News Conference

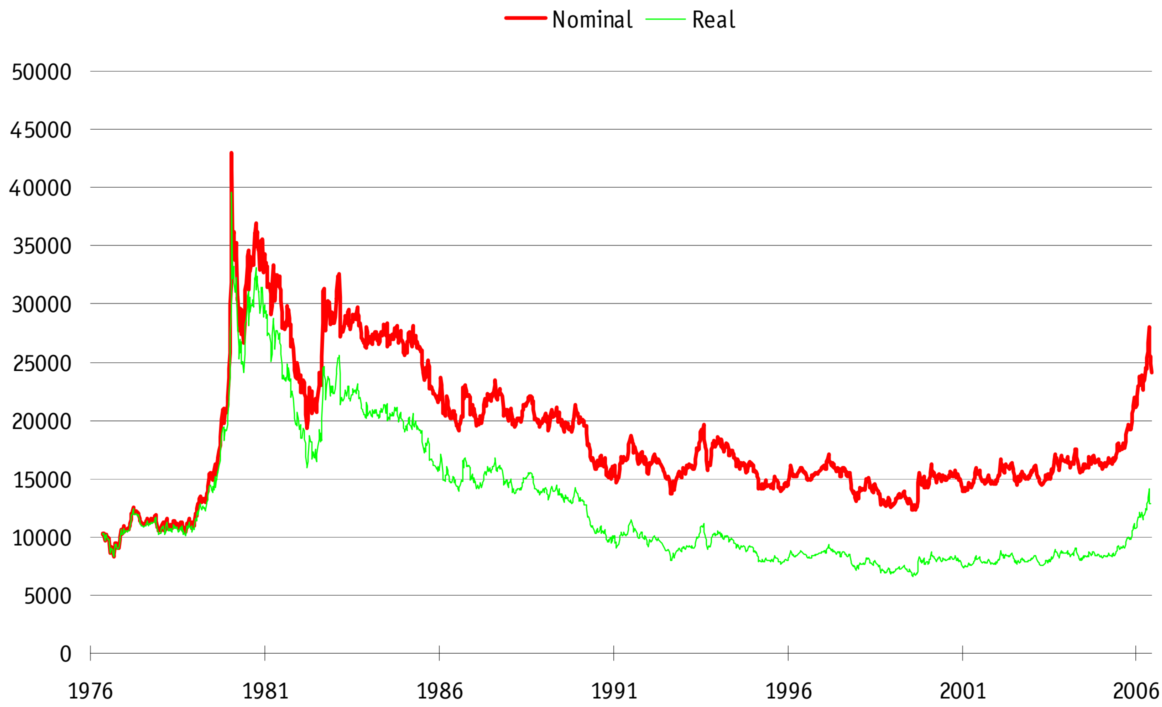
Geneva, 15. June 2006

Introductory remarks by Philipp Hildebrand

Price movements in the gold market

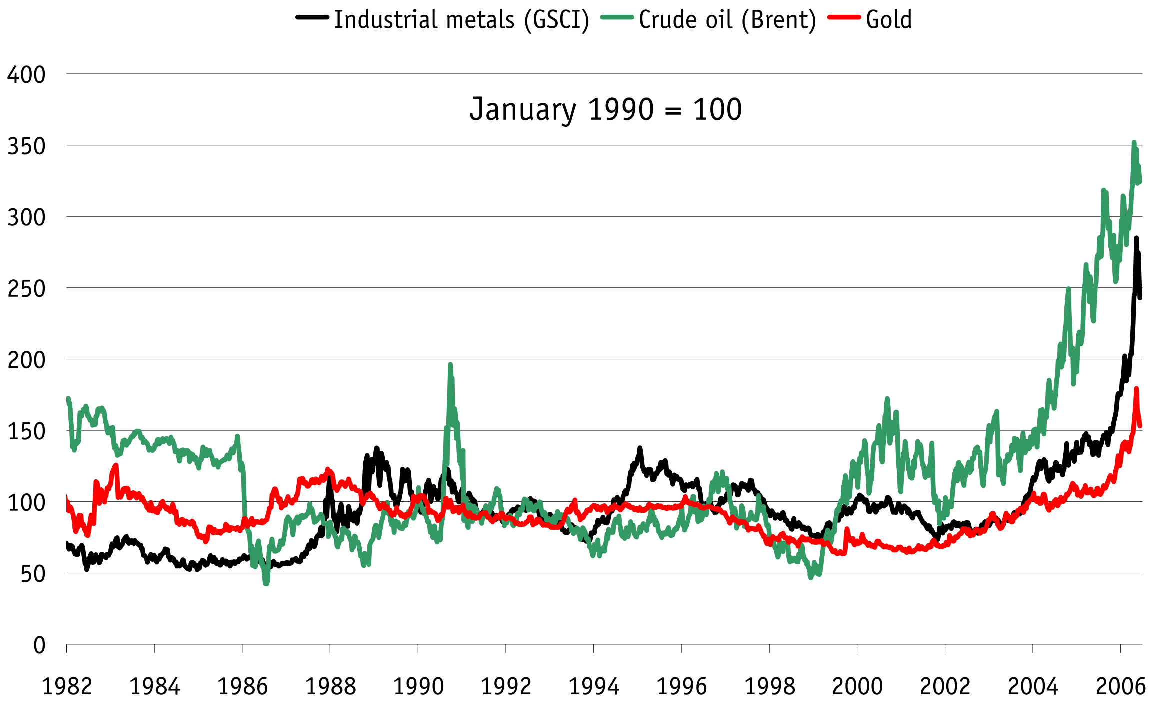
Recent developments in the gold market prompted me to give a brief retrospection and analysis of the specific characteristics of this market. At over CHF 40,000 a kilo, the value of gold in Swiss francs reached an all-time high in January 1980. It subsequently registered a steady downward trend until May 1999. Since then, the price has doubled again. In the last few quarters, it surged ahead, advancing by over 50% in the past 12 months alone – even with the latest correction taken into account. However, the current gold price in Swiss francs is well below its 1980 peak, both in real and nominal terms.

Graph 1: Gold price in Swiss francs, in nominal and real terms (1976 basis)



Other commodity markets have also witnessed a boom in recent years. The price of oil, for example (in US dollars) is seven times higher than in 1999, while prices of industrial metals have increased threefold in the last five years. A comparable parallelism between gold and other commodities already existed during the last gold price rally at the end of the 1970s.

Graph 2: Gold, metals and oil prices in USD



In spite of similarities, the gold market cannot be directly compared with other commodity markets. An important distinction is the fact that, in the case of gold, the available supplies compared with annual production are much higher than with other commodities. A large proportion of the estimated 160,000 tonnes of gold worldwide in the form of jewellery, bars, coins, etc. (sixty times the annual mine production) could be made available at little cost. In contrast to other commodities, pricing on the gold market is not only dependent on the current mine production and processing demand, it is also influenced to a great extent by the supply and demand behaviour of existing and potential owners of the yellow metal. Both supply and demand factors contributed to the gold rally of the last years.

On the supply side – as with other commodities – production capacity has hardly expanded for quite some time. At 2,500 tonnes per year, mine production has stagnated in the last few years. The procyclical impact on the hedging policy of gold mining companies was even more crucial for the price movements of gold than this stagnation in production. In the second half of the 1990s, these companies increasingly sold their future prodution on a forward basis. In so doing, they pushed up gold supplies by more than 10% per year, thus reinforcing the already negative price trend. As from 2001, mining companies increasingly abandoned this type of price hedging, which once again amounted to a de facto reduction in the supply of gold and contributed to the rising prices.

Of late, other sources of the gold supply have tended to have an anti-cyclical effect. Although gold sales of central banks increased somewhat, the agreement on gold sales concluded between 15 European central banks to limit gold sales – renewed in 2004 –

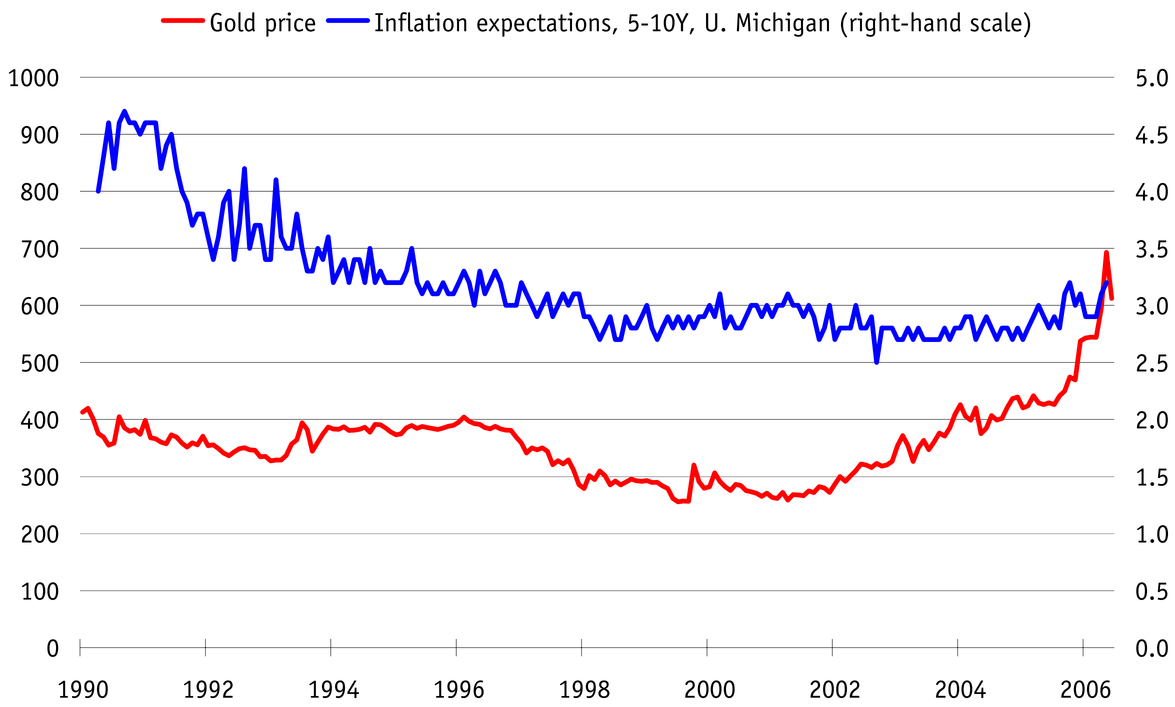
restricted possible additional supplies. As a result of higher prices, greater quantities of old gold came onto the market, however. Nevertheless, these quantities have probably not yet reached the levels recorded in 1998, when more than 1,000 tonnes of old gold flooded the market following the Asian crisis. In other words, total supplies hardly had any perceptible effect thus far, in spite of rising prices.

On the demand side, revived private demand for investment purposes is likely to have been the main driver for the latest increase in the price of gold. According to market specialists, this demand exceeded 700 tonnes in 2005. A new investment vehicle for gold, exchange-traded funds (ETFs), has become particularly popular because it gives investors the opportunity to make flexible and liquid investments in gold, even for small volumes. At the end of 2003, gold ETF investments accounted for less than 20 tonnes. Today, their share may well exceed 500 tonnes.

The reasons for the increased demand for gold for investment purposes are not clear-cut. Increasing prosperity in the emerging economies may be one factor. Gold is an important investment vehicle, especially in Asian countries. Another aspect having an impact may be investors' tendency to jump on the bandwagon. Such behaviour reinforces a trend, in particular in tight markets, such as the gold market.

There are hardly any signs that the strong demand for gold is the result of fears of a renewed worldwide rise in inflation rates. No signs of major inflation fears can be derived from specific indicators for inflation expectations, such as inflation-protected bonds and consumer surveys.

Graph 3: Gold price (USD) and inflation expectations (US)

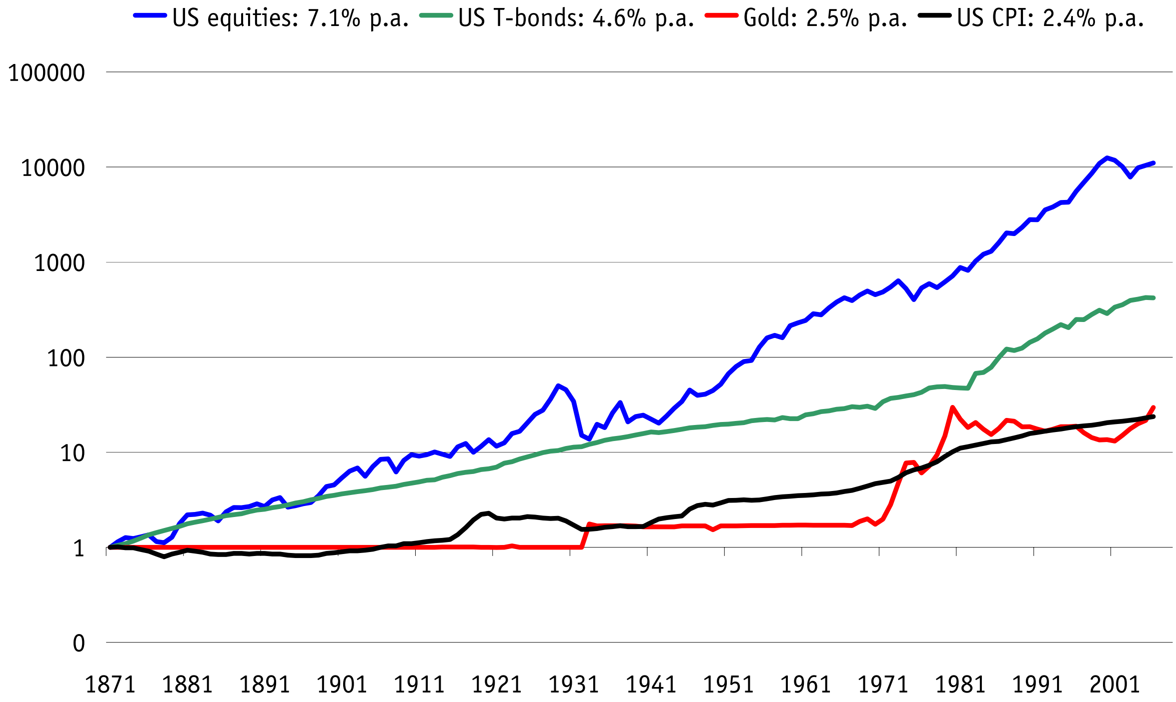


It is unlikely that the trend of the different factors determining the gold price can be predicted. Therefore, future movements in the gold price cannot be forecast with any degree of certainty. The only thing we know for sure is that price fluctuations in both directions are to be expected and may be strong and sustained.

Implications of gold on the National Bank's performance

As a central bank, gold has special significance for the SNB. Unlike currencies, the value of gold does not depend on a national sovereign. Moreover, payment transactions with gold are fully under the SNB's control. These are the reasons why gold, more than any other types of investments, serves to ensure the capacity to act in extreme crisis situations. It fulfils an important monetary policy function and forms an integral part of our currency reserves. From an investment viewpoint, the gold price often moves in exceptional circumstances in the opposite direction to financial assets, in particular to the US dollar. The price for this 'insurance function' is reflected in the fact that gold is less profitable in the long term than financial assets. The long-term performance of gold and of financial assets in the US is a good example of this phenomenon.

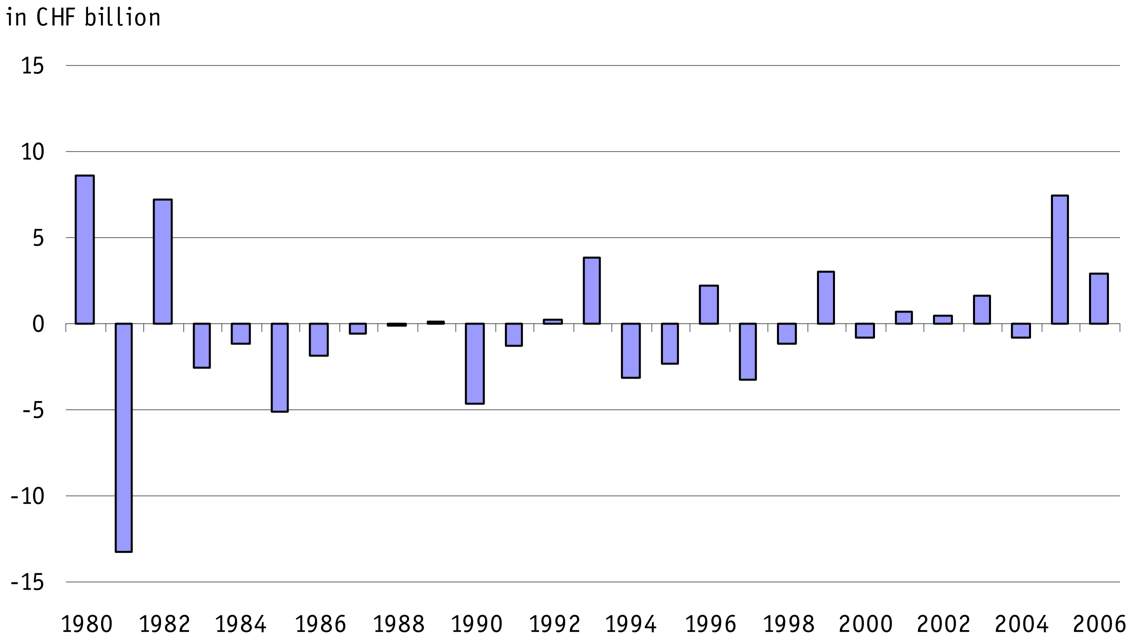
Graph 4: Cumulative returns on gold, bonds and equities in USD



The National Bank holds 1,290 tonnes of gold. The counter value of this quantity currently accounts for roughly 30% of the SNB's assets. Before gold sales started in 2000, the SNB's gold holdings amounted to 2,590 tonnes. Consequently, without the gold sales of the last few years, the proportion of gold in the balance sheet would be considerably higher. These sales of gold reserves no longer needed for monetary purposes were for strategic reasons. Moreover, forecasts of the future gold price are inevitably always fraught with considerable uncertainty.

Since the SNB holds a large part of its assets in gold, any sharp fluctuations in the gold price are clearly reflected in the SNB's balance sheet and income statement. To illustrate this point: Since 1980, the annual fluctuations in the price of gold expressed in Swiss francs have ranged between -31% and + 36%. Expressed in absolute terms and based on the current gold holdings of 1,290 tonnes, these price fluctuations would have corresponded to annual profits or losses to the tune of CHF +8 billion to CHF -13 billion.

Graph 5: Annual valuation changes of 1,290 tonnes of gold



In spite of these pronounced price movements, the Swiss franc gold price is once again at the same level as in 1984. Overall, therefore, the nominal gold yield over the past twenty years is zero. Experience has shown that extreme price movements in markets tend to level out again in the long term. Two central conclusions can be drawn with regard to the SNB's distribution policy and its income estimates.

- First, the SNB could only distribute significant valuation gains on gold in the short term, if it were prepared to sell gold or foreign exchange reserves in the same amount or – in other words – curtail its currency reserves. Should the price of gold subsequently fall or the foreign currency reserve experience a loss in value, there would be a risk of currency reserves shrinking below the level needed. By ensuring a steady flow of payments, as guaranteed under the current profit distribution agreement, such situations could at least be mitigated.
- Second, long-term income expectations should not be geared to unusual gains or losses in the past. Based on its calculations, the SNB continues to estimate a long-term potential return on its total assets at an average annual 2–3%.

In estimating the SNB's future income and distribution potential, it would therefore be unwise to be blinded by the price movements of the recent past. In addition, since gold and the US dollar in particular, are prone to fluctuations, this might result in painful losses on currency reserves.

As Chairman Roth has already explained with regard to the SNB's distribution potential, the people's initiative "National Bank profits for the Old Age and Survivors' Insurance Fund (AHV/AVS)", better known as the Cosa initiative, therefore rests on the assumption of unrealistic long-term profit expectations. Should these expectations not materialise, the SNB's investment and distribution policy could come under political pressure. The goal of price stability could come into conflict with the demand to generate the highest possible return on assets. The SNB's independence would thus be undermined and its credibility compromised. Given this situation, the National Bank's task to conduct a stability-oriented monetary policy would be more difficult.