

## B. Report on Monetary Development

in the Slovak Republic in 1996

# 1. ECONOMIC DEVELOPMENT

The year 1996 was already the third year of economic growth for the Slovak Republic. When compared with the figure for 1995, real gross domestic product (expressed at constant 1993 prices) increased by 6.9%, reaching Sk 443.3 billion at the end of 1996. Regarding the generation of GDP, the tertiary sector was the most important (services, trade, communications); with regard to application, the key factor was domestic demand. The share of the private sector in GDP generation increased to 76.8%, from 62.6% in 1995.

The average rate of inflation, expressed in terms of consumer-prices, fell in 1996 to 5.8%, from 9.9% in 1995. Over the course of the year, the rate of year-on-year inflation dropped from 6.4% in January, to 5.4% in December and, at the same time, the average monthly rate of inflation fell by 0.15 points, to 0.45%.

The Slovak economy employed an average of 2,036.4 thousand persons, representing an increase of 0.8% compared with the figure for 1995. The rate of unemployment fell by 1.2 points, reaching a level of 12.6%, while the average number of registered unemployed was 324.3 thousand.

## 1.1 Price Development

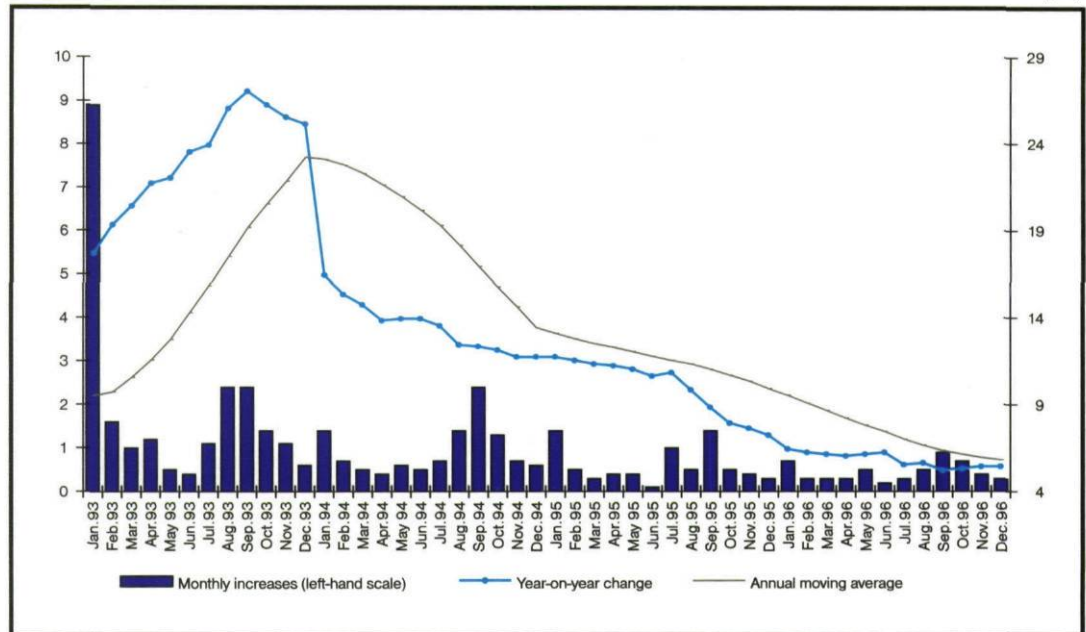
A factor stabilising the general level of consumer prices in 1996 was the development of food prices. Compared with the previous year, the rate of increase in food prices decreased almost three times. The consumer prices of foodstuffs, representing 30% of final household consumption, rose by an average of 4%. The price of potatoes, potato products, and fats were lower than a year earlier. The most significant increases were recorded in the price of eggs and egg products; non-alcoholic beverages; flour-milling, bakery, and pastry products; sugar, sweets, and confectionery goods.

The administrative measures taken over the course of the year did not accelerate the rate of price inflation. The rise in the general price level was moderated by a reduction in the basic rate of value added tax from 25% to 23% in January, and the import surcharge from 10% to 7.5% in July. The cut in these expense items was not reflected in a fall in the level of consumer prices; however, it slowed the rate of increase in the general price level. If unpaid taxes in the entrepreneurial sector were accounted for as profits, then the accumulation of resources would not have to be solved through a marked increase in prices to the detriment of the final consumer. The adjustment of regulated prices had a moderately increasing effect on the level of consumer prices. The most significant increases were recorded in the price of fuels, electricity, water supply, Pharmaceuticals, and postal services. The price adjustments were spread over the whole year, so that there would be no sudden changes in the development of consumer prices. As the deregulation of prices increased the costs of production inputs (especially fuel and electricity prices), the increased cost was reflected in consumer prices influencing the course of inflation. The indirect effects of price adjustments were insignificant in 1996.

The correlation between favourable development of food prices and the gradual price deregulation created conditions for a slowdown in the rate of base inflation, which is incorporated in the system through the market mechanisms of the transforming economy. The price increase from the beginning of the year, without components of seasonal and administrative nature, represented roughly 80% of the achieved rate of inflation.

**Development of inflation**

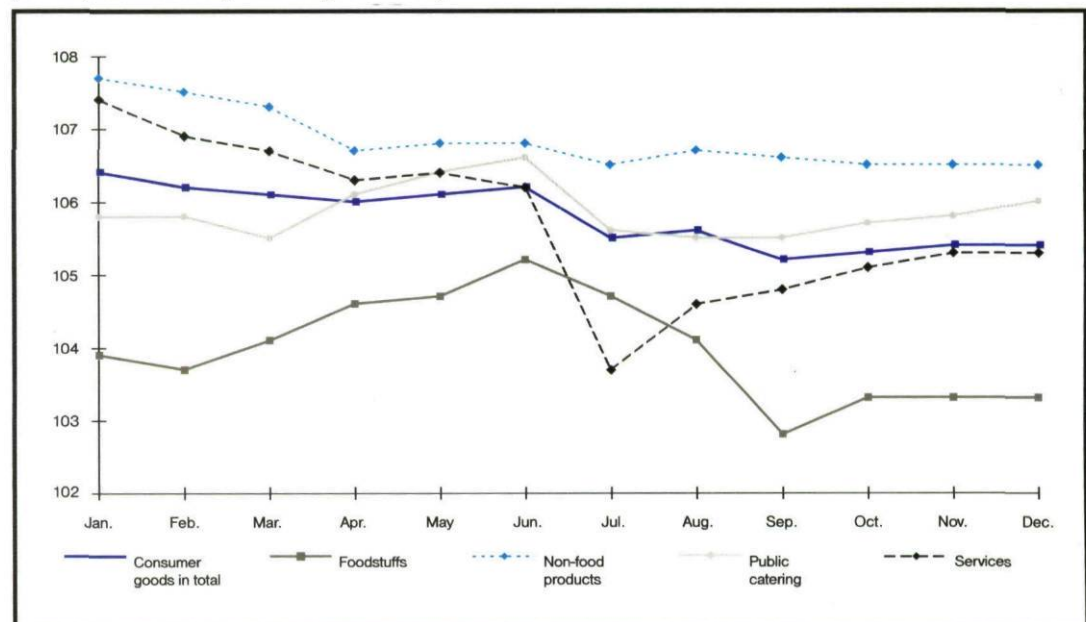
(%)



**Development of consumer price indices by consumption**

	Consumer Price Index (same period of last year = 100)	
	December 1996	Average since January
Goods and services in total	105.4	105.8
Foodstuffs	103.3	104.0
Non-food products	106.5	106.8
Public catering	106.0	105.9
Services	105.3	105.7

**Development of consumer prices in 1996  
(same period of the previous year = 100)**



Regarding the structure of consumption, the most significant price increases were recorded in the category of non-food products. This development was due to an increase in consumer demand for industrial goods in connection with the effects of price deregulation. Above-average increases were recorded in the price of culture,

footwear, leather goods, fuels, and textiles. The level of prices in the category of cultural needs (including books, journals, newspapers, etc.) rose due to the rapidly increasing production costs in the printing industry. The prices of footwear, leather goods, and textiles increased at a much faster rate than production costs.

The price of services and public catering recorded the same increase. In the category of services, the most significant increases were recorded in the price of education, culture, entertainment, sport, and recreation. The rise in the price of the above services is not restricted by price deregulation, and is not directly influenced by competitive import prices, for services belong to the category 'goods non-tradeable on foreign markets'.

**Comparison of consumer and producer prices**

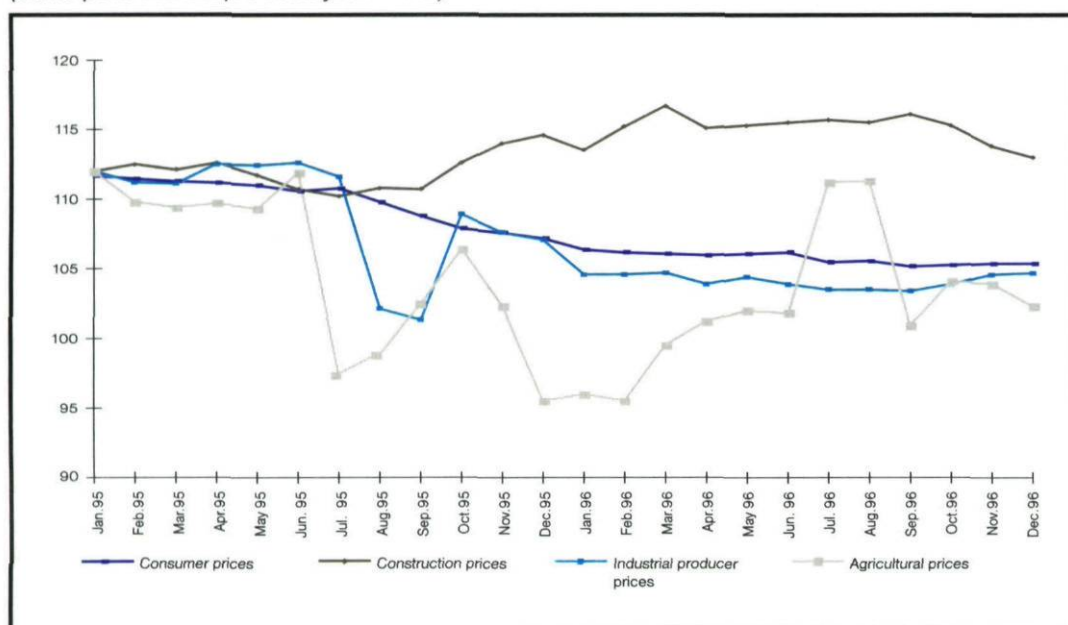
Average price index (same period of last year = 100)	1993	1994	1995	1996
Consumer prices	123.2	113.4	109.9	105.8
Industrial producer prices	117.2	110.0	109.0	104.1
Construction prices	124.1	111.0	112.0	115.0
Building material prices	113.6	109.2	112.2	107.4
Agricultural prices	114.6	110.8	103.3	104.7

The slowdown in the rate of inflation was due partly to the favourable development in industrial producer prices. The average rate of year-on-year growth in industrial prices slowed to 4.1%, from 9% recorded in 1995. The prices of paper, non-ferrous metals, fuels, power, and clothes fell below the level of the previous month. The most significant price increases were recorded in the printing industry (19.6%), due primarily to a rise in import prices, high import demands of the sector, and a marked rise in wages. The price level in the food industry rose by 4.4%.

Agricultural prices rose at a faster rate than the producer and consumer prices of foodstuffs. Compared with the level of the previous year, the rate of increase in agricultural prices accelerated by 1.4 points, to 4.7%. The price of vegetable products rose by 9.1%, and that of animal products by 1.5%.

**Development of producer and consumer prices in 1995-1996**

(same period of the previous year = 100)



Within the price categories under review, the most rapid increase was recorded in the price of construction work (15%). In 1996, the rate of increase in construction

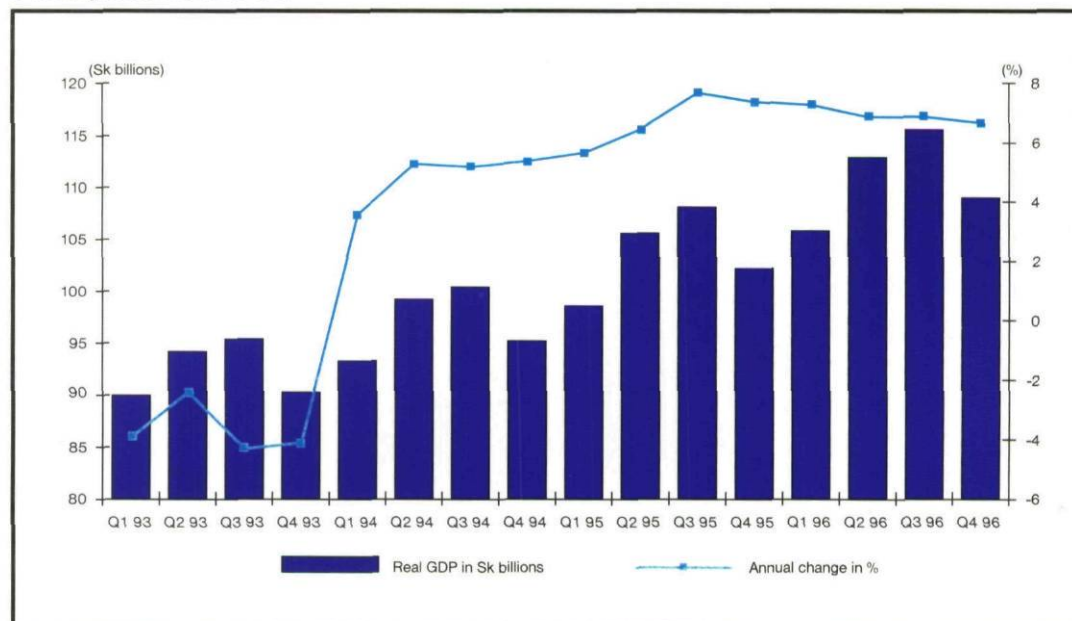
prices accelerated in comparison with the previous year. At the same time, the prices of building materials increased at a slower rate than in 1995. The prices of materials and products used in construction recorded an increase corresponding to a half of the annual rise in the price of construction work. One of the reasons behind the dynamic advance in construction prices was the increased demand for construction work. Regarding the level of expenses, wages in the construction industry recorded a relatively fast increase. With regard to the high wage costs, this factor was also responsible for the accelerated increase in price levels.

The general price level, the fluctuations of which are expressed by the GDP deflator (preliminary data), rose by 5.5% year-on-year (in 1995 by 9.3%). The most significant price increase (7.5%) was caused by final consumption in State administration. Unlike the other components of GDP, the rate of price increase in this category accelerated in comparison with the figure for 1995. While the rise in export prices (4.1%) was in harmony with the rate of increase in domestic producer prices, the level of import prices rose by 6.3%. The development of import prices was most influenced by a marked increase in the price of raw materials for power industry - crude oil and natural gas. Food and industrial prices on world markets increased at a slower rate. The level of import prices rose at a faster pace than that of domestic prices. In the future, this development may lead to a rise in both producer and consumer prices.

## 1.2 Gross Domestic Product

After a revival in 1994, expressed in terms of growth in gross domestic product (4.8%), economic growth continued at an increased rate in both 1995 (6.8%) and 1996 (6.9%). Regarding the structure of supply and demand, however, the development was qualitatively different in comparison with that during previous years.

**Development of real GDP**



## Aggregate Supply

Gross production in current prices reached Sk 1,475.5 billion, representing an increase of 18.8% compared with the figure for 1995. A faster rate of growth was recorded in intermediate consumption (21.9%), which influenced the level of the added value. With regard to the creation of gross domestic product (GDP), a decisive indicator is the added value. Its rate of increase accelerated by 13.5% year-on-year,

but the growth in intermediate consumption reached 21.9%. This unfavourable trend was recorded already in 1995 (the growth in intermediate consumption was higher by 4.5 points). The excess of growth in intermediate consumption over the increase in added value almost doubled in 1996.

**Creation of gross domestic product**

**(Sk billions, current prices)**

	1995	1996	Index 96/95
Gross production	1,242.2	1,475.5	118.8
Intermediate consumption	779.6	950.5	121.9
Added value	462.6	525.0	113.5
Other (including input banking services and products)	-5.2	-2.0	38.5
Indirect taxes	57.7	58.3	101.0
GDP at market prices	515.1	581.3	112.9

The development of the added value indicates that the structure of the economy is still unsuitable: it is dominated by production oriented to the simple processing of raw materials and products with high material, power, and import intensity and less added value.

In terms of sectors, the most dynamic year-on-year increase in added value was achieved in non-market services and construction, whereas the lowest figure was recorded in industry.

**Added values in selected sector**

**(Sk billions, current prices)**

	1995	1996	Index 96/95
Agriculture	29.0	30.2	104.1
Industry	147.1	152.8	103.8
Construction	23.8	27.5	115.5
Market services	211.0	240.9	114.2
Non-market services	63.6	77.9	122.6
Other	40.6	52.0	128.1
GDP at market prices	515.1	581.3	112.9

**Services**

A sector which maintained its dominant position in terms of GDP formation was that of services. The proportion of services to GDP (at current prices) rose to 54.8%, representing an increase of 1.5 points year-on-year. With regard to GDP growth, services represented a key sector, with an 84.3% share of the growth in GDP.

With a growth rate of 16.1%, services ranked second in GDP formation after item 'other' (increased by 28.1%), which covers indirect taxes, profits from stocks, input banking services and products, changes in indirect taxes related to production, etc. An increasing rate of year-on-year growth was recorded in both market and non-market services.

The volume of services was dominated by market services (with a share of 75.6%, i.e. Sk 240.9 billion), especially trade, transport, and telecommunications (representing 69.5% of market services).

The volume of retail sales grew at current prices by 13.1% and at constant prices by 7.0%, representing an increase of 5 points year-on-year. The share of private enterprises of the volume of realised retail sales increased to 94.6%, from 91.7% in 1995.

The source of growth for the service sector was due to a marked increase in domestic demand, in both investment demand and final household consumption. The growth in demand gradually created room for the development of new types of services, especially in the area of real estate, computer engineering, leasing of

machines and equipment, other commercial services, recreation, sports, and cultural activities, etc. The development of receipts from these services (except real estate services) was quite dynamic and exceeded the rate of GDP growth, e.g. computer engineering services increased by 21.4%.

The volume of freight transport experienced a moderate decline (0.3%); the sharpest decreases were recorded in water transport (14.9%) and railway transport (4.5%). The decrease in dynamism of freight transport was a reaction to the slowdown in the rate of growth in industrial production, as well as imports.

In 1996, the most rapid increase was recorded in telecommunications (32.5%); their share of GDP increased to 25.0%, from 21.3% in 1995. The dynamic development of this sector was due to the growing domestic demand for investment, and reaction to the increasing imports of investment nature.

## Industry

As a result of a marked year-on-year fall in the volume of added value in the categories of coke, refined oil products and nuclear fuel (by 22.3%); wood working (by 12.1%); pulp and paper (by 11.4%); the sector of industry (within the category of enterprises with more than 25 employees) recorded a fall of 0.5% in added value. The rise in the value of this indicator in the categories of food processing, beverages, electrical and optical instruments, and especially in the production of vehicles did not influence the total results of the sector.

In parallel with the decline in the volume of added value, the share of industry in GDP gradually decreased, from 28.7% in 1994, to 28.6% in 1995, and to 26.2% in 1996.

This trend was recorded in each production sector, except for the manufacture of machines, electrical equipment, and vehicles, where the share of GDP remained unchanged in comparison with 1995.

The volume of industrial production reached Sk 531.8 billion (at current prices), exceeding the level of 1995 by Sk 34.6 billion. With regard to the rate of growth, this was the lowest increase recorded in the past three years (104.8% in 1994; 108.3% in 1995; and 102.5% in 1996).

With regard to sectors, the most dynamic development was recorded in the manufacture of vehicles, particularly motor vehicles, wagons, and ships (a growth of 22.1%). A downward trend was recorded mainly in the textile and clothing industry, coke production, oil refining, nuclear fuels, and wood working.

Regarding the form of ownership, the volume of production in the private sector increased year-on-year by 8.3%, while production in the public sector declined by 7.9%.

The volume of exports in industry declined, reaching only 94.9% of the level of 1995. In comparison with previous years, the proportion of exports to total sales and industrial production was as follows:

	Volume of exports (Sk billions)	Share in %	
		of sales	of industrial production
1994	171.2	40.4	48.8
1995	212.5	43.2	50.7
1996	201.7	38.3	44.5

## Construction

After a moderate revival in 1995, the favourable trend in construction continued in 1996. The volume of construction work reached Sk 62.0 billion (at current prices), representing the highest figure since 1994:

	1994	1995	1996
Volume of construction work (in Sk billions)	45.8	51.5	62.0
Year-on-year index of growth	93.2	102.7	104.4

Despite the achieved results, the development in construction industry cannot be regarded as dynamic with regard to the price levels of building materials (which rose by 7.4% year-on-year) and construction work (increased by 15.0%). The share of construction in the creation of GDP increased year-on-year by a mere 0.1 percentage points, to 4.7%.

In comparison with 1995, the structure of construction orders at companies with over 25 employees changed in favour of domestic orders:

	Index	
	1995/1994	1996/1995
Domestic construction work	97.5	122.7
Construction work abroad	142.6	55.9

With regard to domestic construction orders, the most significant year-on-year increase was recorded in the volume of new construction projects, reconstruction, and modernisation (by 27.3%), due primarily to growth in investment demand. The volume of maintenance and repair work fell by 6.4%.

## Agriculture

The significance of agriculture for society is substantially greater than contribution to gross domestic product, which reached 4.7% in 1996, representing a year-on-year decrease of 0.35 percentage points. This proportion is still high in Slovakia in comparison with advanced EU countries (below 3.5%).

In 1996, weather conditions negatively affected the grain crop, the volume of which (3.3 million tons) was 4.8% lower than in the previous year. To eliminate the shortage of grain until the next harvest, the Government gave permission for customs free import of 260 thousand tons of grain until 30 June 1997, and for an increase in the 1997 State budget (Sk 600 million) for the purpose of financing an intervention in the wheat market.

After a certain improvement in animal production in 1995, the number of farm animals was again reduced in the main categories (cows by 4.0%, pigs by 4.4%), and the parameters of effectiveness also deteriorated, particularly those relating to the cattle-feed and reproduction.

In 1996, the purchase price of agricultural products increased, for the first time since the beginning of transformation, at a faster rate (4.7%) than the price of food producers (4.4%) or the consumer price of foodstuffs (4.0%). On a year-on-year basis, the price of agricultural inputs increased twice as fast (by 9.4%).

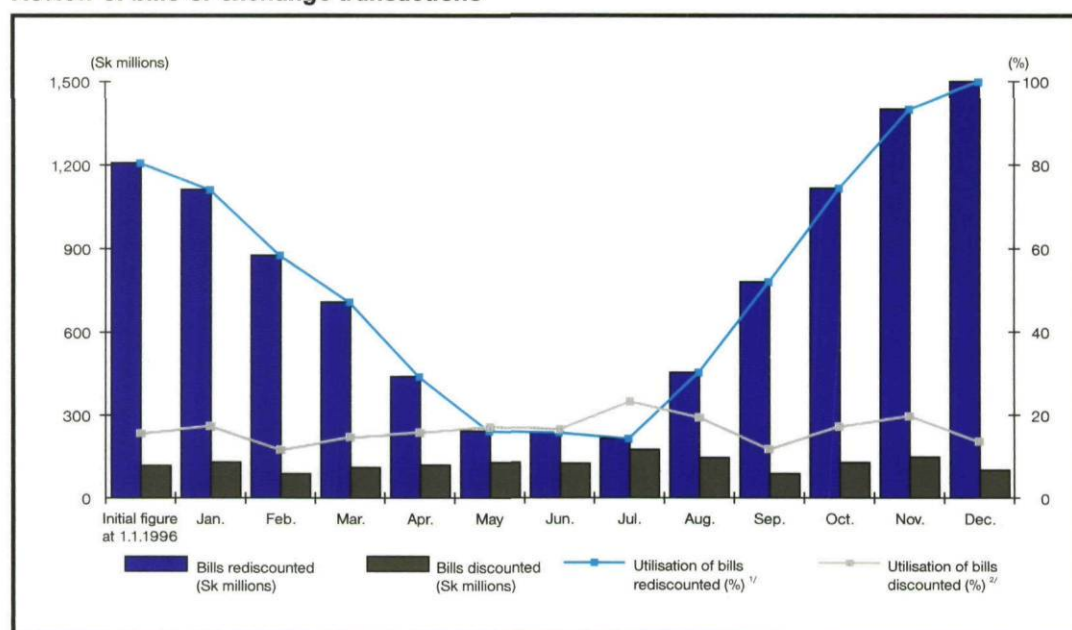
A persisting problem facing the agricultural sector was the deterioration in the balance of foreign trade. In 1996, the negative balance of Sk 12.6 billion (according to valid tariff rates) accounted for 22.5% of Slovakia's trade deficit (excluding imports



within the scope of unblocking receivables) and represented an increase of Sk 5.5 billion (43.7%) compared with the level of 1995. The increase was due to the surplus of wheat exports in 1995 (Sk 2.6 billion), and the deficit arising from the demand for wheat imports in 1996 (Sk 1.0 billion). While the exports of agricultural food products were dominated by raw materials and semi-products, the key import items were finished products, including commodities for the production of which suitable conditions exist in Slovakia (wheat, meat, bakery's goods, fruit juices, spirit, etc.) The low competitiveness of Slovak products on foreign and domestic markets was due, among other reasons, to the strict protection and support of producers in EU countries (in the EU, the average amount of farm subsidy for 1 ha of arable land is ECU 317; in the SR, the subsidy amounts to ECU 76, which is less than 24%).

As part of monetary policy, the National Bank of Slovakia had used a special system of trading in bills of exchange issued for the financing of the needs of agriculture since 1994. In 1996, the volume of trading was set at Sk 1.5 billion and was utilised to 100%. The system of lending for the support of seasonal agricultural work by commercial banks was further improved.

### Review of bills-of-exchange transactions



1/ Volume earmarked for the support of agriculture: Sk 1,500 million.

2/ Volume earmarked for export promotion: Sk 750 million.

### Aggregate Demand

The overall economic growth in 1996 was due primarily to the situation in the area of demand and its structural development.

With regard to the utilisation of GDP, the main source of economic growth was domestic demand (an increase of 21.1%). In contrast with 1994 and 1995, the GDP growth in 1996 was unfavourably influenced by the development of foreign demand expressed in terms of 'net exports of goods and services'. The analysis of trends has revealed that domestic demand exceeded domestic supply, which resulted in a deficit in the current account of the balance of payments in 1996, accompanied by a decline in exports and a marked increase in imports.

### Structure of GDP in terms of utilisation

	Current prices						Constant prices 1993					
	1994		1995		1996		1994		1995		1996	
	Sk billion	Share in %	Sk billion	Share in %	Sk billion	Share in %	Sk billion	Share in %	Sk billion	Share in %	Sk billion	Share in %
GDP	441.3	100.0	515.1	100.0	581.3	100.0	388.1	100.0	414.5	100.0	443.3	100.0
Final household consumption	222.6	50.44	252.6	49.0	286.1	49.2	196.0	50.5	202.7	48.9	217.2	49.0
Final government consumption	96.4	21.8	104.0	20.2	138.8	23.9	82.6	21.3	83.9	20.2	104.2	23.5
Gross fixed capital formation	130.0	29.5	150.6	29.2	212.7	36.6	114.6	29.5	121.2	29.2	161.6	36.5
Change in stocks	-27.4	-6.2	-3.8	-0.7	9.1	1.6	-26.1	-6.7	-3.5	-0.8	6.5	1.5
Exports	287.8	65.2	325.8	63.0	334.0	57.5	260.0	66.9	269.2	64.9	265.0	59.8
Imports	263.4	59.7	316.4	61.4	398.3	68.5	239.5	61.7	262.4	63.3	310.9	70.1
Balance	24.4	5.5	9.4	1.8	-64.3	-11.1	20.5	5.3	6.8	1.6	-45.9	-10.4
Statistical discrepancy	-4.7	-1.1	2.3	0.4	-1.1	-0.2	0.5	0.1	3.4	0.8	-0.3	-0.1

The most dynamic component of domestic demand was gross fixed capital formation, which increased by 42.8% year-on-year. The growth in this area of domestic demand was influenced by an increase in investment demand (gross fixed capital formation) and a rise in stock levels. The high share of fixed capital was created primarily in the non-financial sector (61.3%) and the household sector (19.9%). The growth in investment demand was significantly supported by the processing industry (chemical and oil industries).

Investment in machines, with a 48.3% share in total investment, was directed primarily to trade and services, e.g. equipment for motor-vehicle repairshops, commercial facilities, etc. (Investment in 'reputation' instead of production). Investment in research and development continued to be very low (the proportion of intangible investments to total investment was 3.3% in 1996). Investments were directed largely to non-productive sectors (highways, infrastructure, hydro-electric and other power projects), the implementation of which is not directly reflected in quality improvement and production structure, while their indirect effects on the economy will be possible to evaluate only on a long-term basis.

### Development of investment and savings

(Sk billions, current prices)

	1993	1994	1995	1996
Gross domestic product	369.9	441.3	515.1	581.3
Gross investment	101.0	102.6	146.8	221.8
Gross fixed capital formation	120.7	130.0	150.6	212.7
Change in stock level	-19.7	-27.4	-3.8	9.1
Net imports of goods and services	-20.5	24.4	9.4	-64.3
Exports of goods and services	227.8	287.8	325.8	334.0
Imports of goods and services	248.2	263.4	316.4	398.3
Gross savings	80.5	127.0	156.2	157.5
Investment rate (%) <sup>1/</sup>	27.3	23.3	28.5	38.2
Savings rate (%) <sup>2/</sup>	21.8	28.8	30.3	27.1

1/ Proportion of gross investment to gross domestic product.

2/ Proportion of gross savings to gross domestic product.

The marked increase in investment demand is documented by the development of investment (investment rate increased in 1995 by 4.8 points, in 1996, by as much as 9.7 points). In 1996, this trend reached a level, the exceeding of which may endanger the country's macroeconomic balance and raise the level of inflation. The accelerating growth in gross investment was accompanied by a slowdown in the rate of gross savings. The rapid increase in the savings rate, which reached 7 points in 1994, slowed to 1.5 points in 1995, and dropped by a further 3.2 points in 1996.

The excess of investment rate (38.2%) over the savings rate (27.1%), which reached 11.1 points in 1996, representing a significant year-on-year increase and exerted pressure on the replenishment of domestic savings from foreign resources. This fact was reflected in the growing deficit in the balance of payments current account and the imbalance of foreign trade.

The overall gross capital formation was significantly influenced by the level of stocks, which rose by Sk 6.5 billion (at constant prices) in 1996. The increase in the stocks of commercial goods accounted for 65.8% of the total increase in stocks.

In addition to the growth in investment demand, the development of the economy in 1996 was also marked by an extraordinarily high year-on-year increase in the level of final consumption in State administration (24.2%). This development was due to expenditures on the territorial reorganisation of State administration, expansion of government investment in infrastructure, import of aircraft and other special technology for government needs, and the high increase in wages. The accelerated rate of growth in government consumption, reflected in the increased proportion of the State budget deficit to GDP, will create considerable risks for the preservation of the internal balance of the economy.

In 1996, the final consumption of households increased by 7.2% at constant prices. The growth in final household consumption, depending on the development of gross disposable income and the gross saving rate of households, was influenced by two components, which is indicated in the following survey of the creation and disposal of income in the household sector.

***Creation and disposal of income in the household sector***

	Index 1995/1994	Index 1996/1995
Current income	118.2	114.8
Current expenditure	129.4	122.0
Gross disposable income	114.8	112.2
Final household consumption	113.5	113.3
Gross savings of household	122.0	106.4

Current incomes of households were most influenced by the compensation of employees, which accounted for 58.8% of total income (in the previous year: 57.0%) and recorded the highest rate of growth (17.8%). Unilateral current transfers received, also grew at a faster rate (14.6%), particularly unemployment benefits. Current expenditure of households, paid from their gross current incomes, i.e. items which are not of the nature of final consumption (direct taxes and charges, social security contributions, interest payments on loans received, etc.) grew at a faster rate than current income. A decisive item in the category of current household expenses was represented by unilateral current transfers (91.4%), which include taxes and charges transferred to central and local government budgets, social security contributions paid by employers, employees, and the self-employed to health and social insurance funds, and contributions to the employment fund of the SR. The most rapid increases were recorded in personal income taxes paid by natural persons (29.1%). Significant increases were also recorded in social security contributions (19.1%) and expenses associated with ownership and business undertaking (16.2%), which included interest paid by households and small businessmen on loans received.

Total current expenditure absorbed 28% of the current income of households, i.e. 3 percentage points more than in 1995. However, the disposable income of households grew in 1996 at a rate 2.6 percentage points slower than a year earlier. Households spent 85% of their gross disposable income on final consumption, which represented the same proportion when compared with the figure for 1995. A lower increase in gross disposable income, at the same rate of growth as final household consumption, influenced the development of gross savings of households, which increased by only 6.4%.

The average monthly nominal wage, or salary earned by persons working in the Slovak economy reached Sk 8,154, representing a year-on-year increase of 13.3%,

in real terms 7.2%, while labour productivity as % of GDP at current prices increased by 11.8%, and at constant prices by 6.0%. The accelerated increase in average wages did not correspond to the growth in labour productivity. The accelerated growth in wages supported by the revival of investment activity led to an increase in demand, which was not satisfied from domestic supplies, due to insufficient growth in labour productivity. These trends in the past two years indicated the existence of an inflationary squeeze between real wages and labour productivity.

#### **Development in labour productivity and average wages**

	Index (same period of last year = 100)					
	1994		1995		1996	
	Current prices	Constant prices <sup>1/</sup>	Current prices	Constant prices <sup>1/</sup>	Current prices	Constant prices <sup>1/</sup>
Gross domestic product (GDP)	119.3	104.9	116.7	106.8	112.9	106.9
Labour productivity of GDP per head	120.4	104.9	113.5	103.8	111.8	106.0
Average monthly wage per employee	117.0	103.0	114.3	104.4	113.3	107.2
Number of wage and salary earners	98.2	98.2	102.2	102.2	100.8	100.8

1/ Constant prices of 1993

In the basic sectors of the national economy, the relationships between production, labour productivity, and wages developed differently. In industry, the rate of year-on-year growth in nominal wages was twice as fast as the rate of increase in labour productivity at current prices; whereas in construction (the only sector), labour productivity exceeded the growth of nominal wages at current prices by 5.9 points. In freight transport, the growth in nominal wages (by 16.4%) was accompanied by a fall in labour productivity in terms of transported goods by 0.7%, and in terms of output by 5.1%. In 1996, the faster growth in wages than in labour productivity in some sectors did not lead to a marked rise in price levels. However, it may be regarded as one of the causes of the worsening financial situation of enterprises. In future, the continuation of this trend may lead to a rise in the level of prices and a fall in the competitiveness of products. At the same time, the growth in consumer demand will exert pressure leading to further growth in imports of consumer goods.

The rapid increase in domestic demand was reflected in the accelerated rate of growth of imports (by 18.5% at constant prices), while its share of GDP increased to 68.5%, from 61.4% in 1995. The volume of exports fell year-on-year by 1.6% (at constant prices), which represented a deterioration in export performance to 57.5% in 1996, from 63.2% a year earlier. The unfavourable development in the area of imports as well as exports was reflected in the trade balance deficit of the SR.

### **1.3 Financial Results of Organisations**

The slowdown in the rate of growth in the basic sectors of production, growth in demand for imports, decline in export performance, increase in labour costs, and the rise in stock levels resulted in a fall in profits earned by non-financial organisations.

In comparison with the level of 1995, the profits of non-financial organisations at current prices declined by 7.1%. The level of profits of companies with 25 or more employees fell significantly (by 21.5%), while the profits of small companies with up to 25 employees increased significantly (by 40.7%). Of the total number of companies with over 25 employees, only 45% achieved profits. The remaining 55% ended the year with a loss 76.9% higher than in 1995. The highest losses were reported by companies involved in the manufacturing of machines and equipment (Sk 5.3 billion), agricultural production (Sk 2.6 billion), and the manufacture of other non-metal mineral products (Sk 1 billion).

According to data from the Ministry of Economy of the SR (ME SR), the level of profits fell significantly in all branches of industry, particularly in the manufacturing industry, where a loss of Sk 320 million was recorded in 1996, whereas a year

earlier, a profit of Sk 8 billion had been achieved. Despite the marked worsening in economic performance, average wages increased in each branch of the processing industry (in the range of 9.2% to 30.0%), by an average of 14.7%. In the processing industry, labour productivity increased by only 3.9% and in one-third of these sectors, the level of labour productivity fell in 1996. The most serious losses were reported by the manufacturers of radios, television sets, and telecommunication equipment (76.6%), and the producers of leather goods, particularly footwear (27.7%). In the production of fibres, paper, and cardboard, profits earned in 1996 reached only 10.9% of the level of 1995. In metal working, the level of profits fell below the level of 1995 by as much as 89.7%, while average wages increased by 13.2% and labour productivity dropped by 15.4%.

The most profitable sector of industry - the production and distribution of electricity, gas, and water - generated a profit of Sk 19.6 billion, falling below the level of 1995 by 17.7%.

The increase in the rate of loss was due mainly to the proportion of costs to the volume of production, where the index of cost increase well exceeded the index of income growth. The return on investment in the Slovak industry (according to data from the ME SR) continued to fall by 2.7 points, to 3.3% in 1996 from 6.0% in 1995. The sharpest decline in the rate of return was recorded in the production and distribution of electricity, gas, and water by 8 points, in raw material extraction by 4.1 points, while the manufacturing industry as a whole became unprofitable (return on investment: 0.1%). The less profitable sector was the manufacture of machine tools, where total expenditure per Sk 1 of revenue amounted to Sk 1.26.

The decline in profits, increase in losses, and consequent fall in profitability led to insolvency, characterised by the volume of obligations after maturity, which had reached a level of Sk 102.2 billion by the end of 1996 and the volume had increased by Sk 9.7 billion since the beginning of the year.

The financial performance of entrepreneurial entities, which gradually deteriorated, reflected their situation in the area of production and sales on domestic and foreign markets. It also indicated an acute need for detailed analysis of production, possibilities for increasing the return on investment, especially the need for thorough restructuring in industry, and the necessity for new legislation, especially the law pertaining to bankruptcy and composition.

## **1.4 The Hidden Economy**

To evaluate the development and condition of the economy, it is also necessary to take into account the development of the country's hidden economy, the economic and non-economic activities of which are present in every economy. From the statistical point of view, the hidden economy is understood as economic activities, which are not (partly or fully) recorded in statistics, accounting documents, tax returns, etc., due to economic reasons (e.g. in order to lower tax payments, avoid the payment of social security contributions), or for statistical reasons (e.g. refusal to fill statistical forms, to cover all economic units in statistical registers).

It follows from a study conducted by the Institute of Information Science and Statistics (INFOSTAT) in November 1996, at the request of the NBS, that in 1993 and 1994 the estimated size of the hidden economy, expressed in terms of its share of the total volume of added value, was balanced. In 1993, the hidden economy represented, according to estimates, 13% (Sk 43.2 billion) and in 1994 about 13.1% of the total volume of added value (Sk 51.5 billion). In 1995, the estimated volume of the hidden economy was reduced to 11.8% of the gross domestic product (Sk 55 billion). After 1995, the share of the hidden economy of GDP is expected to stabilise. In 1996, the hidden economy reached a level of Sk 70 billion.

## 2. BALANCE OF PAYMENTS

### 2.1 Balance of Payments

The results of GDP-structure analyses have shown that the Slovak economy in 1996 was characterised by the dominant position of domestic demand, including investment demand, while the influence of external demand diminished. Domestic capacities failed to respond flexibly to growth in demand and its rapidly changing structure, and thus the space available was filled by foreign suppliers. With regard to the openness of the Slovak economy, this imbalance led to growth in trade deficit and, subsequently, in the current account deficit as well. This resulted in a nearly 10 times faster rate of growth in the import of goods and services than in exports, and consequent rapid increase in current account deficit.

The current trends of development document that the growth in GDP was achieved despite increased demands for material inputs. In addition to the increasing use of imported raw materials and intermediate products in the Slovak economy, an important factor was the rise in price of imported raw materials. On the other hand, the prices of exported products could not be increased in proportion to the improvement in their qualitative parameters and degree of processing, with the result that the ratio between import and export prices developed to the detriment of export prices. While the prices of imported goods and services increased by 6.3%, the level of export prices rose by only 4.1%. In 1996, the influence of price developments (with regard to the physical growth in imports) was responsible for roughly Sk 10 billion of the total deficit of the balance of goods and services (Sk 63.3 billion).

In 1996, the balance of payments of the Slovak Republic vis-a-vis abroad resulted in a deficit of Sk 59.5 billion (US\$ 1.9 billion) on the current account, and its share of GDP reached 10.1% (excluding imports related to the unblocking of receivables, the current account deficit amounted to Sk 49.8 billion, representing 8.5% of GDP). The achieved result was influenced to a large extent by the growing trade deficit, which amounted to Sk 64.5 billion (US\$ 2.1 billion). Slovakia's foreign trade turnover increased year-on-year by 17.4%, while its exports grew by 6.1% and imports by 28.5%.

One of the most serious problems facing the Slovak economy in 1996 was the decline in the country's export performance. The volume of commodity exports reached Sk 270.6 billion, representing an increase of Sk 15.5 billion in absolute value. In 1996, the proportion of commodity exports to GDP fell to 46.5%, from 55.5% in 1995, under the influence of various factors. One of the most important was the accelerated growth in domestic demand and fall in the world prices of commodities forming the structure of Slovak exports. Although the decline in exports was associated with the slowdown in the rate of economic growth in EU countries, the present problem facing Slovak exports is structural in nature rather than economic. The structure of exports was to a large extent marked by the disposability of the production base and only secondly by foreign demand. The marked increase in Slovak exports in previous years was due mostly to raw materials and semi-products.

The export of such products had, in all probability, reached its limit, which was reflected in a decline in the exports of a wide range of products, represented by commodities (according to the two-digit code of the harmonised system) such as iron and steel (Sk 3.9 billion), grain (Sk 2.8 billion), chemicals (Sk 0.9 billion), woodpulp (Sk 0.8 billion), copper and copper products (Sk 0.8 billion), etc. The year-on-year increase in exports reflected the gradual revival of machine engineering, particularly the growth in motor-car production for export (Sk 10.1 billion). Regarding other machine engineering products, the increase in exports was realised in the category of machines, spare parts, pumps, and reactors (Sk 2.2 billion). This increase was

spread over several smaller parts, particularly in the sub-group of boilers and boiler equipment.

Exports also increased in the category of electronic recording and reproduction equipment (by Sk 2.2 billion), i.e. optical cables, cable telegraphs, and telephones. The exports of aluminium and aluminium products increased significantly (by Sk 3.8 billion), despite the fall in the price of aluminium on the world market. With regard to the fact that the capacity of aluminium working is very small in Slovakia, the production was oriented to export, predominantly to EU countries and the Czech Republic. The structure of exports continued to be dominated by products with a low degree of processing (raw materials and semi-products accounted for 60.2%, compared with 62.8% in 1995), owing to the existing structure of industry, slow pace of restructuring, and increased share of finished goods.

The year-on-year growth in imports reached 28.5%, representing an increase of Sk 74.4 billion in absolute value. The import of military technology from the Russian federation, as a form of settlement of government receivables, amounted to Sk 8.7 billion, i.e. 11.6% of the total growth in imports. The most rapid increase was recorded in the import of motor vehicles (Sk 19.8 billion, i.e. 26.6% of the total increase in imports), of which car imports accounted for Sk 16.1 billion (21.6%).

The growth in material-, energy-, and capital-intensive industries increased the demand for inputs above the level of GDP growth. The imports of mineral fuels increased by Sk 10.9 billion, i.e. 12.0% of the growth in imports, due to increases in the import of natural gas (Sk 2.9 billion), electricity (Sk 2.1 billion), and crude oil (Sk 2.9 billion). The growth in import of mineral fuels was due to an increase in the energy intensiveness of production and a marked rise in the price of oil and natural gas.

The import of machines and machine parts, pumps, boilers, electronic recording and reproduction equipment, optical, measuring, and medical instruments, which are predominantly of investment nature (they include consumer goods of mechanical and electrical engineering nature), increased by Sk 18.0 billion, i.e. 24.2% of the total growth in imports. Though machinery and equipment represented a significant import item, it is not possible to state that they were used effectively for the restructuring of production companies and the increase of the country's export potential. If we take into account only technological equipment that could directly influence the restructuring of the economy, then imports (according to data from the NBS) amounted to Sk 9.3 billion, i.e. 12.5% of the total increase in imports, and were designed mostly for the needs of industry (Sk 6.7 billion). After including the increase in the imports of power generating equipment, engines, transformers, measuring instruments, etc. (which are imported for productive consumption), the proportion of this category to the total growth in imports will increase to 17.4%. The last import items in this category were mechanical and electrical equipment of mostly consumer nature (air-conditioning, refrigerators, washing machines, cameras, etc.), the amount of which increased by Sk 4.0 billion, representing 5.4% of the total growth in imports. The import of consumer goods was also accompanied by an increase in food imports (Sk 3.0 billion) and industrial goods such as furniture and footwear (Sk 1.1 billion), which together represented 5.5% of the total increase in imports.

In contrast with the previous two years, which saw high surpluses in the services balance, the surplus generated in 1996 amounted to only Sk 1.2 billion. In terms of positive balance, the most significant position within the structure of services was achieved by transport, where the balance produced a surplus of Sk 7.7 billion, due to income from the transport of gas to western Europe via Slovakia (Sk 11.8 billion). The volume of net income from transport was unfavourably affected by the increased costs of freight service in connection with the growth in imports and the related expenses for insurance, package, etc.

The development of travel in 1996 was characterised by faster growth in expenditure than in revenue. While foreign exchange income from foreign travel increased by only 11.4% year-on-year, foreign exchange expenditure grew by 55.0%. The structure of foreign visitors was dominated by visitors from the Czech Republic, Germany, and Poland. The average length of time spent by foreign visitors in Slovakia continued to be rather short in 1996 (1 to 4 days depending on the season), and was characterised by a high proportion of transiting visitors. In contrast with the previous years, when the travelling activity of the population moderately declined, this trend came to a halt in 1995. In 1996, the percentage of the population travelling abroad increased again. The possibility to purchase foreign exchange for personal travel was taken up by 1.1 million persons, i.e. 22% of the population. During the second half of 1996, the increased purchases of foreign exchange were reflected in a moderate growth in household deposits on foreign-currency accounts. The growing interest of households in depositing their free resources was a reflection of the favourable exchange rate of the Slovak koruna against fully convertible currencies, particularly the D-mark (DM). At the end of December 1996, the volume of foreign-currency deposits reached Sk 35.6 billion, representing an increase of Sk 472 million compared with the figure for the beginning of the year, and reached its minimum (Sk 33.5 billion) in July.

The year 1996 saw a change in the development of other services, the total turnover of which fell year-on-year by 16%. Receipts from commercial and non-commercial services fell by 32% and their proportion to total revenue dropped from 48%, to 36.4%. Payments for services remained virtually at the level of 1995, representing 56.8% of total expenditure on services. In the category of 'other services', the most severe decline was recorded in construction and assembly work, where expenditure increased owing to the revival of construction industry, financial services, and insurance services except for life insurance. In this category, expenditure increased probably in connection with the provision of products which are not produced in Slovakia. Despite the fact that expenses on the rent of intangible assets (films, video records, etc.) fell somewhat, the deficit remained relatively high (Sk 1.1 billion). However, the highest deficit was recorded in other commercial services (Sk 5.0 billion), which had the largest share in the structure of other services (29.5% of the revenue and 34.4% of expenditure side). These were receipts and payments for other services of a commercial nature, e.g. expert opinions, agency services, extra costs, engineering and technical services, etc.

The income balance increased the current account deficit by Sk 1.4 billion. The entire deficit was generated in the enterprise and banking sectors, the growing indebtedness of which was reflected in an increase in interest payments to foreign countries. After a surplus recorded in the first half of 1996, the interest balance of the Government and the NBS produced a moderate deficit during the second half of the year, which resulted in a balanced position for the year as a whole.

The highest surplus on current account was achieved in current transfers (Sk 6.2 billion), due primarily to private transfers, where receipts exceeded payments by Sk 5.9 billion. A marked surplus was recorded in the sub-group of transfers, which includes receipts and payments related to foreign currency transfers made by natural and legal persons, such as dowry, benefits, damages, gifts up to Sk 10,000, etc.

The current account deficit was partly offset by the continued inflow of foreign capital into the Slovak Republic. The capital and financial account generated a surplus of Sk 64.4 billion, i.e. US\$ 2.1 billion, representing 11.1% of GDP. To offset the growing current account deficit, it is necessary to take all possible measures to increase the inflow of foreign capital. If foreign capital is invested effectively, the economy will be able to absorb it and generate technological progress by itself. As a result, the gap between aggregate demand and supply will gradually be eliminated in this way.



The most suitable form of foreign capital inflow is direct foreign investment. Such investment is usually based on sound business strategy, so it does not represent a speculative movement of capital, as the foreign investor also takes part in covering the costs of economic transformation in the country concerned. This reduces the vulnerability of the country's economy to external shocks. In the case of Slovakia, the level of direct foreign investment continued to be disproportionately low in 1996.

The volume of direct foreign investment in the SR totalled Sk 7.8 billion. Of this amount, Sk 5.4 billion was invested in the enterprise sector and Sk 2.4 billion in banks (in the form of an increase in equity). In the banking sector, the proportion of direct investment to GDP reached 1.3%, while direct investment in enterprises accounted for only 0.9% of GDP.

Direct foreign investments represented only 14% of the volume of long-term funds drawn by the enterprise sector in 1996. As in past years, most direct foreign investment was attracted by trade and services (39.5%). In industry, the lead was taken by machine engineering (25.3%), food processing (7.4%), and rubber industry (6.9%). Regarding the structure of investments by country, the largest investors in Slovakia were Austria (29.3%) and Germany (24.3%). Of the total capital of Sk 33.1 billion, invested by foreign investors in Slovak enterprises (outside the banking sector), almost 70% came from six countries (Germany, Austria, Britain, France, Czech Republic, USA); while Germany was responsible for 26.6% and Austria for 21.1% of this amount. The capital was spread over smaller investments in a large number of organisations. The month-on-month increases in direct foreign investment ranged from Sk 400 million to Sk 500 million over the course of the year.

The volume of other long-term capital increased by Sk 31.7 billion, as a result of decline in long-term assets and growth in long-term liabilities.

In the structure of long-term assets, a decisive role was played by the repayment of government borrowings from abroad during the previous period, i.e. repayment of some loans from the Russian Federation in the amount of Sk 8.7 billion and the repayment of the last part of the credit limit (on the clearing account) from the CR in the amount of Sk 1.0 billion. The loans were repaid in the form of commodity and service imports in both cases. In the commercial banking sector, a new item appeared: the provision of long-term loans to foreign countries in the amount of Sk 3.9 billion. The loans provided were evenly divided between foreign banks and corporate entities.

Regarding the structure of long-term liabilities, the enterprise sector showed increased interest in long-term loans from abroad (Sk 37.9 billion). In the form of corporate loans, the Slovak economy received long-term foreign capital in the amount of Sk 33.6 billion, i.e. twice as much as in 1995. These loans came mainly from Great Britain (73.3%), Austria (8.0%), Czech Republic (7.1%), and were employed in construction (28.7%), metallurgy (19.5%), power industry (15.2%), and chemical industry (13.0%). The sectoral structure of medium- and long-term loans in fact reproduced the structures of existing capital-intensive facilities, producing goods with stagnating sales. Despite changes in the orientation of these industries towards products with a higher degree of finish, the possibilities for manufacturing more sophisticated products are limited in these sectors, which complicates their realisation on the world market. At present, the indebtedness of companies abroad involves exchange rate risks as well, and the projects usually have no chance in international competition. Increased borrowing from abroad increases the rate of investment in Slovak companies on the one hand, but increases Slovakia's external debt and exerts increased pressure on debt servicing on the other. In 1996, loan repayments in the enterprise sector increased by Sk 6.2 billion, to Sk 9.2 billion (from Sk 3.0 billion in 1995), while the proportion of repaid loans to the volume of exported

goods and services increased to 2.7%, from 0.9%. Commercial loans were repaid in the total amount of Sk 5.2 billion.

The main long-term liability items in the banking sector were long-term credits of a special nature (subordinated debt), in the amount of Sk 5.9 billion. These were unsecured loans, repayable as last in order, after the claims of other creditors are settled in the case of the debtor's bankruptcy and/or liquidation.

The government sector repaid loans made in the previous period in the amount of Sk 8.0 billion. The loan repayments were divided into two parts: repayment of loans to the Central Foreign Exchange Resources (CDZ) in the amount of Sk 4.3 billion, and repayment of loans to the International Monetary Fund (IMF) in the amount of Sk 3.7 billion. Borrowing by the NBS was restricted to loans from the EXIM Bank of Japan (Sk 1.4 billion) and the European Investment Bank (Sk 44.7 million), the crown equivalent of which was earmarked for the implementation of projects in the enterprise sector.

A crucial factor in the development of short-term capital was the movement of short-term capital at commercial banks. The year 1996, especially the last quarter, saw a permanent increase in short-term liabilities in all categories (Sk 37.8 billion). During the twelve months of the year, short-term deposits of non-residents at Slovak banks increased by Sk 13.8 billion, borrowings from abroad grew by Sk 13.7 billion, and the purchase of foreign exchange from foreign banks increased by Sk 10.0 billion. This increased the interest of foreign entities in short-term investment in Slovak koruna due to the high interest-rate differential and the relative stability of the currency. The increase (Sk 21 billion), which took place mainly in December, was connected with the efforts of commercial banks to meet the requirements of the 'foreign exchange position for monetary purposes'. The December increase in short-term liabilities was reflected in the development of short-term assets at commercial banks, which recorded an unbroken decline from January to the end of November owing to the growing current account deficit. As a result of a massive increase in December, the volume of short-term deposits held by commercial banks abroad increased by Sk 12.7 billion and that of loans by Sk 3.6 billion over the course of 1996.

The rapid increase in exports in November and December caused a growth in short-term liabilities in the enterprise sector (by Sk 6.2 billion), consisting mainly of commercial loans (80.3%). The drawing of short-term financial credits in the amount of Sk 4.9 billion (after repayment Sk 3.7 billion) represented 12.7% of the total volume of financial credits drawn by the corporate sector.

## 2.2 Development of Foreign Exchange Reserves

At the end of December 1996, the foreign exchange reserves of the NBS amounted to US\$ 3,473.3 million, representing an increase of US\$ 54.9 million compared with the same period of the previous year. Over the course of the year, the total foreign exchange reserves in the banking sector were influenced by various factors. A key factor that positively influenced the revenue side was the positive balance of transactions in foreign exchange fixing. The expenditure side reflected debt service payments during this period. In 1996, the level of NBS foreign exchange reserves was significantly influenced by the development of exchange rates between fully convertible currencies on the world financial markets. The positive balance of revenues and expenditures (US\$ 199.3 million) was offset by the negative exchange-rate differential (US\$ 144.4 million), which reflected the actual exchange rate of the D-mark to the US dollar on the world financial markets.

The revenue side of foreign exchange reserves was determined by the following factors:

- positive balance of NBS foreign exchange fixing in the amount of US\$ 358.8 million (62% of the total revenue);
- income from deposits and securities in the amount of US\$ 125.2 million;
- receipt of loans from international financial institutions in the amount of US\$ 59.8 million;
- other receipts of the NBS in the amount of US\$ 17.9 million;
- repayment of government assets, proceeds from the sale of government assets and the rectification of principle within the CDZ (Central Foreign Exchange Resources) block, in the amount of US\$ 12.7 million;
- Increase in the volume of deposits accepted over the course of the year, in the amount of US\$ 5.8 million.

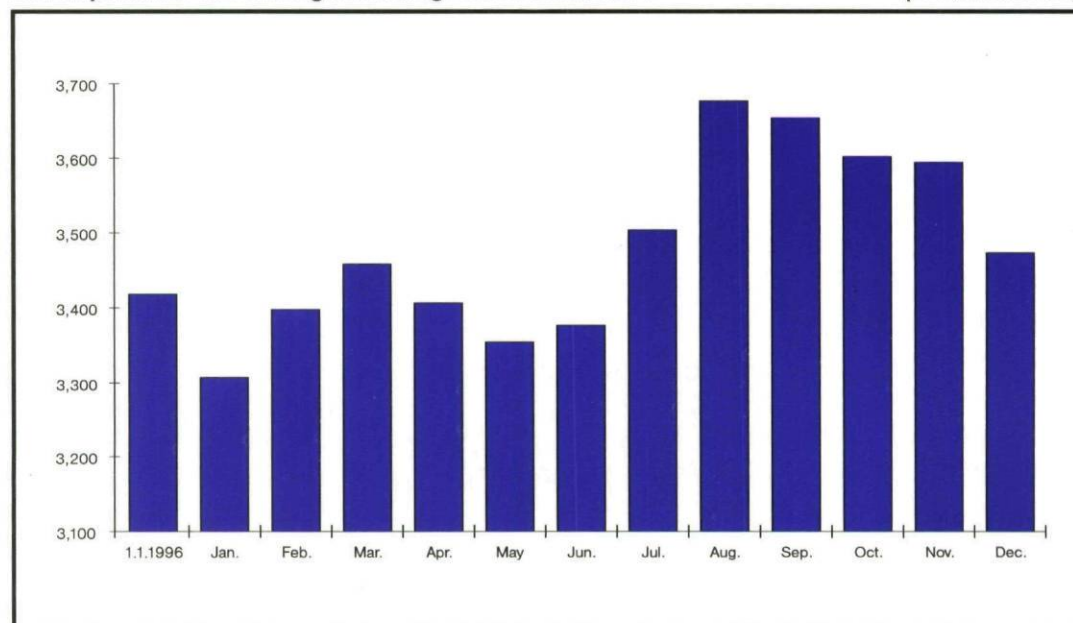
The expenditure side of foreign exchange reserves was influenced by:

- debt service payments by the NBS in the amount of US\$ 200.3 million (52% of total expenditure), while the repayment of principal on loans accepted from the IMF amounted to US\$ 124.9 million;
- debt service payments by the government in the amount of US\$ 150.7 million, of which principal and interest actually paid within the CDZ block accounted for US\$ 118.7 million;
- other expenditures of the NBS in the amount of US\$ 29.8 million.

At the end of December, the foreign exchange reserves of the NBS were 3.3 times greater than the expected volume of average monthly import of goods and services to Slovakia in 1996. The marked year-on-year increase in average monthly imports (19.5%), despite a moderate rise in the level of foreign exchange reserves, led to a decline in foreign exchange reserves earmarked for the coverage of imports of goods and services by 0.6 points, when compared with the level of 1995.

*Development of NBS foreign exchange reserves in 1996*

*(US\$ millions)*



The foreign exchange reserves of commercial banks may be expressed as short-term foreign exchange assets of commercial banks vis-a-vis non-residents. At the beginning of 1996, the volume of such assets stood at US\$ 1,729.1 million. At 31 December 1996, commercial banks held foreign exchange reserves in the total amount of US\$ 2,209.2 million, representing an increase of US\$ 480.1 million.

At the beginning of 1996, the volume of total foreign exchange reserves in the banking sector including NBS amounted to US\$ 5,147.5 million, and reached US\$ 5,682.5 million at the end of December.

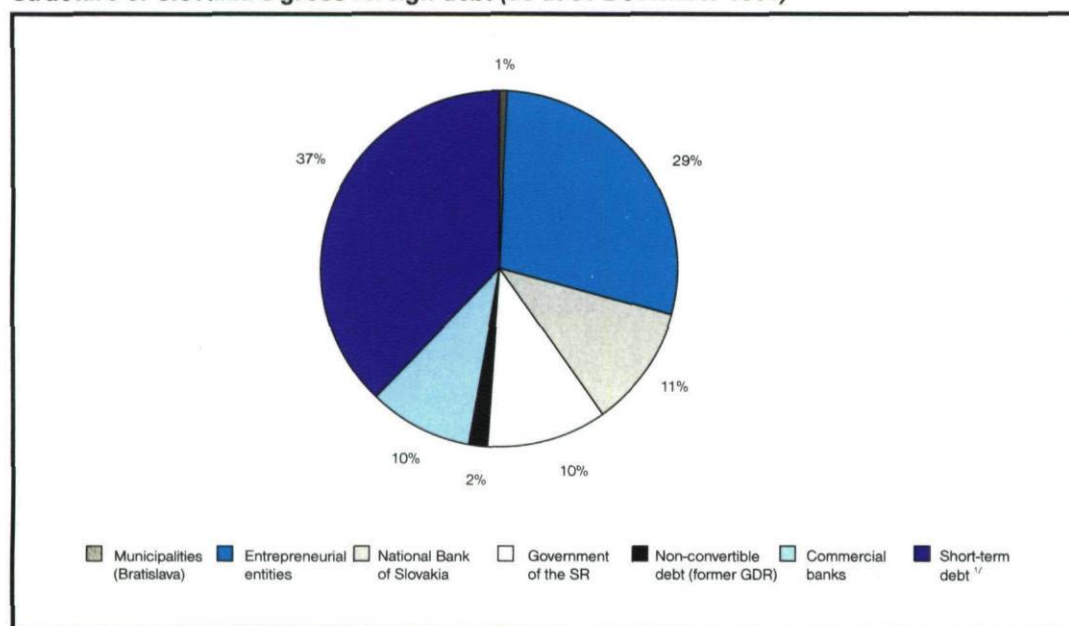
### 2.3 Debt Servicing by the NBS and the Slovak Government

In 1996, the National Bank of Slovakia continued servicing the foreign exchange liabilities of the Government smoothly, without any problems. The continued strengthening of trust, based on servicing the external debt of the Slovak Republic via the National Bank of Slovakia, was one of the main conditions for obtaining favourable ratings for Slovakia in 1996, from internationally recognised rating agencies (Standard and Poor's assigned a BBB- rating to Slovakia in April 1996, the same grade was assigned to the country by IBCA in August 1996).

At the end of December 1996, the total external debt of the Slovak Republic in convertible and non-convertible currencies stood at US\$ 7.81 billion. At the end of the year, the official debt of the Government and the NBS reached a level of US\$ 1.65 billion. The indebtedness of the commercial sector, i.e. commercial banks and entrepreneurial entities, stood at US\$ 5.96 billion, and the debt owed by municipalities (municipal bonds issued by the city of Bratislava) amounted to US\$ 0.06 billion.

The external debt of the SR in convertible currency reached US\$ 7.67 billion and the remaining US\$ 0.14 billion consisted of the estimated debt in non-convertible currency vis-a-vis the former German Democratic Republic.

**Structure of Slovakia's gross foreign debt (as at 31 December 1996)**



1/ The Government and the NBS have no short-term foreign debts

By the end of December 1996, Slovakia's per-capita external debt had increased by US\$ 374, to US\$ 1,473 (from US\$ 1,099 at the beginning of January). Over the course of the year, the country borrowed a total of US\$ 46.0 million from abroad. Of this amount, the drawing of two tranches of a loan from the EXIM Bank of Japan accounted for US\$ 44.6 million (official external debt of the SR). The remaining amount (US\$ 1.4 million) was drawn from the European Investment Bank, as the next tranche of the Apex Global Loan. On the other hand, the official foreign debt was reduced in 1996, by repayments of principal in the equivalent of US\$ 243.3 million.

Regarding the structure of the gross debt at the end of December 1996, total gross medium- and long-term liabilities accounted for US\$ 4.86 billion, while short-

term liabilities of commercial banks and entrepreneurial entities amounted to US\$ 2.95 billion. The level of short-term debt represented 37.7% of the country's total gross external debt.

The absolute growth in the total gross external (hard-currency) debt of the SR during the period under consideration, was due mainly to a gradual increase in the import obligations of entrepreneurial entities, and growth in the foreign exchange liabilities of commercial banks. The most significant increase in the level of total gross external debt was recorded in December, when the statistical level of US\$ 7 billion was exceeded for the first time.

In December 1996, a significant month-on-month increase of US\$ 275 million (US\$ 833 million during the whole year) was recorded in the volume of medium- and long-term debts owed by entrepreneurial (non-bank) entities, as a result of huge borrowings from abroad (Slovak Telecommunications, Vodohospodárska výstavba). In the sector of commercial banks, the same item increased in December by US\$ 264 million month-on-month, and by US\$ 249 million compared with the figure for the beginning of 1996. The increase in medium- and long-term debts owed by commercial banks was due to the acceptance of a subordinated loan by Všeobecná úverová banka (VÚB) and Slovenská sporiteľňa (SLSP).

The rate of growth in short-term debts in the commercial sector (banks and non-banks) deserves special attention. During the twelve months of 1996, the level of short-term debt rose by US\$ 1,232 million. The most significant increase in short-term debt (US\$ 890 million) was recorded in December, and was due partly to the opening of new credit lines in connection with the rapid growth in imports at the end of 1996. A significant part of this increase (ca. US\$ 500 million) was represented by short-term loans accepted by commercial banks for mitigation of the effects of the recently introduced 'foreign exchange position for monetary purposes' rule.

The volume of repaid foreign exchange liabilities, i.e. gross debt servicing of the SR, reached a level of US\$ 367.8 million during the twelve months of 1996. Of this amount, principal repayments accounted for US\$ 243.3 million. The payment of interest and commissions represented an equivalent of US\$ 124.5 million. After including US\$ 46.9 million (i.e. the original balance of unsettled liabilities vis-a-vis the International Investment Bank), the total volume of gross debt servicing reached US\$ 398.3 million in 1996.

After deducting the foreign exchange receipts (US\$ 11.7 million) from the actual level of debt servicing (US\$ 367.8 million), the net volume of external debt servicing amounted to US\$ 356.1 million.

***Influence of debt servicing on foreign exchange reserves*** **(US\$ millions)**

	Foreign exchange reserves of NBS	Forex reserves of commercial banks	Foreign exchange reserves in total	Total foreign debt
31.12.1995	3,418.4	1,729.1	5,147.5	5,826.6
31.03.1996	3,458.4	1,489.3	4,947.7	5,981.9
30.06.1996	3,376.6	1,262.5	4,639.1	6,080.7
30.09.1996	3,654.8	1,142.5	4,797.3	6,347.2
31.12.1996	3,473.3	2,209.2	5,682.5	7,807.0

## **2.4 Licensing Activity of the NBS**

In 1996, foreign exchange permits and foreign exchange licences were issued for operations in the following areas:

- capital account of the balance of payments: 2,880 foreign exchange permits including 104 supplements and 49 foreign exchange licences including 2

supplements for trade in foreign exchange assets - transactions in foreign securities;

- current account of the balance of payments: 515 foreign exchange permits including 117 supplements, 2 foreign exchange licences issued for the conduct of other transactions in foreign exchange assets.

Foreign exchange permits and licences were issued for:

- capital investment abroad;
- trade in foreign securities - shares issued by companies based in the Czech Republic;
- trade in foreign exchange assets;
- acceptance of financial credits from abroad;
- granting of financial credits to a foreign country;
- securing obligations of non-residents by residents;
- transactions in financial derivatives.

In 1996, the NBS issued 273 foreign exchange permits, 16 supplements for financial investments abroad, and 11 foreign exchange permits for investment in the form of purchasing foreign shares.

In a sectoral breakdown, the largest amounts were invested in the areas of commerce, consultancy, construction, assembly, and services. The expected return on investment did not exceed five years.

#### **Structure of investment abroad**

	Number of licences and supplements	Investment in Sk millions		
		in cash	in securities	total
Czech Republic	141	276.38	153.04	429.42
Ukraine	41	79.21	8.56	87.77
China	3	77.07	0	77.07
Kazachstan	2	0.32	16.19	16.51
Russia	13	15.91	0	15.91
Poland	16	9.22	0	9.22
Hungary	34	8.32	0	8.32
Bulgaria	9	7.31	0	7.31
Canada	10	4.38	0	4.38
Ethiopia	1	3.99	0	3.99
USA	3	3.35	0	3.35
Other	27	8.21	0	8.21
Total	300	493.67	177.79	671.46

For transactions in foreign securities, especially shares issued in the Czech Republic, the NBS issued a total of 2,357 foreign exchange permits, of which 2,353 permits (for Sk 843.2 million) were granted for the sale of foreign securities. Two permits were issued for the acceptance of foreign securities as payment for money receivables in the amount of Sk 5.4 million, and two foreign exchange permits for the purchase of foreign securities in the amount of Sk 464.4 million. The Bank granted 49 foreign exchange licences (including supplements) to securities dealers, investment companies and investment funds for dealing in Czech shares.

For option contracts concluded for the purchase of foreign employee shares, the Bank issued 21 foreign exchange permits to natural persons.

In 1996, significant amounts were covered by permits issued for the acceptance of foreign credits. The acceptance of financial loans from abroad was permitted in 177 cases in the total amount of Sk 52,632.6 million. In seven cases, the permit was granted together with an exception from the transfer requirement for the amount of Sk 12,990.3 million, and in nineteen cases with an exception from the surrender requirement for the amount of Sk 14,278.8 million. In thirty cases (in the amount of Sk

101.6 million), foreign exchange permits were granted for the repayment of loans accepted without permission.

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	> 2005
Drawing	34,165	11799	4,855	1,106	0	0	0	0	0	0	0
Repayment	676	6,300	2,753	13,431	2,573	6,453	2,343	2,223	1,752	1,732	11,741
Balance	33,489	5,499	2,102	-12,325	-2,573	-6,453	-2,343	-2,223	-1,752	-1,732	-11,741

Exchange rate at 31 December 1996

Of the total number of credits approved, 146 were provided by non-bank entities (Sk 14,350.8 million) and 61 by foreign banks (Sk 38,383.4 million). Bank guarantee was granted in 28 cases (for Sk 2,778.5 million), and government guarantee in 5 cases (Sk 18,789.1 million).

The credit facilities were earmarked for investment and purchase of real estate (71.6% of the total volume of loans; of which, the purchase of technology from abroad accounted for 5.8%), the financing of operating expenses (28.2%), and privatisation (0.2%).

With regard to structure by term, credits with a maturity of one year represented 12.1%, two years 2.3%, three to five years 34.7%, and those maturing in five or more years accounted for 50.9%

The largest volumes of credits (including international loans) were provided by entities based in Great Britain (Sk 26,682.4 million), the Czech Republic (Sk 10,593.9 million), Germany (Sk 4,635.9 million), Luxembourg (Sk 3,874.7 million), and Austria (Sk 2,637 million).

#### *Structure of credits by sector*

Sector	Volume in Sk millions	Number of licences
Generation and distribution of electricity	21,504.8	8
Industrial production	17,604.8	54
Building and construction	8,283.4	5
Trade, public catering	2,139.6	92
Transport, tourism, telecommunications	43.1	6
Agriculture	7.4	3
Other	3,151.1	39
Total	52,734.2	207

In 1996, the Bank issued four foreign exchange permits for the provision of financial credits to abroad in the total amount of Sk 14.9 million.

To secure the obligations of subsidiary companies abroad arising from credits accepted from foreign banks, the Bank issued 28 foreign exchange permits for the total amount of Sk 1,338.2 million.

For operations related to the current account of the balance of payments, the Bank issued 398 foreign exchange permits and 117 supplements for the following purposes:

- a) Establishment of foreign-currency accounts at foreign banks:
  - 73 foreign exchange permits and 57 supplements issued for the purpose of covering inevitable expenses incurred in connection with construction, assembly, or repair work abroad, which made it possible for entrepreneurs to realise construction and assembly work in the total amount of Sk 3,871.4 million;

- for the purpose of securing payments for unpredictable deficiencies arising during the period of warranty, five foreign exchange permits were issued;
  - eight foreign exchange permits were issued for the payment of inevitable expenses related to water-borne transport;
  - one foreign exchange permit and one supplement issued for the establishment of a bank account abroad for the purchase of preferential shares of a foreign company.
- b) Establishment of foreign-currency accounts at domestic banks:
- the NBS issued 110 foreign exchange permits and 54 supplements, of which 64 permits and 35 supplements were for re-export purposes; the remaining permits were granted for the promotion of exports, introduction of factoring, and increase in receipts from international transport;
  - two foreign exchange permits were issued for the acceptance of credits from abroad.
- c) Establishment of foreign exchange offices in Slovakia:
- 24 foreign exchange permits and 3 supplements were issued for the purpose of providing local workers with foreign exchange for business trips abroad.
- d) Import and export of banknotes and coins denominated in foreign currency by way of tourism or in the form of postal delivery:
- 161 permits and 1 supplement were issued.
- e) Purchase of foreign exchange:
- 9 foreign exchange permits were issued for the payment of fees to foreign participants in international contests;
  - 2 foreign exchange permits were issued for the payment of charges for the re-assembly of exported ships and for the conduct of tests;
  - 3 foreign exchange permits and one supplement were issued for forwarding activities.



### 3. THE PUBLIC SECTOR

#### State Budget

The State Budget of the Slovak Republic for 1996 was approved by Decree No. 304/1995 Z.z., dated 13 December 1995, of the Slovak National Council, based on the following macroeconomic forecasts:

- GDP growth at constant prices: min. 5%;
- rate of consumer-price inflation: 6 to 8%;
- rate of unemployment: max. 13%.

The total revenue of the State budget was budgeted at Sk 162.4 billion; total expenditure at Sk 189.4 billion; and the budget deficit at Sk 27.0 billion.

In accordance with Act No. 222/1996 Z.z. passed by the National Council of the SR, some organisational changes were made in the powers of State bodies and local governments. In compliance with the country's budgetary rules, the Minister of Finance made some modifications in the individual chapters of the State Budget in the form of budgetary measures. At the same time, the yields on government bonds issued in accordance with the State Budget Act of 1996, in the amount of Sk 3.0 billion, for the construction of motorways, were also reflected in the State budget. After these adjustments, total budget revenue amounted to Sk 165.7 billion and budget expenditure totalled Sk 190.7 billion. As a result of these modifications, the size of the budget deficit was changed to Sk 25.0 billion.

Over the course of 1996, there were periods of relative stability combined with periods marked by an increase in the State budget deficit. By regulating budget expenditures during the first eleven months of the year, the budget deficit was maintained at an acceptable level (Sk 13.7 billion at 30 November 1996). In December, however, an abrupt rise was recorded in budget expenditure (Sk 28.1 billion, i.e. almost twice the monthly average), as a result of which the budget deficit increased to Sk 25.6 billion (4.4% of GDP). At the end of December, some problems arose in deficit financing. The National Bank of Slovakia solved these problems through a purchase of Treasury bills in the amount of Sk 8.6 billion for its own portfolio; in this way, the government debt was monetised. Without central bank intervention, the budgetary liquidity of the Slovak Republic would have been endangered.

Total budget revenue reached a level of Sk 166.3 billion, exceeding the figure set in the original budget by Sk 3.9 billion, and that in the modified budget by Sk 0.6 billion. The budget expectations were fulfilled due mostly to tax revenues (84.2%), of which personal income tax revenue exceeded the budgeted figure by Sk 2.7 billion. Corporate income tax revenue remained below the budgeted figure by Sk 3.7 billion, value-added tax revenue by Sk 8.7 billion, and excise tax revenue by Sk 1.6 billion. Non-tax revenue exceeded the budgeted figure by Sk 7.8 billion.

Total budget expenditure reached Sk 191.9 billion, exceeding the figure in the original budget by Sk 2.5 billion and that in the modified budget by Sk 1.2 billion.

Current expenditure, representing the largest part of government spending (77% of total expenditure), remained behind the budgeted figure (reached 97.8% of the original budget and 99.2% of the modified budget). Similar development was recorded in the category of credits, loans, property participations, and principal repayments. Budget expenditure was exceeded in the category of capital (investment) expenditure, while capital assets were financed from the supplementary resources of the State budget.

The size of the budget deficit had ranged from Sk 0.5 billion to Sk 9.6 billion until August, when it suddenly increased to Sk 15.8 billion in September. The deterioration in budget performance was due to the repayment of principal on government bonds within the scope of debt servicing. The last quarter of the year saw a further increase in budget deficit, especially during the second half of December, when the size of the deficit ranged from Sk 21.2 to 26.7 billion.

After taking into account the repayment of principal on loans and government bonds, the budgetary performance of local governments, State funds, State financial assets and liabilities, insurance funds, other government deposits and loans, and extrabudgetary projects, the fiscal deficit of the government sector had reached Sk 5.0 billion (0.9% of GDP) by 31 December 1996. In comparison with the previous year, when the State budget generated a surplus of Sk 2.7 billion (0.5% of GDP), budgetary performance deteriorated over the course of 1996, which led to an increase in domestic demand with subsequent impact on the balance of payments.

The relation of the State budget to the NBS is governed by Act No. 566/1992 Zb. on the National Bank of Slovakia. Under this law, the NBS is obliged to notify the Ministry of Finance of the SR of the rate of interest on State assets and liabilities held at the NBS. The NBS fulfilled this obligation in January 1996. The rates of interest valid from 1 January to 31 December 1996 on credit and debit balances of the individual items held at the NBS were approved, as part of the Monetary Programme for 1996, by the Bank Board of the NBS on 21 December 1995.

The rates of interest on State assets and liabilities held at the National Bank of Slovakia remained unchanged over the course of the year. Government claims vis-a-vis the NBS consisted primarily of State financial assets payable on demand. Government commitments vis-a-vis the NBS consisted of unsettled debts from previous years (State budget deficits for 1991 and 1992) and State financial liabilities.

In 1996, the NBS received Sk 2,714.7 million in interest for the credit of State liabilities and paid Sk 632.1 million for State assets. The National Bank of Slovakia transferred Sk 2,211 million of its profits to the State budget, which means that the central bank's contribution to the State budget was Sk 128.4 million higher than the amount paid by the State budget for its liabilities.

### **Internal Debt of the Government vis-a-vis the Banking Sector**

At the end of 1996, the net position of the government sector vis-a-vis the banking sector stood at Sk 71.4 billion, representing an increase of Sk 7.4 billion compared with the figure for the beginning of January. Of this amount, the NBS covered Sk 15.6 billion and commercial banks Sk 55.8 billion. Over the course of 1996, the level of government debt ranged from Sk 55.1 billion to Sk 62.7 billion, except for December when the position of the Government deteriorated due to the abrupt increase in budget deficit.

Regarding the source of financing, the share of the National Bank of Slovakia in the financing of the country's internal debt ranged between 18.6% (in March) and 29.9% (in August). As the crediting of unsettled debts from previous years remained unchanged through the year, the fluctuation in the Bank's share was influenced by the amount of Treasury bills issued for the Bank's own portfolio at the end of the month, and by the volume of funds forming the difference between the current deficit of the State budget and its coverage by Treasury bills. The remaining part of the debt was financed by commercial banks.

With regard to the structure of internal debt, some items remained unchanged (the volume of State financial liabilities, the 1992 State budget deficit inherited from the federation, government bonds for housing construction issued in 1992).

Insignificant changes were recorded in State financial assets, government bonds issued to cover the 1994 State budget deficit, and in deposits held by local governments. Over the course of 1996, the following issues of government bonds were redeemed: bonds issued to cover the 1991 budget deficit (Sk 0.6 billion), bonds issued to cover the 1993 budget deficit (Sk 8.8 billion), bonds issued to finance the construction of water reservoirs at Malinec and Turček (Sk 1.1 billion), and bonds issued to finance the hydro-electric project at Gabčíkovo (Sk 0.9 billion). In addition, the principal of a direct credit provided by the National Bank of Slovakia for the financing of the 1991 budget deficit was repaid in the amount of Sk 1.4 billion). On the other hand, an issue of one-year government bonds was launched to cover the costs of motorway construction (Sk 3.0 billion).

During the third quarter of 1996, Treasury bills issued in 1995 were converted into one-year government bonds designed to cover the 1995 State budget deficit (Sk 8.1 billion). At the end of the year, the balances of State funds fell significantly due to borrowings by the State fund for motorway construction and the State fund for market regulation in agriculture for government intervention purchases. Of the other items, the internal debt of the Government was positively influenced by an increase in the financial resources of insurance funds (Sk 5.4 billion compared with the beginning of 1996) and an increase in other State deposits (Sk 4.1 billion since the beginning of the year). However, it is possible to state that the net position of the Government vis-a-vis the banking sector was most influenced by the performance of the State budget.

### **State Financial Assets and Liabilities**

At the end of December, the volume of State financial assets held in the form of deposits on accounts with the National Bank of Slovakia reached Sk 9.3 billion, representing an increase of Sk 0.5 billion compared with the figure for the beginning of the year. Revenue operations on the accounts of State financial assets were associated with financial substitutions arising from the provisions of Act No. 330/1991 Zb. pertaining to land adjustments, and with the property of the former Communist Party of Czechoslovakia. Expenditure operations were connected with the financial substitutions arising from out-of-court restitution.

With regard to State financial liabilities (so-called direct liabilities of the Government at the NBS inherited from the former federation), no changes were recorded in the course of 1996 (Sk 21.7 billion).

### **State Funds**

At the end of 1996, the volume of financial resources on the accounts of State funds amounted to Sk 3.9 billion (after including credits in the amount of Sk -0.2 billion). The volume of these funds was significantly influenced by credit resources obtained from the banking sector. The year under consideration saw the establishment of the State Fund for Housing Development, a special-purpose fund created for the financing of housing construction, insulation of residential buildings, etc.

### **The National Property Fund**

The National Property Fund of the SR (including resources held on accounts with the Ministry for the Administration and Privatisation of the National Property of the SR) vis-a-vis the banking sector was in a creditor position, reaching Sk 3.3 billion at 31 December 1996. Of this amount, time deposits accounted for Sk 1.8 billion, and demand deposits Sk 1.1 billion. Funds obtained from privatisation, which are held by the Ministry for Privatisation on a separate account, amounted to Sk 1.8 billion; the volume of bonds and recognised obligations of the National Property Fund (NPF) vis-a-vis commercial banks totalled Sk 1.4 billion.

Developments in previous years and the results of 1996 indicate that the NPF will probably continue to suffer from a lack of liquidity and its position vis-a-vis the banking sector will be at a moderate creditor level. The high proportion of the NPF's obligations and expenditures to its projected revenues may result in a change in its position vis-a-vis the banking sector, from a creditor to a debtor position. To mitigate the impact of concentrated bond repayments after the year 2000 on the country's monetary policy, it would be necessary to accelerate the exchange of corporate shares for NPF bonds.

(Sk billions)

	1.1.1996	31.03.96	30.06.96	30.09.96	31.12.96
Position of NPF vis-a-vis the banking sector	-2.4	-2.9	-2.4	-1.0	1.5
Position of NPF vis-a-vis the banking sector including the deposits of MSPNM SR <sup>1/</sup>	2.3	1.9	1.4	2.7	3.3

<sup>1/</sup> Ministry for the Administration and Privatisation of National Property in the SR.

During the last quarter of 1996, bonds issued by NPF for owners included in the second wave of voucher privatisation were redeemed in the total amount of Sk 2.2 billion (debtors may repay a part of their obligations vis-a-vis the NPF in the form of NPF bonds up to 60% of the regular instalment). Trading in NPF bonds was started only at the end of the year, at a rate slower than expected by the issuer (the NPF expected bond yields in the amount of Sk 3.1 billion, the NBS expected Sk 2.0 billion). At 31 December 1996, the total par value of NPF bonds in circulation amounted to Sk 31.1 billion (plus interest for 1996 in the amount of roughly Sk 2.7 billion).

#### Redemption of bonds issued by

(Sk billions)

	1.1.1996	31.03.96	30.06.96	30.09.96	31.12.96
Bonds issued by NPF for owners included in the 2nd wave of voucher privatisation	33.3	33.3	33.3	33.3	31.1

### Government Guarantees for Bank Loans

Government guarantees for bank loans are used as an instrument of financial policy during the period of economic reform. Over the course of 1996, the Slovak Government granted guarantee for bank loans in the total amount of Sk 36.2 billion. In accordance with the State Budget Act of 1996, the limit for government guarantees was set at Sk 53.6 billion; however, 88% (Sk 47.2 billion) of this amount was earmarked for the completion of the nuclear power plant at Mochovce. The guarantee limit was not fully utilised due the lower volume of government guarantees granted for bank loans to Slovenské elektrárne, a.s. Bratislava, for the completion of the 2nd block of the nuclear power plant at Mochovce. Slovenské elektrárne, a.s. obtained government guarantee for Sk 28.9 billion, Vodohospodárska výstavba, state-owned comp., Bratislava, for Sk 6.2 billion, and Solivary, a.s. Prešov, for Sk 1.1 billion. The government guarantees provided were all used for covering investment projects.

#### Government guarantees for bank loans

(Sk billions)

	1991	1992	1993	1994	1995	1996
Granted during the year	19.5	6.5	14.2	6.9	12.9	36.2
Granted cumulatively	19.5	26.0	40.2	47.1	60.0	96.2
Repaid during the year	0.02	1.2	2.8	4.0	6.1	5.3
Repaid cumulatively	0.02	1.3	4.1	8.1	14.2	19.5
Amount to be repaid	19.5	24.7	36.1	39.0	45.8	76.7

## 4. MONETARY POLICY AND MONETARY DEVELOPMENT

### 4.1 Monetary Development

The valuation of monetary policy on the basis of actual monetary development in 1996 is ambiguous owing to the phases of the given period. While the monetary policy followed by the central bank in the first half of the year may be characterised as passively accommodating, the policy conducted in the second half was actively sterilising. When evaluating monetary development simply on the basis of monetary aggregates and GDP growth, the monetary policy pursued in 1996 may be characterised as expansive.

Despite this characterisation, the basic monetary-policy objectives set by the National Bank of Slovakia for 1996 were fulfilled. The country's inflation rate, expressed in terms of the consumer price index, reached 5.4% (or 5.8% on average base). The exchange rate of the Slovak koruna ranged within the set fluctuation band.

The development of other indicators was not so favourable. Although gross domestic product increased by 6.9% at constant prices, domestic demand at constant prices grew at a rate of 21.1%, which means that it was mostly satisfied from foreign supply. The trade balance, as well as the balance of payments on current account reached a level exceeding 10% of GDP, and was financed through an increase in foreign debt, mainly in favour of short-term debt in comparison with the previous period.

The development of monetary aggregates basically corresponded to macroeconomic development. The money supply in terms of the M2 aggregate increased (at a fixed rate of exchange) in 1996, by Sk 58.8 billion, i.e. 16.5%, representing the slowest rate of growth since 1993, while its value exceeded 20% over the course of the year. In 1996, the growth in M2 was due exclusively to the development of net domestic assets, while net foreign assets fell year-on-year by Sk 1.3 billion at fixed exchange rates (as at 1 January 1996). Over the course of 1996, net domestic assets increased by Sk 60.1 billion, representing a growth rate of 20.5%.

During the first eleven months of 1996, the only source of growth in net domestic assets was bank lending in both crowns and foreign currencies. Increases were recorded not only in loans to enterprises, but in loans to households as well, which grew in 1996 by Sk 2.5 billion, raising the level of consumer demand. The growth in retail turnover (by 13% year-on-year) was due to an increase in the purchasing power of households, as a result of the inflow of other resources (loans) and own resources (savings), particularly the marked increase in real incomes in the economy with impact on the trade balance deficit.

In December, foreign-currency loans to residents recorded a marked decline of Sk 8.4 billion, reducing the rate of year-on-year increase to 31.7%, from 75% in November. The fall in foreign-currency receivables of banks vis-a-vis residents was a response to the monetary-policy measures of the National Bank of Slovakia.

Within the total volume of bank lending to the economy, the growth in crown loans at the end of the year was partly offset by a decline in foreign-currency loans to residents, as a result of which the volume of total credit fell in December, for the first time in 1996, by Sk 1 billion month-on-month, representing a slowdown in the rate of year-on-year growth in bank lending to households and enterprises from 21% in November, to 17.9% at the end of the year.

However, commercial banks were able to finance entrepreneurial entities indirectly as well, by purchasing shares and bonds issued by corporate entities. In 1996, this form of finance (through the capital market) accounted for Sk 11.3 billion, representing an marked increase (Sk 3.3 billion) in comparison with the figure for 1995. After including this source of finance in total domestic credit, its volume would have grown by 20.5% by the end of the year.

Compared with the development of bank lending to the economy, the development of net credit to the Government in 1996 was controversial in respect of net domestic assets. While the budgetary performance of the government sector showed a downward trend during the eleven months of 1996 (Sk -7.1 billion), which partly offset the expansion of bank lending, the volume of net credit to the Government recorded a month-on-month increase in December.

This development was associated with the deficit of the State budget, the favourable development of which over the course of the year was influenced by a marked annual increase in expenditure in December. In comparison with previous years, the State budget performance was most expansive during the last month of 1996, when the position of the government sector deteriorated month-on-month by Sk 11.7 billion (in December 1995, the net credit to the Government increased only by Sk 3.1 billion).

The analysis of monetary development during the first months of 1996, when the balance of payments deteriorated dramatically at the same time as the year-on-year growth rate of 20% was exceeded in all monetary aggregates (at half the set rate of growth) with the exception of net foreign assets, made the National Bank of Slovakia reconsider its monetary programme for 1996 (in May 1996). The updating of monetary objectives was aimed at regulating the foreign trade balance of Slovakia and restricting excessive domestic demand with the aim of preventing the economy from getting overheated and reduce the resulting imbalance.

During the first half of 1996, the central bank created opportunities for the sterilisation of surplus liquidity at commercial banks through issues of NBS bills. The doubtful efficacy of this policy in relation to the lending policy of commercial banks and the permanently increasing rate of growth in imports and monetary aggregates led to the adjustment of monetary instruments by the National Bank of Slovakia in July 1996.

On 15 July 1996, the Bank Board of the NBS decided to modify its monetary policy instruments designed to influence the operations of the banking sector in both domestic and foreign currencies.

With effect from 1 August 1996, the minimum reserve requirements were increased and the ratio of required reserves were set at 9% of primary time and demand deposits for all commercial banks, with the exception home savings banks, which are required to maintain minimum reserves amounting to 3% of primary deposits. In this way, the NBS reduced the level of surplus liquidity in the banking sector by roughly Sk 13 billion.

With effect from 1 August 1996, the required reserves of commercial banks started to bear interest at the rate of 1.5% p.a., up to the amount of required reserves set for the period under consideration.

At the same time, the NBS introduced the concept of 'foreign exchange position for monetary purposes', the basic idea here is the exclusion of foreign exchange assets vis-a-vis residents and the inclusion of Slovak-crown liabilities vis-a-vis non-resident banks. Through the foreign exchange position, the central bank indirectly regulates the activities of commercial banks based in the SR when providing foreign-

currency loans to residents, conducting off-balance sheet operations and operations with non-resident banks in Slovak currency.

With effect from 17 July 1996, the Lombard rate of the NBS was raised to 15%.

Within the scope of measures adopted in foreign exchange fixing, the Bank's Board decided to widen the fluctuation band of the Slovak crown's exchange rate to  $\pm 5\%$  (with effect from 17 July 1996), and at the same time cancelled the limit on the maximum daily rate of exchange within the band.

By implementing the accepted measures, the NBS intended to reduce the level of surplus liquidity and restrict lending activity of commercial banks and thus regulate the development of the balance of payments on the current account.

During the following months, the development of monetary aggregates stabilised and, in December, decreases were recorded in almost all monetary aggregates. Unlike the aggregate variables, the interest rates responded immediately, especially on the interbank deposit market, where the rates began to increase.

While primary interest rates were falling during the first half of 1996, they ceased falling and began to rise in the second half of the year. The fall at the beginning of the year was a reaction to the signal sent by the National Bank of Slovakia, which lowered its discount rate by nearly 1% in January 1996 under the influence of the favourable results achieved in 1995 and an expected fall in inflation in 1996 (which indirectly supported the development of bank lending).

The development of interbank interest rates can be, until May 1996, characterised as stable, with regard to their level as well as volatility (they fluctuated within the range of 8 to 10%). During the following period, the level of interest rates rose on the interbank market in July and August in particular, due to monetary-policy measures designed to reduce the lending activities of commercial banks (the rise of interest rates indirectly affects demand for bank loans). By moderating the rate of growth in bank loans, the NBS intended to indirectly influence the level of domestic demand and the balance of trade.

The growth in disposable funds supported by the expansion in bank lending and the State budget deficit increases the danger of a further deterioration in economic imbalance, which started in the form of a trade balance deficit in 1996. The rise in primary interest rates on deposits also made a contribution to improvement in the structure of gross domestic product, through supporting people's tendency to save rather than spend.

The population's savings rate, expressed as the proportion of increase in unrealised purchasing power to cash income, reached 6.3%, remaining below the level of the previous year (7.7%).

Despite the higher increase in wages - in comparison with labour productivity and the wage increase in 1995 - the population saved relatively less in 1996. Personal consumption also had a negative effect upon the structure of imported commodities and services (cars, electronic consumer goods, holidays, etc.) and thus indirectly supported the introduction of monetary-policy measures by the central bank.

The reduction in the disposable liquidity of commercial banks caused some tension over the financing of the current deficit of State budget, particularly at the end of the year. The expansion in the State budget, concentrated within a single month of the year, represented a problem caused by the price and volume of Treasury-bill issues. Thus, the accumulation of public expenditures influenced the development of

the money supply and the trade balance, not only during the given month, for this influence carried over into the following year as well.

With respect to the expected interest-rate fluctuations on the interbank market, the fluctuation band of the Slovak koruna was widened in relation to central parity within foreign exchange fixing and the maximum daily change in the rate of exchange was cancelled. The expected movements of short-term capital and subsequent response of the National Bank of Slovakia took place during the last quarter, but the volume of inflow and/or outflow of capital along with the reaction of domestic commercial banks caused the exchange rates to range within the set fluctuation band ( $\pm 2\%$ ).

The movement of short-term capital took place mainly at the end of the year, due partly to the growing deficit in the balance of payments current account and its financing, and partly to the rise in domestic interest rates, which attracted the interest of potential short-term foreign investors, particularly during the last months of the year.

In 1996, the Bank's exchange-rate policy was implemented with a view to stabilising the country's economy (policy of fixed nominal exchange rates) and hindering the potential movement of short-term capital (the use of the fluctuation band). An important change in the rules of NBS foreign exchange fixing was the introduction of a spread of  $\pm 0.25\%$ , which supported the expansion of the interbank foreign exchange market, with effect from 1 April 1996. The currency structure receipts and payments for goods and services in 1996 (63.8% DEM and 36.2% US\$) roughly corresponded to the structure of the currency basket to which the exchange rate of the Slovak koruna was pegged, i.e. 60% DEM and 40% US\$.

The stable development in the area of foreign exchange and subsequently in interest-rate policy made it possible for the National Bank of Slovakia and the Government (represented by the Ministry of Finance) to take further steps towards the liberalisation of the country's foreign exchange regime. At the same time, the time schedule of liberalisation was approved until the year 2000. Apart from accelerating the process of joining international economic structures, conditions were gradually created for solving the problem posed by undercapitalisation of Slovak companies. The liberalisation measures adopted in 1996 include the following:

- cancellation of the limit on the export and import of banknotes and coins denominated in Slovak or foreign currency by way of tourism, or in the form of postal or other delivery, and its replacement by a reporting requirement for amounts up to Sk 150,000 and Sk 20,000 respectively.  
liberalisation of financial credits with maturities of five years or more, granted by residents to non-residents based in an OECD member country;  
liberalisation of international trade credits accepted or granted in relation to OECD, for the realisation of payments for goods and services where an intermediary is involved between the customer and the supplier - the borrower;
- liberalisation of the acceptance of financial credits by residents from abroad, with a maturity of three years or more;
- liberalisation of acquisition of real estate by residents in OECD countries;  
liberalisation of direct investment in OECD countries.

## **4.2 Structure of the Money Supply**

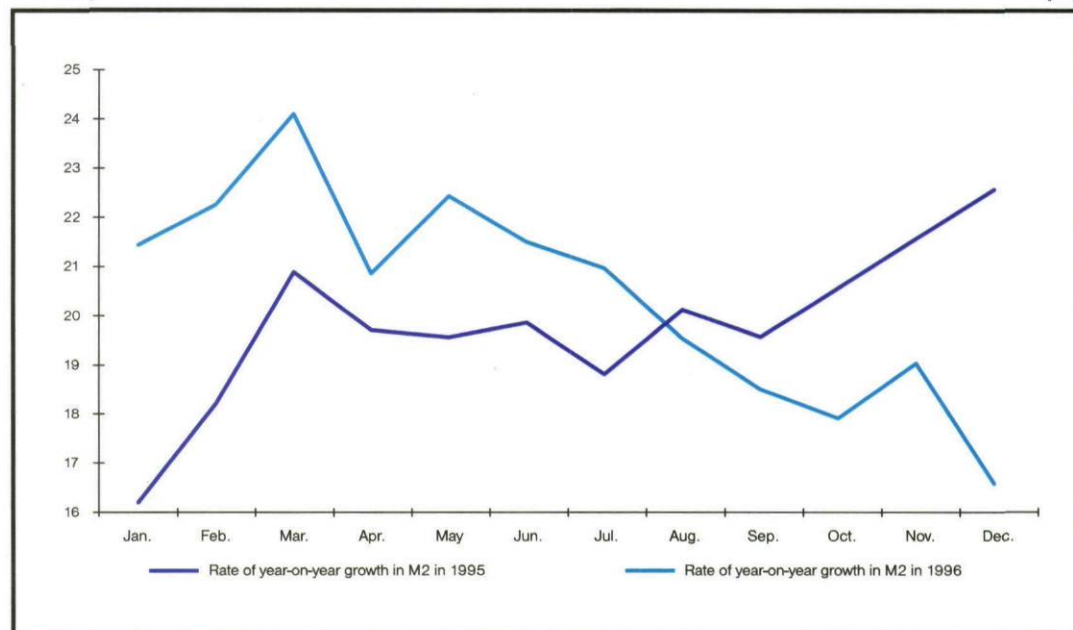
Over the course of 1996, the M2 money supply (at a fixed rate of exchange) increased by Sk 58.8 billion (16.5%), while quasi-money grew by Sk 33.3 billion (15.9%), and the M1 aggregate by Sk 25.5 billion (17.2%). From the beginning of the year, the rate of year-on-year growth in the money supply exceeded the level of 20% and culminated in March (24.1%), due mainly to the postponement of the deadline for



tax payments (taxes for the previous year) until April. The NBS responded to this development by sterilising the excess liquidity with the aim of constraining the expansion of bank lending to households and enterprises, and by adjusting its monetary-policy instruments. The effects of these measures (especially the increase in minimum required reserves) became evident already in August, when the rate of year-on-year growth in the money supply fell below 20% for the first time.

**Development of M2 in 1995 and 1996**

(%)



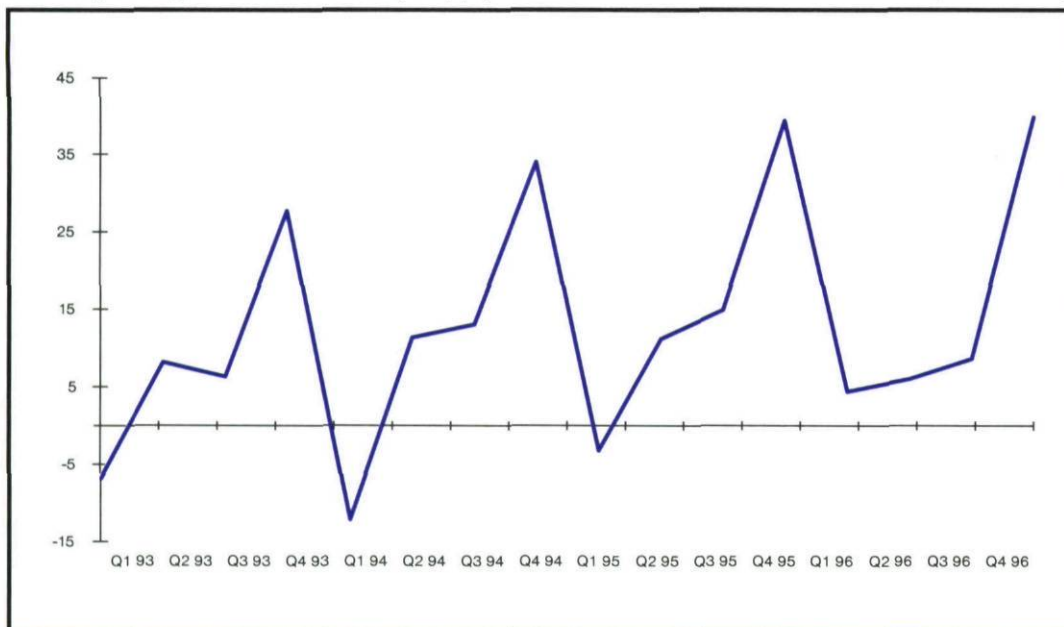
During the individual quarters of the year, the development of the M2 aggregate differed from that of previous years. In past years, the money supply fell during the first quarter due to tax payments and transfers by economic entities to the State budget in January and March. In 1996, postponement of the deadline for tax payments for the previous year until April 1st, combined with the marked growth in bank lending to households and enterprises caused the money supply to record a moderate increase in the first quarter as well. During the following quarters, the money supply continued to grow at a faster rate. The most significant increase in M2 was recorded in the last quarter as usual, due to the crediting of interest to bank deposits. The growth in the money supply during this period was also influenced by the crediting of funds obtained from project financing to crown accounts, the relatively significant increase in bank lending, and the increased position of the Government vis-a-vis the banking sector.

In comparison with quasi-money, development of the M1 sub-aggregate was characterised by higher volatility, due to its transactional nature. Regarding the structure of the money supply, the weight of M1 slightly increased in 1996, due to an increase in the weight of currency outside banks.

In 1996, the volume of currency outside the banking sector increased by Sk 9.0 billion (26.1%), and was one of the most dynamic components of the money supply. When compared with the previous year, currency issuance in 1996 was characterised by a marked upward trend. The high seasonal increase in the volume of currency in December was due to the higher turnover of retail sales before the Christmas holidays.

**Quarterly changes in the M2 money supply**

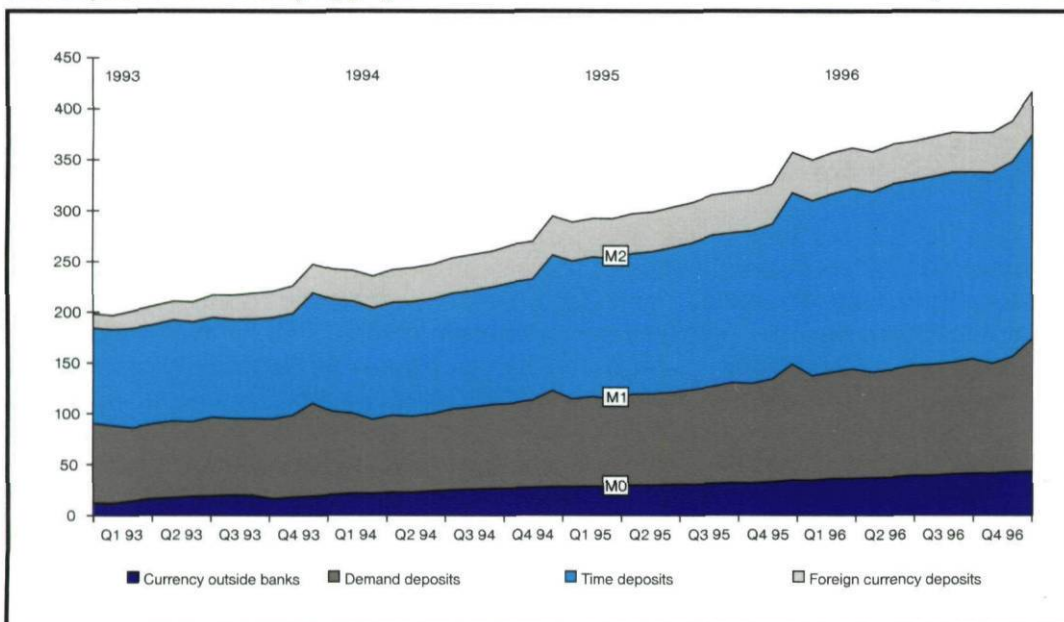
(Sk billions)



The development of demand deposits was due mainly to the demand deposits of enterprises, which are significantly influenced by the deadlines for the discharge of obligations vis-a-vis the State budget. The sharpest decline was recorded in the demand deposits of enterprises, as in previous years, in January. During the following months, with the exception of April and October, the volume of these deposits recorded regular month-on-month increases. In the household sector, the development of demand deposits was characterised by month-on-month increases during the whole year, except for September and October, due probably to the increased number of entities paying wages in the form of transfers to current accounts, and the rise in the level of nominal wages. The level of demand deposits held by insurance companies fluctuated, depending on the deadlines for the settlement of obligations vis-a-vis the State budget.

**Development of monetary aggregates**

(Sk millions)



In 1996, the volume of quasi-money recorded month-on-month decreases only in April, June, and September. The sharpest decrease was recorded in September and

was caused by the transfer of corporate time deposits into demand-deposit accounts (the enterprises needed liquid assets for the payment of quarterly advances on corporate income tax). Operative changes in the time structure of corporate deposits indicated that companies made use of the interest-rate differential between demand and time deposits, when they held their temporarily free funds on accounts with higher interest rates until the date of payment. At the end of the year, the weight of quasi-money fell below the level of January, due primarily to a decrease in the weight of foreign currency deposits.

**Structure of the money supply** (%)

	1.1.1996	31.3.1996	30.6.1996	30.9.1996	31.12.1996
Money supply [M2]	100.0	100.0	100.0	100.0	100.0
Money [M1]	41.52	39.75	40.02	40.83	41.78
Currency outside banks [MO]	9.65	10.03	10.60	11.05	10.45
Demand deposits	31.87	29.71	29.42	29.78	31.33
- Households	10.46	10.97	11.50	11.61	11.10
- Enterprises	20.98	18.19	17.43	17.80	19.82
- Insurance companies	0.42	0.55	0.49	0.37	0.41
Quasi-money [QM]	58.48	60.25	59.98	59.17	58.22
Time deposits	47.29	49.17	49.56	48.91	48.34
- Households	35.17	36.10	36.30	35.89	35.66
- Enterprises	7.72	8.26	8.48	8.34	8.41
- Insurance companies	4.39	4.81	4.79	4.68	4.28
Foreign-currency deposits	11.19	11.08	10.41	10.26	9.88
- Households	9.93	9.54	9.16	9.01	8.48
- Enterprises	1.26	1.55	1.25	1.25	1.39

In 1996, time deposits continued to be a dynamically growing component of the money supply, with the highest absolute increase among other components. The most rapid increase was recorded in household deposits, which experienced regular month-on-month increases with a seasonal maximum in December caused by the interest credited to deposit accounts. With regard to deposits by term, the most significant increases were recorded in time deposits at up to 1-year notice, deposits at above 5-year notice (home savings deposits), and deposits at up to 4-year notice. Marked decline was recorded only in deposits at up to 5-year notice. Home savings deposits increased by Sk 8.8 billion, representing 40% of the total volume of growth in household time deposits. This form of saving is motivated partly by the relatively high yield (a government bonus of 40%) and partly by the possibility to draw bank loans at a favourable rate of interest.

Time deposits of enterprises also recorded a relatively significant year-on-year increase (Sk 7.4 billion) and their month-on-month increases were positive, except for those in April, June, September, and December. Zero increase (April) and/or decline in corporate time deposits during these months were influenced by the deadlines for the discharge of obligations vis-a-vis the State budget - the deposits were used for this purpose or transformed into demand deposits, so that payments could be realised operatively in the near future. Significant increases were recorded only in corporate deposits at up to 1-month notice and deposits at up to 3-month notice. The placement of corporate funds into such short-term deposits was associated with their utilisation, especially for ensuring the liquidity of business entities, and the effort to maximise income by making use of the interest-rate differential between time and demand deposits. Time deposits of insurance companies also increased somewhat and their development was basically subject to the same influences as corporate deposits.

Over the course of 1996, the volume of foreign-currency deposits increased by Sk 1.1 billion, due exclusively to corporate deposits, while household deposits moderately declined.

From 1993 to 1996, the proportion of the M2 money supply and its components to GDP (at current prices) showed an upward trend. The created gross domestic product thus demanded improved financial management. However, the weight of the transaction component of the M1 sub-aggregate was relatively stable. Within the structure of M1, a marked change took place as a result of a fall in the share of demand deposits of GDP in 1994, which was caused by an atypical situation in 1993, after the division of the former CSFR, currency split, and the subsequent exchange of money in circulation. During the following period, its share was more or less stable. The need for transactional funds for the management of GDP remained unchanged. The weight of quasi-money experienced a balanced increase, household time deposits in particular - money in this form had a store of value function. The lack of alternative possibilities of financial investment stimulated the growth of time deposits. Despite a moderate absolute growth in foreign currency deposits, the proportion of these deposits to GDP showed a downward trend.

### 4.3 Bank Lending

Bank lending in Slovak koruna and foreign currency to the entrepreneurial sector, households, central and local authorities for extrabudgetary purposes, by commercial banks and the NBS, recorded significant increases mainly in March, June, and the 4th quarter of 1996. At the end of December 1996, the total volume of loans reached Sk 374.4 billion, of which Slovak-crown loans accounted for Sk 338.8 billion and foreign-currency loans Sk 35.6 billion.

The development of bank lending was influenced by:

- surplus of short-term resources at commercial banks;
- cancellation of credit limits on the part of the NBS;
- increase in required reserves with effect from 1 August 1996;
- requirement for commercial banks to achieve a certain ratio of foreign exchange position for monetary purposes by 31 December 1996.

Of the total increase in bank loans in 1996 (Sk 63.6 billion, i.e. 20.5%), crown loans accounted for 79.7% and loans in foreign currency 20.3%. From the beginning of the year, the volume of crown loans expanded by 17.6% (Sk 50.7 billion), while increases were recorded during the whole year with the exception of January. Loans in foreign currency increased mainly in the 1st quarter; during the 2nd and 3rd quarters, the absolute increases gradually decreased. After the introduction of the so-called foreign exchange position for monetary purposes, the volume of foreign-currency loans fell during the 4th quarter by Sk 4.5 billion, which was offset by a significant increase in crown loans.

Most of the total increase in crown lending (Sk 38.8 billion, i.e. 76.5%) was due to bank loans to non-financial organisations in the entrepreneurial sector. The share of loans to small businesses was low: the total volume of loans increased by only Sk 0.6 billion throughout the year; this was due partly to the strict security requirements of commercial banks for bank lending. The year 1996 was the first year to see a significant increase in loans to households, particularly from September; this was due to the introduction of advantageous loans for the purchase of a car and for housing construction by some commercial banks.

Regarding the structure of loans by sector, the share of the private sector further increased from 57.4% at the beginning of the year, to 60.4% at the end of December. This development was due chiefly to the accelerated pace of privatisation.

The structure of crown loans by term was characterised by an increase in the share of short-term loans (from 36.7% at the beginning of the year, to 40.6% at the end), stagnation in the share of medium-term loans (around 20.5%), and a decrease in long-term loans (from 43.3% to 38.5%). Non-performing loans represented almost one third of the total volume of long-term loans (27.1%).

At the end of 1996, the structure of crown loans by purpose was dominated by current assets (16.8%), investment loans (14.3%), debit current accounts (5.5%). Other loans (for housing construction, stock-turnover, privatisation, temporary shortage of funds, consumer loans, etc.) accounted for 15.3%. A significant share (48.1%) was held by standard receivables with reservation and classified receivables (these loans were not monitored according to purpose). The development of the structure of loans by purpose was characterised by increases in debit current accounts (148%), loans for the temporary shortage of funds (75.6%), investments (31.0%), and current assets (29.3%). Of the total increase in crown loans, the largest amount was provided for current operating expenses, less than a quarter for investments, and a minimal amount for privatisation.

In a sectoral breakdown, significant increases were reported in the volume of crown loans in processing industry (33.4%) and trade, sales, catering, and accommodation (21.6%). In 1996, the most rapid increases were recorded in trade (Sk 12.9 billion), processing industry (Sk 10.0 billion) - of which, food processing represented Sk 3.1 billion; textile, clothing, and leather industry Sk 1.4 billion), banking industry (Sk 5.2 billion), transport and communications (Sk 4.6 billion).

Bank lending in foreign currency was rather unstable over the course of 1996. After a marked increase during the first quarter (Sk 7.6 billion), the volume of month-on-month increases fell by an average of Sk 1.5 billion during the second and third quarters, and by Sk 4.5 billion during the last quarter, due to the introduction of the foreign exchange position of commercial banks for monetary purposes. From the beginning of the year, the volume of loans increased by a total of Sk 12.9 billion (56.8%). In 1995, the total increase amounted to Sk 7.4 billion (49.0%).

Over the course of 1996, commercial banks provided new crown loans in the total amount of Sk 232.4 billion, i.e. 23% more than in 1995. The private entrepreneurial sector received Sk 171.8 billion, representing 73.9% of the total Sk loans provided in 1996. The structure of new loans was dominated by short-term loans (78.7%), which were inadequate for development programmes in the individual sectors. With regard to the discrepancy between the terms of assets and liabilities at commercial banks, 25% of the volume of long-term loans was covered by short-term resources. The development of newly granted loans and their structure by term indicated that commercial banks had made an attempt to gradually eliminate the time discrepancy in question. Thus the key function of loans as tools for the support of long-term development was vitiated, and bank lending gradually became an instrument used for the financing of operating expenses.

#### **4.4 Interest Rate Development**

At the beginning of 1996, the development of interest rates was indirectly influenced by the lowering of the discount rate from 9.75% to 8.8%, by which the NBS signalled its expectations in respect of the future course of price inflation. Commercial banks saw the discount-rate reduction as a significant indicator of the future development of market interest rates and subsequently, though with some delay, adjusted the rates of interest. This was reflected in the level of published interest rates, which fell by 1.5 to 4.0 points. The actual lending and deposit rates recorded smaller changes, due to the persistent high demand for bank loans. Apart from the indirect effect of the reduction in the discount rate on the development of actual

interest rates, the level was influenced by the economic situation of commercial banks, macroeconomic development, competition between domestic and foreign banks, activities of depositors, as well as the monetary policy of the NBS. The interest-rate policy continued to be determined by the main commercial banks and other banks adjusted to it. Despite the relatively high level of lending rates and the low rate of inflation, the total earnings of the banking sector during the current period fell year-on-year by 13.2% in December 1996, while total expenses during the same period increased by 6.4%. The decline in the profitability ratio of the banking sector was due to the increased creation of provisions, reduction in interest receipts, lowering the ratio of earning assets to total assets, and increase in the volume of foreign resources. As a result of this development, the net interest rate margin decreased over the course of the year, to roughly 40% of the level in 1995.

In the light of the above facts, particularly the development of inflation, the level of interest rates on loans as well as deposits remained high. For the future development of lending rates, there is a real possibility of them being lowered at least to the same extent as the rates of interest on deposits.

**Development of interest rates** (%)

	1996											
	1	2	3	4	5	6	7	8	9	10	11	12
Average interest rate on total bank credit <sup>1/</sup>	14.84	14.43	14.20	14.27	13.95	13.43	13.23	13.25	13.28	13.36	13.42	13.22
Average interest rate on deposits	7.52	7.24	6.59	6.49	6.48	6.54	6.58	6.75	6.70	6.70	6.76	6.18
Nominal interest rate margin	7.32	7.19	7.61	7.78	7.47	6.89	6.65	6.50	6.58	6.66	6.66	7.04
Average interest rate on new loans	13.42	13.88	13.54	12.80	12.95	12.58	13.23	13.06	13.56	13.57	14.27	13.45
Discount rate	8.80	8.80	8.80	8.80	8.80	8.80	8.80	8.80	8.80	8.80	8.80	8.80
Annual rate of inflation	6.40	6.20	6.10	6.00	6.10	6.20	5.50	5.60	5.20	5.30	5.4	5.4
Average interest rate on annual deposits	11.33	10.80	9.41	9.24	9.08	9.08	9.03	9.11	9.07	9.05	9.09	8.91
Real interest rate	4.93	4.60	3.31	3.24	2.98	2.88	3.53	3.51	3.87	3.75	3.69	3.51
Average interest rate on loans including 0% rates <sup>2/</sup>	12.90	12.58	12.32	12.35	11.96	11.71	11.58	11.63	11.53	11.55	11.63	11.16
Nominal interest rate	5.38	5.34	5.73	5.86	5.48	5.17	5.00	4.88	4.83	4.85	4.87	4.98

1/ Excluding unpaid interest

2/ Including unpaid interest

Compared with the figure for December 1995, the average interest rate on the total volume of loans fell by 1.56 points, to 13.22% at the end of 1996. The turning point was May, when the interest rate fell below 14%. The most significant reductions were recorded in interest rates on medium-term loans (by 2.49 points, to 15.28%), short-term loans (by 2.31 points, to 13.86%), and on long-term loans (by 0.77 points, to 11.35%). The low level of interest rates on long-term loans was due to the fixed rates of interest on loans granted in the past at an interest rate of up to 6%.

The interest-rate policy of commercial banks was best exemplified by the level of interest rates on new loans, which were not influenced by loans granted in the past with fixed interest rates. The average rate of interest on the total volume of new loans fell from 14.04% in December 1995, to 13.45% in December 1996 (by 0.59 points). The average rate was most influenced by a fall in short-term interest rates (by 0.16 points), which applied to the majority of loans (76% to 84% during the year), and which was supported by the reduction in interest rates on medium- and long-term

loans (0.69 to 3.12 points). Medium and long-term interest rates were considerably influenced by a random change in the structure of loans by purpose, as a result of their small volume. The weight of new short-term loans represented 78.7%, medium-term loans 4.2%, and long-term loans accounted for 7.1%.

Interest rates on new medium- and long-term loans experienced marked fluctuations throughout the year, due mainly to the structure of customers, advantageous loans for certain entrepreneurial entities, drawing of loans for housing construction projects at a rate of 1%, and the introduction of attractive consumer loans at a rate of 10 to 12%.

The development of new short-term loans in 1996, was marked by the absence of any correlation between average interest rates for customers and interbank money market rates, especially during the first half of the year, when the correlation ratio reached negative values. During the second half of 1996, the average rates of interest on the interbank money market approached the average value of interest rates on new short-term loans.

Owing to the reduction in the discount rate and the fall in inflation, the level of lending rates fell significantly, while deposit rates remained virtually unchanged in the second half of 1995. Marked changes in interest rates on crown deposits were first recorded in March 1996. The average interest rate on crown deposits fell by 2.05 points from the beginning of the year, to 6.18%. Marked reductions were recorded in interest rates on time deposits (an average of 2.35 points). The most significant cuts were recorded in interest rates on deposits at 1 to 2-year notice, which represented 37.9% of the total volume of crown deposits at the beginning of the year; this share had fallen to 33.4% by the end of the year. The average interest rates were reduced on crown deposits with the largest volumes. Reductions were recorded in average interest rates on:

- deposits at two-year notice: by 3.09 points, to 9.44%;  
deposits at 18-month notice: by 2.59 points, to 10.43%;
- deposits at one-year notice: by 2.55 points, to 8.91 %.

Over the course of the year, the real interest rates on one-year deposits showed a downward trend with moderate fluctuations in individual months, the level falling from 4.26% in December 1995 to 3.51% at the end of 1996, due mainly to the marked reduction in nominal interest rates on one-year deposits (2.55 points) exceeding the fall in the annual rate of price inflation (1.8 points).

#### **4.5 Implementation of Monetary Policy**

One of the indicators and operative goals of monetary policy is the monetary base, reserve money (sum of issued currency and reserves of commercial banks at the NBS). The monetary base is the narrowest monetary aggregate, which reflects the development of the money supply in terms of M2 on the one hand, and affects the volume of money in the economy by regulating the liquidity of commercial banks through the level of surplus reserves on the other. The level of excess reserves is also regulated through autonomous factors, but mainly through central bank operations by means of monetary-policy factors.

In 1996, the monetary base increased by Sk 16.6 billion; of which, Sk 10.7 billion was created through autonomous factors and the remaining Sk 5.9 billion through monetary-policy factors.

The influence of autonomous factors on the growth of commercial bank reserves moderated, due mainly to the slower rate of growth in net foreign assets, which increased by only Sk 18 billion in 1996, compared with Sk 43 billion in 1995. In 1996,

the development of net foreign assets at the NBS was influenced by outflow of funds previously obtained through the capital account in the form of payments for imports, while in 1995 the volume of the capital and financial account markedly exceeded that of the balance of payment current account.

The deficit of the 1996 State budget, which was Sk 17.2 billion higher than in previous year, was covered by issues of Treasury bills. At first sight, the budget deficit had no influence on the liquidity of commercial banks, because it was fully covered by Treasury bills. However, a part of the deficit could only be covered at the expense of an increase in monetary-policy factors, which means that the NBS purchased Treasury bills for its own portfolio. In this way, the economy acquired an additional amount of financial resources for the support of aggregate demand at the end of the year.

Government funds supplied to the economy through the accounts of banks are, from the point of view of bank liquidity, drawn by issues of Treasury bills, they represent a source of consumption in the economy and create a certain basis for the expansion of bank lending, which is reflected either in a rise in the level of required reserves or fall in foreign assets, through outflow of funds in the form of payments for imports.

In comparison with the development of monetary-policy factors in 1995 (a fall of Sk 1.0 billion), the monetary policy of the NBS for 1996 can be characterised as refinancing, as the monetary-policy factors increased by Sk 5.9 billion over the course of the year, and reached an average of Sk 7.3 billion in December.

The most significant average volumes of monetary-policy factors were reported in May, August, and during the final months of 1996. The August increase in refinancing was associated with the rise in the level of required reserves, when the banking sector could not obtain enough funds even from sales of foreign exchange and transactions in central bank bills (NBS bills). After August, the issues of NBS bills were not renewed within the scope of sterilisation and the due securities of the central bank represented an indirect release of liquidity.

Refinancing in November and December as part of monetary-policy factors, which reached an average amount of almost Sk 6 billion, was caused by the supply of liquidity to the banking sector for the purpose of financing the State budget deficit through purchases of Treasury bills by banking institutions.

In December, the development of monetary-policy factors showed considerable fluctuation. The peak value (Sk 15 billion) was reached, for reasons already mentioned, during the final days of the month.

With regard to the level and development of monetary-policy factors, the monetary policy pursued by the NBS in 1996 may be characterised as expansive.

The resources created through the NBS balance were absorbed by an increase in the volume of issued currency (an average of Sk 12 billion). The remaining funds were consumed by the increase in deposits held by commercial banks on accounts with the NBS. In addition to these resources, the banks made use of funds obtained from NBS bills in the amount of Sk 12.5 billion, by which their portfolios diminished as a result of the lack of interest in new issues and trading (refinancing) in existing securities. This means that the Bank's disposable portfolio earmarked for the sterilisation of liquidity was not utilised during the last quarter of 1996.

Due to surplus liquidity, the NBS began issuing central bank bills (NBS bills) already in the first quarter of 1995 and to create opportunities for banks to invest their free resources.



Within the balances of commercial banks, the possibilities to invest in NBS securities were gradually replaced, in August 1996, by low-interest earning required minimum reserves, on account of the ineffectiveness or low effectiveness of bank liquidity sterilisation by means of NBS bills, which were meant to partly replace bank lending within the balances of commercial banks. The increased lending activities of commercial banks induced the NBS to redirect the free reserves of these banks into required minimum reserves.

In September, the banking sector adjusted to the policy of the NBS and its situation stabilised. In November, the level of free reserves at commercial banks fell by Sk 3 billion and reached, for the first time in 1996, negative values, indicating that the commercial banks were dependent on NBS refinancing, for the volume of monetary-policy factors was higher than that of the banks' own resources in the form of excess reserves and NBS bills portfolios.

Free reserves are defined as the excess reserves of commercial banks and their portfolios of NBS bills excluding monetary-policy factors, which represent a source of temporary refinancing for banks. Free reserves are short-term assets and represent, when banks show interest, a substitution for bank loans and consequently a potential source of pressure on the growth of the money supply.

## **4.6 Instruments of Monetary Policy**

### **1. Interest rate policy**

- a) From 1 January 1996:
  - Discount rate: 9.75%;
  - Lombard rate: 13.00%.
- b) From 13 January 1996:
  - Discount rate: 8.80%;
- c) From 17 July 1996:
  - Lombard rate: 15.00%.

### **2. Reserve requirements**

- a) With effect from 1 January 1996, the ratio of primary deposits for the calculation of minimum required reserves was set at 3% of time deposits, 9% of demand deposits, and 1% of home savings deposits.
- b) With effect from March 1996, the period applied for when evaluating banks' required reserves was reduced from one month to two weeks.
- c) With effect from 1 August 1996, the ratio of required reserves was set at 9% of primary time- and demand deposits for all commercial banks, with the exception of home savings banks, which are required to maintain minimum reserves amounting to 3% of primary deposits. At the same time, required reserves started to bear interest at the rate of 1.5%, up to the level of required reserves set for the period under consideration.

### **3. System of refinancing**

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

- a) Redistribution loans:
  - Traditional - at a rate of 9.5%;
  - Soft loan - at a rate of 7.5%;
- b) Lombard loans (loans backed by a pledge of securities) granted at Lombard rate;

- c) Bills of exchange - bills of exchange are discounted and rediscounted at the discount rate; this form of refinancing included bills discounted for export promotion and bills rediscounted for the support of agriculture;
- d) Open market operations - for the purpose of refinancing.

#### 4. System of bilateral agreements

- Instrument designed to influence the lending operations of commercial banks.

#### 5. Treasury bills

- An effective means of financing the State budget deficit;
- A means of managing the liquidity of commercial banks through
  - a) secondary sales / purchases
  - b) REPO operations (repurchase agreements).

#### 6. NBS bills

- Instrument used by the central bank to influence liquidity of commercial banks via the same trading sectors as for Treasury bills.

#### 7. Exchange-rate and foreign-exchange policy

a) The currency basket of the Sk (since 14 July 1994):

Currency	US\$	DEM
Weight	40%	60%
Exchange rate Sk	31.209	20.227

Absolute definition of the currency basket:  
 $1 \text{ IDX} = 0.012817 \text{ US\$} + 0.029663 \text{ DEM}$

b) Evaluation of the currency basket of the Sk:

The turnover of foreign exchange operations under payment items specified in groups 1 to 6 in convertible currencies (excluding other convertible currencies, i.e. Czech crown, Hungarian forint, etc.) reached Sk 637.6 billion during the period from January to December 1996. The average monthly turnover (Sk 53.1 billion) increased by 29.8% year-on-year. The deficit of foreign exchange receipts and payments reached a level of Sk 34.0 billion during the twelve months of 1996. The currency structure of the turnover was dominated by DEM (41.7%) and US\$ (34.3%). The other European currencies, with a strong correlation to DEM, accounted for 22.1%. Together with DEM, these currencies represented 63.8% of the total volume. The share of non-continental currencies including GBP was substantially lower (1.9%), and, together with US\$, accounted for 36.2% of the total turnover.

The turnover of foreign exchange receipts and payments, including other convertible currencies, mainly the Czech crown (CZK), reached Sk 724.1 billion in 1996. The large share of CZK in the achieved turnover (Sk 85.9 billion, i.e. 11.9%) and its inclusion in total turnover (converted according to the currency basket consisting of 65% CZK and 35% DEM) changed the structure of the total turnover in favour of DEM (64.0%) and to the detriment of US\$ (36.0%).

c) Real effective exchange rate of the Slovak koruna

The real effective exchange rate of the Slovak koruna, calculated on the basis of the consumer price index, compared with those of Slovakia's eight trading partners having a significant share in the country's foreign trade turnover (USA, Great Britain, Austria, France, Germany, Italy, Holland, and Switzerland), appreciated in 1996 by 2.9%; or, when compared with the country's nine trading partners (including the Czech Republic), it depreciated by 2.8%.

The real effective exchange rate of the Slovak koruna, calculated on the basis of the producer price index, compared with those of Slovakia's eight trading partners,

appreciated by 3.9%; or, compared with the country's nine trading partners, depreciated by 0.4% in 1996.

- d) Management of the foreign exchange position of commercial banks:  
Approach to NBS foreign exchange fixing in terms of a FXA/FXL ratio (foreign exchange assets / foreign exchange liabilities) was lower than 1.05; i.e. the commercial bank can adjust its foreign exchange position to the 1.05 coefficient at any time, by the sale or purchase of foreign exchange on the interbank foreign exchange market or upon foreign exchange fixing by the NBS.

Within the scope of monetary-policy instruments, the NBS introduced the concept of 'foreign exchange position of banks for monetary purposes' in July. Its ratio is calculated as the proportion of foreign exchange assets of non-residents to the sum of foreign exchange liabilities, reduced by capital in foreign currency, and liabilities of non-resident banks denominated in Slovak crowns. The value of this ratio was set at 0.65, and banks were required to achieve it by 31 December 1996.

Calculation of the foreign exchange position (FXPMP):

$$\text{FXPMP} = \frac{\text{FXAN}}{\text{FXL} + \text{LNSk} - \text{C}}$$

FXPMP - foreign exchange position for monetary purposes;  
FXAN - foreign exchange assets of non-residents;  
FXL - foreign exchange liabilities in total;  
LNSk - liabilities of non-residents in Slovak koruna;  
C - capital and other own resources in foreign currency and unpaid capital in foreign currency.

- Obligatory values of the FXPMP ratio:
  - As of 31 December 1996 - min. 0.65;
  - As of 31 March 1997 - min. 0.70;
  - As of 30 June 1997 - min. 0.80.
- Penalties for non-fulfilment of the obligatory FXPMP ratio:
  - 9% of the volume of the non-fulfilled ratio of FXPMP.

- e) Exchange rate fluctuation:  
The exchange rates of the Slovak koruna against fully convertible currencies in NBS foreign exchange fixing are regulated by the rate of IDX/Sk, representing the influence of demand and supply on the part of commercial banks. The IDX/Sk rate moves within a fluctuation band of  $\pm 5\%$  (as of 17 July 1996) and is subject to decisions passed by the Auction Committee of the NBS. At the same time, the Bank Board of the NBS cancelled the maximum daily deviation within the fluctuation band, as part of adjustments to the monetary-policy instruments. In 1996, the initial level of the IDX currency basket was 0.9912, which had risen to 1,0175 (max. level in 1996) by the end of December. The minimum level (0.9896) of the IDX unit was recorded in April 1996.

- f) Foreign exchange policy vis-a-vis the population  
In 1996, citizens of the Slovak Republic could purchase foreign exchange at financial institutions up to the equivalent of Sk 60,000.

## 4.7 Monetary Calendar

### *January*

- With effect from 13 January 1996, the Bank Board of the NBS decided to lower the discount rate to 8.8%;

- With effect from 1 March 1996, the National Council of the SR passed an amendment to the Banking Act;

#### *March*

- Change in the method of evaluating minimum required reserves: the period of evaluation was reduced to two weeks;
- The NBS issued a decree stipulating the terms and conditions of trading in foreign exchange by banks on the interbank foreign exchange market.
- With effect from 1 July 1996, the National Council of the SR passed the Protection of Bank Deposits Act.

#### *April*

- The American rating agency, Standard and Poor's, raised the hard currency long-term liability rating of Slovakia, as represented by the NBS, from BB+ to BBB- with stable outlook;
- The specialised rating agency Thompson Bankwatch assigned a new risk rating to the SR, at the level of BB+.
- On 22 April 1996, a credit line agreement was signed with EXIM Bank of Japan for a JPY 10 billion Two Step Loan, earmarked for the support of small- and medium-sized businesses.

#### *May*

- The Bank Board of the NBS approved some adjustments to the Monetary Programme for 1996.

#### *June*

- Representatives of the SR took part in a series of negotiations with OECD in Paris, in connection with the planned admission of Slovakia into OECD.

#### *July*

- The Bank Board of the NBS decided to modify the instruments of monetary policy.
- At the invitation of the NBS and the Ministry of Finance, the IMF sent a mission to Slovakia to study the ongoing structural reform of the economy, the course of privatisation, and the reform of the country's financial system.

#### *August*

- The European rating agency IBCA assigned a BBB- (investment grade) rating to the SR as represented by the NBS.
- In the largest clearing and payment system 'Euroclear', the Slovak koruna was accepted as a clearing currency, in connection with the first issue of Eurocrown bonds, i.e. Eurobonds denominated in Slovak koruna.

#### *October*

- With effect from 1 January 1997, the Bank Board of the NBS passed a decree stipulating the foreign exchange position of banks for monetary purposes.
- The NBS signed an agreement on co-operation with Nomura International Plc, under which Nomura has become financial advisor to the NBS.
- On 10 to 23 October 1996, the NBS was visited by an IMF mission within the framework of regular consultations in accordance with Article 4 of the International Monetary Fund Agreement.

#### *December*

- The Bank Board approved the Monetary Programme of the NBS for 1997. With effect from 1 January 1997, approved the minimum reserve requirements for mortgage bonds and municipal bonds issued by mortgage banks (3%).
- On 1 December 1996, further measures were adopted with the aim of liberalising capital account payments.

## 5. FINANCIAL MARKETS

### 5.1 Money Market

Over the course of 1996, the Ministry of Finance of the SR (MF SR) called 41 auctions of Treasury bills, with 36 issues floated to raise funds to cover the current State budget deficit. On occasions when the auctions of Treasury bills failed to cover the deficit, the MF SR resorted to so-called 'tap' issues for the portfolio of the National Bank of Slovakia (NBS). There were fifteen of them. Since the beginning of the year, the Ministry of Finance issued Treasury bills in the amount of Sk 119.9 billion, an average of Sk 2.3 billion per single issue. Compared to the previous period, this meant an annual increase of Sk 69.1 billion, with the average issue about Sk 0.2 billion larger. In the wake of the Ministry's issuing activity during the year, the volume of traded state securities covering budget shortfalls had mounted from the initial Sk 5.7 to 27.0 billion by the end of the year.

While the amount of Treasury bills sold in regular issues during the first three quarters managed to cover budget financing needs, with only two 'tap' issues worth a total of Sk 2.5 billion required to tide the budget over a temporary discrepancy between revenues and expenditures, heavier budget spending and depleted liquidity in the banking sector called for another thirteen 'tap' issues in the last quarter of the year. Apart from these auxiliary issues, the NBS also bought up an additional Sk 8.8 billion worth of Treasury bills in regular issues, seizing a 37% share in total Treasury-bill sales on the primary market. The share of investors other than banks, in the purchase of Treasury bills was insignificant (1.7%).

#### *Basic characteristics of Treasury-bill issues in 1996*

	Number of issues	Of which, issues for NBS portfolio	Number of bills sold (PCS)	Of which		Average interest rate (%)	Demand (in pcs)
				NBS	Non-banks		
Q1	10	2	16,852	2,500	886	6.756	50,585
Q2	7		6,364	1,260	270	7.066	21,216
Q3	10		16,603	3,400	149	8.296	20,161
Q4	29	13	83,081	38,282	858	10.573	59,659
1996	56	15	122,900	45,442	2,163	9.560	151,621

As far as redemption periods are concerned, Treasury-bill issues had maturities ranging from 3 to 28 days. There was a problem with little variability of maturity in individual periods. While the first three quarters were dominated by items with short redemption periods, around 1 month, the last two months of the year were special for regular auctions, selling government securities largely maturing in 9 months.

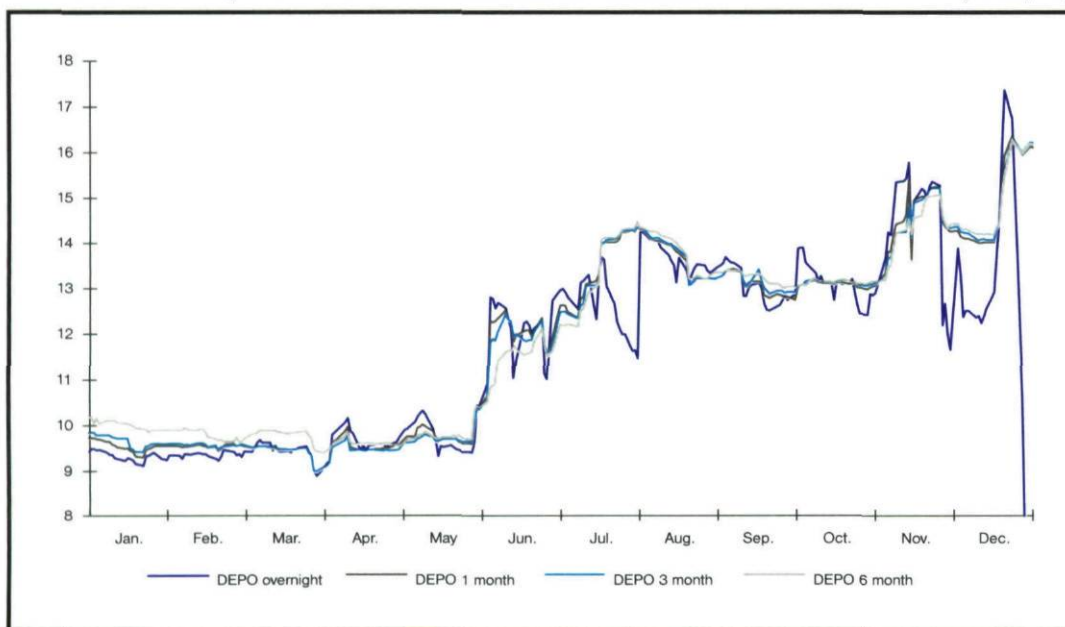
Although the bulk of Treasury bills in primary sale was floated at American auctions, where the volume is not announced in advance and no maximum interest rate is set, the issuer did fix a maximum interest rate in the year's last issue in an attempt to stem additional growth of the average yield. Average interest rates were gaining down the year, starting out at 6.25% p.a. in January's 3-week issue, to top out at 13.59% p.a., in December's 9-month issue, as the average rate weighted by actual volumes mounted from 6.76% in the first quarter to 10.57% in the last quarter. Apart from the development of lending rates on the interbank market, it was especially the efforts of the MF SR to prop up the budget, seen in vigorous issuing activity and a tendency to accept maximum number of auction bids, that boosted interest rates in the primary market from 9.669 to 13.591% p.a., particularly in November and December.

The scrapping of credit limits previously imposed on individual commercial banks, coupled with stronger use of NBS's market instruments, increased the role of the domestic money market as a medium of monetary policy.

In response to fairly excessive liquidity in the money market in early 1996, the NBS drained the surplus by active use of open market operations. With a combination of regular issues of NBS bills and short-term REPO tenders of NBS bills from own portfolio, the NBS managed to stabilise the level of liquidity in the banking sector, a success given away by steady interest rates held between 9.5 and 10%. A series of interventions warded off undesired swings in required reserves compliance of the banking sector. During that phase, the NBS tailored its REPO rates to its intervention goals, which made them the key price factor in the money market. Increased reference weight of the interbank deposit market, characterised by rates charged in the purchase and sale of standard-maturity deposits, can be told from the adding of six-month deposits to the BRIBOR (Bratislava Interbank Offered Rate) list on 1 March, 1996, as well as from the way commercial banks started to peg part of their lending activity to the official BRIBOR.

**Interest rate development on the interbank market - BRIBOR**

(in % p.a.)



For short periods of time, redundant liquidity was drained by REPO transactions (repurchase agreements made over a specific period) maturing in no more than 7 days. This kind of transaction accounted for about two-thirds of NBS's total open market operations in the first quarter. Virtually all of the sterilisation of short-term liquidity was made in individual transactions, except for 3 bulk REPO auctions in February and March, selling NBS bills from its own portfolio. The NBS has been floating special issues of NBS bills designed for its own portfolio throughout the year, all of them maturing in 3 months, save for the last 1-month issue. These issues within its working portfolio gave the NBS a lasting handle on the sterilisation of liquidity in the banking sector through the short-term securities market. The volume of REPO operations conducted by the NBS ranged from Sk 3 to 22 billion, some Sk 8 billion on average.

Despite certain positive achievements in stabilisation of the money market, sterilisation of surplus liquidity did little to bridle lending activities of commercial banks. That is why the NBS decided to lock abundant liquidity for longer periods of time and started staging weekly auctions of 3-month NBS bills in March, followed by 6-month NBS bills in mid-April. A series of seven auctions held between mid-March and the beginning of May floated 17,283 pcs of NBS bills, which would exhaust liquidity in the banking sector until commercial banks found themselves dependent on refinancing in May. In response to the shortage, the market lifted the BRIBOR rates. This in turn led to growing auction interest rates on the primary market for Treasury

bills, as well as the primary market for NBS bills, coinciding with flagging demand for NBS bills on the part of commercial banks.

**Interest rates in the interbank market - BRIBOR**

	Overnight	7 days	14 days	1 month	2 months	3 months	6 months
January	9.33	9.39	9.43	9.53	9.59	9.64	9.99
February	9.37	9.39	9.43	9.53	9.55	9.56	9.78
March	9.43	9.41	9.41	9.42	9.42	9.43	9.77
Q1	9.38	9.40	9.43	9.49	9.52	9.54	9.85
April	9.65	9.59	9.56	9.51	9.46	9.45	9.59
May	9.80	9.79	9.79	9.78	9.74	9.72	9.78
June	12.06	11.99	11.98	11.96	11.88	11.83	11.46
Q2	10.50	10.46	10.44	10.42	10.36	10.33	10.28
July	12.65	13.07	13.27	13.43	13.40	13.40	13.33
August	13.68	13.60	13.63	13.66	13.68	13.69	13.78
September	13.04	12.97	13.00	13.05	13.09	13.11	13.22
Q3	13.12	13.21	13.30	13.38	13.39	13.40	13.44
October	13.12	12.99	13.02	13.08	13.11	13.11	13.13
November	14.37	14.55	14.55	14.46	14.39	14.38	14.30
December	12.34	14.59	14.72	14.91	14.93	14.93	14.97
Q4	13.28	14.04	14.09	14.15	14.14	14.14	14.13
1996	11.57	11.79	11.82	11.87	11.86	11.86	11.93

Prompted by unfavourable developments in money aggregates, the NBS widened the REPO spread to 1.5% in May in an effort to cut refinancing for commercial banks. Interbank rates, after being stable and even for some time, rose in May and continued growing over the next two months. In early June, interbank rates bounced by 2 to 3%; depending on the time of maturity. There was a fairly high volatility in short-term deposit rates, which were not only quick to pick up drifts in absolute liquidity in the banking sector, but also responded to the compliance or failure to comply with required reserves, especially in the final days of each two-week reading. Banks saw some of their money coming back in June and July, the time of redemption of some Sk 14.3 billion worth of 3-month NBS bills. Only two auctions out of eight called were successful, floating NBS bills worth a nominal Sk 5.3 billion. Banks shied away from investments into NBS bills in an effort to maintain their liquidity, as well as because the bills lost their attraction when the NBS ignored market expectations through reluctance to accept interest rates in the primary market. With a large part of the free liquidity released in exchange for redeemed NBS bills no longer spent back in new auctions, the banking sector lost its dependence on refinancing, which led to yet another sterilisation balance in NBS's open market operations in July.

**Basic characteristics of NBS-bill issues in 1996**

	Number of issues	Of which, issues for NBS portfolio	Number of bills sold (in pcs)	Of which		Average interest rate (%)	Demand (in pcs)
				NBS	Banks		
Q1	7	2	50,323	40,000	10,323	7.631	28,501
Q2	14	1	22,910	5,000	17,910	8.043	26,390
Q3	14	1	12,100	10,000	2,100	9.246	8,500
Q4	5	1	7,900	5,000	2,900	10.583	4,030
1996	40	5	93,233	60,000	33,233	8.213	67,421

Unrelenting growth of loans prompted the NBS to rein surplus liquidity by lifting required reserves on 1 August. This brought about an increase of Sk 13 billion in total required reserves, driving commercial banks back into refinancing addiction. On the heels of the announcement made in the middle of July, BRIBOR skipped almost 1 point. Since most of the trading done in the period involved transactions with longer maturity spans, momentary abundance of short-term money pushed down 1-month interest rates and widened the spread of the yield curve to 3 points. In early August, when the NBS's new required reserves regulation came into force, the yield curve nearly levelled out, although at a level almost 2 points higher than in the previous

month. A subtle adjustment of rates at the end of August settled the market for some time and interest rates did not stray too far from an average 13.2 % until the first ten-day period of November.

On 1 August 1996, seven commercial banks signed up with the NBS to serve as reference banks. With the past system of reference banks only bound by informal covenants now turning into a full-fledged official system, this was a qualitative leap in over one-and-a-half years in the building of Slovakia's interbank market. The status of reference banks was granted to banks quoting all standard maturity deposits listed in BRIBOR, which had a substantial share in the deposit market, observed the agreed maximum interest rate spreads between offer and bid, and kept up sufficient mutual credit lines.

In September, the market gained better financial foothold after the redemption of some Sk 6.7 billion of NBS bills, which made up for part of the liquidity lost to higher required reserves and allowed continued decline of interbank interest rates. Contrary to BRIBOR, though, interest rates in the primary market of Treasury bills were going up with the average rate in accepted bids at Treasury bills auctions growing with each additional auction. At the end of the month, in an attempt to straighten out the disproportion between money market rates, the NBS raised the refinancing REPO rate to 8.7% and trimmed the sterilising REPO rate to 7.2%, and this value remained unchanged for the rest of the year. The NBS carried on regulating liquidity in the banking sector with individual REPO transactions and continued auctions of NBS bills, even though commercial bank's stayed largely uninterested, because the yield offered probably was not a sufficient attraction.

After two months of relative stability and balance, the interbank market slipped back into refinancing dependence and became unstable again. Over a few days, one-day money rates hit 15.4%. Other maturity spans traded between 14.3 and 14.8%, with the curve slightly growing by 0.2-0.4 points by the end of month. Since the MF SR did not stop issuing 9-month NBS bills, the NBS suspended auctions of Treasury bills to avoid competing with the MF SR on the primary market, and intervened with individual REPO operations instead. Due to a growing average accepted interest rate at Treasury bills auctions, the central bank increased the refinancing REPO rate to 9.7% at the end of the year.

December caught the interbank market quite unsettled. Along with declining BRIBOR rates during the first days of the month and their rebound later on, yields kept on growing at Treasury-bill auctions. Anxious to cover the budget deficit, the MF SR accepted virtually any bids from commercial banks, which showed increased interest in auctions due to the rising yields. In a mere five days in the second half of December, the lack of liquidity in the banking sector fired up interest rates, especially for short-term deposits, to 17.1-17.8% p.a. One- to six-month rates bounced to 15.5-15.95%, which meant a leap of between 1.5 and 5.2 percentage points. Before the year was out, there had been yet demand for liquid resources on the eve of holidays, as banks struggled to fulfil reserve requirements.



## **5.2 Capital Market**

### **5.2.1 Primary Market**

#### **Government Bonds**

There were four auctions of government bonds in 1996, with three issues floated. In March, pursuant to Article 14 of the 1996 State Budget Act No. 304/1995 Z.z., the Government floated Issue No. 020. Its proceeds were intended to finance new highway construction projects in Slovakia. Other issues were released under Slovak Parliament Resolution No. 396 of 3 July, 1996, to finance the 1995 State budget deficit.

Resident banking institutions were the only eligible entrants for Issue No. 020. Of 15 banks filing for it, the issuer - the Ministry of Finance of the SR (MF SR) - singled out and accepted 7 bids. The advantage of this particular placement was its limited size. Assuming high demand, which outstripped supply, it was possible to bargain for a lower yield before maturity, as compared to the yield set in the terms of issue (7.8% p.a.). The lower yield came as a cost-cutting move for the issuer as well as evidence of a declining trend in the yield of fixed-rate securities. This trend was rooted in the solid macroeconomic results of 1995, a cut in the discount rate in January and especially the high level of liquidity in the banking sector, where demand tripled the actual volume of the issue.

Apart from banks, the August Issue No. 021 was also open to stock dealers, who did not take up the opportunity, however. Its yield was increased to 9% p.a., due to more adverse conditions for primary market placements as compared to the first half of the year, caused by a combination of growing number of non-government bond placements, ongoing lack of banking liquidity and an increase in money market rates. The issue price was set to be at least 100% of the face value, which had a significant effect on pre-redemption yield achieved at the auction and allowed the issuer to accept all ten bids.

September's government bond issue No. 022 had the yield trimmed by 0.5 percentage points, to 8.5% p.a., compared with the previous month's figure. It was especially this cut, coupled with restricted issue price, that failed the auction. Considering the failure of the auction, the issuer decided to follow Article 4, paragraph 7, of the Basic Agreement on Auction Bond Placements and rejected all presented bids.

Aware of the flop of the September auction, the October Issue No. 023 again carried a yield of 9.0% p.a., with no limitations to the issue price. These factors made a significant contribution to the successful placement of the entire volume of this last government bond issue of 1996. Eleven banks checked into the auction, and eight bids were accepted.

All issues of government bonds in 1996, were placed at American-style auctions. Short maturities were their common feature (12, or 18 months), which did not quite fit in the general trend in the primary market. In particular in the March issue of No. 020, this resulted in unused opportunity to obtain long-term funding under good conditions. This was also documented by developments on the primary market, especially after the turn of the second half of the year, which was affected by growing interest rates in the money market.

The good thing about these issues was that their proceeds managed to pay off the 1995 State budget deficit, and that the issuer's interest rate costs, calculated as

the weighted arithmetic average of floated bond volumes, came out at 8.64%, some 1.57 percentage points down from 1995.

By 31 December 1996, the volume of government bond issues had reached Sk 66,395 million. The total of all outstanding state bond issues slipped 0.80% from the 1995 close to Sk 53,665 million. This decline can be traced back to the redemption of six issues worth Sk 11,730 million, as opposed to only three new issues floating Sk 11,299 million.

### **Publicly Negotiable Non-Government Bonds**

In 1996, there were 56 placements of publicly negotiable non-government bonds totalling Sk 22,085 million, an increase of 101.87% from 1995. By months, the placements peaked in December (14 issues worth Sk 7,435 million).

The list of leading and largest placements included bank bonds along with corporate bonds of enterprises such as Benzinol, Železnice Slovenskej republiky, Železiarne Podbrezová, Slovenské elektrárne and others. Virtually all notable issues came with a fixed yield, while smaller releases tended to have variable yields tied to the NBS's discount rate. Although maturity was mostly around 5 years, a number of issues were packed with a call option for early redemption.

Even though a slow primary bond market posed some difficulties to new placements, often leaving issue managers stuck with varying leftovers in their portfolios, the general increase in the number and volume of issues of publicly tradable non-government bonds in 1996 came as a projection of past trends, suggesting an increasingly important role of bonds in the Slovak capital market.

### **5.2.2 Secondary Market**

In 1996, the Bratislava Securities Exchange (BCPB) recorded an increase in the total volume of trading, as well as in the number of securities traded. In 247 business days, the BCPB turned over stock worth a total of Sk 114,116 million, some 184.8% more than the year ago. In other words, about Sk 462 million worth of stock changed hands on an average day.

There has been a considerable upsurge in anonymous trading. While it took BCPB a full year to trade Sk 470.8 million in anonymous transaction in 1995, the same bulk was traded in each of the twelve months of 1996. That amounted up to an annual Sk 15,824 million in anonymous trading, giving it a share of 13.87% in all transactions made on the BCPB floor. Speaking of types of securities, bonds gained somewhat of an edge with 53.3% of corporate equity taking the remaining 46.7%.

Another substantial rise was recorded in direct transactions, which totalled Sk 98,292 million in 1996, about 148.2% up from 1995. Shares were involved in 77.1% of all direct transactions.

### **Bonds**

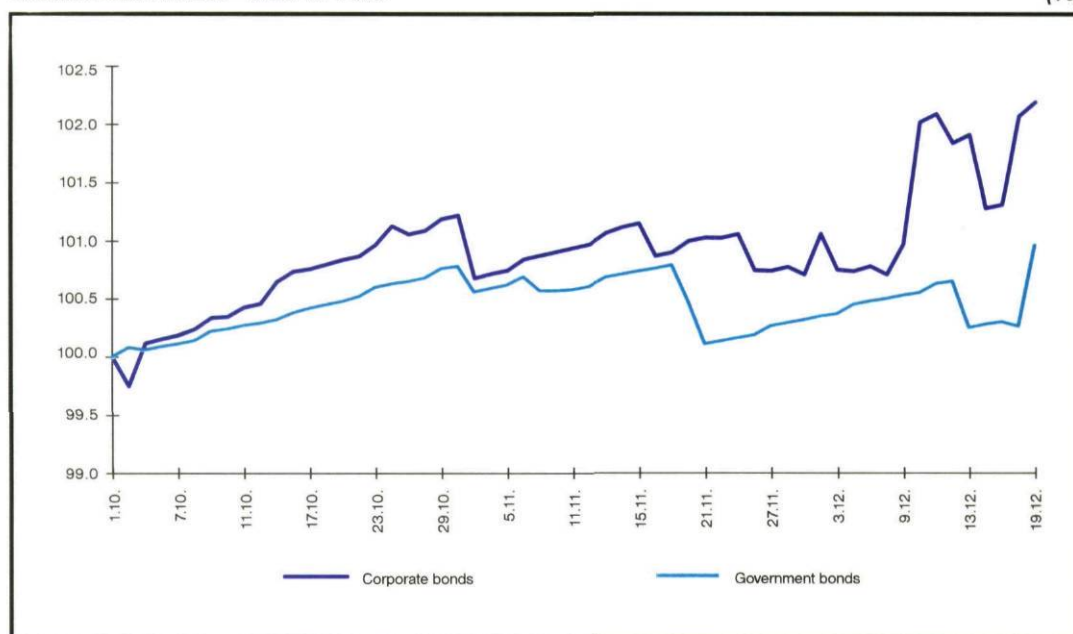
In 1996, bond transactions amounted to Sk 30,986 million, representing an increase of 102.02% from 1995 which brought it to a 27.15% share in BCPB's consolidated turnover. Transactions in listed bonds totalled Sk 17,464 million. During the year, the exchange listed 17 government bond issues, the number of which was down to 12 totalling Sk 47,286 million on the last trading day of the year. Total turnover of government bonds was Sk 10,353 million, which was 7.1% less than in 1995. This fall may be attributed in particular, to thinner supply of new government bond issues, their short maturity, the redemption of five old issues and a growing supply of non-government bonds at the BCPB. The most heavily traded state issues

were No. 013 (Sk 4,098 million), No. 011. (Sk 1,432 million) and No. 008 (Sk 1,196 million). Issues No. 013, and 008, were probably deemed attractive for their approaching redemption date as well as the possibility of their use in REPO operations with the National Bank of Slovakia, where these two were the most frequently appearing issues. Commercial banks were the most active government bond traders.

The best selling non-government item on the listed bond market was the VSZ bond, turning over a total of Sk 2,228 million. Heading the field in anonymous trading was VUB 01 with Sk 918 million.

**Slovak Bond Index - SDX in 1996**

(%)

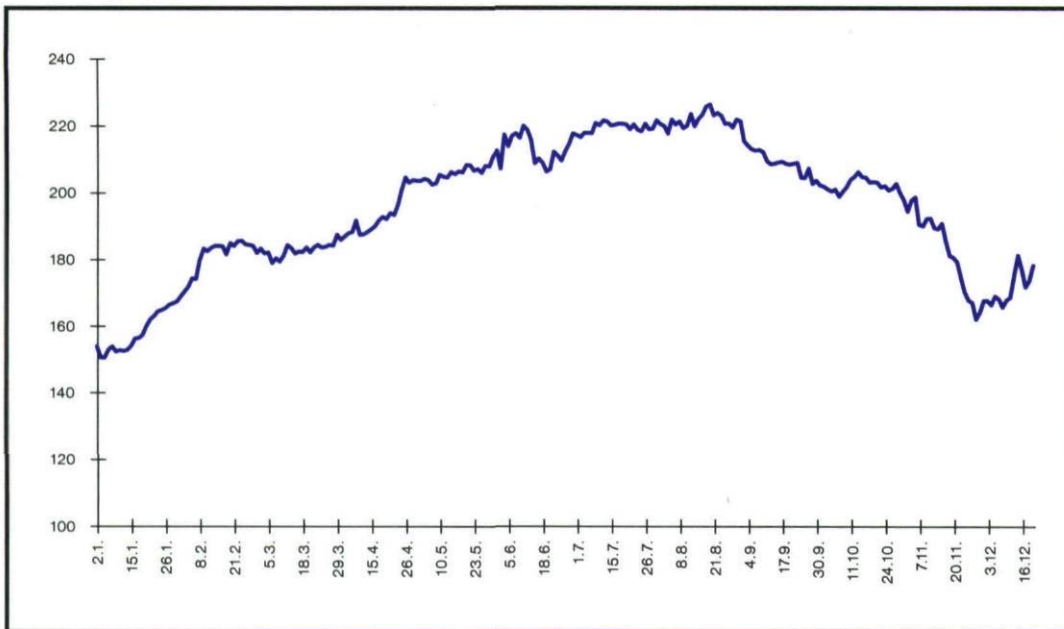


## Shares

The SAX index started out in 1996 at 153.82 points, and recorded its annual minimum (150.40 points) on 4 January. In the five next months, SAX bounced back and kept on growing with only slight random slips, crossing 200 points in April. After a relatively stable spell for corporate stock prices in July 1996, SAX turned around in the middle of August. One of the reasons for its retreat was the publication of mid-year performance reports, which suggested that 1996 would not be as good a year for Slovak companies as 1995. Another relatively adverse impulse came in August when the National Property Fund sold off chunks of its stock holdings of Nafta Gbely and Juhoslovenske papierne a celulozky Štúrovo. However, SAX and other stock indexes were definitely knocked down to their knees only after the first approval of the Securities Act's revision in November. Even though a second passing of the revision in December, this time containing objections raised by the Slovak President, stabilised the situation, the market took some time to respond. Since 20 August, when SAX recorded its annual maximum (226.34 points), the value of the index had fallen by 27% (to 178.05 points) by the end of the year. Even so, however, it chalked up an annual increase of 16%.

**Slovak Equity Index - SAX in 1996**

(%)

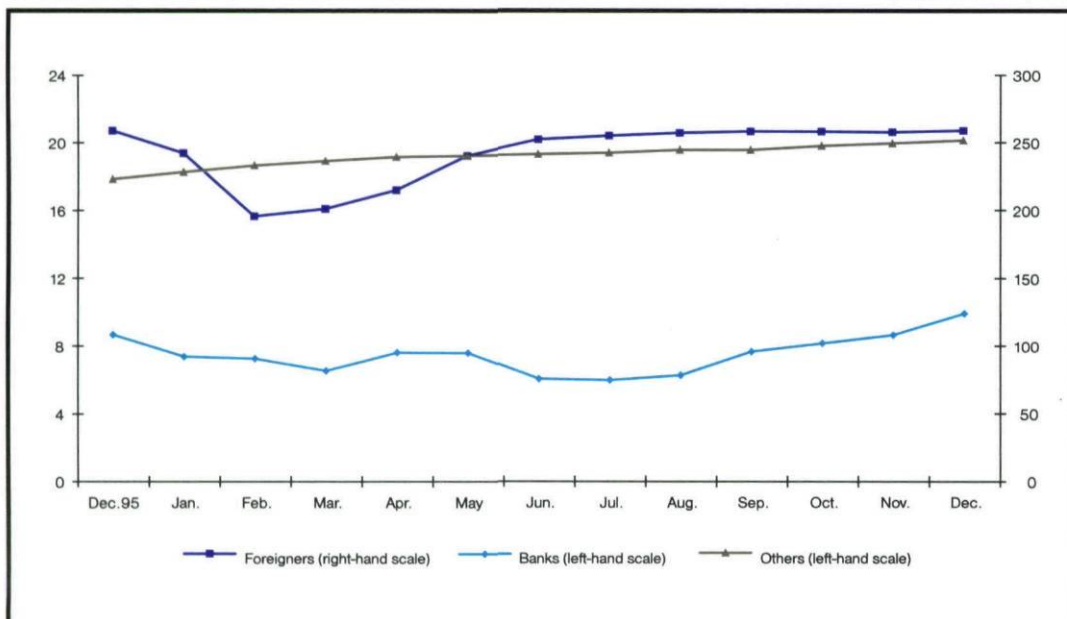


**Security Holders**

There have been significant changes in the structure of bond- and shareholders in 1996, especially in the number of bonds held by residents, which almost doubled over the course of the year. A sharp drop in share holdings of non-residents came in February, which was probably a result of the implementation of a decision to cut the equity of the VUB Kupon investment fund. Foreigners' bond holdings were growing slowly until an abrupt fall came in September. Considering the small amount of bonds held by foreigners, this drop could have been the result of the redemption of a single issue with substantial foreign involvement.

**Structure of security holders in 1996**

(millions of pcs)



## **5.3 Foreign Exchange Market**

### **Foreign Exchange Fixing of NBS**

In the course of 1996, foreign exchange fixing definitely lost its past key role in the interbank foreign exchange market. The share of foreign exchange fixing in the interbank foreign exchange market tumbled from 67.3% (in 1995) to a mere 5.7%. The volume of foreign exchange fixing transactions totalled US\$ 2,502.5 million in 1996, which was 45% down from the US\$ 4,553.7 million traded in 1995. With respect to currencies involved in foreign exchange fixing, the situation was also different from 1995, with the US\$ leading with 56.9% (US\$ 1,425.7 million) before DEM with only 43.1% (DM 1,079.5 million). Foreign exchange fixing transactions peaked in March (US\$ 380.6 million) to hit rock bottom in April (US\$ 59.8 million), due to the introduction of an exchange rate spread of  $\pm 0.25\%$  for the purchase and sale of foreign currencies on 1 April 1996.

The number of transactions fell from 2,321 in 1995 to 835, with an average 3.4 transactions daily trading US\$ 3 million each.

Even though the balance in foreign exchange fixing dropped by 62.7% from a year ago, it still closed over the line at US\$ 358.9 million, meaning that foreign currency purchases outweighed sales. The currency structure (US\$ 19.6%, DEM 80.4%) did not change much from 1995, when the shares were 12.8% for US\$ and 87.2% for DEM. The highest balance was recorded in August (US\$ 178.2 million), as opposed to the lowest reading taken in December (US\$ 71.6 million in deficit). Since both the foreign exchange fixing and foreign exchange transactions between Slovak and foreign banks scored their maximum surpluses in August, this implies that the surplus was nurtured in particular by inflow of speculative foreign capital. The December shortfall may in turn be explained by commercial banks trying to meet their foreign exchange positions for monetary purposes at the end of the year, accompanied by a dramatic shortfall in the balance of trade.

The currency basket unit moved between 0.9896 (26 April 1996) and 1.0175 (31 December 1996).

### **Interbank Foreign Exchange Market**

The interbank foreign exchange market in 1996 was dominated by transactions between Slovak commercial banks, taking 94.3% of all transactions. Total trading volume reached US\$ 41,613.5 million. Compared with 1995, when the consolidated trading volume closed at a mere US\$ 2,215.3 million, this meant almost a 20-fold increase. The most rapid - 5 times increase came in April (US\$ 1,559.4 million) in response to NBS's newly-introduced regulations pertaining to foreign exchange fixing. Unlike in the previous year when DEM was the most heavily traded currency, 1996 was the year of US\$ (59%), tailed by DEM (35.9%) and other European currencies (5.1%). Except for two months, this order lasted throughout the year. The total of transactions made came to 21,586 (2,807 in 1995), some 84 daily (12 transactions per day in 1995) transactions trading an average US\$ 1.9 million (US\$ 0.8 million in 1995) each. The size of average transaction copied the trend in turnover in individual months.

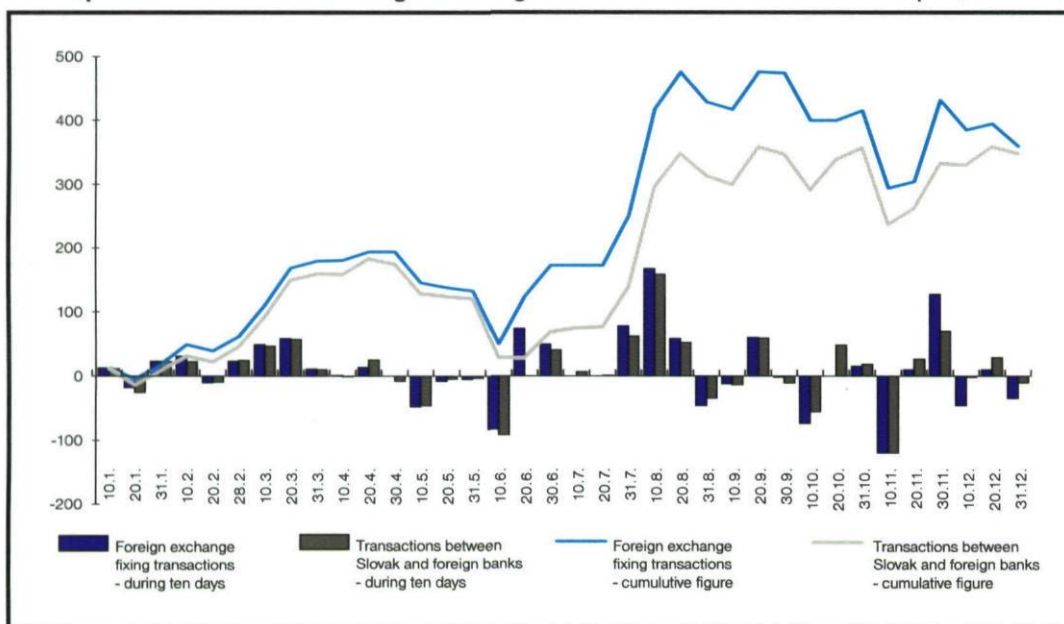
The year 1996 saw a considerable expansion of trading between Slovak and foreign banks. The total amount of transactions conducted between domestic commercial banks and their foreign counterparts reached US\$ 7,956.2 million. Seen against the scant US\$ 348.7 million of 1995, this was almost a 23-fold increase in 1996. The US\$ was on the rise since the very beginning of the year, with the average transaction of US\$ 2.1 million. Unlike in the previous year, when these transactions

resulted in a deficit of US\$ 241.7 million, there was a surplus of US\$ 326.8 million in 1996, which implies the purchase of foreign exchange from foreign banks. The balance of foreign exchange fixing of US\$ 358.9 million is comparable with Slovak commercial banks' total purchases of foreign exchange from foreign banks. After early July brought a vivid interest in selling foreign exchange on the part of foreign banks, their tide peaked at US\$ 135.4 million in August and lasted till October. Behind it was an influx of speculative foreign capital anxious to cash in on a lucrative exchange rate spread and relatively stable currency. In an effort to curb the onslaught of unwanted short-term capital, the NBS stretched the fluctuation band to  $\pm 5$  percent, starting from 17 July 1996. At the same time, it cancelled the maximum allowed daily exchange rate shift of the Slovak koruna against the currency basket unit (0.1%). The greatest daily deviation in the foreign exchange fixing rate (IDX/Sk) of 0.5% occurred on 31 October 1996.

**Basic characteristics of the Slovak foreign exchange in 1996**

	US\$			DEM			Other currencies			Total	
	Volume (US\$ mn)	(%)	Number of trans.	Volume (US\$ mn)	(%)	Number of trans.	Volume (US\$ mn)	(%)	Number of trans.	Volume (US\$ mn)	Number of trans.
Foreign exchange fixing	1,425.7	56.9	397	1,079.5	43.1	441				2,505.2	838
Transactions of Slovak banks, excluding foreign banks	24,541.5	59.0	9,293	14,932.3	35.9	9,200	2,139.8	5.1	3,093	41,613.5	21,586
Interbank foreign exchange fixing: fixing + Slovak banks with each other	25,967.2	58.9	9,690	16,011.8	36.3	9,641	2,139.8	4.8	3,093	44,118.7	22,424
Slovak banks with foreign banks	4,558.5	57.3	1,455	2,526.9	31.8	1,579	870.8	10.9	842	7,956.2	3,876
Slovak foreign exchange market in total	30,525.7	58.6	11,145	18,538.7	35.6	11,220	3,010.5	5.8	3,935	52,074.9	26,300

**Developments on Slovakia's foreign exchange market (US\$ millions)**



## 6. ECONOMIC RELATIONS WITH OTHER COUNTRIES

The 1996 international activities of the National Bank of Slovakia were consistent with the general goals of the foreign policy of Slovakia and were, at the same time, determined by the NBS' specific long-term goals, as well as the priorities of its monetary policy for the near future.

One of the priorities of NBS in the field of international relations is to further develop and intensify co-operation with major international economic groups, such as the European Union (EU), Organisation for Economic Co-operation and Development (OECD), World Trade Organisation (WTO) and the Central European Free Trade Agreement (CEFTA).

To achieve its goals in the area of foreign credit and capital relations in 1996, the NBS continued to expand its international activities, based on the fulfilment of commitments arising from Slovakia's membership in leading international financial institutions such as the International Monetary Fund (IMF), the World Bank (WB), the Bank for International Settlements (BIS), the European Investment Bank (EIB), the European Bank for Reconstruction and Development (EBRD), the International Bank for Economic Co-operation (IBEC) and the International Investment Bank (IB). With a view to the interest which the Slovak Republic shows in becoming a regular member of the European Union and OECD, the banking sector of Slovakia took several steps in support of the integration process.

Bilateral relations represent an important part of the Bank's foreign activities. In 1996, NBS focused its attention on co-operation with the central banks of EU member states.

### 6.1 Foreign Credit and Capital Relations

#### The International Monetary Fund

Based on agreement between the Slovak government and the International Monetary Fund, the validity of a Stand-by Loan expired on 21 March 1996. Of the total amount US\$ 183.41 million made available to Slovakia by the IMF Board of Directors in July 1994, Slovakia drew only two tranches totalling US\$ 46.78 million, in the second half of 1994.

The favourable development of macroeconomic indicators of the Slovak Republic, especially the growth in foreign exchange reserves in 1995 and the beginning of 1996, created prerequisites for not drawing the stand-by facility up to the full amount available.

In meeting the commitments of the Slovak Republic towards the IMF, the National Bank of Slovakia ensures the repayment of principal on loans provided by the International Monetary Fund in accordance with the schedule of repayments, plus the payment of interest on the outstanding amount of IMF loans. In 1996, Slovakia repaid US\$ 124.86 million in principal and paid US\$ 17.17 million in interest.

Between 10-23 October 1996, an IMF mission held consultations with the Slovak Republic pursuant to Article IV of the IMF Articles of Agreement. The purpose of these consultations, held once a year with each member country, is to discuss the most important aspects of the country's economic development.

## **The World Bank**

The National Bank of Slovakia is responsible for transferring increases in capital participation of the Slovak Republic in individual financial institutions of the World Bank group in compliance with agreements between the Slovak government and these institutions. In August 1996, the National Bank of Slovakia paid the final instalment of US\$ 387,800, to increase the capital participation of Slovakia in the International Financial Corporation (IFC).

In meeting the obligations of the Slovak Republic towards the World Bank, the National Bank of Slovakia paid US\$ 16.01 million in interest on World Bank loans. The repayment of principal will begin in 1997.

At the invitation of the Slovak government, the World Bank sent a mission to the Slovak Republic (2-12 December 1996), to prepare the Country Economic Memorandum on Slovakia, evaluate macroeconomic results and growth achieved, as well as to specify the reforms that are desirable with a view to Slovakia's accession to the European Union.

## **The Export-Import Bank of Japan**

### *Two Step Loan I*

On 28 February 1994, the EXIM Bank of Japan and the National Bank of Slovakia signed a Two Step Loan Agreement in the amount of JPY 4.3 billion. The loan is earmarked for the support of small and medium-sized private enterprises and joint ventures. Upon signing the loan agreement and fulfilling conditions preceding disbursement, funds released in three tranches between March 1994 and May 1995 were incorporated into the foreign exchange reserves of NBS which thus obtained long-term foreign exchange funds under favourable economic conditions.

The NBS acts in the capacity of debtor vis-a-vis the Japanese bank, while commercial banks play the role of agents and are debtors towards the NBS. The EXIM Bank of Japan approved Všeobecná úverová banka, Československá obchodná banka - foreign branch in Slovakia, Slovenská poľnohospodárska banka and Tatra banka as lending agents.

As at 31 December 1996, the NBS released a total of Sk 1,354 million (which in JPY equivalent represents 100% of the loan amount) to the above banks which used the funds, to finance a total of 174 projects. Since the facility is revolving, the agent banks were able, by 31 December 1996, to refinance an additional 31 projects totalling Sk 188.5 million.

In 1996, the NBS received from its agent banks Sk 129.26 million as a payment of interest on loans provided, and at the same time NBS paid interest to the EXIM Bank of Japan in the amount of JPY 170.46 million (equivalent to Sk 47.9 million).

### *Two Step Loan II*

On 22 April 1996, the EXIM Bank of Japan and the National Bank of Slovakia signed an agreement on the provision of the second Two Step Loan in the amount of JPY 10 billion. By 31 December 1996 NBS had drawn JPY 5 billion. Similarly as for TSL I, funds available under TSL II, are earmarked for the support of small and medium-sized enterprises in Slovakia. The loan will be disbursed in four tranches (25% each). Lending banks for TSL II are VÚB, Tatra banka, Poľhobanka, Československá obchodná banka - foreign branch in Slovakia, Poštová banka, Priemyselná banka and Istrobanka.



As of 15 August 1996, commercial banks paid the NBS interest of Sk 0.4 million on loans extended.

As of 31 December 1996, the NBS released to the agent banks a total of Sk 995.0 million that was used to finance 72 projects.

These credit lines have proven to be useful and a considerable contribution to the restructuring of the Slovak economy. Their main advantage lies in the long-term nature of the funds and the favourable interest rates.

#### *Co-financing of the Economic Recovery Loan*

Under an agreement, signed by the EXIM Bank of Japan and the Slovak Ministry of Finance in 1995, the EXIM Bank provided a loan in the amount of JPY 5,070 million (US\$ 60 million). The entire loan amount was transferred to the NBS foreign exchange reserves to support the balance of payments; the Sk equivalent was credited to the account of state financial assets of the Ministry of Finance.

According to the specifications of EXIM Bank, and further, to the application by the Finance Ministry, the NBS paid (in February and August 1996) interest on the Economic Recovery Loan in the amount of JPY 195.72 million (Sk 55.32 million). The Finance Ministry remitted Sk equivalent of the payment to the account of the NBS.

### **The European Investment Bank**

#### *Apex Global Loan I*

By 31 December 1996, the NBS received - at the request of commercial banks - eight loan tranches (of which in 1996 alone, one tranche of US\$ 1.4 million, i.e. Sk 44.7 million, was drawn) in foreign currencies according to the preferences of end-users.

In February and August 1996, the NBS received payments of interest from VÚB and Tatra Banka denominated in the currencies of loans disbursed, in the equivalent of Sk 56 million. At the same time, NBS paid the European Investment Bank Sk 52.4 million worth of interest paid in the currencies of loans disbursed.

#### *Apex Global Loan II*

In 1995, the EIB and NBS signed an agreement on the provision of Apex Global Loan II in the total amount of ECU 50 million. The purpose of the loan is identical with that of the first loan from EIB. As lending banks, the European Investment Bank progressively approved Všeobecná úverová banka, Tatra banka, Creditanstalt and Istrobanka. General Loan Agreements between NBS and these commercial banks were signed on 6 June 1996. The banks are now in the process of preparing projects feasible for financing from the AGL II credit line.

### **The Bank for International Settlements**

The Bank for International Settlements (BIS) is the only central banking institution at international level. The function of BIS is to promote co-operation between central banks, to provide additional facilities for international financial transactions, and to act as a banker to central banks.

BIS provides a broad range of investment services for central banks and assistance in the management of foreign exchange reserves, including new instruments for efficient liquidity management. The NBS makes use of these possibilities within the scope of its investment strategy. The NBS also utilises the results of studies made by the Committee for the Payment and Settlement Systems of BIS and its various research groups. In addition, the NBS benefits from the

projects implemented by BIS as part of its monetary and economic research programme, which contributes to the interaction between national monetary programmes and to better understanding of international financial markets' developments.

The National Bank of Slovakia benefits from co-operation with the Basle Committee for Banking Supervision in the creation of rules and regulations governing prudential banking practices. The activities of the Banking Supervision Division of NBS in relation to BIS are also reflected in the work of the regional group of Banking Supervisors of Central and Eastern Europe (BSCEE). The NBS is one of the six founding member of BSCEE and takes an active part in its work.

The National Bank of Slovakia actively performs its duties stemming from its position as a shareholder. On the basis of a decision of the 66th Annual General Meeting of BIS, the National Bank of Slovakia received dividends in the amount of CHF 260 per share, for the fiscal year 1995/96 (ending 31 March 1996). The total amount of dividends paid to the NBS reached CHF 694,200 at 1 July 1996, and the equivalent in Slovak koruna represented Sk 17,173 thousand. The dividends were incorporated into the foreign exchange reserves of the NBS.

### **The European Bank for Reconstruction and Development**

The Slovak Republic became a member of EBRD on 1 January 1993, succeeding to the membership after the former CSFR, along with an obligation to pay one-third of the subscribed capital that has been paid since 1991, i. e. the year of EBRD foundation. Pursuant to the EBRD agreement of incorporation, the membership interest was payable in five instalments and the total amount for the Slovak Republic represented US\$ 14.9 million.

On 15 June 1996, the NBS paid the European Bank for Reconstruction and Development one-third of a bill of exchange in the amount of US\$ 498,000 representing 50% of the fourth instalment of Slovakia's capital participation in EBRD. The Sk equivalent was remitted to the account of NBS from the Finance Ministry. Through this financial transaction, Slovakia paid the last portion of its capital participation in the EBRD.

### **Československá obchodná banka (ČSOB)**

In 1996, the ČSOB continued to play an important role on the Slovak banking market, particularly in the area of foreign trade payments. The capital participation of NBS in ČSOB reached CZK 1,231.7 million (Sk 1,438.6 million) worth of 1,978 shares amounting to 24.13% of the ČSOB's share capital. An additional 847 were in the hands of other Slovak shareholders. The total share of the Slovak Republic in the share capital of ČSOB as of 31 December 1996 represented 25.79%.

In July 1996, the National Bank of Slovakia received ČSOB dividends for 1995, in the total amount of US\$ 4.222 thousand. Since May 1996, NBS has had two representatives on the supervisory board of ČSOB.

### **The International Investment Bank The International Bank for Economic Co-operation**

The Slovak Republic has a 4.83% share in the capital of IIB, with paid-up capital amounting to ECU 10.4 million. The share of Slovakia in IBEC represents 6% with paid-up capital amounting to ECU 8.6 million. Neither IIB nor IBEC paid dividends to shareholders in 1996.

NBS performed activities connected with the membership of the Slovak Republic in IIB and IBEC and settled all obligations arising for Slovakia from loans it had received from IIB.

From 1 January 1996, Slovakia is represented in MB by a vice chairman of the Board of Directors. The interests of Slovakia at IBEC are represented by a member of the Board of Directors.

***NBS equity participation in financial institutions (as at 31 December 1996)***

	Number of shares (in pcs)	Book value			Share in capital
		In foreign currency		in Sk thousands	
		Currency	Amount in thousands		
Stakes in banks of which:				1,463,410	
Czechoslovak Commercial Bank (CSOB), Prague, Czech Republic	1,978	CZK	1,231,700	1,438,626	24.13%
Bank for International Settlements (BIS), Basle, Switzerland	2,670	GF	6,675	24,784	0.56%
Stakes in other companies of which:				120,032	
Bankers' Clearing Centre of Slovakia, a.s. (BZCS) Bratislava, SR	120			120,000	40.27%
Society for Worldwide Interbank Financial Telecommunication (S.W.I.F.T.), La Hulpe, Belgicko	1	BEF	32	32	

## **6.2 Foreign Relations of NBS Within the Framework of the Integration Process**

### **The European Union**

During 1996, direct relations between the Slovak Republic and the European Union intensified in all areas. Slovakia was completing the creation of suitable institutional, organisational and personnel structures to provide for a smooth accession to the EU.

One of the most important activities in 1996, was the completion by Slovakia, of the EC Questionnaire which represents a document based on which the preparedness of the Slovak Republic, as one of the EU associated countries, to enter the Union, will be evaluated. The Slovak Republic and other 10 associated countries received their respective Questionnaires for completion in April 1996. The Questionnaire contains 160 pages of complicated and very specific questions divided into 23 chapters. All ministries, government agencies and institutions of Slovakia were involved in its completion.

The National Bank of Slovakia was responsible for the completion of Chapter 7 entitled "Economic and Monetary Policy", and was also involved in completing other chapters to the extent relevant to NBS remit, namely Chapter 2 "Agriculture" (Ministry of Agriculture), Chapter 10 "Internal Market" (Ministry of Finance), Chapter 19 "Statistics" (Slovak Statistical Office) and Chapter 20 "External Economic Relations (Ministry of Economy).

On 19 July 1996, the Slovak foreign minister, Juraj Schenk, formally handed the completed Questionnaire over to the chief of the EC Delegation and the EU ambassador to Slovakia, Georgios Zawos.

Over the course of 1996, the NBS was also involved in the activities pursued by the Slovak Republic within the framework of the so-called "structured dialogue" between Slovakia and the EU, and took part in a number of meetings of sub-committees for macroeconomics and financial services. The National Bank prepared

supporting documents for these meetings where - for relevant areas falling under its remit and under the banking sector as such - it presented the results achieved and formulated the goals set for Slovakia's accession to the EU, both from a short and long term point of view. The NBS prepared these documents in the light of the need to fulfil individual articles of the European Agreement between the EU and SR, and on the basis of recommendations contained in the White Paper which is considered a helpful guideline for associated countries in their incorporation into the EU internal market.

### **Organisation for Economic Cooperation and Development**

In compliance with the priorities of Slovak foreign policy, negotiations within the pre-accession process of Slovakia into the OECD continued also in 1996. The NBS, as one of the parties involved, continuously participated at individual meetings and negotiations with OECD representatives. Further to a number of negotiations of OECD representatives in Slovakia, and in accordance with the approved schedule of negotiations, individual OECD committees held joint sessions with their counterparts from Slovakia. The purpose and the main goal of these sessions was to evaluate the preparedness of Slovakia for joining OECD, the compatibility of its economic environment with the most developed economies of the world, the state and level of structural changes, legislative framework, as well as the level of liberalisation of the capital account of the balance of payments.

The most important meetings held in 1996, for which NBS had prepared detailed supporting, analytical and informative documents, included:

- A top-level OECD mission which took place in Slovakia on 3-5 February 1996.
- OECD mission which took place in Slovakia on 25-26 March 1996. Negotiations concerned financial services and the banking sector development.  
Session of the Financial Market Committee, held on 17 June 1996. The committee highly appreciated the macroeconomic results of Slovakia, its stable and prudent monetary policy and the exchange-rate policy; it expressed concern, however, over the lack of transparency and the apparent absence of consistency in privatisation of the banking sector.
- Joint session of the Committee on International Investments and Multinational Enterprises (CIME) and the Macroeconomic Committee of OECD held on 24 June 1996 to discuss a study entitled " Slovak Republic: Conclusions of the 1996 OECD Economic Survey". Regarding the process of privatisation in the banking sector, the committee did not recommend to proceed with the privatisation of the "companies encumbered" banks. The committee repeatedly pointed at the high concentration of lending and deposits at the three largest banks and emphasised the need to develop an efficient and competitive banking sector to meet the needs of the business sector. The committee repeatedly emphasised the pressing need for bank restructuring due to the large amount of historical non-performing loans in their portfolios.  
Joint session of the Committee on International Investments and Multinational Enterprises (CIME) and the Committee on Capital Movements and Invisible Transactions (CIME/CMIT) on 2-3 July 1996. The purpose of the meeting was to assess the ability of Slovakia to fulfil the commitments ensuing from its potential OECD membership in connection with the OECD liberalisation codes, and it evaluated progress in the process of privatisation and the level of liberalisation in capital account transaction. The committee positively evaluated the effort of Slovakia to pursue a non-discriminatory policy towards individual OECD member countries and its obligation to expand the principles of liberalisation which apply in relation to the EU and OECD member states. The committee expressed serious concern over the lack of transparency and consistency in the process of privatisation of banks and financial institutions and called on the Slovak delegation to proceed with a clear and efficient solution of the issue. Conclusions

from the meeting included an OECD requirement to remove the discriminatory elements of the policy pursued towards non-residents, and to progressively liberalise conditions for direct foreign investments and other capital operations. The committee urged the Slovak delegation to expedite the adoption of liberalisation steps pursuant to the applicable legislation.

Some of the conclusions drawn by the committees listed above were so serious that the repeated assessment of Slovakia's preparedness will, according to the OECD top representatives, take place only after the relevant Slovak institutions have submitted a revised statement on the Codes of Liberalisation and the relevant legislation has been amended. For this reason, Slovak representatives (including NBS officials) took part at individual meetings of OECD committees in the 2nd half of 1996 only in the capacity of observers.

- In the first half of December 1996, Slovak officials met with OECD representatives under the Partners in Transition programme to discuss individual activities funded by the OECD, as well as future possible supporting activities within the pre-accession process.

### **World Trade Organisation**

The Slovak Republic, as a regular member of the General Agreement on Tariffs and Trade (GATT), took part in the Uruguay Round of multilateral negotiations and had its List of Customs Concessions verified by GATT member states, together with the List of Initial Commitments in Trade in Services, which forms a key component of the General Agreement on Trade in Services. Thereby, Slovakia acquired the right to become one of the founding members of the World Trade Organisation (WTO), which commenced its operations on 1 January 1995.

In March 1996, the Financial Services Committee of WTO held its 11th session, which was attended by an NBS representative. The Slovak delegation informed the committee that upon adopting Amendment 58/1996 Z.z. (on 1 March 1996) which modifies and supplements the Banking Act (Act 21/1992 Zb.), Slovakia complied with the last condition (of reciprocity in licensing the operation of Slovak banks in the countries where the founding foreign bank has its head office) as listed in the exceptions under Most Favoured Nation Status.

The Slovak Republic signed the Second Protocol to the General Agreement on Trade in Services on 12 August 1996.

Between 24-26 June 1996, the WTO Committee for Balance of Payments held consultations with Slovakia regarding the import surcharge. The Slovak delegation, which included NBS officials, successfully defended its import surcharge in the amount of 7.5% from 1 July through 31 December 1996. The import surcharge was lowered to 0% by the Ministry of Finance Decree No. 362/1996 with effect from 1 January 1997.

### **The PHARE Programme**

The PHARE programme of EU technical assistance to the Slovak banking sector is co-ordinated by a Programme Management Unit (PMU) set up at the Foreign Relations Department of NBS in early 1993. Initially, the goal of the PHARE programme was to provide assistance to the newly founded central bank and facilitate the development of banking under new economic conditions.

In 1996, the PHARE programme shifted its focus to support activities aimed at achieving the strategic goal of Slovakia - integration into the EU. Currently prepared

projects are thus designed to create favourable prerequisites for Slovakia's compliance with the conditions of the EU upon accession.

Technical assistance is provided in the form of grants. The funds approved in the Financial Memoranda are released gradually, according to semi-annual operational programmes. The funds made available are deposited on an NBS nostro account and constitute a part of foreign exchange reserves. They must be disbursed within three years from signing the relevant Financial Memorandum.

During 1996, technical assistance provided from the PHARE Fund was disbursed simultaneously on the basis of three Financial Memoranda as follows: Under the programme GTAF (General Technical Assistance Facility) the amount allocated and disbursed was ECU 1.6 million; under the programme FM 93 (Financial Memorandum) allocated was ECU 2.0 million and disbursed ECU 0.8 million; in FM 94 allocated was ECU 2.25 million and disbursed ECU 0.4 million; under the programme COP 95 (Country Operational Programme) allocated was ECU 0.4 million, but no disbursement took place. From the total funding extended an amount of ECU 5.6 million was contracted, of which ECU 2.8 million was disbursed.

The most significant PHARE projects at NBS in 1996 included the technical assistance to the Banking Supervision Division of NBS, which took the form of providing experts from Banque de France under long-term contract along with some technical equipment, providing a long-term contract for an advisor for the implementation of the PHARE programme in the banking sector, funding numerous specialised training programmes conducted by the Institute of Banking Education (IBE) for the employees of NBS and other commercial banks, the provision of technical equipment to the IBE, and introducing external courses in Economy and Banking at IBE for bank employees. Other projects included the provision of IS advisors to NBS, and organisation of an international seminar on the development of banking in economies in transition.

For commercial banks, PHARE provided assistance in developing a long-term restructuring project of Investičná a rozvojová banka, the so-called "Twinning Project" with Všeobecná úverová banka, and a number of other projects of technical assistance, such as two credit portfolio analyses in selected commercial banks, support to the development of selected areas of business in Priemyselná banka, a strategic study for the Bank Clearing Centre of Slovakia, technical assistance in establishing the Bank Association and the delivery of specialised seminars for the Association of Bank Cards.

**Structure of loans received by the NBS (as at 31 December 1996)**

Source of the loan	Type of loan	Year of loan maturity	Amount of loan		
			in foreign currency		in Sk thousands
			currency	amount in thousands	
EXIM Bank of Japan	Two Step Loan I	2009	JPY	4,290,000	1,179,750
	Two Step Loan II	2010	JPY	5,000,000	1,375,000
European Investment Fund	Apex Global Loan	2008	US\$	11,914	379,988
			DEM	5,785	118,675
			CHF	10,813	255,355
			FRF	16,600	100,928
International Monetary Fund	CCFF	1997	SDR	3,913	179,167
	Stand by I	1999	SDR	57,209	2,619,665
	STF	2004	SDR	128,700	5,893,302
	Stand by II	2004	SDR	32,150	1,472,181

CCFF - Compensatory and Contingency Financing Facility  
STF - Systemic Transformation Facility