

Foreword

Monetary development in the Slovak Republic in 1996 saw the further strengthening of the Slovak koruna internal and external stability. The basic objectives set by the National Bank of Slovakia for 1996 were fulfilled. The annual rate of consumer-price inflation was at the level of 5.4%, lower than projected in the monetary programme for 1996. Falling inflation had a stabilising effect on exchange-rate policy, which continued to be the anchor of economic reform. The use and widening of the fluctuation band, particularly during the second half of the year, prevented the excessive inflow of short-term capital designed to profit from the interest-rate differentials. Thus the Slovak koruna became one of the most stable currencies among the transforming economies. The fluctuation band was used within the range of $\pm 2\%$ from central parity.

Monetary development in 1996 was accompanied by a high rate of growth in basic monetary aggregates, particularly in the money supply and its main component - bank credit. The growth in the money supply was significantly influenced by the demand side of the gross domestic product, the growth of which was supported by domestic demand. Foreign demand had a negative effect on GDP, whereas foreign supply increased dynamically, as a result of which the trade balance gradually deteriorated and its deficit reached Sk 64.5 billion at the end of 1996. As the service balance also deteriorated in comparison with the previous year, the current account of the balance of payments also resulted in a marked deficit in 1996. The imbalance of foreign trade and the excessive growth in domestic demand compelled the National Bank of Slovakia to revalue its monetary objectives and monetary-policy instruments in July 1996, and to tighten its monetary policy with the aim of regulating domestic demand with subsequent influence on the development of foreign trade.

The end-1996 results confirmed the justification of the steps taken by the NBS: the rate of year-on-year growth in monetary aggregates slowed and the stability of the Slovak koruna was maintained. A negative aspect was not only the growing current account deficit, but first of all the unsuitable, i.e. consumer-based structure of import and the structure of its financing by term.

One of the main problems of the Slovak economy, which delimits and restricts the operating space of the central bank, is the process of economic transformation and restructuring. The low inflow of long-term foreign capital in the form of direct foreign investment and the growth in domestic demand, supported by the State budget deficit and the development of infrastructural projects, represent further problems for the financing of the trade deficit and servicing of the country's foreign obligations.

A dynamic element in monetary development was the increasing substitution of the lending market by the capital market. Commercial banks financed business projects and their demand for resources not only directly through bank loans, but indirectly as well, through the purchase of corporate bonds and company shares for their own portfolios. For this reason, the banking sector, after satisfying the demands of enterprises and households for financial resources, did not have enough funds to finance the needs of the government sector in December 1996.

In accordance with the goals of the Government and the NBS, the liberalisation of the country's foreign exchange regime continued. The liberalisation of some capital and financial account items was aimed at supporting the restructuring of the economy by liberalising the acceptance of loans from abroad with maturities above three years, which are in great demand within the Slovak economy. At the same time, long-term trade and proprietary relations were also supported through the liberalisation of international trade credits and direct investment in OECD countries.

The favourable results achieved in the area of inflation, the level of NBS foreign exchange reserves (US\$ 3,473 million, an amount 3.3 times greater than the average volume of monthly imports) on the one hand, and the growing trade deficit and the unsuitable structure of its financing on the other, will make increasing demands on the conduct of monetary policy in the future. Under these circumstances, the Bank Board of the National Bank of Slovakia approved, in December 1996, the Monetary Programme of the NBS for 1997, based on suitable monetary-policy instruments.

Since March, the banking sector has been developing under new conditions laid down under the new Banking Act, which has strengthened the position of banking supervision and created a legal background for the introduction of mortgage banking in Slovakia.

In 1996, the NBS continued co-operating with the IMF, the World Bank, BIS, EBRD, and the EXIM Bank of Japan. However, the most significant activities resulted from Slovakia's intention to join OECD and the EU. Negotiations about OECD membership have not yet been completed. Over the course of 1996, the NBS took several measures aimed at liberalising capital account payments. The Bank is prepared to maintain the ongoing trend of liberalisation. The activities aimed at gaining membership in the European Union, in which the Bank takes an active part, represented a significant step towards improvement in the position of Slovakia. We assume that activity in this area will intensify with the approach of the date when the final decisions on EU membership are to be made.

Over the course of the year, the volume of currency in circulation increased significantly. Apart from monetary consequences, this development led to increased demand for new banknotes. This, along with the need for the replacement of worn and torn banknotes, the change in the structure of notes in circulation with the issue of more Sk 5,000 and Sk 200 banknotes, and the growing number of coins in circulation, increased expenditure on the issue of new notes and coins. The number of seized counterfeits also increased, particularly that of poor-quality Sk 1,000 counterfeit notes. However, the safety of Slovak banknotes is still very high.

An inevitable condition for the successful completion of the transformation process is continuation in the restructuring of enterprises as well as the banking sector. The precondition of favourable macroeconomic and monetary development is a harmonised action and orientation of the government and the central bank in reducing domestic demand through restriction on bank lending to the economy, reduction of government spending, and ensuring a reasonable rate of wage increase, i.e. not exceeding the growth of labour productivity.

The basic and primary task in 1997, should be the search for internal mechanisms for increasing domestic savings (from the macroeconomic as well as the microeconomic point of view), and improving and maintaining the competitiveness of exports and production in general, so that the Slovak Republic could take an active part in international economic co-operation and division of labour.

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Vladimír Masár
Governor



Bank Board of the NBS

from left:

Ján Mathes, Executive Director, Currency Division

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