B. Report on Monetary Development

in the SR in 1997

1. ECONOMIC DEVELOPMENT

According to preliminary data from the Statistical Office of the SR, the country's gross domestic product (GDP), expressed at constant 1995 prices, increased year-on-year by 6.5% and reached, in absolute terms, Sk 586.8 billion at the end of 1997. A key role in GDP creation was played by services. With regard to demand, the development of GDP was influenced by domestic as well as foreign demand, the growth of the latter exceeding that of domestic demand. The share of the private sector in GDP generation increased year-on-year by 5.8 percentage points, to 82.6% in 1997.

The average annual rate of inflation, expressed in terms of the consumer price index, reached 6.1%. The average monthly rise in the level of consumer prices increased from 0.44% in 1996, to 0.52% in 1997. Over the course of the year, the 12-month rate of inflation fluctuated around the level of 6%, with maximums in April and August and a minimum in September, which was followed by an upward trend. At the end of the year, the rate of inflation stood at 6.4%.

In 1997, the Slovak economy employed an average of 2,029.1 thousand persons, i.e. 0.4% less than in 1996. The general level of employment was negatively affected by decreases in the numbers of employees in agriculture and fishery (9.0%) and in industry (2.0%), totalling 29.5 thousand in absolute terms. Employment was positively influenced by developments in other sectors, particularly in services. The share of non-productive sectors in total employment increased to 54.1% over the course of the year.

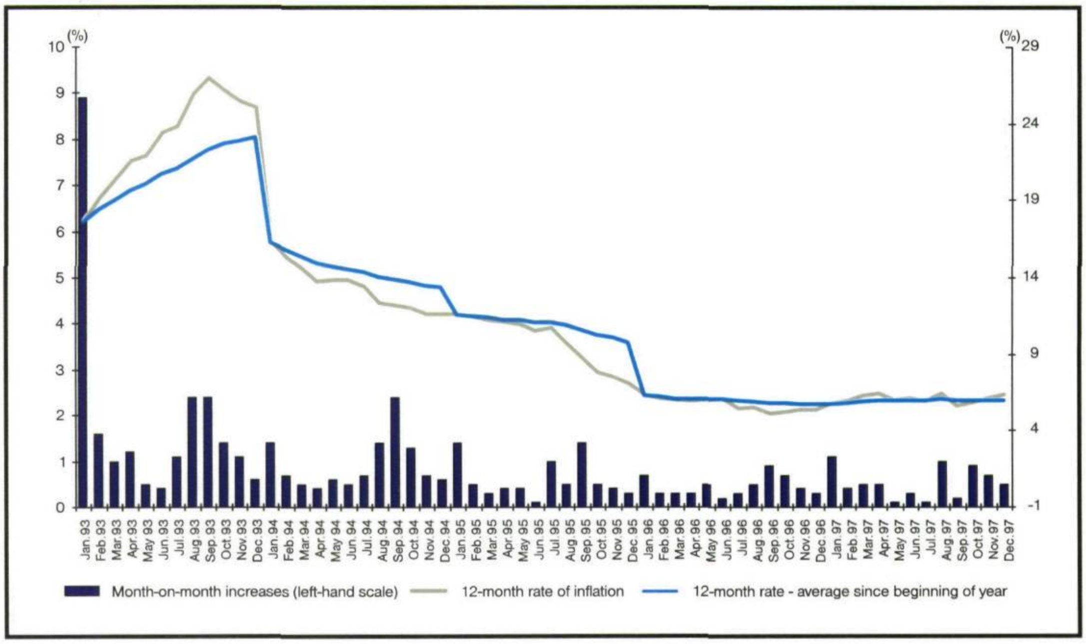
According to data from employment offices, the average number of registered unemployed reached 336.7 thousand in 1997, i.e. 3.8% more than in 1996. Thus the rate of unemployment increased by 0.4 points, to 13.0% at the end of 1997.

1.1 Price Development

The three years of desinflation (1993 to 1995) were replaced, after the slowdown in inflation had come to a halt in 1996, by a moderate acceleration in 1997. This development was induced by standard factors from previous years in combination with administrative measures, applied over the course of the year. The rise in the general price level was due primarily to the persistently high level of domestic demand and its relation to supply, which was rather intractable. The deepening external imbalance and related import-restricting measures, expansive fiscal policy and high interest rates, resulting mostly from excessive lending to the public sector, were other factors behind the increase in prices. The accelerating inflation caused a shift to less favourable expectations regarding inflation, which was based on fear of devaluation and expected price deregulation. With regard to the development of tradable and non-tradable commodities, particularly during the second half of the year, the import surcharge appeared to be a factor with an upward influence on the rate of inflation. In contrast with its previous application, the import surcharge applied to 78.3% of total imports. As the import surcharge was raised from 0% to 7% in July 1997, the price advance accelerated considerably in the area of tradable goods during the ensuing period. During the second half of the year, the development of inflation was significantly influenced by price deregulation.

A negative phenomenon in the course of inflation, recorded along with an acceleration in price development, was the widening price disparity between sectors on the consumer market. The difference between the rate of price increases in the tradable sector, which is exposed to competition from import prices, and that of price increases in the non-tradable sector (excluding regulated prices), widened still further during the period under review. In the non-tradable sector, the level of prices exceeded that of tradable commodities by 2.65 percentage points, while the difference between the rates of price increase per sector reached 1.88 points in the previous year. The development of consumer prices in the individual areas of the tradable and non-tradable sectors is given in the table below.

Development of inflation



The general rise in the level of consumer prices was reduced by food prices, particularly during the last quarter. The rate of year-on-year increase in consumer prices slowed and the dynamics of food prices (excluding non-alcoholic beverages) had fallen to 4.52% by the end of the year. During the first half of 1997, the development of food prices accelerated the rate of inflation; during the 3rd quarter, the price level fell and inflation was again stabilised by the consumer market for foodstuffs. The market maintained this position despite a moderate acceleration in the rate of price increase during the last quarter, which affected the entire tradable sector, not only foodstuffs.

Development of consumer prices in the tradable and non-tradable sectors

	Weight in%	Increase ir consumer prices in %		Change in%
		Dec. 1996	Dec. 1997	
Tradable sector	64.30	4.91	5.74	0.83
Food prices	26.76	5.13	4.52	-0.61
Prices of other commodities	37.54	4.75	6.60	1.86
Non-tradable sector	35.70	6.14	7.57	1.43
Regulated prices	20.46	5.65	6.95	1.30
Market prices of non-tradable services	15.24	6.79	8.39	1.60
Total	100.00	5.35	6.40	1.05

1/ December of the previous year = 100

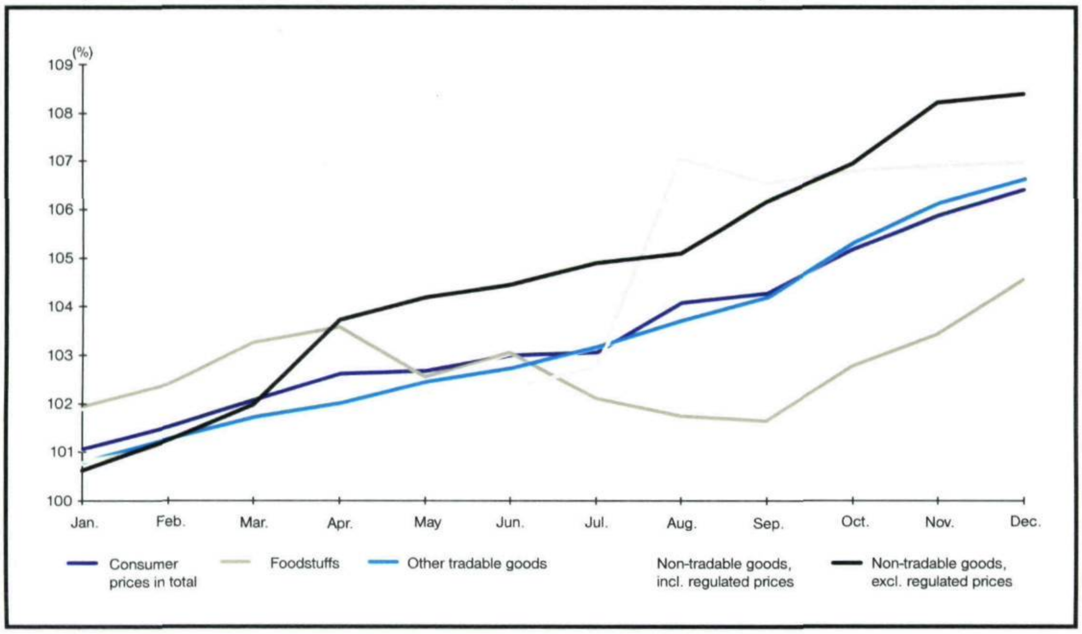
The accelerated rise in the level of consumer prices in the tradable sector during the last quarter was a consequence of the increase in the import surcharge (from 0% to 7%), which was not taken into account when the monetary programme for 1997 was drafted. The existing competitive environment failed to put a brake on the price increase induced by administrative import-restricting measures and the problem of external imbalance was solved to the detriment of inflation. Of all categories under review, the most rapid increases were recorded in the prices of tradable commodities (excluding food prices). If the price increase in the given group were to remain at the level of the previous year (assumption in the monetary programme), inflation would be kept at the projected level. The rate of increase in the prices of tradable commodities excluding foodstuffs (mainly footwear, clothes, tobacco, and non-alcoholic beverages) accelerated already during the first three quarters of 1997 in comparison with the previous year. One may assume that the prices of other tradable commodities reflected (apart from the consequences of the export surcharge) the influence of the Slovak crown's short-term weakening and the additional effects of the price deregulation in 1996.

In the sector of regulated prices, the following adjustments were made to consumer prices over the course of the year:
- increase in nursery-school fees, fees for school clubs, and the price of meals at school canteens (in January);
- increase in the costs of public transport (particularly in January and August), increase in driving-school fees (in April);
- adjustments to the prices of domestic and imported Pharmaceuticals, sanitary aids, and some health services (continuous);
- increase in the price of postal services (in April);
- adjustments in consumer fuel prices (in April, August, November);
- adjustments to telephone charges (in July);
- increase in the maximum price of supplying water to households, sewage disposal from households, and heating for households (in August);
- increase in concession licence fees (in August);
- increase in the price of seat reservation in railway traffic (in September);
- reduction in the parental contributions to the partial coverage of non-investment costs at pre-school establishments (in September).

In addition to these price adjustments, the level of prices was additionally influenced by a number of other measures. Increases were recorded in the price of natural gas (April), the price of electricity for entrepreneurs (August), and in the price of inter-state railway transport (August). Additional expenses arose in connection with the application of an import deposit (May - July).

The prices of goods and services, which are subject to price regulation, had increased by 6.95% by the end of the year under review. The rate of inflation, calculated without taking into account the increase in regulated prices, reached 6.25%.

Development of consumer prices by sector (December 1996 = 100)



The inflationary tendency in individual areas of the economy was absorbed by the sector of non-tradable services. In December 1997, the prices of non-tradable commodities were 8.39% higher than in last December. Due to the lack of effective price competition on the domestic market, the sector in question recorded the fastest rate of price increase.

According to the classification of individual consumption by purpose, the inflation rate was affected by price increases in the categories of health service, clothes and shoes, rental costs, water, electricity, gas, and other fuels. The highest price increase was recorded in health service. The dynamic rise in the prices of selected sanitary goods, with a low share in final consumption, did not have a marked influence on the overall quantification of the rise in consumer prices. The price advance in the category of clothes and shoes was due primarily to the prices of tradable goods (mainly footwear). In the category of rental charges, the most rapid increases were recorded in prices of non-tradable services.

Producer Prices

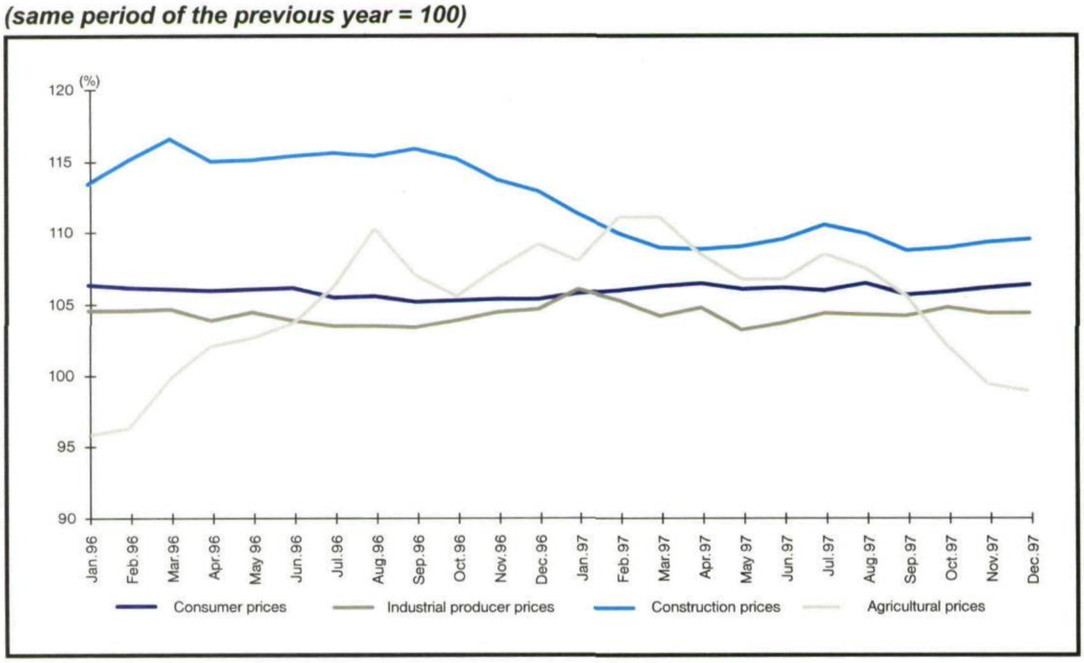
The comparison of price developments in 1996 and 1997 indicates that the most significant increases were recorded in the prices of industrial producers. The prices of agricultural products and building materials increased only slightly, while the dynamics of construction prices slowed.

Comparison of consumer and producer prices in 1993-1997

Average annual price index (same period of last year = 100)	1993	1994	1995	1996	1997
Consumer prices	123.2	113.4	109.9	105.8	106.1
Industrial producer prices	117.2	110.0	109.0	104.1	104.5
Construction prices	124.1	111.0	112.0	115.0	109.7
Building material prices	113.6	109.2	112.2	107.4	107.6
Agricultural prices	114.6	110.8	103.3	105.4	105.6

Source: Statistical Office of the SR

Development of consumer and producer prices in 1996-1997
(same period of the previous year = 100)



In the category of industrial producer prices of 1997, the most rapid increases were recorded in the prices of electricity, gas, steam, and hot water (7.7%), timber and timber goods (7.5%), and other industrial products (7.5%). The second half of

1997 saw adjustments in the full-rate price of electricity for entrepreneurs and organisations, the price of heating and hot water for households, and an increase in charges for water supply and sewage disposal. The price of food, beverages, and tobacco rose by 1.7 points, to 6.2%. Marked reductions were recorded in the prices of pulp and paper, paper products, printing services (5.0%), handling equipment (3.6%), and leather and leather articles (2.6%).

Agricultural prices increased by an average of 0.2 points year-on-year, to 5.6% in 1997. The rate of increase was slower than the rise in the producer prices of foodstuffs and beverages, or the consumer prices of foodstuffs. The most rapid increase (6.3%) was recorded in the price of plant products, which, however, represented a slowdown of 3.6 points on a year-on-year basis. The prices of animal products increased by 5.9%.

A marked slowdown (5.3 points) was recorded in the dynamics of construction prices, which rose year-on-year by 9.7%. This was also influenced by the prices of building materials and products used in construction, which increased by 7.6% year-on-year.

1.2 Gross Domestic Product

The rate of year-on-year growth in gross domestic product (GDP) slowed to 6.5%, compared with the figures for 1995 and 1996, when GDP grew at a rate of 6.9% and 6.6% respectively. In comparison with other transforming economies, however, the achieved rate of growth is still high. The creation of GDP was influenced mainly by the continued increase in added value in the service sector, whereas the utilisation of GDP was affected by the growth in domestic and foreign demand.

Gross production at current prices reached Sk 1,634.1 billion, representing an increase of 11.0% compared with the 1996 figure, while intermediate consumption grew by 10.0%. The development of GDP was substantially influenced by the added value, which increased year-on-year by 12.9% and accounted for 89.7% of GDP, i.e. 0.3 points less than a year earlier. The growth in net production was affected by a moderate year-on-year decrease in the proportion of intermediate consumption to gross production (by 0.6 points, to 64.1%).

Creation of gross domestic product ***(Sk billions, current prices)***

	1995	1996	1997	Index 1996/95	Index 1997/96
Gross production	1,274.6	1,472.1	1,634.1	115.5	111.0
Intermediate consumption	817.8	952.7	1,047.6	116.5	110.0
Added value	456.8	519.4	586.5	113.7	112.9
Indirect taxes	60.0	56.3	67.4	93.8	119.7
GDP	516.8	575.7	653.9	111.4	113.6

1.2.1 Aggregate Supply

A favourable phenomenon in the development of the economy was a moderate year-on-year fall in the material and service intensity of gross production. The slowdown in the growth of aggregate demand reduced the pressure on sectors which are less effective in terms of added value.

The relatively high share of intermediate consumption in gross production was, despite a moderate decrease, associated with the persistent material and power-intensive structure of GDP. The reason behind this is the high material intensity of industry, which was, with regard to the obsolescence of existing plants and the slow creation of new capacities, unable to react in an adequate manner to the high level of aggregate demand of previous years.

The creation of GDP can be characterised by data on the development of the added value by sector. Compared with the previous year, the most rapid increase was recorded in added value in construction and market services, while the lowest figures were reported in agriculture and industry. The different courses taken by added value in the individual sectors influenced the structure of GDP by sector. In comparison with the previous year, the most significant change took place in the share of market services in GDP, which increased by 1.6 points, to 43.4%. The share of industry, however, decreased by 1.6 points, to 28.2% in 1997.

The structure of GDP by cost was influenced by the slower rate of growth in added value than GDP and a steep increase in indirect taxes (value-added tax, net tax on imports, and taxes from previous periods). The proportion of the added value to GDP decreased year-on-year by 0.3 points, to 89.7%, and the share of indirect taxes reached 10.3%.

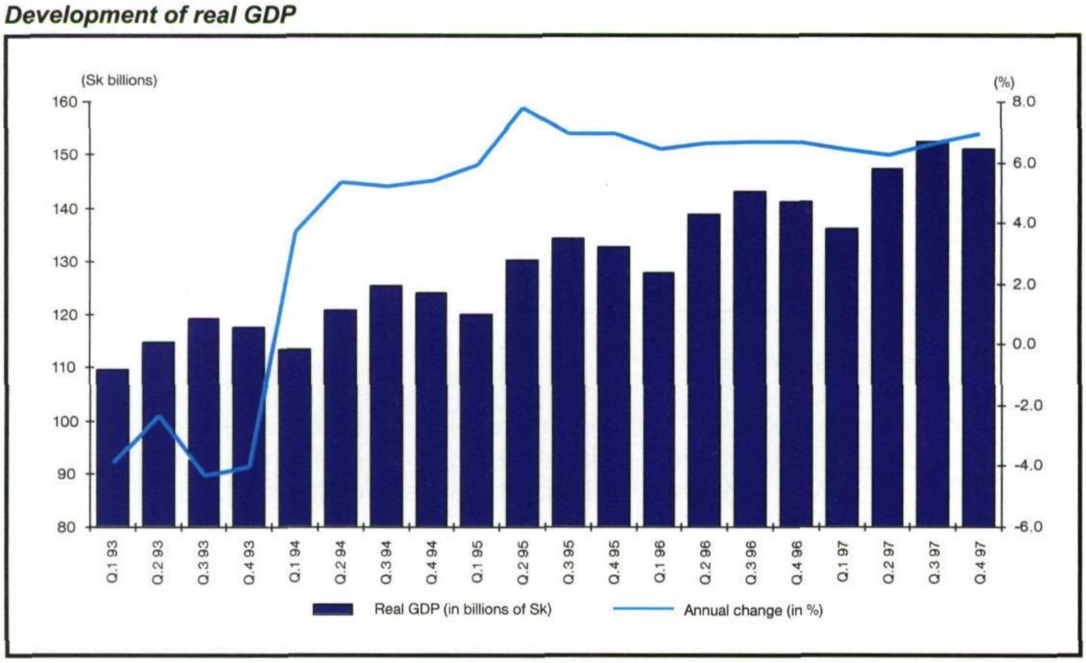
Added values in selected sectors ***(Sk billions, current prices)***

	1995	1996	1997	Index 1996/95	Index 1997/96
Gross domestic product	516.8	575.7	653.9	111.4	113.6
Added value in total	456.8	519.4	586.5	113.7	112.9
of which					
Agriculture	-	29.9	31.6	-	105.7
Industry	-	172.9	184.1	-	106.5
Construction	-	27.3	34.5	-	126.4
Market services	-	240.5	283.9	-	118.0
Non-market services	-	48.8	52.4	-	107.4

Services

In 1997, a significant role in the creation of gross domestic product was again played by services. Trade and services accounted for 33.4% of the added value (representing an increase of 0.2 points). The generation of gross domestic product at constant prices was positively influenced by a year-on-year increase in postal and telecommunications services (12.4%) and in the volume of trade and services (6.8%).

Development of real GDP



Market services, which generated added values in the amount of Sk 283.9 billion, recorded the second most rapid growth (18% at current prices) after construction. The biggest share (69.0%) in market services was taken by trade and services.

Proceeds from retail sales increased year-on-year by 4.6%. The share of the private sector in proceeds from retail sales increased by 1.3 points year-on-year and reached 95.9%.

In freight transport, the volume of transported goods increased year-on-year by 8.1%. Road transport, which is predominantly in private ownership, recorded a 18.3% growth in volume and a 3.4% increase in the share of total transport. In railway transport, the volume of freight exceeded the 1996 figure by 2.3%, while its share of total transport decreased by 3.3 points. The volume of goods transported by water continued to fall (by 6% year-on-year). In passenger transport, the number passengers decreased by 2.4% in all types of public transport except for air and water transport. In railway and road transport, budgetary performance deteriorated over the course of the year.

In the category of postal and telecommunications services, the dynamic growth in market services continued to be influenced by the increase in number of telephone stations (an increase of 16.6%). The number of mobile telephones increased 5.7 times in comparison with the previous year's figure.

In 1997, the turnover of accommodation facilities was 13.2% higher than in 1996. Proceeds from other market services increased year-on-year by 5.8%, while a substantial part (56%) was formed by incomes from other commercial services, mainly architecture and civil engineering. The most dynamic increases (25.1%) were recorded in advertising, computer engineering (21.4%) and architecture (20.5%).

Industry

In industry, the volume of added value, expressed in current prices, increased by 6.5% in comparison with the 1996 figure. Industry accounted for 31.4% of the total added value created in the economy.

In the category of firms with 20 or more employees, the most significant contribution to the creation of added value was made by the generation and distribution of electricity, and gas and water supply. In the category of manufacturing industries, the largest share was achieved in metal working and the processing of food, beverages, and tobacco.

A marked increase in added value (64.1%) was recorded in the production of coke, refined oil products, and nuclear fuels. Decreases were recorded in the processing of leather and leather goods (16.6%), the manufacture of handling equipment (7.3%), chemicals, chemical products, and artificial fibres (6.1%).

The volume of industrial production at constant prices increased year-on-year by 2.7%. The share of production in the private sector increased to 73.2%, compared with 68.2% in 1996.

With regard to sectors (firms with 20 or more employees), marked increases were recorded in the production of electrical and optical instruments (16.8%), and the manufacture of vehicles (14.6%). Positive changes were recorded in the production of metal and metal goods (from a decrease of 8.4% in 1996 to an increase of 6.3% in 1997) and in the production of coke, refined oil products, and nuclear fuels (from a fall of 3.9% to a growth of 3.2%). Production continued to decline in wood-working industry, textiles and clothing industry, leather processing and the manufacture of leather goods.

Construction

The trend of gradual revival in construction continued in 1997. The value of construction projects at current prices reached Sk 74.1 billion, i.e. Sk 12.1 billion more than a year earlier. The rate of growth in the volume of construction work accelerated by 4.8 points, representing a year-on-year increase of 9.2% at constant prices, while average daily production increased by 10.5%.

Entrepreneurial entities operating in the construction sector created added values in the total amount of Sk 34.5 billion. In comparison with 1996, the proportion of construction to GDP creation increased at current prices by 26.4% and the share of construction in GDP increased from 5.2% in 1996 to 5.9% in 1997.

The favourable development in demand for construction work, which was due mainly to the implementation of infra-structural (construction of motorways) and power engineering projects, increased the effectiveness of enterprises operating in the public sector. The year-on-year increase in the output of this sector (16.5%) was 8.7 points higher than the figure for the private sector. At the same time, the share of the private sector in the output of the construction sector increased slightly, from 83.4% in 1996 to 82.2% in 1997.

In comparison with 1996, the volume of domestic construction orders increased, while that of construction projects abroad declined. The fall in construction abroad was halted to some extent:

	Index	
	1996/1995	1997/1996
Domestic construction orders	110.3	112.9
Construction projects abroad	69.4	74.1

Source: Statistical Office of the SR

With regard to domestic construction projects, the volume of new construction, reconstruction, and modernisation work increased year-on-year by 13.5%; the volume of other orders grew by 12.1%, and that of repairs and maintenance by 11.0%.

Agriculture

In 1997, the share of agriculture in the creation of GDP reached 4.4%, representing a year-on-year decline of 0.3 points.

Proceeds from the sale of agricultural products at current prices reached Sk 35.5 billion, i.e. 5.1% more than in the previous year (0.5% less at constant prices). While the purchase price of agricultural products contributed directly to the rise in inflation until the end of the 3rd quarter, it was still below the level of the average year-on-year increase in consumer prices. However, agricultural inputs increased by 10.6%.

In 1997, the volume of grain crops (3.7 million tons) exceeded the previous year's figure by 12.6%. The reduction in quality of grain due to extreme climatic conditions (floods, draught), including the shortage of disposable resources, complicated the situation in crop production. During the second quarter, the domestic grain market was characterised by a marked surplus of fodder crops in relation to demand, as prices fell sharply and excessive stocks piled up (discharge of obligations arising from primary production of goods). The situation was also complicated in the sugar-beet market, as the 1997 beet season resulted in a surplus of 50 thousand tons. Nonetheless, licences were issued for the import of sugar, which was realised in the amount of 8,300 tons.

The persisting surplus of demand over supply on the market for animal products (mainly beef and milk) was the reason for the continued year-on-year decline in the volume of farm animals (beef cattle: 9.9%; pork: 8.8%). The parameters of efficiency in animal production did not improve in any substantial way in 1997.

Of the total number of agricultural units (1,296), 742 (i.e. 61.5%) ended the year with a loss. Problems with insolvency continued. Almost two thirds of agricultural entities reported primary insolvency. Liabilities (Sk 29.2 billion) were more than twice higher than receivables. Investment (Sk 9.3 billion) increased year-on-year by 22.2%, thanks to the utilisation of resources offered by the State Support Fund (which granted loans to agriculture in the amount of above Sk 2.6 billion from 1994 to the end of 1997). In 1997, funds invested in the repair and overhaul of machinery amounted to Sk 4.5 billion, of which domestic appliances accounted for only 15%.

With regard to the need for the revival of financial flows and the stabilisation of the agricultural market, the NBS increased the annual limit on bills-of-exchange rediscounted for the support of agriculture from Sk 1.5 billion, to Sk 3.0 billion in 1997. By 31 December 1997, the said limit had been utilised to 89.4%.

1.2.2 Aggregate Demand

The growth in aggregate demand was due to the development of domestic demand, which increased by 1.2% at constant prices. The slower rate of year-on-year growth in domestic demand in comparison with the previous year, led to a decrease in its share of the total demand from 65.1% in 1996 to 64.0% in 1997. In contrast with the previous year, the growth in GDP was accompanied by a rise in foreign demand (export of goods and services), which increased year-on-year by 6.1% at constant prices.

While exports grew at the above rate and imports saw a 2.3% decline, the negative balance of foreign trade (net exports) fell year-on-year by 51.4%, to Sk 27.1 billion (at constant prices). The fall was due partly to administrative measures taken by the government in the form of a surcharge on imports, stricter measures relating to the certification of products, and by monetary-policy measures adopted by the NBS.

The faster growth in GDP than in exports led to a fall in the export performance of the economy (exports of goods and services as a share of GDP) by 0.3 points, to 58.7%. The import intensity of GDP (ratio of the imports of goods and services to GDP) decreased year-on-year by 5.7 points, to 63.4%, as a result of the decline in imports.

Structure of GDP in terms of utilisation ***(Sk billions, constant 1995 prices)***

	1995	1996	1997	Index 1996/95	Index 1997/96
Gross domestic product	516.8	550.8	586.8	106.6	106.5
Domestic demand	507.4	606.6	613.9	119.6	101.2
of which					
Final consumption in total	360.8	400.2	417.2	110.9	104.2
Final household consumption	252.7	270.2	287.1	106.9	106.3
Final government consumption	108.1	130.0	130.1	120.3	100.1
Gross capital formation	146.6	206.4	196.7	140.8	95.3
Gross fixed capital formation	141.5	197.8	226.4	139.8	114.5
Change in stocks	5.1	8.6	-29.7	-	-
Net exports	9.4	-55.8	-27.1	-	-
Exports of goods and services	325.8	324.9	344.7	99.7	106.1
Imports of goods and services	316.4	380.7	371.8	120.3	97.7

The dynamics of domestic demand was slowed by the development of final consumption in State administration, which increased year-on-year by only 0.1% and its share of GDP decreased by 1.4 points, to 22.2%, due to a significant rise in the level of spending in State administration in 1996 (unblocking of receivables from the Russian Federation, expenditures on the new territorial and administrative division of the SR).

In domestic demand, the most dynamic component was gross fixed capital formation, despite the fact that its year-on-year growth had slowed considerably.

Of the total volume of investments, 65.7% was realised in the non-financial sector, 12.7% in the government sector, and 11.4% in the household sector. In the non-financial sector, most capital was invested by organisations specialising in industrial production, electricity generation, gas and water supply, postal and telecommunications services, and trade. Investment in the non-financial sector increased year-on-year by 21.3%, in the government sector by 12.8%, and in the household sector by 3.9%. Regarding the basic structure of investments, the share of investment in machinery and equipment increased by 1.6 points, to 49.5%, and that of investment in building and construction grew by 1 point, to 41.6%.

Development of investments and savings ***(Sk billions, current prices)***

	1995	1996	1997
Gross domestic product	516.8	575.7	653.9
Gross investment	146.6	226.7	232.1
Gross domestic savings [1/]	156.0	157.5	185.4
Investment rate (%)[2/]	28.4	39.4	35.5
Savings rate (%)[3/]	30.2	27.4	28.4
Coverage of investments by savings (%)	106.4	69.5	79.9

1/ GDP less total final consumption
2/ Share of gross investment in gross domestic product
3/ Share of gross domestic savings in gross domestic product

Despite a slowdown in the growth of investment demand, the rate of investment (35.5%) was very high in international terms. However, this high level of investment was not connected with an adequate level of gross domestic savings, which is documented by data on the coverage of investment by savings. Although the difference between the rates of investment and saving reduced, the volume of domestic savings did not suffice to cover the investment demand, which was reflected in the persistent pressure on the replenishment of domestic savings from foreign resources. As the inflow of direct foreign capital was low, this pressure was exerted through drawings of foreign loans and was one of the causes of the continued external imbalance. The large volume of credit resources, drawn from abroad by business entities, led to an increase in the level of external debt.

Apart from demand for investment, the development of domestic demand reflected the growth in final household consumption, which absorbed almost 50% of GDP in the short term. In 1997, it recorded a relatively dynamic rate of growth, i.e. 12.7% at current prices and 6.3% at constant prices. However, the dynamics of growth slowed somewhat in comparison with the previous year's figure.

The volume of final household consumption, influenced by the development of current incomes and expenditures on the one hand and by the rate of gross savings on the other, recorded a slowdown in the year-on-year growth at current prices (0.5 points).

During the period under review, the current income of households (predominantly wages and salaries) increased year-on-year by 11.4%, exceeding the rate of growth in current expenditures by 1.8 points. The most significant contribution to current incomes was made by the compensation of employees (57.2%), which increased year-on-year by 11.5% (while their dynamics fell by 1.3 points). The gross operating surplus (combined income from business and employment) increased year-on-year by 13.0% (compared with 20.4% in 1996) and its share in current incomes represented 19.0% (18.7% in 1996). The share of incomes from unrequited current transfers (18.6%) was the same as the figure a year earlier (90% consisted of transfers of a social nature), but their growth (10.9%) was 2.1 points lower than a year earlier. A relatively high rate of growth (7.2%), i.e. 5.7 points higher than in 1996, was recorded in incomes from ownership (interest, dividends, income from rented land, etc.). With regard to their weight (4.8%), however, they had no marked influence on current income.

	1996 Sk billions	Index p.y. = 100	1997 Sk billions	Index p.y. = 100
Compensation of employees	271.1	112.8	302.2	111.5
of which: gross wages and salaries	207.7	118.2	233.2	112.3
Gross operating surplus	88.9	120.4	100.6	113.1
Income from ownership and business	21.3	101.5	22.9	107.2
Accident insurance transactions	4.5	103.9	4.5	99.9
Unrequited current transfers received	88.6	113.0	98.3	110.9
Contributions to pension insurance	-		52.5	110.8
Contributions to health insurance	-		22.7	107.0
Contributions to unemployment fund	-		2.8	145.5
Other social security contributions	-		10.5	120.7
Social security contributions in total	79.2	110.0	88.5	111.7
Current income in total	474.4	113.5	528.3	111.4
Income from own property and business	5.5	121.0	4.3	77.7
Accident insurance transactions	5.7	153.7	6.7	117.4
Unrequited current transfers paid	120.1	113.8	132.9	110.7
of which: personal income tax to SB	20.4	129.0	25.6	125.7
contributions to funds 1/	-		93.0	108.5
Current expenditures in total	131.4	114.9	143.9	109.6
Gross disposable income	343.0	113.0	384.4	112.0
Final household consumption	286.1	113.2	322.3	112.7
Gross savings of households	56.9	112.0	62.1	109.0
Rate of savings 2/	16.6		16.15	

1/ Social security contributions paid by employers, employees, self-employed and free-lance persons, non-residents and others.
2/ Savings rate = gross savings of households / gross disposable income.

Source: Macroeconomic indicators from quarterly national accounts for the 1st and 2nd quarters of 1997; Statistical report on the basic trends of development in the Slovak economy in 1997; the index for 1996 was based on absolute figures.

Current expenditures (mostly income taxes and contributions to funds) absorbed 27.2% of the current incomes of households, i.e. 0.5% less than in 1996. Of the gross disposable income after the payment of expenses, 83.8% was used for final consumption and the rest (Sk 62.1 billion) was converted into gross household savings. Apart from cash, deposits, and securities, the gross savings of households included household expenditures on investment from own resources, including investment for the development of small business and the purchase or construction of housing (real estate). The rate of gross savings, i.e. proportion of gross savings to gross disposable income, decreased somewhat in 1997.

The average monthly nominal wage or salary earned by persons working in the Slovak economy reached Sk 9,226, representing a year-on-year increase of 13.1%, in real terms 6.6%, while labour productivity (as % of GDP at current prices) increased by 14.4%, and at constant prices by 7.3%.

Development over the course of the year was characterised by an acceleration in the rate of year-on-year growth in labour productivity, while the rate of wage increase slowed at both constant and current prices. Labour productivity at current prices increased from 8.9% in the 1st quarter, to 15.8% in the 4th quarter; at the same time, the dynamics of wages fell from 14.9% in the 1st quarter to 10.8% in the 4th quarter. The development followed a different course in comparison with the trend in 1996. As a result, the rate of growth in labour productivity exceeded the dynamics of wages by 1.3 points at current prices, or by 0.7 points at constant prices. During the previous two years, wages had increased at a faster rate, but in 1997 labour productivity grew faster.

Development of labour productivity, wages and employment in the national economy

		Index (same period of last year = 100)		
		1995	1996	1997
Gross domestic product	curr.p.	117.3	111.4	113.6
	con.p.[1/]	106.9	106.6	106.5
Labour productivity of GDP	curr.p.	114.0	110.4	114.4
per employee	con.p.[1/]	103.9	105.6	107.3
Average monthly wage per	nom.	114.3	113.3	113.1
employee	real	104.4	107.2	106.6
Total number of employees		102.2	100.8	99.6

1/ Constant prices = average of 1995 = 100

The lowest rate of growth in wages and salaries was recorded in the 4th quarter, due probably to the effects of wage regulation applied in accordance with the provisions of Decree No. 335 issued by the Slovak Government in November 1997. It is not possible to quantify or estimate the extent to which the slowdown in the rate of growth in nominal wages was influenced by the above measures. However, we may assume that the slowdown in the dynamics of wages during the year was caused by the continuing unfavourable development of the financial situation in the corporate sector.

According to NBS estimates, the year-on-year increase in labour productivity was due mostly (97%) to a fall in the level of employment and, to a lesser extent (about 3%), to the influence of other intensifying factors. The development of this indicator and the relation between wages and labour productivity must be seen in the light of the aforementioned facts.

In the basic sectors of the national economy (organisations with 20 and more employees, or registered companies), the level of wages and the relationship between labour productivity and wages developed differently. In industry, average monthly nominal wages increased by 12.0%; in construction by 14.5%; in transport by 12.6%; while the rate of year-on-year growth slowed by 2.6 or 1.9 or 2.1 points respectively. The comparison of real wages and labour productivity at constant prices indicated that, when the growth in labour productivity in construction exceeded the increase in wages by 2.6 points, the rate of year-on-year increase in labour productivity in industry fell behind the growth in wages by 0.4 points. In transport, labour productivity remained behind the growth in wages by 1.6 points.

Financial Results of Organisations

In 1997, financial and non-financial organisations generated a profit of Sk 60.6 billion (before tax), i.e. 6.3% lower than in 1996. The fall in profit was due primarily to the faster growth in expenses than revenues at both financial and non-financial organisations.

In the non-financial sector, companies generated a profit of Sk 52.2 billion, representing 86.1% of the total profit. The most significant contributions were made by trade (37.3%); the generation and distribution of electricity, gas, and water (30.1%); and the rental of real estate, commercial services, research and development (17.2%). The most serious losses were recorded by enterprises in industry, e.g. manufacture of machines and equipment (Sk 7.4 billion, an increase of 42.3%) and wood working and wood products (Sk 1 billion, an increase of 300%). Losses were also recorded in agriculture and fisheries (a decrease of 63.6%), textile and clothing industry (an increase of 38.9%), leather processing and leather articles (an increase of 18.5%), and metal working, which had generated a profit a year earlier.

Of 6,381 non-financial organisations with 20 or more employees, only 3,056 achieved a positive result (47.9%), the remaining 3,325 ended the year with a loss 10% higher than in 1996. At the end of 1997, the total liabilities of these organisations reached Sk 428.3 billion, representing an increase of 9.3% since the beginning of the year. Liabilities due for payment amounted to Sk 118.8 billion, representing 27.7% of total liabilities and an increase of 25.3%.

2. BALANCE OF PAYMENTS

With regard to external relations, the year 1997 was marked by a partial change in the trend that started at the end of 1995, which consisted in a steep increase in domestic demand and decline in foreign demand. By the combined use of stricter monetary policy and import-restricting administrative measures, the development of domestic demand and the rate of growth in imports moderated during the 2nd half of the year, following a period of increased current account deficit during the first six months. On the other hand, the dynamics of exports also slowed during the second half of the year. On account of a year-on-year increase in the exports of goods and services (10.3%), which remained behind the rate of growth in GDP at current prices, the export performance of the economy (expressed as the ratio of exports of goods and services to GDP) fell from 58.0% in 1996 to 56.4% in 1997. Due to faster growth in the export of goods and services than in import, the current account deficit fell year-on-year by Sk 19.2 billion and its share of GDP decreased to 6.9%.

2.1 Current Account

At the end of 1997, the current account of the balance of payments resulted in a deficit of Sk 45.1 billion, i.e. US$ 1.3 billion, due to an increase in the trade deficit to Sk 49.5 billion (preliminary data from the Statistical Office of the SR). Another deficit item was the balance of income amounting to Sk 4.1 billion. In 1997, the balances of services and current transfers also generated surpluses, which, however, reached together only Sk 8.5 billion and covered less than 16% of the deficit of trade and income balances. In 1997, prices of imported goods and services continued to increase year-on-year at a faster rate than prices of exported goods and services. Price developments, including exchange rate fluctuation, accounted for Sk 7.3 billion of the total current account deficit.

In 1997, Slovakia imported goods in the amount of Sk 345.0 billion (according to preliminary data from the Statistical Office of the SR). Over the course of the year, the growth in imports experienced a marked slowdown, with the rate of year-on-year increase reaching only 1.2%. Compared with the previous year, the volume of imports was substantially higher in the 1st half of 1997; it was stagnant during the 3rd quarter and, in the last quarter, 17% lower than in the same period of 1996. The rise in the level of interest rates led to an increase in the price of bank loans and gradual decline in demand for investment, which resulted in a fall in the export of machines and equipment. In addition to handling equipment, which saw the sharpest decline in import, a fall was recorded in the import of machines and equipment for investment in the modernisation of individual sectors of the Slovak economy (imports in category 72 'machinery for certain sectors' fell by 12.4%). The import surcharge acted as a brake on the import of consumer goods, even if its effect was partially mitigated in the case of imports from the CR, Germany, and Austria, by the strengthening of the Slovak crown against the Czech crown and the German mark.

In 1997, Slovakia exported goods in the total amount of Sk 295.6 billion, representing a year-on-year increase of 9.2%. While exports increased during the first three quarters by more than 10% year-on-year, their growth came to a halt in the last quarter. In Slovak exports, there are several key commodities, which play a more and more significant role. Such commodities are: cars, telecommunications equipment, sound recording equipment, instruments and electrical appliances, where higher figures were recorded than in import. The growth in exports influenced by these commodities (which resulted in a shift in structure), however, cannot be attributed to recovery in the corporate sector, but only to a few restructured enterprises, which depend on co-operation with foreign companies, and which have strengthened their positions on foreign markets.

On the other hand, year-on-year declines were also recorded in traditionally strong sectors, such as chemical and rubber industry, iron and steel production. These categories of products are very sensitive to price fluctuations and developments on export markets, where cheap competition is continually on the rise, not only from post-communist countries, but from south-east Asia as well.

In the services sector, the rate of growth in receipts was faster (15.2%) that that of payments (13.2%), so the overall balance increased year-on-year by Sk 1.4 billion, to Sk 2.5 billion. Transport and foreign tourism, i.e. items influencing the positive balance of services, showed conflicting trends of development. While income earned from transport recorded a marked improvement, income from foreign tourism continued to fall.

Revenues most exceeded expenditures in transport services, which generated a surplus of Sk 13.4 billion, representing a year-on-year increase of Sk 5.8 billion.

In the category of transport services, the most significant item was income earned from the transport of gas and crude oil from Russia to the CR and Western Europe via Slovakia. The import of natural gas from the Russian Federation in settlement of transit charges was worth Sk 13.0 billion and represented 64.1% of the total volume of gas supply from the Russian Federation. The surplus generated by the transport balance was also increased by freight transport, where transit charges created conditions for growth in income derived mainly from road transport.

The trend in the area of travel that had characterised its development already during the past year, continued in 1997. The comparative advantages of Slovakia, which led to an increase in the number of visitors and growth in foreign exchange income from tourism, gradually came to an end over the course of 1996 and 1997. In 1997, foreign exchange income from foreign tourism totalled Sk 18.3 billion, representing a year-on-year decrease of 11%. Its contribution to GDP creation showed a downward trend, reaching only 2.8%.

Within the individual items of the services balance, the greatest deficit was recorded in other services (Sk 14.4 billion), which include the whole range of trade and non-trade services. In the Slovak economy, there is insufficient room for the expansion of services serving to increase the effectiveness and competitiveness of material production through feedback. More than a half of the stated deficit was produced in other trade services, which are directly connected with the ability of Slovak firms to succeed on foreign markets.

The competitiveness of Slovak firms in the area of services, especially on the domestic market, is connected with the entire range of other services, where payments have exceeded receipts during the last few years. These services included legal, accounting, and consulting services (Sk 1.0 billion); insurance services (Sk 0.9 billion); licensing (Sk 1.4 billion); and advertising (Sk 0.8 billion), etc., where the range and quality of services are unable to compete with services abroad.

The only category of services in which a significant balance surplus was achieved in 1997, was construction and assembly work where the year-on-year growth in exports made it possible for receipts from abroad to exceed payments abroad by Sk 1.1 billion.

Another area where payments have exceeded receipts since the beginning of the year, was the income balance. The income balance deficit (Sk 4.1 billion) was due mostly to the interest paid. Interest payments accounted for more than 85% of payments in the area of income balance, which reflect the inflow of long and short-term capital and indirectly the rise in the level of indebtedness. The increase in payments of interest on the growth in debt owed by companies and banks was partly offset by interest received from the foreign exchange reserves of the NBS and commercial banks.

2.2 Capital and Financial Account

The capital and financial account of the balance of payments generated a surplus of Sk 54.7 billion, representing a 8.4% share of GDP. Regarding the financing of the current account deficit, an important factor was that the inflow of long-term capital (liabilities less assets) reached Sk 41.1 billion and covered more than 90% of the current account deficit. This largely offset the influence exerted by the movement of short-term capital.

The inflow of foreign capital in the form of direct investment in the Slovak economy, totalled Sk 5.4 billion (US$ 161.4 million). Direct foreign investment in the establishment or enlargement of companies in the SR, that is direct foreign investment associated with the establishment of ownership rights and the management of companies, failed to reach high levels even in 1997. Growth in 1997 took place mainly in industrial production (32%), trade (33%), finance and insurance (14%), and telecommunications (10%). In industrial production, the most significant increases were recorded in the manufacture of machines and equipment, metal products, and chemicals. The increase in investment in the form of direct foreign investment in machines and equipment during the last two years, creates conditions for a revival in this sector, which used to play a significant role in Slovakia's industrial production. Foreign investors participated mostly in the trade sector. Interest in this sector originated from the persisting low labour costs and possibility of increased sales of goods in the SR and more resources being available for export promotion. Most foreign capital came, as in previous years, from Austria (27%) and Germany (26%).

The effort to find suitable ways of increasing the exports of Slovak companies led to growth, since the second half of 1996, in the export of capital in the form of direct foreign investment, though only in a small number of cases which do not always show signs of stability. Last year, direct investment by Slovak companies abroad increased by Sk 3.1 billion. The allocation of capital investment was dominated by the CR, where more than a half of the amount was employed. Apart from the CR, significant amounts were invested in Ukraine and Croatia. Regarding the structure of investment by sector, the largest volumes were directed to the sectors of electricity generation and distribution, gas and water supply, industry, and trade. With regard to the yields of direct investments abroad, it would be more advantageous economically for these investments if their share of trade and services were to increase, which would in turn create conditions for the export of investment in other sectors as well.

While the level of direct foreign investment remained low, the inflow of capital was dominated by debt items. The year 1997 was marked by interaction between the fiscal policy of the Government and the monetary policy of the NBS. Owing to the rise in the level of interest rates on the domestic market, the financial expenses of enterprises increased, so they had to look for financial resources abroad. In 1997, financial credits remained the most significant source of long-term financing in the corporate sector. By drawing financial credits directly from abroad, the corporate sector obtained funds in the total amount of Sk 42.6 billion, i.e. Sk 9.0 billion more than in the same period of the previous year. The credits were granted for the purchase of investments and technologies. The increased demand for investments was satisfied according to the degree of success of companies in foreign markets. With regard to structure by sector, roughly 50% of the credits was directed to the sectors of electricity generation and distribution, gas and water supply. The funds were channelled through companies charged with financing the construction of the nuclear power plant at Mochovce and hydroelectric projects in Slovakia. More than

17% of the loans from abroad were obtained by companies specialising in the production of coke, petroleum refinery products, and nuclear fuels. The third largest amount was employed in the sector trade and services, with a share of roughly 16.5% of the total volume of credit.

The increased drawing of long-term financial credits, which has been ongoing since 1995, contributed to growth in the volume of investment by Slovak enterprises, and the rise in the level of external debt and increased demands on debt servicing, as well as an exchange rate risk arising from fluctuations of the USD and DEM, and SKK against the currency basket, which may increase the costs of these loans. Long-term financial credits were repaid in the corporate sector in the amount of Sk 10.3 billion, which did not represent a marked increase as it had done in previous year. Regarding the structure of borrowings by term and the postponement of date for repayment, the year 2000 is expected to see a breakthrough in repayment.

The volume of short-term capital, including portfolio investment, increased by Sk 13.6 billion, due to increased capital movements in both assets and liabilities. Although short-term capital accounted for only 25% of the total capital and financial account, the turnover of short-term operations represented a substantially higher share of the turnover of the balance of payments capital and financial account. The increase in short-term liabilities in the banking sector accounted for 56% of the total increase in liabilities. A significant role in the inflow of short-term capital was played by the banking sector. The inflow of short-term bank capital in the amount of Sk 38.0 billion was the largest form of capital inflow in 1997. The increase in short-term liabilities in the banking sector was due primarily to growth in foreign exchange deposits held by non-residents at banks operating in Slovakia, in the amount of Sk 25.1 billion.

The increase in the deposits of non-residents at Slovak banks was due to the introduction of a new monetary instrument in the form of the foreign exchange position of banks for monetary purposes, which led to an increase in short-term assets, while short-term deposits abroad grew by Sk 31.0 billion.

2.3 Development of Foreign Exchange Reserves

At the end of 1997, the foreign exchange reserves of the NBS amounted to US$ 3,284.9 million, representing a fall of US$ 188.4 million compared with the figure for the end of December 1996. Over the course of the year, the total foreign exchange reserves of the NBS were influenced by various factors. A key factor that positively influenced revenues was borrowing from international financial institutions. During this period, the expenditure side was influenced by debt service payments by the Government and the NBS. However, it is necessary to emphasise that 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$ 46.0 million) was offset by the negative exchange rate differential (US$ 234.4 million), which reflected the actual exchange rate of the D-mark against the US dollar on international financial markets.

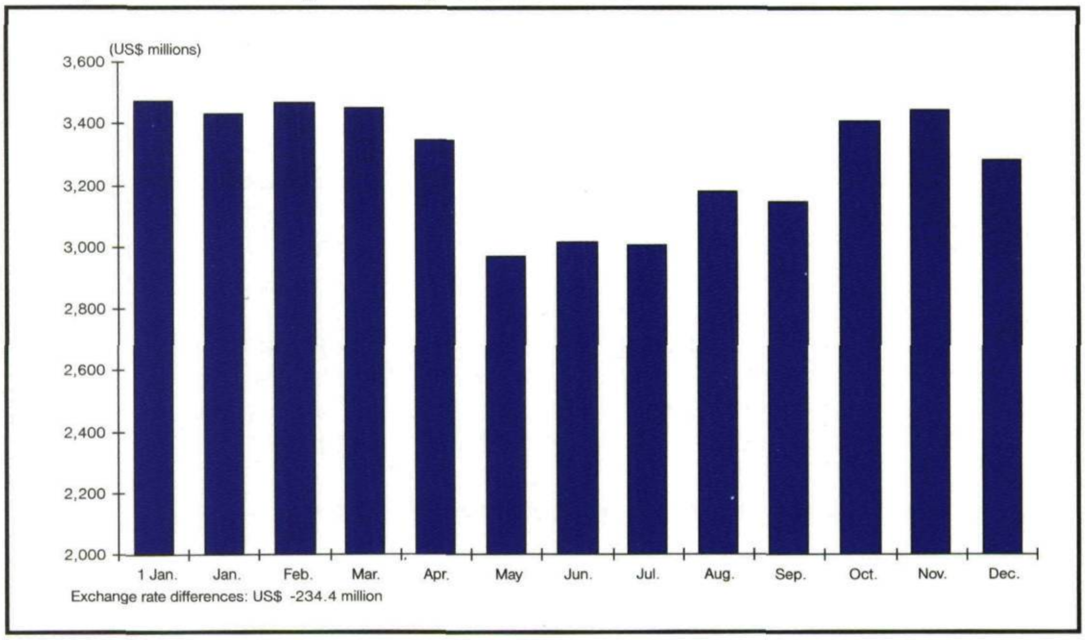
The revenue side of foreign exchange reserves was determined by the following factors:

- the drawing of government loans from international financial institutions (State Road Fund, Mochovce) in the amount of US$ 361.8 million (52% of the total revenue);
- the drawing of NBS loans from international financial institutions (EXIM Bank of Japan, EIB) in the amount of US$ 166.7 million;
- other receipts of the NBS in the amount of US$ 41.5 million, connected with the realisation of cross-border payments for NBS clients;

- income from deposits and securities in the amount of US$ 110.7 million;
- repayments 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$ 17.2 million.

The expenditure side of the foreign exchange reserves was affected by:
- debt service payments by the Government in the amount of US$ 219.2 million (34% of total expenditure), of which principal and interest actually paid within the CDZ block accounted for US$ 97.1 million;
- debt service payments by the NBS in the amount of US$ 142.7 million, while the repayment of principal on loans accepted from the IMF amounted to US$ 65.1 million;
- negative balance of NBS foreign exchange fixing amounting to US$ 164.8 million;
- other expenditures of the NBS in the amount of US$ 125.2 million, incurred in connection with the realisation of cross-border payments for NBS clients.

Development of NBS foreign exchange reserves in 1997



At the end of December 1997, the foreign exchange reserves of the NBS were 3.2 times greater than the expected volume of average monthly imports of goods and services to Slovakia in 1997. Although the coverage of imports with reserves recorded marked deviations over the course of the year (3.4 in January to March, and 2.8 in May to July), the ratio was the same at the end of December 1997 as at the end of 1996. The moderate fall in the level of foreign exchange reserves in 1997 was accompanied by a slight decrease in average monthly imports of goods and services (in US$ equivalent: 4.0%) compared with the previous year's figure.

The foreign exchange reserves of commercial banks may be viewed as short-term foreign exchange assets of commercial banks vis-á-vis non-residents. At the beginning of 1997, the volume of such assets stood at US$ 2,209.2 million. At 31 December 1997, commercial banks held foreign exchange reserves in the total amount of US$ 3,203.6 million, representing an increase of US$ 994.4 million.

At the beginning of the year, the volume of total foreign exchange reserves in the banking sector (including the NBS) amounted to US$ 5,682.5 million, and reached US$ 6,488.5 million at the end of December.

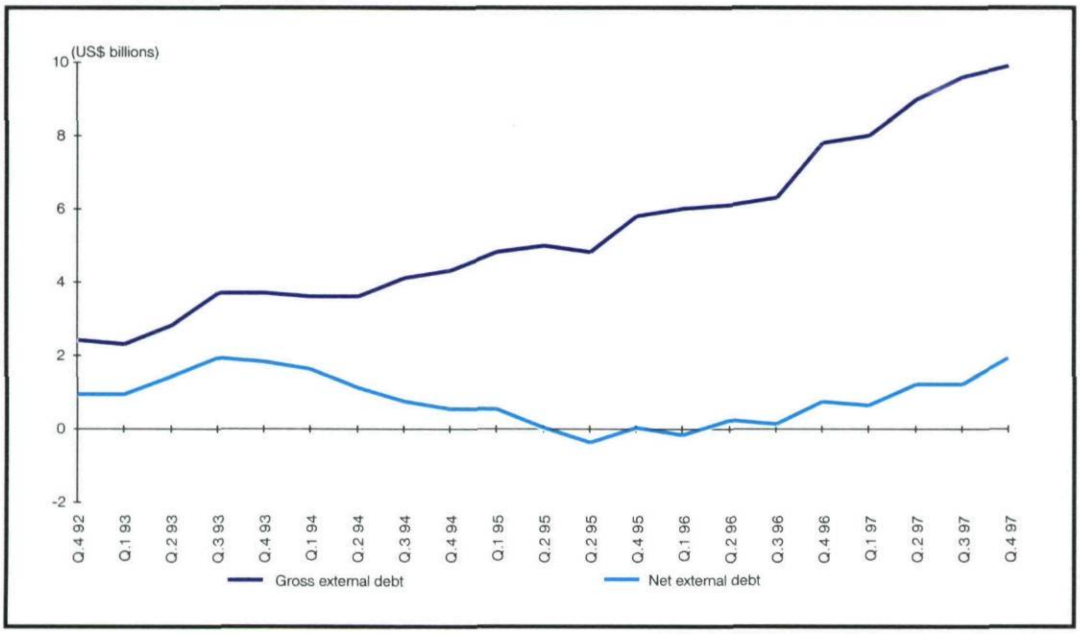
2.4 The External Debt of the SR and Its Servicing by the NBS and the Slovak Government

At 31 December 1997, the total gross external debt of the Slovak Republic stood at US$ 9,896 million. (At the end of December, the actual level of the country's external debt was greater by approx. US$ 800 million. The level of foreign debt was reduced temporarily by means of an accounting operation conducted by a commercial bank in December 1997.) At the end of December, the official debt of the Government and the NBS reached a level of US$ 1,696 million, of which short-term government debt accounted for US$ 190 million. The indebtedness of the commercial sector, i.e. commercial banks and entrepreneurial entities, stood at US$ 8,021 million at the end of December, and the debt owed by municipalities (municipal bonds issued by the city of Bratislava) amounted to US$ 50.3 million.

As other foreign debt, the official external debt of the SR included the foreign debt inherited from the former CSFR vis-á-vis the former German Democratic Republic, and was estimated by the National Bank of Slovakia at US$ 127.8 million at the end December 1997.

Regarding the structure of the country's gross external debt, total gross medium and long-term liabilities accounted for US$ 5,602 million, while the short-term liabilities of commercial banks and entrepreneurial entities amounted to US$ 4,104 million. At the end of December, the volume of short-term debt totalled US$ 4,294 million.

Gross and net external debt



By the end of December, Slovakia's per-capita external debt had increased to US$ 1,867, from US$ 1,473 at the end of the past year.

The net external debt of the SR - calculated as the difference between gross foreign debt, i.e. US$ 9.9 billion (liabilities of the Government and the NBS, liabilities of commercial banks and the corporate sector - import commitments and financial credits) and foreign assets, i.e. US$ 8.0 billion (foreign exchange reserves of the NBS, foreign assets of commercial banks and the corporate sector - export claims and financial credits), reached US$ 1.9 billion at the end of December 1997, compared with US$ 0.7 billion at the end of 1996.

Foreign exchange liabilities of the commercial sector *(US$ millions)*

	31 December 1996	31 December 1997
Total foreign exchange liabilities of the commercial sector, of which:	5,956.0	8,021.5
Commercial banks	2,202.2	2,905.5
Entrepreneurial entities	3,753.8	5,116.0
Debt owed by municipalities	0.057	0.050
Long and medium-term foreign exchange liabilities, of which:	3,010.4	3,917.4
Commercial banks	778.5	680.2
Entrepreneurial entities	2,231.9	3,237.2
Debt owed by municipalities (long-term)	0.057	0.050
Short-term liabilities, of which:	2,945.6	4,104.1
Commercial banks	1,423.7	2,225.3
Entrepreneurial entities	1,521.9	1,878.8

2.5 Licensing Activity of the NBS

In 1997, foreign exchange permits and foreign exchange licences were issued in accordance with the current foreign exchange regulations, based on the gradual liberalisation of transactions on the capital account of the balance of payments.

In 1997, foreign exchange permits and foreign exchange licences were issued for operations in the following areas:

- capital account of the balance of payments: 1,398 foreign exchange permits and 60 supplements;
- current account of the balance of payments: 318 foreign exchange permits and 191 supplements;
- 14 foreign exchange licences and 1 supplement were issued for transactions in foreign securities; 37 foreign exchange licences and 13 supplements were granted to exchange offices outside banks for trading in foreign exchange and traveller's cheques; and 2 licences for dealing in foreign exchange derivatives.

2.5.1 Foreign exchange permits for capital operations

Investment abroad

In 1997, a total of 64 foreign exchange permits and 6 supplements were issued, of which 61 permits were for direct investment abroad in the amount of Sk 119.17 million, and 3 permits were for portfolio investment in the Czech Republic in the amount of Sk 0.33 million.

Country	Number of licences and supplements	Investment (in millions of Sk)
Ukraine	31	92.84
Croatia	6	8.30
Russian Federation	9	6.08
Uzbekistan	3	3.13
Brazil	1	2.32
Yugoslavia	2	2.31
Bulgaria	5	1.58
Lichtenstein	1	0.72
Tunisia	2	0.70
Czech Republic	5	0.51
Other	5	1.01
Total	70	119.50

Note: Direct investment in OECD and EU countries has been liberalised.

Acceptance of financial credits from abroad

Over the course of 1997, the NBS granted 125 foreign exchange permits and 48 supplements in a total amount of Sk 16,951.8 million, of which 100 foreign exchange permits were for the acceptance for financial credits totalling Sk 16,585.4 million; 20 permits were for repayment of credits accepted without a foreign exchange permit in the amount of Sk 366.4 million; and 5 foreign exchange permits remained unused.

At the same time, exceptions to the surrender requirement were allowed in 24 cases in a total amount of Sk 5,509.9 million, and there were 4 exceptions to the transfer requirement totalling Sk 153.6 million.

Credits with a maturity of up to 3 years, valid until 31 December 1997:
Estimated drawing and repayment ***(Sk millions, exchange rate at 31/12/1997)***

	1997	1998	1999
Drawing	15,000.3	1,622.2	0.0
Repayment	2,210.4	10,001.8	4,739.3
Balance	12,789.9	-8,379.6	-4,739.3

With regard to structure by term, credits with a maturity period of one year represented 51.3% (Sk 8,699.6 million) up to two years: 48.6% (Sk 8,231.8 million), and those maturing in up to three years accounted for 0.1% (Sk 20.0 million). One foreign exchange permit in the amount of Sk 0.4 million was granted for the repayment of a long-term credit accepted before Decree No. 335/1996 Z.z. came into force.

Of the total number of credits approved, 57 were provided by non-bank entities (Sk 3,320.4 million) and 63 by foreign banks (Sk 13,631.4 million). Bank guarantee was granted in 67 cases (Sk 5,265.4 million).

The largest volumes of credits (including international loans) were provided by entities based in Great Britain (Sk 11,902.6 million); Germany (Sk 1,847.2 million); Austria (Sk 1,480.6 million); Switzerland (Sk 1,025.3 million); and France (Sk 359.4 million).

Credits in the amount of Sk 10,307.3 million were earmarked for the coverage of operating expenses (60.8%), credits in the amount Sk 6,605.7 million for the financing of investments (39.0%), and credits in the amount of Sk 38.8 million for privatisation (0.2%).

Structure of credits by sector

Sector	Number of licences	Volume in Sk millions
Generation and distribution of electricity	2	4,267.6
Transport, tourism, telecommunications	4	3,801.9
Industrial production	45	3,986.0
Building and construction	8	2,336.4
Trade, public catering, hotel services	40	909.4
Extraction of raw materials	1	47.5
Other	20	1,602.9
Total	120	16,951.7

Note: The acceptance of credits with a maturity of three or more years, and loans from OECD countries for the purchase of goods and services, have been liberalised.

Covering the obligations of non-residents by residents

To secure the obligations of subsidiary companies abroad arising from credits accepted from foreign banks and the issues of eurobonds, the Bank issued 59 foreign exchange permits including 2 supplements in the total amount of Sk 2,512.3 million.

Provision of financial credits

During the period under review, 4 foreign exchange permits were issued for the granting of financial loans abroad in the amount of Sk 47.1 million.

Regulations for granting credits to OECD countries with a maturity of five or more years, and loans to OECD countries for payments for goods and services, have been liberalised.

Trading in foreign securities

For the sale of foreign securities, the Bank issued 1,118 foreign exchange permits and 3 supplements in a total amount of Sk 38.4 million. For the purchase of foreign securities, 25 foreign exchange permits were issued for the amount of Sk 82.6 million. Three permits and one supplement were issued for the purchase of foreign securities in the form of employee shares.

Trading in financial derivatives

The Bank issued two foreign exchange permits for the conclusion of option contracts with foreign companies for the purchase of lucrative foreign securities.

2.5.2 Foreign exchange permits for current account operations

Establishment of foreign-currency accounts at foreign banks

- 72 foreign exchange permits and 22 supplements were issued for the purpose of covering necessary expenses incurred in connection with construction, assembly, or repair work abroad, and which ensured that entrepreneurs could carry out construction and assembly work, in a total amount of Sk 2,248.5 million;
- five special foreign exchange permits for the purchase of foreign exchange and paying into the accounts of foreigners in connection with trading on the commodity market;
- one foreign exchange permit was issued for the placement of funds derived from loans and used for the payment of imported technology.

Establishment of foreign-currency accounts at domestic banks

- the NBS issued a total of 185 foreign exchange permits and 153 supplements, of which 95 permits and 72 supplements were for re-export operations; the remaining permits were granted for the promotion of exports and factoring transactions;
- 31 foreign exchange permits and 3 supplements were issued for the acceptance of credits from abroad.

Purchase of foreign exchange in cash and exceptions to the surrender requirement

- 13 foreign exchange permits and 11 supplements were issued for the purchase of foreign exchange to finance the business journeys of employees;
- 8 foreign exchange permits and 1 supplement were granted for the payment of royalties and fees to foreign participants in international events;
- 2 foreign exchange permits were issued to travel agencies for the purchase of foreign exchange from foreign exchange outlets;
- 1 foreign exchange permit and 1 supplement were issued in connection with forwarding activities.

3. THE PUBLIC SECTOR

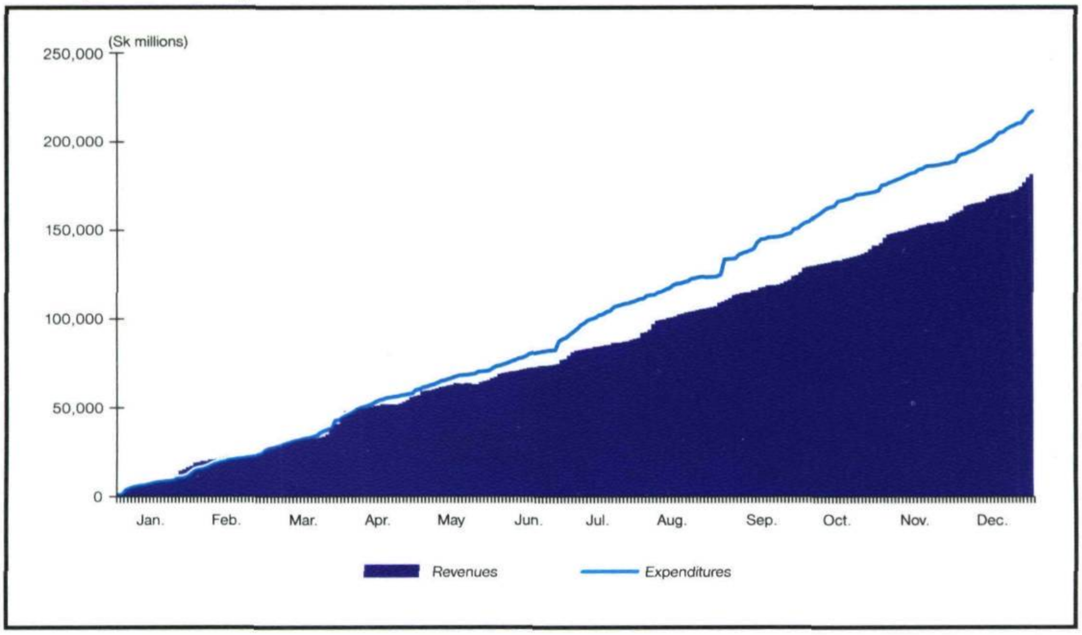
Budgetary Performance

The State budget of the Slovak Republic for 1997 was approved, in the amount of Sk 36.9 billion, by Decree No. 386/1996 Z.z. passed by the National Council of the SR. At the end of December, the budget deficit reached Sk 37.0 billion.

At the end of 1997, the total revenue of the State budget reached Sk 180.8 billion, representing a fulfilment of 105.7%. Revenue exceeded the budgeted figure by Sk 9.7 billion. Tax revenue (Sk 145.5 billion) remained below the budgeted level. Expected budget revenues from taxation amounted to Sk 154.6 billion; however, the actual revenue reached only 94.1% of this amount.

The non-fulfilment of tax revenues was due mainly to a shortfall in corporate income tax revenue (Sk 17.1 billion). Further shortfalls in tax revenues (Sk 2.1 billion) were recorded in the area of excise duties. With a total volume of Sk 21.9 billion, they represented a fulfilment of 91.1% of the budgeted figure. Within the category of income taxes, profits and capital gains, a very favourable result was achieved in personal income tax revenue, which exceeded the budgeted figure by Sk 3.2 billion, due mostly to tax revenues from persons earning a wage or salary. A substantial increase was recorded in the category of tax levied on international trade and transactions, which is linked to the introduction of an import surcharge as one of the measures designed to improve the balance of foreign trade. In budgetary terms, the import surcharge increased revenues by Sk 7.5 billion, which represented a significant source of income and offset to a large extent the shortfall in corporate income tax revenue. Value-added tax revenue (Sk 54.9 billion), which represented almost 38% of the country's total tax revenue, offset the nine month shortfall during the last quarter so that the annual figure corresponded to that forecast in the original budget.

Development of budget revenues and expenditures in 1997



Total budget expenditure (including principal repayments) reached Sk 217.8 billion, representing 104.7% of the figure budgeted for 1997, while the annual budget was exceeded by Sk 9.8 billion.

The greater part (70.8%) of total expenditure was formed by current expenditure, whereas capital expenditure accounted for 15.7%; principal repayments represented 11.5%, and the remaining *2%* belonged to the category of capital stakes and loans. In comparison with the budget expectations, there was a shift in favour of capital expenditure to the detriment of current expenditure.

For current expenditure, Sk 158.2 billion was set aside in the State budget. The actual volume of current expenditure (Sk 154.1 billion) accounted for 97,4% of the annual figure. The structure of these expenditures was dominated by public consumption in the household and government sectors (Sk 82.9 billion), of which the expenditures of central budgetary organisations accounted for Sk 71.3 billion, and the remaining amount (Sk 11.6 billion) was used for debt service payments (debit interest). The actual amounts of these expenditures did not exceed the budgeted figures. Within the individual chapters of the budget, annual current expenditures exceeded the budgeted figures in the sectors of education (109.4%), the interior (104.2%), and regional courts (108.1%).

Further current expenditures in the amount Sk 71.2 billion were accounted for by transfers to non-profit organisations, entrepreneurs, and local governments. The annual plan was fulfilled to 96.5%. With regard to structure, subsidies to the enterprise sector were exceeded (fulfilment to 106.6%). This was due mainly to subsidies on household heating costs, representing a fulfilment of 160.4%; the budgeted figure had been passed at the end of the 1st half of 1997. Subsidies granted to municipalities and non-profit organisations were drawn in accordance with the annual budget. During 1997, capital expenditure on the investment needs of the budgets of non-profit organisations, entrepreneurial entities and municipalities in the total amount of Sk 34.3 billion represented a fulfilment of the budget to 160.3%. Of the total sum realised, a large amount was spent on the acquisition of capital assets for budgetary organisations, the volume of which (Sk 25.5 billion) significantly exceeded the budgeted figure (243.5%). This fulfilment was closely connected with the use of extra-budgetary funds, particularly in the case of the Ministry of Transport, Postal and Telecommunications Services, which were taken from the resources of the State Road Fund and which had been earmarked for the construction of motorways and the road repairs. Budgetary expectations in the category 'property participation and credits' had been fulfilled to 140.2% by the end of 1997. For the year 1997, the repayment of State liabilities were budgeted in the amount of Sk 25.2 billion, while actual repayments of principal had reached roughly the same figure at the end of the year.

According to NBS estimates (based on IMF methodology), the fiscal deficit of the public sector amounted to Sk 29 billion, i.e. 4.4% of GDP. Definitive data will be available only after the State Closing Account for 1997 is approved by the National Council of the SR.

Relationship Between the NBS and the State Budget

The relationship between the State budget and the National Bank of Slovakia is regulated by the provisions of Act No. 566/1992 Zb. on the National Bank of Slovakia. Interest on government claims and liabilities registered at the NBS was credited during the whole year in accordance with the 1997 State Budget Act of the Slovak National Council, in which the rates of interest are defined for the individual activities of the State administered in accounts with the NBS. The rate for State receivables was 3% p.a., except for time deposits in State financial assets. In comparison with previous years, marked changes took place in the rates of interest on State liabilities: apart from the crediting of interest on the 1991 budget (at a rate of 9% p.a.), zero interest rates were set for the other items.

In 1997, the National Bank of Slovakia transferred Sk 1.1 billion to the State budget, in compliance with the provisions of Article 2 of Act No. 386/1996 Z.z. on the State Budget for 1997.

State financial assets (SFA), maintained in the form of deposits on accounts at the NBS, amounted to Sk 6.2 billion at 31 December 1997. Over the course of the year, a change took place in the administration of State financial accounts, as the NBS established - at the request of the Ministry of Finance - a time deposit account for SFA with a maturity period of 1 year, with effect from 1 April 1997. Funds from 12 SFA accounts were transferred to this time deposit account in the total amount of Sk 5.6 billion.

At the end of December, the value of State financial liabilities stood at zero; on 23 December 1997, State financial liabilities were written off from the account in the amount of Sk 21.7 billion, due to the application of Article 3, Section 1 of Act 358/1997 Z.z. in connection with the repudiation of liabilities resulting from the division of SBCS.

State Funds

At the end of the period under review, the total position of State funds was that of creditor in the amount of Sk 11.0 billion. This was due mainly to domestic and foreign credit resources, which had reached a level of Sk 15.5 billion by the end of December. The largest credit transfers (88%) were made to the State Road Fund, for the financing of motorway construction in the SR. Excluding credit resources, State funds disposed of financial means in the amount of Sk 4.5 billion. The State funds used these funds for the financing of their tasks.

Internal Debt of the Government vis-á-vis the Banking Sector

According to preliminary data, the net position of the government sector vis-á-vis the banking sector stood at Sk 70.2 billion at the end of the year.

The internal debt of the public sector vis-á-vis the banking sector gradually increased over the course of the year (until December), due primarily to the size of the budget deficit. During the eleven months of the year, the deficit widened by Sk 16.4 billion, to Sk 87.7 billion in November. In December, however, State liabilities to the NBS were written off on the basis of an amendment to the State Budget Act of 1997, which resulted in a reduction in the level of internal debt of the Government vis-á-vis the banking sector. Owing to this operation, the share of the National Bank of Slovakia in the crediting of the country's internal debt changed: prior to December, the Bank had contributed to covering the Government's internal debt with 16.2% to 30.7%; however, due to the aforementioned repudiation of liabilities, the Bank's position became that of debtor.

Over the course of 1997, the development and structure of internal government debt were influenced by the following factors:

- the deficit financing of the State budget over the course of the whole year, made a significant contribution to the discharge of debt service commitments, which reached Sk 25.2 billion (i.e. 68.1% of the State budget deficit recorded in 1997). The budget deficit was fully covered by issues of Treasury bills, while revolving financing was significantly supported by the National Bank of Slovakia, which, e.g. made 10 special 7-day issues in September alone, when its replenished its portfolio to the legal maximum of Sk 8.3 billion (in July, the NBS made 15 rapid issues of this kind; in October, there were 13, etc.);
- owing to the credits granted to the State Road Fund, through which the construction of railways was financed in Slovakia within the extra-budgetary activities of the Government, the minus position of State funds deteriorated;

- issue of two-year government bonds in the amount of Sk 1.5 billion earmarked for the financing of housing projects;
- over the course of 1997, Treasury bills (issued for the coverage of the 1996 State budget deficit) were gradually converted into one-year government bonds with zero impact on the internal debt of the Government;
- due to the payment of principal on an SAL loan granted by the World Bank and the EXIM Bank of Japan, the volume of State financial assets suffered a decline (Sk 3.2 billion compared with the figure for the beginning of the year);
- after the Government's commitment to the NBS was written off in December in accordance with Article 3, Section 1 of Act No. 358/1997 Z.z., the account of State financial liabilities was closed and the size of the State budget deficit for 1991 was reduced accordingly.

The National Property Fund

At 31 December 1997, the obligations and recognised claims of the Fund vis-á-vis commercial banks totalled Sk 1.2 billion (excluding the bonds of the NPF for owners included in the second wave of voucher privatisation). The volume of deposits amounted to Sk 2.9 billion. This indicates that the position of the Fund vis-á-vis the banking sector was at a creditor level (Sk 1.7 billion).

At 31 December 1997, the funds of the National Property Fund of the SR resulting from privatisation, which are held in a separate account of the Ministry for the Administration and Privatisation of National Property, amounted to Sk 1.3 billion. Including these funds, the total financial position of the NPF vis-á-vis the banking sector was that of creditor at the level of Sk 3.0 billion.

Over the course of 1997, bonds issued by the Fund were redeemed in a total amount of Sk 4.6 billion, representing a much lower amount compared with the forecasted figure (NPF forecast Sk 11.1 billion, and the NBS Sk 7.2 billion). At 31 December 1997, NPF bonds remained in circulation in the amount of Sk 26.5 billion, i.e. 79.7% of the total issue.

Government Guarantees for Bank Loans

During the last quarter of 1997, the Government of the SR decided to grant a government guarantee for a bank loan to the Slovak Railways in the amount of roughly Sk 5.1 billion (the credit was provided in US dollars, principal amounted to US$ 135 million, the rest being interest), which was the only state guarantee provided in 1997. The total limit for government guarantees was set at Sk 19.2 billion, in accordance with the State Budget Act for 1997.

4. MONETARY POLICY AND MONETARY DEVELOPMENT

4.1 Monetary Development

Slovakia's annual inflation, expressed in terms of the consumer price index, reached 6.4% in 1997. In the monetary programme, the rate of price inflation was set at 4.9 to 5.8%, but the import surcharge was not expected to be increased over the course of 1997. The exchange rate of the Slovak crown fell in December by only 0.55% in comparison with the beginning of the year, despite fluctuations on the foreign exchange market at the end of May and the beginning of June. During the period under review, the structure of receipts and payments by currency corresponded to the structure of the currency basket of the Slovak crown, i.e. 60% DEM and 40% USD.

The real effective exchange rate of the Slovak crown (Sk), reflecting the development of domestic prices in comparison with the country's eight major trading partners (excluding the CR), appreciated in 1997 by 9.3 percentage points (or by 7.2 percentage points) on the basis of consumer prices (or producer prices respectively) in comparison with 1996, when it appreciated by 2.8% (or 4.9 percentage points respectively). Including the Czech Republic in the calculation of the crown's real effective exchange rate, it appreciated in terms of the consumer price index (or the producer price index) in 1997 by 10.3 percentage points (or 10.7 points respectively), in comparison with a depreciation of 2.8 percentage points (or 0.2 percentage points respectively) in 1996.

Although the appreciation in the crown's real effective exchange rate might have reduced the competitiveness of Slovak entities on foreign markets to the extent that the actual rate of appreciation in the exchange rate was higher in 1997 than a year ago, the dynamics of growth in exports improved during the period under review. The acceleration in the rate of year-on-year growth in exports in 1997, was significantly influenced by the improved marketing strategies of Slovak exporters and more effective utilisation of production potentials. The increased dynamics of exports were reflected mainly in companies with foreign capital interests.

The year 1997 can be characterised as a year of favourable development in monetary aggregates and improvement in the current account deficit of the balance of payments. In 1997, dynamics of wages gradually approached the rate of growth in labour productivity. Along with the development of bank lending, a moderate increase was achieved in domestic demand in 1997, which led to a decrease in the relation between the current account deficit of the balance of payments and the gross domestic product.

At the end of 1997, the deficit in the current account of the balance of payments was below the level of 7% of gross domestic product (GDP). This was due to monetary-policy measures designed to slow down the rate of growth in monetary aggregates and to administrative measures taken by the government (import deposits and the import surcharge).

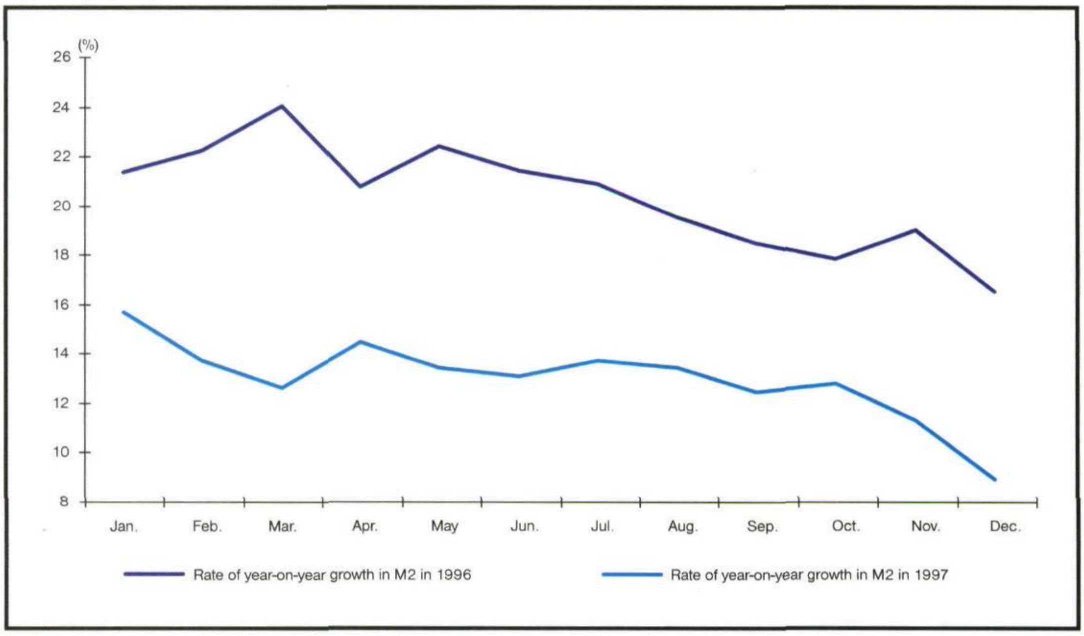
With regard to monetary development, it should be added that the acceptable development of the money supply and net domestic assets, which are the intermediary goals of monetary policy, could only be maintained through a marked reduction in bank lending, owing to the expansive development of the public sector.

Monetary development in 1997 was marked by high and volatile interest rates, the upward trend of which was due primarily to increased demand in the public sector for financial resources. Another cause of increase in the price of money was the attack on the exchange rate of the Slovak crown in May, when the high interest rates (exceeding the level of 100%) made it necessary to maintain a fixed exchange rate regime. Speculations of foreign investors on the exchange rate of the Slovak crown in 1997 were supported by the overall situation on international financial markets resulting from developments in south-east Asia and the CR, and by the deterioration in the external imbalance of the SR, particularly in 1996. The deficit in the current account of the balance of payments exceeding 5% of gross domestic product, the high and persistent fiscal deficit along with the country's increasing external debt, and growing fears of devaluation on the part of both domestic and foreign entities, represented a set of indicators signalling the country's impaired ability to maintain the stability of the national currency.

The high interest rates and restrictions on bank lending in 1997 represented an inevitable reaction to the persistent deficit in the current account of the balance of payments, and the inconsistency between monetary and fiscal policies.

Monetary development in 1997 was influenced by monetary measures introduced during the second half of 1996. These measures were designed to reduce the deficit of trade by regulating the level of domestic demand through the lending activities of commercial banks. In 1997, the NBS applied the decree relating to the foreign exchange position of banks for monetary purposes, and a modified system of liquidity management. In this way, the NBS managed to slow the dynamics of bank lending to the economy, and to maintain the stability of the Slovak currency. During 1997, the exchange rate of the Slovak crown (with the exception of fluctuations in May) ranged from +0.9 to -2.4% within the fluctuation band. The Decree of the NBS stipulating the foreign exchange position of banks for monetary purposes fulfilled its goal, specifically in the area of foreign-currency lending to residents, the dynamics of which slowed to 15.9% in December 1997, from 31.7% in 1996, or over 100% during 1996.

Development of M2 in 1996 and 1997



The money supply, being one of the intermediate goals of monetary policy, recorded a slowdown in 1997, when its volume reached Sk 453.9 billion in December (at fixed exchange rates), representing a year-on-year change of 8.9%, i.e. 1.7 percentage points less than the figure set in the monetary programme. Over the course of 1997, the rate of growth in the M2 aggregate nearly halved in comparison with the 1996 figure. In 1997, the growth of M2 was influenced mainly by the development of net domestic assets, which increased by Sk 30.6 billion compared with Sk 60.1 billion in 1996. Net foreign assets increased by Sk 6.4 billion over the course of 1997.

The slowdown in the rate of growth in the M2 aggregate during 1997 was due primarily to a marked reduction in the dynamics of bank lending to households and enterprises, which increased in absolute terms by Sk 8.1 billion year-on-year, compared with Sk 54.8 billion in 1996. In relative terms, the growth in loans to households and enterprises slowed from 17.9% in December 1996, to 2.2% in December 1997. In this connection, foreign resources became a significant source of growth for gross domestic product. Over the course of 1997, the level of foreign debt in the corporate sector rose from US$ 1.4 billion to US$ 5.0 billion, which increased the sensitivity of companies to exchange rate fluctuations.

Over the course of 1997, the volume of net credit to the government sector increased by Sk 28.9 billion and, in comparison with the previous year (an increase of Sk 4.6 billion), a considerably greater amount of funds were released into the economy, as a result of which the resources of commercial banks were reduced and the room for credit exposure to other entities constricted. In this way, private activities were crowded out by public activities. In 1997, net credit to the Government grew at a rate of 40.4%, and accounted for 78% of the absolute year-on-year increase in M2, compared with 7.8% in 1996. The influence of lending activities on the growth of M2 slackened from 93.2% in 1996 to 21.9% in 1997. In budgetary performance, a marked tension developed between revenues and expenditures during 1997. To keep the budget deficit within the set limits, part of expenditures incurred in 1997 was blocked and transferred to the following period. The financing of the budget deficit was also problematical with regard to the existing imbalance between the budget's demand for resources and their availability on the financial markets, which was reflected in the level of yields demanded. Over the course of the year, the price of money increased and the average cost of budget refinancing reached approx. 25% in December 1997.

The shortage of resources in the banking sector and the non-acceptance of requirements relating to yields on the part of the Ministry of Finance of the SR, was reflected in the fulfilment of the limit set for the purchase of Treasury bills for the central bank's portfolio. During the last quarter of 1997, rising interest rates on government securities were influenced by the uncertainty of investors in connection with the retroactive taxation of income from Treasury bills. In November 1997, the market for short-term securities was opened to foreign investors, with the aim of improving the budget deficit and lowering interest levels on government securities. However, non-residents did not show much interest in Treasury bills, due in all probability to the long period of maturity, which carries an increased exchange rate risk for short-term investors.

During the second half of 1997, the development and dynamics of growth in M2 was significantly influenced by seasonal changes in the volume of net credit to the Government and that of other net items.

The seasonal nature of the development of net credit to the Government changed in 1997 in comparison with previous years. During the first half of 1997, net credit to the Government deteriorated by Sk 6 billion, compared with an improvement of Sk 11 billion in the same period in 1996. During the second half of 1996, the volume of net credit to the Government recorded a moderate increase, which was followed by a marked month-on-month deterioration (Sk 11.7 billion) in December 1996, compared with Sk 3.7 billion in 1997. The change in the character of net credit to the Government, as one of the sources of M2, affected the seasonal development of the money supply over the course of the year, but mainly in December 1997, when the substantially less upward influence of net credit to the Government was a factor behind the slowdown in the rate of year-on-year growth in M2 from 11.3% in November 1997, to 8.9% in December.

In December 1997, the slowdown in the dynamics of M2 was also affected by the development of other items net, among which a change was reported in the development of accrued expenses. Funds for the crediting of interest to accounts at 31 December, were accumulated here. The effort to maintain liquidity levels led commercial banks to introduce deposit products with high interest rates and short maturity. This caused a change not only in the structure of M2, but also in the crediting of interest to accounts and its spread over the year, as a result of which the amount of interest credited to accounts in December decreased. The rate of growth in M2 was also affected by the development of other items net, whose influence was less in December 1997, than a year earlier.

The change in behaviour of depositors was reflected in an upward trend of development in short-term deposits. At the same time, demand deposits declined and the increase in the volume of currency in circulation outside banks (Sk 5.2 billion) halved in 1997 in comparison with the figure recorded a year earlier. The competitive offers of banks in the area of short-term resources resulted from their efforts to maintain the level of liquidity. At the same time, however, structure of the banks' primary resources by term deteriorated in favour of short-term funds, which further widened the difference between the short-term nature of resources and the need for long-term loans.

In 1997, the trend of development in foreign-currency deposits changed for the better, while the most significant increase was recorded in June 1997, due mainly to the expected depreciation in value of the Slovak crown. The development of foreign-currency deposits reflected the increased sensitivity of economic entities to the actual development of exchange rates on the one hand, and uncertainty about the future exchange rate regime of the Slovak Republic.

The savings rate of households, expressed as the proportion of increase in potential purchasing power to current income during the year, gradually decreased to 7.3% at the end of the year. Slovak-crown deposits accounted for 89% of the volume of increase in potential purchasing power (Sk 38.8 billion). The share of crown deposits in the potential purchasing power of households increased by 10 percentage points in comparison with the 1996 figure, due to the transfer of cash into short-term bank products paying interest at advantageous rates. In 1997, part of crown resources in the household sector was transferred to foreign currency accounts due to fears of devaluation; this distorted the actual rate of savings to a certain extent. If household deposits in foreign currency had been included in the potential purchasing power, the rate of savings would have been 8%. The savings rate decreased year-on-year by 1.2 percentage points (by 0.6 percentage points including household deposits in foreign currency), due to a decrease in the share of current household incomes in GDP from 82.4% in 1996 to 80.8% in 1997, while the proportion of potential purchasing power (including household deposits in foreign currency) of GDP fell from 7.1% in 1996, to 6.5% in 1997.

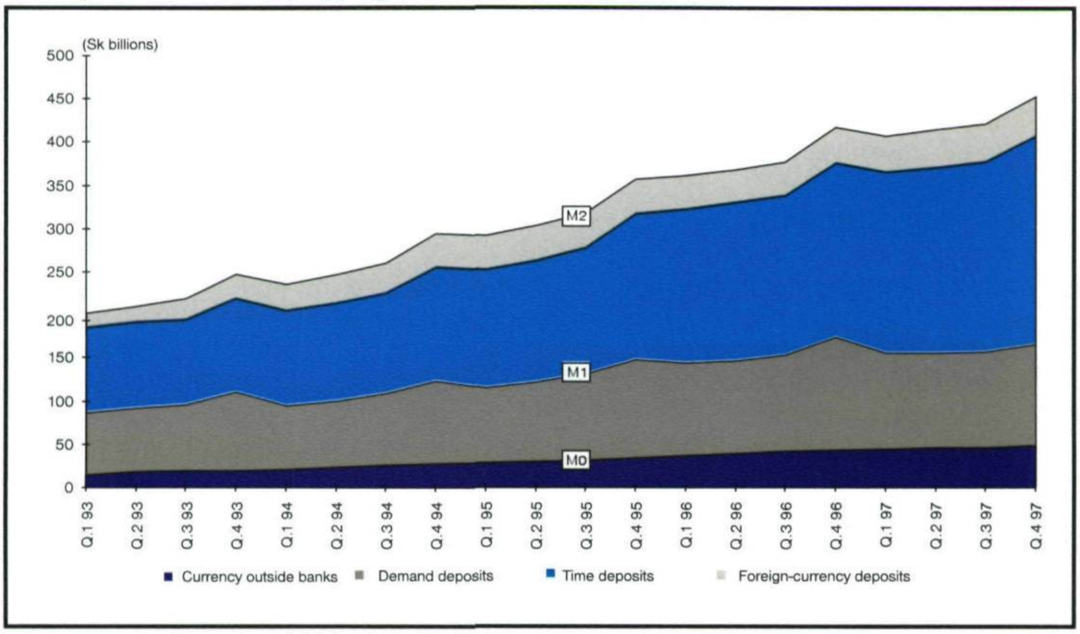
4.2 Structure of the Money Supply

Over the course of 1997, the M2 money supply (at fixed exchange rates) increased by Sk 37.0 billion, reaching Sk 453.9 billion at the end of the year. With regard to individual sub-aggregates, the growth in M2 was due exclusively to an increase in quasi-money (Sk 44.8 billion), while the M1 aggregate suffered a decline of Sk 7.8 billion. In comparison with 1996, when the money supply grew by Sk 59.2 billion, the absolute increase was much lower in 1997. Over the course of the year, the dynamics of year-on-year growth in the M2 money supply was characterised by a downward trend; by the end of December 1997, the annual rate of growth had reached 8.9%.

In 1997, the volume of currency outside the banking sector increased by Sk 5.2 billion. In comparison with previous years, the issue of currency was characterised by a slowdown in the rate of growth.

Compared with the course of development in 1996, when demand deposits increased by Sk 16.5 billion, the year 1997 saw a change in the trend of development (a decline of Sk 13.0 billion), which was influenced significantly by the high level of interest rates on short-term time deposits, where the dominant part of the said increase took place. The development of demand deposits was determined by demand deposits in the corporate sector (amounting to approx. 56% of the total volume of demand deposits in 1997), the seasonal nature of which is conditional upon the deadlines for the discharge of liabilities to the State budget. In the household sector, demand deposits were stagnant during 1997: the annual increase amounting to Sk 0.1 billion. Over the course of the year, the development of demand deposits was influenced by the payment of annual and quarterly premiums, and the level of interest rates on short-term deposits. Demand deposits in the insurance sector fell by Sk 0.1 billion, and experienced only negligible month-on-month changes during the year.

Development of monetary aggregates



Time deposits (term and savings deposits) grew by Sk 39.2 billion, due mostly to an increase in household deposits (Sk 34.4 billion). Over the course of the year, time deposits in the household sector recorded positive month-on-month increases, which accelerated in July and September, as a result of a rise in the level of short-term interest rates to roughly 20%. The largest increase was recorded in December, due to the crediting of interest to deposit accounts at the end of the year. The development of interest rates significantly influenced the structure and volume of time deposits in the household sector. While deposits at up to 1-month notice accounted for only 0.5% of time deposits in the household sector at the beginning of the year, at the end of the year they had increased to 13.7%, representing 70.6% of the total growth. The year 1997 was marked by a downward trend in the proportion of home savings deposits to the increase in time household deposits. In 1996, this share represented nearly 40%; then in 1997, it fell to 22.5%, the sharpest decrease being recorded in the 3rd quarter of 1997. In the corporate sector, the volume of time deposits increased by Sk 6.4 billion during 1997. The most significant increase took place in January. During the following period, month-on-month increases fluctuated and were influenced by the actual need for, or surplus of free resources (mainly in connection with the settlement of liabilities vis-á-vis the State budget). In the enterprise sector, most funds were allocated to short-term deposits at up to 1-month notice, whose share in total time deposits of enterprises increased from 40.0% to 66.7% over the course of 1997. This group absorbed 211% of the increase in time deposits held by enterprises, when almost all the other groups of time deposits declined (mainly deposits at up to 3-month and up to 1-year notice). Time deposits in the insurance sector fell by Sk 1.6 billion in 1997.

Foreign-currency deposits recorded an increase of Sk 5.6 billion, the greater part of which took place during the months June to August, as a consequence of the pressure on the exchange rate of the Slovak crown. The increase in foreign-currency deposits was due mostly to household deposits in foreign currency, which grew by Sk 4.1 billion and recorded positive month-on-month increases throughout the year. In 1997, corporate deposits increased by Sk 1.5 billion and followed a different course of development than that of household deposits. From the beginning of the year to May (except March), corporate deposits declined. In June, however, corporate deposits increased month-on-month by Sk 3.0 billion, in response to the situation on the foreign exchange market. During the following period, this development moderated, along with the stabilisation of the foreign exchange market. The relatively marked reaction of foreign currency deposits to the attack on the exchange rate of the Slovak crown at the end of May and the beginning of June was due to fears of devaluation. However, a positive development was that crown deposits were not switched into foreign currency accounts on a mass scale and foreign exchange was not purchased by households in excessive amounts. This was a sign of the monetary policy's effectiveness and credibility in relation to households as well as enterprises.

4.3 Bank Lending

Bank lending in Slovak crown and foreign currency to the entrepreneurial sector, households, central and local authorities for extrabudgetary purposes, by commercial banks and the NBS (to residents and non-residents), was rather uneven over the course of the year (it ranged from an increase of Sk 5.4 billion in March and Sk 4.4 billion in August, to a fall of Sk 4.9 billion in January and Sk 2.5 billion in July). This development reflected the general problems of external and internal disequilibrium of the economy, liquidity of commercial banks, and the situation on the interbank money market. While month-on-month increases in crown loans ranged from Sk -3.9 billion to Sk 4.8 billion, the month-on-month increases in foreign currency loans were more or less stable and fluctuated around Sk 1 billion, except for a month-on-month increase in June (Sk 3.1 billion), which was one of the highest since 1993, and a decline in October (Sk 1.6 billion).

Of the total increase in bank lending in 1997 (Sk 14.5 billion), crown loans accounted for 24.1% and loans in foreign currency 75.9%. At the end of December, the volume of bank credit totalled Sk 388.9 billion, of which crown loans accounted for Sk 342.3 billion and loans in foreign currency Sk 46.6 billion.

A characteristic feature of bank lending in 1997, was that the increase in crown loans took place predominantly in the financial (Sk 3.0 billion), household (Sk 2.6 billion), and entrepreneurial sectors (Sk 2.2 billion). The volume of loans to non-financial organisations declined by Sk 5.3 billion. A considerable part of credit resources was used by the public sector for the construction of motorways and other projects, as a result of which the total annual increase in crown loans to the entrepreneurial sector (residents and non-residents), households, and the extra-budgetary needs of central and local bodies reached only 1.0%. As a result of restrictions on crown resources, solvent entrepreneurial entities drew foreign loans at advantageous interest rates. Lending in foreign currency increased significantly mainly during the 2nd, 3rd, and 4th quarters; the total increase since the beginning of the year being 30.9%. At the end of the year, however, foreign-currency loans accounted for only 12% of total credit.

The structure of loans by term was characterised by a slight increase in the share of short-term loans (by 1.5 points, to 43.4%), medium-term loans (by 0.8 points, to 22.3%), and a decrease in the share of long-term loans (by 2.3 percentage points). The increases in total credit took place in short-term (Sk 11.6 billion) and medium-term loans (Sk 6.2 billion). Long-term loans declined by Sk 3.3 billion. Such a distribution of loans failed to contribute to the structural reform of the economy, the introduction of modern technology, and innovations in production.

A significant increase was recorded in the share of short-term loans in foreign currency (11.5 percentage points), while medium-term loans decreased by 7.2 points and long-term loans by 4.3 points in proportion to total credit in foreign currency.

Over the course of the year, the structure of loans by sector was fairly stable, the change in the share of crown loans ranged from 0 to 1.1 percentage points. The largest part of the total volume of crown loans was consumed in the manufacturing industry (33.4%), almost a half of which (13.7%) in metallurgy, and 21.9% in machine engineering, trade, sales, catering, and hotel services (average figures for the year).

Structure of loans in Sk and foreign currency ***(%)***

	1 January 1997	31 December 1997
Bank lending in total	100.0	100.0
of which		
Short-term loans	41.9	43.4
Medium-term loans	21.5	22.2
Long-term loans	36.6	34.4

Of the total volume of credit extended (Sk 272.5 billion), bank loans to the entrepreneurial sector accounted for 94.3%. These were mostly short-term loans with a maturity of up to 3 months, which in fact indicated that the total volume of loans in the sector fell by Sk 0.2 billion, due mainly to the entrepreneurial sector.

Regarding the structure of loans by purpose, operating loans accounted for 49.1%. Loans granted for development programmes represented only 9.7% of the total volume of bank lending during the given period, which was associated with their structure by term. Due to the relatively low level of interest rates on loans granted to households (10% to 12.5%), their volume remained at the same level; however, demand had not been fully satisfied as a result of the limited amount of funds earmarked for these purposes. The structure of new loans by purpose did not provide adequate support for the development projects of entrepreneurial entities. Short-term loans with a maturity of up to 1 year accounted for 84.5% of the volume of new loans, while most large banks provided loans with a maturity of up to 3 months, which were later renewed for solvent clients over the course of the year. A significant volume was represented by 1-day loans provided for operating purposes. Other significant items were loans granted for the coverage of credits, which the clients were unable to repay and which reduced the actual volume of loans applicable for the financing of specific development projects.

4.4 Interest Rate Development

At the beginning of 1997, marked fluctuations and increases were recorded in interest rates on the interbank money market (mainly in May and June), which affected the rates of interest for clients as well. The high level of interest rates was also influenced by the large volume of risky claims, which were concentrated at large banks, and in effect determined the country's interest rate policy. Over the course of the 3rd and 4th quarters, interest rates on new loans stabilised to a certain extent, but at a relatively high level, fluctuating around 20%.

Compared with the figure for December 1996, the average interest rate on the total volume of loans rose by 3 percentage points, the level being influenced by further factors such as the structure of loans by term, the structure of customers, and the structure of loans by purpose. A marked increase was recorded in the average lending rate for short-term loans (by 6.05 points, to 19.91%), a virtually instantaneous response to changes in economic and other factors. The average interest rate on medium-term loans rose by 1.13 points (to 16.41%) and that on long-term loans by 0.54 points (to 11.9%), while these rates were constantly influenced by loans granted in previous years at fixed and low interest rates.

Over the course of 1997, commercial banks raised the level of interest rates on short-term loans first at the beginning of the year (by 1 to 3 points), then in April (by 1.5 points), July (by 1.25 to 2 points), and later in November (by 1 to 4 points). The actual increase in the price of new loans was 7.47 points (to 20.92%) in comparison with December 1996. With regard to the dominant share of short-term loans (84.5%), the average interest level (21.60%) influenced the development of average lending rates for new loans. Lending rates for new short-term loans followed, to a significant extent, the development of interest rates on the interbank money market. In December 1997, interest rates on new medium and long-term loans increased to 16.30% (by 3.25 points) and 15.4% respectively (by 1.72 points), compared with the figures for December 1996. This reversal in development of interest rates continued in 1997.

Over the course of the year, the development of interest rates by purpose was characterised by marked fluctuations in lending rates for operating loans, which ranged from 15.4% to 21.4%; in rates for development loans, fluctuating between 13.9% and 19.1%; rates for standard loans (15.6% to 24.6%), and in rates for overdrafts (14.3% to 26.0%). Average interest rates on consumer loans to households fluctuated between 7.8% and 11.6%.

Real interest rates on new loans increased by 6.6 points, to 16.53% (in terms of industrial producer prices); of this, the rates for short-term loans rose by 6.9 points, to 17.2%.

Commercial banks raised the level of interest rates on deposits at the beginning of the year (by 1 to 1,5 points), in July and August (by 1 to 2 points), and then in November (by 1.5 to 6 points), particularly the rates for short-term deposits.

This led to an increase in actual average interest rates on crown deposits: they rose by 2.51 points in comparison with the level of December 1996, to 8.69% in December 1997. In the effort to obtain short-term crown resources, commercial banks raised the level of interest rates considerably, particularly on deposits at up to 3-month notice (by 6.2 to 7.6 points), with preference for deposits above Sk 100 thousand. The total increase in time deposits (Sk 37.4 billion) was fully absorbed by 1-month and 7-day deposits. With regard to the marked external and internal disequilibrium of the economy, commercial banks failed to create an adequately stimulating environment for the expansion of long-term deposits, which resulted in a lack of interest on the part of households in long-term deposits (except building savings deposits, totalling Sk 29.7 billion in December). The latter represent a special deposit product, which attract a state premium and offer the possibility of obtaining advantageous loans for households. The volume of other long-term deposits (mainly certificates of deposit) remained basically unchanged during the period under review (Sk 3.4 billion). For deposits at up to 1-year notice, commercial banks offered mostly flexible interest rates, while deposits at over 1-year notice attracted fixed interest rates.

In comparison with December 1996, actual interest rates on demand deposits rose by 0.63 points, to 3.5%; and those on time deposits by 2.99 points, to 11.62%. In the category of time deposits, marked increases were recorded in interest rates on deposits at up to 7-day notice (7.59 points), deposits at up to 1-month notice (7.38 points), and deposits at up to 3-month notice (6.15 points). The average interest rate on time deposits at up to 7-day notice was significantly influenced by the development of interest rates on the interbank money market (the value of the correlation ratio was 0.99).

In December 1997, the actual interest rate on one-year deposits (4.79%) increased year-on-year by 0.6 points, due to a higher rise in the level of nominal interest rates on one-year deposits (by 1.6 percentage points) than in the 12-month rate of inflation (by 1.0 percentage point).

4.5 Implementation of Monetary Policy

The monetary policy of the NBS was implemented in accordance with the Monetary Programme for 1997, the priority of which was to maintain, through mitigating the imbalance of foreign trade, the external stability of the currency as a precondition for the favourable development of inflation (and vice versa).

In 1997, the goal of monetary policy was to regulate the dynamics of domestic demand by influencing the lending activities of banks through quantitative liquidity management. Over the course of 1997, the attainment of this goal was hampered by problems in financing the deficit of the State budget on the part of commercial banks, which increased the central bank's interest in purchasing Treasury bills for its own portfolio. As part of its monetary policy, the NBS took account of the planned issues of government securities, which influenced its implementation in favour of supplying liquidity to the banking sector. The conduct of monetary policy was influenced significantly by the attack on the Slovak crown in May 1997, when the NBS responded by suspending the refinancing of the banking sector with the aim of warding off the threat of currency devaluation.

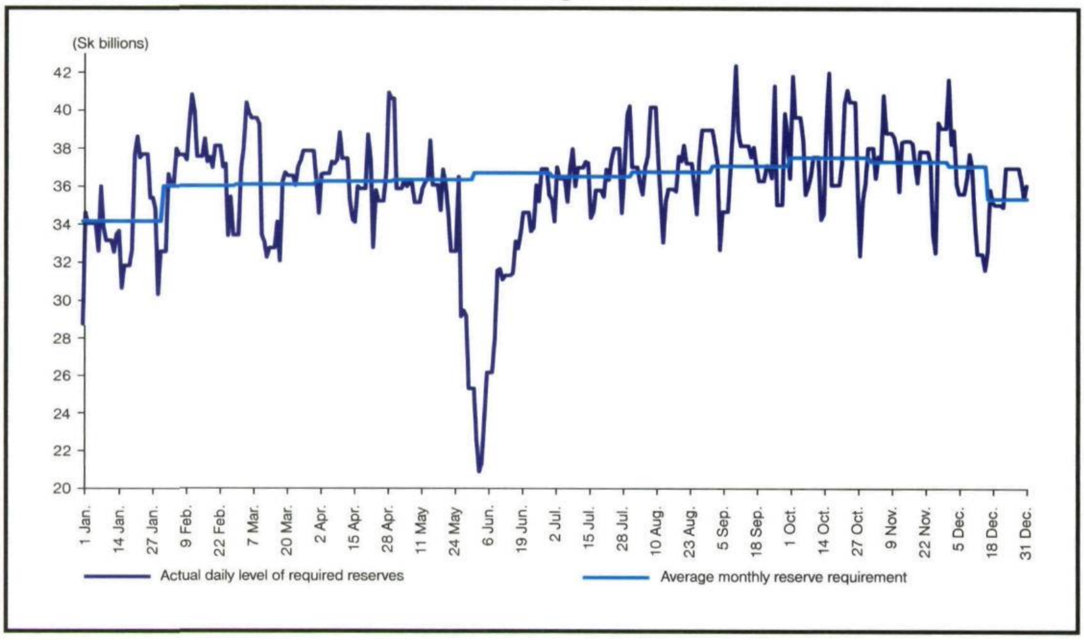
The official exchange rate of the Slovak crown (Sk), listed by the NBS, depreciated by 0.07% over the course of May. However, the exchange rates at commercial banks were, on some days, on the edge of the devaluation zone of the fluctuation band. The exchange of crown liquidity for foreign exchange liquidity by banks (non-resident and resident) and non-bank entities, caused a shortage of crown liquidity in the banking sector. During this period, the goal and strategy of the central bank was to maintain the stability of the Slovak crown; to this end, the Bank subordinated the implementation of monetary policy as well, mainly in the form of a restriction on refinancing.

Commercial banks began raising interest rate levels and subsequently stopped listing rates for non-residents in order to prevent their crown resources from being further reduced through sale of foreign exchange to non-residents. After the situation on the interbank market calmed down, the NBS started to replenish crown liquidity by conducting refinancing operations, as a result of which monetary-policy factors increased month-on-month by Sk 11 billion in June 1997. During this period, the pressure on the foreign exchange reserves of the NBS was dependent upon the crown liquidity of commercial banks; the volume of deposits held by non-residents in the banking sector; the purchase of foreign exchange by individuals, and acceleration of cross-border payments and the holding of money received from abroad by entrepreneurial entities. The attack on the currency at the end of May 1997, was due to a combination of factors, of which the most significant was not direct speculation on the part of foreign investors. This situation affected mainly domestic banks and non-bank entities (including households).

The high interest rates, which exceeded the level of 20%, persisted until the end of the year, despite the smooth fulfilment of minimum reserve requirements in the banking sector after the second period of July. During the second half of 1997, the price of money was influenced, apart from the uncertainty of commercial banks about the attitude of the NBS to refinancing; by the growing demand of the State budget for financial resources, where Treasury bills issued to cover the new deficit of the State budget and government bonds used for the financing of old debts culminated and overlapped during the second half of the year.

The liquidity of commercial banks was significantly influenced by the net foreign assets of the NBS, which increased during the year by an average of Sk 4.1 billion, after the NBS reserves were replenished subsequent to the attack in May. The growth in net foreign assets was influenced by the development of trading in foreign exchange fixing, where commercial banks sold foreign exchange to the NBS, with the aim of replenishing crown liquidity. The decline in deposits of State funds and the State budget at the NBS (by an average of Sk 2.8 billion) also had a favourable influence on the level of liquidity in the banking sector, despite the high pressure on the resources of banks. The favourable influence of the public sector on bank liquidity was due in part to the issue of short-term Treasury bills for the portfolio of the NBS, which represented another form of refinancing. The supply of liquidity took place in the form of central bank operations through increased bills-of-exchange rediscounting and purchase of government securities from commercial banks.

Fulfilment of reserve requirements in the banking sector in 1997



The creation of minimum required reserves, which had been set for banks as the minimum level of liquidity in the banking sector, followed a rather uneven course of development in 1997. Regarding the fulfilment of reserve requirements, the most problematical period was that from the second period of May to the first period in July. During that period, the shortage of reserves in the banking sector reached a level of Sk 15 billion for a short time, i.e. the first period of June 1997.

During the individual periods, the average volume of excess reserves ranged from Sk 2.8 billion to a shortage of Sk 4.3 billion. More detailed data on minimum reserves is given in the table below.

In connection with the shortage of liquidity in the banking sector during the period from May to July and developments on the domestic money market, three Lombard loans were granted in the amount of Sk 4.9 billion.

Development of required reserves in 1997 ***(in Sk billions and %)***

	Set	Actual	Fulfilment in 1st period		Fulfilment in 2nd period	
	level of RR	level of RR	average	%	average	%
January	34.23	34.10	33.38	97.50	34.69	101.35
February	36.08	37.05	37.21	103.14	36.87	102.20
March	36.16	36.37	36.34	100.50	36.39	100.63
April	36.33	36.60	36.73	101.11	36.48	100.41
May	36.41	34.53	36.41	99.99	32.76	89.96
June	36.76	30.99	27.28	74.21	34.71	94.42
July	36.58	36.69	36.55	99.91	36.81	100.63
August	36.82	37.19	37.06	100.65	37.32	101.38
September	37.13	37.33	37.46	100.88	37.21	100.21
October	37.57	37.77	37.72	100.39	37.82	100.67
November	37.36	37.85	38.21	102.28	37.49	100.35
December[1/]	37.14	35.83	35.83	96.45	-	-
December[2/]	35.41	35.88	-	-	35.88	101.34

1/ Set level of RR (required reserves), including IRB(Investičná a rozvojová banka, a.s.)
2/ Set level of RR, excluding IRB, after the imposition of receivership on 19 December 1997.

The rediscounting of bills of exchange, conducted by the National Bank of Slovakia with commercial banks as one of the forms of refinancing, was increased twice over the course of the past year. In September 1997, the National Bank of Slovakia increased the bills-of-exchange limit from Sk 1.5 billion to Sk 2.0 billion, in support of the purchase of agricultural crops from 1997 (certain preferred commodities). Another adjustment to the bills-of-exchange limit was made by the National Bank of Slovakia in November. The rediscounting of agricultural bills was increased from Sk 2.0 billion to Sk 3.0 billion, while the discounting of export bills was suspended, as export promotion is regarded as the special remit of organisations established to this end, e.g. EXIMBANKA SR.

In 1997, the volume of issued currency increased by an average of Sk 6 billion, which reduced the level of liquidity in the banking sector. However, the growth in the volume of currency in 1997 was less than half the figure for 1996, due probably to an increase in the expenses of household and enterprises arising from their non-interest-bearing cash holdings and the transfer of a part of these holdings into short-term deposit accounts with advantageous interest rates. To obtain liquidity, commercial banks reduced the levels of cash in their vaults, which also led to a reduction in the need for currency issue.

The structure of monetary policy was determined by the need to make corrections in the unfavourable structure of gross domestic product, which was dominated by domestic demand fuelled from foreign resources. This situation was reflected in the growing deficit in the country's foreign-trade balance, particularly in 1996. The implementation of monetary policy was influenced mainly by the character of the economic policy as a whole, which predetermined - during the expansion of the public sector - the 'policy mix', i.e. correction, or supplementing one policy by the other (fiscal policy by the monetary policy). Naturally, the situation on the foreign exchange market in May affected the implementation of monetary policy during the remaining period of the year. By means of its monetary-policy instruments, the NBS managed to resist the pressures of devaluation and the expectations of domestic as well as foreign economic entities.

4.6 Instruments of Monetary Policy

1. Interest rate policy

a) From 13 January 1996:
Discount rate = 8.8%

b) From 17 July 1996:
Lombard rate = 15.0%

2. **Reserve requirements**

a) With effect from 1 August 1996, the ratio of primary deposits for the calculation of minimum required reserves was set at 9%, irrespective of the term of deposit, 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 commenced bearing interest at the rate of 1.5%, up to the level of required reserves set for the period under review.

b) With effect from 1 January 1997, the ratio for required reserves of the volume of non-fulfilled obligatory foreign exchange position for monetary purposes was set at 9% (non-interest-bearing) and the ratio for required reserves of mortgage and municipal bond issues at 3%.

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 loans - at a rate of 7.5%;

b) Lombard loans - loans backed by the pledge of securities granted at Lombard rate;

c) Bills-of-exchange deals - bills of exchange are discounted and rediscounted at the discount rate; his form of refinancing included bills discounted for export promotion and bills rediscounted for the support of agriculture; with effect from 17 November 1997, the NBS ceased discounting bills of exchange for export promotion;

d) Open market operations.

4. Treasury bills

a) An operative means of financing the State budget deficit;

b) A means of managing the liquidity of commercial banks through:
- secondary sales and purchases;
- REPO operations (repurchase agreements).

5. NBS bills

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

6. Exchange-rate and foreign-exchange policy

a) The currency basket of the Slovak crown (Sk):

Currency	USD	DEM
Weight Exchange rate Sk	40% 31.209	60% 20.227

Absolute definition of the currency basket:

1 IDX = 0.012817 USD + 0.029663 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 702.8 billion during the period from January to December 1997. The average monthly turnover (Sk 58.6 billion) increased by 10.2% year-on-year. The deficit in foreign exchange receipts and payments reached a level of Sk 37.5 billion during the twelve months of 1997. The currency structure of the turnover was dominated by DEM (41,6%) and USD (36.3%). The other European currencies, with a strong correlation to DEM, accounting for 20.1%. Together with DEM, these currencies represented 61.7% of the total volume. The percentage of non-continental currencies including GBP was 2.0%, and together with USD accounted for 38.3% of the total turnover.
- The turnover of foreign exchange receipts and payments, including other convertible currencies (mainly the Czech crown), reached Sk 794.4 billion from January to December 1997. The balance of foreign exchange receipts and payments resulted in a deficit of Sk 77.4 billion. The large share of CZK in the achieved turnover (Sk 91.0 billion, i.e. 11.5%) and its inclusion in total turnover (converted according to the original currency basket of the CZK, i.e. 65% DEM and 35% USD) changed the structure of the total turnover in favour of DEM (62.1%) and to the detriment of USD (37.9%).

c) Nominal exchange rate of the Slovak crown:

- The nominal exchange rate of the Slovak crown (Sk) against the currency basket depreciated in 1997 by 0.55% compared with 31 December 1996, when it reached 2.30% within the devaluation band. During the period under review, the currency structure of receipts and payments for goods and services corresponded to the structure of the crown's currency basket, i.e. 60% DEM and 40% USD. The development of the crown's official exchange rate, listed and set by the NBS, depends upon the development of cross-currency rates of the D-mark and the US dollar on the world markets; the supply of, and demand for foreign exchange, expressed as the balance of foreign exchange fixing at the NBS; and upon the policy and goals of the central bank.

d) Real effective exchange rate of the crown:

- The real effective exchange rate of the Slovak crown, 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 by 9.3 percentage points during 1997; or, when compared with the country's nine trading partners (including the Czech Republic), it appreciated by 10.3 percentage points.
- The real effective exchange rate of the Slovak crown, calculated on the basis of the producer price index, compared with those of Slovakia's eight trading partners having a significant share in the country's foreign trade turnover, appreciated by 7.2 percentage points over the course of 1997; or, compared with the country's nine trading partners (including the Czech Republic), appreciated by 10.7 percentage points.

e) Management of the foreign exchange positions of banks:

- Commercial banks have free access to NBS foreign exchange fixing; they can adjust their foreign exchange positions by selling or purchasing foreign exchange by foreign exchange fixing. On the day of purchase, however, the ratio of foreign exchange assets to foreign exchange liabilities may not exceed 1.05.
- The foreign exchange position of banks for monetary purposes: The ratio of foreign exchange position for monetary purposes is calculated as the proportion of foreign exchange assets of non-residents to the sum of total liabilities of non-resident banks denominated in Slovak crowns and foreign exchange liabilities, less capital in foreign currency. The value of this ratio was first set at 0.65, and banks were required to achieve it by 31 December 1996.

Calculation of the foreign exchange position (FXPMP):

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

FXAN - Foreign exchange assets of non-residents
FXL - Foreign exchange liabilities in total
LNSk - Liabilities of non-residents in Slovak crowns
C - Capital and non paid-up 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.

Period of monitoring the FXPMP ratio:
Before 10 July 1997, the FXPMP ratio had been calculated on the basis of average data from the 2nd and 3rd periods of the month N-2 and from the 1 st ten-day period of the month N-1 of Survey of Assets and Liabilities V(NBS) 6-36. With regard to the fact that banks, especially branches of foreign banks, circumvented the Decree by increasing FXAN and FXL vis-á-vis non-residents (FXLN) only at the end of the ten-day periods, the NBS issued a decree whereby FXPMP is monitored on a daily basis, with effect from 16 July 1997.

f) Exchange rate fluctuation:

- The exchange rates of foreign currencies against the crown in NBS foreign exchange fixing are regulated by the IDX/Sk rate, reflecting the influence of demand and supply on the part of commercial banks. The IDX/Sk rate moves within a fluctuation band of ±7% (as of 1 January 1997) and is subject to decisions passed by the Auction Committee of the NBS. In 1997, the initial level of the IDX currency basket was 1.0175; at the end of the year, the value of the unit reached 1.0230. The maximum level of the IDX stood at 0.989 (7 February 1997) and the minimum was 1.024 (3 December 1997).

4.7 Monetary Calendar

January

- The NBS and the Ministry of Finance of the SR issued a decree (Decree No. 16) on the register of mortgages and the activities of mortgage controllers.

February

- The rating agency JBRI paid a regular visit to Slovakia, without changing the country's BBB- rating.

- The law on protection against dumping of commodity exports (of 6 February 1997) came into force on 1 July 1997.

March
- Law No. 80/1997 Z.z. pertaining to the Export-Import Bank of the Slovak Republic came into effect on 1 July 1997.

April
- The NBS returned the completed EU Questionnaire for Slovakia, containing information for the evaluation of the country's application for EU membership.
- The NBS issued a decree amending and augmenting Decree No. 1 dated 21 December 1995, stipulating the minimum level of liquid assets.
- The Ministry of the Economy issued a decree on the introduction of import deposits.

May
- The Board of the NBS approved some adjustments to the Monetary Programme of the NBS for 1997 and the Report on Monetary Development in the SR for 1996.
- Due to instability on world financial markets, the Slovak crown was also exposed to devaluation pressure. The crown's depreciation was prevented by a set of measures adopted by the NBS. In this connection, Slovak commercial banks suspended the listing of the BRIBOR rate.
- With effect from 30 June 1997, the National Bank of Slovakia issued Decree No. 5, dated 16 May 1997, relating to the capital adequacy of banks.

June
- The rating agency Standard and Poor's confirmed the high credibility of the Slovak Republic. The agency assigned a BBB- hard currency long-term liability rating (on the scale between AAA, the highest, and D, the lowest grades) and an A internal debt rating to Slovakia.
- The NBS issued the first licence for the conduct of mortgage banking operations to VÚB, a.s.
- With effect from 1 July 1997, the NBS passed a decree (Decree No. 3) amending and supplementing the provisions of Decree of 24 October 1996, stipulating the foreign exchange position of banks for monetary purposes, and Decree No. 4 amending the provisions of Decree No. 15 of 22 November 1996, on the submission of reports by banks and branches of foreign banks to the NBS.
- The decree on bank liquidity (of 1994) was amended by Decree No. 7, dated 23 June 1997, stipulating the rules of liquidity management for banks, with effect from 31 August 1997.

July
- The National Council of the SR approved a law on the revitalisation of companies, a law pertaining to import protection measures, and an amendment to the law on securities, which has liberalised trading in foreign securities in Slovakia.
- The National Council of the SR approved an amendment to the law regulating the duty on hydrocarbon fuels and lubricants. The amendment has increased the rate of excise duty.
- The Government of the SR approved an issue of Eurobonds in the amount of US$ 250 million. The bonds were issued by the Ministry of Finance and managed by Nomura International. The Japanese investment company granted a US$ 70 million loan to Slovakia for the start-up of EXIMBANKA SR.
- On 21 July, the Decree of the Ministry of Finance, introducing a seven percent surcharge on imports, came into effect. At the same time, import deposits were cancelled.

August

- The Bank Board of the NBS approved a credit agreement for a JPY 20 billion Two Step Loan III granted by the EXIM Bank of Japan to the NBS. The loan was provided for the support of small and medium-sized businesses, with a maturity of 13 years.

September

- A long-term syndicated loan agreement was signed by the representatives of the Ministry of Finance and five foreign banks for a US$ 120 million loan; the loan was earmarked for the construction of motorways in Slovakia.
- The National Council of the SR approved an amendment to the law pertaining to wages, salaries, and average incomes. The said amendment creates a legal framework for the regulation of wages in the corporate sector, where the increase in wages exceeded the growth in labour productivity.
- The NBS approved the application of the Ministry of Agriculture for an increase in the limit on the volume of bills-of-exchange deals from Sk 1.5 billion to Sk 2.0 billion.
- The Decree of the NBS, amending the provisions of Decree No. 1, dated 21 December 1995, stipulated the minimum level of liquid assets.

October

- The National Bank of Slovakia and the selected intermediary banks (Všeobecná úverová banka, a.s., Poľnobanka, a.s., Tatra banka, a.s., Poštová banka, a.s., and Priemyselná banka, a.s.) signed credit line agreements for the realisation of the third Two Step Loan from the EXIM Bank of Japan.
- On 16 October, the official BRIBOR rate appeared again, for the first time since the attack on the Slovak crown.

November

- During the period from 28 October to 12 November 1997, the Mission of the International Monetary Fund (IMF) revisited Slovakia to hold consultations with the Slovak Government in accordance with Article IV of the IMF Agreement.
- The rating agency IBCA confirmed the existing rating of the SR at the level of BBB-.
- With effect from 1 January 1998, the NBS issued Decree No. 11, dated 28 November 1997, imposing restrictions on risky foreign exchange positions of banks.

December

- On 19 December 1997, the National Bank of Slovakia placed IRB, a.s. (Investment and Development Bank) under receivership.
- In connection with the amendment to the 1997 State Budget Act, the debt arising from the division of the SBCS was written off from the accounts maintained at the NBS.
- The Bank Board of the NBS approved the Monetary Programme of the NBS for 1998.
- The NBS granted licences to Slovenská sporiteľňa, a.s. (Slovak Savings Bank) and HYPO-BANK, a.s. for the conduct of mortgage transactions.

5. FINANCIAL MARKETS

5.1 Money Market

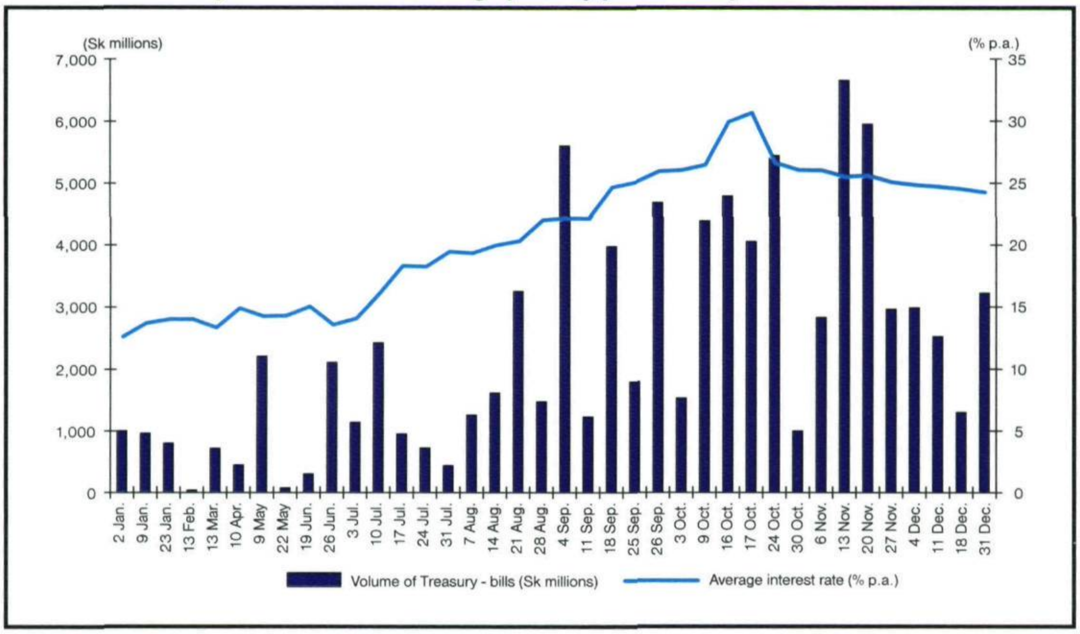
5.1.1 Primary Treasury-bills Market

During 1997, the Ministry of Finance of the SR staged auctions of Treasury bills in line with its schedule for government security issues. In addition to that, the Ministry (MFSR) resorted to 4 ad-hoc Treasury-bill auctions during the second half of the year, bringing the total of auctions to 51.

In 1997, the market for short-term securities took in 38 Treasury-bill issues (placed at auctions) with maturity ranging from 21 to 315 days, worth an aggregate Sk 88.813 billion, some Sk 2.345 billion more than in 1996. The average size of an issue worked out at Sk 2.337 billion, falling short of the previous year's average by Sk 0.065 billion. One improvement from the previous year was that the issuing schedule for government securities was arranged in quarterly intervals. Also on the positive side, there was a greater variety of maturities on sale in individual periods. Along with the 1-, 3-, and 9-month redemption periods available in 1996, last year further enriched the offer with 2-, 6-, 7-, 8-, 10- and 11-month Treasury bills.

In primary sales, Treasury bills were sold at American-style auctions (except for a single auction in October, which was carried out in the Dutch way), with no volume announced in advance and no interest rate limit. The average interest rate at Treasury-bill auctions reached 23.54% p.a., with the year's average low at 12.549% p.a. and the average high at 30.617% p.a.

Volume of Treasury-bill issues and average primary placement yields in 1997



Out of 51 auctions announced, the issuer (the MFSR) decided not to accept any bid at 11 of them. Most of the auctions that failed occurred in the first half of the year, when the liquidity situation in the banking sector held demand for Treasury bills earthbound. Failed auctions, especially those staged in late May and early June, were affected by adverse shifts in interbank deposit rates. Those, in turn, were triggered by a shortage in liquidity in the banking sector under pressure on the devaluation of the Czech crown, which eventually spread over to the Slovak market as well. At that point, it was next to impossible to finance the running budget deficits by proceeds from Treasury-bill auctions. The situation in the financing of the current budget deficits took another turn in June, when a series of past bond issues fell due. That, coupled with Treasury bills used to cover the state budget deficit in 1996 maturing in July, explains the heavier issuing activity of the Ministry of Finance. All these factors combined with the 1997 deficit projections to lift the level of average interest rates at auctions. In the second half of the year, interest rates have tended to grow due to the MFSR original intention to impose a retroactive tax on Treasury-bill discount and government bonds coupons as well. A revision of the Income Tax Act went into force on 5 November. As a result, interests earned on Treasury bills issued from that date are subject to a 15-percent withholding tax. At last, the primary market Treasury-bill interest rates came to a halt in late October. The time remaining to the end of the year was marked with Treasury-bill issues redeemable in 1998 with interest rates showing a moderate trend downwards.

In November, the NBS, in its capacity as administrator of the short-term securities market, let in foreign investors, which are now allowed to bid at auctions through an agent who is a direct participant. The ranks of direct participants, previously limited to national commercial banks, have been expanded by insurance companies and securities dealers based in the Slovak Republic. Direct market participants have subscribed an entire 92% of Treasury bills auctioned. Indirect participants' share reached 5 percent, representing a 3.3% rise from a year ago. Above all, the latter group of investors was attracted by the rising interest rates available at auctions. The NBS share in primary market Treasury-bill auctions was a mere 3%, only an echo of the 10% share of the central bank in 1996. The NBS trading on the Treasury-bills market was primarily of short-term nature, as the bank purchased and consequently sold to commercial banks 7-day issues.

A growing gap between budget revenues and expenditures caused a term mismatch between the running budget deficit and the auction placements of Treasury bills. It was these problems that made it quite difficult to finance the deficit with issues sold at auctions. For that reason, the issuer conducted several technical issues sold straight to the NBS, without auction, in the first half of 1997. In the second half of the year, technical issues have proceeded almost without a break. Save for two auctions, this was the method of choice for the NBS in delivering its share of help to cover the State's debts. All of these Treasury-bill issues were redeemable in short periods of time (1-8 days), with 7 days being the most frequent maturity.

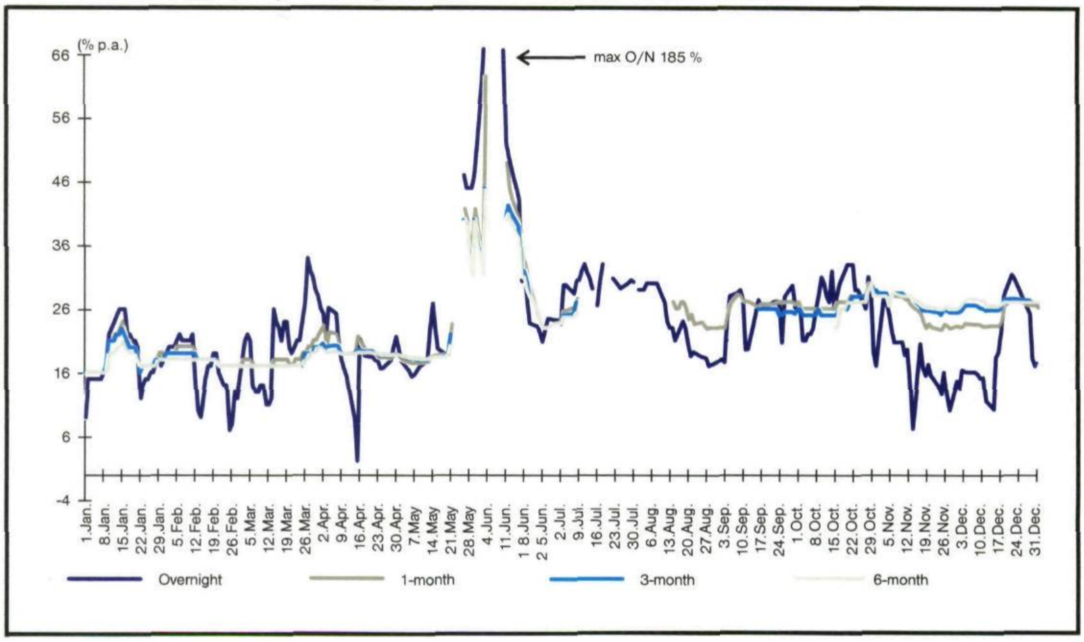
5.1.2 Secondary Market

In 1997, the money market was influenced by a newly-approved monetary program and, in particular, by its implementation. In pursuit of its monetary policy, the central bank's prime concern was to achieve quantitative goals, with an internally-set percentage of minimum required reserves chosen for the immediate target. Unlike in the previous period, money market interest rates ceased to be one of the final goals and, instead, were considered to be a product of the implementation of monetary policy. Interest rates were allowed to respond to actual market supply and demand, reflecting current shortages or surpluses of resources in the banking sector, even though the NBS could no longer regulate them at will. The uncertainty of the banking sector over liquidity injections from the central bank became an important momentum in the implementation of its monetary program. To that end, the listing of rates for individual repurchase operations (REPO) had been stopped, on the first business day of the calendar year. At the same time, the National Bank of Slovakia announced that block REPO deals - REPO tenders - would become the principal vehicle for open market operations. By moving to REPO tenders as the major money market instrument, the NBS completed its departure, started in 1996, from the market-making function to the adoption of an intervention-only strategy.

The NBS first few one-day tenders in both January periods fell short of actual refinancing needs of the banking sector. The money market response was instantaneous. Interest rates, depending on maturity, shot up from 400 to 1,000 base points and even when the situation somewhat subsided, stayed well above 18%, except for 6-month deposits. Additionally, a failure to meet the minimum reserve requirements on the first January check was followed by the aforementioned uncertainty effect, forcing banks to look for ways to break their refinancing dependence on NBS by raising money elsewhere. In the first period, banks tried to do this by foreign exchange fixing with the NBS at the cost of shortening some of their foreign exchange positions. Thanks to that, however, the banks were even able to surpass their reserve requirements in the second January period. On the other hand, this sort of uncertainty had its repercussions in rising and fairly erratic interest rates. That notwithstanding, the yield curve, showing expectations of possible developments, displayed an inverse relationship during the period. It may also be viewed as a positive thing that the NBS had a relative success in its first sterilisation REPO tenders, with which it tried to pull commercial banks back into their refinancing dependence. Apart from the upsurge in interest rates mentioned above, among other negative reactions to NBS policy was a general contraction of the money market, which was betrayed by a halving of trading volumes quoted and actually executed by the market's pacemakers - the reference banks. They also stopped listing a developing interbank REPO market for government securities. Although the market bounced back later in the month, it could not make it back to its original level by the end of year. February found the money market calming down, as average rates in all maturities edged down. A similar trend was observed in March. With banks still not knowing what the central bank was up to, interest rates stayed highly volatile, swaying between 6.8% and 21% in February and rising and falling between 11% and 33.8% in March. During that period, the NBS was mostly trying to drain liquidity by 7-day REPO tenders and by selling off parts of its portfolio. That was the picture until the end of the first quarter, when refinancing REPO tenders came back as the leading transaction, mostly with one-day redemption periods. In late March, the NBS influenced the crown market by conducting several individual transactions. All in all, the NBS refinancing activities in the first quarter had a slightly decreasing tendency, in particular owing to direct sales, and, at times, the balance of March transactions had a sterilising character.

In the second quarter, it was a different picture in the money market. Despite continued refinancing policy, average interest rates on all maturities, except one-day money, crossed the 19% mark in April already. At the same time, the yield curve began to level out. A breaking point came in May, when the situation in the national money market was largely affected by developments in the foreign exchange market. In the last ten-day period, the heavy demand of non-residents for foreign currencies depleted the foreign exchange reserves of domestic banks, which had to forfeit some of crown liquidity to fill up in NBS foreign exchange fixing. This led to a general decline in aggregate foreign exchange reserves. The NBS responded by winding down its refinancing activities, pressing banks to curb sales of foreign exchange. Prompted by a critical shortage of liquid crown funds, reference banks made an agreement to cut back on foreign exchange transactions, thereby helping to stabilise the foreign exchange market. When interest rates passed the 100% mark, trading in the money market stopped. Since interest rates were no longer bidding, BRIBOR ceased to be quoted on 29 May 1997. However, banks continued to follow the rate, calling it "interest rates monitoring". The only moving item was overnight money in limited amounts. Afflicted by a major shortage of liquid funds, the sector closed both May periods far below the prescribed required reserves target. The tensions in the money market continued in the last month of the second quarter. Driven by a lack of crown liquidity, average interest rates used as indicators climbed well above 30%, with overnight rate reaching 70% in the first ten-day period. The NBS, combining refinancing tenders with individual REPO transactions, started to increase its refinancing activities. During the first period, the refinancing through open market operations amounted to Sk 8.8 billion, rising to Sk 12.2 billion at the end of the second period. With Lombard loans provided during the period added, the NBS total refinancing activities in the period reached an even higher figure. The end of the first half of the year brought a paradoxical situation where, despite a lingering shortage of crown resources, rates charged in refinancing tenders tumbled from nearly 55% to almost 5% as a result of exhausted refinancing facilities of under-supplied banks. Taking advantage of the situation were banks involved in the redistribution of missing crown funds. The NBS responded with setting a lower interest rate limit at the level of the discount rate applied in its refinancing tenders. In foreign exchange, which had a major impact on the money market in the previous period, the NBS managed to check negative trends and bring its foreign exchange fixing back to a surplus in June. Despite signs of stabilisation in the financial market, banks again failed to meet their required reserve targets in both June periods.

Interbank offered rates (BRIBOR) in 1997



The second half of the year, in particular the third quarter, brought additional stability and some recovery from the May collapse. In July, reference banks confirmed the facultative character of listed rates and, by reducing the spread to 5% and tightening other conditions, helped the market renew its basic mechanisms. It was again possible to provide standard quotations to non-residents. With NBS foreign exchange fixing back to surpluses, the banking sector was able to measure up to its minimum reserve requirements in the second period of July. At the same time, the NBS was able to reduce its refinancing involvement to Sk 8.3 billion. An improved situation in crown liquidity at first sparked yet another increase in interest rates as banks tried to catch up on their required reserves. Later on, interest rates came to rest at around 26%. As another sign of stabilisation, the NBS successfully resumed direct sales of its portfolio holdings. The standard maturity for refinancing tenders in that period was 7 days. At the end of July, the market was disturbed by news of an intended 15% tax on government securities, bound to apply retroactively. The deposit market rates, along with rates applied in refinancing tenders, continued to decline. The NBS carried on its open market operations, dominated by tenders, and, to fine-tune liquidity, started to sell off technical issues of Treasury bills. In mid-September, the situation was so steady that reference banks reintroduced obligatory quoting of transactions with maturity of up to 2 weeks, inclusive. The buy/sell spread was narrowed to 2% and Sk 100 million was back as the standard transaction volume. In response to a deficit in foreign exchange fixing, fearing the May scenario might repeat, banks drove the money market rates beyond 26%. The rates were also fuelled by the state budget, especially when it became difficult to finance it by Treasury bills. The NBS helped relieve the serious fiscal predicament by buying technical issues up to the ceiling imposed by law. For that reason, the NBS had to halt its radical and continued retreat from refinancing involvement, away from the maximum at the beginning of August, for the period. The average volume of state budget refinancing reached Sk 7.6 billion in September, while direct refinancing of the banking sector through open market operations amounted to Sk 5.9 billion. The total involvement of the NBS was also influenced by an increased limit for bills of exchange discounts from Sk 1.5 billion to Sk 2.0 billion.

Average deposit rates on the interbank money market in 1997

	Overnight	7-day	14-day	1-month	2-month	3-month	6-month
January	18.82	18.53	18.77	18.82	18.72	18.63	17.85
February	16.20	18.12	18.30	18.29	18.16	18.04	17.63
March	19.97	18.20	18.09	17.71	17.35	17.30	17.15
April	18.71	19.96	19.94	19.92	19.43	19.36	19.09
May	26.75	25.77	25.12	24.27	23.83	23.78	23.61
June	53.91	42.34	40.76	33.80	32.48	31.48	30.89
July	29.58	28.06	26.23	25.46	25.22	24.93	24.45
August	23.63	24.96	23.31	24.70	-	-	-
September	25.18	26.20	26.09	26.51	26.50	25.66	-
October	27.18	27.48	27.28	27.00	26.59	26.17	26.68
November	17.71	22.00	23.06	25.52	26.61	26.93	27.10
December	18.55	21.18	21.71	24.42	25.54	26.48	26.92

Note: All average rates are calculated in days, when they were actually quoted

The reintroduction of BRIBOR in mid-October can be seen as a positive and very significant sign of a stabilising money market. Nevertheless, the listing obligation was not extended to additional maturities. For the first time in its refinancing tenders, the NBS accepted government bonds redeemable in up to one year, making it harder for some banks to use their excess liquidity for arbitrage transactions. The average refinancing volume in regular open market operations was scaled down to Sk 5.9 billion in October, parallel to ensuring compliance with required reserve obligations. As before, the NBS continued to cover the budget deficit with large purchases of technical Treasury-bill issues. To regulate liquidity in the banking sector, the central bank resold some of its portfolio holdings, clearing the way for further technical issues, if necessary. Coming into effect in November, a revision of the Income Tax Act did not affect the money market rates very much since it had been anticipated two months in advance. The deposit market saw the rates charged for individual maturities drift apart, as the yield curve edged up for the first time in the year. A slight relief in the budget deficit allowed the NBS to reduce its participation and overall refinancing exposure. At the same time, interest rates at the short-term end of the yield curve were able to go down to 25%. Even though the decline continued the next month, interest rates were still well above the level of early May. In November, there were quite serious problems with liquidity at Investičná a rozvojová banka (IRB), which eventually led to the imposition of receivership upon the bank in the second half of December. That is why the banking sector, as a whole, failed to comply with the reserve requirements for a seventh time in the year. Despite a slight decline at the year-end, the contrast between short-term and long-term interest rates had become even sharper.

All in all, the money market had a difficult time last year. Though betraying how fragile and incomplete its structure still is, the market clearly proved to be the spine of the entire financial market. The first shocks it had to sustain came right at the beginning of the year, when the NBS rethought old monetary policy and gave up its leading part in the market. Banks responded by influencing the money market by shortening redemption periods and moving the bulk of interbank trading to overnight deposits. Banks have tried to raise missing funds in the money market by reducing reciprocal limits, which in turn led to lower investment activity and demand for securities shown by rising rates in primary placements. The complexity of developments in the money market can also be documented by a less strong correlation between short-term (1- and 7-day) deposits and deposits made over longer periods of time (1-, 3-, and 6-month), which had previously been decisive for the investment market. Although the 1-month rate remained the principal indicator followed by the NBS, the central bank, given its new approach to the implementation of monetary policy, lost its direct control over this particular rate. A shift from one-day to 7-day refinancing tenders did have some beneficial effects, but it was still not enough to stabilise a market not knowing when and if a tender, i.e. fresh funds, would come along. The interbank market involving REPO deals in government securities also suffered a severe setback, as its trading volumes were just a fraction of the turnovers recorded year ago.

On top of changes in the execution of monetary policy, the money market was also tested by a major onslaught of speculators in the national currency from abroad. A positive aspect of almost ultimate reduction of this pressure is that it exposed the relationships between national monetary policy and foreign political events, as well as the need for the NBS to pursue consistent ends in the crown and foreign exchange markets alike.

5.2 Capital Market

5.2.1 Primary Market

Government Bonds

There were 11 issues of government bonds in 1997, designed to cover the 1996 budget deficit of Sk 27.9 billion. All of them had two things in common - a short redemption period (1 year) and an unlimited issue price. An extra two bond issues worth Sk 1.5 billion were brought out to finance the State Housing Development Fund. During the first half of the year, bond auctions were staged once a month, just as planned in a schedule published earlier. However, that period was marked by a considerable number of auctions not accepted by the Ministry of Finance, as well as for low placement volumes. Given their short maturity, the government bonds offered in the primary market were exposed to developments in the money market, which explains why yields have climbed up with each additional auction.

The second half of the year was marked by growing placement volumes. Auctions started to occur every two weeks, since there was still a large amount of government bond issues needed to cover the 1996 deficit. That, coupled with a sharply growing current budget deficit, had a major impact on the rising yields offered at government securities auctions. Another substantial factor behind the rise of yields in the primary market with government bonds was an announcement by the Ministry of Finance of the SR of its intention to start taxing coupons on government bonds.

Compared to 1996, it was good to see insurance houses and securities brokers grow more interested in government bond auctions. On the negative side, short redemption periods exposed the primary market with government bonds to the ailments of a problematic money market.

Publicly Negotiable Non-Government Bonds

Total issues of publicly negotiable non-government bonds reached Sk 7,284 million in 1997, some 67.28% down from the same period in 1996 (Sk 22,260 million).

More than half of the amount was floated in the first two months of the year in placements decided in 1996. A recession in the volume of bond issues that followed afterwards was largely due to uninterested investors who, attracted by rising money market rates, preferred short-term investments carrying higher yields.

5.2.2 Secondary Market

In the secondary market, the Bratislava Stock Exchange (BCPB) reported transactions totalling Sk 164.1 billion in 1997, a 44% rise from 1996. The figure comes as a projection of a rising curve of total trading volume started in previous years. Even though the increase in quantity of trading in the market is indisputable, its quality, measured in terms of liquidity, was missing last year. This is documented by a 63% fall in anonymous trading to Sk 5.9 billion (as opposed to Sk 15.8 billion in 1996).

The setback in trading on the BCPB floor can be blamed on unrelenting high interest rates, which made investors prefer the money market. Low liquidity in the capital market ultimately distorted prices and undermined the meaningfulness of official stock exchange indices (SAX and SDX).

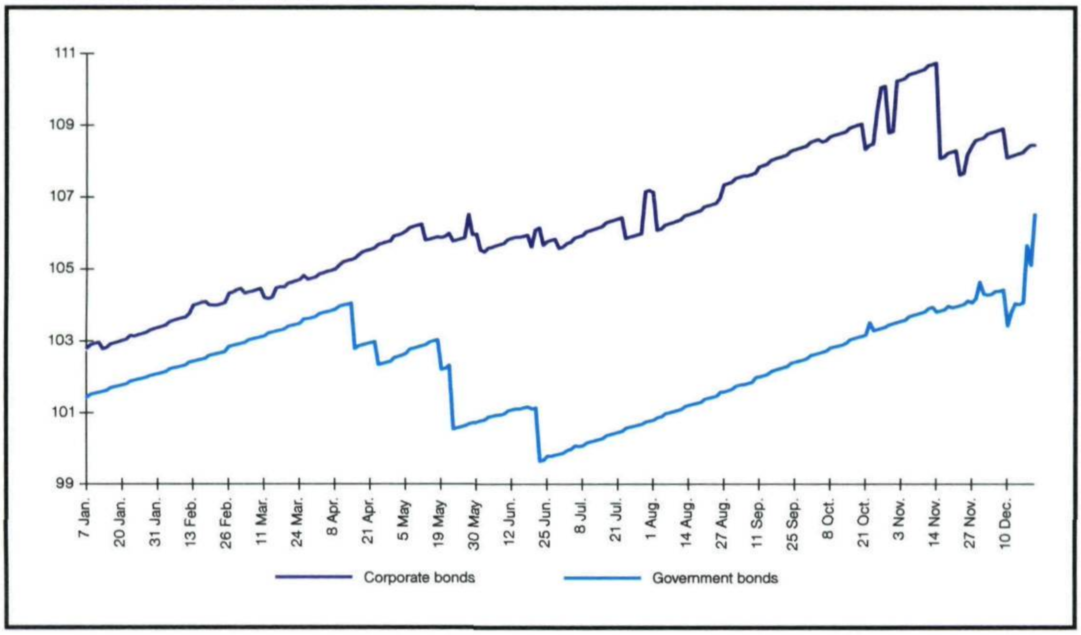
Compared to the end of 1996, the capital market made no headway last year. Despite the increase in aggregate trading stated above, the market's liquidity worsened, owing to the large share of direct transactions which do not have to be cleared via the BCPB. As a result, the meaningfulness of stock listings is unsatisfactory, failing to perform the price-setting functions of a capital market.

Save for the government sector, there is virtually no use of the capital market for raising funds. Corporate bond issues are still mostly meant to substitute bank loans and usually remain in the hands of the bank which initially subscribed the issue until maturity.

Bonds

As far as the individual types of securities traded on the BCPB are concerned, the exchange has seen bonds increase their share of total trading, as expected, to 49.6% in 1997 from 27.2% in 1996. The sum of all trades arrived at Sk 81.4 billion (up 126.7% in one year), as anonymous contracts amounted to Sk 3.6 billion (57% down in a year), and direct transactions to Sk 77.8 billion (up 244.9% in a year).

Slovak Bond Index (SDX) in 1997



In terms of trading volumes, government bonds clearly topped the list. Bond trading was depressed by rising interest rates in the money market, which naturally had investors fetching their margins from assets with shorter redemption periods. That also explains the unbroken spell of low liquidity that has afflicted bond trading on the BCPB floor in 1997.

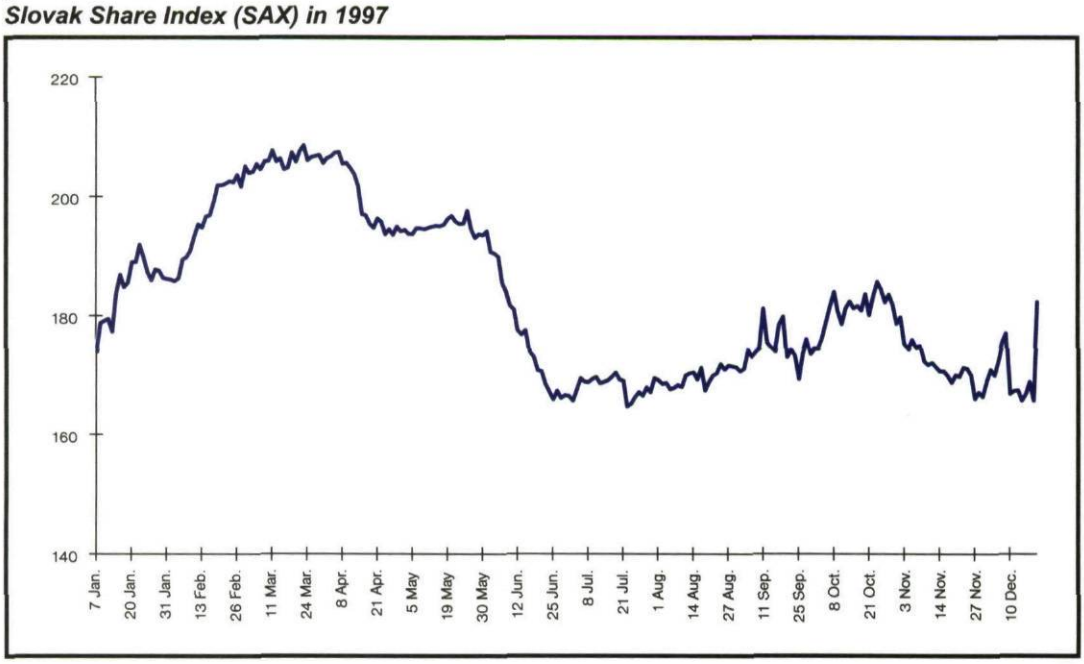
The most significant increase in volumes of traded bonds was seen in the last quarter, as bond holders traditionally re-evaluated their portfolios.

At the close of 1997, the market value of yet unredeemed bonds was reckoned at Sk 92.8 billion, with Sk 73.6 billion attributed to listed bonds and Sk 18.9 billion to bonds traded in the market with registered securities. Both components of the SDX index posted a slight increase from their readings at the end of 1996, with corporate and bank bonds gaining 6.12% and government bonds rising by 5.50%. A government bond portfolio with the SDX index at 106.52 points delivered an average yield to maturity of 18.170%, as opposed to 14.204% earned on a portfolio composed of corporate and bank bonds (SDX at 108.90 points). This comparison of yields on government and non-government bonds is quite intriguing: since government bonds are generally considered to be a risk-free investment, their superior yields over other bonds are likely to be temporary.

Shares

More than any other item, shares have suffered a sharp fall in trading, compared to 1996. Although the total turnover in shares totalled Sk 82.7 billion, dipping just 0.6% from 1996, an overwhelming part of the transactions was made directly (Sk 80.4 billion), mostly at unrealistic prices. The price-setting anonymous market was left trading a mere Sk 2.3 billion worth of shares which, compared to Sk 7.4 billion in 1996, represented a fall of 68.9%. The product of this is a non-transparent market, where even an insignificant amount traded can spell major price shifts. That way, the market prices can no longer be counted on to reflect the true value of shares.

Slovak Share Index (SAX) in 1997



SAX, an index designed to record price developments in shares, has gained 2.49% to 182.48 points in the year from the end of 1996. Low volumes of price-setting anonymous transactions and high price volatility caused SAX to fluctuate.

Over the year, the index experienced several major local swings. Until the end of March, SAX was headed upward, if with a few slight slips, to reach a maximum for the year of 208.64 points on 21 March. After keeping fairly steady through April and May, the index took an abrupt dive in the next two months, probably on fears of devaluation of the Slovak crown (reaching the lowest figure for the year of 164.81 points on 22 July). With shares gaining some liquidity in August and October, the index recovered to above 180 points only to go down again in the next two months. On the year's last trading day, SAX jumped 10% to close at 182.48 points, but its sharp single-day increase was sparked by an artificial 50% rise in the average price of VUB shares, which was enabled by the change of these shares' ISIN and a consequent non-existing allowable price range.

Security Holders

The structure of government bond holders was influenced by the redemption of maturing issues and their systematic replacement by new ones. The 13 government bond issues floated in 1997 were worth Sk 29,395 million, as compared to 8 issues redeemed for a total Sk 21,629 million.

Whereas the ranks of government bond holders barely changed during the first half of the year, there was a clear change in the structure of holders in the year's second half which, apart from the timetable for the redemption of old and issuance of new bonds, was also due to the issuer's late registration of new government bond issues with the Central Securities Depository of the Slovak Republic.

Non-residents formed a special group of portfolio investors, coming to hold 46% more bonds than at the end of 1996. In shares held by non-residents, the amount was slightly on the rise throughout the year.

5.3 Foreign Exchange Market

Foreign Exchange Fixing at the NBS

In 1997, the National Bank of Slovakia's foreign exchange fixing activities were influenced by transactions performed by Slovak and foreign banks, as well as domestic businesses, with the greatest impact registered in May and June.

Similarly as in 1996, foreign exchange fixing eventually accounted for 5.7% of total interbank foreign exchange operations. The volume of foreign exchange fixing transactions reached US$ 2,491.1 million in 1997, slipping 0.4% from the US$ 2,502.2 million reported a year ago. In the first two months, fixing trades continued in a slight growth recorded towards the end of 1996, as foreign investors started to purchase SKK to take advantage of a sharp increase in interests paid on crown deposits. Subsequently, there was a substantial decline in turnover in March and April, when foreign exchange fixing almost came to a halt. A major rebound in the next two months was boosted by Slovak commercial banks purchasing foreign exchange to pay off retiring foreign short-term investors, to replenish their short-term foreign exchange positions and, probably, also by businesses prepaying their liabilities in foreign currencies and deferring their foreign exchange receivables, with turnover peaking out in June (US$ 519.1 million). However, an overwhelming part of the deficit in foreign exchange fixing can be ascribed to residents who, driven by fears of devaluation of the Slovak crown, tried to safeguard foreign exchange funds. Their share in the deficit is estimated at 80%. The year's low in foreign exchange fixing was recorded in November, when there was no trading at all. In 1997, the number of transactions sank from 835 a year ago to 382, with the average transaction size more that doubling from US$ 3 million to US$ 6.5 million.

In terms of structure of currencies, there was no real change from 1996, as US$ accounted for the biggest share in trading with 59.8% (56.9% in 1996), followed by DEM with 40.2% (43.1% in 1996).

BasiccharacteristicsoftheSlovakforeignexchangemarketin1997

	US dollars			Deutsche marks			Other currencies			Total	
	Volume		Number	Volume		Number	Volume		Number	Volume	Number
	(US$ mn)	(%)	of trans.	(US$mn)	(%)	of trans.	(US$ mn)	(%)	of trans.	(US$ mn)	of trans.
Foreign exchange fixing	1,489.5	59.8	194	1,001.6	40.2	188				2,491.1	382
Transactions of Slovak banks, excluding foreign banks	28,894.0	70.3	11,607	9,726.9	23.7	6,741	2,455.4	6.0	1,834	41,076.3	20,182
Interbank foreign exchange market: fixing + Slovak banks with each other	30,383.5	69.7	11,801	10,728.5	24.6	6,929	2,455.4	5.6	1,834	43,567.4	20,564
Slovak banks with foreign banks	33,725.1	82.4	7,750	6,005.7	14.7	3,660	1,178.1	2.9	1,046	40,908.9	12,456
Slovak foreign exchange market - total	64,108.6	75.9	19,551	16,734.2	19.8	10,589	3,633.5	4.3	2,880	84,476.3	33,020

In 1997, the NBS made use of foreign exchange fixing to sell some US$ 164.8 million-worth of foreign currencies, in contrast to the previous year when it purchased US$ 358.9 million. The balance of trade involved the following currencies: US$ 19.2% and DEM 80.2%. In the first two months, foreign exchange fixing was dominated by money purchases, triggered by a rising inflow of short-term foreign capital. Foreign currencies started to sell in March, topping out in May when the NBS sold US$ 466.6 million.

Transactions between Slovak Banks

Transactions between Slovak banks played a dominant part in interbank foreign exchange market in 1997, accounting for an entire 93.8%. Their total annual turnover was US$ 41,076.3 million, which was a 1.3% decline from the US$ 41,613.5 million reported in 1996. Trading slowed down by 63.6% in May, with another 53.2% setback coming in June, due to flagging crown liquidity. The US dollar strengthened its trading position in 1997 to reach 70.3% (as opposed to 59% in 1996), tailed by the Deutsche mark with 23.7% (35.9% in 1996) and other currencies together taking 6% (5.1% in 1996). It is interesting to observe that the percentage of USD and DEM in the total volume is practically the opposite of their shares in the balance of foreign exchange fixing (USD 19.2% and DEM 80.2%). The total number of transactions was counted at 20,182 (21,586 transactions in 1996), representing an average 81 transactions a day (84 in 1996) with an average volume of US$ 2.0 million (US$ 1.9 million in 1996).

Transactions between Slovak and Foreign Banks

There was a substantial revival in trading between Slovak and foreign banks right from the beginning of the year. The volume of transactions that Slovak banks entered with their foreign counterparts added up to a total US$ 40,908.9 million, taking 48.4% of the entire foreign exchange market of Slovakia. In other words, this means that almost half of all transactions involving the Slovak crown was made with foreign banks. Considering that, in 1996, the same total was a mere US$ 7,956.2 million, this was a 5.1-fold increase. Showing a rising trend from the beginning of the year, trading kept on rising to hit a record maximum of US$ 7,075.7 million in April. The year's minimum was reached in June (US$ 1,703.2 million), after trading dropped 68% from the previous month. The fall was caused by a major erosion of crown liquidity in the banking sector. In total, 12,455 transaction were registered, with the average volume US$ 3.3 million (US$ 2.1 million in 1996). Most of the transactions involved the U.S. dollar (82.4%), followed by DEM (14.7%), and other European currencies accounting for a scant 2.9%.

The balance of these particular transactions created a surplus of US$ 178.7 million, meaning that purchases of foreign currencies from foreign banks prevailed. Whereas in 1996, the foreign exchange fixing balance was comparable to the total volume of foreign currency that Slovak banks purchased from foreign ones, with the foreign exchange balance copying the balance in trading with foreign banks all year long, in 1997 the correlation was no longer so strong and the foreign exchange fixing even ended with a deficit. Slovak banks conducted most of their money purchases from foreign banks in January (US$ 224 million). The largest total sales were registered in May (US$ 209 million).

In April 1996, when the NBS radically reassessed its access criteria for foreign exchange fixing, the activity of commercial banks also changed dramatically. Earlier, virtually all interbank foreign exchange trading was done by fixing transactions. The most radical change introduced in April 1996, was a trade margin of ±0.25% (14-15 haliers/US$) applied in the settlement of foreign exchange fixing transactions, which was a lot more that the common spread applied in the interbank foreign exchange market (1-2 haliers/US$). Foreign exchange fixing fell more or less immediately to a minimum, while turnovers in the interbank foreign exchange market in some months soared to a 20-fold of the previous volumes. Among those joining in the vibrant trading were non-residents, attracted by a vision of profits derived from considerable interest margins and a fairly stable SKK which, pegged to a currency basket, displayed good resistance to exchange rate fluctuations.

Ten-day and cumulative balances of foreign exchange fixing transactions and transactions between Slovak commercial banks and foreign banks