NÁRODNÁ BANKA SLOVENSKA

Annual Report 2004

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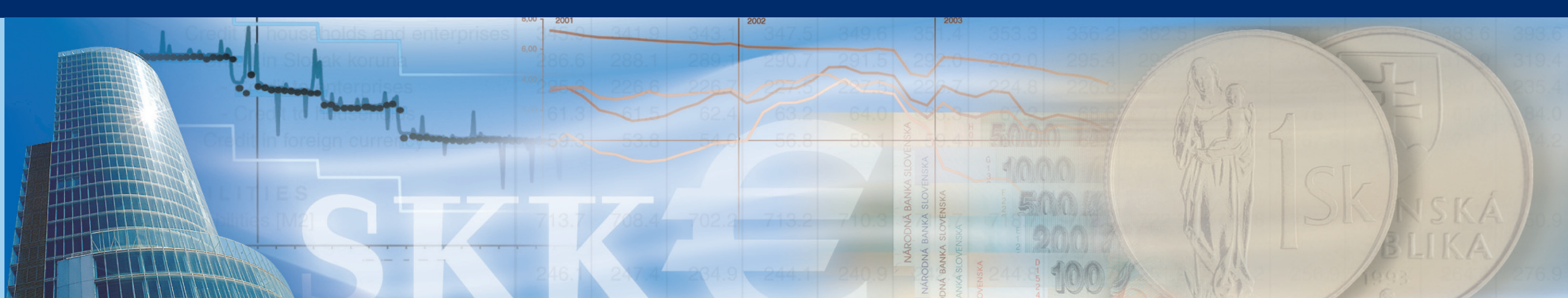

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2004

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Národná banka Slovenska
Imricha Karvaša 1
813 25 Bratislava
Slovakia

National Bank of Slovakia
Public Relations Department
tel.: +421/2/5787 2141
fax: +421/2/5787 1128

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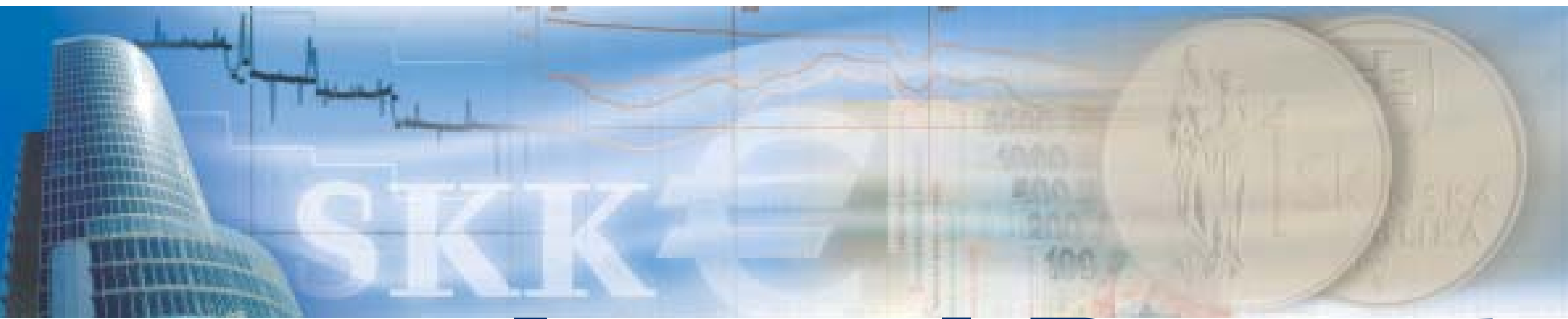

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Foreword

The Slovak Republic, together with nine other countries, became a member of the European Union on 1 May 2004. Within one year of our membership of this integrated community, the first positive signs are visible in the Slovak economy. One of the most significant is the growing interest in foreign direct investment. It was Slovakia's growing investment attractiveness which became a driving force behind last year's economic growth of 5.5%, which was 1 percentage point higher than in 2003. Hand in hand with the investment demand, renewed growth in final household consumption, resulting from real wage increases, better access to lending sources and partly also the tax reduction contributed to this economic recovery. Conversely, the increase in the net export deficit had a moderately dampening effect on the economy. This however was related to production technology imports connected with foreign direct investments.

In comparison with 2003, consumer prices growth slowed by 3.4 percentage points to 5.9%, while the price development in 2004 was to a significant extent determined by adjustments to regulated prices and indirect taxes. This is seen in the relatively low level of core inflation of 1.5 % (compared to 3 % in 2003). Its decreasing dynamics was to a large extent influenc ed by foodstuff prices and also by the appreciation of the exchange rate of the Slovak koruna (vis-à-vis the euro and the US dollar), which was reflected in a price reduction in the so-called tradable goods. In other words, the Slovak Republic imported deflation last year.

In monetary policy implementation, with regard to the key interest rates, room was created in the course of the year for their gradual reduction by a total of 2 percentage points. In the environment of decreasing inflation, these cuts were designed to boost domestic demand and eliminate growing speculative pressures on the unwarranted appreciation of the Slovak koruna. Through the interest rates reduction the National Bank of Slovakia mitigated the restrictive effects of the exchange rate, while the overall impact of the monetary policy was neutral.

In addition to these cuts, the National Bank of Slovakia responded to the excessive exchange rate strengthening by foreign exchange market interventions as well as by several verbal warnings of the risks associated with such developments.

In connection with the introduction of the euro in the Slovak Republic and with the central bank's role in this process, it is noteworthy that the Slovak government adopted a document "Specification of the Strategy for Adopting the Euro in the SR" in September 2004, according to which the introduction of the euro is realistic in 2009.

In its documents and public announcements, the National Bank of Slovakia has repeatedly emphasised the advantages of Slovakia's membership in the euro area. The NBS is playing an active role in preparing the country for this significant change in order to enable the smooth implementation of the single currency so that its positive effects are felt as strongly as possible in all segments of economic life, while at the same time minimizing all foreseeable costs. These specific steps will be discussed in a joint document of the Ministry of Finance of the SR and the National Bank of Slovakia called "The National Plan for Adopting the Euro in the Slovak Republic".

However, the country must meet the so-called Maastricht criteria in a sustainable manner in order to qualify for the euro area entry. The National Bank of Slovakia is aware of the formidable challenge for its monetary policy in meeting these criteria, especially those relating to price stability and exchange rate. Bearing this in mind, the NBS has modified its monetary policy strategy and, as of 2005, it defined its strategy as inflation targeting in the ERM II conditions (Monetary Programme until 2008). On one hand, it has formulated an unambiguous monetary policy orientation to price stability in compliance with meeting its inflation criteria. On the other hand, this strategy has made it possible to take into account the necessity of meeting the exchange rate criteria and complying with the ERM II conditions.

The change in the monetary policy strategy and the explicit definition of inflation targets have been possible due to a considerable reduction in administrative price adjustments this year and the years to come, thus reinforcing the credibility of the gradual disinflationary process. This commitment has also been supported by the consistent budgetary policy of the government and its commitment to gradual reduction of the public finance deficit.

As at 31 December 2004, a total of eighteen banks, three branches of foreign banks, forty eight providers of free cross-border banking services, and seven representative offices of foreign banks were operating in the Slovak banking sector. Following the Slovak Republic's accession to the European Union the provisions of the Act on Banks entered into force, on the basis of which credit institutions registered in the European Economic Area (all EU member states plus Norway, Lichtenstein and Iceland) may conduct banking activities in the Slovak Republic without a banking licence granted by the National Bank of Slovakia, provided the bank has been granted a banking licence in its home state (the principle of a single banking licence). In 2004, the already launched trend of the risk-based supervision was fully manifested. In the period under review, the Banking Supervision Division focused on the implementation of rules relating to additional supervision of financial conglomerates, as well as on the preparation of the legal framework of integrated supervision of the financial market. The positive development of the Slovak banking sector was evidenced inter alia by an SKK 177 billion year-on-year growth in total assets of the entire banking sector. As at 31 December 2004, the banks reported assets of SKK 1.16 trillion and profits of SKK 12 billion.

The year 2004 was extraordinary for the National Bank of Slovakia as to its cash circulation function. In accordance with the adopted policy to store and process money exclusively in the NBS-owned vaults and processing facilities, starting on 1 October 2004, issuing activities began in new buildings of the NBS subbranches in Trenčín, Nové Zámky, Žilina, Lučenec, Poprad and Humenné. Last year, the National Bank of Slovakia removed the 10 and 20 halier coins from circulation and supervised their gradual liquidation.

In its capacity as operator of the SIPS interbank payment system and in an effort to enhance its smooth running, the National Bank of Slovakia introduced the provision of intraday credit on 1 January 2004. And as of 1 April 2004, it extended the functionality of the SIPS payment system to the real-time settlement of payments. In 2004, the strategy concerning the further development of the payment system in the Slovak Republic following the European Union entry was approved. This included especially the linking of the National Bank of Slovakia to the TARGET 2 payment system, inclusion of the euro in the SIPS payment system and the harmonisation of the procedures concerning the low-value cross-border payments in euros within the territory of the European Union.

June 2005

Ivan Šramko
Governor

Members of the NBS Bank Board as at 31 December 2004

Front row (left to right):
Karol Mrva, Chief Executive Director, Trade and Foreign Exchange Division
Elena Kohútiková, Deputy Governor
Marián Jusko, Governor
Ivan Šramko, Deputy Governor
Martin Barto (from 1 December 2004)

Back row (left to right):
Peter Ševčovic, Chief Executive Director, Monetary Division
Ladislav Balko, Comenius University, Faculty of Law
Ján Mathes, Chief Executive Director, Currency Division

Jozef Košnár was a member of the NBS Bank Board until 30 November 2004.