FUNCTIONING OF THE SLOVAK FINANCIAL MARKET

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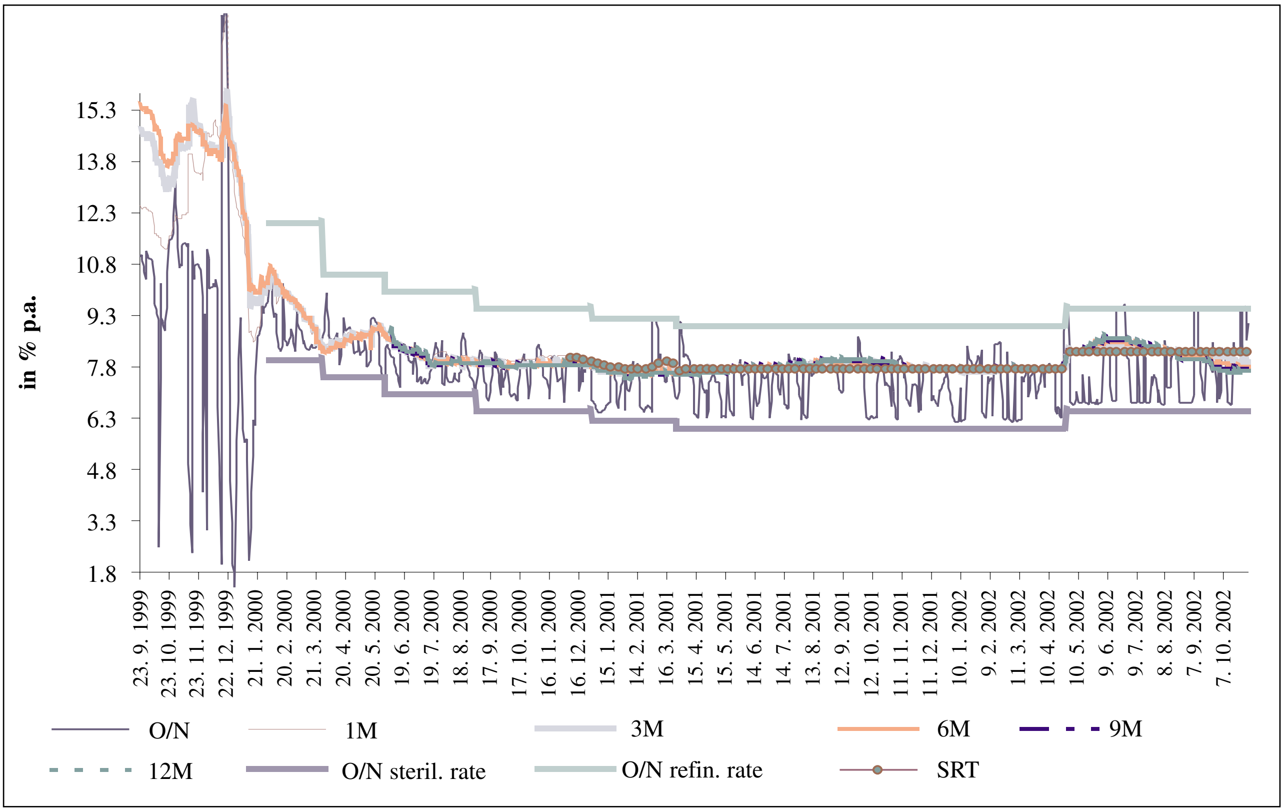
If we were to describe the current situation of the domestic financial market, we could, and even with some satisfaction, use the expression stable and functioning for its short-term segment – the money market. Let us attempt, however, to evaluate, though only in words, some of its parameters.

Part of the financial market – the money market - serves the central bank in mediating information for other financial fields. Following the creation of a system of interest rates of the National Bank of Slovakia at the start of the year 2000 it has been possible to influence to a greater extent the level of the interest rate of the domestic financial market via interest rate stimuli on the basis of sterilisation, or re-financing lines, which limit the room for the market interest rate level to vary. It is not perhaps correct to overrate the value of this price information, but it is indisputable that following the system's introduction there has to date been achieved unprecedented stability and transparency, and at least for the time being, except for several very exceptional and particular daily movements, when the market interest rate exceeded the daily refinancing interest rate of the central bank, there have not occurred any systemic disturbances. As is shown very clearly in graph 1, since February 2000 there has been an apparently higher order of stability in the money market measured by its price parameters. Since May 2000 there may be noted a steadying in all maturities, where the financial market reacted promptly to changes in the National Bank of Slovakia's interest rates. We consider the significant movements of overnight money to be a natural reaction to the overnight position of the banking sector, which is influenced by a range of factors, for example tax dates, the structure of the banking sector or particular situations, which in the conditions of the Slovak economy are for the time being still connected in particular with privatisation. In connection with mention has been made over the past years of a destabilising influence of foreign financial investors, but for a definitive conclusion there is an insufficient quantity of wholly convincing findings.

Looking more closely it is appropriate to mention

Graph 1: Development of interest rates on the money market

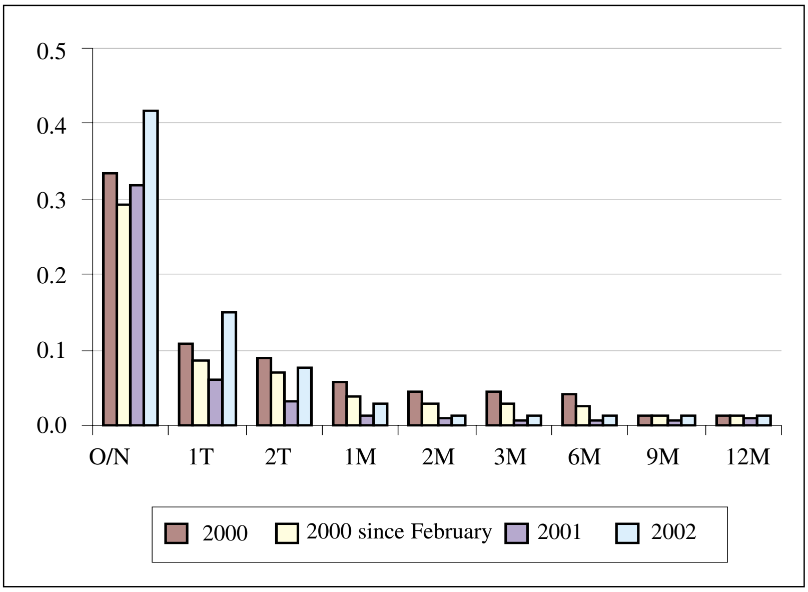


also the volatility of individual maturities, measured by an arithmetic average of day-to-day changes. The significant decline in this figure since February 2000 is quite natural, including the subsequent stabilisation in 2001, when the system underwent a definitive practical testing. The year 2002 is however questionable, when in all, even in the shortest maturities – and there most of all – its increase is demonstrable. There are numerous explanations, as usual connected with political and economic risks. It will be interesting to monitor the continuing development up until the end of this year and in the subsequent periods.

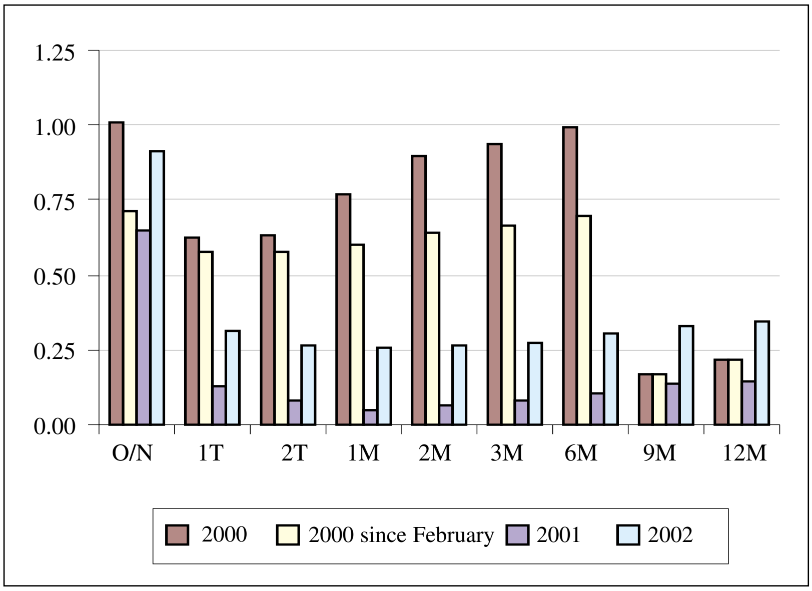
A similar development can be seen also via the variability of interest rates, which have been confirmed by previous findings. In the framework of individual years traded 9- and 12 month money have rarely had the most stable development. Moreover, the year 2002 has pointed to interestingly steady deviations in the case of all maturities, with the exception of the shortest.

The average daily turnover on the money market between domestic banks for the first 10 months of this year reached SKK 25.4 billion. Trading in the shortest maturities remains a typical feature, where an essential part of the trades are still conducted at the level of overnight and 1-week money. We estimate that this very short sector forms approximately 90% of the interbank money market. 6- and more month trades are still sporadic and rather occasional, which significantly casts doubt upon their use in price indications. An interesting question is why the shortest part of this market has for so long held the dominant position, what causes such behaviour and indeed whether this is justified.

Graph 2: Volatity of BRIBOR rates 2000 – 2002

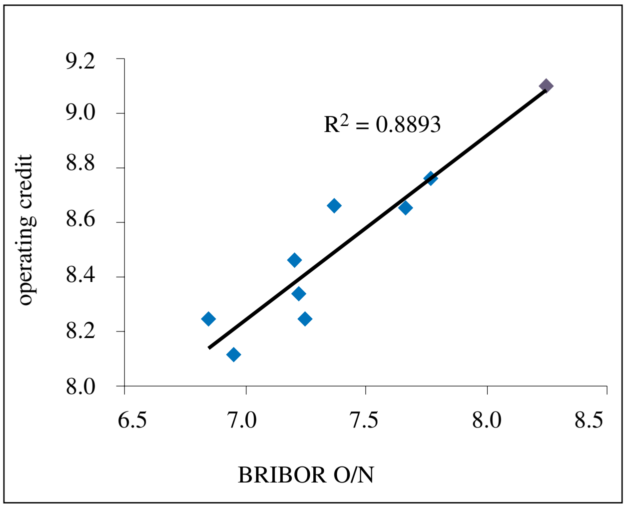


Graph 3: Variability of BRIBOR rates 2000 – 2002

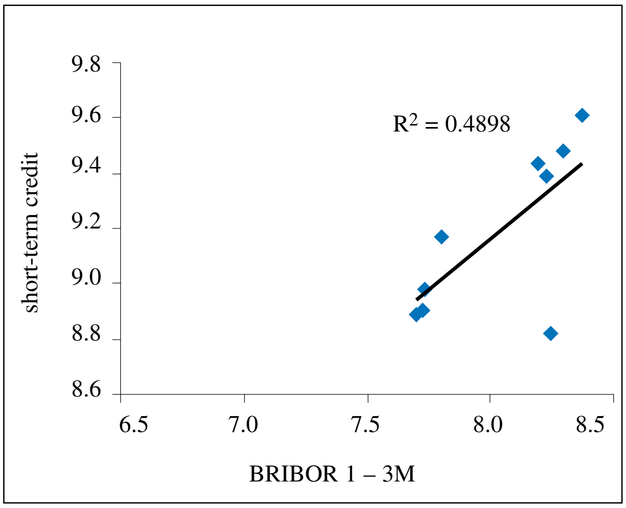


One of the significant, if not fundamental, goals of applying an interest rate mechanism founded on the basis of the central bank declaring interest rates was to strengthen transmission-price information to subsequent market segments. Already from empirical observations there results a stability in the relationship between the operations of the National Bank of Slovakia and prices connected with these and the development of 2-week as well as 1-month money. The 2-week connection may be considered as trivial, since this results from maturities of the main free-market instrument, 2-week repo tenders. As far as this concerns the link to 1-month money, we can speak of a desirable and natural interconnection, which as we assume is now a manifestation of the systemic changes introduced. There remains partly unanswered the question of how the transmission mechanism functions in the framework of individual markets and mutually between them. For illustration we present the regression findings of the relation between the most sensitive market interest rate of the interbank money market, namely overnight money and for working purposes the determined reference category of short-term credit, as well as an equal relation to 1- and 3-month BRIBOR. We have selected this basic pair for the reason that - as we will state in the next text – among credit actually

Graph 4: Relation between short-term operating credit and BRIBOR O/N



Graph 5: Relation between short-term credit and BRIBOR 1 – 3-M



drawn in 2002 short term credit is clearly the most significant. We also concurrently expect (although if perhaps wrongly and prematurely), that the functional, at minimum 3-month segment of the money market should be characteristic for the market, say for at least, of a promisingly developing economy and its individual instruments. From graphs 4 and 5, even though these are not fully comparable, it rather results that Slovakia is probably at the beginning of the money curve and is only slowly approaching the middle.

An interesting fact is the differentiation, or relation of individual actively lending banks on the market of interbank deposits and/or primary sources. As far as this concerns sources for credit trades, at minimum two groups of banks may be discerned. The first uses for its activities primarily sources purchased on the domestic market and the second group significantly, even if not completely, clearly gives priority to obtaining resources from primary depositors. In 2002 it has for the time being held true the fact that their mutual proportion is rather balanced and is individual depending on internally adopted procedures. This situation could be seen also in 2001, whereas a year earlier the relation shown between credit drawn and the interbank money market had manifested more strongly. As regards the money market and in the end also the market for bank deposits, again short money has dominated. As regards the link between price sources and credit products, the slight differentiation between the two most significant categories, which in this case are overnight and 1-week money, is worth mentioning. A different more system-intensive relation has not yet been confirmed.

Here we feel it important to mention in particular the fact that a large part of effective credit drawn, after taking account of the transfer from Konsolidačná banka to Slovenská konsolidačná, a.s., is formed, similarly as in other years, by short-term credit. This represents more than 80% of total credit drawn. In the framework of this principal group only two banks provided up to two-thirds of credit drawn, prevailingly to enterprises with foreign control. This overview of lending is not complete, because it does not touch upon financing from foreign sources, for example in the form of financing loans and credit from parent companies, but certainly has some meaning.

Of the 21 banks only 7 of those relevant had recorded as at the end of September this year more than a 50% share of loans in revenue assets. The minimum value was 16.6% and the maximum 75.0%, and the median stood at only 39.6%. In comparison the share of loans in total assets of the banking sector was 33.7%. What then does the significant part of the remaining bank assets comprise? These are mainly government securities and trades with the central bank. As at the end of September banks had invested more than SKK 204.0 billion in government securities and in trades with the central bank had placed almost SKK 118.0 billion, which is approximately 19% and 11% of total bank assets respectively.

The aim of this article has been to draw attention to the selected facts and findings from the functioning of the Slovak financial market, possibly to bring about a discussion on this topic. Despite the fact that from the aspect of activities the banking system is far from complete and many times the issue is defined only in aggregate terms, it can contain an important view not only on its own functioning. Let everyone make their own usual summary, unless they have already done so. It seems, however, that in its functionality, as has been manifested for several years now, there may be found something which may in some way be fashionably termed a challenge.