NÁRODNÁ BANKA SLOVENSKA

Annual Report 2005

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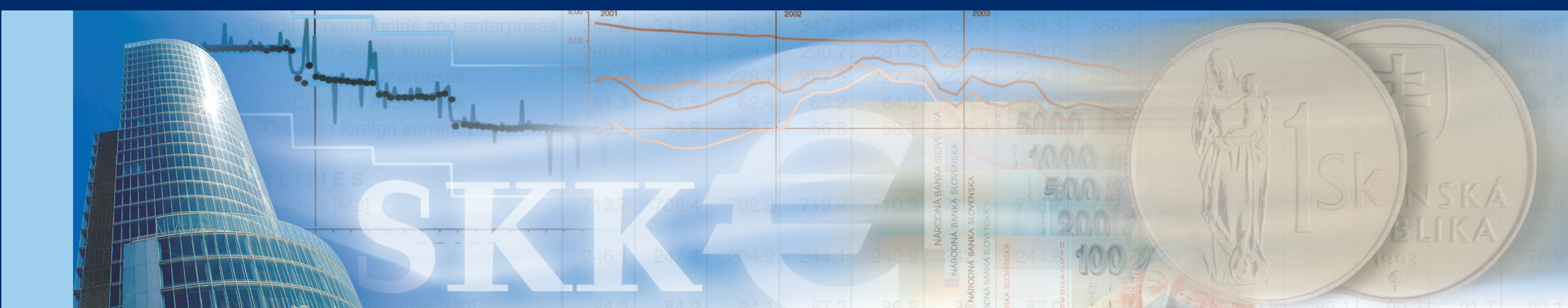

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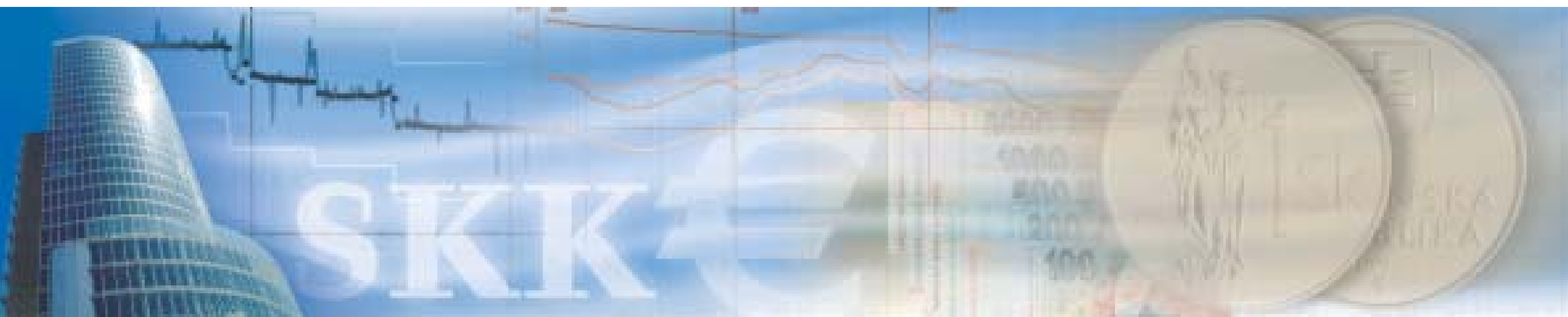

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Foreword

In 2005 the Slovak economy has come to feel the effects of the ongoing reform process and integration efforts, with the National Bank of Slovakia playing its part as well. This resulted in a gradual convergence in both real and nominal terms. The price and wage levels converged and the gross domestic product level was catching up, as implemented reforms created favourable conditions for the strong economic growth recorded until now, as well as for growth outlooks.

Following its Monetary Programme untill 2008, since early 2005 the NBS has pursued an inflation targeting strategy within ERM II, with inflation targets set as the main anchor for the NBS‘ monetary policy. As a result, the monetary policy of the NBS now explicitly aims at price stability, while allowing for the meeting of the Maastricht criteria (inflation and exchange rate) and respecting the ERM II mechanisms.

In connection with the new monetary policy strategy, in early 2005 the Bank Board approved the NBS Communication Strategy untill the year 2009. Monetary programmes were replaced by medium-term forecasts, published quarterly. In May 2005, the NBS started publishing the outcome of votes held at the previous month’s Bank Board meeting and from the end of the year the voting results have been published on the date of decision. Communication on monetary policy issues has been closely co-ordinated with Slovakia’s national communication strategy for the adoption of the euro.

Economic and monetary developments in 2005 were marked by a slowdown in price growth, accelerating economic activity, continuing consolidation in public finance, the Slovak koruna appreciating against the euro, and a relatively dynamic growth in bank lending to both households and businesses.

Price growth slowed down considerably in early 2005 already, mainly due to smaller changes in regulated prices compared to 2004. However, the lower year-on-year inflation measured by the harmonised index of consumer prices (HICP) was also affected by low imported inflation, reflecting developments in the exchange rate of the Slovak koruna, as well as by strong retail competition. In the last quarter of 2005, a rise in regulated prices had an upward effect on the price level. Nevertheless, HICP ended the year below the upper limit of the 2005 target range.

Economic growth accelerated in comparison with the previous year to reach a new high since 1996. The structure of economic growth was balanced, driven by both domestic and foreign demand. GDP growth was dampened by net exports, with higher imports fuelled mainly by a robust investment demand and, to a lesser extent, consumer demand.

In 2005, the ratio of the deficit in the current account of the balance of payments to GDP increased as compared to 2004. The increase was partly due to a larger deficit in the balance of trade. For the most part, however, it stemmed from the income balance, due to higher dividend payments coupled with a change in the methodology requiring disclosure of reinvested earnings from 2005 onward.

In an environment of robust economic growth, the conduct of the NBS’ monetary policy, in line with its objective, focused on maintaining price stability and meeting the inflation target not only for 2005, but also in the medium run. In the face of an unduly rapid exchange rate appreciation in early 2005, straying from the equilibrium paths, the National Bank of Slovakia resorted to foreign exchange market interventions in February and stopped accepting commercial bank bids in regular sterilisation repo tenders. The NBS Bank Board decided, effective from 1 March 2005, to lower its key interest rate by 1 percentage point, to 3.0%.

As a result, appreciation pressures subsided and at the same time, partly as a consequence of regional factors, the trends were realigned. In the following period the exchange rate showed a volatile pattern, recording another major gain in the wake of Slovakia's ERM II entry.

The increase in regulated prices, against the backdrop of a strong real wage growth outstripping productivity and a rapid economic growth implying a closing of the negative output gap, gave rise to the risk of secondary effects and higher inflation expectations. That is why in October 2005 the NBS started, in its rationales behind the decisions of the Bank Board on the set levels of interest rates, to alert to these risks and to the possible need to tighten the monetary policy in the period ahead.

In 2005, steps were taken to carry out the implementation plan for integrated financial market supervision (covering the banking sector, capital market, insurance sector, and pension saving schemes) as set out in a Slovak government resolution. In the process of integrating financial market supervision, and following the law, the Financial Market Authority was abolished on 1 January 2006, with its full jurisdiction taken over by the National Bank of Slovakia. The purpose of integrated supervision over the financial market is to contribute to the stability of the financial market as a whole, as well as to its safe and sound functioning in order to maintain its credibility, protect customers, and respect competition rules.

As regards banking regulation, considerable drafting efforts were made in 2005 to remove several shortcomings in decrees and methodological guidelines prepared by the Banking Supervision Division and to introduce qualitative risk management requirements laid down in the amended European Union Directives into the NBS decree on risks and the risk management system.

In 2005, the National Bank of Slovakia continued to operate the interbank payment system SIPS, seeking to enhance the security and smooth processing and settlement of interbank payments. During the year, it worked on a TARGET2 payment system project. The National Bank of Slovakia agreed to join the forthcoming TARGET2 platform no later than on the date of introduction of the euro as single currency in Slovakia.

2005 was the first year the issue and management of the stock of the Slovak currency took place exclusively in the NBS' own ten storage and processing sites. This facilitated a more efficient and flexible management of currency in circulation.

At the national centre for the analysis and monitoring of counterfeit banknotes and coins, the currency division has verified suspicious national and foreign currency banknotes and coins, provided expert opinions to law enforcement authorities and reported information to the euro counterfeits monitoring system run by the ECB.

The NBS has played an active role in preparations for the adoption of the euro in Slovakia and in implementing the Strategy for Adopting the Euro in the Slovak Republic. It was closely involved in the drafting of the National Euro Changeover Plan for the Slovak Republic and has performed all tasks it was assigned in the National Plan so far.

On 28 November 2005, the Slovak koruna entered the exchange rate mechanism ERM II at a central rate of 38.4550 koruna per euro. Upon ERM II entry, Slovakia made a commitment to continue pursuing a sound fiscal policy and to support a wage growth correlated to productivity. This policy fully complies with Slovakia's Convergence Programme and the NBS Monetary Programme.

As part of the ESCB, the NBS has taken an active part in the Common ESCB Training and open seminars for ECB and NCB staff. On a bilateral level, the NBS has also organised training activities, in particular expert consultations and secondments, for staff of selected central banks, especially from the new EU member states. There has been an uptrend in the NBS' training activities on an international scale, in particular through offering cross-border technical assistance to central banks in the countries outside the European Union.

Ivan Šramko
Governor

June 2006

Members of the NBS Bank Board as at 31 December 2005

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

Back row (left to right):
Peter Ševčovic, Chief Executive Director, Monetary Division
Milena Koreňová, Chief Executive Director, Financial Management and Payments System Division
Ladislav Balko, Comenius University, Faculty of Law