

## 2. MONETARY DEVELOPMENTS AND MONETARY POLICY

### 2.1 Monetary Developments

The macro-economic environment in 1993 was marked by the establishment of an independent republic, a monetary union with the CR and its discontinuation, a deceleration of the process of transition to a market economy, tax reform, and a high state budget deficit. These specific factors gave rise to a host of formidable conditions and required the National Bank of Slovakia to bolster its monetary policy during the first year of the Bank's independent activities. Notwithstanding these conditions, the basic objectives of the monetary policy were still achieved. With a moderate increase in domestic prices and with the internal convertibility of the Slovak crown maintained, the monetary policy was one of the key factors that preserved the macro-economic stability of Slovakia.

#### Inflation

The price development in the SR in 1993 was marked by several factors including tax reform, the introduction of new health and social insurance, the devaluation of the currency, the modification of certain tax rates, changes in some regulated prices, tariffs, fees, etc. The effects of these developments were felt in all price areas and differentiated their development over time.

In 1993, the level of consumer prices increased by 25.1%. The highest increase (that of 11.8%) was reported in the first quarter and was associated mainly with the introduction of the new tax system and partially with the dissolution of the CSFR and the subsequent split of the currency. Development in the following quarters was mainly affected by the devaluation, changes in the value added tax (VAT), and developments in agriculture. Other factors influencing the increase in consumer prices were governmental administrative measures associated with changes in the rates of transportation and telecommunication tariffs, fees, commissions, and insurance premiums.

The course of inflation in 1993 was paralleled almost exactly by the price increases in all basic areas while in individual time periods the rates in these areas were different. This is documented by the following review:

	1993	Q1	Q2	Q3	Q4
Consumer prices in total	125.1	111.8	102.2	106.1	103.2
of which:					
- food	122.0	109.1	99.0	109.7	103.0
- industrial goods	124.4	110.1	103.4	105.4	103.7
- public catering	135.6	123.7	100.9	105.1	103.4
- services	125.4	114.6	104.9	102.5	101.8

The reasons for this development stem from the varying VAT rates charged on individual products, consumer taxes, differentiated VAT rates on imports, and the seasonal effects of agricultural production.

For goods, the prices of which rose by 22% in 1993, the highest increase (that of 31.1%) was recorded in the area of flour, bakery, and pastry products, the prices of meat and meat products rose by 22.4%, while alcoholic beverages recorded a growth in price by 27.9%. The lowest increase (that of 9.6%) was reported in fats. Prices of milk and dairy products increased by 19.6%.

The general price level of industrial goods increased by 24.4%. The most rapid price increases were recorded in fuels (49.3%), tobacco products (47.6%), and household appliances (34%); the lowest increases were reported in the prices of household supplies, construction equipment, and textile products. The former grew by 18.7% and the latter by 16.1%. The prices of shoes increased by 28.4%.

The prices of services increased the most in transportation and telecommunications, i.e. by 30.5%, while administrative fees and insurance premiums rose by 29.5%.

Industrial producer prices in 1993 were affected by the same factors as consumer prices. However, the rate of increase was significantly lower, and this led to a notable disparity in these two categories of prices. The difference between the increase of consumer prices and producer prices in 1993 was approximately 6 percentage points (in 1992 it was roughly 3.5 points). This greater divergence precipitated the increase in consumer prices. Producer prices increased by almost 19% in 1993. A breakdown of producer prices for the year 1993:

Year 1993	Q1	Q2	Q3	Q4
118.9	112.5	99.8	103.8	102.0

Compared with the previous year, the highest (that of 70.3%) price increase was reported in crude oil processing; the textile industry recorded an increase of 50.6%; the costs of food production grew by 26%; the costs of tobacco processing rose by 21.3%, and those of wood products by 20.3%.

Prices of construction work rose by 23.6%, while those of building materials increased by 13.6%. The price level of agricultural products increased by 14.6%, of which plant products grew by 21.1%, animal products by 10.6%, and vegetables by 7.8%.

## Money Supply

In 1993, the money supply expressed by the monetary aggregate M2 increased by Sk 38.8 billion (i.e. 18.1%), reaching Sk 253.2 billion at the end of the year.

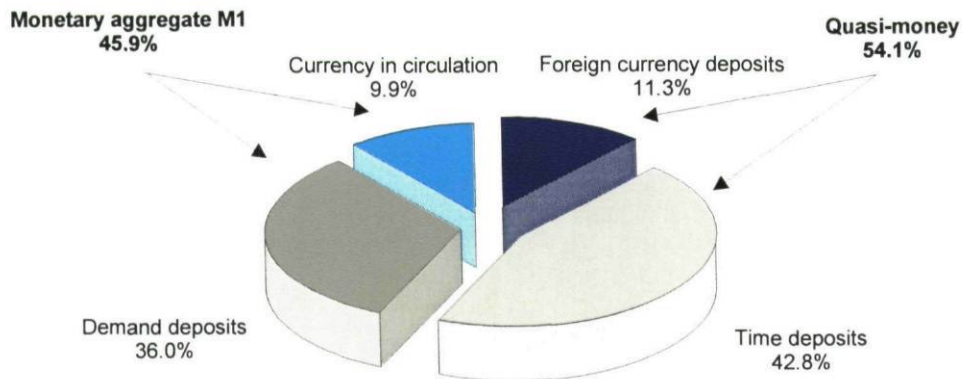
Increases were reported in both constituent components of the money supply. The monetary aggregate M1 (including currency and demand deposits) reached Sk 116.3 billion, representing an increase of 7.6%. Quasi-money consisting of time deposits in crowns and foreign currency increased by 28.8%, reaching Sk 136.9 billion by the end of the year.

Over the course of the year, the development of the money supply was affected by extraordinary events associated mainly with the split of the currency which caused a change in both the structure of the money supply and its development over time.

The change in the structure of money supply was primarily associated with a significant drop in the currency share of the overall money supply from 14.4% at the beginning of the year to 9.9% at the end of the year. With a relatively stabilized share of demand deposits, this decrease meant a drop in the share of the monetary aggregate M1 by 4.5 points.

Quasi-money constituted a majority share (54.1%) of the monetary aggregate M2. This development was mainly due to a significant increase in foreign currency deposits, which rose from 6.3% to 11.3% of the total volume of M2.

**Structure of M2 as at 31 December 1993**



Structure of M2 as at 31 December 1993	(Sk billions)
Money supply M2	253.2
Monetary aggregate M1	116.3
- currency in circulation	25.1
- demand deposits	91.2
Quasi-money	136.9
- time deposits	108.4
- foreign currency deposits	28.5

The effects of the currency split were most evident in the first quarter, when the money supply dropped by 3.3%, mostly as a result of the drop in the volume of currency. In the following two quarters, the growth rate settled at 4.0%. An unwelcomed 13.0% increase in the monetary aggregate M2 took place in the fourth quarter. In December, in terms of absolute figures, M2 increased by Sk 21.5 billion, as a result of the interest posted to deposits and the higher state budget expenditure for the real economy, which created redundant liquidity in the economy at the end of the year.

Within the monetary aggregate M1, the level of currency in circulation outside banks reached Sk 25.1 billion at the end of the year, and was Sk 5.8 billion lower than at the beginning of the year, given the ratio 2:1 used by the administrative division of federal currency. The sharp decline in currency by approximately Sk 13.0 billion in the first two months of the year was a result of the amount of replaceable banknotes and the mass depositing of the rest of the money to be replaced in bank accounts. In the following months, the volume of currency increased as expected with the exception of the month of October, when a drop was reported because of the withdrawal of the Sk 1,000 notes from circulation. However, the currency did not regain the initial balance recorded at the beginning of the year.

The extension of the bank network brought about a greater need for currency in banks and decreased the amount of currency in circulation outside banks. At the end of the year, the overall level reached approximately 9% of the volume of issued currency. Other currency (approximately 3%) was comprised of cash held by post offices and the rest consisted of the cash possessed by households and enterprises.

From the point of view of individual components of the overall money supply, the household sector had the highest share of the money aggregate M2 throughout the

year. This share continued to increase during the year and reached 54.3% at the end of the year. At the same time, the share of the money supply M2 in the business sector increased from 27% to 30%.

In comparison with the overall earnings of households, the rate of savings for the same group, expressed as purchasing power deposited in the form of cash in crown savings accounts, increased from 3.3% to 3.5%, compared with the previous year. This development was mainly due to the fact that the increase in household deposits exceeded the considerable drop in the amount of retained money caused by the currency split.

Comparing the growth of individual components of the monetary aggregate M2 with that recorded at the beginning of the year, a high rate was achieved in corporate time deposits (136.0%), and in foreign currency deposits held by households (residents) (117.1%).

Of all the factors that affected the inflow of capital into the economy, the increase in the net credit to the government was the most decisive independent factor in generating money within the economy and supplying a primary source of capital inflow. Similar contribution to money supply was made by domestic credits, which were directed mostly to the corporate sector.

The other factors influencing the inflow of money into the economy (e.g. the change in the net foreign position and the increase of domestic credit in foreign currency) played a less important role in creation of the money aggregate M2.

## Development of Deposits and Credits

The level of primary crown deposits and foreign currency deposits held by non-bank entities reached Sk 238.7 billion, representing an increase of Sk 36.3 billion (17.9%). An evaluation of the structure of the total volume of deposits during the period in review reveals the following changes (in billions of Sk):

	1.1.1993	31.12.1993	Changes	Index 1993/92
<b>Total volume of crown and foreign currency deposits <sup>1/</sup></b>	202.4	238.7	36.3	117.9
of which: - <b>crown deposits</b>	188.6	208.9	20.3	110.8
of which: - inhabitants	99.4	113.4	14.0	114.1
- public sector	37.2	42.6	5.4	114.5
- private sector	26.6	35.4	8.8	133.1
- government sector <sup>2/</sup>	18.5	9.3	-9.2	50.3
of which NPF <sup>3/</sup> deposits	11.5	5.2	-6.3	45.2
- other	6.9	8.2	1.3	118.8
- <b>foreign currency deposits</b>	13.8	29.8	16.0	215.9
of which: - legal entities	2.8	5.0	2.2	178.6
- private persons	11.0	24.8	13.8	225.5

<sup>1/</sup> Crown (Sk) and foreign currency deposits held by residents and non-residents, i.e. Slovak and foreign legal entities and individuals

<sup>2/</sup> Extra-budgetary deposits of the central and local bodies

<sup>3/</sup> NPF - National Property Fund

Compared with the initial figure, the volume of primary crown deposits (excluding the NPF deposits), increased by Sk 26.6 billion (15,0%), and totalled Sk 203.7 billion. Their share of the total volume deposits, however, dropped by 2.2 percentage points to 85.2%.

With a 215.9% growth index, foreign currency deposits were significantly higher at the end of the year; moreover, as a percentage of the total volume of deposits, the aforementioned deposits increased from 6.8% at the beginning of the year to 12.5%.

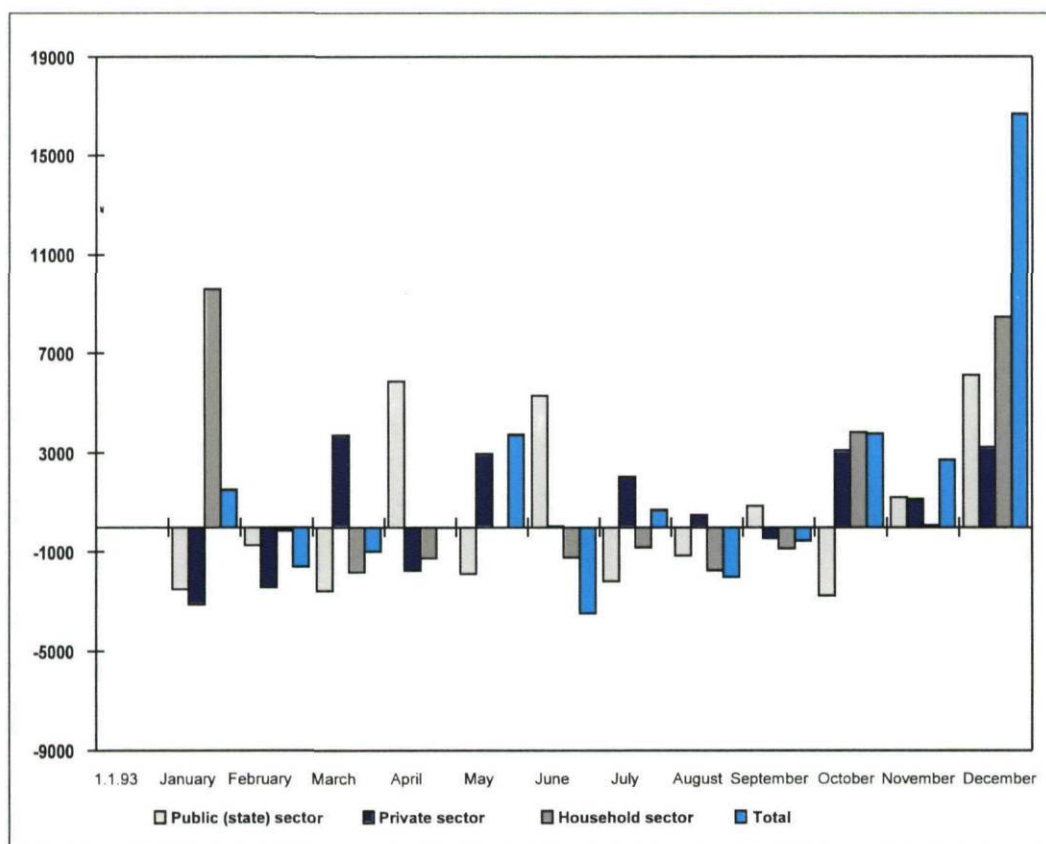
The development of primary crown deposits held by households and enterprises (excluding the NPF) and characterized by an unbalanced development throughout the year, compared with the corresponding period of the previous year, is shown in the following monthly review of their gradation (in Sk billions):

Period	1993	1992	Difference
January	2.3	-2.9	5.2
February	-1.7	-1.9	0.2
March	-1.0	-3.2	2.2
April	-0.1	1.5	-1.6
May	4.0	6.8	-2.8
June	3.5	-0.3	3.8
July	0.6	3.5	-2.9
August	-1.9	-0.8	-1.1
September	-5.2	-6.7	1.5
October	3.7	1.7	2.0
November	2.8	-2.0	4.8
December	19.6	12.8	6.8
<b>Total</b>	<b>26.6</b>	<b>8.5</b>	<b>18.1</b>

The development of crown deposits was influenced by several factors including the anomalous situation at the beginning of the year created by the devaluation expectations after the dissolution of the monetary union, the drop in the purchasing power of the Slovak crown with a simultaneous increase in the overall cost of living, the low liquidity of the entrepreneurial sector, etc.

#### Monthly Increases in Crown Deposits by Sector

(Sk millions)



The household sector had a dominant share (54.3%) in the overall generation of crown deposits. The development of crown deposits was influenced by the Sk 9.6 billion increase in February caused by the replacement of banknotes, of which one

part, despite large withdrawals in the following months of the year, remained in bank accounts. A similar situation leading to an increase in household deposits was caused by the replacement of Sk 1,000 notes by those of lower denominations in October 1993. The increase in primary crown deposits held by households, comprising 69.0% of the overall increase, was, however, partially affected by the sum of the interest accrued and posted to passbooks at the end of the year. The overall level of crown deposits was positively influenced by further increases in the private and public sectors, and in organizations and enterprises not incorporated into the sectors, with the exception of extra-budgetary deposits held by central and local authorities, including the resources of the National Property Fund (NPF), which dropped within the year to 50.3% of the 1992 level. The drop in NPF deposits contributed to more than two-thirds (Sk 6.3 billion) of this decrease. These deposits were mostly used to support the development of the banking infrastructure (Consolidation Bank), direct capitalization of selected clients of VÚB (arms manufacturers), further capitalization of companies via FIZAKO, and a part went to Slovakia a.s., Banská Bystrica. The remaining amount of the drop in deposits (Sk 2.9 billion) was a result of both the liquidation of federally run organizations and the decrease in deposits held by municipal and local authorities.

The time structure of deposits emphasized the problem of the high deficit of medium- and long-term primary crown resources of commercial banks. This problem was also reflected in the new increase in crown deposits, of which as much as 87.7% were short-term deposits; medium-term deposits comprised 8.1%, and long-term deposits 4.2%. The increase in the share of short-term time deposits vis-à-vis the overall balance increased during the year by 1.5 percentage points, i.e. to 73.5%.

With regard to the level of foreign exchange deposits, 83.2% consisted of deposits made by households and individuals and included income and wages earned abroad and on foreign business trips, deposits of parts of the foreign currency purchased in banks and earmarked for travel, as well as the purchases outside the official exchange market. The rest of the foreign currency deposits (16.8%) were comprised of deposits by legal entities, in particular companies with a large foreign capital participation, companies with savings deposits approved by the Foreign Exchange Division of the NBS, and smaller balances in residual foreign currency accounts.

The total **volume of credits in Slovak crowns and foreign currency** in the whole banking system including the NBS reached a level of Sk 268.9 billion at the end of the year, and grew by 12.2% compared with the beginning of the year. Credit extended to enterprises and households comprised 98.4 % of the total volume and the remaining 1.6% consisted of extra-budgetary credit to central, municipal, and local authorities.

A more detailed survey of the structure of credits is presented in the following table (in Sk billions):

	1.1.1993	31.12.1993	Difference	Index 1993/92
Total bank credit <sup>1/</sup>	239.7	268.9	29.2	112.2
of which:				
- Credit in crowns (Sk)	236.0	260.8	24.8	110.5
of which government sector credit <sup>2/</sup>	0.9	4.4	3.5	488.9
- Credit in foreign currency	3.7	8.1	4.4	218.9
Credit to households and enterprises	238.8	264.5	25.7	110.8

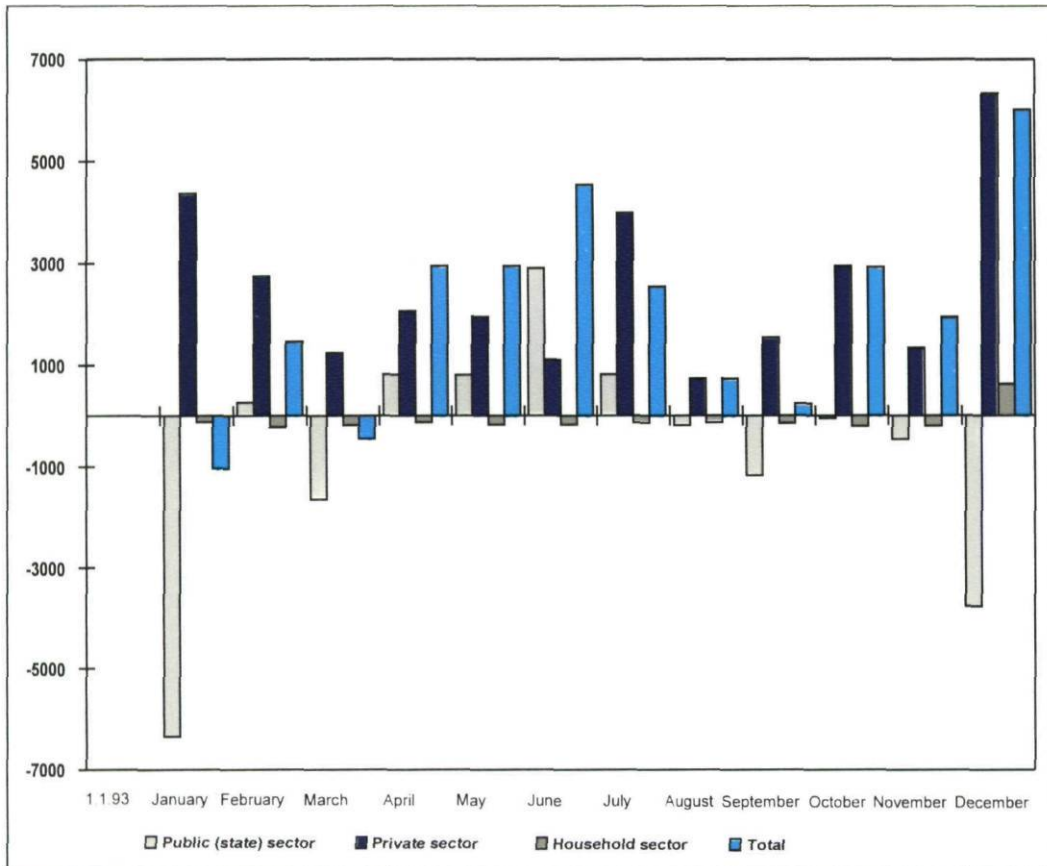
<sup>1/</sup> Total bank credit to residents and non-residents

<sup>2/</sup> Credit to cover the extra-budgetary needs of central and local authorities

The development of crown lending was more differentiated in a sectoral breakdown. Banks were most active in extending loans to entrepreneurs. In comparison with 1992, a high index of 138.2% was recorded in the increase of crown credits to private sector enterprises and organizations including cooperatives and small businesses. Their share in relation to the total credit increased from 33.6% at the beginning of the year to 42.0%, and at the end of the year it stood at Sk 109.6 billion.

Month-to-Month Increases in Crown Credits by Sector

(Sk millions)



The lengthy lack of economic and financial stability in the public sector led to a reserved and cautious approach of banks to lending to state-owned enterprises and organizations. This was reflected in the drop in crown credits, the volume of which fell by 6.1% from Sk 123.4 billion. Moreover, their share in relation to the overall balance also dropped by 47.3%, i.e. by 8.4 points.

After the loans to newly weds together with loans for the construction of housing projects and the purchase of household equipment were cancelled, the trend denoted by a drop in credit to the household sector was reflected by the Sk 1.2 billion annual decrease in the indebtedness of households and individuals vis-à-vis the banking system. Their share of the volume of crown credits comprised just 7.1 % at the end of the year and dropped by 1.3 percentage points compared with the figure at 1 January 1993.

The Sk 3.5 billion increase in crown credit extended to the government sector was affected by the transfer of a loan which arose because of the division of state financial assets and liabilities between the CSOB (Czecho-Slovak Commercial Bank) Prague and the Ministry of Finance of the Slovak Republic.

With regard to the sectoral classification, a gradual change in the structure of crown credit is evident. This change was most pronounced in building and construction, where the growth in crown credit amounting to Sk 12.1 billion represented as much as 66.3% of the overall volume. In trade, sales, public catering, accommodation, transportation, warehousing, communications, and travel, bank credit increased by Sk 2.0 billion representing 6.3% of the total volume of credits at the end of the year. The Sk 4.9 billion increase (10.9%) in the processing industry (food processing, metallurgy, mechanical engineering, and others) was partially offset by a Sk 1.1-billion drop in credit in the textile, garment, and leather industries. Together these loans represented as much as 26.1% of the overall volume. A drop in crown lending totalling Sk 2.6 billion, i.e. 14.4%, was recorded in agriculture, hunting and fishing, and in raw material

extraction. These loans fell by Sk 1.0 billion (10.2%) compared with the figure at the beginning of the year.

A significant negative factor affecting the development of crown credits was the high volume of crown loans provided in the past with a return that is accompanied by a significant risk as well as new high risk loans extended mostly to the private sector. The volume of doubtful, risky, and bad loans as well as temporarily non-liquid loans changed over the course of the year in the following way: (Sk billions)

Type of credit	As at 31 December		Difference	Index
	1992	1993		
Total volume of crown credits:	236.0	260.8	24.8	110.5
of which public sector	131.4	123.4	-8.0	93.9
private sector	79.3	109.6	30.3	138.2
Temporarily non-liquid loans - total:	26.6	26.0	-0.6	97.7
of which public sector	20.8	14.3	-6.5	68.7
private sector	5.7	11.4	5.7	200.0
Doubtful, risky, and bad loans - total:	7.7	30.8	23.1	400.0
of which public sector	6.4	15.4	9.0	240.6
private sector	1.3	14.7	13.4	1130.8

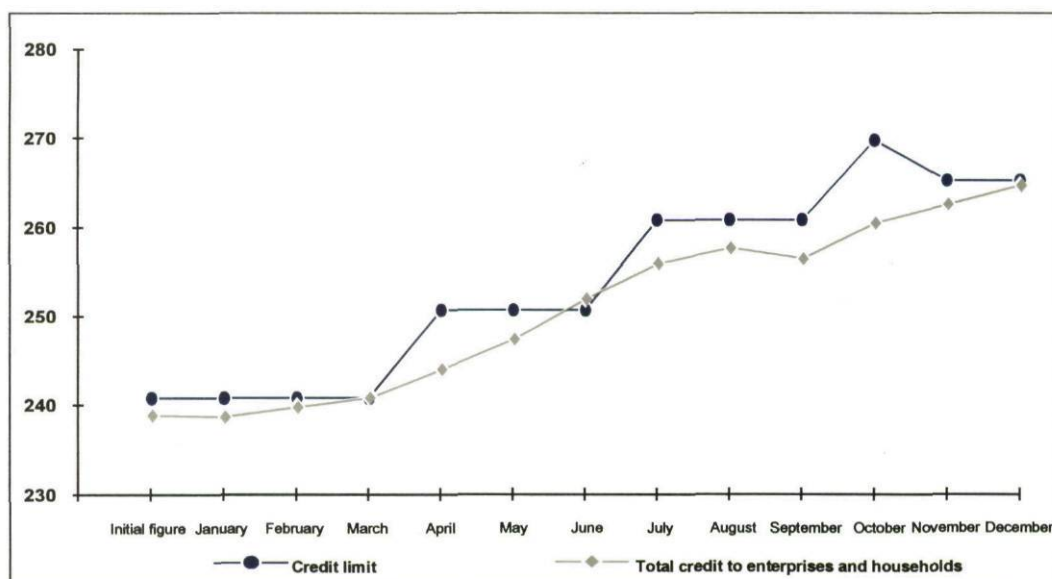
The unfavourable development of high risk loans is evidenced by the deterioration of commercial banks' credit portfolios, the slow and delayed repayment of loans, and mainly by the rapid increase in the volume of bad loans in both the public and private sectors. The main reasons for this situation have their roots in the rapid changes in the business environment, the low prosperity or failing business projects as well as in mistakes made by commercial banks when making decisions on new credits.

The volume of loans granted for small- and large-scale privatization was in the process of being repaid, and by the end of the year, it dropped to Sk 8.8 billion compared with Sk 13.3 billion at 1 January 1993.

Commercial banks extended foreign currency credits exclusively to legal entities. Since the beginning of the year, the share of foreign currency credit in the total volume of credits increased by 1.5 points reaching 3.2%.

#### Credit to Enterprises and Households in 1993

(Sk billions)





**Credit to Enterprises and Households in 1993****(Sk billions)**

Period	Credit limit	Credit to enterprises and households			Credit limit fulfillment in %
		in Slovak crown (Sk)	in convertible currency	total	
Initial position	240.6	235.1	3.7	238.8	
January	240.6	234.1	4.4	238.6	99.2
February	240.6	235.5	4.2	239.7	99.6
March	240.6	235.1	5.6	240.7	100.0
April	250.5	238.1	5.8	243.9	97.4
May	250.5	241.1	6.3	247.3	98.7
June	250.5	245.5	6.3	251.8	100.5
July	260.6	248.1	7.7	255.8	98.2
August	260.6	248.8	8.7	257.5	98.8
September	260.6	249.0	7.3	256.3	98.3
October	269.5	252.0	8.3	260.3	96.6
November	265.0	253.9	8.5	262.4	99.0
December	265.0	256.4	8.1	264.5	99.8

The method applied in 1993:

Initial position: Sk + credit in convertible currency + NBS credit (excl. credit to government)

January - May: Sk

June: Sk + convertible currency

July - December: Sk + convertible currency + NBS credit

**Interest Rate Development**

In 1993, the rates of interest on new short-term crown loans ranged between 11.5% and 24%; interest rates on medium-term loans were between 13% and 25%, and long-term lending rates ranged from 14% to 24%. The level of interest rates was influenced by several factors including the credibility of the customer, the risk associated with the repayment, the quality of the project, and other criteria set by commercial banks.

With regard to individual banks, the interest rate development differed significantly. Newly established banks issued loans with interest rates ranging between 17% and 25%, with slight differences in the structure of short-term, medium-term, and long-term loans. In other banks, lending rates were relatively lower.

In examining individual sectors, there was no significant change in interest rates with the only exception being the rates of interest on loans made to private individuals. In this category, the upper limit of the spread applicable to short-term loans ranged from 18% to 19%; the interest rates on medium-term loans rose from 18.5% to 20%, while the interest rates on long-term loans remained at 20%.

Interest rates on deposits were more differentiated depending on the size of the deposit and its term.

Interest rates on demand deposits fluctuated between 0.5% and 13.6% over the course of the year, and in the case of time deposits, the rate of interest was between 3.0% and 20.0%. In both categories of deposits, the upper limit of the interest rate rose considerably as evidenced by the fact that for demand deposits it increased by 6.5 percentage points and for time deposits by 2.5 points.

In individual sectors of the economy, with the exception of households and individuals, this increase did not differ in any significant way. The establishment of new banks caused an intensification in the activities of all banks, which tried to obtain deposits from households and individuals. These efforts were reflected in the level of interest rates, which were 1 to 2 points higher in comparison with other sectors.

Over the course of the year, several commercial banks provided additional deposit incentives such as supplementary extras, premiums, bonuses, discounts, prizes, etc., which particularly in the last three months of the year affected an increase in primary crown deposits at some banks.

## **Balance of Payments and the Development of Foreign Exchange Reserves**

In 1993, the total consolidated balance of payments of the SR reached a surplus of Sk 1.7 billion. The level of the favourable balance was determined by the balance on current account (Sk -17.2 billion), capital and financial account (Sk 17.8 billion), and by omissions and errors (Sk 1.1 billion).

The unfavourable current account balance indicates that the national economy of the SR was unable to use its material flows to obtain the needed foreign exchange resources abroad. Therefore, transfers to the capital and financial account were the principal factor responsible for the increase in the volume of foreign currency resources.

### **Convertible currencies**

A favourable balance of payments for the SR in convertible currencies (commensurate with the value of the increase in the NBS reserves) was achieved through long-term loans from the IMF and the World Bank, credits to commercial banks and the business sector (import obligations), through direct investments, and by a reduction in the long-term receivables of Slovakia from abroad.

The current account deficit of Sk 21.5 billion was caused mostly by the unfavourable balance of trade (Sk -33.7 billion) and revenues (Sk -0.7 billion). The shortfalls of these two items was partially offset by a favourable balance of services (Sk 10.7 billion) and current transfers (Sk 2.3 billion).

Looking at foreign trade, a clear orientation of Slovakia towards developed market economies was obvious (55.6% in exports and 50.4% in imports). Slovakia's chief exports included material semi-products (45.0%), machinery and transportation equipment (16.6%), various industrial products (13.8%), and chemicals (10.5%). Imports to Slovakia were mainly in machinery and transportation equipment (28.8%), fuels (26.8%), and chemicals (11.7%). In final analysis, this resulted in a highly unfavourable trade balance.

Services rendered abroad were the main element affecting the balance of payments in current account and played a positive role in the creation of the NBS foreign exchange reserves. Transportation (Sk 7.7 billion) should be mentioned, for on the income side, the economy obtained funds for transit in the form of gas supplies (Sk 10.6 billion), and travel (Sk 5.1 billion). These two items significantly contributed to the favourable services balance (Sk 10.7 billion).

With regard to the unfavourable balance of revenue (Sk -0.7 billion), the negative influence of the payments of interests accruing on foreign credits is evident. Only in the debt service by the NBS, did the interest payments comprise as much as Sk 2.6 billion, and those to the IMF were approximately Sk 1 billion.

On the basis of an intergovernmental agreement between the Slovak Republic and the Federal Republic of Germany, employment opportunities for citizens of the SR were created in 1993. The assessment of income from these jobs indicates that Slovakia obtained funds amounting to approximately Sk 2.2 billion from foreign countries. This figure was fully reflected in the favourable balance of compensation paid to employees.

Unrequited transfers recorded a favourable balance of Sk 2.3 billion with the earnings of households and individuals playing a decisive role.

The unfavourable balance of foreign trade stemming from the world-wide economic recession and high loan repayments was outweighed by the income generated in the Slovak economy arising from gas transit and travel in the services balance.

**Balance of Payments of the Slovak Republic in 1993**

	Convertible currency		Non-convertible currency		Czech Republic		Consolidated balance of payments	
	in Sk millions	in USD millions	in Sk millions	in USD millions	in Sk millions	in USD millions	in Sk millions	in USD millions
<b>Trade balance</b>	-33717	-1 095.1	413.0	13.4	1 343.0	43.6	-31 961.0	-1 038.0
- Exports (f.o.b)	92 327.0	2 998.6	841.0	27.3	70 068.0	2 275.7	163 236.0	5 301.6
- Imports (f.o.b)	126 044.0	4 093.7	428.0	13.9	68 725.0	2 232.1	195 197.0	6 339.6
<b>Services balance</b>	10 691.0	347.2	208.0	6.8	1 944.0	63.1	12 843.0	417.1
<b>Receipts</b>	36 515.0	1 185.9	907.0	29.5	22 591.0	733.7	60 013.0	1 949.1
- Transportation	11641	378.1			2 469.0	80.2	14 110.0	458.3
- Travel	9 680.0	314.4	867.0	28.2	1 467.0	47.6	12 014.0	390.2
- Other services	15 194.0	493.5	40.0	1.3	18 655.0	605.9	33 889.0	1 100.6
<b>Expenditures</b>	25 824.0	838.7	699.0	22.7	20 647.0	670.6	47 170.0	1 532.0
- Transportation	3 888.0	126.3			502.0	16.3	4 390.0	142.6
- Travel	4 616.0	149.9	686.0	22.3	1 358.0	44.1	6 660.0	216.3
- Other services	17 320.0	562.5	13.0	0.4	18 787.0	610.2	36 120.0	1 173.1
<b>Income balance</b>	-727.0	-23.6	4.0	0.1	-447.0	-14.5	-1 170.0	-38.0
<b>Interest income</b>	-2 895.0	-94.0	0.0	0.0	-200.0	-6.5	-3 095.0	-100.5
- Income	2 517.0	81.7	1.0	0.0	50.0	1.6	2 568.0	83.4
- Payments	5 412.0	175.8	1.0	0.0	250.0	8.1	5 663.0	183.9
<b>Investment</b>	-49.0	-1.6	4.0	0.1	-436.0	-14.2	-481.0	-15.6
- Income	474.0	15.4	5.0	0.2	336.0	10.9	815.0	26.5
- Payments	523.0	17.0	1.0	0.0	772.0	25.1	1 296.0	42.1
<b>Compensation of employees</b>	2 217.0	72.0	0.0	0.0	189.0	6.1	2 406.0	78.1
- Income	2 239.0	72.7			213.0	6.9	2 452.0	79.6
- Payments	22.0	0.7			24.0	0.8	46.0	1.5
<b>Current transfers</b>	2 275.0	73.9	-4.0	-0.1	806.0	26.2	3 077.0	99.9
- Official	119.0	3.9					119.0	3.9
- Private	2 156.0	70.0	-4.0	-0.1	806.0	26.2	2 958.0	96.1
<b>Current account</b>	-21 478.0	-697.6	621.0	20.2	3 646.0	118.4	-17211.0	-559.0
<b>Capital transfers</b>	0.0		0.0		16 300.0	529.4	16 300.0	529.4
<b>Net medium- and long-term financial account</b>	26 911.0	866.6	52.0	1.7	-18 358.0	-596.2	8 605.0	272.0
<b>Direct investment</b>	4 440.0	144.2	0.0	0.0	-315.0	-10.2	4 125.0	134.0
<b>Portfolio investment</b>	7 631.0	244.3	0.0		-15 726.0	-510.8	-8 095.0	-266.5
<b>Borrowing from abroad</b>	6 872.0	219.3	52.0	1.7	-2 008.0	-65.2	4 916.0	155.8
- Disbursements	19 724.0	636.8	53.0	1.7	211.0	6.9	19 988.0	645.3
- Repayments	-12 852.0	-417.4	-1.0	0.0	-2 219.0	-72.1	-15 072.0	-489.5
<b>Lending abroad</b>	7 968.0	258.8	0.0	0.0	-309.0	-10.0	7 659.0	248.7
- Disbursements	-349.0	-11.3	0.0	0.0	-331.0	-10.8	-680.0	-22.1
- Repayments	8 317.0	270.1	0.0	0.0	22.0	0.7	8 339.0	270.8
<b>Net short-term financial account</b>	-14 472.0	-378.2	1 137.0	36.9	812.0	26.4	-12 523.0	-314.9
<b>Clearing balance</b>					5 408.0	189.4	5 408.0	189.4
<b>Capital and financial account</b>	12 439.0	488.4	1 189.0	38.6	4 162.0	148.9	17 790.0	675.9
<b>Errors and omissions</b>	10 729.0	267.7	-1 810.0	-58.8	-7 808.0	-267.3	1 111.0	-58.4
<b>Overall balance</b>	1 690.0	58.5	0.0	0.0	0.0	0.0	1 690.0	58.5
<b>Change in reserves</b>	-1 690.0	-58.5	0.0	0.0	0.0	0.0	-1 690.0	-58.5
- Gold stock	-199.0	0.9					-199.0	0.9
- Holdings of SDRs <sup>1/</sup>	360.0	12.5					360.0	12.5
- Foreign exchange assets	-3 864.0	-71.9					-3 864.0	-71.9
- Valuation changes	2 013.0						2 013.0	

Exchange rate applied: USD = Sk 30.79

<sup>1/</sup> Special Drawing Rights

The domestic economy did not become a significant source of foreign currency income, and this fact was reflected in the unfavourable current account balance (Sk -21.5 billion). Generation of foreign resources was moved to the long-term capital and financial account.

The long-term capital and financial account showed a favourable balance of Sk 26.9 billion. The remaining surplus of the long-term capital and financial account balance (Sk 7.9 billion) was caused mainly by a decrease in the Slovak Government's receivables from Russia. This decrease was a result of the importation of gas (Sk 2.4 billion - Yamburg) and the importation of army aircraft totalling Sk 3.6 billion in December 1993.

The liabilities side of the long-term financial account (Sk 18.9 billion) was mostly influenced by credits drawn by individual sectors of the national economy:

- portfolio investments reflected the issue of the NBS bonds worth Sk 7.6 billion and organized by Nomura International PLC.;
- a Sk 3.0 billion loan was obtained from the IMF, and a loan of Sk 1.1 billion came from the World Bank;
- the business sector with its import obligations amounting to Sk 8.7 billion contributed to the increased debt of the Slovak economy;
- funds drawn from the credit lines of commercial banks represented Sk 6.8 billion.

Total credit to these represented Sk 27.2 billion, i.e., 85.5% of the overall liabilities of the long-term capital and financial account (Sk 31.8 billion). Within the total reported liabilities, instalments represented Sk 12.8 billion.

Direct foreign investments also deserve a positive evaluation. In this area, the inflow of capital into Slovakia amounted to Sk 4.4 billion, of which Sk 2.2 billion was earmarked for the National Property Fund and the rest for the corporate sector.

The inflow of capital through operations on the long-term capital and financial account was negatively outweighed by the banking sector transfers to the short-term financial account. Looking at the short-term financial account, it was only the corporate sector that achieved a favourable balance (Sk 3.1 billion), because of an increase in import obligations (Sk 2.7 billion) and a decrease in receivables (Sk 0.4 billion).

### **Non-convertible currencies**

In the area of non-convertible currencies, the current account showed a favourable balance of Sk 0.6 billion. The volume of this surplus was positively affected by the balance of trade (Sk 0.4 billion) and services (Sk 0.2 billion). As to the balance of trade, these were mostly transactions between the Slovak Republic and Albania, Afghanistan, Iran, India, and North Korea.

A favourable balance was also achieved in the short-term financial account (Sk 1.2 billion). Here, the biggest contribution consisted of banking sector liabilities (Sk 0.9 billion) and the drop in export receivables of the corporate sector (Sk 0.6 billion).

### **Relations with the Czech Republic**

The balance of payments on current account shows the actual volume of exports and imports registered by the Central Customs Office (and not the collections and payments for the goods monitored in the clearing).

In trade relations with the Czech Republic, by 31 December 1993, the Slovak Republic achieved a surplus on current account (Sk 3.6 billion). It was mostly a result of the favourable balance of trade (Sk 1.3 billion), services (Sk 1.9 billion), and current transfers (Sk 0.8 billion).

Despite the overall favourable balance of trade between Slovakia and the Czech Republic, the trading waned in 1993. While exports to the CR averaged Sk 17.5 billion in each quarter, imports continued to increase (while the volume of imports amounted to Sk 14.0 billion in the first quarter, they reached Sk 18.4 billion in the fourth quarter). An unfavourable balance was also recorded in the structure of commodities exported from the SR, which mostly comprised of material semi-products (35%). The structure of imports was primarily affected by products sorted by the type of material (26.1%), machinery and equipment (23.7%), and fuels (13.7%).

The services balance (Sk 1.9 billion) was significantly influenced by the income associated with transportation (Sk 2.5 billion), which also included the transit of gas (Sk 1.1 billion).

The asset side of current transfers provides a record of unrequited transfers between individuals. In this section of current transfers, the earnings of Slovak households represented Sk 2,7 billion and payments to the CR amounted to Sk 1.8 billion.

The capital and financial account reached a favourable balance of Sk 4.2 billion. Looking at its structure, the highest volumes were recorded in capital transfers (Sk 16.3 billion), portfolio investments (Sk -15.7 billion), in the clearing account, and in long-term financial accounts.

The high share of capital transfers and the long-term financial account in the overall capital and financial account was caused by the voucher privatization (Sk 16.3 billion). The remaining part of the long-term financial account (less voucher privatization) was influenced by instalments to the Ministry of Finance of the SR in the amount of Sk 2 billion.

The favourable balance of the short-term financial account (Sk 0.8 billion) was a result of a contrary flow of capital in the banking and corporate sectors. The banking sector reported a capital inflow. It was mainly the branch offices of Czech banks operating in Slovakia that obtained financial resources in this way. In the corporate sector, an increase in short-term export receivables (Sk 2.0 billion) was reported although the sector's liabilities increased as well (Sk 0.4 billion).

The clearing balance in the period between February and December 1993 can be viewed as credit to Slovakia or as a form of foreign capital inflow.

### **Consolidated balance of payments**

The most significant feature of the overall consolidated balance was the current account deficit with respect to countries with convertible currencies. After a correction of transactions concluded with the Czech Republic, the final current account deficit of the consolidated balance amounted to Sk 17.2 billion.

The current account deficit was mostly due to the development of foreign trade. Exports were outweighed by imports by Sk 32 billion. The unfavourable development of the trade balance was partially offset by transactions falling under the balance of services, transportation (in particular, through fixed payments for the transit of gas) and travel.

The capital and financial account surplus (Sk 17.8 billion) was mostly due to the following factors:

- foreign capital participation in the corporate sector reflected in direct investments (Sk 4.1 billion);
- the long-term financial account surplus (Sk 12.6 billion), which was mostly a result of the importation of gas and army aircraft (which reduced the Slovak Government's receivables from Russia), borrowings from the IMF and the World Bank, and also the increased net import obligations of the corporate sector.

The inflow of capital from abroad also included the clearing deficit with the CR, which in fact represented a Sk 5.8 billion credit extended to Slovakia by the Czech Republic.

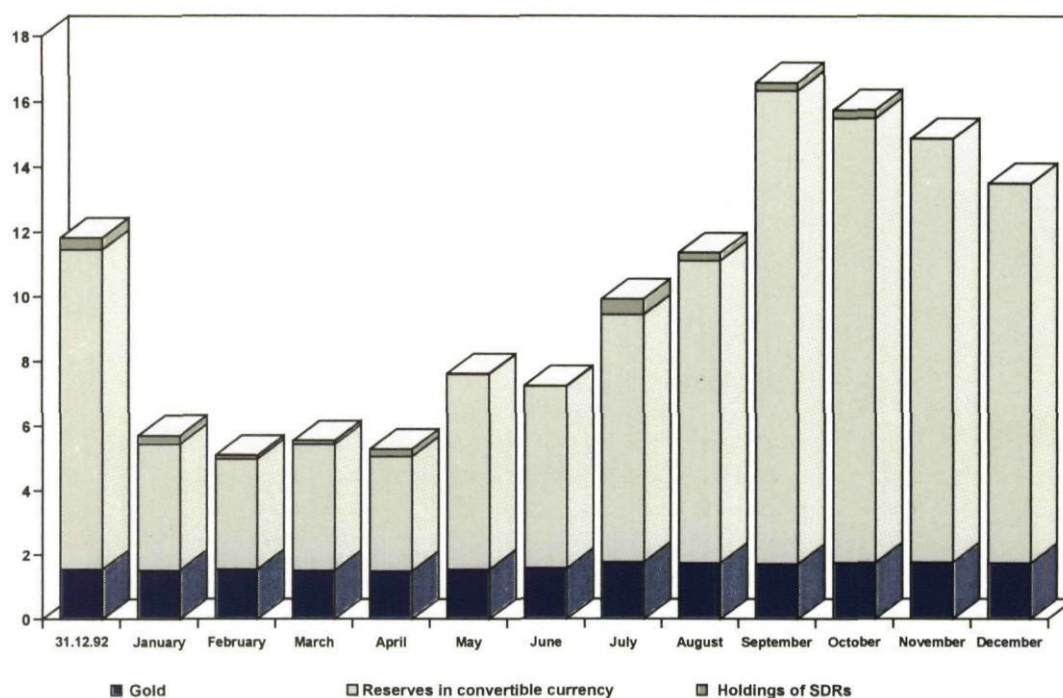
It was the deficit of the short-term financial account that had a negative effect on the balance of the capital and financial account. This deficit was caused primarily by commercial banks, which transferred their foreign currency funds (deposits in foreign currency) to their nostro accounts abroad.

### Foreign Exchange Reserves Held by the NBS and Commercial Banks

The total foreign exchange reserves of the National Bank include foreign exchange funds in fully convertible currency (FCC), gold delimited after the split of Czechoslovakia (appraised by using the IMF methodology at a book value of USD 42.22 per Troy ounce), and the holdings of SDRs (Special Drawing Rights) on the IMF account.

Development of the NBS Reserves in 1993

(Sk billions)



The development of the overall foreign exchange reserves of the NBS in 1993 was to a great extent influenced by the growing current account deficit of the balance of payments and the significant pre-devaluation expectations of business entities and inhabitants.

At 31 December 1993, the total foreign exchange reserves of the NBS stood at Sk 11.8 billion. Over the course of the year, the total foreign exchange reserves increased by Sk 1.7 billion.

The following are the elements which positively affected the development of foreign exchange reserves:

- a drawdown of new foreign exchange resources from abroad in the amount of Sk 11.6 billion (the World Bank, the International Monetary Fund, the issue of government bonds by the NBS);
- income from the NBS debt service at the level of Sk 1.0 billion resulting from the revaluation of the principals of loans incorporated into the Central Foreign Exchange Resources (CDZ) and also from the sale of government CDZ assets, which comprised 65% of the overall debt service income;
- income arising from the split of the foreign exchange reserves of the former SBCS in the amount of Sk 0.9 billion;

- the NBS's extra foreign exchange revenues in the amount of Sk 0.6 billion;
- interest accrued on deposits and investments amounting to Sk 0.4 billion;
- currency swaps between freely convertible currencies and the Sk with commercial banks, the volume of which was flexibly controlled by the National Bank of Slovakia in accordance with other monetary tools. At end-1993, the volume of currency swaps totalled Sk 0.3 billion.

The following are the elements which had a negative effect on the level of total foreign exchange reserves:

- regular quarterly instalments and other payments to the IMF in the amount of Sk 1.0 billion;
- expenses of the NBS debt service in the total amount of Sk 4.5 billion, where 72% were instalments of CDZ principals and interest, 16% were payments of interest accrued on government loans obtained after 1990, 8% were payments of interest accrued on bond issues, and 4% were interests on loans from the World Bank;
- operations in the NBS foreign exchange fixing, which had a decisive influence on the development of the total foreign exchange reserves of the NBS.

The cumulated annual balance of the NBS foreign exchange fixing showed a deficit of Sk 7.3 billion. These foreign exchange resources were drawn by commercial banks mostly because of the lack of funds for payments.

In the first two months of the year, there was a considerable outflow of foreign currency in the amount of Sk 6.3 billion through trading in the NBS foreign exchange fixing. The National Bank of Slovakia responded to this undesirable development by imposing restrictive measures on the access of commercial banks to the foreign exchange fixing. The criterion applicable to commercial banks trading in foreign exchange fixing was the bank's overall foreign exchange position to equity ratio. In January, this ratio had a limit of 15%, in February 35%, and in April 30%.

The December liberalization of the balance of payments on capital account was a positive signal for foreign investors. At the same time, the NBS freed the conditions for the commercial banks' access to the foreign exchange fixing of the NBS.

The development of the NBS foreign exchange reserves was rather unstable, and in the first months of the year, it was marked by an accelerated outflow of foreign exchange. In the following period, this development was gradually brought under control. By the end of the year, the total volume of foreign exchange reserves reached the level of a 1.5-month import for the SR expressed in convertible currency and the equivalent of a one-month total import (including imports from the CR).

### **Foreign Exchange Reserves of the Banking Sector**

The development of foreign exchange reserves held by commercial banks (short-term foreign assets of commercial banks) was influenced by the pre-devaluation expectations of the public and the associated realization of prepayments directed abroad as well as the purchase of foreign currency by households and individuals, who later redeposited their foreign currency back into foreign currency accounts.

At the beginning of the year, the level of reserves held by commercial banks was Sk 14.1 billion, and by 31 December 1993, it had increased to Sk 31.6 billion. The main source of the increase in the commercial banks' foreign exchange reserves was the rise in deposits in foreign currency accounts belonging to private individuals (Sk 13.5 billion).

When evaluating the development of the total foreign exchange reserves of the banking sector (the NBS + commercial banks), an increase of Sk 19.2 billion can be reported. At the beginning of the year, the foreign exchange reserves amounted to Sk 25.9 billion, and by the end of the year, they increased to Sk 45.1 billion.

## Debt Service by the SR and the NBS

While creating a basis for the required credibility of the Slovak Republic, it was also necessary to ensure the best possible management of the debt service. First of all, it was a step-by-step creation of the economic environment that allowed for the generation of foreign exchange resources, which would, particularly in the first stage, at least partially cover the servicing of the national debt. A specific problem in this area was the drafting of a careful assessment of the level of debt acceptable to the Slovak Republic. This was to be done mainly from the point of view of the necessary structural changes.

On 1 January 1993, the official gross foreign currency debt, i.e. the gross debt of the Slovak Government and the NBS, amounted to USD 1.625 billion. After including the foreign debt of the commercial sector, the gross foreign currency debt of the SR amounted to USD 2.981 billion on the same day. At the end of 1993, the Slovak Republic recorded an overall gross foreign exchange debt amounting to USD 3.622 billion (including the debt in the clearing system to the Czech Republic). The official debt of the Government and the NBS was USD 1.982 billion and the total debt of the national economy in convertible currency stood at USD 3.341 billion. The remaining part of the total debt of the Slovak Republic consisted of debt in non-convertible currency, which comprised of the debt to the Czech Republic (clearing system) and the debt to the former German Democratic Republic currently discussed with Germany. The official debt increased mainly because of the drawing of the IMF loan, the third tranche of SAL from the World Bank, and the issue of bonds by the NBS.

### Development of Foreign Debt

Date	Official debt of the Slovak Government and the NBS in convertible currency (USD billions)	Total debt incorporating the debt of the banking and corporate sectors, and the debt in non-convertible currency (USD billions)	Total gross foreign debt per capita in the SR (USD)	Total gross foreign debt as % of GDP <sup>1</sup>
1.1.1993	1.625	2.981	562.45	29%
31.3.1993	1.614	2.970	560.38	-
30.6.1993	1.647	2.860	539.62	-
30.9.1993	1.978	3.320	626.42	-
31.12.1993	1.982	3.622	683.40	35%

<sup>1</sup> GDP at current prices, exchange rate at 1 January 1993, USD 1 = Sk 29, exchange rate at 31 December 1993, USD 1 = Sk 33.

The differences between these data and the originally published debt statistics were caused by the additional verification of the statistical data reported by the corporate sector.

The structure of foreign exchange liabilities that the SR inherited from the former CSFR was as follows:

1. The obligations of the CSOB prior to 1990 were incorporated into the Central Foreign Exchange Resources (CDZ);
2. Government loans that were assumed by the Government of the CSFR after 1990;
3. Loans from the IMF which became a direct foreign exchange liability of the NBS
4. Bonds issued by the former SBCS which also represent a direct foreign exchange liability for the NBS.

The performance of the foreign currency debt service by the NBS followed the established system of payments. These payments were in compliance with the incorporation of obligations and receivables (in fully convertible currencies included in the CDZ) into the state financial assets and liabilities.

Within the debt service performance in 1993, the NBS sold foreign exchange to the Ministry of Finance and also provided for the technical realization of payments. In dealings with foreign creditors, it was the CSOB, a.s. Prague, that played the main role and, after receiving a one-third share of the total debt due from the NBS (divided debt of the former CSFR), paid to foreign banks and other creditors the total mature debt owed by the CR and the SR (after adding the two-thirds share of the Czech Republic).



The NBS and the Ministry of Finance of the SR signed agreements defining the schedule of covering the receivables and obligations in fully convertible currencies incorporated into the CDZ as well as the repayment the loans granted to the former CSFR by the World Bank, the EC, Japan, and other members of the G-24 group. In debt servicing, the NBS played the role of a government agent for the Ministry of Finance of the Slovak Republic. Such obligations were seen as state financial liabilities, which the Ministry paid in crowns. Therefore, the respective amounts in local currency were posted to the NBS account on the same day on which the payments in convertible currency were made.

Incoming collections arising from the receivables that were taken over, the income from interest and CDZ assets (loans granted by the former CSFR), and other revenues from the revaluation of principals became a part of the foreign exchange reserves of the NBS. In such cases, the NBS credited the commensurate amount in Slovak crowns to the crown account of the Ministry of Finance.

Larger obligations that were due were included in the payment of principals within the CDZ block and interest on government loans. The CDZ included instalments of principals in USD, DEM, JPY, and CHF. Instalments of government loans were paid in XEU, USD, and JPY.

In connection with the instalments of government loans, we still have to deal with the process of succession, i.e., the division of the government debt incurred by the former CSFR between the successor states of the Czech Republic and the Slovak Republic. However, with respect to foreign creditors, this process was not completed. Except for the agreements with Austria and Japan on the division of the obligations associated with government loans made by Japan and Austria to the former CSFR, no other agreements were signed with the successor states pertaining to the division of obligations arising from government loans. When paying these obligations, the NBS maintained links with the Czech National Bank; however, it also established direct relations with foreign creditors. The majority of instalments of the government loans were paid together with the CNB.

#### A Review of Debt Service Performance

Year 1993	Sk	USD
January	-125 908 645.11	-3 962 257.14
February	-196 269 193.91	-6 133 412.31
March	-410 933 430.81	-12 841 669.71
April	-373 733 574.16	-11 679 174.19
May	11 048 405.84	345 262.68
June	-245 930 100.49	-7 685 315.64
July	-52 990 338.59	-1 655 948.08
August	2 627 914.53	82 122.33
September	-803 179 269.36	-25 099 352.17
October	-644 304 059.25	-20 134 501.85
November	-440 000 912.70	-13 750 028.52
December	-225 482 883.82	-7 046 340.12
Total	-3 505 056 087.83	-109 533 002 74

Applied exchange rate: USD 1 = Sk 32.0

Important elements influencing the performance of the debt service were the income items and collections accepted in freely convertible currencies, both of which corrected the volume of the obligations paid. In 1993, the total accepted collections associated with the sale of foreign exchange assets, revenues, interest accrued on loans granted by the former CSFR, and the revaluation - rectification of principals comprised 21.7% of the paid obligations.

Rectification of principals was applied with some tranches of loans and was associated with the so-called "multicurrency clause", which allowed for the optimization of the currency composition of the real debt against its nominal description in the original

contracts. In fact, it was a continuous change of the principal (an increase or decrease) depending on the exchange rate of the relevant convertible currency (DEM or XEU against USD).

The total volume of the obligations paid in 1993 reached USD 140 million (Sk 4.478 billion). Of this amount, USD 30 million (Sk 973 million) consisted of accepted collections, which were continuously affecting the debt service performance. The final level of the debt service (less USD 30 million) amounted to USD 110 million (Sk 3.505 billion).

#### A Review of Debt Service Performance

<b>Income items:</b>		
- Rectification of principals	Sk	335 927 314.33
- Foreign exchange assets	Sk	632 285 169.76
- Interest payments, charges	Sk	5 181 390.81
Total (in Sk)	Sk	973 393 874.90
Total (in USD)	USD	30 418 558.59
<b>Repaid liabilities:</b>		
- Instalments of principals	Sk	-1818 075 211.76
- Instalments of interest	Sk	-2 660 374 752.55
Total (in Sk)	Sk	-4 478 449 964.31
Total (in USD)	USD	-139 951561.38

Exchange rate applied: USD = Sk 32.0

#### Borrowings from Abroad

After the split of the CSFR, the Slovak Republic obtained parts of several loans granted by international banking and financial institutions.

From the Structural Adjustment Loan (SAL) of USD 450.0 million granted by the World Bank in order to restore the equilibrium of the balance of payments after short-term imbalances, the Slovak Republic obtained a part amounting to USD 150.0 million, i.e. Sk 5.0 billion (divided 2:1). The first and the second tranches of this loan were drawn by the former State Bank of Czechoslovakia, and the third SAL tranche was drawn by the NBS itself. This drawdown amounted to USD 39.8 million and was transferred to the NBS nostro accounts in April/May 1993. The structure of the third tranche of the SAL (Sk 1.3 billion) was as follows: USD 22.4 million, DEM 25.7 million, and ATS 11.6 million.

On the grounds of the succession, the Slovak Republic took over the financial commitments to the IMF arising from the transfer of the property share of the SR and the CR using the ratio 1:2.29. The membership quota applicable to the SR was SDR 257.4 million (Sk 12.0 billion), of which SDR 60 million was paid in convertible currencies (Sk 2.8 billion). Slovakia's share of the obligations associated with stand-by loans, CCFF, and enlarged access, granted by the IMF to the CSFR in 1991-1992, amounted to SDR 340.8 million. Repayment of the principals of these loans is to start in April 1994 with the final instalment to be paid in April 1999.

In July 1993, the Slovak Republic obtained a Systemic Transformation Facility (STF) loan from IMF in the amount of USD 180.0 million. The first tranche amounting to SDR 64.35 million, i.e. approximately USD 90 million (Sk 3.0 billion), was provided at the end of July in the following currencies: SDR 46.35 million, CHF 14.8 million, IDR 23.3 billion, LUF 32.4 million, and NZD 5.9 million.

All the currencies (apart from CHF) were, with the assistance of the IMF, converted into USD. Of the total amount of SDR 46.35 million, SDR 36 million were converted into USD and deposited in the NBS nostro accounts. The remaining part was left in the current SDR account of the SR with the IMF. This account was used to effect the payment of the regular charges to the IMF till the end of 1993.

The STF loan was granted to the SR for the period of 5.5 years with the payment of principal postponed for 5 years. The payment of the principal of this loan is bound to start in 1998 with the final instalment to be paid in the year 2003.

On 3 September 1993, the National Bank of Slovakia in cooperation with Nomura International PLC. floated bonds in the nominal value of YEN 25 billion (USD 240 million). The bond issue was divided into two parts by their maturity, with YEN 15 billion (USD 140 million) maturing 1998 and YEN 10 billion (USD 100 million) maturing in the year 2000. The issue was placed with institutional investors in Europe and Asia.

## Foreign Exchange Licences

In 1993, the National Bank of Slovakia, acting in accordance with the Foreign Exchange Act, granted to Slovak entrepreneurs 414 foreign exchange licences for capital operations and 123 permissions associated with the balance of payments on current account.

Of the total number of foreign exchange licences issued for capital operations, 295 were granted for equity participation abroad with the right to invest Slovak capital; 219 were permissions to accept foreign currency credits from "foreign exchange non-residents".

The total amount of capital for equity participation amounted to Sk 340.9 million, of which Sk 152.4 million was finance capital, Sk 176.0 million were tangible assets, and Sk 12.5 million was used to purchase stocks issued by foreign companies. Under the agreed conditions, the returns on this capital through the yields of the business should not exceed 2 years.

The total returns on the invested finance capital with respect to its repatriation, in case the business is to be closed or liquidated, was ensured by interstate agreements on the support and protection of investments.

From the territorial point of view, the biggest part of the capital was directed not only to the Czech Republic, the AIS, Hungary, Western Europe, and the USA, but also to the United Arab Emirates, Egypt, Peru, and Cyprus.

The number of foreign exchange licences and permissions issued, and the structure and geographical direction of the invested capital are documented in the following table (in Sk millions, exchange rate as at 31 December 1993):

Country	Number of licences issued	Volume of invested capital	of which		Purchased shares
			finance capital	tangible property	
Czech Republic	110	100.4	34.8	53.1	12.5
The AIS	44	94.3	2.3	92.0	
Other states	141	146.2	115.3	30.9	
Total	295	340.9	152.4	176.0	12.5

The total credit in foreign currency amounted to Sk 21.1 billion. In 11 cases, an exemption from the obligation to offer the foreign currency for conversion was granted and the funds were left in foreign currency accounts.

The volume of foreign credits approved in 1993, and the expected drawings and repayments: (Sk billions, exchange rate as at 31 December 1993)

Years	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	After 2000	Total
Drawings	0.063	0.13	9.00	7.62	2.91	1.38	0.01	-	-	-	-	21.14
Repayments	-	0.005	0.65	2.31	1.07	1.34	2.19	1.87	1.80	1.56	8.21	21.01
Balance	0.003	0.125	8.35	5.31	1.84	0.04	-2.00	-1.87	-1.80	-1.56	-8.21	0.13

- the difference between the repayments and drawings is caused by loans of which one part does not need to be repaid;  
 - in the years 1991 and 1992, cases of additionally approved credits are presented (drawings without the foreign exchange permission of the NBS);

As far as the structure of creditors is concerned, in 38 cases the creditors were banking institutions, and in 76 cases they were non-bank entities.

#### Structure of Foreign Credits by Country

Country	Number of permissions	Share in %	Country	Number of permissions	Share in %
Austria	43	37.7	Netherlands	3	2.6
Switzerland	16	14.0	Luxembourg	3	2.6
Germany	13	11.4	Sweden	2	1.8
Great Britain	9	7.9	Denmark	2	1.8
USA	8	7.0	Liechtenstein	1	0.9
theCR	5	4.4	Italy	1	0.9
France	4	3.5	Canada	1	0.9
Belgium	3	2.6	Total	114	100.0

The following table shows the number and volume of foreign credits by purpose:

	Number	%
1. Purchase of real estate, investments, privatization (in Slovakia)	53	46.5
of which: privatization	8	25.0
2. Purchase of machinery, technology, equipment (abroad)	12	10.5
3. Solution of financial problems in operation	49	43.0

In 1993, the current account of the balance of payments was affected by 123 licences and 129 supplements. The greatest number of permissions was issued to open foreign currency accounts in foreign financial institutions in order to finance construction and assembly work abroad; for this purpose, 30 licences and 102 supplements were issued. These foreign exchange licences should enable Slovak entrepreneurs to export construction and assembly work abroad in the volume of Sk 2.9 billion.

The approved amount of foreign currency deposited in accounts abroad until the projects were finished represented Sk 184 million.

The number of foreign exchange licences for the opening of foreign currency accounts in domestic financial institutions in order to perform active re-export operations was 32 with 12 supplements. Using these permissions, profit making operations worth Sk 4.6 billion were to be concluded, one-third of which have been carried over into 1994. The foreign exchange profit generated by these operations should reach Sk 400 million with an average profitability of 10%.

In order to make the organization of foreign business trips and the allocation of foreign currency easier, 14 foreign exchange licences were granted to establish an

operational accounting base. The approved limit of foreign exchange resources exempted from the obligation to offer for conversion and used to finance business trips was Sk 1.6 million.

Eleven foreign exchange licences and 4 supplements were issued for opening foreign currency accounts in domestic financial institutions for non-profit operations, of which 3 licences covered funds provided to Slovak entities within the PHARE programme. The volume of these funds was insignificant.

Other licences covered the export of coins to be tested with ATMs and other machines, the export of Slovak currency and commemorative coins, the export of domestic securities, the transfers from the accounts of foreign residents held in Slovak crowns in local financial institutions, the mailing of Slovak cash in registered letters, and the purchase of foreign currency in cash. Looking at the total value, these transactions were also insignificant.

Licences to transfer amounts from the crown accounts held in Slovak financial institutions to the Czech Republic constituted a specific group. These permits were issued reciprocally after the agreement with the CNB for cases when legal and private entities moved out or wanted to transfer proceeds from the sale of real estate, or the rent from leased real estate, and also in cases when the transfer from accounts in the other republic was not realized within the fixed 3-month period and the accounts were established before the currency split, or when the accounts were opened on the grounds of foreign exchange licences issued by the central banks.

## **Budget Performance and the Internal Debt of the Government**

The establishment of the independent Slovak Republic brought about a significant change in the budget performance of the Government. Instead of three inter-bound budget areas, this was the first time that the state budget of the SR was applied in a sovereign state.

Along with internal factors (Slovakia's sovereignty, introduction of a new tax system, unemployment, inflation, etc.), the budget was also affected by external factors (worldwide economic recession, destruction of traditional markets, etc.). The state budget performance in the Slovak Republic proved that the notion of achieving a balanced state budget for 1993 was unrealistic as e.g. the Government Debt Chapter did not incorporate the interest accrued on credits covering the government debt (also from the previous periods) and the provisions for the likely fluctuations in the exchange rate of the Slovak crown. Over the course of the year, we had periods of relative stability combined with those marked by a growing state budget deficit because of both unequally spread tax revenues and contributions to insurance funds and unbalanced drawings against the budgeted expenses.

Throughout the year, budget receipts were negatively influenced by low retirement, sick and health insurance payments and contributions to the employment fund at the level of less than 80%, insufficient income tax revenues from legal entities at 63%, value added tax at 90%, and consumer taxes at 77% of the annual budgeted amount. On the other hand, the development of the total revenue (fulfilled at 91%) was positively influenced by the quarterly disbursement from the profit of the National Bank of Slovakia and the final payments of levies and taxes due from 1992. The overall deficit of the budget revenue was Sk 13.6 billion.

Budget expenditures were affected by regulatory measures which did not fully correspond to the real development of revenues. Therefore, the budget deficit increased during the year (however, the increase was partially offset by the positive effect of the "credit" associated with the clearing balance with the Czech Republic).

In December, the Ministry of Finance passed a decision approving the excess of certain expense limits. In some chapters of the budget, this decision caused a sharp increase in the total budget expenditure which, at the end of December 1993, reached Sk 167.5 billion, and taking into account the effect of clearing, expenses were as much as Sk 173.3 billion. Compared with the projected amount of Sk 158.1 billion, they were Sk 9.4 billion higher (Sk 15.2 billion). This was caused by higher-than-expected volume of transfers to inhabitants (mainly due to the payment of the state balancing allowance which was covered by the budgetary resources only in the first two months of 1993), by expenditures for private and public consumption (health care, foreign service, security) as well as by expenditures associated with the state debt which was underassessed when drafting the budget.

#### End-of-Month Positions of the State Budget of the SR

	Revenue		Expenditure		Difference (revenue - expenditure)	Treasury bills	Total position
	Total	Increase	Total	Increase			
January	6 800	6 800	8 489	8 489	-1 689	574	-1 115
February	17 370	10 570	18 884	10 395	-1 514	6 878	5 364
March	22 971	5 601	34 003	15 119	-11 032	8 695	-2 337
April	38 977	16 006	50 002	15 999	-11 025	7 588	-3 437
May	50 063	11 086	61 907	11 905	-11 844	8 829	-3 015
June	64 422	14 359	79 244	17 337	-14 822	8 900	-5 922
July	79 173	14 751	93 273	14 029	-14 100	9 024	-5 076
August	90 670	11 497	105 050	11 777	-14 380	8 917	-5 463
September	104 629	13 959	120 528	15 478	-15 899	8 537	-7 362
October	115 236	10 607	132 038	11 510	-16 802	9 489	-7 313
November	129 663	14 427	145 737	13 699	-16 074	8 224	-7 850
December	144 541	14 878	167 552	21 815	-23 011	7 891	-15 120

The combined effect of the above factors resulted in the fact that the total state budget deficit of the SR reached Sk23.0 billion by 31 December 1993. This was partially covered by the issue of Treasury bills, of which bills worth Sk 7.9 billion were sold, and the remaining part of Sk 15.1 billion was covered by direct credit from the NBS. The reported deficit of the state budget did not take into account Slovakia's clearing obligation with the Czech Republic in the amount of Sk 5.8 billion.

#### Net Position of the Government vis-à-vis the Banking Sector

(Sk millions)

	1.1.	31.1.	28.2.	31.3.	30.4.	31.5.	30.6.	31.7.	31.8.	30.9.	31.10.	30.11.	31.12.
Current budgetary position	-7 754	-1 114	5 363	-2 337	-3 437	-3 015	-5 922	-5 075	-5 463	-7 362	-7 313	-7 850	-15 120
Deposits of local authorities, incl. their funds and reserves	2 200	3 492	3 344	3 656	3 492	3 387	2 905	2 535	2 325	2 222	2 158	2 173	2 292
<b>State financial assets</b>	11 890	11 891	11 892	11 900	11 928	13 060	13 483	5 558	5 711	5 736	5 173	5 181	5 174
State financial liabilities	-21 716	-21 671	-21 715	-21 716	-21 716	-21 716	-21 716	-21 716	-21 716	-21 716	-21 716	-21 716	-21 716
Balance of government funds	301	253	573	667	645	623	951	718	821	614	1 044	402	967
State budget deficit from 1991	-7 400	-7 400	-7 400	-7 400	-7 400	-7 400	-7 400	-7 400	-7 400	-7 400	-7 400	-7 400	-7 400
State budget deficit from 1992	0	-7 933	-7 933	-7 933	-7 933	-7 933	-7 933	0	0	0	0	0	0
State deficit from the federation (1992)	0	-2 333	-2 333	-2 333	-2 333	-2 333	-2 333	-2 333	-2 333	-2 333	-2 333	-2 333	-2 333
Government Treasury bills	-4 920	-1 080	-7 500	-9 000	-7 750	-9 000	-9 000	-9 142	-9 000	-8 800	-9 200	-8 327	-7 891
Government bonds for housing construction	-4 200	-4 200	-4 200	-4 200	-4 200	-4 200	-4 200	-4 200	-4 200	-4 200	-4 200	-4 200	-4 200
Government bonds to cover the 1991 budget deficit	-600	-600	-600	-600	-600	-600	-600	-600	-600	-600	-600	-600	-600
Government bonds for the Gabčíkovo Hydroelectric Project	0	-900	-900	-900	-900	-900	-900	-900	-900	-900	-900	-900	-900
Government bonds for the reservoirs at Málinec and Turček (1993)	0	0	0	-26	-76	-76	-490	-495	-661	-672	-772	-1 460	-1 764
<b>Net position of the Government (incl. foreign loans)</b>	<b>-32 199</b>	<b>-31 595</b>	<b>-31 409</b>	<b>-40 222</b>	<b>-40 280</b>	<b>-40 103</b>	<b>-43 155</b>	<b>-43 050</b>	<b>-43 416</b>	<b>-45 411</b>	<b>-46 059</b>	<b>-47 030</b>	<b>-53 491</b>
Of which: at the NBS	x	-29 550	-27 597	-36 664	-37 338	-31 398	-35 220	-32 351	-36 624	-34 361	-34 840	-34 014	-41 158
at commercial banks	x	-2 045	-3 812	-3 558	-2 942	-8 705	-7 935	-10 699	-6 792	-11 050	-11 219	-13 016	-12 333

On 1 January 1993, the net position of the Slovak Government vis-à-vis the banking system amounted to Sk 32.2 billion and included the delimitation of a part of the former federal deficit, a one-third share of the state financial liabilities of the former CSFR, the budget performance of the Slovak Republic in the previous years, and the issued government bonds and other partial items. Over the course of the year, it followed the continuous growth of the state budget deficit reaching Sk 53.5 billion by 31 December 1993, i.e. 15.9% of the GDP.

## **Money and Capital Market Developments**

The development of the short-term securities market (STSM) deserves a positive evaluation. In a very short time, the National Bank of Slovakia was capable of providing for all the activities arising from the function of manager of this market. Government securities became an important tool for financing the state budget; however, because of the imperfect and gradually developing financial market, it was not possible to use all their features. Hence, state Treasury bills were used to a large extent as a tool for financing the temporary budget deficit in particular in the first quarter of 1993.

As early as the end of March, the size of the budget deficit and the increased volume of Treasury bills on the market exceeded the absorption capabilities of commercial banks despite the fact that the most active participant in the short-term securities market was the NBS, which purchased the unsold part of the issued Treasury bills on the primary market. On a daily basis, the NBS held Treasury bills in its portfolio worth Sk 4.9 billion (from the possible maximum of Sk 7.9 billion).

Over the course of 1993, the Ministry of Finance of the SR prepared 42 regular issues and three "special" issues of Treasury bills, the latter served to cover the period necessary for the preparation of a regular issue. With the increasing deficit of the state budget, both the frequency of regular issues and the volume of Treasury bills on the market grew.

In the last quarter of the year, the amount of refinancing funds provided by the NBS in the form of auction refinance loans increased. This together with the freeing of interest rates on the primary market stimulated the interest of commercial banks in Treasury bills. Thus, the volume of bills in the NBS portfolio started to decrease and the Treasury bills started to be held by commercial banks.

Because of the development of the budget deficit, the difference between the deficit and the portion of the deficit covered by Treasury bills continued to rise. Almost throughout the whole year, the so-called American type of auction was used with the volume of the issue announced in advance. At each particular auction, an authorized representative of the Ministry of Finance set the acceptable volume of Treasury bills directly taking into account the interest rates.

Since June 1993, the development of interest rates on the Treasury bills market was influenced mainly by the system measure of the Ministry of Finance - Act 124/1993, which amended and supplemented the Income Tax Act, under which the earnings on government bonds were not subject to tax. With this Act coming into force, the average interest rates achieved at auctions dropped by approximately 4.5%, and remained at 12% for almost 6 months. Interest rates on Treasury bills were to a significant extent influenced by the drawing of a direct credit by the state budget from the NBS. At the end of the year, when the NBS in accordance with the law did not participate in the primary market, the Ministry of Finance accepted a higher interest rate proposed by commercial banks.

Treasury bills started to be used as a tool for open market operations. They were used to influence the liquidity of banks and also to solve their short-term liquidity movements; in this capacity, the NBS played the decisive role of market maker.

In compliance with Act No. 14/1993 concerning the State Budget of the Slovak Republic for 1993, the Ministry of Finance organized three issues of government bonds. Funds obtained from these issues were designed to cover the construction costs of the hydro projects at Málinec, Turček, and Selice (issues No. 005 and No. 006) and also to cover the costs of housing complexes under construction (issue No. 007).

### Slovak Government Bonds Issued in 1993

Issue No.	ISIN	Volume of issue	Date of auction	Date of issue	Date of maturity	Nominal value (in Sk)	Interest pa. (in%)	Interest payment	Volume of bonds sold <sup>2/</sup>		Volume of bonds for further auctions	
		(in Sk thous.)							(in Sk thous.)	(in %)	(in Sk thous.)	(in %)
3010396 005	CS0001000045	1 200 000	25.2.1993	1.3.1993	1.3.1996	5 000	D <sup>1/2</sup> + 8.5	semi-annually	76 000	6.3	0	0
3030696 006	SK4120000019	1 124 000	periodic	3.6.1993	3.6.1996	5000	D <sup>+</sup> + 5.5	semi-annually	1 091 990	97.2	32 010	2.8
020295 007	SK4120000035	1 000 000	periodic	2.8.1993	2.2.1995	5 000	D <sup>1/2</sup> + 4.0	semi-annually	651 585	65.2	348 415	34.8
Total		3 324 000							1819575	55	380 425	

<sup>1/</sup> Discount rate of the NBS

<sup>2/</sup> Sales at 31 December 1993

All three issues of bonds were in a dematerialized form. In compliance with the issue conditions, they were primarily offered to banks, insurance companies, and licensed legal entities (securities brokers). However, in reality, they were purchased mostly by commercial banks. Other entities such as insurance companies and investment companies purchased bonds only sporadically. Bonds from these three issues were sold in the primary market for at least their par value.

The development of the secondary market for government bonds was negatively influenced by delayed activities not only on the Bratislava Stock Exchange (BCPB), which under the issue conditions was responsible for the secondary market, but also by the Securities Centre, where the securities were to be registered as a precondition for their trading on the Bratislava Stock Exchange (BCPB). Because of these facts, the NBS looked for ways of making the government bonds market accessible also to small and medium-sized investors. After an agreement with the issuer, the NBS allowed the primary market traders to establish "Temporary Registers Monitoring the Changes in Ownership Rights" and to sell bonds over the counter in the secondary market.

Private persons in the secondary market were provided with the possibility of purchasing (in April 1993) the first government bonds from the 004 issue, sold by Všeobecná úverová banka, a.s. (VÚB), and bonds from the 005 issue, sold by Investičná a rozvojová banka, a.s. (IRB). In the second half of June, both banks started to sell bonds from the 006 issue. In October, the offer of government bonds was extended to bonds of the 007 issue.

The development of the prices of government bonds in the secondary market were influenced by the amendment to the Income Tax Act, under which earnings on government bonds were not subject to taxation. The further development was linked with the increase of prices of individual bonds, which influenced the level of yields before maturity. Because of the fact that the increasing price of government bonds negatively influenced the net yields before maturity, the bonds were not so attractive to potential purchasers as the issuer had expected.

The development of market mechanisms in the Slovak Republic was accompanied by the development of a financial market which, in the evaluated year, reported an increase in the activities of the participants. Apart from the National Bank of Slovakia and commercial banks, which in terms of the money market, had already started activities in the previous period, it was also the Bratislava Stock Exchange, the Bratislava Options Exchange, RM-System Slovakia, and numerous investment funds and companies that started their activities and created the fundamental preconditions for the development of the capital market.



## 2.2 MONETARY POLICY

### Calendar and Tools of Monetary Policy

#### 1. Interest rate policy

Since 1 January 1993:

Discount rate = 9.5%.

Lombard rate = 14.0%.

Sanction rate applied to stand-by credit = 3 x the discount rate = 28.5%.

Sanction rate for the Ministry of Finance applied to technical debit in the state budget performance = 2x the discount rate = 19%.

Since 20 December 1993:

Discount rate = 12.0%.

Lombard rate = 1 % over the last interest rate on auction refinance loans.

Sanction rate applied to stand-by credit = 3 x the discount rate = 36.0%.

Sanction rate for the Ministry of Finance applied to technical debit in the state budget performance = 2x the discount rate = 24%.

#### 2. Minimum reserve requirements

Since 1 January 1993, the methodology of the SBCS continued to be applied:

3% of primary time deposits,  
9% of primary demand deposits.

#### 3. Credit limits

- a tool for the control of commercial banks, introduced in March 1993.

#### 4. System of refinancing

The refinancing of commercial banks took one of the following forms:

- a) Auction refinance loans - monthly, the Dutch pattern of auction;
- b) Lombard loans - loans associated with securities collateral;
- c) Bills of exchange rediscounted - the rediscount rate is equal to the discount rate, this type of refinancing incorporated traditional trade bills, bills of exchange for the support of export and agriculture, privatization bills.
- d) Redistributive loans:
  1. classic - the rate of interest is equal to the discount rate;
  2. soft - interest rate = discount rate - 2%;On 20 December 1993, there was a change in the fixed rates of interest on classic loans (9.5%), and soft loans (7.5%).

#### 5. Auctions of Treasury bills

- an operative tool for financing the current account deficit of the state budget;

Since 21 June 1993, earnings on Treasury bills have been exempt from tax.

## 6. Exchange rate and foreign exchange policy

On 8 February 1993, the former Czechoslovak currency (Kčs) was split into two new currencies: the Slovak crown (Sk, SKK) and the Czech crown (Kc, CZK). Mutual payments between the two republics were settled via the clearing system using the following two methods:

The old block in the currency unit XCS, XCS 1 = SKK 1 = CZK 1.

The new block in the currency unit XCU. Operations applied the following exchange rates:

8 Febr. 1993	XCU 1 = ECU 1	(SK)	= ECU 1	(CZ)
15 Febr. 1993	XCU 1 = ECU 1.02	(SK)	= ECU 1	(CZ)
23 Febr. 1993	XCU 1 = ECU 1.035	(SK)	= ECU 1	(CZ)
2 March 1993	XCU 1 = ECU 1.05	(SK)	= ECU 1	(CZ)
8 March 1993	XCU 1 = ECU 1.05	(SK)	= ECU 0.98	(CZ)
20 April 1993	XCU 1 = ECU 1.03	(SK)	= ECU 0.98	(CZ)
4 May 1993	XCU 1 = ECU 1.00	(SK)	= ECU 0.98	(CZ)
10 July 1993	Slovak crown devalued by 10%			
	XCU 1 = ECU 1.00	(SK)	= ECU 0.90	(CZ)
			XCU 1 (CZ) = ECU 0.98 (CZ)	
12 July 1993	XCU 1 = ECU 1.00	(SK)	XCU 1 (CZ) = ECU 1.00 (CZ)	
3 Dec. 1993	XCU 1 = ECU 1.00	(SK)	XCU 1 (CZ) = ECU 0.97 (CZ)	
7 Dec. 1993	XCU 1 = ECU 1.05	(SK)	XCU 1 (CZ) = ECU 0.97 (CZ)	

The NBS and the CNB used these exchange rate changes to solve the fluctuating balance of mutual settlements between the two republics, with a total deviation at the end of the year being 18%.

The transfer of the old block balance to the new block was carried out according to the Payments Agreement (A Notification by the Slovak Ministry of Foreign Affairs on the Payments Agreement between the Slovak Republic and the Czech Republic No. 33, Part 8/93) and in accordance with the Protocol agreed between the SR and CR on the mutual settlement of accounts payable and receivable of legal entities and private persons (entrepreneurs) established before 8 February 1993 (of 4 February 1993), Articles 5 and 7 in accordance with Article 3 of the Payments Agreement of 4 February 1993, at a fixed rate of exchange 1 ECU = 34.499 Sk (equal to the Kčs/ECU exchange rate announced by the NBS and CNB on 5 February 1993).

Interest earned on the clearing account balances:

Old block - currency unit XCS - 3% interest

New block - currency unit XCU - 5% interest

The exchange rate policy with respect to freely convertible currencies was marked with a significant change when, **on 10 July 1993, the National Bank of Slovakia devalued the Slovak crown by 10% against the freely convertible currencies.** At the same time, the weight ratios of individual currencies in the currency basket were changed as follows:

Currency	USD	DEM	ATS	CHF	FRF
Weight	49.06 %	36.16%	8.07 %	3.79 %	2.92 %
Sk exchange rate	33.0620	19.2550	2.7410	21.6370	5.6690

The exchange rate policy with respect to commercial banks was, after the first weeks of 1993, marked by a restriction of access to the fixing of the National Bank of Slovakia because of the drop in the foreign exchange reserves of the NBS.

The NBS Vice-Governor announced a change in the conditions of the commercial banks' access to the foreign exchange fixing of the NBS. The ratio of the short open foreign exchange position of the bank to its equity capital enabling the bank to buy foreign currency in the foreign exchange fixing was defined as follows:

- 27 January 1993 > 15%;
- 3 February 1993 > 35%;
- 22 April 1993 > 30%;

On 2 February 1993, a decree issued by the National Bank of Slovakia was enacted to define the procedure to be applied by commercial banks when making payments to foreign exchange non-residents (Decree No. 6, 30/93). This procedure was designed to restrict advance payments and to stabilize the foreign exchange reserves of both commercial banks and the National Bank of Slovakia.

At its 18 November 1993 meeting, the Bank Board of the NBS cancelled, as of 8 December 1993, the "Directive" dated 2 February 1993, and adopted a new regulation defining the access of commercial banks to foreign exchange fixing. This new measure facilitated the commercial banks' access to the foreign exchange fixing of the NBS, and at the same time, it also changed the method of calculation of the foreign exchange position of commercial banks.

The foreign exchange policy with respect to inhabitants was defined by the notification issued by the NBS Vice-Governor on the purchase of foreign currency by Slovak citizens from commercial banks in January 1993. The regulation enabled all citizens of the Slovak Republic to purchase hard currency equivalent of Sk 7,500 from financial institutions in 1993. Of this sum, Sk 4,000 worth of foreign currency could be purchased in the first half of the year.

## **Implementation of the Monetary Policy**

The monetary policy for 1993 was defined by the monetary programme drawn up at the beginning of the year with the following parameters:

- rate of inflation: 17%,
- increase in the volume of net credit to the government: Sk 15.8 billion,
- growth rate of M2: 12%,
- decline in production: 4%,
- constant rate of currency circulation.

After re-evaluating the development of the real economy in the 1st half of 1993 with regard to the size of state budget deficit, the National Bank of Slovakia defined the monetary programme for the 2nd half of 1993 on the basis of the following preconditions:

- increase in the volume of net credit to the government: Sk 22 billion,
- rate of inflation: 25% to 30.4% (including devaluation and import surcharges),
- decline in production: 5.2%.

The monetary development was monitored on a monthly, quarterly, and yearly basis in the form of the Monetary Survey, which recorded the systemic changes in the economy - lending activity, budget performance, foreign position of the Slovak Republic, and the development of deposits (M2), i.e. the basic parameters defined in the monetary programme.

The basic instrument used for operative management was the daily monitoring of the monetary base, which recorded the Bank's consolidated balance of payments with an emphasis on reserve money, autonomous factors, as well as monetary-policy factors.

The monthly development of inflation in 1993 was as follows:

January	8.9%
February	1.6%
March	1.0%
April	1.2%
May	0.5%
June	0.4%
July	1.1%
August	2.4%
September	2.4%
October	1.4%
November	1.1%
December	0.6%
Total 1993:	25.1%

The development of inflation shows that the National Bank of Slovakia, using its monetary instruments, contributed significantly to the slow-down in the growth rate of consumer prices following the introduction of VAT in January and August 1993, and the devaluation of the Slovak crown in July 1993. The price increases in transportation and communications were also brought under control.

Deviations from the projected parameters of the monetary programme resulted from the fact that no import surcharges were introduced in the 2nd half of 1993. In consequence, the rate of core inflation reached a level of approx. 8% in the year under consideration. This development was mainly due to the shrinkage in the market (following the split of the former CSFR), decline in foreign trade turnover, monopolistic structures, and the expectations of a growing consumer-price inflation.

A special problem in monetary policy was in the area of foreign exchange, especially the development of foreign exchange reserves. After a sharp fall at the beginning of the year, the level of foreign exchange reserves was stabilized by means of administrative measures.

The devaluation of the Slovak crown by 10% on 10 July 1993 partly balanced the difference between the exporters' profits obtained at home and abroad, cut imports, and met in part the expectations of domestic and foreign businesses.

### **Utilization of Monetary Policy Tools**

In 1993, the NBS used both direct and indirect tools in order to achieve the objectives of its monetary policy. As far as direct monetary tools are concerned, mainly credit limits were utilized.

The monetary policy of the NBS for 1993 allowed for the extension of credit worth Sk 265.0 billion to households and enterprises. Of this amount of money available, commercial banks used Sk 264.5 billion.

Compared with the figure at the beginning of 1993, credit to households and enterprises recorded a total increase of Sk 25.7 billion (10.8%), of which foreign currency credits grew more rapidly.

The credit limits defined for individual quarters for the whole banking sector were complied with. The only exception was June 30th, when the limit was exceeded because of a change in the nature of credit limits, which started to incorporate foreign exchange credits that had not been included originally.

Within the credit limit for the first half of 1993, special funds were earmarked for spring agricultural work in the amount of Sk 1.6 billion. Of these assigned funds, Sk 1.56 billion (97.5% ) was utilized by the end of June.

Looking at the development of lending activities over the course of the year, different tendencies were observed in individual financial institutions. Several banks did not use the credit limits in full. In these cases, the NBS reacted by decreasing the limits, and the mass of funds saved as a result was utilized in other commercial banks. Lower-than-expected lending activities were reported mostly from smaller banks. This was due to their cautious approach to the business plans submitted and aimed at minimizing the risk exposure on new credits.

Requests for an increased credit limit made by individual commercial banks arose from extended lending activities in the initial production, privatization, and primary securitization of collaterals, as well as from other specific activities. The requests were also linked to credits for large and economically important projects (Calex Zlaté Moravce, Jadrová elektrárne (nuclear power plant) Jaslovské Bohunice, Slovenský plynárenský podnik (gas company) Bratislava, etc.).

Indirect monetary tools were used systematically; however, their forms varied. A specific position was held by refinance resources which, on the average, ranged between Sk 5.1 billion and Sk 11.1 billion.

Refinancing was realized in three forms: auction refinance loans, Lombard loans, and bills of exchange deals, in which the NBS provided rediscount loans. Export-promoting bills of exchange were introduced as of May 3rd, and bills to support privatization appeared as of June 1st. The forms of refinancing did not change significantly over the course of the year.

#### Development of Refinancing Loans in 1993

(Sk millions)

	Auction refinance loans	Lombard loans	Bills of exchange rediscounted	Total resources
Initial figure at 1 January 1993	2 500.0	3 595.0	2 129.8	14 224.8
January	2 500.0	1 725.0	971.6	7 030.2
February	0.0	1 720.0	2 731.8	4 451.8
March	1 600.0	2 318.0	2 799.4	6 717.4
April	3 400.0	2 196.5	2 335.4	7 931.9
May	4 200.0	2 913.7	2 266.4	9 380.1
June	1 900.0	3 802.7	3 887.4	9 590.1
July	0.0	5 289.0	5 193.2	10 482.2
August	0.0	3 256.5	5 625.0	8 881.5
September	1 000.0	3 408.5	6 013.2	10 421.7
October	2 500.0	2 180.8	6 096.4	10 777.2
November	5 000.0	0.0	5 219.7	10 219.7
December	3 000.0	0.0	3 367.6	6 367.6

The initial volume of resources includes refinancing loans in the amount of Sk 6.0 billion.

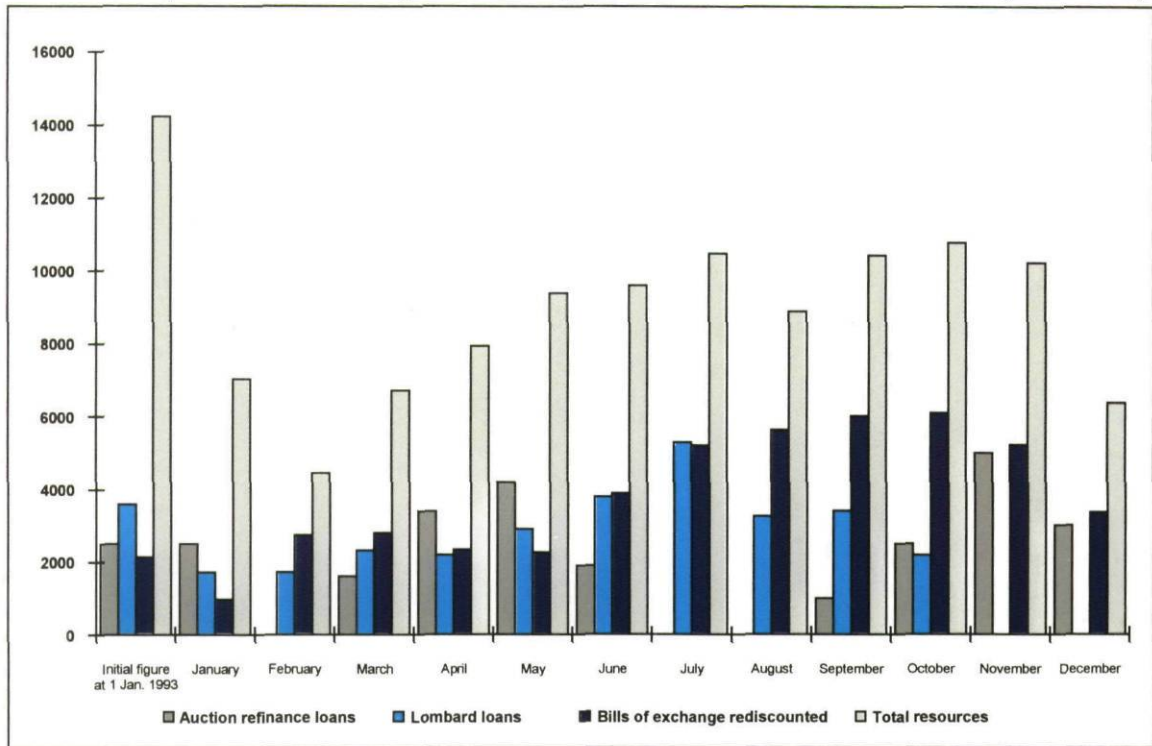
In the last quarter of 1993, a principle change was introduced in the structure of refinancing favouring the market-oriented form, in particular, the auction refinance loan with concurrent change in the volume and form of interest accrual on bills of exchange and on Lombard loans.

Of the total refinancing funds of Sk 6.4 billion granted to commercial banks in the course of the year, bills of exchange represented Sk 3.4 billion (53.1%), and auction refinance loans comprised Sk 3.0 billion (46.9%).

The auction refinance loan was used operatively reflecting the timely intents of the NBS. Thirty auction of refinance loans were organized during the year. The average amount offered in auction was Sk 970 million and the highest average quarterly volume was Sk 1,041.7 million reached in the fourth quarter.

### Development of Refinancing Loans during 1993

(Sk millions)



Interest rates on auction refinance loans fluctuated over the course of the year. They ranged between 10.0% to 24.0%, while both limit interest rates were reached in the first quarter of 1993. They were associated with the change in the conditions for auction refinance loans at the beginning of 1993, with the banks' interest in this form of refinancing as well as with the tense situation in the interbank money market. In the following quarters, the interest rate spread became narrower, but the fluctuation was still quite high (in the second quarter the interest rates moved between 14.0% and 22.5%; in the third quarter there was only one auction with a 17.9% interest rate, and in the fourth quarter the rate of interest was between 14.7% and 18.6%). The average interest rate on auction refinance loans was 17.0% in 1993.

There were two banks which had a particular demand for auction refinance loans and, at almost each auction, they attempted to acquire the whole volume offered. The loan offered by the NBS was distributed at every auction, and the demand was several times higher with the exception of the period in which the split of the currency took place.

Bills of exchange enjoyed a dominant position, because of their favourable interest rates and the longest maturity period compared with other refinance resources. Bills served different purposes including the support of agriculture, whereby the NBS assigned 3k 1.0 billion to rediscount agricultural bills of exchange (utilization at the level of 12%). The volume of rediscount loans increased in June in connection with the extended opportunity to draw refinancing funds in the form of export-promoting bills of exchange. The opportunity to purchase bills of exchange to support privatization was utilized by banks only and the volume reached Sk 10.5 million.

In the fourth quarter, a volume restriction was imposed on bills of exchange trading. The volume was set at the same level as on 30 October 1993, and this limit was imposed as a hard limit. The NBS branches could support new bills of exchange deals only to the extent they received payments against the bills, i.e., up to the amount of repurchase. It was in particular due to these measures that bills of exchange transactions dropped in volume by the end of the year.

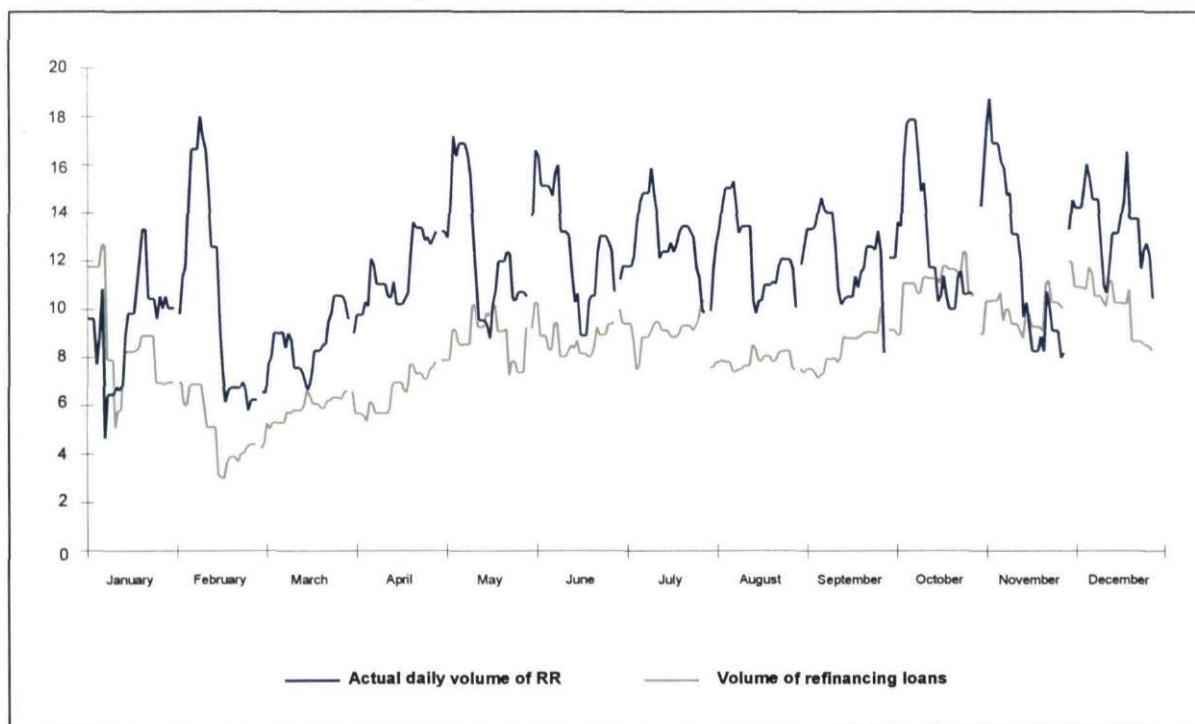
The Lombard loan was a very frequently utilized form of refinancing in the second and third quarters of the year with the highest monthly average reached in July (Sk 4.4 billion). Taking into account the development of refinance transactions and the goals of monetary policy, the NBS started to regulate this form of refinancing in September. In the fourth quarter of the year, an approach was adopted to reduce the maturity of Lombard loans by establishing a more direct tie to the current liquidity of commercial banks. At the ends of November and December, no commercial bank drew a Lombard loan.

Redistributional loans were granted to two commercial banks in the amount of Sk 33.6 billion. No repayment instalments of these loans were scheduled for the evaluated year.

In the course of 1993, the methodology applied to the minimum reserve requirements remained unchanged together with the percentage rates of individual categories of primary deposits. In the whole banking sector, the set level of required reserves (RR) was not achieved in the months of January (95.4%), March (79.8%), and April (93.3%). When free funds were deposited in bank accounts, a critical situation regarding the maintenance of RR developed in March in connection with the split of the currency.

**Required Reserves and Refinancing in 1993**

**(Sk billions)**



Liquidity management at commercial banks reflected the non-market behaviour of some newly established banks, which in several cases kept a reserve several times higher than required for the period. Stand-by loans drawn by commercial banks were used only to offset the temporary lack of liquidity.

### **Monetary Policy for 1994**

The NBS monetary policy for the second year of activities is built on two core ideas. First, the monetary policy is based on the need for a demanding anti-inflationary policy that would ensure the monetary stability of the Slovak economy. Second, the monetary policy must take into account the current status of the economy, which will serve as a basis for further economic and monetary development in 1994.

In accordance with these principles, the NBS monetary policy was based on the following assumptions:

GDP	0 to -2%
Inflation	10.0% to 13.2%
State Budget Deficit	Sk 14.0 to 18.0 billion
Growth of foreign exchange reserves:	USD 500 million

These projections were used as a basis to calculate the 13.2% annual growth of the M2 money supply. With the second decisive parameter of the NBS monetary policy defined as credit to companies and households, the rate of growth was projected at 6%.

The implementation of the monetary policy for 1994 will be extremely demanding. Therefore, the NBS will very carefully monitor the macroeconomic development of the real economy in the area of ownership transformation and restructuring together with economic and financial stability. The results will be used as a basis for the application of the NBS's own monetary tools for the purpose of responding to the actual situation and economic development with the aim of meeting the objectives set in the area of monetary operations.



## Conclusion

The implementation of the Slovak Republic's monetary policy in the first year of the existence of an independent central bank were influenced by several unique factors, such as the consequences of the split of the CSFR, the common currency used until 8 February 1993, and the introduction of a separate Slovak currency. Other significant factors include the introduction of a new tax system, continued price liberation, devaluation of the Slovak crown as well as the economic development partially affected by the establishment of a sovereign state.

The main objective of the monetary policy for 1993 was to ensure a sustainable level of inflation and maintain the internal convertibility of the currency. Based on the objectives of the monetary policy, which were formulated precisely over the course of 1993, the recorded level of inflation was 25.1%, which represented the lowest expected level. It was achieved under the influence of the tax reform, devaluation, price liberalization, and the continuous development of the budget management.

It was mainly due to the financing of the state budget deficit in 1993 that restrictions were imposed on more extensive lending activities mainly with regard to the corporate sector, which might have provided support to the restructuring process and to the improvement of the liquidity of companies. The budget performance remains to be one of the critical points that will affect the achievement of the monetary objectives defined for 1994.

Another critical point that affected the implementation of the monetary policy in 1993 (and it may also principally affect the monetary programme for 1994) was the development of the balance of payments, in particular, the current account. In the past year, there were several negative factors affecting the maintenance of internal convertibility. The first was the development of the balance of payments on current account and the pre-devaluation expectations. These factors put considerable pressure on the foreign exchange reserves and also on the exchange rate of the Slovak crown. Internal convertibility was maintained thanks to partial restrictions imposed by administrative measures, which included obligatory consultations on payment terms in the case of imports, restrictions on foreign exchange fixing as well as devaluation. Another factor influencing foreign exchange development was the increase in Slovakia's external debt, which given the achieved volume, can be considered acceptable both to the Government and the NBS, as well as the banking and corporate sectors.