

2005

SCHWEIZERISCHE NATIONALBANK
BANQUE NATIONALE SUISSE
BANCA NAZIONALE SVIZZERA
BANCA NAZIUNALA SVIZRA
SWISS NATIONAL BANK



98th Annual Report

Goals and responsibilities of the Swiss National Bank

Mandate

The Swiss National Bank conducts the country's monetary policy as an independent central bank. It is obliged by Constitution and statute to act in accordance with the interests of the country as a whole. Its primary goal is to ensure price stability, while taking due account of economic developments. In so doing, it creates an appropriate environment for economic growth.

Price stability

Price stability is an important condition for growth and prosperity. Inflation and deflation are inhibiting factors for the decisions of consumers and producers; they disrupt economic activity and put the economically weak at a disadvantage. The National Bank equates price stability with a rise in the national consumer price index of less than 2% per annum. Monetary policy decisions are made on the basis of an inflation forecast and implemented by steering the three-month Libor.

Cash supply and distribution

The National Bank is entrusted with the note-issuing privilege. It supplies the economy with banknotes that meet high standards with respect to quality and security. It is also charged by the Confederation with the task of coin distribution.

Cashless payment transactions

In the field of cashless payment transactions, the National Bank provides services for high-value payments between banks. These are settled in the Swiss Interbank Clearing (SIC) system via sight deposit accounts held with the SNB.

Investment of currency reserves

The National Bank manages the currency reserves. These engender confidence in the Swiss franc, help to prevent and overcome crises, and may be utilised for interventions in the foreign exchange market.

Financial system stability

Within the context of its task to contribute to the stability of the financial system, the National Bank analyses sources of risk emanating from the financial system. It oversees the systemically important payment and securities settlement systems and helps to promote an operational environment for the financial sector.

Tasks on behalf of the Confederation

The National Bank acts as banker to the Confederation and, together with the federal authorities, participates in international monetary cooperation.

Statistics

The National Bank compiles statistical data on banks and financial markets, the balance of payments, the international investment position and the Swiss financial accounts.

Swiss National Bank
98th Annual Report 2005

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Preface

Ladies and Gentlemen

In accordance with art. 7 para. 2 of the National Bank Act (NBA), the Swiss National Bank is obliged to submit an annual accountability report to the Federal Assembly in which it outlines how it has fulfilled its mandate as defined in art. 5 NBA. Furthermore, the SNB is required – pursuant to art. 7 para. 1 NBA – to submit its Business and Financial Report to the Federal Council for approval, before handing it, together with the Audit Board's report, to the General Meeting of Shareholders for subsequent approval.

The first part of this year's report – the 98th Annual Report of the National Bank – comprises the Accountability Report to the Federal Assembly (cf. pp. 6–65). This is submitted to the General Meeting of Shareholders for information purposes only, and does not require their approval. It explains in detail how the National Bank has fulfilled its statutory mandate – in particular the conduct of monetary policy – and also describes the economic and monetary developments in the year under review. A summary of the Accountability Report is provided on pages 7–9.

The Business Report, for the attention of the Federal Council and General Meeting of Shareholders, deals with the organisational and operational development of the National Bank and its business activity, and includes the Financial Report, which contains the income statement, balance sheet and notes (cf. pp. 66–115).

From an organisational and operational perspective, the consolidation of new organisational structures and partially new procedures played a pivotal role in the year under review. In October 2005, the National Bank decided to bring its operational structures into line with the continuing concentration of activities in cash transactions. As a consequence, 18 jobs will be cut in the cash distribution services. The cash office in Lugano is due to be closed at the end of 2006 as it no longer has the processing volume needed for rational operations. Nevertheless, the National Bank will maintain its presence in Ticino with a delegate for regional economic relations.

The preparatory work that began in 2004 on the production of a potential new series of banknotes culminated in 2005 in a design competition. The outcome of the competition was decided in November, when three award winners were chosen. The National Bank now has to decide which designer should be given the mandate to develop the submissions further. It is unlikely that the new banknotes will be put into circulation before 2010.

The sale of the 1,300 tonnes of gold no longer required for monetary policy purposes was concluded in March 2005. The proceeds – amounting to CHF 21.1 billion – were distributed from the 2004 annual result to the Swiss Confederation and the cantons. This was in addition to the planned distribution of profits (CHF 2.9 billion) for the 2004 financial year. The proceeds were distributed in ten weekly tranches between the beginning of May and mid-July 2005.

Owing to an unusual accumulation of favourable market developments, particularly with regard to the gold price and the US dollar, the annual result for 2005 came to CHF 12.8 billion (2004: CHF 21.6 billion, including the proceeds from the gold sales for distribution). In accordance with the current profit distribution agreement, the amount to be paid out to the Confederation and the cantons for 2005 should total CHF 2.5 billion. The surplus for future distributions will increase by CHF 9.5 billion to CHF 16.5 billion.

We wish to thank the bank authorities as well as our employees for their valuable support over the past year.

Berne and Zurich, 24 February 2006

Hansueli Raggenbass

President of the Bank Council

Jean-Pierre Roth

Chairman of the Governing Board

Accountability Report for the Federal Assembly

On 15 February 2006, the Governing Board of the Swiss National Bank submitted its 2005 Accountability Report to the Federal Assembly in accordance with art. 7 para. 2 of the National Bank Act of 3 October 2003. The following Accountability Report is provided to the Federal Council and the General Meeting of Shareholders for information purposes only, and does not require their approval.

Summary

In accordance with art. 7 para. 2 of the 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 2005 is structured in line with art. 5 NBA, with a separate section devoted to each of the eight tasks listed there.

The SNB's main focus during the year under review was on monetary policy, investments and the distribution of the proceeds from the gold sales. Monetary policy remained expansionary because of the uncertainty about economic developments and the lack of any direct inflationary risk. However, the process of normalising the SNB's key interest rates, begun the previous year, was finally resumed. An accumulation of price and exchange rate movements – two parameters that normally move in opposite directions – gave rise to unusually large increases in the value of investments. The proceeds from the sale of gold no longer required for monetary purposes, amounting to CHF 21.1 billion, were distributed without affecting liquidity and without causing any disruption to the market. In all areas of its operations, the SNB consolidated the reforms initiated after the total revision of the NBA in the previous year.

(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 impacts 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 the first half of the year, growth in the global economy was more modest and less steady than in the previous year. The substantial increase in commodity prices and the difficulties experienced by the large countries neighbouring Switzerland weighed on the economy. Later in the year, the economic impetus emanating from the US and Asia fed into the European economies, and they regained momentum. Incipient inflation gradually prompted less expansionary monetary policies.

Developments in Switzerland were similar. The initial weakness in the economy was due to falling exports, under-utilised capacity and general uncertainty. However, from the middle of the year, a recovery based on exports and construction became apparent. This boosted confidence and developed into a broad-based upswing that finally took in consumption, although little impetus was transmitted to employment. Prices remained steady, while capital yields were low and the value of the Swiss franc declined in step with the euro.

Monetary policy

In December 2004, the National Bank suspended the normalisation of monetary policy commenced in the middle of that year. Interest rates remained extremely low and various monetary indicators showed that the course of monetary policy was clearly expansionary. However, the global economy remained unpredictable, while economic indicators for Europe and Switzerland were suggesting that the recovery would be weak. Moreover, recessionary second-round effects of the overheating in the oil market were just as possible as an inflationary impact. Consequently, caution was necessary, especially since no general inflationary pressure was evident despite the rise in oil prices. Towards the end of 2005, however, the upturn was clearly taking hold, and to some extent had even become established. The recovery became broader based and more sustained, and it was finally possible to raise the target interest rate range.

Liquidity supply

(2) Maintaining an adequate supply of liquidity to the money market goes hand in hand with the implementation of monetary policy. The NBA sets out the permissible 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 is ensured through a range of instruments, almost all of which are based on repo transactions. The new minimum reserve requirements applied from the beginning of 2005, while for liquidity-shortage financing, Lombard advances were available until the end of the year, alongside the new special-rate repo transactions.

Cash supply and distribution

(3) The National Bank holds the note-issuing privilege. Through the banks and postal service, it supplies the economy with banknotes and coins, the latter on behalf of the Confederation. In 2005, it again focused on maintaining the quality of banknotes and of cash transactions, on cash deposits held with third parties, on further developing security features and on precautionary measures to prevent counterfeiting. The development project for a new series of banknotes focused on the search for a suitable designer.

Payment systems

(4) In the area of cashless payments, the National Bank is mandated to facilitate and secure the functioning of the appropriate systems. It operates accounts for the banks, steers the SIC system for the settlement of interbank payments and oversees payment and securities settlement systems. In the year under review, the SNB's powers as the SIC steering body were extended and separated from its powers as the authority charged with the oversight of SIC. The National Bank specified the statutory minimum requirements for systemically important settlement systems.

Currency reserves

(5) The National Bank manages Switzerland's currency reserves. Its actions in this field are guided by the three criteria of security, liquidity and return. Guidelines laid down by the Governing Board define the investment principles and instruments, as well as the investment and risk control process. The SNB portfolio continued to focus on the most liquid currencies and markets, and on borrowers with the highest credit ratings. In the previous year, corporate bonds had been purchased for the first time and in the year under review, the investment universe was expanded to include foreign shares. Earnings were unusually high for all forms of investment, with gold and the dollar experiencing particularly strong value increases.

Financial system stability

(6) The National Bank is charged with helping to secure the stability of the financial system. This stability is both the result of and the condition for successful monetary policy and well-functioning financial markets. The SNB endeavours to identify risks at an early stage and to help create an environment conducive to stability through its monetary policy and other activities. In its Financial Stability Report, the SNB found the banking system and financial market infrastructure to be stable and well prepared to cope with disruptions. The National Bank helped to identify and initiate the implementation of measures for contingency planning and crisis management. It cooperated with domestic and foreign regulatory and supervisory authorities in various fields.

Monetary cooperation

(7) The National Bank participates in international monetary cooperation activities. Important bodies are the International Monetary Fund (IMF), the Group of Ten (G-10), the Bank for International Settlements (BIS) and the Organisation for Economic Cooperation and Development (OECD). The main activities of the IMF were surveillance of member states, crisis management, the financial problems of poorer countries and its own strategic direction. The interests of the G-10 included the impact of ageing on pensions and on financial markets. The BIS committees in which the SNB participates were concerned with banking supervision, payment transactions, the global financial system and financial markets. The National Bank's technical assistance focused on the countries that belong to its IMF constituency and involved the transfer of central bank knowledge alone.

Banker to the Confederation

(8) The National Bank provides the Swiss Confederation with banking services in the areas of payment transactions as well as liquidity and securities management. In the year under review, a new agreement with the Federal Finance Administration specified the details of services to be provided, as well as the remuneration for these services, as envisaged in the new NBA.

1 Monetary policy

Overview

The year 2005 was characterised by sluggish economic developments both in Switzerland and abroad. After a one-year interruption, the National Bank resumed the normalisation of its monetary policy, lifting its interest rates in December. Price stability was assured at all times.

Section 1.1 will discuss the legal basis underlying the National Bank's monetary policy, its mandate and its monetary policy strategy. Sections 1.2 and 1.3 will give an overview of economic developments abroad and in Switzerland. Section 1.4 will review the implementation of monetary policy in 2005 and the Governing Board's decisions in the context of the quarterly monetary policy assessments. Section 1.5 will describe the National Bank's statistical activities.

1.1 Monetary policy strategy

Constitutional and legal mandate

The Federal Constitution (FC) entrusts the National Bank, as an independent central bank, with the conduct of monetary policy in the interests of the country as a whole (art. 99 FC). The mandate is explained in greater 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 National Bank is thus obliged to resolve as best as possible any conflicts arising between the objective of price stability and steady economic activity, while taking into consideration the interests of the country as a whole and giving priority to price stability. The requirement to act in the "interests of the country as a whole" indicates that the National Bank must gear its policy to the needs of the Swiss economy as a whole rather than to the interests of individual regions or industries.

Significance of price stability

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

The National Bank's monetary policy aims at ensuring price stability in the medium and long term; in other words, it strives to prevent both sustained inflation and deflation. Short-term price fluctuations, by contrast, cannot be counteracted by monetary policy. By keeping prices stable, monetary policy creates an environment in which the economy can fully exploit its production potential.

To secure price stability, the National Bank 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 economic capacity is stretched, thus causing prices to rise. By contrast, if interest rates are too high for a lengthy period, this reduces the supply of money and credit to the economy and consequently leads to a shortage of aggregate demand. This has a dampening effect on the prices of goods and services.

The economy is subject to numerous domestic and foreign influences. These cause fluctuations in the business cycle which generate, alleviate or increase the pressure on prices. Such fluctuations are inevitable, but although monetary policy takes a medium to long-term focus, it helps to reduce them. In this sense, the National Bank also takes economic activity into account when formulating its monetary policy.

The National Bank 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 are caused, for example, by 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 ease in phases in which 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. 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 boost corporate costs and curb production. A continuous rise in the oil price is an example of such a shock. Under these circumstances, monetary policy must seek to ensure that the higher production costs do not result in an inflationary process, nor excessively disadvantage the companies affected by the shocks. A strategy aimed at the rapid restoration of price stability might have an adverse effect 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 delay, and the scale with which monetary policy impacts on the business cycle and prices.

The National Bank needs indicators to determine whether or not its chosen monetary policy is appropriate for its price stability objective. It bases its decisions on a broad range of real and monetary indicators. The monetary policy concept in force since the beginning of 2000 consists of three elements: a definition of price stability, a medium-term inflation forecast and – on an operational level – a target range for a reference interest rate, the three-month Libor (London Interbank Offered Rate) for Swiss francs.

Definition of price stability

The National Bank equates price stability with a rise in the national consumer price index (CPI) of less than 2% per annum. In so doing, it takes account of the fact that not every price movement is necessarily inflationary. 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, inflation, as measured by the CPI, will be slightly overstated.

Quarterly publication of inflation forecast

Each quarter, the National Bank publishes a forecast on the development of inflation over the three subsequent years. The period of three years corresponds more or less to the time required for the 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 National Bank emphasises the need to adopt a forward-looking stance and to react at an early stage to any inflationary or deflationary threats.

The National Bank'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 stance in Switzerland. It cannot therefore be compared with projections by other institutions, which usually incorporate expected monetary policy responses.

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 thus play a primary role in the quantitative models used to forecast inflation over the next two to three years. For shorter-term inflation forecasts, other indicators – mainly relating to economic activity and exchange rates – are important.

The National Bank regularly issues statements on the development of the principal monetary policy indicators factored into its inflation forecast. Moreover, the SNB has set out details of the models it uses to predict inflation in several of its publications.

Review of monetary policy based on the inflation forecast

If the inflation forecast indicates a deviation from price stability, monetary policy needs to be adjusted. Should inflation threaten to exceed 2% permanently, the National Bank would consider tightening its monetary policy. Conversely, it would loosen the monetary reins if there were a danger of deflation. The National Bank does not, however, react mechanically to the inflation forecast. To determine the nature and scale of its response, it also takes account of the general economic situation.

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

The National Bank implements its monetary policy by influencing the interest rate level in the money market. It fixes a target range for the three-month Libor, 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 keeps the Libor in the middle of the range.

The SNB undertakes quarterly economic and monetary assessments at which it reviews its monetary policy. If circumstances so require, it also adjusts the target range for the three-month Libor between these quarterly assessments. It sets out the reasons for any changes in a press release issued on the day the decision is made.

1.2 International economic developments

Moderate global economic growth in 2005

After an exceptional year in 2004, global economic growth was less robust in 2005. While Asia's emerging economies and the United States retained their lead positions, growth in Continental Europe lagged behind. The international economy was characterised by asynchronous growth cycles and pronounced regional differences.

Global economic developments were subdued in the first half of 2005; this trend was reflected in the manufacturing industry and in demand for equipment goods, where a flattening off in activity was observed. This was attributable in part to the massive rise in commodity prices, with fossil fuels and metals being particularly affected. The global economic recovery firmed, however, in the second half of the year.

Commodity prices hit record highs

On the back of the dynamic global economy, particularly in Asia's emerging countries, the price of crude oil stiffened by more than 50% between January and August 2005; the barrel price climbed from USD 40 to roughly USD 65. With parts of the US's energy infrastructure destroyed by Hurricanes Katrina and Rita, refined products such as petrol and diesel experienced yet another price spike in September. Most raw materials, particularly metals such as steel and copper, also recorded major price rises at the beginning of the year. The price of most energy products retreated towards the end of the year to a level which, although still high, was comparable to the level observed in mid-2005.

Inflation rises and core inflation is moderate

The strength of consumer prices in 2005 can be largely explained by the fluctuations in oil prices. Annual inflation in the US rose from 3.0% in the first quarter of 2005 to 3.7% in the fourth quarter, making it the highest rate since 1991. Inflation in the euro area grew from 2.0% to 2.3% in the same period. The indirect impact of the rise in energy prices on other consumer prices remained moderate, however.

Measured by core inflation (which factors out energy and food prices), inflation in the US never exceeded 2.4% in 2005, while in Europe, it actually dropped from 1.8% in January to 1.5% in December.

The weak inflationary pressure was due, on the one hand, to the confidence of consumers and manufacturers in the ability of the monetary authorities to keep inflation in check in the medium term and, on the other hand, to the brisk international competition in the goods markets. This was underpinned by an important economic factor, namely the persistent unemployment in the majority of industrialised nations and the associated moderation in wage claims.

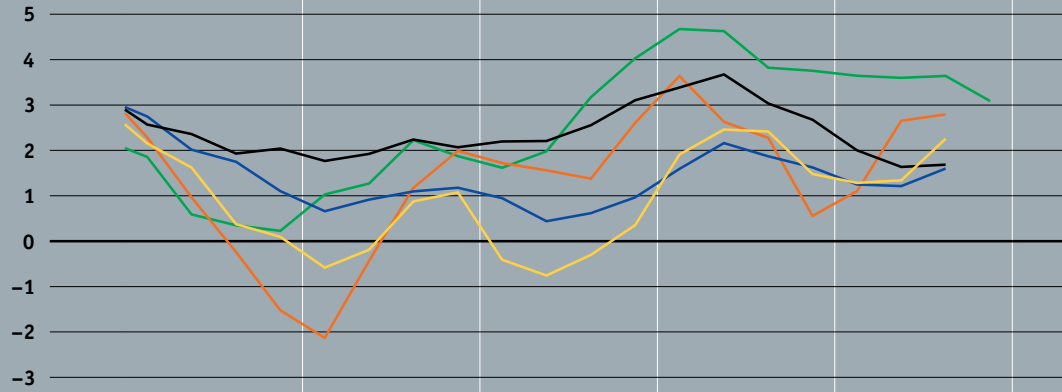
Vigorous demand in the US

The US economy was the major growth engine for industrialised countries. Although performance did not match that of 2004, GDP growth in the US considerably exceeded the average for OECD countries (2.7% according to OECD forecasts), with an increase of 3.5% (2004: 4.2%). Owing to this economic momentum, unemployment in the US fell by almost one percentage point between January 2004 (5.7%) and December 2005 (4.9%).

Gross domestic product

- United States
- Japan
- Euro area
- United Kingdom
- Switzerland

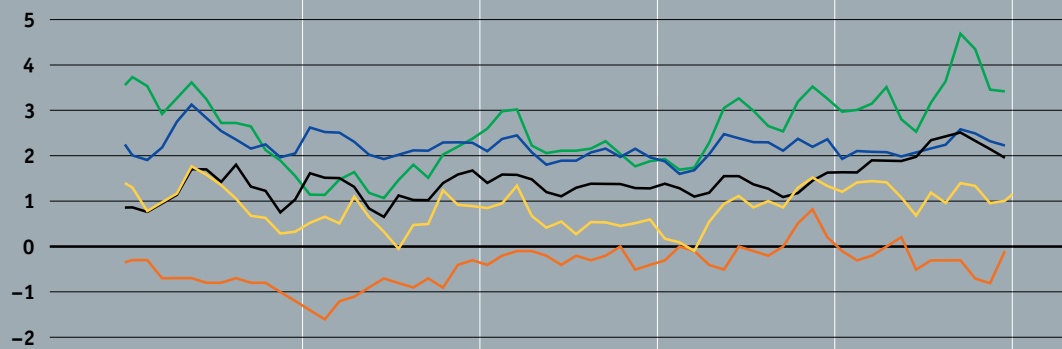
Year-on-year change
in percent, in real terms
Sources:
Thomson Datastream, seco



Inflation

- United States
- Japan
- Euro area
- United Kingdom
- Switzerland

In percent
Sources:
Thomson Datastream, SFSO



Domestic demand proved very robust on the whole. Despite the small rise in disposable income, consumer sentiment in US households remained upbeat – particularly with regard to cars – thanks to the considerable increase in the value of real estate. Consumer spending dropped in the fourth quarter, however. This was largely in response to the massive hikes in fuel prices at the beginning of the period. Government spending in the US also helped bolster growth.

Although demand for equipment goods in transportation and industrial machinery was slightly dampened by the high commodity prices, equipment investment (including information software) by companies continued the upward trend that has been observable since early 2003. The low interest rate levels, smaller risk premiums and the recovery of the stock exchange contributed considerably to shoring up investments.

Furthermore, 2005 was characterised by the fact that the net contribution from foreign trade was only slightly negative – a development that can be attributed to the robust demand from Asian trading partners, to the delayed knock-on effect of the weak dollar and to the decline in imports of petroleum products.

The European economy was rather lacklustre at the beginning of 2005. The slowdown in international trade in the first six months of the year particularly affected activities. The contribution to growth made by domestic demand did nothing to offset the decrease in exports. On the contrary, the steady deterioration in production prospects in industry actually curbed companies' equipment investment.

Private sector spending remained exceptionally low in the first half of 2005, particularly in Germany. The gloomy employment outlook – due in part to the rigid labour market and regulatory hurdles – led to this chronic weakness in household consumption in Europe. This situation consequently impaired the necessary redistribution of production factors. The inability to adapt became particularly obvious when major newly industrialised nations such as China and India came into the picture.

In the second half of the year, the domestic economy in Europe began to show clear signs of a recovery, however. Underpinned by the weak euro, exports boosted investments considerably. Owing to this improvement, the situation in the labour market relaxed slightly. For the first time in four years, unemployment decreased across the entire euro area.

Once again, the emerging economies of Asia reported extremely vigorous growth. The rapid expansion of China's manufacturing industry, in particular, buoyed international trade. Although the sharp rise of 9.9% in the country's GDP in 2005 primarily reflected the pronounced increase in exports, strong domestic demand was also a contributing factor. This notwithstanding, development in domestic demand was mixed – spending on equipment goods fell off slightly, while construction and private sector spending climbed.

Slow recovery in European domestic demand

Robust growth in Asia's emerging economies

China's economic upswing benefited the entire of Asia, particularly Japan. Despite the fact that its GDP fluctuated strongly from one quarter to the next, Japan's economy visibly went from strength to strength. Companies' high earnings shored up investment. The improved earnings situation stemmed from the far-reaching restructuring of production facilities in the 1990s. Consumer spending rose thanks to the brighter employment and wage prospects. Compared to previous recovery phases when it relied purely on developments abroad and government spending, Japan's growth should now be on firmer footing.

The asynchronous economic cycles in industrialised countries are the reason for the differing monetary conditions. The European Central Bank (ECB) left its reference rate unchanged at 2% for the first eleven months of 2005. With uncertainties regarding the economic outlook partly assuaged and monetary indicators, such as the credit volume and the M3 monetary aggregate, pointing to continued growth, the ECB raised its key rate in December by 25 basis points.

In the United States, meanwhile, the Federal Reserve (Fed) increased its key rate – the federal funds rate – in eight consecutive steps of 25 basis points each time, to 4.25% by the end of 2005. In the absence of inflationary pressure, Japan's central bank was able to maintain its policy of injecting the banking system with generous amounts of liquidity. Consequently, short-term interest rates remained at zero, as they have done for the past five years.

The US economy is set to remain robust in 2006. With employment clearly trending upwards, private sector spending should recover. This is all the more likely considering that the price of refined oil products retreated to a level far below that recorded at the end of summer 2005.

Domestic demand in Europe is expected to gain further momentum. The business climate indices for industry in most European countries – particularly in Germany – are set to return to their historical highs, thus encouraging companies to expand their production capacity. The situation in the service sector should improve together with consumer sentiment. Growth in China continues unabated and developments in the other Asian emerging markets suggest that activity will pick up pace once again. The likelihood is high, therefore, that the global economy will record robust growth in 2006. It can be expected that expansion of this kind will be accompanied by a tightening in monetary conditions in the majority of industrialised countries.

1.3 Economic developments in Switzerland

Hesitant start to the year

At the beginning of the year, the Swiss economy showed signs of weakness. Exports of goods declined and capacity utilisation in manufacturing dipped. Surveys of the economic situation increasingly reflected corporate diffidence about short-term movements in demand. Moreover, difficult weather conditions held back construction. In an initial estimate, seco projected GDP growth of an annualised 0.2% in the first quarter of 2005.

Signs of recovery from the second quarter onwards

Tangible indications of a recovery were evident in the second quarter. In spring, Swiss exports of goods had already returned to a strong growth path. The growth impetus came from the European Union, the US, Asia and the oil-exporting countries, the latter having benefited from increases in the price of oil. Construction recorded robust growth and made up the previous backlog. These two components – goods exports and investment in construction – were largely responsible for the vigorous advance in final demand in the second quarter.

However, GDP growth remained relatively modest, at 1.1%, since a reduction in inventories took up a large part of the increased demand. With the publication in September of GDP figures for the second quarter, seco also revised its first-quarter growth figures upwards. The new figures now showed that annual growth, originally estimated at 0.7%, had actually amounted to 1.2%.

... despite weak equipment investment

Although exports were again climbing, companies remained uncertain about short and medium-term growth in demand. This uncertainty, coupled with the decline in capacity utilisation in manufacturing, held back equipment investment until the middle of the year.

Vigorous private consumption from the beginning of the year

Favourable developments in private households' disposable income meant that overall private consumption was already robust in the first half of the year. Although basic salaries rose by only 1.2%, bonus payments had a positive impact on earned income.

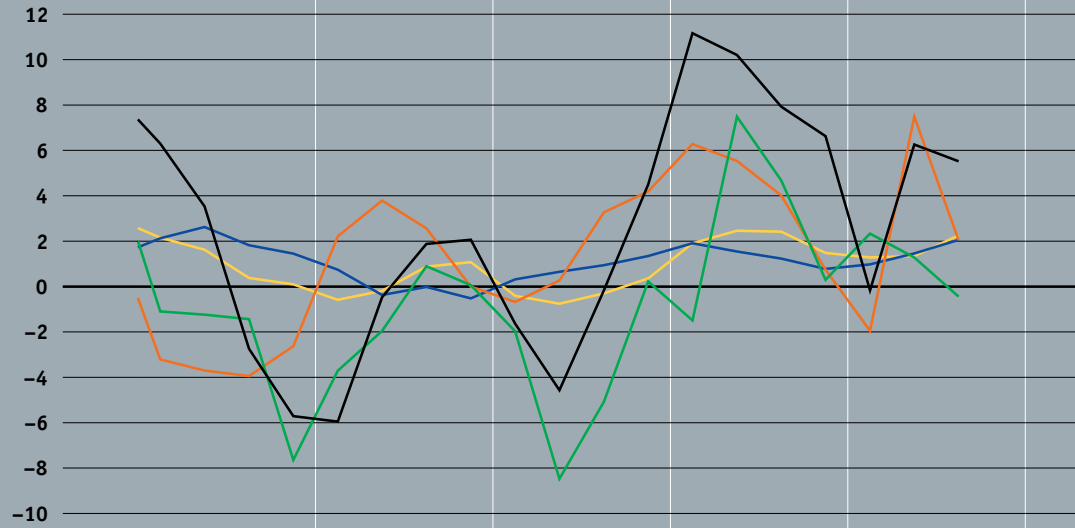
Nevertheless, there were differences between the individual components of private consumption, in particular with respect to consumer durables. While retail sales in household furnishings continued to increase in line with construction investment, there was a decline in new car purchases. Moreover, the improvement in the consumer sentiment index petered out as the year progressed because of the increase in energy prices and the absence of any brightening in the labour market. However, this did not really affect the growth in private consumption. On the contrary, industries such as domestic tourism benefited from progressive increases in expenditure from one month to the next.

Annual growth due to dynamic second half

The recovery firmed in the second half of the year. The number of new orders increased and – once most stocks of finished products had been depleted – the rise in demand acted as a stimulus to production. From the third quarter onwards, capacity utilisation in manufacturing began to rise again, and corporate expectations improved considerably. An upturn in business activity and the renewed confidence in the demand outlook caused businesses to resume spending on equipment. In the third quarter, real GDP was up by 2.3% year-on-year. At the same time as it released its data for the third quarter, seco also revised its figures for the first and second quarters upwards.

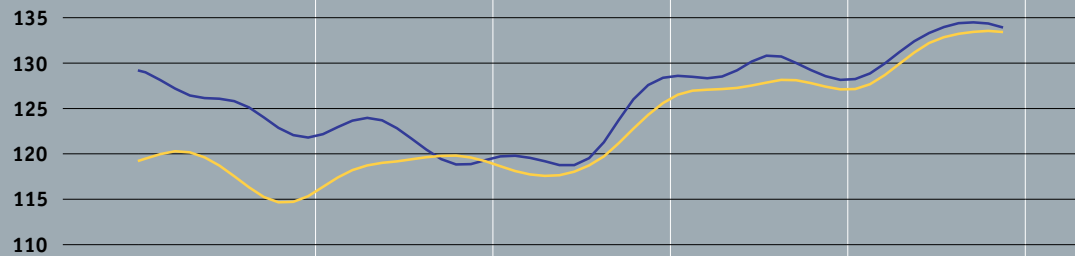
Gross domestic product and components

— GDP
— Private consumption
— Investment in construction
— Investment in equipment
— Exports
 Year-on-year change in percent, in real terms
 Source: seco



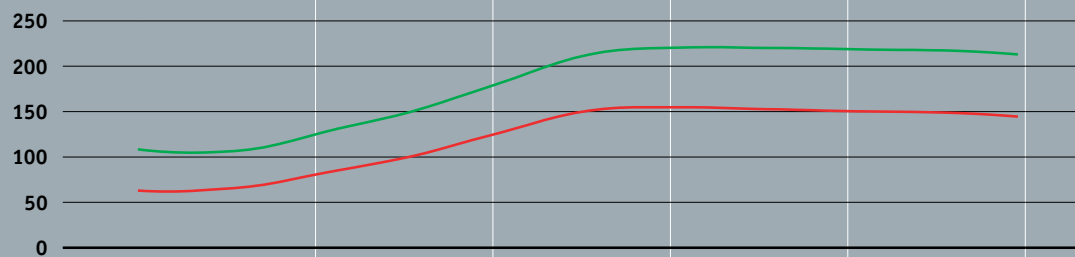
Foreign trade

— 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



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

	2001	2002	2003	2004	2005 ¹
Private consumption	2.0	-0.0	0.8	1.4	1.5
Government consumption	4.2	1.7	2.2	1.4	1.8
Investment in fixed assets	-3.1	0.3	-1.3	3.3	1.8
Construction	-3.4	2.2	1.8	4.1	2.5
Equipment	-2.9	-1.2	-3.8	2.7	1.1
Domestic demand	2.3	-0.5	0.4	1.0	1.5
Exports of goods and services	0.2	-0.7	-0.5	8.9	3.9
Aggregate demand	1.7	-0.5	0.1	3.5	2.3
Imports of goods and services	3.2	-2.6	1.3	7.4	4.0
Gross domestic product	1.0	0.3	-0.3	2.1	1.6

¹ Average of first three quarters.

Sources: SFSO, seco

Stagnating employment

Business momentum was insufficient to bring about a noticeable improvement in the labour market. Many companies remained cautious about recruiting staff because of the continued uncertainty about the duration and extent of the economic recovery.

Overall, employment – calculated on the basis of full-time equivalents – stagnated in the first three quarters of 2005. Although there was a net rise in the number of jobs in manufacturing and construction, employment continued to drop in key areas of the service sector – in particular in financial intermediation, insurance and retailing.

Slight fall in unemployment

Over the year as a whole, there was only a very gradual decline in the number of unemployed persons, despite a stagnation in employment figures and an expansion in the number of jobs on offer. In December, the seasonally adjusted rate of unemployment stood at 3.7%, as compared to 3.8% at the beginning of the year.

The ratio of job seekers to persons in employment dropped slightly to 5.4%. In addition to unemployed persons, this indicator includes people looking for jobs who are either temporarily engaged in employment or training programmes, or who receive temporary earnings. The fact that it declined slightly, despite a larger number of jobs on offer, was because the number of persons who are either no longer eligible for benefits or have withdrawn from the labour market (and are therefore not recorded as job seekers) climbed. This latter development is reflected in a reduction in the participation ratio among people of working age.

Labour market

	2001	2002	2003	2004	2005
Employment in terms of full-time equivalents ¹	1.9	-0.2	-1.3	-0.4	-0.2 ²
Unemployment rate in percent	1.7	2.5	3.7	3.9	3.8
Number of job seekers in percent	2.8	3.8	5.2	5.6	5.5
Swiss nominal wage index ¹	2.5	1.8	1.4	0.9	1.1 ²
Total wage bill index, nominal ^{1,3}	2.2	5.4	1.5	0.7	2.5

1 Year-on-year change in percent.

2 Average of first three quarters.

3 Wage contributions to AHV/AVS.

Sources: AHV/AVS, SFSO, seco

The Swiss wage index compiled by the Swiss Federal Statistical Office (SFSO) shows that, in 2005, nominal wages rose in line with inflation, as they had done in the previous year. For the second year in succession, real wages stagnated in 2005, after having risen by an average 1% a year from 2001 to 2003. It is worth noting that the Swiss wage index takes no account of changes relating to the structure of employment (an increasing number of employees in higher-wage industries) or the qualification of employees. This means that the increase in wage levels tends to be underestimated.

The figures for contributions to the Old Age and Survivors' Insurance Fund (AHV/AVS) are closer to the total wage bill concept used in the national accounts, and provide a more complete picture. The average real wage per full-time equivalent job can be calculated on the basis of this total wage bill. Taking an average for the years 2004 and 2005, the real wage calculated in this manner rose by 0.8%. This was about the median value recorded over the past ten years. Thus, the real wage grew more strongly than in terms of the Swiss wage index, a fact that is attributable to changes in the structure of employment and employee qualifications, as well as to bonus payments.

At the end of 2005, the growth outlook for the new year was still favourable. At its press conference on 15 December 2005, the National Bank forecast growth of a little more than 2% for the year 2006.

In a global environment that remains encouraging, exports of goods and services are likely to increase, while equipment investments will probably continue recovering. The rise in the demand for labour, the brighter outlook for the labour market and the improvement in real wages should allow consumption to grow at a rate somewhat above the long-term average. However, construction is unlikely to progress, following the strong increases recorded in 2003 to 2005. The easing in the housing market is likely to stabilise residential construction at a high level, while investment in commercial construction will probably stagnate due to substantial excess capacity.

Slight increase in real wages

Optimism for 2006

Little fluctuation in import and producer prices

Throughout the year, the fluctuations in import and producer prices remained low overall. In a year-on-year comparison, the rate of change in the import price index slowed from 1.8% in January to 0.9% in June. The rise in producer prices also became less pronounced in the first months of 2005, with the rate of increase falling from 1% in January to a mere 0.3% in June. In the second half of the year, energy prices drove import and producer prices up again, although the rate of increase remained moderate. In December, the import price index was 1.5% above the year-back figure, while the index for producer prices rose 1.1%.

Inflation stable in 2005

The rate of growth in consumer prices recorded only little change during the course of the year. In December, it stood at 1%, slightly below the figure of 1.2% recorded for January. In general, the absence of any stronger inflationary pressure could be linked to the persistence of excess capacity in production. Nevertheless, despite the steadiness of the CPI, there were still substantial differences in the movements of prices for individual goods and services.

The rate of growth in import goods prices (a component of the CPI) climbed from 1.5% to 3%. This increase was mainly attributable to the prices of petrochemical products, index components that shot up by 18.8% year-on-year to December 2005, while the prices of other import goods and services stagnated.

Domestic inflation amounted to 1.1% at the beginning of the year, and 0.3% in December. Throughout the year, stronger competition in the domestic market held down the prices of goods; in food and electricity, in particular, there was a drop in prices. Although the rate of inflation in the area of services remained positive, it tailed off from one month to the next. Growth in the prices of public sector services slowed to 1.3% in December (January: 2%). Rents increased, but the rate of increase subsided from 2.1% in January to 1% at the end of 2005. The prices of other private services held steady in December, as compared to the beginning of the year when they were still rising at a rate of 1%.

National consumer price index and components

Year-on-year change in percent

	2004	2005	2005 Q1	Q2	Q3	Q4
Overall CPI	0.8	1.2	1.4	1.1	1.2	1.1
Domestic goods and services	0.9	0.6	1.1	0.7	0.5	0.3
Goods	0.4	-0.4	-0.2	-0.4	-0.4	-0.7
Services	1.0	1.0	1.5	1.1	0.8	0.6
Private services (excluding rents)	0.6	0.5	1.1	0.7	0.3	0.1
Rents	1.2	1.4	1.9	1.6	1.2	1.0
Public services	1.9	1.5	1.9	1.3	1.5	1.3
Foreign goods and services	0.6	2.7	2.2	2.0	3.2	3.5
Excluding oil products	-0.9	-0.3	0.0	-0.4	-0.8	-0.0
Oil products	9.3	18.5	14.0	14.7	23.5	21.0
Core inflation						
Core inflation (SNB)	0.8	0.8	1.0	0.8	0.7	0.6
Core inflation 1 (SFSO)	0.5	0.5	0.9	0.6	0.3	0.3
Core inflation 2 (SFSO)	0.3	0.3	0.8	0.4	0.0	0.1

Sources: SFSO, SNB

2001


2002

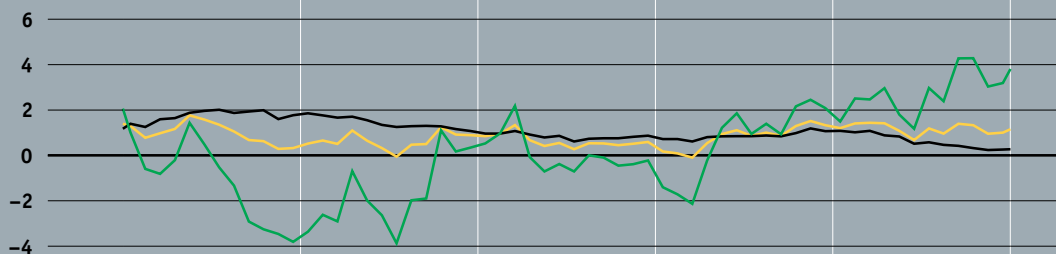
2003

2004




2005

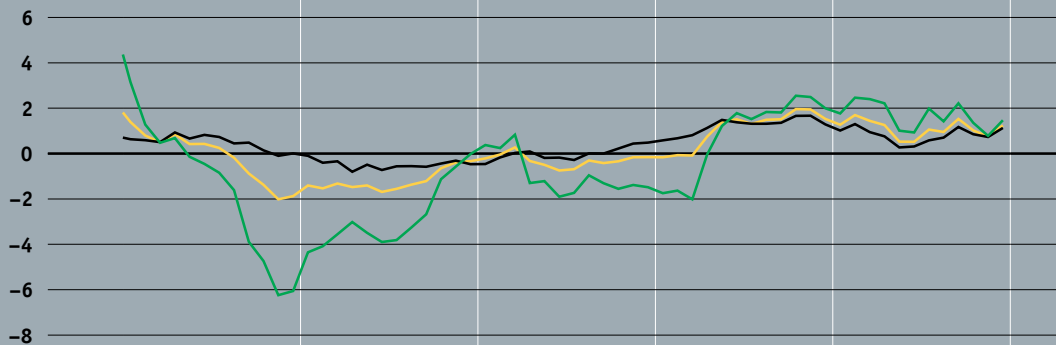
Consumer prices

 Consumer prices
 Domestic goods
 Imported goods
 Year-on-year change in percent
 Source: SFSO







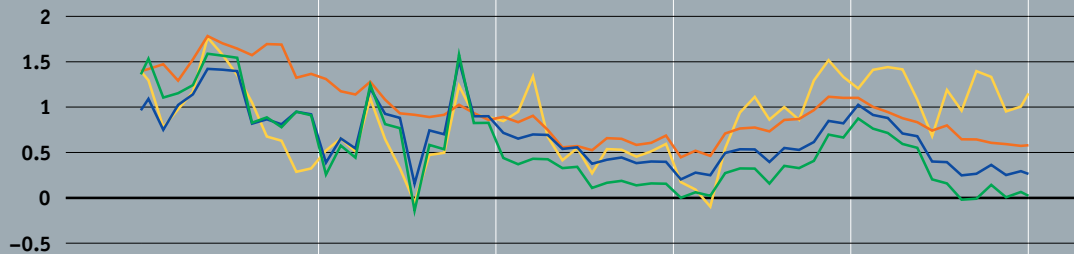
Producer and import prices

 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



2001

2002

2003

2004

2005

The SNB measure of core inflation, which excludes the strongest price fluctuations, declined from 1.1% in January to 0.6% in December, thus mirroring the generally quiet situation on the inflation front.

Libor lifted in December

During the first nine months of the year, the three-month Libor remained stable at 0.75%. Financial markets were anticipating an increase in the rate of interest at the end of the year. Consequently, the three-month Libor rose gradually, arriving at around 1% in the weeks before the December monetary policy assessment. Following the decision reached at this final quarterly assessment for 2005, to raise the target range for the key rate by 25 basis points, the Libor stabilised at 1%, i.e. in the middle of the new target range (0.5–1.5%).

Capital market yields stable

While most interest rates in the capital market had declined in the second half of 2004 – thus also including those for Swiss Confederation bonds – this trend appeared to have been halted at the beginning of 2005. In the first few months of 2005, there was actually a reversal of the former trend, but by spring, yields had already reverted to the downward trend of 2004. Swiss Confederation bonds reached their lowest level in September, at 1.8%. In autumn, there was another reversal in the trend, so that the yield on these bonds again amounted to 2% at the end of December. Consequently, looking at 2005 as a whole, yields on Swiss Confederation bonds dropped only 40 basis points.

In autumn, there was a rise in long-term interest rates which also affected securities with a term of less than ten years. Thus, we may assume that international financial markets were anticipating a normalisation in the monetary policies pursued by several countries. The good economic outlook in the second half of the year and the slight upturn in inflation contributed to this development.

**Dollar recovery,
euro stability**

In 2005, the Swiss franc moved within a relatively narrow band against the euro, with exchange rates ranging from 1.53 CHF/EUR to 1.57 CHF/EUR. The US dollar, however, was less static, recording an increase in value against both the Swiss franc (from 1.13 CHF/USD in January to 1.31 CHF/USD in December) and the euro. The dollar appreciation followed many years of decline, and was linked to interest rate increases by the Fed as well as expectations – maintained throughout the year – that the process of monetary policy normalisation in the US would continue.

In the first half of the year, both the nominal and the real export-weighted external value of the Swiss franc declined. This was attributable to the robust US economy and the strengthening in the US currency. At the end of the year, the Swiss franc firmed slightly.

**Continued reduction
in money overhang**

The monetary aggregates expanded strongly due to the National Bank's expansionary monetary policy, in place since 2001. A money overhang – as measured by the M3 aggregate – already existed as early as 2003. The monetary aggregates reacted rapidly to the increase in the Libor in June and September 2004, and until mid-2005, M1 and M2 declined, while M3 grew only slightly. Along with the improvement in the economic situation, the three monetary aggregates began to expand again in the second half of 2005, and from September the rate of increase gained momentum. Despite the renewed growth in money stocks, the money overhang that had existed since the beginning of 2003 receded further in the year under review.

2001



2002

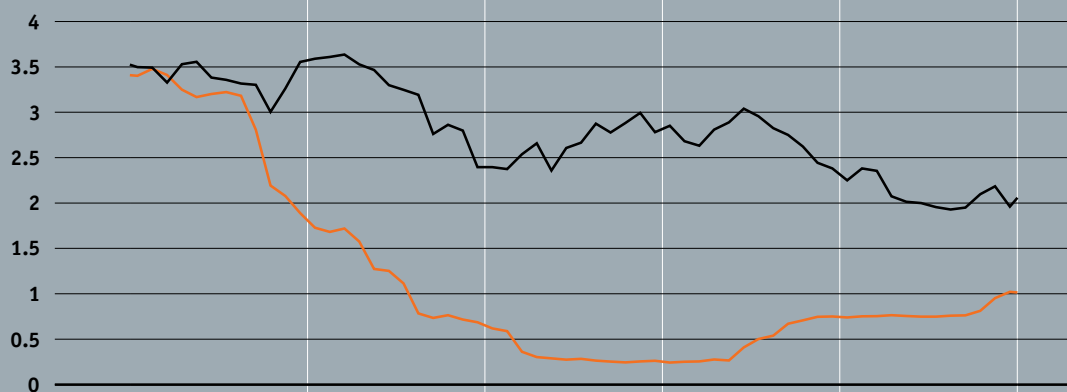
2003

2004

2005

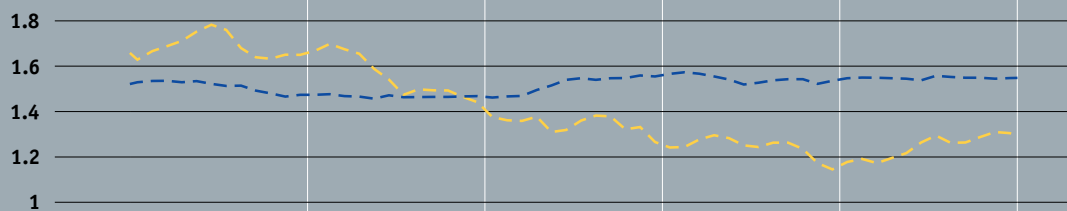
Money and capital market rates

 Three-month Libor
 Yield on ten-year Swiss Confederation bonds (spot interest rate)
 In percent



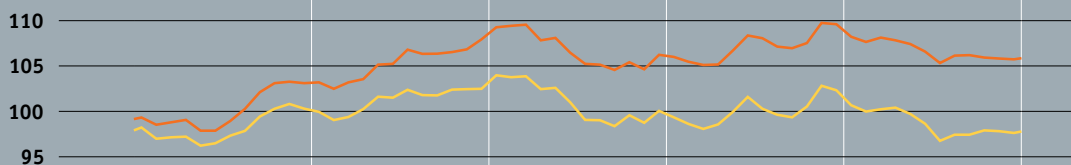
Exchange rates

 CHF/USD
 CHF/EUR
 Nominal



Export-weighted Swiss franc exchange rates

 Real
 Nominal
 24 trading partners
 Index: January 1999 = 100



2001

2002

2003

2004

2005

1.4 Monetary policy decisions

Four times a year – in mid-March, June, September and December – the National Bank's Governing Board conducts a regular assessment of the monetary policy situation. Each of these assessments results in an interest rate decision. If circumstances so require, the National Bank also adjusts the Libor target range for three-month investments in Swiss francs between regular assessment dates. In 2005, however, this was not the case.

Monetary policy challenge in 2005

Despite the decision taken on 15 December to raise the three-month Libor by 25 basis points, monetary policy remained expansionary throughout 2005. The normalisation of interest rates that began in summer and autumn of 2004 was suspended in 2005. On many occasions the National Bank had indicated that the interruption in interest rate increases, maintained since December 2004, would only be temporary. However, the major challenge in 2005 was to determine the moment when the interest rate should be lifted again.

Temporary stability

The first signs of a vigorous recovery in the Swiss economy were already evident in spring 2004, when the National Bank initiated the process of raising its interest rates. However, the upswing faltered at the end of 2004 and economic activity grew only hesitantly in the first half of 2005. In view of a global economy rendered erratic and unpredictable due – in particular – to the listless economy in Europe and the record levels of oil prices, growth forecasts for Switzerland were adjusted downwards during the course of 2005. The slowdown, while linked to a favourable inflation outlook, caused the National Bank to maintain the Libor at the level of September 2004 throughout the first three quarters of 2005.

... and increase in Libor in December

The National Bank raised its interest rates in December, at the final monetary policy assessment of the year. By making this one-year break, the SNB had demonstrated its flexibility. Taking account of the declining long-term inflation risks, it had utilised the greater degree of leeway available to it for maintaining an expansionary monetary policy. Nevertheless, it had monitored developments carefully throughout the year, as is evident in the monetary policy assessments undertaken in March, June and in particular September. It acted promptly once the indications of a robust and sustained economic recovery had finally consolidated.

2001

2002

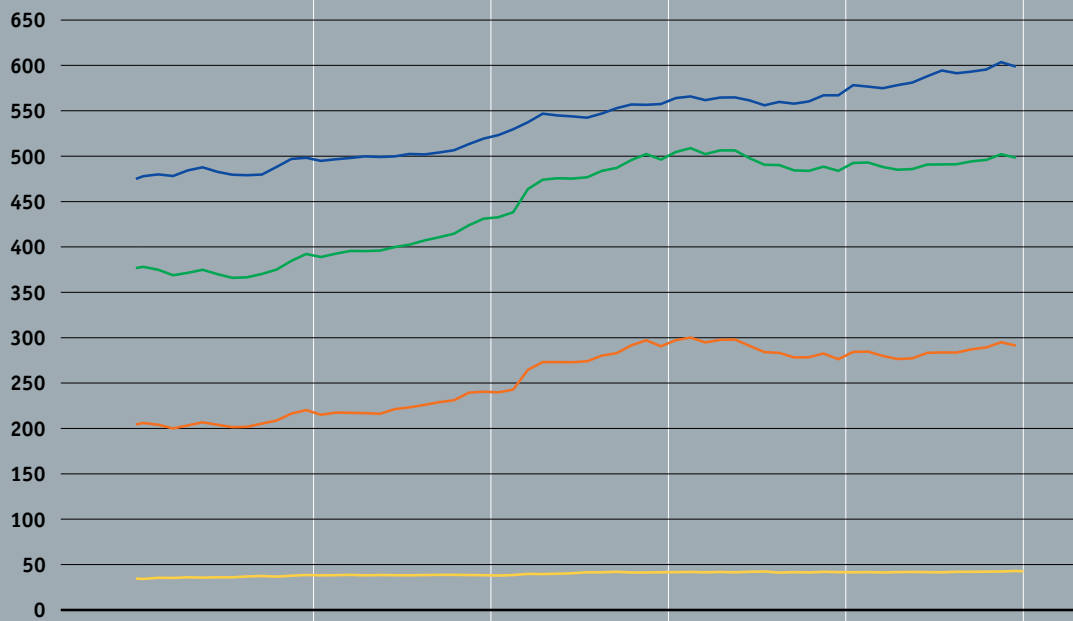
2003

2004

2005

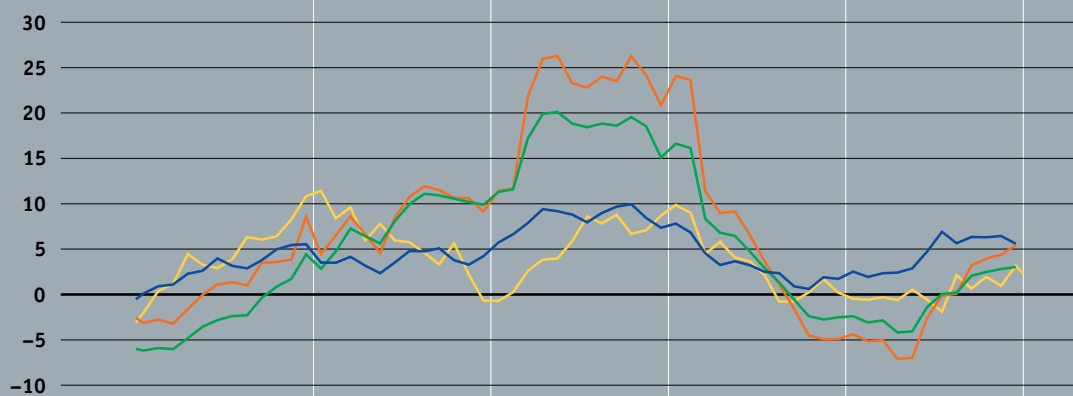
Level of monetary aggregates

— Monetary base
— M₁
— M₂
— M₃
 In CHF billions



Growth rates of monetary aggregates

— Monetary base
— M₁
— M₂
— M₃
 Year-on-year change in percent



2001

2002

2003

2004

2005

**Monetary policy risks
in 2005**

As in previous years, monetary policy in 2005 was subject to numerous short, medium and long-term risks. The probability of such risks occurring, their consequences for the economy and their impact on monetary policy are analysed regularly by the National Bank.

... in the long term

The low interest rate of the past three years was incompatible with a recovering economy. The inflation forecasts made in 2005 clearly showed that medium and long-term price stability could not be guaranteed at the interest rates prevailing in the year under review. It was evident, therefore, that the normalisation initiated in 2004 had not been concluded; an excessively long interruption in this process would have entailed a substantial inflation risk. The National Bank's awareness of these interconnections led to the interest-rate decision in December.

... in the medium term

In the medium term, the biggest risk was posed by the many uncertainties associated with the economic situation in the world and in Switzerland. The US economy maintained a strong rate of growth despite the environmental disasters experienced in the southern states. However, in Europe, the situation was unsatisfactory since domestic demand was slow in picking up. Moreover, it was considered possible throughout 2005 that the global economy might pursue a different course. Switzerland's growth engines – investments and exports – are largely dependent on international conditions. Consequently, there was considerable uncertainty with regard to economic developments in Switzerland in 2005, and this created additional difficulties when deciding on the timing for a resumption of normalisation.

... and in the short term

In the short term, oil price fluctuations were again the focus of attention. There were no further inflation risks. Oil prices persisted at a high level, but there were no significant second-round effects. On the one hand, the high oil prices had a dampening effect on demand and growth (even if this effect was limited), while on the other hand, strong competition in numerous markets helped to moderate price and wage developments, thereby reducing the risk of spiralling inflation. Even though the situation was worrying, it did not require the National Bank to take any special action during the course of 2005.

**Initial situation:
final quarterly assessment
in 2004**

The National Bank's inflation forecast on 16 December 2004 was based on a Libor of 0.75%. At that time, the SNB forecast annual inflation of 1.1% for 2005, taking account of an increase in oil prices as well as a higher valuation of the Swiss franc against the dollar. The stronger Swiss franc meant a tightening in monetary conditions and thus a lower inflationary impact from the increase in oil prices. For 2006 – in the medium term – the SNB now predicted a lower inflation rate of 1.3% averaged out over the year and 2% at the end of the year. This adjustment to the previous quarterly assessment was due to the expectation that the closure of the output gap would be delayed. In the longer term, finally, the forecast reflected lower inflationary pressure than had been assumed for the same period during the course of 2004. The easing in the situation was mainly due to the absorption of the liquidity surplus that had begun in summer 2004.

Q4 2004



Q1 2005

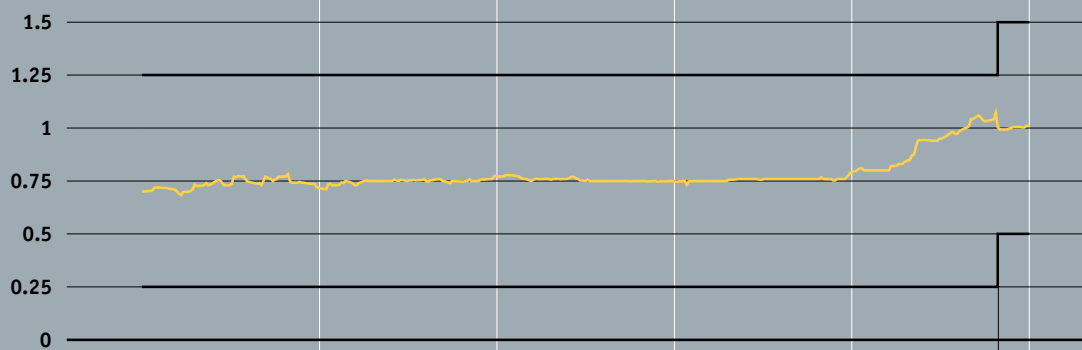
Q2

Q3

Q4

Three-month Libor

 Three-month Libor
 Target range
 Daily values in percent



15.12.2005

After raising the Libor twice, in June and September 2004, the Governing Board decided in December to leave the target range unchanged at 0.25–1.25%, and to keep the Libor at 0.75%. Since inflationary pressure was expected to lessen, the National Bank did not see any need to take a further step towards the normalisation of interest rates. Apart from these considerations, monetary conditions were already tighter because of a stronger Swiss franc. Despite this, monetary policy at the beginning of 2005 remained expansionary. The National Bank nevertheless noted that, in view of the inflation anticipated in the long term, the normalisation of interest rates begun in mid-2004 had not been completed.

At each monetary policy assessment, the National Bank bases its inflation forecast on the global economic scenario it regards as most likely. In the quarter preceding the March 2005 assessment, the US economy was strong and broad-based, giving rise to expectations that this would continue in the following quarters of 2005, with an annual growth rate of 3.4% for 2005. In the European Union, by contrast, growth rates in the final two quarters of 2004 were below expectations. The recovery during the course of 2005 foreseen in the scenario of December 2004 was still anticipated, although it would be a little delayed. For 2005, the National Bank forecast about 1.9% growth in Europe. With a renewed increase in fossil fuel prices, it predicted that prices would remain high for the next few quarters.

For Switzerland, the National Bank forecast real GDP growth of about 1.5% in 2005, as compared with 1.5–2.0% in the September 2004 assessment. Even though it might be modest, a continuation of economic recovery was linked with the foreseeable stimulus provided by exports and investments. Renewed strength was also evident for 2005 in private consumption, which had slowed markedly in 2004. However, the SNB did not expect that production capacity would be fully utilised until the second half of 2006. With respect to monetary aggregates, there was a drop in M1 and M2, while M3 grew only slightly. Aware that its monetary policy was still expansionary, the National Bank paid particular attention to the real estate sector and in particular to the rapid and continuous rise in mortgage lending.

The inflation forecast published in March 2005 was based on a Libor of 0.75% and showed consistently lower rates of inflation than the December 2004 forecast. At 0.7%, forecast inflation would have reached its low point in the fourth quarter of 2005. The expectation of a marked decline in the rate of inflation right through the year was essentially the result of a statistical effect. On average, inflation would amount to 1% for the year. In the medium term, from 2006, it was likely to creep up because of higher utilisation of production capacity. An inflation rate of 2.6% was expected for the end of 2007. Consequently, at the end of the forecast period the 2% mark – the upper limit of the range the National Bank equates with price stability – would have been clearly exceeded. On the basis of the inflation forecast, therefore, it was clear that the rate of interest could not remain unchanged in the long term, and that it would be raised by the SNB when the production gap began to close.

Despite this situation, the Governing Board decided to leave the target range for the three-month Libor unchanged at 0.25–1.25%. The reasons for this decision were two-fold. First, inflation prospects had improved slightly since the last monetary policy assessment on 16 December 2004. As a result, there was more leeway for monetary policy action. Second, the National Bank had lowered its forecast for the Swiss economy. In addition, there had been disturbing developments in a number of possible scenarios since the December assessment. For instance, the persistence of high oil prices could have held back the global economy more severely than had been assumed.

By leaving the target range for the three-month Libor unchanged, the National Bank maintained its expansionary monetary policy. It made use of the monetary policy leeway available to it in order to support the economic recovery, but without jeopardising medium and long-term price stability.

Since the beginning of the year, repeated increases in the price of oil had put a brake on the global economy. The situation was particularly unsatisfactory in Europe because, in addition to expensive oil, the rise in the value of the euro in the fourth quarter of 2004 was also curbing economic activity. Consequently, the National Bank lowered its growth assumptions for Europe to 1.5% for 2005 and 2.1% for 2006. By contrast, the US economy seemed to be only mildly affected by the difficulties in the oil markets and growth estimates there were maintained at 3.4% for 2005 and 3.6% for 2006.

As usual, international conditions had a strong impact on the Swiss economy. Contrary to the expectations of the National Bank at its previous monetary policy assessment, economic activity in Switzerland remained sluggish in the first quarter of 2005. Real GDP was unchanged from the previous quarter, although domestic demand increased slightly. This disappointing result was mainly attributable to weak exports and investments. In view of the low level of demand, companies curtailed investment, and this, in its turn, affected employment. The uncertain labour market situation had a dampening impact on consumer spending. Although private consumption rose, the rate of increase was below the historical average.

In these circumstances, the Swiss economy could no longer be expected to grow by approximately 1.5% in 2005, as forecast by the National Bank in March. Consequently, the forecast for real GDP growth in 2005 was adjusted down to about 1% at the June assessment. Assuming that exports recovered, the National Bank was still expecting the economy to record a moderate improvement over the course of the year.

The incentive for consumers and producers to hold liquid investments remained strong due to the persistence of a low interest rate. In the view of the SNB, there was still an excess of liquidity in the economy. Although the M3 monetary aggregate was still rising slightly, excess liquidity was no longer increasing. Financial conditions remained favourable in real estate. Mortgage lending had risen by an average of over 5% a year since the beginning of 2003, and even though mortgages granted to private households had slowed towards the end of 2004, the rate of growth still exceeded that of previous years. Since the beginning of 2005, corporate mortgage lending had also increased, after having declined in the five previous years.

**Quarterly assessment
of 16 June 2005**

The SNB did not change its inflation forecast for 2005 from that published at the March assessment, continuing to expect a 1% increase in prices for the year. The projected decline in the rate of inflation over the course of the year was attributable to the assumed stabilisation in the oil price. At the June assessment, inflation levels for the period after the end of 2005 were expected to be substantially lower than those forecast in March. Given a Libor of 0.75%, inflation for 2006 was forecast at 0.5% and for 2007 at 1.4%. Consequently, the medium-term inflation outlook was more positive than at the previous monetary policy assessment (2006: 1%, 2007: 2.1%). The expected low level of inflation for 2006 was attributable to the fact that the economy was likely to be sluggish. For 2007, however, the rate of inflation was set to increase faster as a result of better utilisation of production capacity and a high level of liquidity. At the end of the forecast period, inflation would reach 2.4%. As at the previous monetary policy assessment, the outer limit of the range which the National Bank equates with price stability would have been exceeded. However, the amount by which this limit was exceeded would not have been quite as great due to the fact that the liquidity surplus was gradually receding.

Once again, the Governing Board decided to leave the target range for the three-month Libor unchanged at 0.25–1.25%. The reasons for this decision were three-fold. First, the National Bank had lowered its forecast for the Swiss economy. Second, the medium-term inflation outlook associated with this slow economic development was improved, and an increase in the target range for the three-month Libor appeared less urgent. Third, there was more uncertainty with regard to international developments. It was harder to judge the economic outlook for Europe than it had been in March 2005. While oil prices had dropped in April and May, they had risen again in June and there was a risk of them persisting at a high level for a long period to come. In addition, the decline in long-term interest rates observed in numerous international markets was difficult to reconcile with a recovery in the economy.

By leaving the Libor unchanged, the National Bank maintained the monetary policy course pursued up to then. It continued to use the available leeway to support the economy without jeopardising medium and long-term price stability.

In the previous monetary policy assessment, the SNB had assumed that, although the price of oil would remain high, it would gradually edge downwards. However, contrary to this assumption, oil prices had continued to rise sharply. Consequently, the forecast drawn up in September was based on a very high price for oil. This would be even more detrimental to the recovery in Europe, and the growth forecast for 2005 was cut back to 1.4%, while that for 2006 fell to 2%. In the US, by contrast, the rise in oil prices was more than compensated by other factors, in particular the high level of consumption. For this reason, the SNB was a little more optimistic about US growth than in June, and adjusted its forecasts upwards for 2005 and 2006, to 3.6% for both years.

Inflation forecast of 17 March 2005

Inflation

December 2004 forecast:
three-month Libor 0.75%

March 2005 forecast:
three-month Libor 0.75%

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



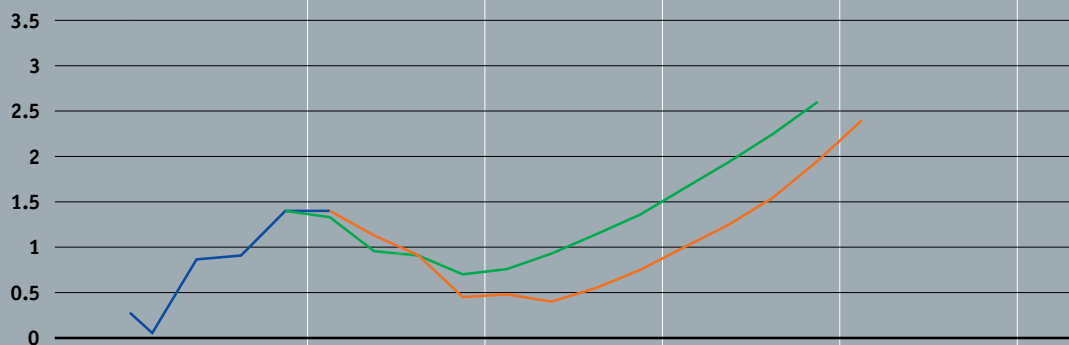
Inflation forecast of 16 June 2005

Inflation

March 2005 forecast:
three-month Libor 0.75%

June 2005 forecast:
three-month Libor 0.75%

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



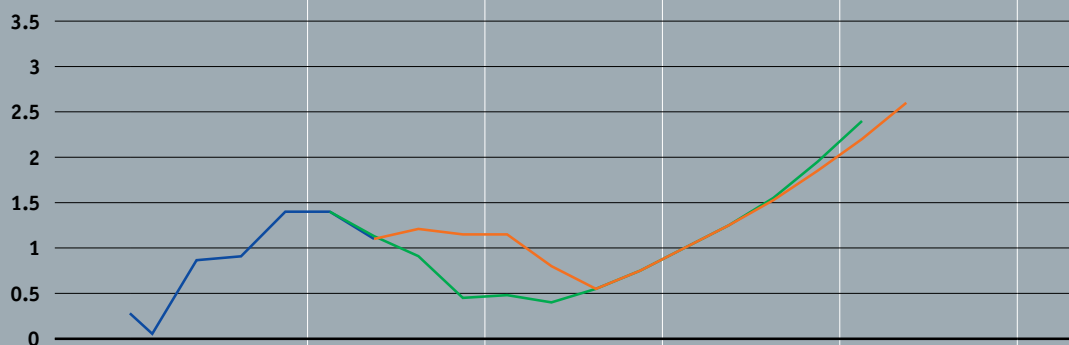
Inflation forecast of 15 September 2005

Inflation

June 2005 forecast:
three-month Libor 0.75%

September 2005 forecast:
three-month Libor 0.75%

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



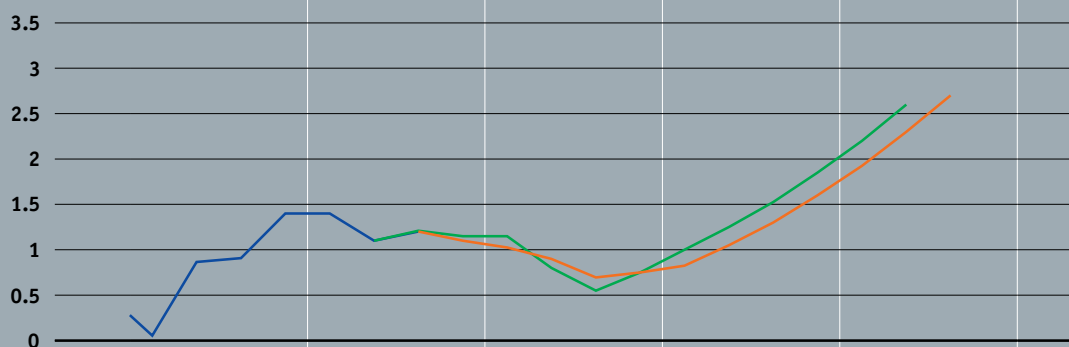
Inflation forecast of 15 December 2005

Inflation

September 2005 forecast:
three-month Libor 0.75%

December 2005 forecast:
three-month Libor 1.00%

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



For Switzerland, the National Bank was still forecasting real GDP growth of about 1% in 2005. Both investments and private consumption had already picked up before September. Growth was now broader-based, and a continuation of this trend appeared probable for the second half of 2005. It was assumed that exports and construction would provide the major impetus, while consumption continued to suffer from the high oil prices and the persistence of unemployment. The economic recovery expected in 2006 would bring with it an improvement in the labour market, and thus also stronger growth in consumption in the medium term. Full utilisation of production capacity was likely to be achieved towards the end of 2006.

The M1 and M2 monetary aggregates were no longer receding, while M3 was advancing at an even faster rate. Although the supply of liquidity to the economy remained abundant, it did not present any direct threat to price stability. Mortgage lending in the real estate market continued to grow strongly.

Due to the high oil prices, the rate of inflation forecast for the period to mid-2006 was higher in September than it had been in June. A high level of inflation was expected to persist for a number of quarters. It could be assumed that the increase in oil prices would not trigger spiralling inflation since it was probable that the level of economic activity would be relatively moderate and the recovery in the labour market very slow. However, in view of the recent developments in oil prices, the National Bank revised upwards its forecast of average inflation for the year 2005 to 1.2%. Assuming a stabilisation in oil prices, it forecast that inflation would recede in the first half of 2006, due to a statistical effect. Thereafter, given full utilisation of production capacity and a persistently high level of liquidity, higher rates of inflation could be expected from the end of 2006. At 0.8%, average inflation for 2006 was slightly higher than at the previous assessment, while the 2007 figure was unchanged at 1.4%. By the end of the forecast period, inflation would amount to 2.6%, still above the limit of the range that the SNB equates with price stability.

The National Bank decided to leave the target range for the three-month Libor unchanged at 0.25–1.25% and to maintain its expansionary monetary policy course. There were two factors that gave rise to this decision. First, the curve for projected inflation remained low until mid-2006, despite the fact that, in real terms, oil prices had reached the highest level for twenty years. This afforded the National Bank a certain amount of leeway which it could use without jeopardising price stability.

Second, there was a degree of uncertainty with regard to the development of economic activity in Switzerland. Nevertheless, a growth rate of 1% for 2005 could be assumed, as at the previous monetary policy assessment. Consequently, the National Bank decided to maintain the level of interest rates, while also making it clear that, as soon as the recovery in the economy was confirmed, it would change the monetary policy course which had been expansionary for a long time.

Although the growth forecasts for the euro area and the US were almost unchanged from the September monetary policy assessment, the SNB expressed confidence on the outlook for the global economy. For 2005, it continued to work on the basis of a European growth rate of 1.4%, and for 2006, 2%, while its growth assumptions for the US were lowered slightly, to 3.5% for 2005 and 3.6% for 2006. In view of the vitality of the US economy, the National Bank forecast growth of about 3.5% in 2007. The SNB was also optimistic about developments in the euro area, projecting a growth rate of 2.4% in 2007. As compared to the situation at the previous monetary policy assessment, world oil markets had eased somewhat. Consequently, the National Bank no longer regarded oil prices as having the potential to hold back the industrialised economies, although it assumed that the price level would remain high over the next few quarters.

Unlike the September monetary policy assessment, when the SNB was still expecting the Swiss economy to grow by only 1% in 2005, at the December assessment it revised its forecast upwards to just over 1.5%. First, seco's revised GDP growth rates for the first two quarters supported a more optimistic evaluation. Second, both consumption and equipment investment were strong in the third quarter, and positive developments could be expected in the next few quarters. This scenario would not be affected by the levelling off in construction investment expected in 2006. Economic activity at the end of the year was a further factor supporting the National Bank's confidence in the outlook for 2006. Given this situation, the SNB forecast GDP growth of a little more than 2%.

Monetary indicators also pointed to an improvement in the economic situation. The trends that had emerged at the September assessment were further reinforced shortly before the December assessment. There was an additional acceleration in the movement of the M1 and M2 aggregates that had persisted since August. M3 grew even more strongly. In October 2004, its rate of growth was just 1%, while at the monetary policy assessment it came to more than 6%. The SNB also devoted special attention to real estate, an area which remained very active.

As at the previous monetary policy assessment, the National Bank forecast inflation of 1.2% for 2005. On the assumption of an unchanged Libor of 0.75% in the following three years, the December forecast for inflation in 2006 was revised upwards from the rate forecast at the September assessment. By the end of the forecast period, inflation would amount to 3%, considerably above the limit of the range that the SNB equates with price stability.

Given this situation, the Governing Board decided to increase the target range for the three-month Libor by 25 basis points, to 0.50–1.50%, and to hold the Libor in the middle of the target range for the time being. At the beginning of the year, with the considerable improvement in the medium and long-term inflation outlook, the National Bank had suspended the normalisation of its interest rates. At the monetary policy assessment in September 2005, it had again decided against increasing the interest rate. While the improvement in the inflation outlook appeared to be petering out, a sudden rise in the oil price created uncertainty with respect to economic prospects. In December, the need for action became more urgent with the upturn in the global and Swiss economies. As a result, the SNB resumed normalisation of its monetary policy course.

Assuming an unchanged three-month Libor of 1% for the next three years, the Governing Board forecast annual inflation of 0.8% in 2006, 1.2% in 2007 and 2.7% for the end of the forecast period. This would still be above the limit of the range that the National Bank equates with stability. Thus, monetary policy remained expansionary and continued to support economic recovery.

1.5 Statistical activities

Since 1 May 2004, a uniform legal basis (art. 14 NBA) has governed the collection of statistics that the SNB requires in order to fulfil its statutory tasks. Statistical data are needed for the conduct of monetary policy, the oversight of payment and securities settlement systems, for helping to maintain the stability of the financial system, for preparing both the balance of payments and statistics on the international investment position, for international monetary cooperation and for analyses by international organisations.

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

The National Bank 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.

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 exchanged with the competent supervisory authorities for the Swiss financial market (art. 16 para. 4 NBA).

The National Bank manages a database containing 1.7 million time series and publishes the results of its surveys. The most important publications containing statistical information are the Monthly Statistical Bulletin and the Monthly Bulletin of Banking Statistics, as well as Banks in Switzerland, which is published annually. These publications are supplemented by reports on Switzerland's balance of payments, the international investment position and direct investment. All publications are also accessible on the internet (www.snb.ch), along with other data series. The two monthly publications are now available in English.

The National Bank has extended its test phase for the collection of data on the terms and conditions of new loans extended to companies (lending rate statistics). This will make it easier for reporting banks to ensure that the data can be provided at the level of data required. The extension of the test phase will also allow the National Bank to conduct additional investigations and, consequently, to modify the form used for reporting. The test phase will terminate in mid-2006 and normal data collection will begin immediately thereafter.

At the beginning of the year under review, the National Bank began collecting data on the new minimum reserve requirements, thereby implementing the relevant provisions in the NBA and the NBO. It ceased collection of data on banks' cash liquidity at the start of the same year.

Purpose of statistical activities

Institutions required to provide data

Confidentiality and exchange of data

Publications and database

New surveys

In the third quarter, the National Bank began collecting data for the revised investment fund statistics. The revisions were needed because data collection did not fully reflect developments in funds business over the past few years. The new statistics contain more detailed data and have made it possible to arrive at an appropriate definition of the boundaries of the Swiss investment fund market.

Financial accounts published for the first time

For the first time, the National Bank has published financial accounts for Switzerland. The accounts set out the scope and structure of the financial assets and liabilities of the different economic sectors. The published stock data cover the period 1999–2003. The financial accounts provide information for monetary policy and close a gap in the system of national accounts, as well as enabling Switzerland to meet a requirement under the bilateral statistical agreement with the EU.

Collaboration

In compiling statistical data, the National Bank cooperates 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

As part of the agreement on the reciprocal exchange of data for the financial sector, the National Bank assisted the SFBC secretariat with the revision of supervisory reports processed by the National Bank.

... with the banking statistics committee

The National Bank consulted the banking statistics committee on the content of its banking surveys (art. 7 NBO). The committee comprises representatives of the Swiss commercial banks, the Swiss Bankers' Association, the SFBC and the Liechtenstein banks.

... with the group of experts on the balance of payments

A group of experts under the direction of the National Bank 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 the Swiss Federal Institute of Technology.

... with the Principality of Liechtenstein

The National Bank stepped up its collaboration with the Liechtenstein authorities. A trial collection of data from manufacturing companies and within the services sector was conducted in order to complete the balance of payments and statistics on the international investment position.

... with foreign agencies

In the area of statistics, the National Bank works closely with the Bank for International Settlements (BIS), the Organisation for Economic Cooperation and Development (OECD), the Statistical Office of the European Communities (Eurostat), and the International Monetary Fund (IMF). This collaboration is aimed at harmonising statistical survey methods and analyses.

2 Supplying the money market with liquidity

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.

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 for the counterparties. Since May 2004, the National Bank has been publishing a weekly report containing important monetary policy data.

Mandate

Guidelines on monetary policy instruments

2.1 Regular instruments for steering the money market

All regular monetary policy instruments of the SNB, with the exception of Lombard advances (abolished with effect from the end of 2005), are based on repo transactions. In a repo transaction, the cash taker sells securities spot to the cash provider. At the same time, the cash taker enters into an agreement to repurchase securities of the same type and amount from the cash provider at a later point in time. The cash taker pays interest (the repo rate) for the duration of the transaction. From an economic perspective, a repo is a secured loan.

The purpose of the National Bank’s main financing operations is to provide the banking system with liquidity, while that of liquidity-absorbing operations is to withdraw surplus liquidity from the system.

Where main financing operations are concerned, transactions are concluded by way of auction. The auctions in turn are conducted by volume tender – in other words, the National Bank’s counterparties request a certain amount of liquidity at a fixed price (repo rate). The repo rate, the size of the individual operations and their maturities depend on monetary policy requirements. The maturity of repo transactions varies from a day (overnight) to several weeks. In exceptional circumstances, contracts may 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.

Main financing and liquidity-absorbing operations

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 bilateral repo transactions that are concluded when necessary. The conditions for these repo transactions may vary from those applying to 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.

In 2005, there were still two instruments available for this purpose: conventional Lombard advances and special-rate repo transactions. However, since the beginning of 2006, the only way of accessing the liquidity-shortage financing facility has been via special-rate repo transactions. The precondition for concluding special-rate repo transactions is that a limit be granted by the National Bank and that this limit be covered by collateral eligible for SNB repos. The limit determines the maximum amount of liquidity that a counterparty may obtain, and it is utilised in the form of an overnight repo transaction. The securities are held by the counterparty in a Custody Cover Account "SNB" at SIS.

Most banks had begun or completed the changeover before the end of 2005. At CHF 11.1 billion, these banks' limits exceeded the Lombard credit limits granted under the old system by some 25%. As of 1 December 2005, the procedure for obtaining liquidity through the liquidity-shortage financing facility was simplified. Before the end of the day, banks are requested to report their liquidity requirements through the repo trading platform.

2.2 Liquidity supply with the different facilities

Monetary policy instruments in CHF billions

	2004 Holding Average	Turnover	2005 Holding Average	Turnover
Repo transactions				
Main financing and fine-tuning operations	22.31	1 087.15	21.08	1 066.53
Maturities of				
less than 1 week	0.48	95.42	0.10	18.38
1 week	16.06	852.12	19.16	993.15
2 weeks	4.42	115.59	1.63	42.90
3 weeks	1.07	13.52	0.00	0.00
Other	0.28	10.50	0.19	12.10
Liquidity-absorbing operations	0.00	0.00	0.03	7.50
Intraday facility	6.19	1 584.13	6.34	1 610.62
Liquidity-shortage financing facility	0.00	0.52	0.01	1.02

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. In the period to mid-December, repo rates fluctuated between 0.54% and 0.67%. Along with the increase in the target range for the three-month Libor in December 2005, the SNB raised its repo rates by a moderate amount, to 0.74%.

In 2005, the average volume of the National Bank's repo transactions still outstanding at the end of the day fell by CHF 1.2 billion to CHF 21.1 billion. The turnover – in other words the sum of all of these repo transactions – fell by CHF 12.6 billion to CHF 1,075.1 billion. Almost all of this turnover was achieved with a maturity of one week. Fine-tuning operations were only used in exceptional cases.

In the year under review, banks' daily bids at National Bank repo auctions fluctuated between CHF 1.3 billion and CHF 98.3 billion, averaging CHF 34.6 billion. The amount of liquidity allocated varied from CHF 1.3 billion to CHF 8.5 billion, averaging CHF 4.0 billion over the year. The allocation rate fluctuated between 3% and 100%, with the average rate amounting to 16.8%.

Average use of the intraday facility by banks rose moderately in 2005, from CHF 6.2 billion to CHF 6.3 billion.

In 2005, banks again made only occasional use of the liquidity-shortage financing facility for bridging unexpected liquidity bottlenecks.

Repo transactions in detail

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. In 2005, these instruments were used within the context of asset management and the distribution of proceeds from gold sales.

2.4 Distribution of proceeds from gold sales (with no effect on liquidity)

In 2005, between the beginning of May and mid-July, the National Bank transferred the proceeds from the sale of gold no longer required for monetary purposes to the Confederation and the cantons. The amount of CHF 21.1 billion was paid out in ten weekly tranches, and the SNB credited the Confederation's account with CHF 2.1 billion on each occasion. Following each of these payments, CHF 1.4 billion was forwarded to the cantons the same day. Prior to each distribution, foreign currency and Swiss franc investments into which gold proceeds had originally been channelled were liquidated. The timing was chosen to match the ten payment dates. With effect on these same dates, Swiss francs were purchased with the proceeds from the sale of foreign currency investments. Hedging transactions were also timed to mature on these dates. In this way, the Swiss franc inflow to the SNB arising from the liquidation of the investments neutralised the liquidity effects of the Swiss franc outflow resulting from the distribution. Regular monetary policy instruments were used to offset short-term liquidity fluctuations. As a result of this continual neutralisation of outflows, the distribution had no significant impact on the money and foreign exchange markets, despite its historical proportions.

2.5 Emergency liquidity assistance

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.

A bank or group of banks is of systemic importance if its inability to pay would seriously impair the functioning of the Swiss financial system or major parts thereof, and have a negative impact on the economy. To assess the solvency of a bank or group of banks, the National Bank obtains an opinion from the Swiss Federal Banking Commission (SFBC). The National Bank determines what collateral is sufficient.

In 2005, no emergency assistance of this kind was required.

**Liquidity
assistance conditions**

**Systemic importance
of financial institutions**

2.6 Minimum reserves

Under the new National Bank Act, the former cash liquidity provisions based on the Banking Act were replaced by the minimum reserve regulation in the NBA (arts. 17, 18, 22). This regulation came into effect on 1 January 2005 and was first applied in the reporting period from 20 January to 19 February 2005. The purpose of the minimum reserves is to secure a minimum level of demand for base money, thus fulfilling a monetary policy objective. Both eligible assets and relevant liabilities have been redefined. Eligible assets in Swiss francs now comprise only coins in circulation, banknotes and sight deposits held at the National Bank. With respect to liabilities towards banks, minimum reserves are now obligatory only in the case of liabilities towards banks that are not themselves subject to minimum reserve requirements. 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.

In 2005 (from 20 January to 19 December), the average minimum reserves required by law amounted to CHF 7.6 billion. This was CHF 1.0 billion below the figure required under the old cash liquidity requirements. The decline was mainly due to the fact that minimum reserves no longer need to be held for short-term liabilities towards banks that are themselves subject to minimum reserve requirements. Existing eligible assets amounted to an average CHF 9.3 billion. Consequently, surplus liquidity averaged CHF 1.7 billion over the year and the liquidity ratio was 122%.

In 2005, all of the 300 or so banks fulfilled the statutory minimum reserve requirements, with very few exceptions. Ten 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 punitive interest that the contravening banks were required to pay totalled about CHF 24,000.

New minimum reserve regulation

Minimum reserve volumes in 2005

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 National Bank is charged with ensuring the supply and distribution of cash 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 National Bank 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 also includes the immediate redistribution of cash, is assumed by the bodies mentioned above.

Closure of the cash office in Lugano

The cash office at the SNB branch in Lugano is to be closed at the end of 2006. This decision, reached by the Bank Council in October, but still to be approved by the Federal Council, is the consequence of structural changes involving the commercial banks, Swiss Post and cash processing operators. These organisations are important business partners of the SNB and are concentrating their processing of banknotes and coins in a small number of Swiss cities. As a result, the cash office in Lugano no longer has the processing volume needed for rational and secure operations. In future, cash processing operators in Ticino will take care of all cash distribution needs there.

Cash deposit facilities

Since 2003, cash processing operators have been able to request the National Bank to provide them with cash deposit facilities, which comprise stocks of banknotes and coins. The National Bank retains ownership of these facilities. The cash processing operators obtain and deposit cash by exchanging cash deposit holdings for their sight deposits at the SNB. In the second year after the cash deposit facilities were set up, the National Bank again recorded a drop in its own number of incoming and outgoing banknotes, as well as in the number of transports made by the operators of cash deposit facilities. Consequently, the supply and distribution of cash have become more efficient.

Turnover at offices

In 2005, the National Bank's offices registered currency turnover amounting to CHF 121.4 billion, as compared with CHF 124.4 billion a year earlier. They received 391.4 million banknotes (previous year: 407.0 million). The value of incoming coins stood at CHF 257.3 million (previous year: CHF 289.2 million), their weight at 1,373 tonnes (previous year: 1,498 tonnes). The National Bank examined the banknotes and a number of the coins with regard to quantity, quality and authenticity.

... agencies

The agencies' currency turnover (incoming and outgoing) rose in the year under review to CHF 15.2 billion, compared with CHF 14.3 billion a year earlier. Agencies are cash distribution services operated by cantonal banks on behalf of the National Bank. They are responsible for the distribution and redemption of cash in their region. In order to do this, the agencies have access to cash belonging to the National Bank. In previous years, the reorganisation of Swiss Post and the emergence of cash processing operators had led to a steady decline in the agencies' turnover.

The National Bank can grant banks the authority to act as correspondents in areas where it is not active. Together with the post offices, these banks perform local cash redistribution transactions. In 2005 the domestic correspondents supplied 2.3 million banknotes (previous year: CHF 2.6 million) for a total value of CHF 353.6 million (previous year: CHF 407.1 million). Here too, turnover is highly dependent on the activity of the cash processing operators.

... domestic correspondents

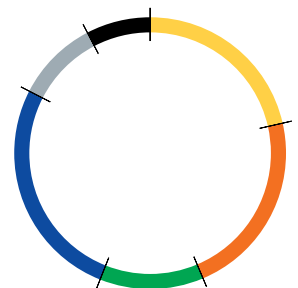
3.2 Banknotes

Pursuant to art. 7 of the Federal Act on Currency and Payment Instruments (CPIA), the National Bank 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.

In 2005, banknote circulation averaged CHF 37.1 billion (previous year: CHF 36.2 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 276.2 million on average (previous year: 271.9 million). The rise is attributable to GDP growth, the increased use of the 20-franc note in ATMs, and the generally growing demand for 10-franc notes.

Mandate

Banknote circulation



Number of banknotes in circulation
In millions

CHF 10s:	59
CHF 20s:	61
CHF 50s:	34
CHF 100s:	73
CHF 200s:	27
CHF 1,000s:	21

Annual average

Issue and disposal

In 2005, the National Bank put 107.8 million (previous year: 108.6 million) freshly printed banknotes with a face value of CHF 7.7 billion into circulation (previous year: 8.7 billion), and destroyed 99.9 million (previous year: 112.7 million) damaged or recalled notes with a nominal value of CHF 7.0 billion (previous year: CHF 8.2 million).

Counterfeits

Roughly 4,000 counterfeit banknotes were confiscated in Switzerland in 2005. The National Bank's offices alone discovered 142 counterfeit notes (previous year: 244). By international standards, 14 seized counterfeit notes per million Swiss franc notes in circulation is fairly negligible. Moreover, the counterfeits are by and large of poor quality.

Development of new banknote series

In 2004, initial preparatory work was done on a new banknote series, and in early 2005 the National Bank invited twelve artists to take part in a competition for the artistic design of the new banknotes. The theme of the designs was "Switzerland open to the world", and the participants were asked to use the six denominations to present Switzerland as a centre for sport, for culture, for tourism and recreation, for human rights, for education, research and development, and as an economic centre. Portraits are no longer to be used, although the denominations and basic colours used in the current series are to remain unchanged. A jury chaired by Jean-Christophe Amman, an art historian, exhibition organiser and former director of the Museum of Modern Art in Frankfurt am Main, Germany, awarded the first prize for the designs submitted by Manual Krebs and equal second for those by Manuela Pfrunder and Martin Woodtli. In 2006, the National Bank will decide on who should be given the mandate to further develop the submissions.

3.3 Coins

Mandate

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

Withdrawal of the one and five centime coins

In a submission made as part of a Federal Department of Finance consultation procedure, the National Bank concurred in principle with the department's considerations regarding a withdrawal of the one and five centime coins, and drew special attention to the importance of providing businesses with early and comprehensive information. Elaborate rounding-off procedures will need to be programmed into equipment such as cash registers and vending machines.

Coin circulation and minting

At CHF 2.4 billion, average coin circulation in 2005 remained at the year-earlier level. The number and denomination of coins in circulation depend greatly on the prices of items sold in vending machines.

In 2005, demand for new coins amounted to 32 million coins (previous year: 32 million), with a nominal value of approximately CHF 10.6 million (previous year: CHF 13.7 million). A large proportion of these coins replace those taken out of the country by tourists.

4 Facilitating and securing cashless payment transactions

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.

Mandate

4.1 Facilitating cashless payment transactions

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 are the core of the Swiss Interbank Clearing (SIC) system, through which the banks and PostFinance conduct their payment transactions with each other. 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 irrevocable and final; they have the character of cash payments. SIC is operated by Swiss Interbank Clearing AG, a subsidiary of Telekurs Group, on behalf of the National Bank.

Bodies responsible for the cashless payment system

The National Bank steers the system. This includes the transfer of liquidity from the sight deposit accounts to the clearing accounts in the SIC system at the beginning of each clearing day. At the end of the day, the SNB transfers the balances from the clearing accounts back to the sight deposit accounts. 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. Over the course of the day, the SNB monitors operations and ensures that there is sufficient liquidity by granting, when necessary, intraday loans to banks against collateral.

National Bank steers SIC

An agreement concluded between the SNB and SIC AG entrusts the latter with providing data processing services for the SIC system. This agreement had to be revised as the new NBA commissioned the SNB to oversee systemically important payment and securities settlement systems. The stability of the financial market and the implementation of monetary policy hinge on the smooth functioning of the SIC system. Under the NBA, this system is thus deemed to be systemically important and is subject to oversight by the SNB. The new “Agreement with regard to the SIC system” (SIC agreement) has been in force since June 2005. While it does not contain any fundamental changes, the SNB’s steering powers are defined in a more comprehensive manner than before and are more clearly geared towards monetary policy requirements and towards the SNB’s efforts to facilitate and secure the payment system. This distinguishes the SNB’s powers as the SIC steering body from its statutory powers as oversight authority. Moreover, the SNB created the internal organisational and institutional conditions required to prevent conflicts, duplications and overlaps that could result from its double mandate of steering and overseeing.

New SIC master agreement

New SIC giro agreement

The SNB also modified the SIC giro agreement, which governs the relationship between the SNB and the holders of sight deposit accounts, and which refers to the SIC agreement. The revised giro agreement takes the changing needs of the market (outsourcing) and the SNB's longstanding experience with SIC into account.

Participation in payment system bodies

Moreover, the National Bank influences the further development of SIC at a conceptual level and, therefore, has an indirect impact on the entire payment system in Switzerland. 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. In addition to contingency planning, standardisation and harmonisation problems were the main focus in 2005. The principal goal was to develop technical and organisational solutions for straight-through processing, i.e. to automate the settlement process from the sender of payment orders to the recipient as far as possible, thus eliminating the need for manual intervention.

Adoption of European standards

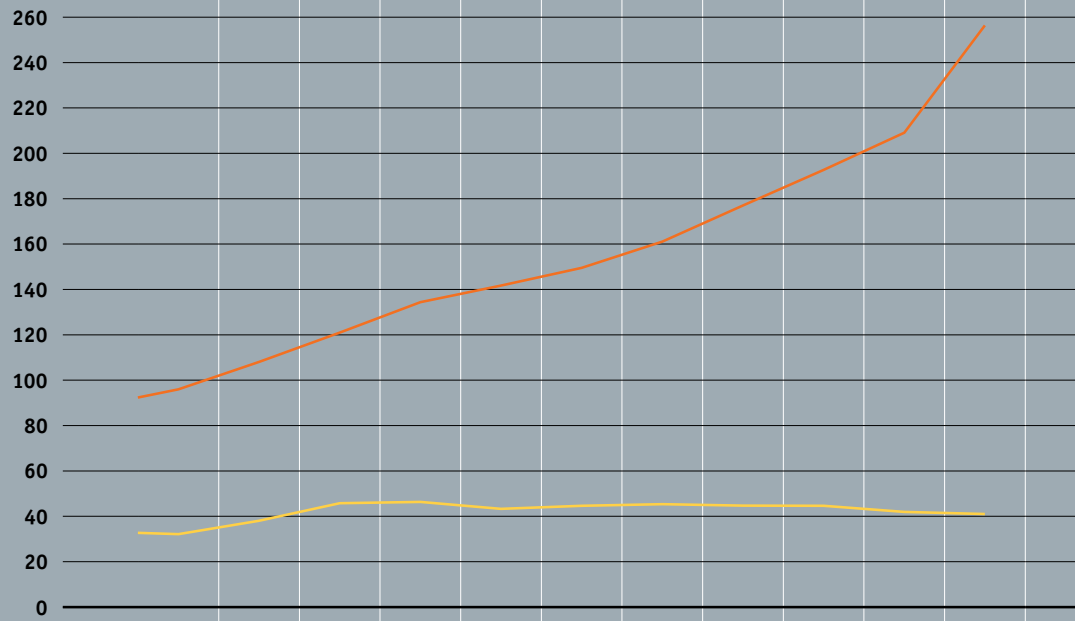
To this end, the EU is in the process of implementing a concept for uniformly structuring the identification numbers of banks and bank accounts. A new standard, the International Bank Account Number (IBAN), was created to identify the beneficiary's account. The already existing Bank Identifier Code (BIC) of SWIFT (Society for Worldwide Interbank Financial Telecommunication) identifies the beneficiary's bank. From the beginning of 2006, cross-border euro payments within the European Economic Area (EEA) must have an IBAN and a BIC. During 2006, a fee will be charged for euro payments not carrying the IBAN and BIC. As of 2007, the EEA financial institutions will be entitled to reject such non-conforming payments. This also applies to payments from Switzerland. The Swiss payment system bodies recommend that IBAN be used not only for euro payments but also for domestic payments in Swiss francs so as to exploit the rationalisation and cost reduction potential of the standardisation also within Switzerland. Where reasonable, the SNB adjusted its account codes to the European standard.

Key figures on SIC

At the end of 2005, 325 participants were connected to SIC, as compared with 306 the previous year. The SIC AG data processing centre settled approximately 1 million transactions amounting to CHF 161 billion each day. On peak days, up to 2.7 million transactions and a volume reaching CHF 247 billion were processed. Total transactions processed in the SIC system rose substantially. Commercial clients increasingly used the bank/SIC system to settle their retail payments, which were previously settled via the data carrier exchange (DTA) application. DTA bundles the payments submitted on data carriers into batches. They are then credited or debited to the corresponding bank accounts via the SIC system. As this procedure is not very transparent and requires various manual interventions, DTA is no longer available as of 2006.

Transactions and turnover in Swiss Interbank Clearing per year

Number of transactions (in millions)
Turnover (in CHF 1,000 billions)



Key figures on SIC

	2001	2002	2003	2004	2005
Transactions (in thousands)					
Daily average	644	705	768	816	1 009
Highest daily value of the year	2 078	1 874	2 145	2 215	2 690
Volume (in CHF billions)					
Daily average	182	180	178	163	161
Highest daily value of the year	274	270	284	273	247
Amount per transaction (in CHF thousands)					
	282	253	232	200	160
Average liquidity (in CHF millions)					
Sight deposits at the end of the day	3 339	3 327	4 811	5 339	4 831
Intraday liquidity	2 566	3 897	5 972	6 188	6 340

4.2 Oversight of payment and securities settlement systems

Mandate

The NBA (art. 5 para. 2 (c) and arts. 19–21) obliges the National Bank to oversee systems for the clearing and settlement of payments (payment systems) and transactions involving financial instruments, in particular securities (securities settlement systems). It entitles the SNB to impose minimum requirements on the operation of systems that might be a source of risks 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 financial system may emanate, namely the Swiss Interbank Clearing (SIC) payment system, the securities settlement system SECOM, the central counterparty x-clear and Continuous Linked Settlement (CLS), the system for foreign exchange settlements.

Minimum requirements spelled out

The minimum requirements for the operators of systemically important payment and securities settlement systems are the core of system oversight. These requirements are quite abstract, however. In the year under review, the National Bank therefore adopted so-called control objectives that set out in more specific terms the minimum requirements for each individual system that is subject to oversight. For the system operators, these control objectives enhance the transparency and comprehensibility of the regulatory requirements. At the same time, they facilitate the review of compliance with the minimum requirements. Like the minimum requirements, the control objectives are formulated in a target-oriented manner and cover three areas. The first includes general requirements regarding corporate governance and the contractual basis of a system. The second covers requirements relating to the analysis, management and control of risks. The third and largest area contains requirements in the field of IT security. Before adopting the control objectives, the SNB consulted the Swiss Federal Banking Commission (SFBC) and invited submissions from the system operators subject to oversight.

SIS SegInterSettle AG and SIS x-clear AG, which operate the securities settlement system SECOM and the central counterparty x-clear respectively, both hold a banking license and are supervised by the SFBC (institutional supervision) as well as the SNB (system oversight). While institutional supervision primarily aims at protecting the individual creditor, 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. 23^{bis} para. 4 Banking Act). This applies in particular to the collecting of information required for the supervision of institutions and the oversight of systems. The SFBC and the SNB have agreed that the SNB will, as far as possible, rely on the information already compiled by the SFBC when assessing whether a system operator complies with the minimum requirements.

The National Bank cooperated with authorities abroad in overseeing internationally active payment and securities settlement systems. Where CLS is concerned, the US Federal Reserve system – the authority with primary responsibility for 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 National Bank and the SFBC cooperated with the British Financial Services Authority (FSA). Moreover, the SNB participates in overseeing the Society for Worldwide Interbank Financial Telecommunication (SWIFT), a company domiciled in Belgium. SWIFT operates a global network for the secure transfer of financial information. The smooth functioning of the SWIFT network is essential for the payment and securities settlement systems of many countries and, notably, also for cross-border payment transactions. SWIFT is overseen by the central banks of the Group of Ten (G-10), with the National Bank of Belgium coordinating the oversight activities.

In the year under review, the operators of the systemically important payment and securities settlement systems initiated a range of measures to enhance the resilience of Switzerland's financial market infrastructure to major disruptions. These measures include the evaluation of risk profiles of the data processing centres and the formulation and implementation of operational concepts which take due account of the shortage of competent staff to be expected in the event of a crisis. These measures were initiated as a result of the analyses and recommendations of a working group consisting of representatives from the entire financial sector; this working group reviewed and assessed the contingency planning and crisis management of the major companies in the financial sector.

5 Asset management

5.1 Basic principles

Mandate

Under art. 5 para. 2 of the National Bank Act (NBA), the National Bank is responsible for managing the currency reserves. Asset management is governed by the primacy of monetary policy and is implemented according to the criteria of security, liquidity and return. Within these parameters, investments are made in line with the principles of modern asset management. Diversification of investment aims at achieving an adequate risk/return profile. In view of the extended investment possibilities under the new NBA, the National Bank issued Investment Policy Guidelines in 2004 which define the scope of investment activity as well as the investment and risk control process.

Asset classes

The National Bank's assets essentially consist of foreign currency, gold and financial assets in Swiss francs (securities and claims from repo transactions). They fulfil important monetary policy functions. Their composition is determined mainly by the established monetary order and the requirements of monetary policy. Part of the assets, including claims from repo transactions, are used directly for the implementation of monetary policy. The National Bank uses repo transactions to supply commercial banks with liquidity in the form of base money by purchasing securities from them. By setting the terms for such transactions, the SNB influences the interest rate level in the money market. The National Bank holds currency reserves – in the form of foreign currency and gold – in order to have room for manoeuvre in monetary policy at any time. Currency reserves serve to prevent and overcome potential crises.

5.2 Investment and risk control process

Responsibilities of Bank Council and Risk Committee

The NBA, which entered into force in 2004, defines the SNB's responsibilities and describes in detail its mandate with regard to asset management. The Governing Board decides on the composition of the currency reserves and other assets. The Bank Council is charged with the integral oversight of the investment and risk control process. It assesses the principles of the process and monitors compliance with them. The Risk Committee – which is composed of three members of the Bank Council – supports the Bank Council in this task and monitors risk management in particular. All internal reporting carried out is addressed directly to the Governing Board and Risk Committee. To avoid conflicts of interest, the responsibilities for monetary policy and investment policy operations are largely separated on the operational level.

... Governing Board

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

An internal Investment Committee determines the tactical allocation on an 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. In order to facilitate access to investment categories such as US mortgage-backed securities or indexed equity portfolios, the SNB uses external asset managers. For performance comparison purposes with internal portfolio management, other mandates are outsourced.

... Investment Committee and Portfolio Management

The investment strategy is based on the quantitative specifications as to risk tolerance and liquidity of the investments, and on comprehensive risk/return analyses. Risk management and risk limitation are carried out by means of a system using reference portfolios, guidelines and limits. All relevant financial risks on investments are continuously compiled, assessed and monitored. Risk measurement is based on standard risk indicators and procedures. While market risk is mainly assessed by means of sensitivity and Value-at-Risk (VaR) analyses, credit risk is appraised using information from major rating agencies. Risk indicators are aggregated over all investments. Compliance with the guidelines and limits is monitored on a daily basis. 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.

... Risk Management

5.3 Development of the asset structure

The National Bank manages currency reserves of a little over CHF 70 billion, two-thirds of which are held in foreign exchange reserves and one-third in gold. In addition to this are approximately 30 billion Swiss franc assets in the form of claims from repo transactions and bond investments in the domestic capital market.

Composition of assets

With the entry into force of the new NBA in May 2004, former legal restrictions regarding eligible investment categories and debtors were dispensed with. This opened up the possibility to broaden the investment universe, thus improving the risk/return profile of investments. The National Bank acted on this already in 2004, adding corporate bonds to its asset mix. It also lowered the required minimum rating for bond investments from A to BBB – the lowest investment grade category. Then, for the first time, the SNB invested part of its foreign exchange reserves in a well-diversified equity portfolio in early 2005. 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 from foreign companies are held. At the end of 2005, 5% of the foreign exchange reserves were invested in corporate bonds and 10% in equities.

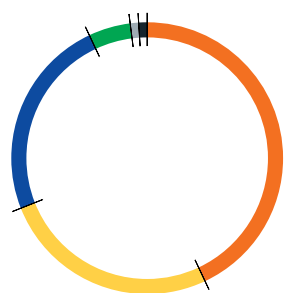
Broader investment spectrum

Most of the investments were fixed-income ones, with roughly CHF 40 billion in foreign exchange reserves, CHF 26 billion in claims from repo transactions, CHF 6 billion in Swiss franc securities and CHF 3 billion in claims from gold lending transactions. At the end of 2005, the bond portfolios consisted of government and quasi-government bonds as well as bonds of international organisations, local authorities, financial institutions and other companies. To a limited extent, secured and unsecured money market investments were also made at banks. Exchange rate and interest rate risks were

Debtor categories and instruments

managed by derivative instruments, such as interest rate swaps, interest rate futures and forward foreign exchange transactions. In addition, futures on equity indices were also used to manage the equity share.

Investment structure at the end of 2005



Structure of National Bank assets In percent

Foreign exchange reserves 43

Gold reserves 26

Claims from repo transactions 24

Securities in Swiss francs 5

Monetary institutions 1

Other assets 1

Total: CHF 109 billion
End of 2005

Reduction of US dollar share

Distribution of free assets

	Foreign exchange reserves	Swiss franc securities
--	---------------------------	------------------------

Currency allocation, incl. derivative positions

Swiss francs	–	100.0%
US dollars	28.3%	–
Euros	47.4%	–
Pounds sterling	9.9%	–
Other (yen, Canadian dollars, Danish kroner)	14.4%	–

Investment categories

Money market investments	3.2%	–
Government bonds ¹	62.9%	48.3%
Other bonds ²	25.2%	51.7%
Shares	8.7% ³	–

Risk indicators

Duration of bonds (years)	3.8	5.1
Value-at-Risk (1 year, 95%) in CHF billions	2.1	0.1

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

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

3 Including share index futures not backed by money market investments: 9.8%.

The US dollar share in the foreign exchange reserves was scaled back yet further in 2005. Having been largely reduced in favour of the pound sterling in 2004, this year saw the share of yen increased. This move brought the SNB another step closer to achieving a balanced and diversified currency allocation.

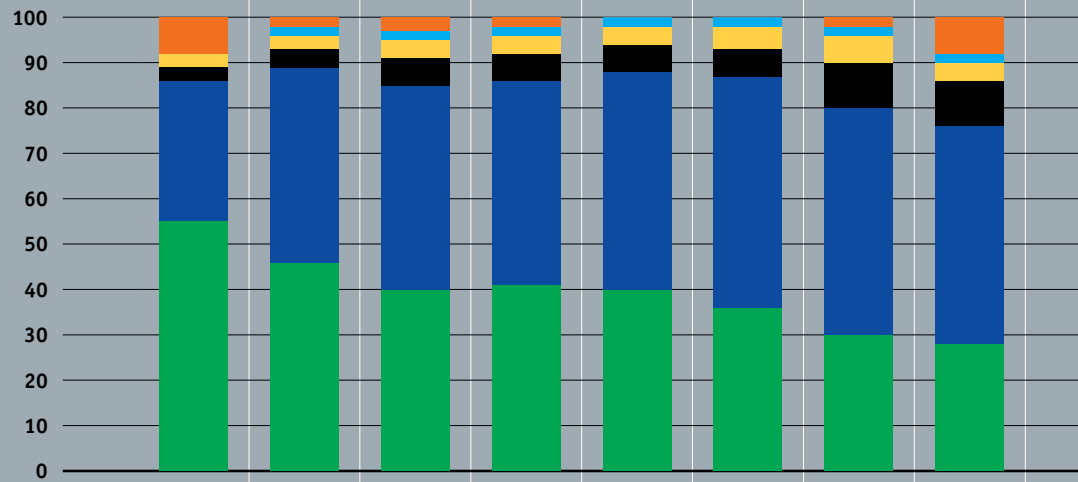
The sale of the gold no longer required for monetary purposes was completed at the end of March. A total of 1,300 tonnes of gold was sold between 2000 and 2005. The proceeds were invested on an ongoing basis in fixed-income investments, in accordance with a separate investment strategy. The proceeds from the sale were distributed to the Swiss Confederation and the cantons between the beginning of May and mid-July 2005 (cf. 2.4, p. 42).

The investment income was not included in this distribution. A percentage of the earnings were already distributed in 2004 and 2005 as part of the annual result. Following the distribution, the remainder – around CHF 1.5 billion – was transferred to the portfolios of the foreign exchange reserves and Swiss franc securities.

Currency breakdown of foreign exchange reserves

- █ US dollars
- █ Euros¹
- █ Pounds sterling
- █ Danish kroner
- █ CA dollars
- █ Yen

In percent
 1 Before 1999, German marks and Dutch guilders



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 by diversification. The National Bank counters liquidity risk by holding a considerable part of its investments in the world's most liquid currencies and markets. In addition, it also takes some credit risk. Compared with the market risk, this is insignificant, however.

... of currency reserves

The addition of equities to the currency reserves and the improved currency allocation contributed to enhancing the risk/return profile of the foreign exchange reserves. The average duration of fixed-income investments was decreased from five to four years, with the result that the interest rate risk was also slightly reduced. The price of gold and the US dollar exchange rate were still the dominant risk factors of currency reserves. By contrast, equity, interest rate and credit risks contributed only marginally to 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 gold lending. At the end of 2005, approximately 134 tonnes of gold had been lent to different financial institutions against remuneration. Roughly 90% of the gold lending was secured by bonds with above-average ratings.

... and of Swiss franc investments

Swiss franc securities are managed passively. The maturity and credit structure largely correspond to that of the Swiss Bond Index. Duration at year-end was 5.1 years. Monetary policy repo transactions pose virtually no credit risk, since the claims are secured by first-class collateral. These collateralised securities are re-valued daily, and shortfall is covered immediately. Given the very short maturities, there is no interest rate risk.

Credit risks

The National Bank was exposed to credit risk by purchasing bonds from different 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. Even though credit risk tolerance has been somewhat higher since 2004, the SNB's fixed-income investments had a very high average rating. Overall, 77% of the investments were graded AAA, the highest possible rating. The lowest still eligible rating category – BBB – accounted for approximately 1% of these investments.

Overall risk

The overall risk of investments can be estimated – among other methods – with the VaR analysis. This indicator illustrates the SNB's risk tolerance and is applied both to the 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. The probability level is set at 95%. Based on this calculation method, the VaR indicates the loss threshold which should only be exceeded one in every twenty years. Taken separately, the VaR for gold came to a little over CHF 6 billion and to approximately CHF 2 billion for foreign exchange reserves. Owing to diversification effects, the VaR for total assets was – at roughly CHF 6 billion – significantly lower than the sum of the VaRs for the sub-portfolios.

5.5 Investment performance

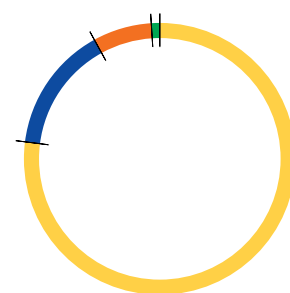
The National Bank's investment performance is calculated across all asset categories (foreign currency assets, gold, Swiss franc assets including repo transactions). In 2005, it amounted to 12.8%, which, in contrast to 2004, was considerably higher than the long-term return expectations. Gold and exchange rate gains in particular, as well as share profits, contributed to the above-average result. With a 35% increase, the Swiss franc gold price recorded an exceptionally strong rise over the course of the year. Both the value of gold in US dollars and the value of the dollar in Swiss francs increased significantly. This is a rare occurrence. In previous years, both of these values tended to develop in opposite directions. On the whole, changes in the interest rate level had no major impact on performance. The generally low interest rate level resulted in low current interest earnings in all investment currencies.

Return on investments in Swiss francs¹

	Foreign exchange reserves	Gold	Swiss franc securities	Total return ²
1999	9.7%		0.7%	
2000	5.8%	-3.1%	3.3%	2.2%
2001	5.2%	5.3%	4.3%	4.0%
2002	0.4%	3.4%	10.0%	3.0%
2003	3.0%	9.1%	1.4%	4.2%
2004	2.3%	-3.1%	3.8%	0.9%
2005	10.8%	35.0%	3.1%	12.8%

1 Sum of direct income and realised and unrealised price changes on holdings.

2 Including the return on monetary policy repo transactions and on free assets.



Rating allocation of fixed-income investments
In percent

AAA 77

AA 15

A 7

BBB 1

End of 2005

6 Contribution to financial system stability

Mandate

Pursuant to art. 5 para. 2 (e) of the National Bank Act (NBA), the National Bank is obliged to contribute to the stability of the financial system.

Stability as important condition

Stability-oriented monetary policy makes a significant contribution towards a stable financial system which, in turn, inspires confidence in a balanced economic development and helps consumers, savers and investors to make long-term decisions. A stable financial system is also a prerequisite for properly functioning financial markets and is thus indispensable for a successful implementation of monetary policy. The National Bank makes every effort to identify any potential risks to stability at an early stage. It also plays an active role in creating an operational environment that promotes stability. To this end, the National Bank collaborates closely with the Swiss Federal Banking Commission (SFBC) and other federal offices.

6.1 Publication of a financial stability report

Analysis of banking sector and financial market infrastructure

In June 2005, the National Bank published its third Financial Stability Report. The report looked at developments in the banking sector and in the financial market infrastructure with regard to stability. The individual banks were analysed solely in terms of their systemic importance.

Stable banking sector

According to the report, the banking sector raised its profits substantially in 2004 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. Consequently, the National Bank judged the Swiss banking system to be stable. Moreover, the economic environment in which the banks operate remains favourable.

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 that also compares favourably with that of other countries. The architecture of the payment and securities settlement systems that are integrated in the Swiss value chain reduces settlement risks significantly. The Swiss financial sector is also well prepared for severe disruptions. An analysis, lead-managed by the National Bank, examined the existing contingency planning and crisis management measures of the key financial market infrastructures and the major system participants and presented a generally positive picture. Various measures to increase the resilience of the financial system were identified, and a start has been made on implementing them.

6.2 New Basel Capital Accord

As a member of the Basel Committee on Banking Supervision, the National Bank continued to participate in the revision of the Basel Capital Accord. The Committee modified the 2004 Accord (Basel II, original version), notably with regard to counterparty risk of derivatives and illiquid positions in the trading book. The National Bank supports the direction in which Basel II is headed. Substantial and risk-adequate capital cushions 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. Only well-capitalised banks can fulfil their macroeconomic task of granting credit, also in difficult economic times.

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 National Bank, 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 first half of 2005, the working group drafted the ordinances and circulars on the new capital adequacy requirements. The drafts were approved by the SFBC in autumn and then submitted for consultation. The new provisions are likely to be passed in mid-2006, and the new capital adequacy regulation could then enter into force at the end of 2006, at the earliest. For the advanced calculation method of capital adequacy requirements (internal ratings approach), Swiss standards will be based strongly on the Basel Capital Accord. With regard to the standard approach, which is better suited to smaller banks, differences will remain, however, particularly in relation to risk weighting.

The National Bank supports the direction in which the Swiss implementation of Basel II is headed. From the SNB's point of view, three issues are particularly important. The first relates to the reliability of the advanced methods used by large banks to calculate capital adequacy requirements. The second relates to the necessity of restricting the procyclical potential of the new capital adequacy requirement; the SNB places great emphasis on the careful conduct of stress simulations by the banks. The third concerns the need to reduce the potential for contagion in the Swiss banking sector; the SNB is calling for stricter regulation and diversification of interbank claims.

SNB supports Basel II

SNB's role in implementation

SNB's concerns regarding implementation

6.3 Legislation relevant to the financial market

Legislation on financial market supervision

The National Bank contributed in various ways to legislative projects that are important for the Swiss financial centre. As part of a government working group headed by the Federal Department of Finance (FDF), it helped to finalise the Federal Act on Financial Market Supervision (FINMA Act) and draw up the corresponding message (cf. 97th Annual Report 2004, p. 60). The draft law provides for the establishment of a Federal Financial Market Supervisory Authority (FINMA) integrating the SFBC, the Federal Office of Private Insurance and the Money Laundering Control Authority. The independence and corporate governance of the future financial market supervisory body will be strengthened. The statutory instruments for supervision and the system of sanctions will be unified as far as possible. Furthermore, the draft obliges FINMA to estimate the follow-up costs of regulation projects.

Reform of securities legislation

On behalf of the FDF, the National Bank continued to actively support the reform of the securities act. The SNB had contributed substantially to drawing up the draft legislation on the custody and transfer of uncertificated securities (Uncertificated Securities Act), which updates the legal basis for the safekeeping of securities by financial intermediaries. The draft law was met with broad approval in an informal consultation procedure. The Federal Council mandated the FDF to revise the draft based on the comments received and to submit a message by mid-2006.

On an international level, the National Bank assumed the chair of a committee of government experts at the International Institute for the Unification of Private Law (Unidroit), which is preparing an agreement on the harmonisation of the law on securities held with intermediaries. Work is scheduled to be concluded by 2007.

7 Involvement in international monetary cooperation

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

Mandate

On an international level, the National Bank primarily cooperates with the International Monetary Fund (IMF), the Group of Ten (G-10), and the Bank for International Settlements (BIS) and the Organisation for Economic Cooperation and Development (OECD). It also provides technical assistance.

7.1 International Monetary Fund

Switzerland has been a member of the IMF since 1992. The IMF works to promote stable monetary conditions worldwide and support free trade and payment flows internationally. As an open economy with a globally important financial sector, Switzerland shares these aims.

Swiss membership since 1992

The Chairman of the National Bank is a governor 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. As a representative of a constituency, which also includes Azerbaijan, the Kyrgyz Republic, Poland, Serbia and Montenegro, Tajikistan, Turkmenistan and Uzbekistan, it participates in formulating IMF policy. The Swiss seat on the Executive Board is held alternately by a representative of the FDF and the SNB. The FDF and the SNB determine Switzerland's policy in the IMF together and support the Swiss executive director in his activities.

In addition to its surveillance of the economic situation in member countries (crisis prevention), the Executive Board's main activities in 2005 addressed crisis management, the IMF's medium-term strategic direction and its activities in favour of poor nations. Significant progress has been made in recent years in the area of surveillance. As regards crisis management, the focus was on countries with loan packages. The IMF's medium-term strategy is devoted to the challenges posed by globalisation. In so doing, the focus is on more effective country surveillance, better assistance with regard to institution and capacity building as well as structural reforms of the Fund. Together with other international financial organisations, the IMF reduced the burden on Heavily Indebted Poor Countries (HIPCs) by cancelling debt. An Exogenous Shocks Facility (ESF) was set up for the poorest member countries. An additional Policy Support Instrument (PSI) provides assistance to low-income countries without balance of payments problems when implementing a sustainable economic policy.

Important activities in 2005

The IMF finances its activities with the member countries' quotas, i.e. capital subscriptions. Quotas in the IMF amount to SDR (Special Drawing Rights) 213 billion (approx. CHF 400 billion), with Switzerland's quota coming to SDR 3,458.5 million (roughly CHF 6,505.4 million). The portion of the Swiss quota drawn by the IMF – the reserve position – is financed by the National Bank. For the National Bank, it represents a currency reserve and may be used by it at any time. At the end of 2005, Switzerland's reserve position amounted to SDR 571.2 million, compared with SDR 1,153.9 million at the end of 2004. At the end of 2005, one SDR was equivalent to CHF 1.88. The value of the SDR is calculated on the basis of weighted exchange rates for the US dollar, euro, yen and pound sterling.

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 completely drawn down by the end of 2001. Owing to the fact that the PRGF cannot be established as a self-supporting facility before 2006, interim financing (interim PRGF) was necessary. The National Bank made a contribution of SDR 250 million to the interim PRGF's capital. The Swiss Confederation guarantees the National Bank the timely repayment of both the PRGF and interim PRGF loans, including interest payments.

7.2 Group of Ten

The National Bank participates in meetings of the finance ministers and central bank governors of the G-10 countries and in various working groups. In 2005, a G-10 group of experts prepared a report entitled "Ageing and pension system reform: implications for financial markets and economic policies". Funded pension schemes were the main focus of the analysis. In addition to the problems of private (funded) pension schemes – still in their infancy in many countries – three areas of reform were identified: firstly, a regulatory and supervisory framework should be set up to support a more rigorous risk management, adequate governance, as well as transparency and comparability between the return achieved by different pension funds. Secondly, financial instruments must be made available that are specially tailored to institutional investors and pension funds so as to better coordinate their investments and obligations. Thirdly, protection of pension beneficiaries must be enhanced and their knowledge in financial matters improved. Informed and critical pension beneficiaries are in a better position to assess risks and to make more careful decisions.

7.3 Bank for International Settlements

The central bank governors of industrialised countries and emerging economies meet every two months at the BIS for an exchange of information. In addition, the National Bank participates in the four standing committees of the BIS: the Basel Committee on Banking Supervision, the Committee on Payment and Settlement Systems, the Committee on the Global Financial System and the Markets Committee.

The Basel Committee on Banking Supervision serves as a platform for regular cooperation in banking supervision matters. Its tasks are described in more detail in the chapter on the National Bank's contribution to the stability of the financial system.

The Committee on Payment and Settlement Systems (CPSS) monitors and analyses the developments in national and international payment and securities settlement systems. The CPSS issued two reports in 2005. The first report provides an overview on the developments and innovations in high-value payment systems in the last few years. The second report discusses the oversight of payment and securities settlement systems. It concludes that oversight practices of the G-10 central banks are very similar and contains principles on effective oversight.

The Committee on the Global Financial System (CGFS) monitors and assesses the developments in 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 2005, the CGFS published two reports. The first report on the role of ratings in structured finance examined the rapidly expanding markets for structured financial instruments, the critical importance of rating agencies and the ensuing implications for people responsible for financial stability. The second report is a survey of the use of stress tests in major financial institutions and clearly illustrates the crucial role of such tests within risk management.

The Markets Committee serves as a discussion forum for the G-10 central bank staff members responsible for financial market operations. Topics addressed in the discussions included the developments in the foreign exchange and other financial markets, as well as the impact of individual events on the overall functioning of these markets.

BIS bodies

Basel Committee on Banking Supervision

Committee on Payment and Settlement Systems

Committee on the Global Financial System

Markets Committee

7.4 OECD

Switzerland is a member of the OECD. In the OECD committees, it works to promote the development of economic relations, particularly among industrialised countries. The National Bank, together with the Federal Administration, represents Switzerland in several OECD bodies. The Economic Policy Committee (EPC), its Working Parties, WP1 and WP3, and their working groups deal with the global economic outlook on a political and scientific level. The Committee on Financial Markets (CMF) discusses current developments and structural problems in international financial markets. In November 2005, the OECD's country survey on Switzerland was discussed with the experts of the Economic and Development Review Committee (EDRC).

7.5 Monetary assistance loans

No new monetary assistance loans were extended in 2005. One balance-of-payments loan remained outstanding at the end of the year – EUR 14.3 million to Bulgaria, expiring in 2007.

7.6 Technical assistance

The National Bank fosters good relations with the central banks of those countries Switzerland works with in the International Monetary Fund. With their support, 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 central bank-specific expertise. The SNB provides no financial support.

The Swiss National Bank is assisting the National Bank of Azerbaijan in the introduction of a new banknote series and advising it on the implementation of monetary policy. Work on these projects continued in 2005, including the successful introduction of liquidity planning in the money market. Moreover, an already existing project on the investment of currency reserves was pursued further. The National Bank of Azerbaijan began receiving assistance in personnel matters for the first time. In Serbia and Montenegro, assistance to their respective central banks in investing currency reserves continued. The National Bank of the Kyrgyz Republic again received technical support in the area of cash management and now also receives advice on securities issues. The project assisting the National Bank of Tajikistan in the preparation of monetary policy decisions was continued. Finally, staff members of the National Bank held a seminar on investment strategy and risk controlling at Turkmenistan's central bank.

Furthermore, the National Bank provided topic-related technical assistance to several countries. In May 2005 – together with the National Bank of Poland – it organised a conference on exchange rate regimes and monetary policies in Zurich. The conference addressed in particular participants from central banks whose countries are members of the Swiss constituency at the IMF as well as other countries of the former Soviet Union and Southeast Europe.

Outside of the Swiss constituency within the Bretton Woods institutions, the National Bank advised the National Bank of Kazakhstan with regard to investment strategy and risk controlling.

**Transfer of central
bank-specific expertise**

**... to countries in
its IMF constituency**

... and to other countries

8 Banking services for the Confederation

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

The services are to be provided by the National Bank for an adequate consideration. However, the services are provided free of charge if they facilitate the implementation of monetary policy. Remunerable services include payment transactions, liquidity management and custody of securities. The details of the services to be provided and the remuneration are to be laid down in agreements concluded between the Federal Finance Administration (FFA) and the National Bank.

On 1 January 2005, an agreement with the Federal Department of Finance (FDF) on the remuneration for banking services provided to the Swiss Confederation entered into force. At the same time, the modalities for the provision of services in connection with the Confederation's liquidity management were laid down in a provisional agreement and a declaration of intent. In the year under review, the SNB and the FFA agreed to combine all concerns in connection with the provision of banking services to the Confederation in one single agreement. Consequently, the agreement on the remuneration for banking services has been an integral part of this new agreement since the beginning of 2006.

An important change in the agreement concerned the level of interest-bearing sight deposit accounts with the SNB which was lowered from CHF 600 million to CHF 200 million. A limit of CHF 10 billion was set for time deposits with the SNB and the maximum maturities were restricted from two years to six months. These new regulations are likely to have the effect that the FFA will aim to keep sight deposits with the SNB within the interest-bearing level and to invest any surplus liquidity in the banking system. The fluctuations in market liquidity will therefore be less pronounced and the volatility of call money rates will tend to go down.

In 2005, the National Bank issued money market debt register claims (MMDRC) and bonds on behalf of the Confederation via the auction system of the Eurex Repo electronic trading platform. A total of CHF 99.5 billion MMDRCs were subscribed, of which CHF 51.9 billion were allocated. Market participants subscribed Swiss Confederation bonds in the amount of CHF 8.5 billion. Bonds totalling CHF 5.5 billion were allocated. In the area of payment transactions, the SNB carried out 51,600 foreign payments and 57,100 domestic payments on behalf of the Confederation (incl. the Swiss Federal Institute of Technology).

Mandate

**Remuneration
for banking services**

**New agreements
with the FDF**

Liquidity management

Issuing activity

Business Report

1 Legal framework

1.1 Agreement on distribution of proceeds from gold sales

On 25 February 2005, the Federal Department of Finance (FDF) and the Swiss National Bank (SNB) concluded a special agreement on the distribution of the proceeds from the sale of 1,300 tonnes of gold. Under this agreement, the SNB distributed the countervalue of the 1,300 tonnes of gold no longer required for monetary policy – i. e. CHF 21.1 billion – from its 2004 annual profit, with one-third going to the Confederation and two-thirds to the cantons. The proceeds were distributed in ten weekly tranches after the SNB's 2005 General Meeting of Shareholders and in addition to the regular profit distribution of CHF 2.9 billion for the 2004 financial year.

The above-mentioned agreement was concluded on the basis of the Council of States' decision of 16 December 2004 not to consider – for the second time – the Federal Council's proposal regarding the appropriation of the SNB's gold assets (cf. 97th Annual Report 2004, pp. 73–74). The attempt to create a new legal basis for the appropriation of the surplus gold reserves had thus failed in both Federal Chambers. On 2 February 2005, the Federal Council decided not to submit a new proposal on the appropriation of the gold assets to Parliament, but to have the SNB distribute these assets to the Confederation and the cantons in accordance with the existing law (art. 99 para. 4 Federal Constitution in conjunction with arts. 30–31 National Bank Act). On 25 February 2005, the Bank Council resolved to liquidate the provisions for the assignment of free assets in the income statement as at 31 December 2004. The supplementary agreement concluded between the FDF and the SNB on 12 June 2003 regarding the distribution of income on free assets (cf. 96th Annual Report 2003, p. 48) became null and void following the distribution of the proceeds from the sale of gold.

**Distribution to
the Confederation and
the cantons**

**Council of States, Federal
Council and Bank Council
in agreement**

1.2 Cosa initiative and indirect counter-proposal

Cosa initiative

The people's initiative "National Bank profits for the Old Age and Survivors' Insurance Fund (AHV/AVS)", better known as the Cosa initiative, which was submitted in October 2002 and demands that the National Bank's net profit be allocated to the AHV/AVS (minus an annual amount of CHF 1 billion to be distributed to the cantons), was blocked for several months in 2005 in the Federal Chambers. While the Council of States had recommended rejecting the initiative without a counter-proposal in December 2004, the National Council passed such a counter-proposal (cf. 97th Annual Report 2004, pp. 73–74).

Agreement on use of Confederation's share of National Bank gold

At the end of October, a proposal that had been discussed among the parties represented in the Federal Council was submitted to the National Council's Committee for Economic Affairs and Taxation. This proposal foresees channelling the Swiss Confederation's share of the proceeds from the sale of the National Bank's gold reserves no longer required for monetary policy (roughly CHF 7 billion) to the Old Age and Survivors' Insurance Fund (AHV/AVS). Based on this, the Commission drafted a federal act on the use of the Confederation's share of the National Bank gold. The act is seen as an indirect counter-proposal to the Cosa initiative, only entering into force should the people's initiative fail to get a "yes" vote. It was passed by the National Council and subsequently by the Council of States in the December session and approved in both councils in the final vote of 16 December 2005. At the same time, the two councils agreed to recommend the electorate and the cantons to reject the Cosa initiative. The issue will be put to the vote in September 2006.

2 Organisation and tasks

The National Bank's management and executive body is the Governing Board. It is primarily responsible for monetary policy, asset management strategy and international monetary cooperation. The Governing Board is independent in the fulfilment of its monetary policy mandate. The Enlarged Governing Board consists of the three members of the Governing Board and their three deputies and is responsible for the operational management of the National Bank. The Bank Council, meanwhile, oversees the SNB's business activity and the Internal Auditors report directly to it.

Management and oversight

The National Bank has two seats: one in Berne and one in Zurich. It is divided into three departments. The organisational units of Departments I and III are, for the most part, located in Zurich; those of Department II, primarily in Berne. Each of the three departments is headed by one member of the Governing Board. In order to ensure the supply and distribution of cash, the National Bank also has branches in Geneva and Lugano. As with the head offices and branches, the representative offices – located in Basel, Lausanne, Lucerne and St Gallen – are responsible for monitoring economic developments and explaining the SNB's policy in the regions. The SNB also has 16 agencies, which are operated by cantonal banks, for the receipt and distribution of banknotes and coins.

Structure

The National Bank's principal task is to pursue a monetary policy serving the interests of the country as a whole. The monetary policy concept is drawn up in Department I. The Economic Affairs unit provides the basis for monetary policy decisions. It analyses the economic situation and developments in Switzerland and abroad and produces the inflation forecast. Delegates for regional economic relations support Economic Affairs in its analysis of economic developments in Switzerland. The Financial Market Operations unit of Department III implements monetary policy by carrying out transactions in the financial markets. It also steers the three-month Libor.

Monetary policy

The management and investment of gold, foreign exchange reserves and Swiss franc assets are the responsibility of the Asset Management and Financial Market Operations units in Department III. Investment strategy and risk control are dealt with by the unit of the same name. The Bank Council's Risk Committee oversees risk control.

Asset management

The tasks relating to cash transactions fall within the domain of the Cash unit in Department II. The National Bank issues banknotes and puts the coins minted by the Confederation into circulation via its network of bank offices. It checks the cash returned to it and replaces banknotes and coins that no longer meet requirements.

Cash transactions

Conceptual and technical issues arising with regard to cashless payment transactions are dealt with by the Financial Stability and Oversight unit in Department II as well as the Banking Operations and Information Technology units of Department III. The Banking Operations unit also steers the payment system SIC.

Cashless payment transactions

Financial system stability

The Financial Stability and Oversight unit in Department II is responsible for contributing to the stability of the financial system and overseeing the systemically important payment and securities settlement systems.

Banker to the Confederation

Acting as the bank of the Confederation is a function performed by the Banking Operations and Financial Market Operations units of Department III. These units settle domestic and foreign payments, participate in issuing money market debt register claims and bonds, and assist the Confederation in safekeeping its securities. They also effect money market and foreign exchange transactions on behalf of the Confederation.

International monetary cooperation

The International Affairs unit of Department I deals both with the international aspects of monetary policy and with technical assistance.

Statistics

The Statistics unit of Department I is responsible for compiling statistical data on banks and financial markets, the balance of payments, the international investment position and the Swiss financial accounts.

Central services

The central services are divided between the three departments. The Secretariat General, Legal Services, Human Resources, Communications, and Premises belong to Department I. Department II includes Central Accounting, Controlling, and Security. Department III is responsible for Information Technology.

3 Corporate governance

The National Bank is a special statute joint-stock company that is administered with the cooperation and under the supervision of the Confederation. Its organisational structure and responsibilities are governed by the National Bank Act of 3 October 2003 (NBA, SR 951.11) and the Regulations on the Organisation of the Swiss National Bank of 14 May 2004 (Organisation Regulations, SR 951.153; both available at www.snb.ch). At the National Bank, statutes and regulations fulfil the function of articles of association. The SNB has a share capital which totals CHF 25 million and which is paid up in full (art. 25 NBA).

The corporate bodies of the National Bank are the General Meeting of Shareholders, the Bank Council, the Governing Board and the Audit Board. The Bank Council oversees and controls the conduct of business of the National Bank (art. 42 NBA). Six of its members are appointed by the Federal Council; the remaining five are elected by the General Meeting of Shareholders (art. 39 NBA). The Bank Council set up a Compensation Committee, a Nomination Committee, an Audit Committee and a Risk Committee, each comprising two to three Bank Council members (arts. 11–14 Organisation Regulations). The Governing Board is the management and executive body (art. 46 NBA); its three members are appointed for a six-year term by the Federal Council upon recommendation of the Bank Council (art. 43 NBA). The operational management of the National Bank is the responsibility of the Enlarged Governing Board, which is composed of the three Governing Board members and their deputies (arts. 21–24 Organisation Regulations). The Audit Board examines whether the bookkeeping and the annual accounts (Financial Report) as well as the proposal for the allocation of the net profit comply with the statutory requirements. Furthermore, it is entitled to inspect at any time all aspects of the National Bank's business (art. 48 NBA). It is elected for a term of one year by the General Meeting of Shareholders (art. 47 NBA). The auditors must meet special professional requirements pursuant to art. 727b of the Swiss Code of Obligations (SCO), and they must be independent of the Bank Council, the Governing Board and the controlling shareholders (art. 47 NBA).

The rights of the shareholders are also embodied in the NBA; company law is applied merely complementarily (art. 2 NBA). As the National Bank fulfils a public mandate and is administered with the cooperation and under the supervision of the Confederation, the shareholders' rights are restricted as compared with a joint-stock company under private law. Shareholders who do not belong to the public-law sector may not be registered for more than 100 votes (art. 26 para. 2 NBA). Shareholders may only be represented at the General Meeting of Shareholders by other shareholders (art. 37 NBA). Only five of the eleven members of the Bank Council are elected by the General Meeting of Shareholders (art. 39 NBA). The right to a dividend is limited to 6% of the paid-up capital (art. 31 para. 1 NBA); the remaining distributable profit goes to the Confederation and the cantons (art. 31 para. 2 NBA). The Business and Financial Report must be approved by the Federal Council, before being submitted to the General Meeting of Shareholders (art. 7 para. 1 NBA). Other provisions deviating from company law concern the passing of resolutions (art. 38 NBA), the agenda and the convention of the General Meeting of Shareholders (art. 35 NBA). Agenda items with proposals from shareholders must be signed by at least 20 shareholders and be submitted to the President of the Bank Council in writing in due time before the invitation is sent out (art. 35 para. 2 NBA).

Basic principles

Corporate bodies and responsibilities

Shareholders' rights

Remuneration and affiliations of bodies

The remuneration of the National Bank's bodies is determined in regulations drawn up by the Bank Council (art. 42 para. 2 (j) NBA). The affiliations of the members of the bodies are recorded in the supervisory and management bodies list (cf. pp. 122–123).

The remuneration of the Bank Council consists of a fixed annual salary plus an attendance allowance, while the members of the Governing Board receive a salary plus a lumpsum compensation for representation expenses. The remuneration of the members of the Bank Council and the Governing Board currently in office breaks down as follows:

In CHF thousands	2005	2004	Change
Members of the Bank Council	722	659 ¹	+63
of which for the President of the Bank Council	130	114	+16
of which for the Vice-President of the Bank Council	60	54	+6
Three members of the Governing Board	1 819	1 764	+55
of which for the Chairman of the Governing Board ²	637	620	+17
of which for the Vice-Chairman of the Governing Board	591	572	+19

¹ Before the entry into force of the new NBA on 1 May 2004, the Bank Council consisted of 40 members.

² Including remuneration in the amount of CHF 45,000 (2005) and CHF 28,000 (2004) for serving on the BIS Board of Directors.

In the period under review, the National Bank did not make any severance payments to former members of the Bank Council or the Governing Board. The SNB does not pay any performance-linked remuneration. In particular, there are no share or option programmes for members of the Governing Board or Bank Council. The National Bank does not grant any loans to governing bodies.

No National Bank shares were held by members of the Governing Board or Bank Council as at 31 December 2005.

In the 2005 financial year, fees for the statutory auditing mandate totalled CHF 269,504. PricewaterhouseCoopers Ltd. has been entrusted with the mandate since 2004, and the chief auditor has been in office since then. The Audit Board was not given any other mandates. A special IT audit mandate (with a fee totalling CHF 19,368) was awarded to Compass Security Network Computing AG.

Notifications to shareholders are, in principle, communicated by post to the address listed in the share register and published in the Swiss Official Gazette of Commerce (art. 28 NBA). Shareholders do not receive any information not also made available to the public (cf. pp. 130–132). Information for shareholders can be found on the National Bank's website (www.snb.ch/e/snb/aktionaer/aktionaer.html). The deadlines for the submission of proposals and the registration of shareholders for participation in the General Meeting of Shareholders are also published at this address.

The registered shares of the National Bank are traded on the stock market. A total of 53.45% of the shares are held by cantons and cantonal banks; the remaining shares are owned primarily by private individuals (cf. p. 108). The major shareholders at the end of 2005 were the Canton of Berne with 6.6% (6,630 shares) and the Canton of Zurich with 5.2% (5,200 shares). The Confederation is not a shareholder.

The National Bank is not structured as a group.

4 Personnel, resources and bank management

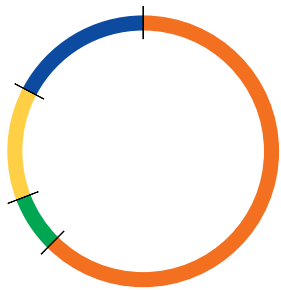
4.1 Human resources

At the end of 2005, the National Bank employed 671 persons (including 23 apprentices) – 15 persons (including one apprentice) more than the previous year. In full-time equivalents, this corresponded to 625 positions (2004: 611.3). The number of part-time employees increased by 11 to 161, bringing the part-time rate up to 24.0%. Staff turnover edged down to 4.7% from 4.9% a year earlier.

The National Bank conducted a staff survey on job satisfaction for the second time. As 88% of the employees participated in the 2005 survey, it yielded representative results. General satisfaction was higher than in the first survey in 2001 and above the average recorded at comparable companies in Switzerland. The potential for improvement is now being evaluated at all levels throughout the SNB and discussed with the staff. Suitable measures will be implemented.

Number of employees and turnover

Employee satisfaction



Human Resources

Number of employees

Full-time, men 419

Part-time, men 45

Full-time, women 91

Part-time, women 116

Total: 671
End of 2005

4.2 Resources

In the year under review, cost-unit accounting was reorganised in conformity with the new National Bank Act (NBA). The number of cost units was increased from six to eight. *Cash transactions* (including banknote production) incurred 39% of operating costs, which is still the largest share. *Monetary policy* (including statistics) followed with a share of 20%, and the management of *currency reserves* with around 17%. The other cost units, namely *services for third parties* (international cooperation, Study Center Gerzensee), *financial system stability*, *liquidity supply*, *services for the Confederation* and *cashless payment transactions* accounted for the remaining 24% of costs, with shares ranging from almost 8% to around 2%.

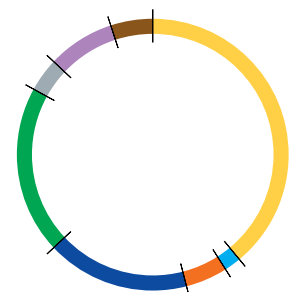
As information technology had to fulfil new business requirements, various applications in the field of banking transactions, statistics and the SNB's operational activities had to be extended. This related in particular to Asset Management, Money Market and Foreign Exchange, Payments, and Central Accounting, as well as to archiving, document management, and internal and external information. Measures to ensure the secure and reliable operation of the IT systems continued to absorb a substantial proportion of the available IT resources. The technical facilities for secure communication with external parties were partly updated, and the IT services for the productive use of the systems were optimised.

As in previous years, the main focus in the area of real estate was on the renovation of the premises at Börsenstrasse 15 and Nüscherstrasse 22 in Zurich. The renovated building at Nüscherstrasse was ready for use on 2 May as planned and now houses the organisational units Statistics as well as Financial Stability and Oversight. The final phase of the Börsenstrasse project, i.e. the renovation of the three office floors, started in June. All renovation work and the related large-scale relocation of offices went according to schedule.

Cost-unit accounting

Information technology

Real estate



Cost units In percent

Cash transactions	39
Cashless payment transactions	2
Liquidity supply	5
Currency reserves	17
Monetary policy	20
Services for the Confederation	4
Services for third parties	8
Financial system stability	5

Environmental management

The SNB's latest environmental performance evaluation (for 2004) revealed that the trend in the past few years to reduce the use of resources did not continue in all areas. Due to the renovation work at the Zurich office, heat consumption was considerably higher than in previous years. Air travel emissions and office waste increased as well. The efforts to reduce water and paper consumption yielded further results. Overall, the emission of greenhouse gases rose by approximately 2% year-on-year. Greenhouse gas emission was the focus of environmental management in 2005. The Environmental Committee decided to purchase ecologically produced electricity to neutralise greenhouse gases.

4.3 Supervisory and management bodies

Bank Council

The composition of the Bank Council remained unchanged in 2005.

Audit Board

On 29 April 2005, the General Meeting of Shareholders elected PricewaterhouseCoopers Ltd., Zurich, as the Audit Board for the 2005/2006 term of office.

Bank management

At the end of March 2005, Rudolf Hug, who had headed the National Bank's Information Technology unit for 16 years, went into retirement. His vast expertise and management skills coupled with his wealth of experience were very valuable for the SNB. The National Bank wishes to thank him for his commitment.

5 Business performance

5.1 Financial result

The 2005 business year was strongly affected by the advances in both the price of gold and the value of the US dollar. This gave rise to substantial valuation gains which resulted in an extraordinarily high annual result of CHF 12,821 million. The distributable profit remaining after the allocation of CHF 795 million to the provisions for currency reserves, as prescribed by law, amounted to CHF 12,027 million. The profit distribution for 2005 totals CHF 2,502 million. The remaining CHF 9,525 million will be channelled into the distribution reserve.

Valuation gains were the dominant element in the net result from gold, which totalled CHF 7,457 million. In the course of 2005, the gold price rose substantially. At CHF 21,692 per kilogram, it closed 36% higher than at the end of 2004, the biggest increase since 1979. A valuation gain of CHF 7,439 million was recorded on the SNB holdings of 1,290 tonnes of gold. Consequently, this element contributed more than the half of the entire annual result.

About three-quarters of foreign currency investments made by the Swiss National Bank (SNB) are denominated in euros and US dollars. While the euro exchange rate closed only slightly higher than the previous year, the value of the dollar was considerably higher, at 17% up. This had a pronounced effect on the result from foreign currency investments. Exchange rate gains were also recorded for all other foreign currency holdings apart from investments in Japanese yen. Thus, at a total CHF 2,507 million, exchange rate gains accounted for almost half the net result of CHF 5,327 million from foreign currency investments.

Interest rates in the market segments of interest to the SNB declined slightly, apart from investments in US dollars, where there was an increase. In 2005, capital losses on dollar investments were more or less balanced out by capital gains on investments in other currencies. In 2004, capital gains had clearly predominated. In addition, due to the distribution of the proceeds from gold sales, the holdings of investments in foreign currencies declined. This resulted in a fall in interest income. At CHF 2,091 million, total interest income and capital gains were about one-third lower than in the previous year.

Last year, the National Bank expanded its investment spectrum, investing a small portion of its currency reserves in foreign shares. Due to favourable market developments, these investments earned a total of CHF 742 million (dividends and price gains).

Summary

Unusually strong increase in gold price

Substantial exchange rate gains on foreign currency investments

Decline in interest income and capital gains

Shares as a new investment category

Net result from Swiss franc investments maintained

At CHF 296 billion, the net result from investments denominated in Swiss francs was almost exactly the same as in 2004. The substantial drop in earnings on Swiss franc securities was almost offset by higher interest income from repo transactions in Swiss francs. For Swiss franc securities, lower holdings of investments due to the distribution of gold sales proceeds as well as reduced capital gains led to a decline in earnings. In the case of repo transactions in Swiss francs, the rise in money market interest rates resulted in higher earnings.

Higher operating expenses

Operating expenses comprise banknote and personnel expenses, general overheads and depreciation on tangible assets. At CHF 272 million, this item was CHF 59 million higher in 2005 than in the previous year. Of this amount, CHF 49 million was attributable to impairment losses on the real estate portfolio. All properties underwent impairment tests in 2005. These tests were conducted in conjunction with a real estate specialist and revealed that property values reflected only part of the figure carried as assets in respect of renovation work and conversions specifically undertaken for the head office in Zurich. Developments in cash distribution prompted the National Bank to further concentrate its cash handling processes. Consequently, it is reorganising its cash distribution services in Zurich, Berne and Geneva, and is closing its cash distribution service in Lugano with effect from the end of 2006, subject to approval from the Federal Council. A provision of CHF 5 million was made for early retirements arising out of this development, and charged to other personnel expenses.

Proceeds from sale of surplus gold reserves distributed

Between May and July, proceeds from the sale of surplus gold reserves amounting to CHF 21,113 million were distributed. One-third of this sum was paid out to the Confederation and two-thirds to the cantons. The distribution was made from the 2004 annual result and financed from the sale of foreign currency and Swiss franc security.

5.2 Provisions prescribed in the National Bank Act

The National Bank does not distribute its entire annual result, as it is obliged by the National Bank Act (NBA) to set aside provisions from its earnings surplus to build up currency reserves. These reserves allow the National Bank to intervene on the market should the Swiss franc become excessively weak. The currency reserves also make Switzerland's economy less vulnerable to international crises and thereby engender confidence in the Swiss franc. The need for foreign currency reserves is growing in tandem with the size and international integration of the Swiss economy.

Moreover, the provisions for currency reserves have a general reserve function and cover the market, credit and liquidity risks to which the National Bank's investments are exposed.

In accordance with art. 30 para. 1 NBA and the profit distribution agreement of 5 April 2002 between the SNB and the Federal Department of Finance (FDF), the provisions formed on the liabilities side of the balance sheet for the purpose of building up currency reserves are increased in step with the growth of nominal gross domestic product (GDP). The targeted percentage rise is based on the average GDP growth over the past five years. This avoids the need for subsequent corrections and prevents large fluctuations from year to year.

Purpose

Targeted level

Development of targeted level

	Growth in nominal GDP ¹ In percent (average period) ²	Annual allocation CHF millions	New targeted level ³ CHF millions
2001	2.6 (1995–1999)	682.4	27 337.8
2002	3.3 (1996–2000)	902.1	28 239.9
2003	2.3 (1997–2001)	829.3	36 886.7 ⁴
2004	2.4 (1998–2002)	885.3	37 841.0 ⁵
2005	2.1 (1999–2003)	794.7	38 635.7
2006	2.3 (2000–2004)	888.6	39 524.3

1 Until 2002: nominal gross national product (GNP).

2 The data is revised on a continuous basis. The growth rates shown in the table thus differ slightly from the latest available data.

3 After the allocation of the reporting year.

4 Including CHF 7,817.5 million from the integration of the provisions for market and liquidity risks on gold on 1 January 2003 (cf. 96th Annual Report 2003, pp. 105–106).

5 Including CHF 69.0 million from the transfer of the reserve fund on 1 May 2004 pursuant to art. 57 para. 2 NBA.

Allocation from the 2005 annual result

This year's increase in the targeted level of provisions amounts to CHF 795 million, in accordance with the average growth in GDP during the 1999–2003 period, which was 2.1% in nominal terms. The allocation is to be made as part of the appropriation of the 2005 annual result.

Distributable annual profit

Pursuant to art. 30 para. 2 NBA, the distributable annual profit corresponds to the earnings remaining after the provisions for currency reserves are set aside. For the 2005 business year, the distributable annual profit amounted to CHF 12,027 million.

5.3 Profit distribution

Profit distribution agreement

In accordance with art. 31 NBA, one-third of profits are distributed to the Confederation and two-thirds to the cantons. The amount of the annual profit distribution is laid down in an agreement between the National Bank and the Federal Department of Finance.

According to the latest agreement, concluded on 5 April 2002, the amounts distributed to the Confederation and the cantons are fixed in advance, with the aim of achieving a steady flow of payments in the medium term. The figure of CHF 2,500 million each year for the ten years 2003–2012 is based on an earnings forecast. The agreement covers year-to-year National Bank profits and the reduction of the distribution reserve. It will be reviewed once five years have elapsed.

Expiry of supplementary agreements

An agreement concluded on 25 February 2005 (cf. p. 67) governed the non-recurring special distribution of CHF 21,113 million to the Confederation and the cantons, corresponding to the countervalue of the 1,300 tonnes of gold no longer required for monetary policy purposes. This distribution was carried out in ten weekly tranches between the beginning of May and the middle of July 2005, in accordance with the resolution of the General Meeting of Shareholders on 29 April 2005.

Thus the supplementary agreement concluded on 12 June 2003 – relating to earnings on invested proceeds from gold sales, as long as these were managed by the National Bank – is no longer applicable. Under this agreement, the National Bank had paid out CHF 300 million to the Confederation and the cantons from the annual result for 2003 and CHF 400 million from the result for 2004, over and above the normal profit distribution.

2005 profit distribution

In accordance with the relevant agreement, the profit distributed to the Confederation and the cantons for the 2005 business year will amount to CHF 2,500 million. Dividend payments will amount to CHF 1.5 million.

Distribution reserve

Pursuant to the agreement, the difference between distributable profit for the year and actual profit distributed will be shown in the distribution reserve. The distributable profit for 2005 exceeds the distribution by CHF 9,525 million. Consequently, the distribution reserve will rise to CHF 16,473 billion.

Development of profit distribution and distribution reserve

	Residual surplus prior to distribution CHF millions	Profit distribution ¹ CHF millions	Residual surplus for future distributions CHF millions
2001	14 881.0	1 500.0	13 381.0
2002	13 240.4	2 500.0	10 740.4
2003	13 047.0	2 800.0	10 247.0 ²

	Distribution reserve prior to distribution CHF millions	Distributable annual profit CHF millions	Profit distribution CHF millions	Distribution reserve after distribution CHF millions
2004	10 235.5 ²	20 727.6	24 014.7	6 948.4
2005	6 948.4	12 026.5	2 501.5	16 473.4

1 Excluding per capita distribution to the cantons; excluding dividends.

2 Cf. 97th Annual Report 2004, p. 126, on transfer of the residual surplus for future distributions to the distribution reserve.

Definition

5.4 Currency reserves

The major part of the currency reserves held by the National Bank consist of gold (including claims from gold transactions) and foreign currency investments. The reserve position at the IMF, international payment instruments, and the positive and negative replacement values of derivative financial instruments are also allocated to currency reserves. Liabilities in foreign currencies reduce the level of currency reserves. The free assets managed by the National Bank until their distribution were not included in the currency reserves.

In the short term, the currency reserves fluctuate as a result of inflows and outflows of funds as well as valuation changes. In the medium and long term, the aim is to ensure that they grow in step with gross domestic product (GDP). In order to achieve this goal, the National Bank does not distribute its entire annual result, withholding part of the earnings surplus in the form of provisions entered on the liabilities side of the balance sheet (cf. 5.2, p. 79).

Composition

Composition

	31.12.2005	31.12.2004	Change
In CHF millions			
Gold	25 066.0	18 463.5 ¹	+6 602.5
Claims from gold transactions	2 984.2	2 153.4	+830.8
Foreign currency investments	46 585.5	41 270.0 ¹	+5 315.5
Reserve position in the IMF	1 079.8	2 035.1	-955.3
International payment instruments	78.9	80.1	-1.2
Derivative financial instruments	34.1	150.4 ¹	-116.3
less: foreign currency liabilities	-230.8	-0.5	-230.3
Total	75 597.7	64 152.0	+11 445.7

1 Excluding free assets.

Developments in the last five years

Development

	Holdings at year-end	Year-on-year change
In CHF millions		
2001	66 137.4	-2 565.7
2002	65 492.4	-645.0
2003	65 749.9	+257.5
2004	64 152.0	-1 597.9
2005	75 597.7	+11 445.7

Financial Report

1 Income statement and appropriation of profit for 2005

In CHF millions

		2005	2004	Change
	Item no. in Notes			
Net result from gold	01	7 456.9	-900.7	+8 357.6
Net result from foreign currency investments	02	5 327.3	1 191.2	+4 136.1
Net result from Swiss franc investments	03	296.1	304.4	-8.3
Net result from other assets	04	13.2	22.4	-9.2
Gross income		13 093.5	617.3	+12 476.2
Banknote expenses		-39.7	-41.8	+2.1
Personnel expenses	05, 06	-106.2	-99.7	-6.5
General overheads	07	-49.1	-45.6	-3.5
Depreciation on tangible assets	15	-77.3	-26.6	-50.7
Net income		12 821.2	403.6	+12 417.6
Released from provisions				
for the assignment of free assets			96.0	-96.0
Write-back of provisions				
for the assignment of free assets			21 113.2	-21 113.2
Annual result		12 821.2	21 612.9	-8 791.7
Allocation to provisions for currency reserves		-794.7	-885.3	+90.6
Distributable annual profit		12 026.5	20 727.6	-8 701.1
Allocated to (-) / released from (+)				
distribution reserve		-9 525.0	3 287.1	-12 812.1
Total distribution of profit		2 501.5	24 014.7	-21 513.2
of which				
Payment of a dividend of 6%		1.5	1.5	-
Ordinary distribution of profit to the Confederation and the cantons (Agreement of 5 April 2002)		2 500.0	2 500.0	-
Supplementary distribution of profit to the Confederation and the cantons (Agreement of 12 June 2003)			400.0	-400.0
Distribution of proceeds from the sale of 1,300 tonnes of gold (Agreement of 25 February 2005)			21 113.2	-21 113.2

2 Balance sheet as at 31 December 2005

In CHF millions

		31.12.2005	31.12.2004	Change
Assets	Item no. in Notes			
Gold holdings	08	25 066.0	19 485.8	+5 580.2
Claims from gold transactions	09	2 984.2	2 153.4	+830.8
Foreign currency investments	10	46 585.5	60 708.0	-14 122.5
Reserve position in the IMF	11	1 079.8	2 035.1	-955.3
International payment instruments	27	78.9	80.1	-1.2
Monetary assistance loans	12, 27	270.2	291.3	-21.1
Claims from Swiss franc repo transactions	26	26 198.6	24 502.7	+1 695.9
Lombard advances	26	-	6.6	-6.6
Claims against domestic correspondents		5.3	11.8	-6.5
Swiss franc securities	13	5 729.1	7 393.6	-1 664.5
Banknote stocks	14	137.6	144.0	-6.4
Tangible assets	15	355.5	393.3	-37.8
Participations	16, 28	122.3	96.7	+25.6
Other assets	17, 30	375.2	606.3	-231.1
Total assets		108 988.2	117 908.8	-8 920.6

		31.12.2005	31.12.2004	Change
Liabilities	Item no. in Notes			
Banknotes in circulation	18	41 366.5	39 719.3	+1 647.2
Sight deposits of domestic banks		5 852.7	6 541.7	-689.0
Liabilities towards the Confederation	19	3 126.3	2 154.8	+971.5
Sight deposits of foreign banks and institutions		483.9	329.4	+154.5
Other sight liabilities	20	189.9	165.0	+24.9
Liabilities from Swiss franc repo transactions		-	-	-
Foreign currency liabilities	21	230.8	0.5	+230.3
Other liabilities	22, 30	90.7	160.9	-70.2
Provisions for operating risks	23	11.7	8.1	+3.6
Provisions for currency reserves		37 841.0	36 955.7	+885.3
Share capital	24	25.0	25.0	-
Distribution reserve		6 948.4	10 235.5	-3 287.1
Annual result ¹		12 821.2	21 612.9	-8 791.7
Total liabilities		108 988.2	117 908.8	-8 920.6

1 Before allocation to provisions for currency reserves.

3 Changes in equity capital

In CHF millions

	Share capital	Non-paid-up share capital
Equity capital as at 1 January 2004	50.0	-25.0
Endowment of provisions for currency reserves pursuant to the NBA		
Released from distribution reserve		
Allocation to reserve fund		
Distribution of dividends to the shareholders		
Per capita distribution to the cantons		
Profit distribution to the Confederation and the cantons		
Reduction of nominal value	-25.0	25.0
Liquidation of reserve fund		
Annual result of the year under review		
Equity capital as at 31 December 2004 (before appropriation of profit)	25.0	-
Equity capital as at 1 January 2005	25.0	-
Endowment of provisions for currency reserves pursuant to the NBA		
Released from distribution reserve		
Distribution of dividends to the shareholders		
Profit distribution to the Confederation and the cantons		
Distribution of proceeds from the sale of 1,300 tonnes of gold		
Annual result of the year under review		
Equity capital as at 31 December 2005 (before appropriation of profit)	25.0	-
Proposed appropriation of profit		
Endowment of provisions for currency reserves pursuant to the NBA		
Allocation to distribution reserve		
Distribution of dividends to the shareholders		
Profit distribution to the Confederation and the cantons		
Equity capital after appropriation of profit	25.0	-

Reserve fund	Provisions for currency reserves	Distribution reserve	Annual result (net profit)	Total
68.0	36 057.4	10 728.5	3 144.6	50 023.5
	829.3		-829.3	
		-493.0	493.0	
1.0			-1.0	
			-1.5	-1.5
			-5.8	-5.8
			-2 800.0	-2 800.0
-69.0	69.0		21 612.9	21 612.9
-	36 955.7	10 235.5	21 612.9	68 829.1
-	36 955.7	10 235.5	21 612.9	68 829.1
	885.3		-885.3	
		-3 287.1	3 287.1	
			-1.5	-1.5
			-2 900.0	-2 900.0
			-21 113.2	-21 113.2
			12 821.2	12 821.2
-	37 841.0	6 948.4	12 821.2	57 635.6
	794.7		-794.7	
		9 525.0	-9 525.0	
			-1.5	-1.5
			-2 500.0	-2 500.0
-	38 635.7	16 473.4	-	55 134.1

4 Notes to the accounts as at 31 December 2005

4.1 Accounting and valuation principles

General

General principles

The present Financial Report has been drawn up in accordance with the provisions of the National Bank Act (NBA), the Swiss Code of Obligations (SCO) and – with due account being taken of circumstances specific to the National Bank – in compliance with the Swiss GAAP FER accounting principles. The Financial Report gives a true and fair view of the financial position, the results of operations and the cash flows in accordance with Swiss GAAP FER.

As a company listed in the main segment of the Swiss stock exchange SWX, the National Bank would be obliged to present its accounts in accordance with the International Financial Reporting Standards (IFRS) or the United States Generally Accepted Accounting Principles (US GAAP). Citing art. 27 NBA, the National Bank requested to be exempted from this obligation. By letter of 5 November 2004, the SWX granted the exempt status.

Changes from previous year

The employee benefits obligations statement was brought in line with the revised Swiss GAAP FER 16 standard.

Cash flow statement

The National Bank does not prepare a cash flow statement. Since the National Bank can autonomously create money as a central bank, such a statement is not meaningful.

Interim reporting

Since the 2005 financial year, the National Bank has been publishing quarterly interim results in accordance with Swiss GAAP FER 12.

Segment information

The National Bank operates exclusively as a central bank. For this reason, the Financial Report does not include any segment information.

Consolidated financial report

The National Bank does not hold any material participating interests which are subject to consolidation according to Swiss GAAP FER 2. For this reason, the Annual Report does not include a consolidated financial report.

Recording of transactions

All business transactions are recorded and valued on the day the transaction is concluded (trade day accounting). However, they are only posted on the value date. Transactions completed by the balance-sheet date with a value date in the future are stated under off-balance-sheet transactions.

Accrual reporting

Expenses are recognised in the financial year in which they are incurred, and income in the financial year in which it is earned.

Profit tax

Pursuant to art. 8 NBA, the National Bank is exempt from profit taxes. Tax exemption applies to both direct federal taxes and cantonal and municipal taxes.

Transactions with related parties

Shareholders of the National Bank have very limited rights; for this reason, they cannot exert any influence on financial and operative decisions. No material transactions are concluded with members of the SNB's executive bodies or the Bank Council.

Balance sheet and income statement

Gold and negotiable financial instruments are stated in the balance sheet at market value or fair value. Tangible assets are stated at their acquisition cost less required depreciation. Other items are stated at their nominal value inclusive of accrued interest. Foreign currency items are translated at year-end rates. Income and expenses in foreign currency are translated at the exchange rates applicable at the time the income/expenses was/were posted to the accounts. All valuation changes are reported in the income statement.

Physical gold holdings, consisting of gold ingots and gold coins, are stored at various locations in Switzerland and abroad. These holdings are stated at market value. Valuation gains and losses are reported in *net result from gold*.

In managing its investment portfolio, the National Bank lends a part of its gold holdings to first-class domestic and foreign financial institutions. The National Bank receives interest on the gold loaned. Gold lending transactions are effected on a secured and unsecured basis. The gold price risk remains with the National Bank. Gold lent is entered in the balance sheet under *claims from gold transactions* and stated at market value inclusive of accrued interest. The valuation result and interest are stated in *net result from gold*.

In *foreign currency investments*, negotiable securities (money market paper, bonds and shares) as well as credit balances (sight deposit accounts, call money, time deposits and repos) denominated in foreign currency are recorded. Securities, which make up the bulk of the foreign currency investments, are stated at market value inclusive of accrued interest. The credit balances are stated at their nominal value inclusive of accrued interest. Gains and losses from revaluation at market value, interest earnings and exchange rate gains and losses are stated in *net result from foreign currency investments*.

Securities lending transactions are concluded as part of the management of foreign currency investments. The SNB loans securities from its own portfolio in exchange for collateral securities. It receives interest on the securities loaned. Loaned securities remain in the *foreign currency investments* item and are disclosed in the notes to the accounts. Interest income from securities lending is stated in *net result from foreign currency investments*. The National Bank does not engage in securities borrowing.

The reserve position in the International Monetary Fund (IMF) comprises the Swiss quota less the IMF's sight balances at the National Bank. The quota is Switzerland's portion of the IMF capital financed by the National Bank. It is held in the form of Special Drawing Rights (SDRs), which are the IMF's currency. A part of the quota was not transferred to the IMF, but remained in a sight deposit account. The IMF can dispose of these assets for its transactions at any time. The income from interest on the reserve position as well as the exchange rate gains and losses from revaluation of the Special Drawing Rights are stated in *net result from foreign currency investments*.

Summary

Gold holdings

Claims from gold transactions

Foreign currency investments

Securities lending

Reserve position in the IMF

International payment instruments

Claims from two-way arrangements with the IMF are stated in *international payment instruments*. The National Bank has committed itself to purchase up to SDR 400 million against foreign currency. These sight deposits attract interest at market conditions. Interest earnings and exchange rate gains and losses are stated in *net result from foreign currency investments*.

Monetary assistance loans

In the context of international cooperation, Switzerland may participate in the IMF's internationally coordinated, medium-term balance-of-payments aid. It may do so in the form of a credit tranche or by granting bilateral monetary assistance loans to countries with balance of payments problems. In addition to one bilateral monetary assistance loan, currently outstanding claims include those under the Poverty Reduction and Growth Facility (PRGF). This is a fiduciary fund administered by the IMF which finances long-term loans at reduced interest rates to poor developing countries. The Confederation guarantees the interest and principal repayments both on the bilateral loans and on Switzerland's participation in the PRGF credit account. These loans are stated at their nominal value inclusive of accrued interest. Interest earnings and exchange rate gains and losses are stated in *net result from foreign currency investments*.

Claims and liabilities from repo transactions in Swiss francs

Repo transactions in Swiss francs are the National Bank's major monetary policy instrument. Repo transactions are used to provide the banking system with liquidity or to withdraw liquidity from it. Claims from repo transactions are fully backed by securities from the SNB General Collateral Basket. Claims and liabilities from repo transactions are stated at their nominal value inclusive of accrued interest. Interest earnings and expenses are stated in *net result from Swiss franc investments*.

Lombard advances

Lombard loans were used by the banks to bridge unforeseeable liquidity shortfalls in the short term. These claims attracted interest at the call money rate plus 200 basis points. They were stated at their nominal value inclusive of accrued interest. Interest earnings were stated in *net result from Swiss franc investments*. Since 1 January 2006, the Lombard facility has no longer been offered and has been superseded by special-rate repo transactions.

Claims against domestic correspondents

On behalf of the National Bank, domestic correspondents perform local cash redistribution transactions and cover the cash requirements of federal agencies and enterprises associated with the Federal Government (Swiss Post and Swiss Federal Railways). This results in short-term claims of the National Bank which attract interest at the call money rate. They are stated at their nominal value inclusive of accrued interest. Interest earnings are stated in *net result from Swiss franc investments*.

Swiss franc securities

Swiss franc securities are made up exclusively of negotiable bonds. They are stated at their nominal value inclusive of accrued interest. Valuation gains/losses and interest earnings are stated in *net result from Swiss franc investments*.

Banknote stocks

Freshly printed banknotes which have never been put into circulation are capitalised at their acquisition cost and stated in *banknote stocks*. At the time a banknote first enters into circulation, its acquisition cost is charged to *banknote expenses*.

Tangible assets comprise land and buildings, fixed assets under construction, and sundry tangible assets. Software is also included in the tangible assets. For materiality reasons, the intangible asset software is not shown separately in the balance sheet, but only disclosed in the notes to the accounts. Day-to-day maintenance expenses for real estate and sundry tangible assets are stated in *general overheads*. The minimal value for capitalisation is CHF 1,000. Acquisitions below this amount are charged directly to *general overheads*. Tangible assets are stated at their acquisition cost less required depreciation. Depreciation is always carried out on a straight-line basis. In the case of real estate (including conversions), sub-categories were redefined in the 2005 financial year and assets were reallocated. Previously, buildings and the corresponding land were recorded under the heading "real estate" and written down over 100 years. In future, land will no longer be written down, while buildings are written down over 50 years. Conversions are written down over 10 years and also subsumed under the heading "land and buildings". These changes have no major impact.

Period of depreciation

Land and buildings	
Land	no depreciation
Buildings (building structure)	50 years
Conversions (technical equipment and interior finishing work)	10 years
Fixed assets under construction	
Software	3 years
Sundry tangible assets	
Hardware	3 years
Machinery and equipment	5–10 years
Furnishings	5 years
Motor vehicles	6–12 years

The recoverable value is checked periodically. If this results in a decrease in value, an impairment loss is recorded. Scheduled and unscheduled depreciations are reported in the income statement item *depreciation on tangible assets*.

Profits and losses from the sale of tangible assets are stated in *net result from other assets*.

Minority interests in excess of 20% qualify as an associated company and are valued according to the equity method. The remaining minority interests in companies in which the National Bank exercises no material influence or non-essential majority interests are valued at acquisition cost less required value adjustments. The entire income from participations is stated in *net result from other assets*.

Derivative financial instruments

The National Bank uses foreign currency forward transactions, futures and interest rate swaps to manage its currency reserves. All derivative financial instruments are stated at market value. Official prices are applied, if available. If not, fair value is established in accordance with generally recognised financial mathematical methods. Valuation changes are recorded in the income statement and stated in *net result from foreign currency investments*. Unrealised gains and losses (positive and/or negative replacement values) are stated in *other assets* or *other liabilities*.

Accrued expenses and deferred income

The National Bank does not state accrued expenses and deferred income as separate items in its balance sheet. For materiality reasons, they are reported in *other assets* or *other liabilities* and are disclosed in the notes to the accounts.

Banknotes in circulation

The *banknotes in circulation* item shows the nominal value of all banknotes held by the public and by the banks, including recalled, still exchangeable notes from previous series.

Sight deposits of domestic banks

Sight deposits of domestic banks in Swiss francs form the basis on which the National Bank controls monetary policy. They also facilitate cashless payments in Switzerland. These sight deposits are non-interest-bearing accounts which are stated at their nominal value.

Liabilities towards the Confederation

The National Bank holds a sight deposit account for the Confederation which bears interest at the call money rate. Until 31 December 2005, interest was payable for amounts up to CHF 600 million. With effect from 1 January 2006, this amount was lowered to CHF 200 million. Moreover, the Confederation may place time deposits with the National Bank at market rates. The liabilities towards the Confederation are stated at their nominal value inclusive of accrued interest. Interest expenses are recorded in *net result from Swiss franc investments*.

Sight deposits of foreign banks and institutions

The National Bank holds sight deposit accounts for foreign banks and institutions which facilitate payment transactions in Swiss francs. These sight deposits do not bear interest and are stated at their nominal value.

Other sight liabilities

Sight deposits of non-banks, accounts of active and retired staff members and of the SNB's pension funds as well as liabilities in the form of bank cheques drawn on the National Bank but not yet cashed are stated in *other sight liabilities*. They are stated at their nominal value inclusive of accrued interest. Interest expenses are stated in *net result from Swiss franc investments*.

Foreign currency liabilities

Foreign currency liabilities comprise liabilities towards the Confederation and repo transactions related to the management of foreign currency investments. They are stated at their nominal value inclusive of accrued interest. Interest expenses and exchange rate gains and losses are stated in *net result from foreign currency investments*.

Provisions for operating risks

Provisions for operating risks comprise reorganisation and other provisions pursuant to Swiss GAAP FER 23. The bulk of reorganisation provisions are financial obligations to staff members taking early retirement as a result of reorganisation.

Art. 30 para. 1 NBA stipulates that the National Bank set up provisions permitting it to maintain the currency reserves at a level necessary for monetary policy. In so doing, it must take into account economic developments in Switzerland. Under the profit distribution agreement concluded between the Federal Department of Finance (FDF) and the SNB on 5 April 2002, the provisions for currency reserves must expand in line with the growth in nominal gross domestic product. These special-law provisions are equity-like in nature and are incorporated in the table "Changes in equity capital". The allocation is made as a part of the profit appropriation.

Provisions for currency reserves

With the exception of the dividend which – pursuant to the NBA – may not exceed 6%, the Confederation and the cantons are entitled to the total remaining profit after adequate provisions for currency reserves have been set aside. To achieve a steady flow of payments in the medium term, the profit distributions are fixed in advance in an agreement concluded between the Confederation and the National Bank. The distribution reserve contains the as yet non-distributed profits.

Distribution reserve

The National Bank's pension plans comprise two staff pension fund schemes under the defined benefit system. Contributions are made by the National Bank and the employees. Ordinary employee contributions are 8% of the insured salary and those of the SNB 16%. In accordance with Swiss GAAP FER 16, any share of actuarial surplus or deficit is shown on the asset side or reported as a liability.

Pension schemes

Off-balance-sheet transactions

Contingent liabilities are obligations entered into in the past as a result of contracts, laws or implied actions. A resultant future outflow of funds is possible, but will probably not materialise. The maximum amount owed from contingent liabilities is stated in the notes under off-balance-sheet transactions.

Contingent liabilities

Fiduciary transactions encompass investments which the National Bank makes in its own name but exclusively on the basis of a written contract for the account and at the risk of the Confederation. These transactions are shown in the notes at market value under off-balance-sheet transactions.

Fiduciary transactions

Irrevocable undertakings include credit arrangements the National Bank has granted to the IMF in the context of international cooperation and credit lines extended to banks in the form of liquidity-shortage financing facilities (Lombard advances and special-rate repos). The maximum of resulting liabilities are stated in the notes under off-balance-sheet transactions.

Irrevocable undertakings

4.2 Foreign currency exchange rates and gold price

	31.12.2005 CHF	31.12.2004 CHF	Change In percent
1 US Dollar (USD)	1.32	1.13	+16.8
1 euro (EUR)	1.56	1.54	+1.3
1 British pound (GBP)	2.27	2.18	+4.1
100 Danish kroner (DKK)	20.86	20.74	+0.6
1 Canadian dollar (CAD)	1.13	0.94	+20.2
100 Japanese yen (JPY)	1.12	1.10	+1.8
1 Special Drawing Right (SDR)	1.88	1.76	+6.8
1 kilogram of gold	21 692.03	15 939.44	+36.1

4.3 Notes to the income statement and balance sheet

Item no. 01

Net result from gold

In CHF millions	2005	2004	Change
Net result from changes in market value	7 438.7	-927.6	+8 366.3
Interest income from gold lending transactions	34.9	22.8	+12.1
Net result from hedging transactions ¹	-16.7	4.2	-20.9
Total	7 456.9	-900.7	+8 357.6

¹ Foreign currency forward transactions concluded to hedge proceeds from gold sales in US dollars.

Net result from foreign currency investments

Item no. 02

Breakdown of net result by type	2005	2004	Change
In CHF millions			
Interest and capital gain/loss	2 090.9	3 203.6	-1 112.7
Dividend income and price gain/loss	741.7	-	+741.7
Interest expenses	-1.0	-12.5	+11.5
Exchange rate gain/loss	2 507.3	-1 989.5	+4 496.8
Asset management and safe custody account fees	-11.6	-10.4	-1.2
Total	5 327.3	1 191.2	+4 136.1

Breakdown of net result by origin	2005	2004	Change
In CHF millions			
Foreign currency investments	5 138.1	1 282.5	+3 855.6
Reserve position in the IMF	160.6	-70.6	+231.2
International payment instruments	4.0	0.6	+3.4
Monetary assistance loans	25.7	-8.8	+34.5
Foreign currency liabilities	-1.0	-12.5	+11.5
Total	5 327.3	1 191.2	+4 136.1

Breakdown of net result by currency	2005	2004	Change
In CHF millions			
USD	2 574.4	-615.0	+3 189.4
EUR	1 413.3	1 575.6	-162.3
GBP	530.9	156.4	+374.5
DKK	127.6	179.0	-51.4
CAD	281.3	54.1	+227.2
JPY	221.6	-70.2	+291.8
SDR	189.6	-79.1	+268.7
Other	-11.4	-9.7	-1.7
Total	5 327.3	1 191.2	+4 136.1

Breakdown of exchange rate gain/loss by currency	2005	2004	Change
In CHF millions			
USD	1 916.8	-1 293.2	+3 210.0
EUR	143.5	-313.5	+457.0
GBP	192.1	-157.2	+349.3
DKK	11.8	-11.2	+23.0
CAD	205.6	-23.7	+229.3
JPY	-107.0	-70.2	-36.8
SDR	144.5	-121.2	+265.7
Other	0.0	0.6	-0.6
Total	2 507.3	-1 989.5	+4 496.8

Net result from Swiss franc investments

Breakdown by type	2005	2004	Change
In CHF millions			
Interest and capital gain/loss	324.3	327.2	-2.9
Interest expenses	-25.3	-19.4	-5.9
Trading and safe custody account fees	-2.9	-3.3	+0.4
Total	296.1	304.4	-8.3

Breakdown by origin	2005	2004	Change
In CHF millions			
Swiss franc securities	184.0	265.1	-81.1
Swiss franc repo transactions	137.3	58.7	+78.6
Other assets	0.2	0.1	+0.1
Liabilities towards the Confederation	-19.3	-13.0	-6.3
Other sight liabilities	-5.9	-6.4	+0.5
Total	296.1	304.4	-8.3

Net result from other assets

Item no. 04

In CHF millions	2005	2004	Change
Commission income	14.5	16.3	-1.8
Commission expenses	-11.6	-15.5	+3.9
Income from participations	6.0	17.1	-11.1
Income from real estate	3.7	3.7	-
Other ordinary income	0.6	0.7	-0.1
Total	13.2	22.4	-9.2

Personnel expenses

Item no. 05

In CHF millions	2005	2004	Change
Wages, salaries and allowances	77.9	78.3	-0.4
Social insurance	16.9	15.4	+1.5
Other personnel expenses ¹	11.4	6.0	+5.4
Total	106.2	99.7	+6.5

¹ Including reorganisation costs (cf. p. 78).

Employee benefit obligations¹

Item no. 06

Share of actuarial surplus of pension plans ² In CHF millions	31.12.2005	31.12.2004	Change
Overfunding in accordance with Swiss GAAP FER 26	127.5	102.0	+25.5
SNB's share of actuarial surplus	-	-	-

Employee benefit expenses In CHF millions	2005	2004	Change
Employer contributions	11.3	9.9	+1.4
Change in share of actuarial surplus	-	-	-
Employee benefit expenses as part of personnel expenses	11.3	9.9	+1.4

¹ Pension funds do not have any employer contribution reserves.
² Overfunding (actuarial surplus) is not used in favour of the employer but in favour of the insured.

Item no. 07

General overheads

In CHF millions	2005	2004	Change
Premises	11.5	9.0	+2.5
Maintenance of mobile tangible assets and software	7.5	8.5	-1.0
Consulting and other third-party support	5.1	3.7	+1.4
Administrative expenses	12.5	11.9	+0.6
Operating contributions ¹	7.0	6.6	+0.4
Other general overheads	5.5	5.9	-0.4
Total	49.1	45.6	+3.5

1 Mainly contributions towards the Study Center Gerzensee (a Swiss National Bank foundation).

Item no. 08

Gold

Breakdown by type	31.12.2005		31.12.2004	
	Tonnes	CHF millions	Tonnes	CHF millions
Gold ingots	980.3	21 265.7	1 047.3	16 693.3
Gold coins	175.2	3 800.3	175.2	2 792.5
Total	1 155.5	25 066.0	1 222.5	19 485.8

Breakdown by purpose	31.12.2005		31.12.2004	
	Tonnes	CHF millions	Tonnes	CHF millions
Monetary gold	1 155.5	25 066.0	1 158.4	18 463.5
Gold from free assets	-	-	64.1	1 022.3
Total	1 155.5	25 066.0	1 222.5	19 485.8

Free assets: Gold sales per annum ¹	Amount sold	Sales proceeds	Price per kilogram
	Tonnes	CHF millions	CHF
2000	170.8	2 589.9	15 167
2001	220.8	3 252.8	14 730
2002	281.9	4 376.0	15 524
2003	283.4	4 458.8	15 733
2004	279.0	4 567.6	16 372
2005	64.1	1 039.7	16 210
Total	1 300.0	20 284.8²	15 604

1 Excluding net result from hedging transactions.

2 In spring 2005, the special distribution to the Confederation and the cantons totalled

CHF 21,113.2 million. This amount included the proceeds from gold sales concluded until the end of 2004, the net result from hedging

transactions as well as the market value of the as yet unsold 64.1 tonnes of gold (cf. 97th Annual Report 2004, p. 124).

Claims from gold transactions

Item no. 09

	31.12.2005		31.12.2004	
	Tonnes	CHF millions	Tonnes	CHF millions
Claims from unsecured gold lending	10.9	237.8	31.9	514.6
Claims from secured gold lending ¹	123.5	2 743.9	99.8	1 637.4
Claims on metal accounts	0.1	2.4	0.1	1.4
Total	134.6	2 984.2	131.8	2 153.4

1 Secured by securities eligible for repo transactions (CHF Basket) with a market value of CHF 2,857.8 million (2004: CHF 1,865.9 million).

Foreign currency investments

Item no. 10

Breakdown by investment type	31.12.2005	31.12.2004	Change
In CHF millions			
Sight deposits and call money	1 265.8	1 201.4	+64.4
Time deposits	595.2	362.7	+232.5
Money market paper	2 648.8	2 680.3	-31.5
Bonds ¹	38 408.6	56 463.7	-18 055.1
Equities	3 667.0	-	+3 667.0
Total	46 585.5	60 708.0	-14 122.5

1 Of which CHF 71.7 million (2004: CHF 320.3 million) lent under securities lending operations.

Breakdown by borrower category	31.12.2005	31.12.2004	Change
In CHF millions			
Governments	31 988.7	45 546.8	-13 558.1
Monetary institutions ¹	1 675.5	1 919.7	-244.2
Corporations	12 921.2	13 241.5	-320.3
Total	46 585.5	60 708.0	-14 122.5

1 Investments at the BIS, at central banks and multilateral development banks.

Breakdown by currency ¹	31.12.2005	31.12.2004	Change
In CHF millions			
USD	16 281.8	20 405.0	-4 123.2
EUR	21 570.2	28 854.9	-7 284.7
GBP	4 816.9	6 944.8	-2 127.9
DKK	2 002.6	3 130.5	-1 127.9
CAD	1 045.7	1 371.8	-326.1
JPY	867.5	0.2	+867.3
Other	0.7	0.7	-0.0
Total	46 585.5	60 708.0	-14 122.5

1 No account being taken of foreign exchange derivatives. For a breakdown of currency positions including foreign exchange derivatives, cf. Risks posed by financial instruments, p. 113.

Item no. 11**Reserve position in the IMF**

	31.12.2005	31.12.2004	Change
In CHF millions			
Swiss quota in the IMF ¹	6 505.4	6 080.7	+424.7
less: IMF's Swiss franc sight balances at the National Bank	-5 425.6	-4 045.6	-1 380.0
Total	1 079.8	2 035.1	-955.3

¹ This quota amounts to SDR 3,458.5 million: change due entirely to exchange rates.

Item no. 12**Monetary assistance loans**

	31.12.2005	31.12.2004	Change
In CHF millions			
Bilateral loan to Bulgaria	22.4	22.2	+0.2
PRGF credit facility	166.7	193.7	-27.0
Interim PRGF credit facility ¹	81.2	75.4	+5.8
Total	270.2	291.3	-21.1

¹ Undrawn loan commitments cf. p. 110, Item no. 27.

Swiss franc securities

Item no. 13

Breakdown by borrower category	31.12.2005	31.12.2004	Change
In CHF millions			
Governments	3 261.3	4 368.0	-1 106.7
Corporations	2 467.8	3 025.6	-557.8
Total	5 729.1	7 393.6	-1 664.5

Breakdown of the <i>Governments</i> borrower category	31.12.2005	31.12.2004	Change
In CHF millions			
Swiss Confederation	1 876.4	2 249.4	-373.0
Cantons	580.2	862.4	-282.2
Municipalities	336.6	417.4	-80.8
Foreign states	468.1	838.8	-370.7
Total	3 261.3	4 368.0	-1 106.7

Breakdown of the <i>Corporations</i> borrower category	31.12.2005	31.12.2004	Change
In CHF millions			
Domestic banks	19.1	137.7	-118.6
Domestic mortgage bond institutions	787.6	1 063.2	-275.6
Other domestic corporations ¹	135.8	126.4	+9.4
Foreign corporations ²	1 525.2	1 698.2	-173.0
Total	2 467.8	3 025.6	-557.8

1 International organisations headquartered in Switzerland.
2 Banks, international organisations and other corporations.

Banknote stocks

Item no. 14

In CHF millions	Banknote stocks
Position as at 1 January 2004	147.0
Additions	37.4
Disposals	-40.4
Position as at 31 December 2004	144.0
Position as at 1 January 2005	144.0
Additions	31.3
Disposals	-37.6
Position as at 31 December 2005 ¹	137.6

1 Of which CHF 26.8 million advance payments.

Tangible assets

	Land and buildings ¹	Assets under construction ²	Software	Sundry tangible assets ³	Total
In CHF millions					
Historical cost					
1 January 2005	375.0	24.0	24.0	68.0	491.1
Additions	15.7	11.1	8.2	4.4	39.4
Disposals	–	–	–9.6	–6.2	–15.8
Reclassified	20.0	–20.1	–	0.1	
31 December 2005	410.7	15.0	22.6	66.3	514.7
Cumulative value adjustments					
1 January 2005	38.7		10.7	48.3	97.6
Scheduled depreciation	9.9		9.0	9.1	28.0
Impairment loss ⁴	49.3		–	–	49.3
Disposals	–		–9.6	–6.2	–15.8
Reclassified	–		–	–	
31 December 2005	97.9		10.1	51.2	159.2
Net book values					
1 January 2005	336.4	24.0	13.3	19.7	393.3
31 December 2005	312.8	15.0	12.5	15.1	355.5

1 Insured value: CHF 374.5 million (2004: CHF 362.6 million).

2 Renovation projects at the Zurich head office.

3 Insured value: CHF 83.3 million (2004: CHF 83.3 million).

4 In the 2005 financial year, the buildings underwent a periodic impairment test. As a result, an impairment loss was recorded for two buildings.

Participations (not consolidated)

Item no. 16

In CHF millions	Orell Füssli ¹	BIS ²	Others	Total
Equity participation	33%	3%		
Book value as at 1 January 2004	27.0	60.9	0.6	88.6
Investments	-	-	-	-
Divestments	-	-	-	-
Valuation changes	8.1	-	-	8.1
Book value as at 31 December 2004	35.1	60.9	0.6	96.7
Book value as at 1 January 2005	35.1	60.9	0.6	96.7
Investments	-	29.3	-	29.3
Divestments	-	-	-	-
Valuation changes	-3.7	-	-	-3.7
Book value as at 31 December 2005	31.4	90.2	0.6	122.3

1 Orell Füssli Holding Ltd, Zurich, whose subsidiary Orell Füssli Security Documents Ltd produces Switzerland's bank-notes.

2 The interest in the Bank for International Settlements (BIS) is held by reason of collaboration on monetary policy. The equities purchased

during the year under review originate from newly issued shares the BIS had repurchased from private investors in 2001.

Other assets

Item no. 17

In CHF millions	31.12.2005	31.12.2004	Change
Coins ¹	211.1	266.4	-55.3
Foreign notes	0.7	0.7	-
Other accounts receivable	42.9	19.6	+23.3
Prepayments and accrued income	7.1	3.2	+3.9
Cheques and bills of exchange (collection business)	1.2	0.3	+0.9
Positive replacement values ²	112.3	316.1	-203.8
Total	375.2	606.3	-231.1

1 Commemorative coins acquired from Swissmint which are placed in circulation by the National Bank.

2 Positive replacement values correspond to unrealised gains on derivative financial instruments and outstanding spot transactions (cf. p. 112, Item no. 30).

Item no. 18**Banknotes in circulation**

Breakdown by issue	31.12.2005	31.12.2004	Change
In CHF millions			
8 th issue	39 654.8	37 852.9	+1 801.9
6 th issue ¹	1 711.8	1 866.3	-154.5
Total	41 366.5	39 719.3	+1 647.2

1 Exchangeable at the National Bank until 30 April 2020.

Item no. 19**Liabilities towards the Confederation**

	31.12.2005	31.12.2004	Change
In CHF millions			
Sight liabilities	67.2	54.3	+12.9
Term liabilities	3 059.0	2 100.5	+958.5
Total	3 126.3	2 154.8	+971.5

Item no. 20**Other sight liabilities**

	31.12.2005	31.12.2004	Change
In CHF millions			
Sight deposits of non-banks	19.6	20.5	-0.9
Deposit accounts ¹	169.8	144.0	+25.8
Cheque liabilities ²	0.5	0.5	-
Total	189.9	165.0	+24.1

1 These mainly comprise accounts of active and retired employees, and liabilities towards SNB pension schemes.

Current account liabilities towards the latter amounted to CHF 16.8 million on 31 December 2005 (2004:

CHF 16.2 million).
2 Bank cheques drawn on the National Bank but not yet cashed.

Foreign currency liabilities

Item no. 21

In CHF millions	31.12.2005	31.12.2004	Change
Sight liabilities towards the Confederation	0.3	0.5	-0.2
Liabilities from repo transactions ¹	230.6	-	+230.6
Total	230.8	0.5	+230.3

¹ Relating to the management of foreign currency investments.

Other liabilities

Item no. 22

In CHF millions	31.12.2005	31.12.2004	Change
Other liabilities	6.4	10.8	-4.4
Accrued liabilities and deferred income	6.2	5.3	+0.9
Negative replacement values ¹	78.2	144.7	-66.5
Total	90.7	160.9	-70.2

¹ Negative replacement values correspond to unrealised losses on derivative financial instruments and outstanding spot transactions (cf. p. 112, Item no. 30).

Provisions for operating risks

Item no. 23

In CHF millions	Provisions due to reorganisation	Other provisions	Total
Book value as at 1 January 2004	11.5	-	11.5
Formation	0.7	0.7	1.3
Release	-4.5	-	-4.5
Write-back	-0.2	-	-0.2
Book value as at 31 December 2004	7.5	0.7	8.1
Position as at 1 January 2005	7.5	0.7	8.1
Formation	5.6	0.3	5.9
Release	-2.2	-0.1	-2.4
Write-back	-	-0.0	-0.0
Book value as at 31 December 2005	10.9	0.8	11.7

Share capital

Shares

	2005	2004
Share capital in CHF	25 000 000	25 000 000
Nominal value in CHF	250	250
Number of shares	100 000	100 000
Symbol/ISIN ¹	SNBN/CH0001319265	
Closing price as at 31 December in CHF	1 130	1 000
Annual high in CHF	1 205	1 275
Annual low in CHF	914	910
Average daily trading volume in number of shares	83	140

¹ The SNB share is listed in the main segment of the Swiss stock exchange (SWX).

Shareholder structure

	Number of shares	In percentage of shares registered
2,309 private shareholders with a total of	35 589	39.5¹
of whom 1,993 shareholders with 1–10 shares each		
of whom 283 shareholders with 11–100 shares each		
of whom 13 shareholders with 101–200 shares each		
of whom 20 shareholders with over 200 shares each		
80 public-sector shareholders with a total of	54 515	60.5
of whom 26 cantons with a total of	38 981	
of whom 24 cantonal banks with a total of	14 473	
of whom 30 other public authorities and institutions with a total of	1 061	
Total 2,389 shareholders with a total of²	90 104³	100
Registration applications pending or outstanding for	9 896	
Total shares	100 000	

¹ 14.7% are legal entities and 24.8% private individuals.
² In the 2005 financial year, the transfer of 24,481 shares (2004: 21,912) to new holders was authorised. The number of shareholders decreased by 87 year-on-year.
³ 6,280 shares are in foreign ownership.

Principal shareholders

	31.12.2005		31.12.2004	
	Number of shares	Equity participation	Number of shares	Equity participation
Canton of Berne	6 630	6.63%	6 630	6.63%
Fritz Aeschbach-Müller, Monaco			6 232	6.23%
Canton of Zurich	5 200	5.20%	5 200	5.20%

4.4 Notes regarding off-balance-sheet business

Contingent liabilities

Item no. 25

In CHF millions	31.12.2005	31.12.2004	Change
Documentary credits ¹	1.0	1.8	-0.8
Other contingent liabilities	0.3	0.5	-0.2
Total	1.3	2.3	-1.0

1 Chiefly in connection with development aid provided by the Confederation (covered by balances earmarked for this purpose).

Irrevocable undertakings

Item no. 26

Undrawn credit lines provided to banks under the liquidity-shortage financing facilities In CHF millions	31.12.2005	31.12.2004	Change
Credit lines for Lombard advances	699.3	6 551.4	-5 852.1
Credit lines for special-rate repos	10 229.5	3 170.5	+7 059.0
Total	10 928.8	9 721.9	+1 206.9

Credit lines for Lombard advances in detail In CHF millions	31.12.2005	31.12.2004	Change
of which drawn down	-	6.6	-6.6
of which not yet drawn down	699.3	6 551.4	-5 852.1
Total	699.3	6 558.0	-5 858.7

Credit lines for special-rate repos in detail In CHF millions	31.12.2005	31.12.2004	Change
of which drawn down	-	-	-
of which not yet drawn down	10 229.5	3 170.5	+7 059.0
Total	10 229.5	3 170.5	+7 059.0

Item no. 27

Undrawn credit lines provided to the IMF	31.12.2005	31.12.2004	Change
In CHF millions			
Two-way arrangement	673.7	623.3	+50.4
Interim PRGF	390.3	364.8	+25.5
General Arrangements to Borrow (GAB) and New Arrangements to Borrow (NAB)	2 896.7	2 707.6	+189.1
Total	3 960.7	3 695.7	+265.0

1 National Bank undertaking to purchase Special Drawing Rights against currency up to the agreed maximum of SDR 400 million or to return the Special Drawing Rights in exchange for currency (cf. p. 92).
2 Change due entirely to exchange rates.

Two-way arrangement in detail¹	31.12.2005	31.12.2004	Change
In CHF millions			
Credit undertaking	752.4	703.3	+49.1 ²
of which drawn down	78.7	80.0	-1.3
of which not yet drawn down	673.7	623.3	+50.4

1 Limited-term credit undertaking to the IMF's trust fund amounting to SDR 250 million (cf. p. 102, Item no. 12) with federally guaranteed repayment of principal and payment of interest.
2 Change due entirely to exchange rates.

Interim PRGF in detail¹	31.12.2005	31.12.2004	Change
In CHF millions			
Credit undertaking	470.2	439.5	+30.7 ²
of which drawn down	79.9	74.7	+5.2
of which not yet drawn down	390.3	364.8	+25.5

1 Credit lines totalling SDR 1,540 million (of which a maximum of SDR 1,020 million in the context of the GAB) in favour of the IMF for special cases, without a federal guarantee (cf. p. 92).
2 Change due entirely to exchange rates.

General Arrangements to Borrow (GAB) and New Arrangements to Borrow (NAB) in detail¹	31.12.2005	31.12.2004	Change
In CHF millions			
Credit undertaking	2 896.7	2 707.6	+189.1 ²
of which drawn down	-	-	-
of which not yet drawn down	2 896.7	2 707.6	+189.1

Other obligations not carried on the balance sheet

Item no. 28

In CHF millions	31.12.2005	31.12.2004	Change
Additional funding BIS ¹	121.5	105.5	+16.0
Liabilities from long-term rental, maintenance and leasing contracts	25.9	26.2	-0.3
Total	147.4	131.7	+15.7

1 The BIS shares are 25% paid up. The additional funding obligation is stated in Special Drawing Rights.

Assets pledged or assigned as collateral for own liabilities

Item no. 29

In CHF millions	31.12.2005	31.12.2004	Change
Foreign currency investments in USD	35.7	16.3	+19.4
Foreign currency investments in EUR	66.9	77.4	-10.5
Foreign currency investments in GBP	231.0	-	+231.0
Securities in CHF	11.3	-	+11.3
Total ¹	345.0	93.7	+251.3

1 Collateral lodged in connection with repo and futures transactions.

Item no. 30

Outstanding derivative financial instruments

In CHF millions	Contract value	Replacement value	
		Positive	Negative
Interest rate instruments	29 866.9	70.6	37.9
Forward contracts ¹	15 780.5	5.7	2.8
Interest rate swaps	7 130.1	64.9	35.1
Futures	6 956.3	0.1	0.1
Foreign exchange	5 289.9	40.9	40.1
Forward contracts ¹	5 289.9	40.9	40.1
Precious metals	237.5	-	-
Forward contracts ²	237.5	-	-
Equities/indices	836.1	0.7	0.2
Forward contracts ¹	1.8	0.0	0.0
Futures	834.2	0.7	0.2
Total as at 31 December 2005	36 230.4	112.3	78.2
Total as at 31 December 2004	32 080.0	316.1	144.7

1 Including spot transactions with value date in the new year.

2 From gold lending transactions with value date in the new year.

Item no. 31

Fiduciary investments

In CHF millions	31.12.2005	31.12.2004	Change
	Fiduciary investments of the Confederation	621.6	745.3

4.5 Risks posed by financial instruments

The National Bank's activities in the financial markets are based on its statutory mandate. Asset management is governed by the primacy of monetary policy and is carried out according to the criteria of security, liquidity and performance. When implementing its monetary and investment policies, the SNB enters into a variety of financial risks, with its risk profile being determined by the risk on investments.

The National Bank uses a multiple-stage investment and risk control process to manage and limit its risks. This process is overseen by the Bank Council. The Governing Board defines the strategic guidelines. Compliance with these guidelines is monitored on a daily basis. The Governing Board and the Bank Council's Risk Committee receive quarterly reports informing them about investment activities and the associated risks. A detailed description of the risk control process may be found on pages 52–53 of the Accountability Report to the Federal Assembly.

The main risks to investments are market risks, i.e. risks related to the gold price, exchange rates, share prices and interest rates. These risks are managed primarily through diversification.

The National Bank holds currency reserves in the form of foreign currency and gold, thereby ensuring that it has room for manoeuvre in its monetary policy at all times. Consequently, the risk of exchange rate fluctuations against the Swiss franc is not hedged. Gold and the US dollar represent the most important risk factors with respect to investments because they account for a large proportion of total reserves and are very prone to fluctuations.

Risks faced by the National Bank

Risk control process

Market risk

... gold and foreign currency risk

Balance sheet by currency

In CHF millions	CHF	Gold	USD	EUR	Other	Total
Gold		25 066				25 066
Claims from gold transactions		2 919	65			2 984
Foreign currency investments			16 282	21 570	8 733	46 585
Reserve position in the IMF					1 080	1 080
International payment instruments					79	79
Monetary assistance loans				22	248	270
Sundry assets	32 810		109	4	1	32 924
Total assets as per balance sheet	32 810	27 985	16 455	21 597	10 141	108 988
Total liabilities as per balance sheet	-108 679		-57	-4	-248	-108 988
Foreign exchange derivatives (net) ¹	64		-3 261	454	2 794	51
Net exposure as at 31.12.2005	-75 805	27 985	13 137	22 047	12 687	51
Net exposure as at 31.12.2004	-75 559	21 586	13 884	26 033	14 207	151

¹ Delivery claims and delivery obligations from foreign exchange spot and forward transactions.

... interest rate risk

Movements in market interest rates affect the market value of fixed income financial investments. The longer the maturity of a fixed interest-bearing investment, the higher its interest risk. Interest rate risks are limited through the specification of benchmarks and management guidelines. Various means, including the use of derivative instruments such as interest rate swaps and futures, are used to manage these risks. The effect of interest rate fluctuations is calculated with a measure referred to as the “present value of one basis point” (PVBP), which shows the impact on valuation of a simultaneous rise of one basis point (0.01 percentage points) in the yield curves for all investment currencies. If PVBP is positive, a loss is recorded. Duration is a measure of the average time prior to the receipt of payment, and thus is another indicator of interest rate risk. The longer the residual maturity of investments and the lower the coupon rates, the higher the duration.

Interest-bearing investments	Duration	Market value	PVBP
Position as at 31 December 2005	In years	CHF millions	CHF millions
Gold lending		2 982	
Investments in CHF ¹	5.1	5 729	3.0
Investments in USD	3.6	14 393	5.3
Investments in EUR	4.0	20 016	8.0
Investments in other currencies	4.1	6 577	2.8

1 Excluding repos.

... and share price risk

Investments in shares are made in order to optimise the risk/return profile. A passive equity investment strategy is used, in which broad-based indices are replicated. At the end of 2005, CHF 3,667 million were invested in shares. In addition, the SNB held a contract volume of CHF 836 million in equity index futures for the purpose of tactical fine-tuning.

Total market risk

One way of estimating the total market risk of assets is by calculating the Value-at-Risk (VaR, cf. explanations on page 56 of the Accountability Report). The VaR calculated with respect to the composition of assets at the end of 2005 amounted to CHF 6.1 billion, or about 6% of assets. In other words, only one year in twenty, at the most, would see a loss of more than CHF 6.1 billion. The major part of the VaR originates from gold price and exchange rate risks. Share price and interest rate risks are less significant. The VaR is only a rough guide to the risks posed by assets. Additional parameters as well as periodic supplementary analyses, such as stress and scenario analyses, are also used for risk assessment.

Default risk: credit risk

Credit risk results from the possibility that counterparties or other issuers of securities will fail to meet their obligations. The National Bank incurs credit risk through its investments in securities and through over-the-counter business (OTC) with banks. Credit risk in OTC business originates from deposits, derivatives contracts (the amounts at risk are the replacement values) and from gold lending. In addition, there are credit risks due to commitments to the IMF that are not guaranteed by the Confederation (cf. p. 110, Item no. 27).

The SNB controls its credit risk with respect to counterparties by means of a system of limits that restricts the aggregated exposure for all types of business. An above-average rating is required for counterparties, and the vast majority are rated AA or similar. Also, certain transactions are secured by collateral. At the end of 2005, the National Bank's total unsecured exposure with respect to the international banking sector amounted to approx. CHF 3.4 billion. For borrowers in the bond market, a minimum rating of "investment grade" is required. The rating allocation for investments is shown on page 57 of the Accountability Report. In total, credit risks were an insignificant part of the total risk.

The country risk arises from the possibility that a country may hinder payments by borrowers domiciled in its sovereign territory or block the right to dispose of assets held there. In order to avoid entering into any unbalanced country risks, the SNB takes care to distribute assets amongst a number of different depositories and countries.

National Bank liquidity risks relate to the danger that, should investments in foreign currencies need to be sold, this can only be done partially or subject to considerable price concessions. The restricted liquidity of the investments may be due to technical or market disruptions, or to regulatory changes. The SNB ensures a high level of liquidity for its foreign currency reserves by holding a large number of liquid government bonds in the major currencies, EUR and USD. Liquidity risk is reassessed periodically.

... and country risk

Liquidity risk

Proposals of the Bank Council

Proposals of the Bank Council to the General Meeting of Shareholders

At its meeting of 24 February 2006, the Bank Council approved the 98th Annual Report – which includes the Business and Financial Report for 2005 – as presented by the Governing Board for submission to the Federal Council and the General Meeting of Shareholders.

On 17 March 2006, the Federal Council approved the Business and Financial Report pursuant to art. 7 para. 1 National Bank Act (NBA). The Audit Board signed its report on 24 February 2006.

The Bank Council presents the following proposals to the General Meeting of Shareholders:

1. that the Business and Financial Report be approved;
2. that the annual result (net profit) of CHF 12,821,247,385.59 be appropriated as follows:

Appropriation of profit In CHF millions	2005
Annual result (net profit pursuant to art. 36 NBA)	12 821.2
Allocation to provisions for currency reserves (art. 30 para. 1 NBA)	-794.7
Distributable annual profit (art. 30 para. 2 NBA)	12 026.5
Allocation to distribution reserve	-9 525.0
Total distribution of profit (art. 31 NBA)	2 501.5
Payment of a dividend of 6%	-1.5
Ordinary distribution to the Confederation and the cantons ¹	-2 500.0
Balance after appropriation of profit	-

¹ Agreement of 5 April 2002 between FDF and SNB on the distribution of profit.

3. that PricewaterhouseCoopers Ltd., Zurich, be appointed as the Audit Board for the 2006/2007 term of office.
4. that the Bank Council be granted discharge.

Report of the Audit Board

Report of the Audit Board to the General Meeting of Shareholders

As statutory auditors, we have audited the accounting records and the financial statements (balance sheet, income statement and notes / pages 84 to 115) of the Swiss National Bank for the year ended 31 December 2005.

These financial statements are the responsibility of the Bank Council. Our responsibility is to express an opinion on these financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with the Swiss Auditing Standards, which require that an audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the financial statements. We have also assessed the accounting principles used, significant estimates made and the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accounting records and financial statements give a true and fair view of the financial position, the results of operations and the cash flows in accordance with the Swiss GAAP FER. We should, however, point out the particular features (explained in the notes to the accounts) of the accounting methods used by the Swiss National Bank as Switzerland's central bank and note-issuing institution.

We further confirm that the books of account and the annual financial statements as well as the proposals for the appropriation of the annual profit comply with the provisions of the National Bank Act and the Swiss Code of Obligations.

We recommend that the financial statements submitted to you be approved.

PricewaterhouseCoopers Ltd.

Peter Ochsner

Yvonne Staub

Zurich, 24 February 2006

Selected information

1 Chronicle of monetary events in 2005

On 25 February 2005, the Federal Department of Finance (FDF) and the Swiss National Bank (SNB) conclude an agreement on the distribution of the proceeds from the sale of 1,300 tonnes of gold. Under this agreement, the SNB distributes CHF 21.1 billion from its 2004 annual profit, with one-third going to the Confederation and two-thirds to the cantons (cf. p. 67).

February

On 17 March, at its quarterly assessment, the Governing Board leaves the target range for the three-month Libor unchanged at 0.25–1.25%. For the time being, the three-month Libor is to be kept in the middle of the target range at around 0.75% (cf. p. 30).

March

On 16 June, at its quarterly assessment, the Governing Board leaves the target range for the three-month Libor unchanged at 0.25–1.25%. For the time being, the three-month Libor is to be kept in the middle of the target range at around 0.75% (cf. p. 31).

June

On 15 September, at its quarterly assessment, the Governing Board leaves the target range for the three-month Libor unchanged at 0.25–1.25%. For the time being, the three-month Libor is to be kept in the middle of the target range at around 0.75% (cf. p. 32).

September

On 15 December, at its quarterly assessment, the Governing Board raises the target range for the three-month Libor to 0.50–1.50%. For the time being, the three-month Libor is to be kept in the middle of the target range (cf. p. 35).

December

On 16 December, the Council of States and the National Council pass a federal act on the use of the Confederation's share of the National Bank gold. Pursuant to this act, the Confederation's share of the proceeds from the sale of the National Bank's gold reserves no longer required for monetary policy are to be channelled into Old Age and Survivors' Insurance Fund (AHV/AVS), unless the Cosa initiative is approved in the national vote on the issue (cf. p. 68).

2 Supervisory and management bodies, Regional Economic Councils

(as at 1 January 2006)

Bank Council (2004–2008 term of office)

Hansueli Raggenbass, Kesswil, Attorney-at-law, President^{1, 2}

Ruth Lüthi, Fribourg, Member of the Cantonal Government and Head of the Health and Social Welfare Department of the Canton of Fribourg, Vice-President^{1, 2}

* Ueli Forster, St Gallen, Chairman of the Board of Directors at Forster Rohner Ltd¹

* Serge Gaillard, Bolligen, Executive Secretary of the Swiss Federation of Trade Unions⁴
Konrad Hummler, Teufen, Managing Partner of Wegelin & Co., Private Bankers⁴

* Armin Jans, Zug, Professor of Economics at the Zurich University of Applied Sciences,
Winterthur³

* Franz Marty, Goldau³

Marina Masoni, Lugano, Member of the Cantonal Government and Head of the Department
of Finance and Economic Affairs of the Canton of Ticino

Fritz Studer, Meggen³

* Alexandre Swoboda, Geneva, Professor at the Graduate Institute of
International Studies^{2, 4}

Eveline Widmer-Schlumpf, Felsberg, Member of the Cantonal Government and
Head of the Finance and Military Department of the Canton of Graubünden

* Elected by the General
Meeting of Shareholders

1 Member of the Compen-
sation Committee

2 Member of the Nomination
Committee

3 Member of the Audit
Committee

4 Member of the Risk
Committee

Hansueli Raggenbass	Further relevant affiliations of the Bank Council members
– Chairman of the Board at the Health Care Organisation SWICA, Winterthur, and associated companies	
– Member of the Board at Oerlikon Contraves, Zurich	
Ruth Lüthi	
– None	
Ueli Forster	
– Chairman of the Swiss Business Federation (economiesuisse)	
– Deputy Chairman and Lead Director of the Board at Helvetia Patria Group, St Gallen	
Serge Gaillard	
– None	
Konrad Hummler	
– Chairman of the Board at Telsonic Holding AG, Bronschhofen	
– Member of the Boards at Christian Fischbacher Co. AG and CF Holding AG, both in St Gallen	
– Member of the Board at Finansbank (Suisse) SA, Geneva	
– Member of the Board at Habib Bank AG, Zurich	
– Member of the Board at Neue Zürcher Zeitung AG, Zurich	
– Member of the Board at Private Client Bank, Zurich	
Armin Jans	
– Vice-President of Schweizerischer Mieterinnen- und Mieterverband Deutschschweiz (Association of Tenants in German-speaking Switzerland)	
– Member of the Bank Board at Zuger Kantonalbank, Zug	
Franz Marty	
– Chairman of the Board at the Swiss Union of Raiffeisen Banks, St Gallen	
Marina Masoni	
– Member of the Board at the Compensation Fund for the Old Age and Survivors' Insurance scheme (AHV/AVS), Geneva	
Fritz Studer	
– Member of the Board at Luzerner Kantonalbank, Lucerne	
– Chairman of the Board at Sarna Kunststoffholding AG, Sarnen	
Alexandre Swoboda	
– Member of the Board at LB InterFinanz AG, Zurich	
– Member of the Board at ABD Capital SA, Geneva	
Eveline Widmer-Schlumpf	
– None	
Ulrich W. Gilgen, Director	Internal Auditor
PricewaterhouseCoopers Ltd., Zurich	Audit Board (2005/2006 term of office)

Regional Economic Councils
(2004–2008 term of office)

Geneva

Charles Seydoux, Choulex, Director of DMB SA, Chairman

Raymond Léchaire, Bussigny, Director and Head of Sales Area Coop Romandie

Claude-Daniel Proellochs, Neuchâtel, General Manager and Chairman of the Board at Vacheron Constantin SA, Branch of Richemont International SA

Mittelland

Jean-François Rime, Bulle, National Councillor, Chairman of the Board at Despond SA, Chairman

Edgar Geiser, Brügg/BE, Senior Vice-President and Chief Financial Officer, Member of the Executive Board at Swatch Group Ltd

Oscar A. Kambly, Trubschachen, President of the Board at Kambly SA, Spécialités de Biscuits Suisses

André Haemmerli, La Chaux-de-Fonds, General Manager of Johnson & Johnson in the Canton of Neuchâtel

Northwestern Switzerland

Bruno Sidler, Binningen, President of the Executive Board and CEO of Panalpina Management Ltd, Chairman

Hans Büttiker, Dornach, CEO of EBM

Matthys Dolder, Bienne-Benken, CEO of Dolder AG

Gabriele Gabrielli, Möriken, Head of Sales Switzerland, ABB Switzerland

Eastern Switzerland

Charles Peter, Uzwil, CEO, President and Managing Director of Benninger AG, Chairman

Urs Kienberger, Sils-Maria, Director and Chairman of the Board at Hotel Waldhaus Sils

Christoph Leemann, St Gallen, Chairman of the Board and CEO of Union AG

Eliano Ramelli, Trogen, Partner and Member of the Board of Management at Abacus Research AG

Ticino

Franz Bernasconi, Genestrerio, President and General Manager of Precicast SA, Chairman

Olimpio Pini, Sorengo, Director of Pini & Associati, Ingegneri Consulenti SA

Giancarlo Bordoni, Viganello, Chairman of the Board at Oleificio Sabo SA

Vaud-Valais

Gérard Beytrison, Conthey, Delegate of the Board at Orgamol SA, Chairman

Bernard Rüeger, Féchy, General Manager of Rüeger SA

Jean-Jacques Miauton, Epalinges, CEO of Gétaz Romang Holding SA

Ruth Pedrazzetti-Weibel, Lucerne, Hotel Manager, Hotel Continental-Park, Chairwoman
Werner Steinegger, Schwyz, Chairman of the Board at Celfa AG

Xaver Sigrüst, Lucerne, President and CEO of Anliker AG Bauunternehmung

David Dean, Volketswil, CEO of Bossard Group

Central Switzerland

Reto H. Müller, Dietikon, Chairman of the Board and CEO of Helbling Holding SA,
Chairman

Hans R. Rüeegg, Rüti/ZH, Chairman of the Board and CEO of Baumann Springs Ltd

Milan Prenosil, Kilchberg, Chairman of the Board at Confiserie Sprüngli AG

Zurich

Governing Board	Jean-Pierre Roth, Chairman, Zurich
	Niklaus Blattner, Vice-Chairman, Berne
	Philipp M. Hildebrand, Member, Zurich
Enlarged Governing Board	Jean-Pierre Roth, Chairman
	Niklaus Blattner, Vice-Chairman
	Philipp M. Hildebrand
	Ulrich Kohli
	Thomas Wiedmer
	Thomas J. Jordan
Secretariat General	Peter Schöpf, Secretary General, Director, Zurich

Head of Department	Jean-Pierre Roth, Chairman of the Governing Board	Department I
Deputy Head	Ulrich Kohli, Alternate Member of the Governing Board, Chief Economist	
International Affairs	Ulrich Kohli, Alternate Member of the Governing Board, Chief Economist	
Economic Affairs	Michel Peytrignet, Director	
Legal and Administrative Affairs	Peter Klauser, Director	
Human Resources	Martin Hiller, Director	
Communications	Werner Abegg, Deputy Director	

Head of Department	Niklaus Blattner, Vice-Chairman of the Governing Board	Department II
Deputy Head	Thomas Wiedmer, Alternate Member of the Governing Board, Chief Financial Officer	
Finance and Controlling	Thomas Wiedmer, Alternate Member of the Governing Board, Chief Financial Officer	
Cash	Roland Tornare, Chief Cashier of the Bank, Director	
Financial Stability and Oversight	Daniel Heller, Director	

Head of Department	Philipp M. Hildebrand, Member of the Governing Board	Department III
Deputy Head	Thomas J. Jordan, Alternate Member of the Governing Board, Chief Investment Officer	
Financial Market Operations	Thomas J. Jordan, Alternate Member of the Governing Board, Chief Investment Officer	
Asset Management	Thomas Stucki, Director	
Investment Strategy and Risk Control	Dewet Moser, Director	
Banking Operations	Daniel Wettstein, Director	
Information Technology	Hans Peter Biland, Director	

Geneva	Marco Föllmi, Member of Management, Geneva	Delegates for regional economic relations
Mittelland	Anne Kleinewefers Lehner, Member of Management, Berne	
Northwestern Switzerland	Thomas Kübler, Member of Management, Basel	
Eastern Switzerland	Jean-Pierre Jetzer, Director, St Gallen	
Ticino	Mauro Picchi, Director, Lugano	
Vaud-Valais	François Ganière, Director, Lausanne	
Central Switzerland	Walter Näf, Member of Management, Lucerne	
Zurich	Margrit Hardegger Lennemann, Member of Management, Zurich	

3 Organisational chart

General Meeting of Shareholders			Audit Board	
Bank Council			Internal Auditors	
Governing Board			Secretariat General	
Enlarged Governing Board				
Department I Zurich			Department II Berne	
Human Resources	Communications	Regional Economic Relations	Management Support	Security
International Affairs	Economic Affairs	Legal and Administrative Affairs	Finance and Controlling	Cash
International Research and Technical Assistance	Research	Legal Services	Central Accounting	Administration
International Monetary Relations	Economic Analysis	Pension Fund	Controlling	Storage
	Statistics	Premises, Technical Services	Premises, Technical Services	Processing
	Library			Technical Services
				Cashier's Offices Berne, Geneva, Lugano, Zurich

Department III Zurich

Financial Stability and Oversight

Financial Stability

Financial Market Infrastructure

Financial Market Operations

Money Market and Foreign Exchange

Financial Market Analysis

Asset Management

Investment Strategy and Risk Control

Banking Operations

Payments

Back Office

Support

Information Technology

Banking Applications

Statistics Applications

Office Automation and Operations Applications

Technical Services

IT Operations Zurich

IT Operations Berne

4 Publications

Annual Report	<p>The <i>Annual Report</i> is published in April in German, French, Italian and English.</p> <p>Free of charge</p>
Reports on the balance of payments, the international investment position and direct investment	<p>The <i>Swiss Balance of Payments</i> provides comments on the development of the balance of payments and is published once a year as a supplement to the <i>Monthly Statistical Bulletin</i>.</p> <p>The report on Switzerland's international investment position provides comments on the development of foreign assets, foreign liabilities and Switzerland's net investment position. It is published once a year as a supplement to the December issue of the <i>Monthly Statistical Bulletin</i>.</p> <p>The report on direct investment provides comments on the development of Switzerland's direct investment abroad and foreign direct investment in Switzerland. It is published once a year as a supplement to the December issue of the <i>Monthly Statistical Bulletin</i>.</p> <p>The reports are available in German, French and English (English version only on the SNB website).</p> <p>Free of charge</p>
Swiss Financial Accounts	<p>The <i>Swiss Financial Accounts</i> show the volume and structure of financial assets and liabilities held by the different sectors of the domestic economy, as well as those held with respect to the rest of the world, and those held by the rest of the world with respect to Switzerland. It is published once a year (in autumn) in German, French and English, as a supplement to the <i>Monthly Statistical Bulletin</i>.</p> <p>Free of charge</p>
Financial Stability Report	<p>The <i>Financial Stability Report</i> provides an assessment of the stability of Switzerland's banking sector. It is published once a year in June. The publication is in English and contains summaries in German and French.</p> <p>Free of charge</p>
Quarterly Bulletin	<p>The <i>Quarterly Bulletin</i> includes the monetary policy report used for the quarterly assessment of the Governing Board. Furthermore, articles on topical central bank policy issues and abstracts of the SNB's Economic Studies and Working Papers are published. The <i>Quarterly Bulletin</i> also contains the speeches delivered at the General Meeting of Shareholders and the chronicle of monetary events. The <i>Quarterly Bulletin</i> is available in German, French and English (English version only on the SNB website).</p> <p>Subscription: CHF 25* per year (outside Switzerland CHF 30); for subscribers to the Monthly Statistical Bulletin: CHF 15* per year (outside Switzerland CHF 20)</p>

Economic articles are published at irregular intervals in the two series *Swiss National Bank Economic Studies* and *Swiss National Bank Working Papers*. They are available in one language only (German, French or English).

Free of charge

**Swiss National Bank
Economic Studies/
Swiss National Bank
Working Papers**

The *Monthly Statistical Bulletin* contains graphs and tables on key Swiss and international economic data (available in German and French; English version only on the SNB website). The *Monthly Bulletin of Banking Statistics* contains detailed banking statistics. The latest issue together with machine-readable data is available on the SNB website in German, French and English (under Publications, Monthly Bulletin of Banking Statistics). The printed version is published every quarter (German and French only; free of charge as a supplement to the *Monthly Statistical Bulletin*).

Subscription: CHF 40* per year (outside Switzerland CHF 80)

**Monthly Statistical
Bulletin/Monthly Bulletin
of Banking Statistics**

Banks in Switzerland, the statistical yearbook of the Swiss banks, provides commented source material on the development and structure of the Swiss banking sector. It is compiled mainly from data contained in the National Bank's year-end statistics. *Banks in Switzerland* is published in the middle of the year in German, French and English.

Price: CHF 20*

Banks in Switzerland

The publication *Money and monetary policy* provides an introduction to the financial world and monetary policy for teaching purposes. It has been published as part of the "Bildung und Wirtschaft" teaching aid series (no. 2000/1) by the "Jugend und Wirtschaft" association (available in German, French, Italian and English).

Free of charge

**Money and monetary
policy**

The National Bank is a brochure that outlines the importance of the Swiss National Bank for the economy and encourages readers to develop their own ideas about the Swiss economy. Published in German, French and Italian by the "Jugend und Wirtschaft" association (in the "Input" series, issue 5/2005), the brochure is accompanied by an e-lesson (www.jugend-wirtschaft.info).

Free of charge

The National Bank

The Swiss National Bank in brief, a brochure, describes in concise form (approximately 30 pages) the monetary policy concept, major tasks, and the organisation and legal basis of the National Bank's activity. The brochure is available in German, French, Italian and English.

Free of charge

**The Swiss National Bank
in brief**

<p>Information tools for schools and the interested public</p>	<p><i>What is money really about?</i>, a brochure, describes the activity of the National Bank in simple terms. It is an ideal teaching aid for intermediate and higher grades.</p> <p><i>The Swiss National Bank and that vital commodity: money</i>, a brochure, provides information on the National Bank and its tasks. It is suitable as a teaching aid for the higher grades and for vocational training and generally appeals to people interested in the National Bank.</p> <p><i>An 'A to Z' of the Swiss National Bank</i>, a glossary, explains important terms from the world of the National Bank and money.</p> <p>The contents of the above-mentioned brochures are briefly outlined on the SNB website: www.snb.ch, The world of the National Bank</p> <p><i>The National Bank and money</i>, a short film available on DVD or VHS, illustrates the characteristics of money.</p> <p><i>The National Bank and its monetary policy</i>, a short film available on DVD or VHS, illustrates how the National Bank conducts monetary policy on a daily basis and explains the principles of monetary policy.</p> <p>All these information tools are available in German, French, Italian and English.</p> <p>Free of charge</p>
<p>Obtainable from:</p>	<p>Swiss National Bank, Documentation, Bundesplatz 1, CH-3003 Berne Telephone +41 31 327 02 11, e-mail: library@snb.ch</p> <p>Swiss National Bank, Library, Fraumünsterstrasse 8, P.O. Box, CH-8022 Zurich Telephone +41 44 631 32 84, e-mail: library@snb.ch</p>
<p>*All prices include 2.4% VAT.</p>	<p>The printed publications are available on the SNB website: www.snb.ch, Publications</p>

5 Addresses

Berne		Head offices
Bundesplatz 1	Telephone +41 31 327 02 11	
CH-3003 Berne	Fax +41 31 327 02 21	
	Telex 911 310 snb ch	
Zurich		
Börsenstrasse 15	Telephone +41 44 631 31 11	
CH-8022 Zurich	Fax +41 44 631 39 11	
	Telex 812 400 snb ch	
Geneva		Branch offices
Rue François Diday 8	Telephone +41 22 818 57 11	with cash distribution
P.O. Box	Fax +41 22 818 57 62	services
CH-1211 Geneva 11		
Lugano		
Via Canova 12	Telephone +41 91 911 10 10	
P.O. Box	Fax +41 91 911 10 11	
CH-6901 Lugano		
Basel		Representative offices
Aeschenvorstadt 55	Telephone +41 61 270 80 80	
P.O. Box	Fax +41 61 270 80 87	
CH-4010 Basel		
Lausanne		
Rue de la Paix 6	Telephone +41 21 213 05 11	
P.O. Box	Fax +41 21 213 05 18	
CH-1002 Lausanne		
Lucerne		
Münzgasse 6	Telephone +41 41 227 20 40	
P.O. Box	Fax +41 41 227 20 49	
CH-6000 Lucerne 7		
St Gallen		
Neugasse 43	Telephone +41 71 227 25 11	
P.O. Box	Fax +41 71 227 25 19	
CH-9004 St Gallen		
The Swiss National Bank maintains agencies operated by cantonal banks in Altdorf, Appenzell, Basel, Bienne, Chur, Fribourg, Glarus, Liestal, Lucerne, Sarnen, Schaffhausen, Schwyz, Sion, Stans, Thun and Zug.		Agencies
www.snb.ch		Internet
snb@snb.ch		E-mail

6 Rounding conventions and abbreviations

Roundings	<p>The figures in the income statement, balance sheet and tables are rounded; the total may therefore deviate from the sum of individual items.</p> <p>The figures 0 and 0.0 are rounded values representing less than half of the unit used, yet greater than zero (rounded zero).</p> <p>A dash (-) in place of a number stands for zero (absolute zero).</p>
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Abbreviations	ARR	Swiss Accounting and Reporting Recommendations (Swiss GAAP FER)
	art.	Article
	AS	Official Compilation of Federal Laws and Decrees
	BIS	Bank for International Settlements
	CAD	Canadian dollar
	CHF	Swiss franc
	CPI	Consumer price index
	DKK	Danish krone
	EUR	Euro
	FC	Federal Constitution
	FDf	Federal Department of Finance
	Fed	US Federal Reserve
	G-10	Group of Ten
	GAAP	Generally Accepted Accounting Principles
	GBP	Pound sterling
	IMF	International Monetary Fund
	Libor	London Interbank Offered Rate
	NBA	National Bank Act
	NBO	National Bank Ordinance
	OECD	Organisation for Economic Cooperation and Development
	para.	Paragraph
	SDR	Special Drawing Rights
	seco	State Secretariat for Economic Affairs
	SFBC	Swiss Federal Banking Commission
	SFSO	Swiss Federal Statistical Office
	SIC	Swiss Interbank Clearing
	SNB	Swiss National Bank
	SR	Classified Compilation of the Federal Law
	USD	US dollar

Design

Weiersmüller Bosshard Grüniger WBG, Zurich

Composition and printing

Neidhart + Schön AG, Zurich

ISSN 1421-5497

