

President's address by Hansueli Raggenbass,
President of the Bank Council,
at the General Meeting of Shareholders of the
Swiss National Bank on 28 April 2006

Dear Shareholders

Dear Guests

Ladies and Gentlemen

I will begin my address today with a look at the 2005 financial statements, before moving on to say a few words about the operating costs of the Swiss National Bank.

Please allow me now to make a few remarks on the financial statements for 2005.

2005 Financial Report

Introduction

At CHF 12.8 billion, the annual result for 2005 was unusually high. This was mainly due to valuation gains on gold and on assets denominated in US dollars. However, the impressive result in no way reflects the long-term earnings potential of the Swiss National Bank.

Gross income

Last year, the SNB's gross income was CHF 13.1 billion. Of this, valuation gains on gold alone – whose price rose by more than one-third during the course of the year – accounted for CHF 7.4 billion.

Almost half of SNB assets are invested in foreign currencies, and consist essentially of fixed-interest securities. Since the beginning of 2005, the National Bank has also placed a small amount of assets in foreign shares, in the interests of greater diversification and a better risk/return profile.

Earnings from foreign currency investments totalled CHF 5.3 billion, just under half of which came from exchange rate gains. A 17% appreciation in the US dollar contributed the largest share, although the other investment currencies also generated exchange rate gains. Some CHF 2.1 billion was attributable to interest and capital gains. The equity portfolio built up in 2005 performed well. Investments in foreign shares are managed pas-

sively by replicating broad-based indices. At the end of the year, this category accounted for 10% of foreign currency investments. Because of the good performance of stock markets, it generated total income of CHF 0.7 billion.

Total income earned on Swiss franc assets amounted to CHF 0.3 billion, which was comparable to the previous year's figure. While earnings on Swiss franc securities declined, higher interest rates in the money market boosted revenues from repo transactions.

Earnings down after exclusion of valuation gains

Once again, last year's results demonstrated the strong dependence of the SNB's financial results on fluctuations in exchange rates and the price of gold. Of an overall result amounting to CHF 12.8 billion, CHF 9.9 billion was attributable to changes in valuation (CHF 7.4 billion for gold and CHF 2.5 billion for exchange rates). In the longer term, however, it is not these extreme fluctuations in valuation gains and losses that are the determinants of earnings potential. What is important is the level of those assets that can generate earnings, plus current earnings on these assets. Looking back at the results of the past years we note that, if we exclude income from valuation changes, the earnings trend has been downwards. There are two reasons for this. First, the drop in interest rates has resulted in lower current earnings. Second, the stock of interest-bearing investments has fallen because of the distribution of the proceeds from gold sales and the reduction in the distribution reserve. The figures for the last few business years make this clear. In the past five years, current investment income has fallen from over CHF 3 billion to CHF 2.4 billion in 2005.

All in all, we note that unusually high book profits were recorded in the 2005 business year, resulting in an inflated annual result. This was attributable in particular to surge in the gold price and the appreciation of the US dollar. If these two factors are excluded, we see that income figures were anything but spectacular and that the average return on assets was in line with the long-term expectations of a 2–3% return.

Profit distribution to Confederation, cantons and shareholders unchanged

Following the statutory allocation to provisions for currency reserves, distributable profit amounted to CHF 12.0 billion. According to the agreement between the Swiss Federal Department of Finance and the SNB, CHF 2.5 billion is to be distributed to the Confedera-

tion and cantons for the 2005 business year. The shareholders will receive the customary 6% of profit, which is the statutory maximum.

The remaining CHF 9.5 billion will be allocated to the distribution reserve. This will make it possible to smooth out earnings fluctuations and secure a steady flow of distributed profits. Just as 2005 saw an unusually favourable result, substantial losses could be recorded in future years due to the volatility of earnings. I would like to take this opportunity of reminding you that a total of CHF 6.4 billion had to be withdrawn from the distribution reserve in the previous four years in order to carry out the agreed distribution of profit.

Based on the current position, the SNB estimates its long-term distribution potential at about CHF 1 billion. The annual distribution of CHF 2.5 billion which has been agreed for the medium-term is considerably higher than this figure. Consequently, the distribution reserve is likely to shrink over the course of the next few years, in line with the SNB's intentions.

Operating costs at the SNB

I will now make a few remarks on the SNB's operating costs.

Background

The National Bank has its own public mandate, and this distinguishes it from private companies or the public administration in a number of respects. As the "banker's bank", it has a monopoly position and is not, in principle, subject to the laws of the market. The SNB's core mandate is to conduct monetary policy, and this shapes its operating procedures and activities. Moreover, the SNB's note-issuing monopoly and its key position in the system of cashless payment transactions necessitate a high level of security. This places particular demands on operational management, with the need for continual consideration of the competing claims of cost-efficiency and fulfilment of the bank's mandate. Nevertheless, in the past few years SNB management has directed increased attention to the goal of improved cost-management.

Consequently, three years ago, the Governing Board decided to introduce an integrated planning and budgeting process which links the strategic elements based on the statutory mandate, on the one hand, to project and staff planning as well as budgeting, on the other. Detailed annual budgets ensure transparency and promote the responsible use of resources at all levels of management.

Operating expenses in 2005

The SNB attaches great importance to keeping a check on its operating expenses. Consequently, the ordinary part of operating expenses experienced only moderate growth last year. The constant efforts to keep costs under control have had a beneficial effect. Operating expenses in 2005 totalled CHF 272 million, or CHF 59 million above the previous year's figure. This is due to two special factors.

The first factor was the posting of an impairment loss on real estate (unscheduled depreciation) of some CHF 49 million. An external estimate of the recoverable value of SNB real estate conducted last year revealed that the comprehensive renovation measures of the past few years are only partially reflected in the market value of the properties. Consequently, a large part of the investment in security technology required by the SNB is not covered by the current market value. Moreover, some of the National Bank properties are historical buildings, and this makes renewal and renovation work more expensive. The regulations on financial reporting specify that an appropriate write-down should be made.

Second, operating expenses were also strongly affected by expenditure on planned restructuring measures in the cash area. These measures represent the SNB's reaction to changed market conditions in the supply and distribution of cash. The most important business partners for cash transaction activities are increasingly shifting transport, storage and processing of bank notes and coins to third parties. For this reason, the Lugano branch is to be closed at the end of 2006. The associated financial arrangements contributed an additional amount of approximately CHF 5 million to personnel expenses in 2005.

If these factors are excluded, the increase in total operating expenses amounted to only about 2%.

Operating expenses over the past five years

In the past five years, operating expenses at the SNB have risen by about 15% in nominal terms. At first glance, this might not appear particularly restrained. A closer look, however, reveals that these increases were due essentially to higher depreciation and developments in personnel expenses.

The higher figure for depreciation is in part attributable to the growing use of information technology in everyday SNB operations. In order to fulfil its mandate, the bank requires information systems of increasing complexity, and the automation of operating processes is taking on greater importance.

Personnel costs have also contributed to the mounting operating expenses over the past five years. This is due, in the first place, to the payment of appropriate salaries that maintain the SNB's position as an attractive employer. The second reason is an increasing shift in emphasis from activities focusing more on operations and implementation to fields of work that are geared to research and knowledge-based activities. As a result, the bank is employing better qualified staff with higher salaries. While 25 years ago, only one in eight employees were university graduates, the current level is almost one in three.

International comparison

A comparison of the SNB's operating costs with those of other central banks reflects well on the Swiss institution. Although it is still hard to find official statistics with reliable figures, more attention is now being paid to the cost efficiency of central banks. Personnel constitute the bulk of costs faced by most of these banks, as confirmed in a study of operating expenses at European central banks which was published recently by Central Banking magazine. At the banks investigated for the study, personnel expenses accounted for an average 60% of total operating expenses. Despite the diversity of functions performed by the different central banks, cost comparisons are often based on key figures relating to personnel. A standard comparison is to express the number of employees as a proportion of the total population of the individual countries. With the aid of this key figure, rough comparisons can be made between institutions and it is also possible to trace changes over time at an individual bank.

Based on population statistics, an internal evaluation of annual reports published by European central banks for the year 2004 showed that the Swiss National Bank has one of the lowest levels of staff of all central banks in Europe. At about 83 employees per million inhabitants, the Swiss National Bank is considerably below the average of some 155 for all of the institutions investigated. However, these figures should be treated with care since the individual institutions have varying functions as well as very differing structures.

Over time too, the SNB's figures have remained steady. The relevant figure was already 84 employees per million inhabitants in 1990. Thus, in relative terms, the number of SNB employees is unchanged. Although caution should be exercised in interpreting these figures, they still show that the SNB's operating resources are not unreasonably high, and – as compared to other central banks – are perfectly justifiable. Even without such international comparisons, the SNB will continue to use the resources at its disposal both sensibly and carefully.

Concluding remarks

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