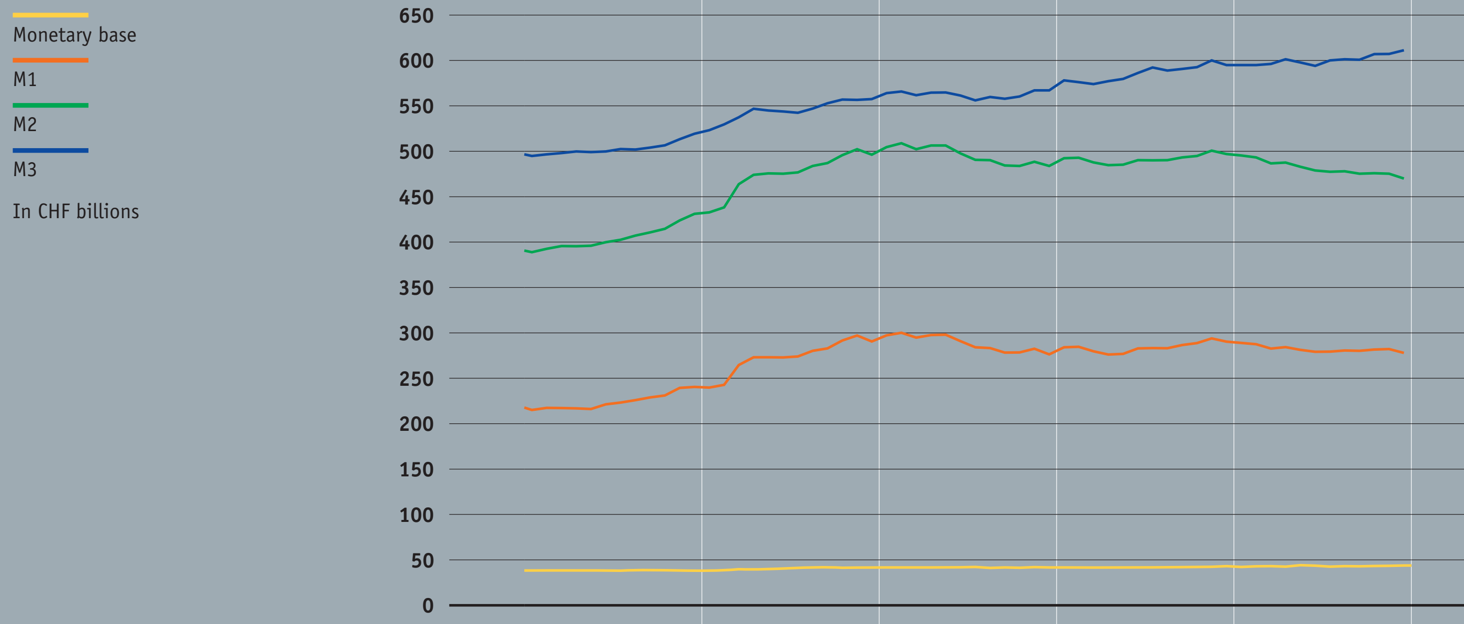
The external value of the Swiss franc weighted by nominal and real trade flows declined throughout 2006 apart from a brief surge in the middle of the year.

Continued absorption of money overhang

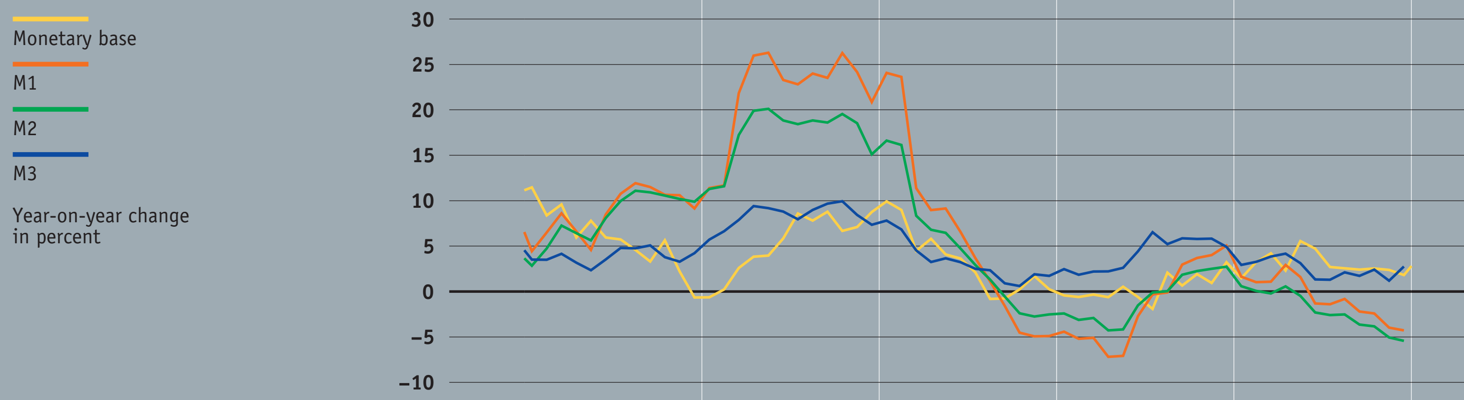
The monetary aggregates responded rapidly to the two increases in the Libor target range in 2004. M1 and M2 declined until mid-2005, while growth in M3 was very slow. In the second half of 2005, along with the improvement in the economy, the three aggregates returned to positive growth figures. However, their rate of expansion declined again after the resumption of monetary policy normalisation in December 2005, and in the wake of successive increases in the Libor in 2006. M3 continued growing, but at a weaker rate, while M1 and M2 retreated from the middle of the year onwards. Consequently, the money overhang, which has existed since 2003, receded further.

2002 2003 2004 2005 2006

Level of monetary aggregates



Growth in monetary aggregates



2002 2003 2004 2005 2006

1.4 Monetary policy decisions

Four times a year, in March, June, September and December, the SNB's Governing Board conducts an assessment of the monetary policy situation. Each of these assessments results in an interest rate decision. In addition, if circumstances so require, the SNB also adjusts the Libor target range for three-month investments in Swiss francs between regular assessment dates. In 2006, however, this was not the case.

Monetary policy challenges in 2006

In 2005, the SNB had demonstrated its flexibility by pausing temporarily in the normalisation of its monetary policy course. With long-term inflation risks declining, it was able to make use of the available leeway for further pursuing its expansionary policy. By December 2005, the indications of a robust and sustained recovery had become so clear that the National Bank resumed normalisation of its monetary policy. There was no doubt that this course would need to be pursued in 2006; the inflation forecasts of the final monetary assessments in 2005 had made this abundantly clear. However, it was the magnitude and frequency of these interest rate increases which constituted the principal challenges of monetary policy in 2006.

Four increases in the Libor target range

In 2006, the SNB raised its target interest rate on four occasions, by 25 basis points each time. This took the Libor to 2% by the end of the year. The National Bank pursued its policy of normalising interest rates through moderate increases, carried out at regular intervals, an approach which should ensure price stability in the medium and long term while also taking the best possible account of economic reality. Despite the rise in oil prices in mid-2006, the economic and inflationary perspectives developed evenly, thereby allowing the SNB to gradually tighten the monetary policy reins.

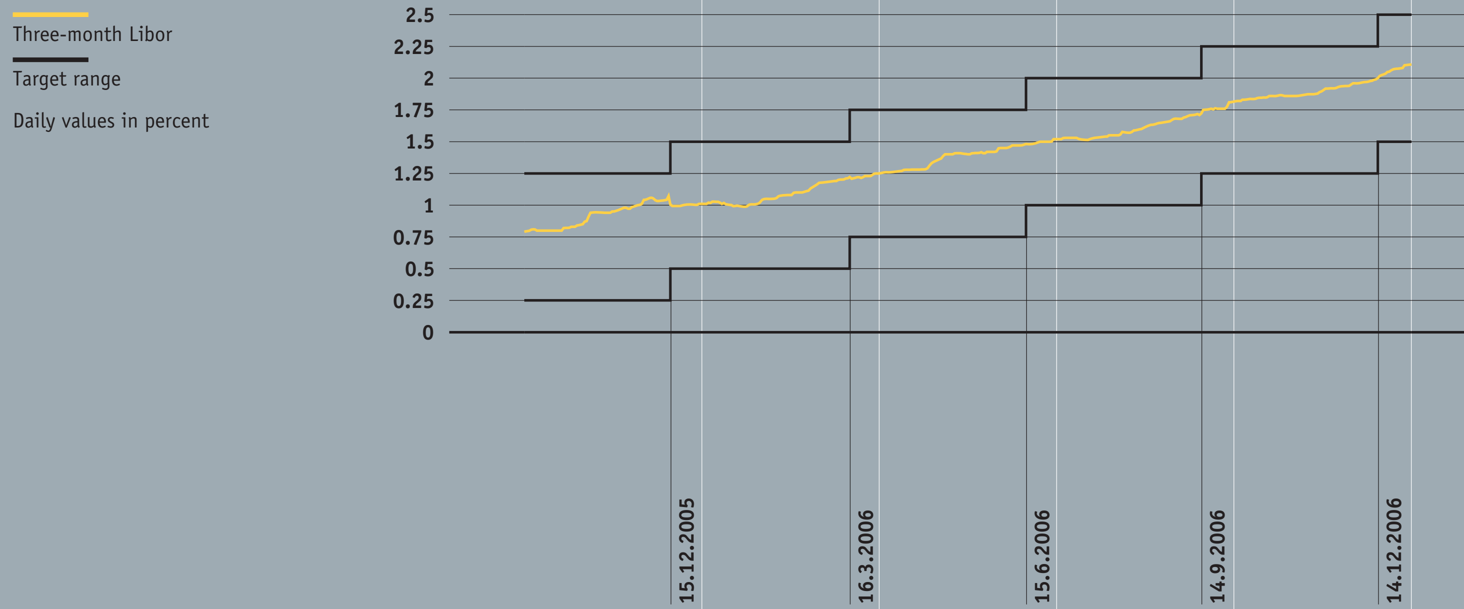
Monetary policy risks in 2006

As in previous years, monetary policy in 2006 was subject to numerous risks in the short, medium and long term. The National Bank regularly evaluates the probability of such risks, their consequences for the economy and their implications for monetary policy.

Short-term risks

The vagaries of oil prices represented the chief short-term risk in 2006. However, the volatility in energy prices did not induce the SNB to take any special measures. On the one hand, it would have been inappropriate to act against the inflationary effects of higher oil prices, since a tightening in monetary policy could have added force to the moderating impact of increased oil prices on the economy. On the other hand, since there was no reason to fear a greater slowdown, it would also have been wrong to intervene by lowering interest rates.

Three-month Libor



Medium-term risks

Uncertainties with respect to the global and Swiss economies remain the principal risks in the medium term. Neither Europe nor Switzerland gave rise to any major concern in 2006. However, there were repeated indications, particularly in the second part of the year, that the US economy might be facing a more substantial slowdown in the future. This kind of scenario represented a major risk to the economic situation since investment and exports are largely dependant on international conditions. Furthermore, the appreciation of the euro against the Swiss franc – in particular at the end of the year – created an additional risk which the SNB needed to keep a careful eye on.

Long-term risks

The outlook for inflation in the medium and long term would have deteriorated if the SNB had not resumed the normalisation of its monetary policy and continued on this path in 2006. Thus, raising the rate of interest was necessary if favourable perspectives for price stability were to be preserved.

Starting point: the final quarterly assessment of 2005

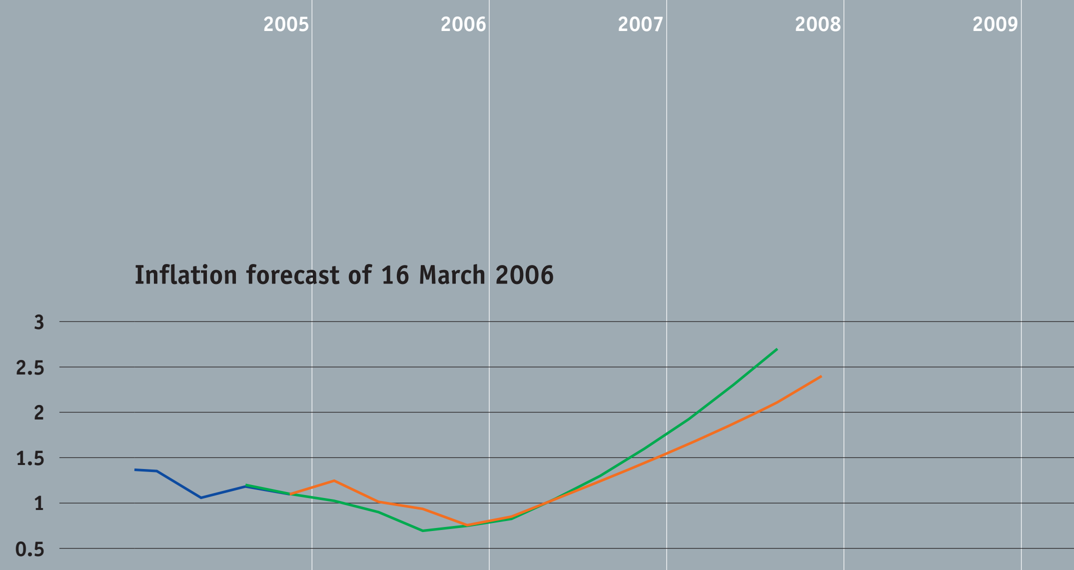
At its quarterly assessment of 15 December 2005, the National Bank had been confident about the outlook for the global economy. With the US economy continuing to show signs of vitality as it moved into the new year, the SNB had forecast growth of approximately 3.5% for both 2006 and 2007. It had also been optimistic for the euro area, predicting growth of 2% for 2006 and 2.4% for 2007. It had expected the price of oil to be high in the upcoming quarters.

Based on the state of the Swiss economy at the end of 2005, the SNB had been confident about developments in 2006 and forecast growth of just over 2%. Consumption and equipment investment had been relatively robust in the third quarter of 2005, and positive developments could be expected over the next few quarters.

As compared to the September assessment, the inflation outlook had been adjusted upwards. In these circumstances, the Governing Board had decided to lift the three-month Libor target range by 25 basis points in December 2005. The new range had been set at 0.5–1.5%. At the beginning of 2005, the SNB had initiated a break in the process of normalising its target interest rate. In view of the economic upswing expected for 2006, it had then resumed normalisation of this interest rate at the end of 2005.

Under the new assumption, which saw the Libor at a constant 1% for the three following years, inflation – according to the graph published at the time of the assessment (cf. *98th Annual Report 2005,* p.36) – had been forecast to rise to 0.8% in 2006 and to 1.2% in 2007. By the end of the forecast period, inflation had been expected to rise to 2.7%, thereby exceeding the upper limit of the range which the SNB equates with price stability.

Inflation forecast of 16 March 2006



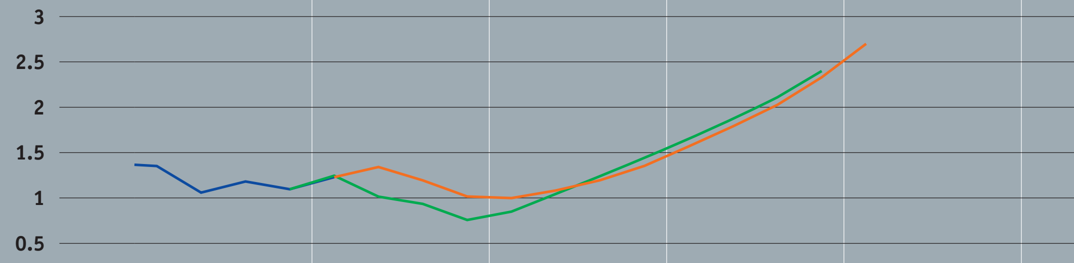
Inflation

December 2005 forecast: three-month Libor 1.00%

March 2006 forecast: three-month Libor 1.25%

Year-on-year change in national consumer price index in percent

Inflation forecast of 15 June 2006



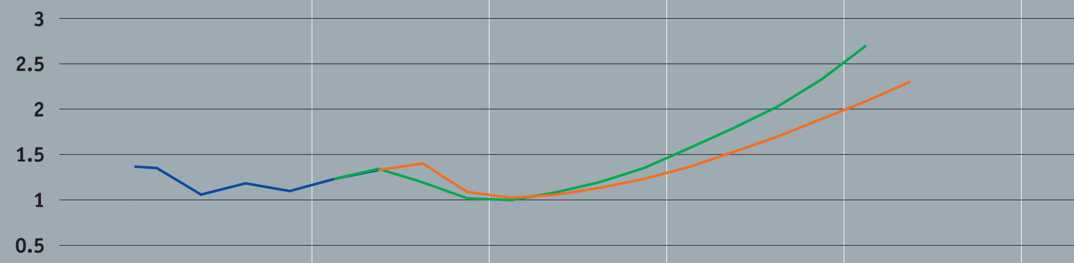
Inflation

March 2006 forecast: three-month Libor 1.25%

June 2006 forecast: three-month Libor 1.50%

Year-on-year change in national consumer price index in percent

Inflation forecast of 14 September 2006



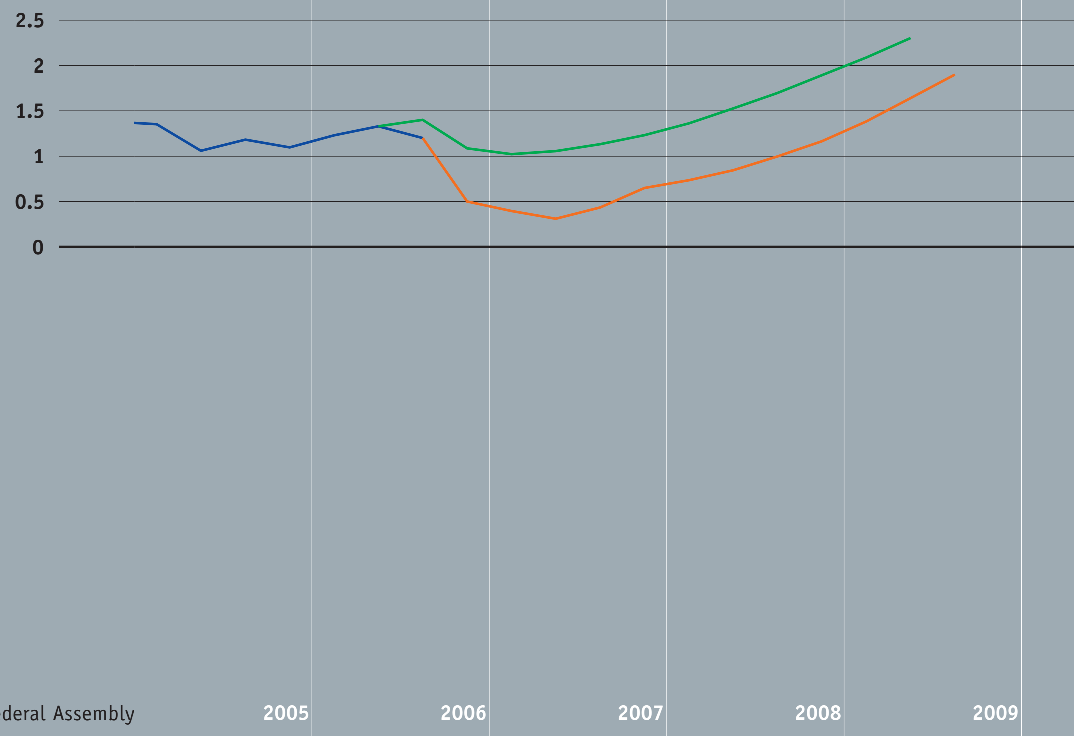
Inflation

June 2006 forecast: three-month Libor 1.50%

September 2006 forecast: three-month Libor 1.75%

Year-on-year change in national consumer price index in percent

Inflation forecast of 14 December 2006



Inflation

September 2006 forecast: three-month Libor 1.75%

December 2006 forecast: three-month Libor 2.00%

Year-on-year change in national consumer price index in percent

Quarterly assessment of 16 March 2006

At each monetary policy assessment, the SNB bases its inflation forecast on the global economic scenario it regards as most likely.

In general, the hypotheses for the global economy at the first assessment in 2006 were similar to those of December 2005. Once again, the SNB forecast a robust global economy. Although-fourth quarter GDP growth in the US in 2005 had failed to meet the expectations of the previous assessment, the SNB still forecast strong growth for 2006, predicting a rise of over 3%. In the euro area, economic growth was shaping up more favourably than had been expected in the previous forecast. Consequently, the SNB forecast growth of approximately 2.5% for 2006. With regard to oil, it continued to work on the basis of high prices for the quarters ahead.

Since, at the time of the March assessment, the Swiss economy was progressing as expected, the SNB continued to forecast GDP growth of a little above 2%, as it had done in December 2005. The economy was likely to gain a little more strength and become even more broad-based. Thanks to the favourable development in sales in the main export countries, exports were likely to continue growing, albeit at a less buoyant pace. The higher level of capacity utilisation in manufacturing would probably again stimulate investment and increase demand for equipment. Only construction was expected to weaken a little, given its high level. An upturn in consumption and an improvement in the labour market were also likely.

Monetary aggregates react rapidly and clearly to interest rate decisions. Consequently, growth in the aggregates slackened following the rate increases in 2004 and December 2005. The money overhang generated during the period of extremely expansionary monetary policy stopped advancing after the interest rate hikes, while the growth in the volume of loans stabilised at a relatively high level. Furthermore, the SNB continued monitoring movements in the real estate market, in particular mortgage loans, which were still climbing at a rate of over 5%.

At the time of the March assessment, the increase in prices was mainly attributable to the price of oil. At that time, the SNB was forecasting an average annual rate of inflation of 1% for 2006. As compared to the December assessment, the inflation outlook was adjusted upwards. In these circumstances, the Governing Board decided to lift the Libor target range by 25 basis points to 0.75–1.75%.

Assuming that the new Libor was maintained unchanged at 1.25% for the following three years, the SNB forecast inflation to be higher than that predicted at the previous assessment until the end of 2006, as can be seen from the graph published at the time of the March assessment. The assumption of a high price for oil and the slight increase which was shaping up for the prices of imported goods contributed to this inflationary pressure in the early part of the forecast period. For the period 2007–2008, however, the new forecast showed a lower path than the previous forecast. At the end of the forecast period, expected inflation again exceeded the upper limit which the SNB equates with price stability.

Quarterly assessment of 15 June 2006

At the time of the June assessment, the international environment was little changed from the situation at the previous assessment. For the US, the SNB expected that GDP growth could once again exceed potential in 2006, although it would then weaken gradually. Similarly, the recovery observed in Europe over the past few quarters would lead to growth above potential in 2006, flattening off gradually thereafter. With respect to oil prices, the National Bank assumed a higher price than that envisaged in March.

After having weakened in the fourth quarter of 2005, Swiss growth regained a certain amount of momentum in the first half of 2006. According to the State Secretariat for Economic Affairs (SECO), GDP was up 3.8% year-on-year in the first quarter of 2006. The SNB then revised its forecast for 2006 upwards to a little over 2.5%. Most components of demand were likely to bolster growth in the quarters following the assessment, particularly exports, which would probably continue to expand at a healthy pace. Due to the improvement in the labour market and a better income outlook, additional stimuli would probably feed into consumption. Since the recovery was broad-based, demand in the labour market was also likely to increase. For the first time in over a year, the number of employed persons in the services sector was up. At the time of the assessment, the rate of unemployment had fallen to 3.4%, and the SNB was expecting a continued decrease over the course of the year.

The M1 and M2 monetary aggregates were stabilising at the time of the monetary assessment, while M3 was only rising slightly. In the wake of economic developments the monetary overhang was likely to recede further. The effect of the higher interest rate had been negligible as far as loans were concerned. This was particularly noticeable in the case of mortgages, which continued to grow at a rate of about 5%.

As in March, inflation at the time of the June assessment was largely attributable to the high oil prices. The SNB forecast an average rate of inflation of 1.2% for 2006. As compared to the March assessment, the inflation outlook was adjusted upwards. In these circumstances, the SNB decided to lift the Libor target range by 25 basis points to 1–2%.

Assuming an unchanged three-month Libor of 1.5% for the subsequent three years, the SNB forecast inflation of 1.2% in 2007 and 1.9% in 2008. As compared to March, the inflation forecast for these two years remained largely unchanged, despite the moderating influence of the increased Libor. The main reason for this was the higher level of capacity utilisation in manufacturing. The inflation forecast also showed that there was no risk of inflation in the short term. However, the increase in the rate of inflation expected for the end of the forecast period indicated that monetary policy was still expansionary.

Quarterly assessment of 14 September 2006

The situation in September was different to that in June in two respects. First, growth in the US economy was slowing more markedly than had been anticipated previously. However, the SNB still expected growth to reach 3% in 2007 and 3.2% in 2008. Second, recovery in the European economy was better than expected. Consequently, the outlook for 2007 and 2008 was likely to remain favourable with growth at around 2%.

Once again, economic developments in Switzerland were regarded as pleasing. The upswing was broad-based and was expected to have a positive impact on the labour market. Exports were likely to continue expanding, although they would probably lose a certain amount of their momentum. In addition, equipment investment was expected to continue rising, while the level of capacity utilisation in manufacturing was likely to remain high. In these circumstances, the SNB increased its growth forecast for 2006 to almost 3%, which was above the long-term average. In 2007, growth was likely to slow a little, although it would remain above potential.

Because of the gradual adjustment in interest rates, expansion in the monetary aggregates remained moderate. M3 was still increasing slightly, but M1 and M2 had exhibited negative growth rates in the months leading up to the assessment. In the real estate market, the SNB expected that the growth rate for mortgage loans would drop below the 5% level recorded at the time of the assessment. Despite the fact that the National Bank was anticipating a calmer period in the real estate market – signs of market weakening were already perceptible – it continued to keep a close watch on developments in this field.

The SNB forecast an average annual rate of inflation of 1.3% for 2006. However, it did not expect a rise in inflation in the quarters that followed. A number of factors combined to hold back price increases. These included competition from transition and emerging economies in Asia, the opening up of the Swiss employment market to foreign labour and the drop in the oil price at the time of the assessment. Nevertheless, on the assumption of an unchanged Libor of 1.5% for the next three years, the inflation outlook towards the end of the forecast horizon was likely to remain worrying. In these circumstances, the SNB decided to continue pursuing its policy course of gradually normalising the target rate of interest, and lifted the Libor target range by 25 basis points to 1.25–2.25%.

On the assumption of an unchanged new interest rate of 1.75% over the next three years, the path of the new inflation forecast lay above that for the previous assessment in June until the second quarter of 2007, despite the fact that the previous forecast was based on a lower interest rate. This new forecast was based, in particular, on the assumption that productive resources would be better utilised. For the remainder of the period, however, the inflation forecast was lower than the previous forecast, due to the moderating influence of the Libor. Taking this to be 1.75%, average annual inflation was likely to amount to 1.1% in 2007 and 1.6% in 2008. Thus, the inflation forecast showed that there was no inflationary risk in the short term. Nonetheless, the slight acceleration in inflation at the end of the forecast period indicated that monetary policy was still expansionary.

Quarterly assessment of 14 December 2006

At the December assessment, the most important international development was the substantial decline in the price of oil. This drop halted an upward trend that had been almost unbroken since 2004. As a result, the National Bank forecast downward pressure on inflation in most economies over the next few quarters. The SNB did not believe that the impact on the global economy would be particularly great since oil prices were still high, in historical terms. Otherwise, the international economic trends observed in the previous assessment – a slowdown in the US and strong growth in Europe – were unchanged at the time of the December assessment. Consequently, the SNB forecast growth of 2.9% in the US and 2.3% in Europe in the year 2007, and 3.3% in the US and 2.2% in Europe in the year 2008.

As at the previous assessment, economic activity in Switzerland was assessed favourably. The effects of the economic upswing, which was broad-based, spilled over into the labour market, and the SNB expected the rate of unemployment to drop below 3% as early as the beginning of 2007. Again in 2007, all the components of demand would probably continue rising, although the rate of increase would be a little more restrained than had been expected in September. Consumption was likely to join exports and equipment investment (spurred by the high level of capacity utilisation in manufacturing) as one of the most important growth drivers in 2007. In these circumstances, the SNB confirmed its forecast of about 3% growth in 2006 and 2% in 2007.

Of the monetary aggregates, M3 expanded to about 2% at the time of the assessment, while M1 and M2 continued their downward trend. Clearly, movements in these aggregates were again being influenced by the interest rate increases. Growth in mortgage loans was below 5% at the end of the year, confirming expectations of a slowdown in their growth momentum. Therefore, the SNB was still anticipating a return to a period of greater calm in the real estate market. Based on movements in the monetary aggregates, the National Bank was also expecting a slowdown in other types of loan for the upcoming quarters, despite their liveliness at the time of the assessment.

The inflation outlook was good for the time being. Both oil price developments and the interest rate hikes were holding back price increases. Consequently, the National Bank lowered its average annual inflation forecast for 2006 slightly, to an average of 1.1%. Nevertheless, the SNB decided to continue its gradual normalisation of the target rate of interest, and lifted the Libor target range by 25 basis points to 1.50–2.50%. In doing so, its aim was to avoid excessive use of resources in the years 2007 and 2008, thereby exercising a moderating influence on inflation in the medium term.

The curve for the new inflation forecast, drawn up on the assumption of an unchanged Libor of 2% over the next three years, was well below that published in September. This change was attributable mainly to the new, higher level of the Libor, but also to the drop in oil prices. Average inflation was expected to amount to 0.4% in 2007 and just under 1% in 2008. Thus, the inflation forecast showed that there was no inflationary risk in the short term. However, towards the end of the forecast period the inflation curve showed a clear upward trend. This reflected the fact that monetary policy was still expansionary in view of the expected development of the Swiss economy.

1.5 Statistics

Purpose of activities in the field of statistics

A uniform legal basis (art. 14 NBA) governs the collection of statistical data that the Swiss National Bank requires in order to fulfil its statutory tasks. The SNB collects data for the conduct of monetary policy and the oversight of payments and securities settlement systems, for safeguarding the stability of the financial system and preparing both the balance of payments and the statistics on the international investment position. Statistical data compiled for purposes relating to international monetary cooperation are made available to international organisations.

Institutions required to provide data

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

The SNB limits the number and type of surveys to what is strictly necessary (art. 4 National Bank Ordinance (NBO)). It seeks in particular to minimise the demands placed on those required to provide information.

Confidentiality and exchange of data

The National Bank is required to ensure the confidentiality of the data it collects and may only publish them in aggregated form. However, the data collected may be supplied to other Swiss authorities which are responsible for supervising the financial market (art. 16 para. 4 NBA).

Publications and database

The SNB manages a database containing 3.5 million time series and publishes the results of its surveys. Statistical information is made available primarily in the *Monthly Statistical Bulletin,* the *Monthly Bulletin of Banking Statistics* and *Banks in Switzerland,* which is published annually. These publications are supplemented by reports on Switzerland's balance of payments, the international investment position, direct investment and the financial accounts. The SNB's publications are also available in English. *Banks in Switzerland* was published in English for the first time in 2006. All publications are also accessible on the SNB website, www.snb.ch, along with other data series.

New surveys

Following a lengthy test phase, the SNB introduced lending rate statistics (data on the terms of new loans to companies) in mid-2006. The rapid growth in credit cards has prompted it to include additional card issuers in the group of companies that are required to provide information for statistics on the use of credit cards in payment transactions.

Broad collaboration

In compiling statistical data, the SNB collaborates with the competent federal government bodies, notably the Swiss Federal Statistical Office (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 SFBC

Under the agreement on the reciprocal exchange of data on the financial sector, the SNB assisted the SFBC secretariat in implementing the statistical requirements of the new capital adequacy regulations based on Basel II. This new survey, too, is carried out by the SNB. In mid-2006, the National Bank was for the first time commissioned by the SFBC to conduct a survey as part of the SFBC's half-yearly Supervisory Reporting. This survey enables the SFBC to set up an early warning system for risk-oriented supervision.

... with the banking statistics committee

The SNB is advised on the content of its banking surveys by the banking statistics committee (art. 7 NBO). This 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 SNB participates in the drawing up of the balance of payments. It comprises representatives from industry, banking, insurance, various federal agencies and the Swiss Institute for Business Cycle Research at ETH Zurich.

... with the Principality of Liechtenstein

The SNB has stepped up its collaboration with the Liechtenstein authorities. Industrial companies and the service sector in Liechtenstein were included in the relevant surveys at year-end 2006 for the first time to complete the statistics on the balance of payments and international investment position.

... with foreign agencies

The SNB works closely with the Bank for International Settlements (BIS), the OECD, the EU statistical office (Eurostat) and the IMF. This collaboration is aimed at harmonising statistical survey methods and analyses.

2 Supplying the money market with liquidity

Mandate

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

Guidelines on monetary policy instruments

The "Guidelines of the Swiss National Bank (SNB) on Monetary Policy Instruments" dated 25 March 2004 contain more explicit information with regard to art. 9 NBA 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. In its transactions, the National Bank only accepts securities that fulfil its currency, liquidity and credit-rating criteria. Basically, all banks domiciled in Switzerland as well as internationally active banks abroad that meet the conditions stipulated by the National Bank are accepted as counterparties. The guidelines are supplemented by five instruction sheets which are primarily intended to be used by the counterparties. Since May 2004, the National Bank has been publishing a weekly report containing important monetary policy data.

2.1 Regular instruments for steering the money market

All of the SNB's regular monetary policy instruments are based on repo transactions. In this kind of transaction, the cash taker sells securities spot to the cash provider, while entering 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 (the 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 the purpose 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 even run for several months. The SNB sets the maturity of repo transactions in such a way that the commercial banks have to request liquidity on an almost daily basis to ensure they have the sight deposits required to meet minimum reserve requirements.

Fine-tuning operations

Fine-tuning operations are used to smooth the undesired impact of exogenous factors on liquidity supply as well as sharp fluctuations in short-term money market rates. Fine-tuning is carried out through auctions, by acting as the counterparty in the interbank market or through bilateral repo transactions. Fine-tuning operations are carried out when necessary. The conditions that apply in fine-tuning operations may differ from those applying in 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 must be repaid by the end of the same bank working day at the latest. These funds do not qualify when evaluating compliance with minimum reserve requirements or liquidity requirements under banking law.

Liquidity-shortage financing facility

The National Bank provides a liquidity-shortage financing facility to bridge unexpected liquidity bottlenecks. The interest rate for liquidity provided through this facility is two percentage points above the call money rate. The basis upon which the rate is calculated 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.

The liquidity-shortage financing facility is accessed via "special-rate repo transactions". The prerequisite for concluding such 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.

At the end of 2006, 75 banks had been granted a limit for the liquidity-shortage financing facility, with total limits for these banks amounting to CHF 12.1 billion. Before the end of each day, banks are invited to report their liquidity requirements through the repo trading platform.

2.2 Liquidity supply with regular instruments

Monetary policy instruments in CHF billions

	2005 Holding Average	Turnover	2006 Holding Average	Turnover
Repo transactions				
Main financing and fine-tuning operations	**21.08**	**1 066.53**	**20.82**	**1 069.47**
Maturities of				
less than 1 week	0.10	18.38	0.13	40.66
1 week	19.16	993.15	18.91	980.19
2 weeks	1.63	42.90	1.50	39.11
3 weeks	0.00	0.00	0.00	0.00
Other	0.19	12.10	0.27	9.50
Liquidity-absorbing operations	**0.03**	**7.50**	**0.00**	**0.16**
Intraday facility	**6.34**[1]	**1 610.62**	**7.07**[1]	**1 773.94**
Liquidity-shortage financing facility	**0.01**	**1.02**	**0.01**	**1.72**

1 Amount utilised per bank business day

Repo transactions in detail

During the course of the year, the SNB allocated liquidity to banks at differing prices, depending on monetary policy criteria and the situation in the money market. Along with the increases in the target range for the three-month Libor, the repo rates were adjusted to take account of the latest monetary policy developments. In the course of 2006, they rose from 0.73% to 1.90%. The average difference between the repo rate and the three-month Libor was 24 basis points.

In 2006, the average volume of the National Bank's repo transactions from main financing and fine-tuning operations still outstanding at the end of the day fell by CHF 0.26 billion to CHF 20.82 billion. The turnover – in other words the sum of all of these repo transactions – reached CHF 1,069.47 billion. Almost all of this turnover was achieved with a maturity of one week. Liquidity-absorbing operations were only used in one exceptional case.

In the year under review, banks' daily bids at National Bank repo auctions fluctuated between CHF 1.5 billion and CHF 107.0 billion, averaging CHF 16.4 billion. The amount of liquidity allocated varied from CHF 1.0 billion to CHF 7.6 billion, averaging CHF 4.0 billion over the year. Of this amount, 68% was allotted to domestic banks, the remainder to internationally operating banks abroad. The allocation rate fluctuated between 3% and 100%, with the average rate amounting to 24%.

In 2006, the average use of the intraday facility by banks rose from CHF 6.3 billion to CHF 7.1 billion.

In 2006, banks again made only occasional use of the liquidity-shortage financing facility for bridging unexpected liquidity bottlenecks.

2.3 Further monetary policy instruments

In addition to the regular monetary policy instruments, the National Bank has a number of other instruments at its disposal, as provided for in art. 9 para. 1 NBA. These are foreign exchange spot and forward transactions, foreign exchange swaps and the SNB's own interest-bearing debt certificates; it can also purchase or sell securities in Swiss francs. In addition, it can create, purchase or sell derivatives on receivables, securities, precious metals and currency pairs. Such instruments were not used in the context of monetary policy in 2006.

2.4 Emergency liquidity assistance

Liquidity assistance conditions

Within the context of the emergency liquidity supply facility, the National Bank may provide liquidity assistance to domestic banks if they are no longer able to refinance their operations in the market (lender of last resort). However, the bank requiring credit must be systemically relevant and solvent, and the liquidity assistance must be fully covered by collateral at all times.

Systemic importance of a financial institution

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 securities it will accept as collateral for liquidity assistance.

In 2006, no emergency assistance of this kind was required.

2.5 Minimum reserves

Main features of the regulation

The purpose of the minimum reserves (arts. 17, 18, 22 NBA) is to ensure that bank demand for base money reaches a minimum level. They thus fulfil a monetary policy objective. Eligible assets in Swiss francs comprise coins in circulation, banknotes and sight deposits held at the National Bank. Short-term liabilities comprise sight liabilities or liabilities with a residual maturity not exceeding three months as well as 20% of the liabilities vis-à-vis customers in the form of savings or investments. If a bank fails to fulfil the minimum reserve requirement, it is required to pay interest to the National Bank with respect to the 30-day period for which there was a shortfall. The interest rate is three percentage points higher than the one-month Libor for Swiss franc investments averaged over the reporting period in question.

Minimum reserve volumes in 2006

In 2006 (from 20 December 2005 to 19 December 2006), the average minimum reserves required by law amounted to CHF 8.2 billion. This is a 7% increase year-on-year. Existing eligible assets amounted to an average CHF 9.8 billion. Surplus liquidity averaged CHF 1.7 billion over the year and the liquidity ratio was 120%. In the previous year, the corresponding values amounted to CHF 9.3 billion, CHF 1.7 billion and 123%.

In 2006, all of the 300 or so banks fulfilled the statutory minimum reserve requirements, with very few exceptions. Seven banks infringed the requirements, in each case for one reporting period. The amount involved was insignificant, amounting to 0.1% of total required assets. The penalty rate that the contravening banks were required to pay totalled about CHF 25,000.

2.6 Collateral eligible for SNB repos

To protect the SNB against losses and to ensure equal treatment of business partners, collateral eligible for SNB repos must meet certain requirements, if it is to be suitable for monetary policy operations. For repo transactions, the SNB accepts securities in selected currencies that fulfil certain liquidity and credit rating criteria. The SNB groups securities that are eligible for repo transactions in baskets. The baskets are tailored to the SNB's requirements and general market trends. In order to guarantee the supply of liquidity to the banks and promote the stability of the financial system, the range of securities eligible for SNB repos should be as large as possible.

Of the securities which were used as collateral in monetary policy operations in 2006, an average of 51% was denominated in Swiss francs and 49% in foreign currencies.

3 Ensuring the supply of cash

3.1 Organisation of cash distribution

Mandate

Pursuant to art. 5 para. 2 (b) of the National Bank Act (NBA), the Swiss National Bank is responsible for ensuring the supply and distribution of cash (coins and notes) in Switzerland. In conjunction with the commercial banks and their jointly operated organisations, as well as Swiss Post, it works to ensure an efficient and secure payment system.

Role of the SNB

The SNB works with the head and regional offices of the commercial banks, Swiss Post, Swiss Federal Railways (SBB/CFF) and the cash processing operators. It offsets seasonal fluctuations in the demand for cash and replaces notes and coins that are unfit for circulation. The role of retailer, which includes the distribution and redemption of coins and banknotes, is assumed by commercial banks, Swiss Post and cash processing operators.

Closure of the Cashier's Office in Lugano

At the end of 2006, the cash office at the SNB branch in Lugano was closed. Customers were informed of the implications of this closure in good time. In future, they will be able to execute cash transactions either through the cash office in Zurich or through a cash processing operator in Ticino. Cash processing operators may apply for cash deposit facilities, which comprise stocks of notes and coins. The SNB retains ownership of these third-party facilities.

Turnover at offices

In 2006, the National Bank's offices registered currency turnover amounting to CHF 126.9 billion, as compared with CHF 121.4 billion a year earlier. They received 405.0 million banknotes (previous year: 391.4 million). The value of incoming coins stood at CHF 360.3 million (previous year: CHF 257.3 million), their weight at 1,802 tonnes (previous year: 1,373 tonnes). The SNB examined the quality, quantity and authenticity of the notes and some of the coins.

... agencies

The agencies' turnover (incoming and outgoing) stabilised at CHF 14.9 billion in the year under review, compared with CHF 15.2 billion a year earlier. Agencies are cash distribution services operated by cantonal banks on behalf of the SNB. 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.

... domestic correspondents

The SNB can grant banks the authority to act as correspondents in areas where it does not have its own operations. Together with the post offices, these banks perform local cash redistribution transactions. The domestic correspondents supplied 2.2 million banknotes (previous year: 2.3 million) with a total value of CHF 340.0 million in 2006 (previous year: CHF 353.6 million).

3.2 Banknotes

Mandate

Pursuant to art. 7 of the Federal Act on Currency and Payment Instruments (CPIA), the SNB issues banknotes commensurate with demand for payment purposes and takes 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 their security. 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 cooperation with third parties.

Banknote circulation

In 2006, banknote circulation averaged CHF 38.2 billion (previous year: CHF 37.1 billion). This increase is primarily attributable to a corresponding development in the 1,000-franc notes, which are often held as a store of value. The number of notes in circulation amounted to 283.4 million on average (previous year: 276.2 million). The rise is principally attributable to GDP growth and the increased use of the 20-franc note in ATMs.

Issue and disposal

In 2006, the National Bank put 111.5 million (previous year: 107.8 million) freshly printed banknotes with a face value of CHF 7.8 billion into circulation (previous year: 7.7 billion), and destroyed 97.0 million (previous year: 99.9 million) damaged or recalled notes with a nominal value of CHF 6.4 billion (previous year: 7.0 billion).

Counterfeits

Roughly 2,600 counterfeit banknotes were confiscated in Switzerland in 2006 (previous year: 4,000). The National Bank's offices alone discovered 108 counterfeit notes (previous year: 142). By international standards, 9 seized counterfeit notes per million Swiss franc notes in circulation is fairly negligible (14 in the previous year).

Number of banknotes in circulation
In millions

CHF 10s: 60

CHF 20s: 64

CHF 50s: 35

CHF 100s: 74

CHF 200s: 29

CHF 1,000s: 21

Annual average

Development of new banknote series

In 2006, the previous year's award-winning designers were given an opportunity to refine the content, design and printability of their submissions on the theme "Switzerland open to the world". The SNB will make its final decision on a graphic designer for the new series of banknotes in spring 2007. This decision will take into account the further refinements as well as prints of the 50-franc notes and the designs for the other notes.

3.3 Coins

Mandate

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

Withdrawal of the one-centime coin

During the year under review, the Swiss Federal Council decided to withdraw the one-centime coin as of 1 January 2007. Pursuant to the guidelines on withdrawn coins of 7 April 2006, the SNB will accept these coins at nominal value for 20 years after their withdrawal, i.e. until 31 December 2026. Swiss Post and Swiss Federal Railways (SBB/CFF) will accept the coins until 31 December 2008. It was decided not to withdraw the five-centime coin, although this was also discussed in the year under review.

Coin circulation and minting

The average value of coins in circulation was CHF 2.5 billion (previous year: CHF 2.4 billion), while the number of coins amounted to 4.3 billion (previous year: 4.2 billion). The number and denomination of coins in circulation depend greatly on the prices of items sold in vending machines.

In 2006, swissmint minted 30.5 million coins (previous year: 32 million) with a nominal value of around CHF 21.3 million (previous year: CHF 10.6 million). A large proportion of these coins replace those taken out of the country by tourists.

4 Facilitating and securing cashless payment transactions

Mandate

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

4.1 Facilitating cashless payment transactions

Bodies responsible for the cashless payment system

Art. 9 NBA empowers the SNB to keep interest-bearing and non-interest-bearing accounts (SNB sight deposit accounts) for banks and other financial market participants. These accounts enable them to participate in the Swiss Interbank Clearing (SIC) system, through which they conduct payment transactions with each other. 'Other financial market participants' are companies that operate commercially on the financial markets. They are currently defined as securities traders and institutions that are of significance either for implementation of the National Bank's policy or for clearing payments transactions. Every financial market participant with a sight deposit at the SNB is eligible to use the SIC system. However, not all of them do. At the end of 2006, the SNB had 459 account-holders (previous year: 469), 302 of whom were domiciled in Switzerland (previous year: 305). 330 of these account-holders used the SIC system. Of these, 239 (previous year: 236) were domiciled in Switzerland. Ten domestic participants in the SIC system are non-banks and five of these are cash processing operators.

SIC: a real-time gross settlement system

SIC is a real-time gross settlement system. Such systems settle payments individually – and only if there is sufficient cover for the transaction – through the accounts of the system participants. Once executed, transactions are final and irrevocable. Balances on sight accounts are legal tender like cash. SIC is operated by Swiss Interbank Clearing AG, a subsidiary of Telekurs Group, on behalf of the SNB.

SNB steers SIC

The SNB steers the system. It transfers liquidity from the sight deposit accounts at the SNB to clearing accounts in the SIC system at the start of each clearing day and transfers the balances from the clearing accounts back to the sight accounts at the end of the clearing day. Legally, the two accounts form a unit. The clearing day in the SIC system starts at 5.00 pm and ends at 4.15 pm the following day. During this time, the SNB monitors operations and ensures that there is sufficient liquidity by granting, when necessary, intraday loans to banks against collateral. In addition, the National Bank is responsible for crisis management.

SIC agreements

An agreement concluded between the SNB and SIC AG (SIC master agreement) entrusts the latter with providing data processing services for the SIC system, while the relationship between the SNB and the holders of sight deposit accounts is governed by the SIC giro agreement.

Participation in payment system bodies

The SNB influences the development of the SIC system on a conceptual level. Based on the SIC master agreement, the SNB is the final approval body for upgrades and enhancements to SIC. It also exerts influence through the Board of Directors of SIC AG, in which it is represented, as well as through various technical working groups.

Participation in SEPA

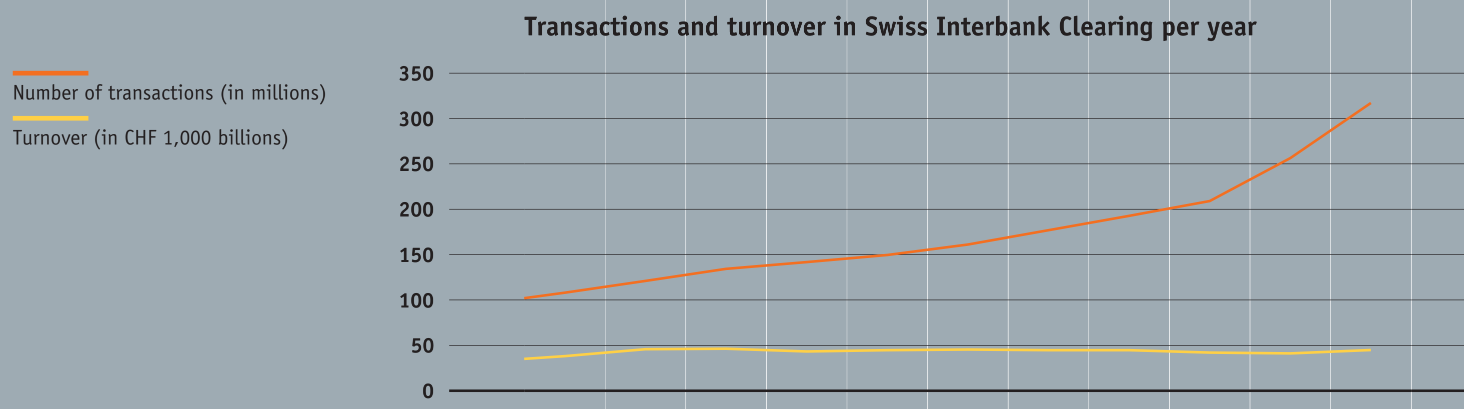
In March 2006, the European Payments Council (EPC) adopted the so-called Swiss Resolution, making Switzerland an official member of the Single Euro Payments Area (SEPA). The aim of the SEPA project is to create a single Europe-wide market for euro payments, allowing the adoption of uniform standards for the processing of cashless payments (bank transfers, direct debits and payments by card) in euros by 2008. Moreover, national borders will no longer play a role in such payments. Since payments within SEPA will be regarded as domestic payments, the relevant domestic charges will be applicable.

Key figures on SIC

The SIC AG data processing centre settled approximately 1.3 million transactions amounting to CHF 178.6 billion each day. On peak days, up to 3.8 million transactions and a total volume of CHF 318 billion were processed. The number of transactions handled by the SIC system increased by around 25%, and turnover was up roughly 10%.

Key figures on SIC

	2002	2003	2004	2005	2006
Transactions (in CHF thousands)					
Daily average	705	768	816	1 009	1 264
Highest daily value of the year	1 874	2 145	2 215	2 690	3 844
Volume (in CHF billions)					
Daily average	180	178	163	161	179
Highest daily value of the year	270	284	273	247	318
Amount per transaction (in CHF thousands)	253	232	200	160	141
Average liquidity (in CHF millions)					
Sight deposits at the end of the day	3 327	4 811	5 339	4 831	5 217
Intraday liquidity	3 897	5 972	6 188	6 340	7 070


Transactions and turnover in Swiss Interbank Clearing per year
Number of transactions (in millions)
Turnover (in CHF 1,000 billions)
350
300
250
200
150
100
50
0

4.2 Oversight of payment and securities settlement systems

Mandate

The NBA (art. 5 para. 2(c) and arts. 19–21) requires the SNB to oversee systems for the clearing and settlement of payments (payment systems) or transactions involving financial instruments, especially securities (securities settlement services). It empowers the National Bank to impose minimum requirements on the operation of systems that might be a source of risk to the stability of the financial system. The National Bank Ordinance (NBO) lays down the details of system oversight (arts. 18–39 NBO).

Focus on systemically important systems

Oversight focuses on those systems from which risks for the stability of the Swiss financial system may emanate. These include the payment system, Swiss Interbank Clearing (SIC), the securities clearing system (SECOM), and the central counterparty (x-clear). Pursuant to art. 22–34 NBO, the operators of these systems must meet minimum requirements. These are outlined in greater detail in system-specific Control Objectives issued in 2006. The SNB also introduced self-assessments in 2006. The systems operators use these to provide detailed evidence of compliance with the Control Objectives. The self-assessments are an important source of information for the SNB's own assessments. Other systems of systemic significance for the stability of the Swiss financial system are the Continuous Linked Settlement (CLS) system for foreign exchange transactions, whose operator is based in the US, and the central counterparty, LCH.Clearnet Limited (LCH), domiciled in the UK. CLS and LCH are exempted from the obligation to meet the minimum requirements because they are already subject to adequate oversight by their local regulators and there is a smooth exchange of information with the SNB.

Classification of LCH as systemically important

In 2006, the SNB defined the central counterparty, LCH.Clearnet Limited (LCH), as systemically important. LCH is a joint stock company registered in the UK, and is a wholly owned subsidiary of LCH.Clearnet Group Limited. The main shareholders of its parent company are the stock market operator Euronext, the LCH members, and the international central securities depositary Euroclear. LCH provides clearing services for a variety of spot and futures markets in the UK, the rest of Europe and the US. Of particular relevance for the Swiss financial system are the clearing services it provides for the virt-x trading platform and will shortly be providing for SWX Swiss Exchange. virt-x trading is mainly used for trading in blue chips included in the Swiss Market Index, while shares in Swiss companies with lower market capitalisation are traded on the SWX. LCH provides these services in competition with x-clear. For all transactions in which one trading partner is a participant in LCH and one in x-clear, there is a link between x-clear and LCH, which can be used for settling such transactions.

Cooperation with the SFBC

SIS SegaInterSettle AG and SIS x-clear AG, which operate the securities settlement system SECOM and the central counterparty x-clear respectively, both hold a banking licence and are supervised by the SFBC (institutional supervision) as well as the SNB (system oversight). While institutional supervision primarily aims at protecting individual creditors, system oversight deals with systemic risks and the functioning of the financial system. Although the SFBC and the SNB exercise their supervisory and oversight powers separately, they coordinate their activities as stipulated by law so as to avoid duplication (cf. art. 21 para. 1 NBA and art. 23bis para. 4 Banking Act). This applies in particular to the collecting of information required for the supervision of institutions and the oversight of systems. When assessing whether a system operator complies with the minimum requirements the SNB relies – as far as possible – on the information already gathered by the SFBC.

Cooperation with authorities abroad

The SNB cooperates with authorities abroad in the oversight of cross-border payment and securities settlement systems. In the case of CLS, the Federal Reserve Bank of New York, which is the authority with primary responsibility for its oversight, involves all central banks whose currencies are settled via this system. As regards the central counterparty x-clear, which holds the status of Recognised Overseas Clearing House (ROCH) in the UK, the SNB and the SFBC cooperate with the British Financial Services Authority (FSA). In 2006, the SNB and the SFBC drew up a Memorandum of Understanding with the FSA on cooperation and the exchange of information for the oversight of LCH, which (in Switzerland) has been newly defined as being systemically important.

Together with the other central banks in the Group of Ten (G10), and under the leadership of the Belgian central bank, the Swiss National Bank participates in the oversight of the Society for Worldwide Interbank Financial Telecommunication (SWIFT), which operates a global network for the transmission of financial information. Oversight is confined to those of SWIFT's operations that are of significance for financial stability and the smooth functioning of its infrastructure. It does not include compliance issues.

Current focus of systems oversight

In systems oversight, the SNB devotes special attention to developments that will have a lasting influence on the security and efficiency of financial market infrastructure. Two developments received special attention in the year under review. The first was that the IT infrastructure services of the Telekurs Group and SIS Swiss Financial Services Group were integrated. It makes economic sense to amalgamate data processing in two joint centres and it also helps system operators implement contingency plans to offset the possible loss of specialists in a crisis. However, this development also resulted in a certain concentration of risk. The SNB therefore strongly encouraged the system operators to set up a third, supraregional data processing centre in the medium term which could be brought into service in an emergency. This recommendation is scheduled for implementation in 2007.

The second development relates to SIS x-clear AG, which previously operated exclusively as the central counterparty for the virt-x trading platform. SIS x-clear AG intends to offer its clearing services also to SWX Swiss Exchange and the London Stock Exchange (LSE) in the course of 2007. The expected sharp rise in business volume requires a number of adjustments to risk management at x-clear. The National Bank has given its approval in principal for their implementation. The SNB also advocated appropriate control of the risks arising from the clearing of transactions between x-clear and LCH.

5 Asset management

5.1 Basic principles

Mandate

Under art. 5 para. 2 of the National Bank Act (NBA), the Swiss National Bank is responsible for managing the currency reserves. Asset management is governed by the primacy of monetary policy and is carried out in accordance with the criteria of security, liquidity and performance. The SNB's own Investment Policy Guidelines define the scope for its investments and for the investment and risk management process. Within this framework, investments are made in line with the principles of modern asset management. Diversification of investment aims at achieving an appropriate risk/return profile.

Asset classes

The SNB's assets essentially consist of foreign exchange, gold and financial assets in Swiss francs (securities and claims from repo transactions). They fulfil an important monetary policy function. Their composition is determined mainly by the established monetary order and the requirements of monetary policy. Some of the assets, including claims from repo transactions, are used directly for the implementation of monetary policy. Using repo transactions, the SNB supplies commercial banks with liquidity in the form of base money by purchasing securities from them. The SNB holds currency reserves – in the form of foreign exchange and gold – in order to ensure it has room for manoeuvre in monetary policy at all times. Currency reserves serve to prevent and overcome potential crises.

5.2 Investment and risk control process

Responsibilities of Bank Council and Risk Committee

The NBA defines the SNB's responsibilities and describes in detail its mandate with regard to asset management. The Bank Council is charged with the integral oversight of the investment and risk control process. Its role is to assess the underlying principles and monitor compliance with them. The Risk Committee – which is composed of three members of the Bank Council – supports the Bank Council in this task. In particular, it monitors risk management. All internal reporting is addressed directly to the Governing Board and Risk Committee. To avoid conflicts of interest, operational responsibilities for monetary policy and investment policy operations are largely separated.

... Governing Board

The Governing Board defines the requirements with regard to the security and liquidity of investments and the eligible currencies, investment categories, instruments and debtors. It decides on the composition of the currency reserves and other assets, and normally sets the investment strategy once a year. The investment strategy encompasses the allocation of total assets to the different portfolios and the guidelines for their management, in particular the allocation to different currencies and investment categories, and the leeway for active management at the operational level.

... Investment Committee and Portfolio Management

An internal Investment Committee determines the tactical allocation at the operational level. Within the strategically prescribed range, it adjusts the currency allocations, duration or allocation to the different investment categories to changing market conditions. The management of the individual portfolios is the responsibility of Portfolio Management. The majority of investments are managed by internal portfolio managers. External asset managers are used to obtain efficient access to investment categories, such as US mortgage-backed securities or indexed equity portfolios. Other mandates are outsourced in order to conduct performance comparisons with internal portfolio management.

... Risk Management

The investment strategy is based on quantitative specifications relating to risk tolerance and liquidity of the investments, and on comprehensive risk/return analyses. Risk Management and limitation is carried out by means of a system of reference portfolios, guidelines and limits. All relevant financial risks on investments are identified, assessed and monitored continuously. 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 the guidelines and limits is monitored systematically. A quarterly risk report for the attention of the Governing Board and the Bank Council's Risk Committee documents the results of risk management activities.

5.3 Breakdown of assets

Composition of assets

The SNB's currency reserves totalled CHF 78 billion at year-end 2006. Gold accounted for CHF 32 billion of this amount and foreign exchange reserves for CHF 46 billion. In addition, the SNB held assets of approx. CHF 32 billion in the form of claims from repo transactions and bond investments in the Swiss franc capital market. Due to seasonal factors, claims from repo transactions at the end of the year were – as usual – several billions Swiss francs higher than the average for the year.

Investments

The vast majority of the investments were fixed-income investments. They comprised CHF 27 billion in claims from repo transactions, CHF 5 billion in CHF bonds, CHF 3 billion in claims from gold lending operations and most of the foreign exchange reserves. The remaining foreign exchange reserves consisted of equities.

At the end of 2006, the bond portfolios consisted of government and quasi-government bonds as well as bonds issued by international organisations, local authorities, financial institutions and other companies. To a limited extent, secured and unsecured money market investments were also made at banks. The equities are managed on a purely passive basis, whereby broad market indices in euros, US dollars, yen, pounds sterling and Canadian dollars are replicated. In order to avoid any conflict of interest with monetary policy, only corporate bonds and equities issued by foreign companies are held.

Debtor categories and instruments

Exchange rate and interest rate risks were managed using derivative instruments, such as interest rate swaps, interest rate futures and forward foreign exchange transactions. In addition, futures on equity indices were used to manage the equity investments.

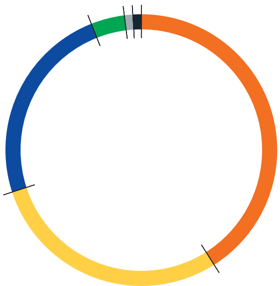
Breakdown of investments

	2005 Foreign exchange reserves	CHF bonds	2006 Foreign exchange reserves	CHF bonds
Currency allocation, incl. derivative positions				
CHF		100%		100%
USD	28%		27%	
EUR	47%		48%	
GBP	10%		10%	
JPY	8%		10%	
Other (CAD, DKK)	7%		5%	
Investment categories				
Money market investments	3%		3%	
Government bonds[1]	63%	48%	58%	48%
Other bonds[2]	25%	52%	29%	52%
Equities	9%	–	11%[3]	
Risk indicators				
Duration of bonds (years)	3.8	5.1	4.2	5.4
Value-at-Risk (1 year, 95%) in CHF billions	2.1	0.1	2.5	0.1

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

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

3 Including share index futures: 12%



Breakdown of National Bank assets
In percent

Foreign exchange reserves 41

Gold reserves 29

Claims from repo transactions 24

Securities in Swiss francs 4

Monetary institutions 1

Other assets 1

Total: CHF 112 billion
At year-end

Changes made in 2006

The currency allocation of the foreign exchange reserves was altered marginally compared with the previous year. The proportion invested in Japanese yen increased slightly at the expense of Danish kroner and US dollars. The proportion invested in equities also increased slightly.

5.4 Investment risk profile

Risk profile

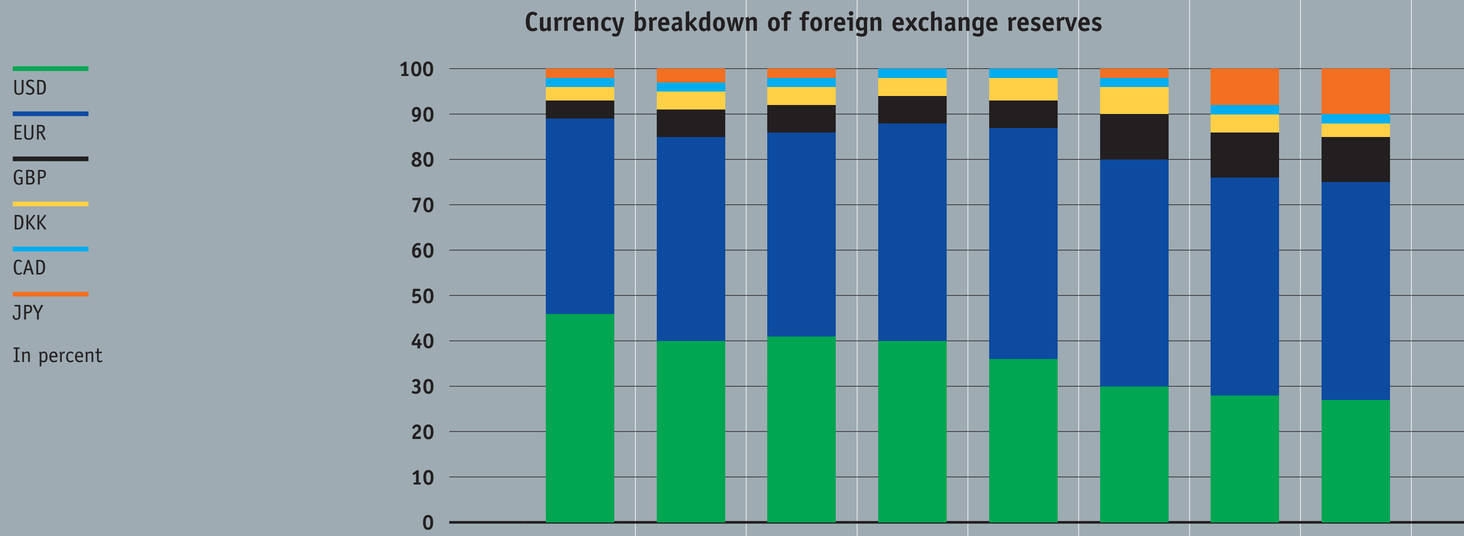
The main risk to investments is market risk, i.e. gold price, exchange rate, share price and interest rate risks. These risks are managed primarily through diversification. The SNB counters liquidity risks by holding the majority of its investments in the world's most liquid currencies and investment markets. In addition, it takes some credit risk. Compared with the market risk, this is insignificant, however.

... of currency reserves

The adjustments made in recent years, especially the more balanced allocation of foreign exchange reserves and diversification into equities, have improved the risk/return profile of the currency reserves. The average duration of fixed-income investments was around four years. The price of gold and the US dollar exchange rate were still the dominant risk factors. By contrast, equity, interest rate and credit risks contributed only marginally to the overall risk. The rise in the price of gold during the year increased the proportion of the currency reserves held as gold and, with it, the overall risk. With the exception of gold lending, gold was not actively managed. Slightly more than one-quarter of the gold holdings are available for lending transactions. At the end of 2006, about 123 tonnes (previous year: 134 tonnes) had been lent to various financial institutions. Most of these gold lending operations were secured by bonds with above-average ratings.

... and of Swiss franc investments

Swiss franc bonds are managed passively. Their maturity and credit structure generally correspond to that of the Swiss Bond Index. Duration at year-end was 5.4 years. Monetary policy repo transactions pose virtually no risk. Given the very short maturity of these transactions, they do not involve any interest rate risk. Moreover, they pose virtually no credit risk since the claims are secured by first-class collateral. Collateral is re-valued twice daily and any shortfall is covered immediately.


Currency breakdown of foreign exchange reserves
USD
EUR
GBP
DKK
CAD
JPY
In percent
100
90
80
70
60
50
40
30
20
10
0

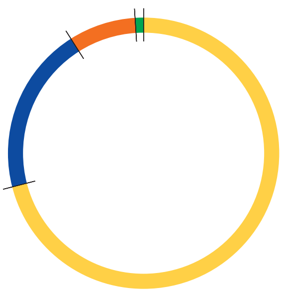
Credit risks

The SNB was exposed to credit risk by purchasing bonds from various debtors and debtor categories. Moreover, credit risk vis-à-vis banks existed in the form of time deposits, replacement values of derivatives, and gold lending. Although credit risk tolerance has increased in recent years, the average rating of the SNB's investments was high. 71% of the investments were graded AAA, the highest possible rating. As in 2005, the lowest rating category still eligible for investment – BBB – accounted for approximately 1% of these investments at the end of the year.

Overall risk

The overall risk of investments can be estimated, among other methods, by a VaR analysis. This indicator illustrates the SNB's risk tolerance and is applied both to total assets and to all sub-portfolios. The VaR shows the loss that – based on a prescribed probability level – will not be exceeded within a specific period of time. In view of the long investment horizon, the VaR for the SNB is calculated for a period of 12 months. Probability is set at 95%. Based on this calculation method, the VaR indicates the loss threshold which should only be exceeded once in every twenty years. Taken separately, the VaR came to roughly CHF 7.5 billion for gold and approximately CHF 2.5 billion for foreign exchange reserves. Owing to diversification effects, the VaR for total assets was – at roughly CHF 7 billion – significantly lower than the sum of the VaRs for the sub-portfolios.

In view of the limitations of the VaR method, such as the fact that it provides no information on possible extreme losses and tends to underestimate the risk of major losses, further risk analyses are required. The SNB, therefore, uses a range of other stress and scenario analyses. The National Bank's comparatively long-term investment horizon is taken into account in all of these calculations.



Rating allocation of investments[1]
In percent

AAA 71

AA 20

A 8

BBB 1

At year-end
1 Excluding shares and CHF repo transactions

5.5 Investment performance

The SNB's investment performance is calculated across all asset categories (foreign currency assets, gold and Swiss franc assets, including repo transactions). In 2006, it amounted to 5,2%, which was above the long-term return expectations. As in the previous year, by far the best performance – 15% – came from gold. By contrast, foreign exchange reserves (2%) and CHF bonds (0%) yielded below average returns. The return on the foreign exchange reserves was reduced by exchange rate losses. Exchange rate gains on euro and sterling investments were insufficient to offset the substantial exchange rate losses on dollar and yen investments. The good return on equities made a positive contribution, while rising interest rates reduced returns on fixed interest-rate investments.

Return on investments in Swiss francs[1]

	Foreign exchange reserves	Gold	CHF bonds	CHF repos	Total return[2]
1999	9.7%	–	0.7%	0.9%	–
2000	5.8%	–3.1%	3.3%	2.7%	2.2%
2001	5.2%	5.3%	4.3%	2.9%	4.0%
2002	0.4%	3.4%	10.0%	1.0%	3.0%
2003	3.0%	9.1%	1.4%	0.2%	4.2%
2004	2.3%	–3.1%	3.8%	0.3%	0.9%
2005	10.8%	35.0%	3.1%	0.6%	12.8%
2006	1.9%	15.0%	0.0%	1.3%	5.2%

1 Sum of direct income and realised and unrealised price changes on holdings.
2 From 2000–2005, including the return on free assets.

6 Contribution to financial system stability

Mandate

Pursuant to art. 5 para. 2 (e) of the National Bank Act (NBA), the Swiss National Bank is obliged to 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 indispensable for a successful implementation of monetary policy. The Swiss 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 SNB continued its close collaboration with the Swiss Federal Banking Commission (SFBC) and other federal offices in 2006.

6.1 Financial Stability Report

Analysis of banking sector and financial market infrastructure

In June 2006, the SNB published its fourth *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.

Stable banking sector

According to the report, the banking sector raised its profits substantially in a generally favourable macroeconomic and financial environment. This increase led to an overall rise in capital, thus improving the banking sector's capability to absorb shocks. No major imbalances which might trigger a crisis were identified. The SNB pointed out that there is little potential for further improvement in the present environment. It also warned against an excessive increase in the appetite for risk-taking in the banking sector.

Secure and efficient financial market infrastructure

With regard to the settlement and processing of payments, securities transactions and transactions using other financial instruments, the report stated that the Swiss financial sector has a smoothly functioning financial market infrastructure. By international standards, Switzerland's financial market infrastructure displays a high level of security and efficiency. Thanks to the rules and procedures that form part of the integrated architecture of the payment and securities settlement systems, settlement risks are significantly reduced. However, the SNB pointed out that unremitting efforts are required in order to reduce operational risks and strengthen the financial system's resilience to crises.

6.2 New Basel Capital Accord

SNB supports new accord

On an international level, the SNB, as a member of the Basel Committee on Banking Supervision, took part in work on the new Basel Capital Accord (Basel II). The Committee did not make any further changes to the Accord in 2006. However, it did take initial steps towards the Accord's implementation, e.g. it conducted a study which quantified the impact of the Accord on the level of capital adequacy requirements. In so doing, the Committee chose not to recalibrate these requirements. The National Bank supports the objectives of Basel II. Capital buffers at a level that is appropriate to risk strengthen the stability of the banking system. They protect banks from solvency problems and thus also from crises of confidence that may lead to liquidity shortages. Furthermore, only well-capitalised banks can effectively fulfil their macroeconomic function as credit intermediaries, also in difficult economic times.

SNB's role in implementation

In autumn 2003, a working group lead-managed by the SFBC began to implement the new Capital Accord in the Swiss banking regulatory framework. The SNB, together with the commercial banks and auditing companies, participated in this task, concentrating on areas related to the stability of the banking system and the smooth functioning of the credit market. In the second half of 2006, the Swiss Federal Council and the SFBC passed the definitive ordinances and circulars on the new capital adequacy requirements. The standard approaches for the calculation of capital adequacy requirements entered into effect at the beginning of 2007; the more complex approaches will follow at the beginning of 2008.

SNB supports direction of implementation

The SNB supports the direction in which the implementation of Basel II is headed in Switzerland. From the National Bank's point of view, three aspects are particularly important. The first relates to the reliability of the complex approaches adopted by the larger banks in Switzerland to calculate capital adequacy requirements. It is important that the risk parameters which form the basis of the calculation of capital adequacy requirements are correctly estimated. The second is restricting the procyclical potential of the capital adequacy requirements. The SNB attaches particular importance to careful execution of stress tests by the banks. Lead-managed by the SFBC, it actively participated in the process of quality assessment in 2006. The third aspect concerns the need to reduce the potential for contagion in the event of a bank failure. In this context, the SNB successfully called for a stricter regulation of large exposures in interbank transactions.

6.3 Legislation relevant to the financial market

As previously, the SNB contributed to the reform of securities legislation in 2006. It participated in the revision of the preliminary draft of an Uncertificated Securities Act, which had been drawn up by a working group headed by the National Bank in 2004 (cf. *98th Annual Report 2005,* p. 60). The Federal Council submitted the revised draft to the Federal Parliament on 15 November 2006. The Uncertificated Securities Act will modernise the legal basis for the custody of securities by financial intermediaries. In addition, the SNB chaired a committee of government experts at the International Institute for the Unification of Private Law (Unidroit), which is preparing an agreement on the world-wide harmonisation of the law on securities held with intermediaries. This project should be concluded in 2008.

7 Involvement in international monetary cooperation

Mandate

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

7.1 International Monetary Fund

Swiss interests

The IMF works to promote stable monetary conditions worldwide and support free trade and international payment flows. As an open economy with a globally important financial sector, Switzerland shares these aims.

Responsibilities

The Chairman of the National Bank sits 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, Tajikistan, Turkmenistan and Uzbekistan, and actively participates in formulating IMF policy. Montenegro, which has been independent of Serbia since 3 June 2006, joined the IMF on 18 January 2007 as an independent member and no longer belongs to the Swiss constituency. 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 in 2006

The most important activities undertaken by the Executive Board in 2006 were surveillance of the economic situation in member countries (crisis prevention) and the reform of quotas and voting rights. Significant progress has been made in the area of surveillance in recent years and some countries have repaid IMF loans ahead of schedule. To improve the response to global problems, multilateral consultation has been set up for systemically import countries and economic blocs. In addition, there are plans to introduce a new liquidity instrument for crisis prevention. These credit lines are for emerging markets that are pursuing a sound economic policy but are still vulnerable with regard to foreign trade and capital flows.

Reform of quotas and voice

The purpose of the reform on quotas and voice (voting rights), which should be completed within two years, is to ensure that representation of the member countries reflects recent global economic trends. As a first step, it was decided to increase the quotas for four countries (China, Mexico, South Korea and Turkey). As a result, Switzerland's quota dropped from 1.62% to 1.60%. The second step will comprise negotiating a new quota formula, realigning the quotas and raising the basic voting rights of member countries.

Financial Sector Assessment Program; FSAP

Within the framework of bilateral economic policy surveillance, Switzerland – in addition to the annual Article IV Consultation – participated in the IMF's Financial Sector Assessment Programme. FSAP is voluntary, but is recommended for financial centres as it entails a detailed examination of the health and stability of the financial sector. In Switzerland's case it comprised updating the first evaluation, which was carried out in 2001. The results are expected to be available in early summer 2007.

Financing of the reserve position

The IMF finances its activities with the member countries' quotas, i.e. capital subscriptions. Total quotas in the IMF amount to 217 billion in Special Drawing Rights (SDR) (approx. CHF 400 billion), with Switzerland's quota coming to SDR 3458.5 million (roughly CHF 6350 million). The portion of the Swiss quota used by the IMF – the reserve position – is financed by the National Bank. This is essentially a currency reserve that the SNB may use at any time. At the end of 2006, Switzerland's reserve position amounted to SDR 303.4 million, compared with SDR 571.2 million at the end of 2005. At the end of 2006, one SDR was equivalent to CHF 1.8358. This figure is calculated from the weighted exchange rates of the US dollar, euro, yen and pound sterling.

Contributions to PRGF and interim PRGF

The National Bank also finances the Swiss contribution to the loan account of the IMF's Poverty Reduction and Growth Facility (PRGF). The PRGF funds, in which Switzerland participates with a loan commitment of SDR 151.7 million, were fully drawn down by the end of 2001. Since the PRGF could not be maintained as a self-supporting facility, 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 SNB the timely repayment of both the PRGF and interim PRGF loans, including interest payments.

7.2 Group of Ten

At the start of 2006, the SNB took over the Chairmanship of the Deputies of the Group of Ten for the interim period to March 2007. At the request of the Group of Ten, the role and mode of operation of the G10 were examined and the ministers subsequently decided to retain the annual meetings of the G10 ministers and central bank governors but to abolish the regular meetings of their Deputies. For Switzerland, its proposed membership in the Financial Stability Forum (FSF) would fully compensate the abolition of this body. The potential influence of financial market regulation on the global markets was also discussed at this meeting.

7.3 Bank for International Settlements

BIS bodies

At the start of 2006 the SNB assumed the chairmanship of the Board of Directors of the BIS. 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 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 matters of banking supervision. 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. It issued two reports in 2006. The first provides an overview of the challenges facing international banks in the field of liquidity management for payments systems. In this context, the report analyses the processes available to banks to deposit foreign collateral in order to gain access to central bank liquidity. The second report looks at remittances, i.e. low-value cross-border payments transferred principally by foreign workers to relatives in their home countries. The report outlines various principles that should be observed to promote secure and efficient handling of such remittances.

Committee on the Global Financial System

The Committee on the Global Financial System (CGFS) monitors and assesses developments on the international financial markets and draws up recommendations which support central banks in their responsibilities with regard to the stability of the financial system. In 2006, the CGFS conducted two investigations. The first examined the reasons why the volatility of financial markets has declined in recent years. The second analysed the global shift in the financing of residential housing construction and its impact on consumer spending.

Markets Committee

The Markets Committee serves as a discussion forum for the G10 central bank staff members responsible for financial market operations. The discussions dealt with the developments on the foreign exchange and other financial markets and the impact of individual events on the overall functioning of these markets.

7.4 OECD

Committee work

Switzerland is a member of the OECD. On the Organisation's committees, it works to promote the development of economic relations, particularly among industrialised countries and major emerging economies. The National Bank, together with the Federal Administration, represents Switzerland in several OECD bodies. The Economic Policy Committee (EPC) and its three Working Parties examine economic structures, current account imbalances and the global economic outlook from the political and academic angles. The Committee on Financial Markets (CMF) discusses current developments and structural problems in international financial markets. The CMF's two Working Parties draw up rules to ensure optimum management of public debt and principles for compiling financial statistics. The Statistics Committee (CSTAT) drafts standards for the National Accounts in association with other international organisations. The Economic and Development Review Committee (EDRC) reviews the sustainability of the economic policies of OECD countries. In March 2006, Switzerland evaluated the OECD's country report on Germany as an EDRC examiner.

7.5 Monetary assistance loans

No new monetary assistance loans were extended in 2006. There was one outstanding balance-of-payments loan at the end of the year – EUR 14.3 million to Bulgaria, expiring in 2007.

7.6 Technical assistance

Focus on the countries in Switzerland's constituency

The National Bank fosters good relations with the central banks of those countries that Switzerland represents in the International Monetary Fund (IMF). With the support of those countries' voting power, Switzerland is able to head a constituency in the IMF and claim one of 24 seats on the Executive Board. The National Bank primarily provides the central banks of these countries with technical assistance, with a particular focus on the transfer of knowledge specific to central banks. The SNB provides no financial support.

Transfer of central bank-specific expertise

In 2006, the SNB continued to assist the central bank of Azerbaijan with the introduction of its new series of banknotes and the investment of its currency reserves. The programme for providing advice on human resources management was completed and the National Bank has now started to advise the Azerbaijani central bank on internal auditing. The central banks of both Serbia and Montenegro received further assistance with the investment of international reserves. For the central bank of the Kyrgyz Republic, the SNB provided advice on the introduction of new coins, the investment of international reserves, financial market operations and security issues. A joint survey of parts of the Republic's financial sector was also undertaken. In addition to established assistance with monetary policy analyses, the SNB provided support for the central bank of Tajikistan on cash and financial market operations.

Special events

In 2006, the SNB again organised meetings on specific topics for central banks from the countries in its constituency and other countries in the former Soviet Union and south-eastern Europe. In May, it organised a conference on "Inflation Targeting" in Warsaw in conjunction with the Polish central bank and in September it ran a cash management course in Berne.

Technical assistance to countries outside the Swiss constituency at the IMF

Outside of the Swiss constituency within the Bretton Woods institutions, noteworthy support provided by the SNB benefited the central banks of China, Kazakhstan and Tanzania. It also received visits from representatives of several Asian central banks on fact-finding missions.

8 Banking services for the Confederation

Mandate

Based on art. 5, para. 4 and art. 11 NBA, the Swiss National Bank provides banking services to the Swiss Confederation.

Remuneration for banking services

These services are provided in return for adequate compensation. However, they are provided free of charge if they facilitate the implementation of monetary policy. Remunerable services include payment transactions, liquidity management, the issue of money market debt register claims and the custody of securities. The details of the services to be provided and the remuneration payable are set out in an agreement concluded between the Federal Finance Administration and the National Bank dated 1 January 2006.

Issuing activities

In 2006, the SNB issued money market debt register claims (MMDRC) and bonds on behalf of and for the account of the Confederation by auction. MMDRCs totalling CHF 86.8 billion were subscribed, of which CHF 47.0 billion worth was allocated. The corresponding figures for Confederation bonds were CHF 7.3 billion and CHF 4.7 billion respectively.

Payments

In the area of payment transactions, the SNB carried out roughly 45,000 payments in Swiss francs on behalf of the Swiss Confederation (including ETH) and around 36,000 payments in various foreign currencies. Roughly 69,000 incoming payments (mainly in CHF) were recorded in the accounts held on behalf of the Swiss Confederation.