

**B. REPORT ON MONETARY DEVELOPMENT IN THE SR IN 2002**





## 1. ECONOMIC DEVELOPMENTS

### 1.1. Price developments

#### Consumer prices

In 2002, the rate of increase in consumer prices slowed in comparison with 2001, when the 12-month rate of inflation, expressed in terms of the consumer price index, reached 3.4% in December (compared with 6.5% in the same period a year before). The average rate of consumer-price inflation stood at 3.3% in 2002.

The fall in the year-on-year dynamics of consumer prices in 2002 (compared with the previous year) was due to a slowdown in the rate of price increase in all basic categories of the consumer basket. Of the total increase in consumer prices (3.4%), core inflation accounted for 1.46 percentage points. Administrative adjustments to regulated prices contributed 1.50 percentage points (compared with 4.17 points in

2001 and 4.51 points in 2000) to the total increase in consumer prices. In non-regulated prices, adjustments to indirect tax rates contributed 0.41 of a percentage point to the rise in overall inflation. In 2002, the increase in price levels was ascribable, as in previous years, to administrative measures.

The 12-month rate of consumer-price inflation fluctuated below the level of December 2001 throughout the year. Consumer prices followed a divergent course of development in the first and second halves of the year, with the rate of increase showing a tendency to slow until July and then accelerating slightly from August.

The slowdown in the rate of price increase in the first half of the year, was caused by the synergic effect of external and, in particular, internal cost factors. The effect of external cost factors was connected with volatile development in the prices of energy-producing raw materials and the appreciation of the Slovak koruna vis-à-vis the US dollar. The low level of domestic cost pressure was due mostly to the suspension of, or slow-



**Consumer price developments****(same period a year before = 100)**

Structure of the consumer basket	2000	2001	2002			
			March	June	Sept.	Dec.
Total in %	8.4	6.5	3.6	2.6	2.8	3.4
Regulated prices in %	20.7	17.2	5.1	5.5	5.3	6.5
<i>Share of total, in percentage points</i>	4.51	4.17	1.18	1.27	1.22	1.50
<b>Effect of changes in indirect taxes on non-regulated prices –</b>						
<b>share of total, in percentage points</b>	0.31	-0.03	0.35	0.35	0.35	0.41
<b>Core inflation in %</b>	<b>4.6</b>	<b>3.2</b>	<b>2.7</b>	<b>1.2</b>	<b>1.6</b>	<b>1.9</b>
<i>Share of total, in percentage points</i>	3.55	2.39	2.10	0.95	1.24	1.46
of which:						
Food prices in %	6.0	3.7	4.2	0.0	0.1	-0.2
<i>Share of total, in percentage points</i>	1.38	0.83	0.88	0.00	0.02	-0.04
Tradable goods in % <sup>1/</sup>	2.6	1.0	1.3	0.7	1.9	2.8
<i>Share of total, in percentage points <sup>1/</sup></i>	0.99	0.35	0.49	0.27	0.70	1.05
Market services in % <sup>1/</sup>	7.5	7.7	4.1	3.8	2.8	2.5
<i>Share of total, in percentage points <sup>1/</sup></i>	1.20	1.22	0.74	0.67	0.52	0.45
Net inflation (excluding the effect of changes in indirect taxes) in % <sup>2/</sup>	4.1	3.0	2.2	1.7	2.2	2.7
<i>Share of total, in percentage points</i>	2.18	1.56	1.22	0.94	1.22	1.50

Source: Statistical Office of the SR (data for 2000 and 2001 are end-of-period figures).

1/ Estimates of the NBS based on data from the Statistical Office of the SR.

2/ Net inflation – includes price increases in tradable goods (excluding foods) and market services.

down in, the process of price deregulation and a moderate year-on-year fall in food prices.

During the second half of the year, the rates of overall and core inflation rose somewhat. This was due to an increase in fuel prices, which reacted to the rise in the world market price of oil. The effect of oil prices was dampened to a certain extent by the appreciation of the Slovak koruna vis-à-vis the US dollar. Another factor that contributed to the slight but steady increase in the rate of overall inflation, was the adjustment of regulated prices.

**Regulated prices**

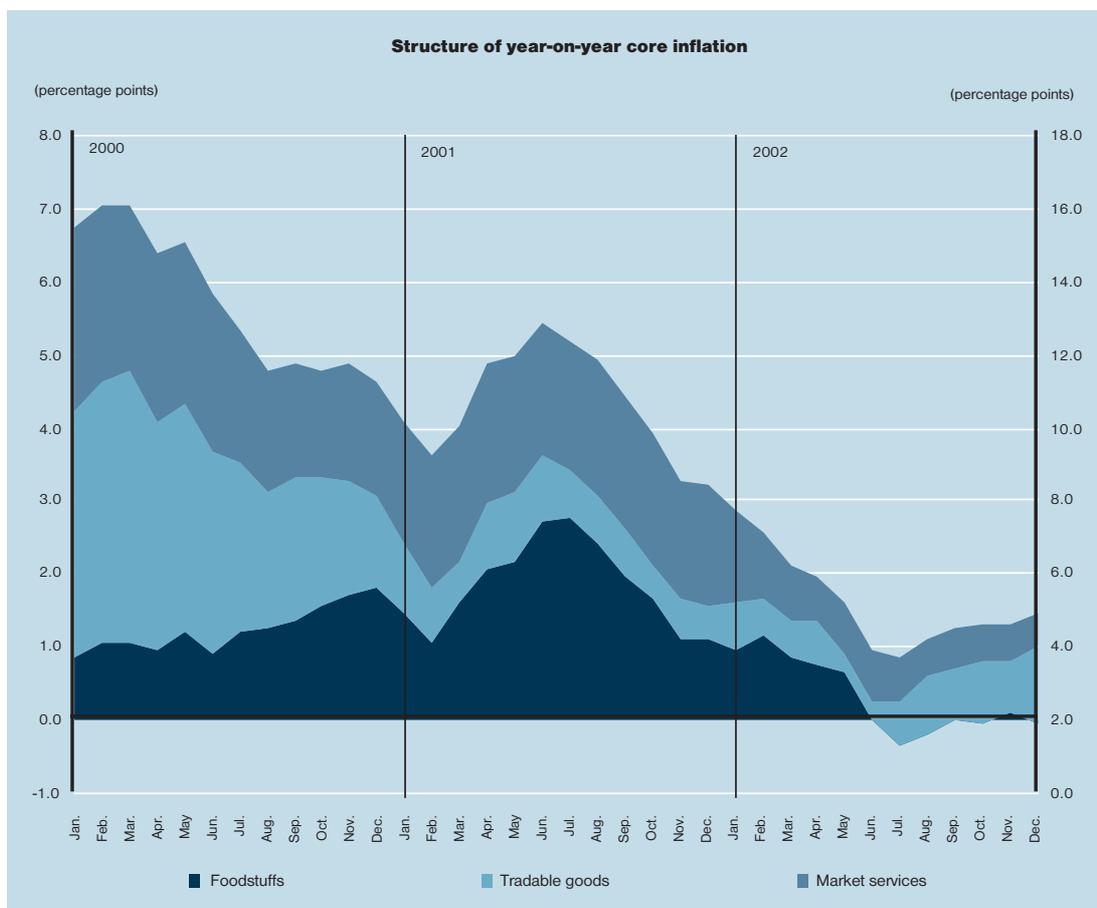
Despite a slowdown in price deregulation in 2002, the factor determining the development of consumer prices was, as in previous years, the application of administrative measures in the area of regulated prices. Regulated prices rose year-on-year by 6.5% (compared with 17.2% in

2001) and accounted for roughly one third of the total price increase.

Of regulated prices, January saw an increase in the price of heating, charges for the disposal of solid waste, prices in health care, and in prices for meals at educational facilities. During the year, adjustments were made to prices for telecommunications services, accommodation at university colleges, health services, and the price of compulsory insurance for motor vehicles (in December).

**Changes in indirect taxes**

Price development in 2002 was also affected by changes in indirect taxes, mainly adjustments to excise duties on tobacco and cigarettes with effect from January. The final effect of changes in indirect tax rates was a rise of 0.41 of a percentage point in overall inflation.



## Core inflation

In December 2002, core inflation reached 1.9%, representing a fall of 1.3 percentage points in comparison with the same period in 2001. Its course during the year was characterised on the one hand by an increase in fuel prices, caused by a rise in the world market price of oil, and by a fall in food prices and stable development in the other components of core inflation on the other. This led to stagnation in net inflation (the prices of market services and tradable goods excluding foodstuffs), adjusted for the effects of fuel prices, within the range of 1.7 to 2.5% throughout the year.

The downward trend in core inflation, which persisted from the beginning of the year to July, was connected with the absence of cost stimuli on the input side. The effect of this factor culminated in July, when the rate of core inflation reached 1.2%. Due to a modest price increase

in the second half of 2001, the 12-month rate of core inflation started to rise slowly but surely in August 2002 (base effect).

Food prices (excluding non-alcoholic beverages), as a component of core inflation, recorded a year-on-year fall of 0.2% at the end of the year. Apart from the absence of cost pressures, food prices were affected by the excess of supply over demand for basic food commodities, mainly the abundant supply of meat. Of food prices, vegetable and fruit prices fell seasonally during the summer months. Up to May, food prices had had an upward effect on core inflation, when their year-on-year dynamics had ranged from 3.0 to 5.6%. June saw a marked month-on-month fall in the price of fruit, vegetables, and meat. In July, food prices fell further and also recorded a record fall on a year-on-year basis (1.7%). From that time, the year-on-year dynamics of food prices were basically stagnant, with a few periods of moderate growth or fall.

The trend in food prices was determined by the price of unprocessed foodstuffs. Increased seasonality in comparison with the previous year, was shown by the volatile prices of fruit and vegetables in particular. Meat prices were affected by the widely publicised news about BSE disease, and the abundant supply of pork on the market, partly from cheap imports from the Czech Republic (the surplus of pork and the resulting pressure on price levels was recorded in the rest of Europe as well). Thus, while the prices of processed foods followed a stable course (except for the first two months, they fluctuated within the range of 2.3-2.9% throughout the year), the year-on-year dynamics of prices fell across the whole foodstuffs sector.

The rate of core inflation was dampened by the prices of tradable goods, the year-on-year dynamics of which reached 2.8% in December. The slow rate of price increase in the tradable sector was due to several factors. In the given environment, marked by strong competition in the retail trade, the growth in domestic demand exerted no undue pressure for a rise in price levels. On the consumer market, characterised by a large proportion of imported goods, the slowdown in the rate of price increase in the tradable sector was supported by the appreciation of the koruna in relation to the reference currency (euro).

In the sector of tradable goods, increased volatility was recorded in fuel prices, which reacted flexibly to changes in the price of oil, the exchange rate of the koruna to the dollar, and to developments in fuel prices on the commodity markets. From January to December, the price of oil increased steadily, from US\$ 20.5/barrel in January to US\$ 28.4/barrel in December. For most of the year, the price of this strategic commodity fluctuated within US\$ 22-28/barrel, i.e. the reference band declared by the Organisation of Petroleum Exporting Countries (OPEC). Thus, fuel prices recorded a year-on-year fall of over 10% in 2002 (in May and June), but closed the year with a year-on-year increase of 0.5% and contributed roughly

0.02 of a percentage point to the rise in core inflation.

The prices of market services, which are determined mostly by domestic factors, increased at a faster rate than prices in other categories of core inflation, but showed a tendency to fall throughout the year. At the end of December, the year-on-year rate of price increase in this segment reached 2.5%, which was roughly 5.2 percentage points less than in the same period a year before. The absence of increased costs in connection with the rise in energy prices, created conditions for a slowdown in the rate of increase in prices for market services. The slowest increase was recorded in prices for services related to housing, which have the largest share in the services sector, and in prices for recreation and restaurant services.

### **Producer prices**

Producer prices in 2002 were affected by the prices of imported energy-producing and other industrial raw materials, the appreciation of the Slovak currency vis-à-vis the US dollar, the suspension of adjustments to domestic energy prices, and the situation in primary agricultural production, where demand for basic commodities was exceeded by supply throughout the year. These factors resulted in a fall in the dynamics of industrial producer prices, including the price of materials and products used in construction, as well as the price of construction work. The average prices of agricultural products fell in comparison with the previous year.

### **Industrial producer prices**

The slowdown in the 12-month rate of increase in industrial producer prices (by 4.5 percentage points against the previous year, to 2.1%) was due to the effects of domestic cost factors, mainly the price of electricity, gas, steam and hot water, the weaker dynamics of which were connected with the postponement of numerous important

**Producer price developments (average for the period, same period a year before = 100)**

	2000	2001	2002				Year
			Q1	Q2	Q3	Q4	
Industrial producer prices	109.8	106.6	102.1	101.9	102.1	102.2	102.1
Price of mining and quarrying products	111.8	108.5	104.9	107.9	108.2	108.7	107.4
Price of industrial products	109.1	104.5	99.4	100.4	101.4	101.9	100.7
Price of electricity, gas, steam, and hot water	113.1	116.6	112.6	106.6	104.7	103.3	106.7
Construction prices	109.0	106.8	105.6	104.8	105.0	105.0	105.1
Building material prices	106.0	106.8	103.7	103.3	102.8	103.0	103.2
Agricultural prices	107.2	107.8	100.9	99.4	99.1	98.4	99.3
Price of plant products	107.2	111.2	97.9	92.8	100.6	98.1	98.8
Price of animal products	107.1	106.6	101.5	100.2	98.3	98.4	99.4

deregulation measures in 2002. The less pronounced increase in energy prices was reflected in the prices of industrial products (a rise of 0.7%, compared with 4.5% in 2001), mainly in energy-intensive sectors, such as the production of rubber and plastic goods (a rise of 1.1%) or the chemical industry, where prices remained below the level of the previous year (a fall of 1.1%).

Apart from energy prices, the rate of increase in the prices of industrial products was dampened by the prices of foodstuffs, beverages, and tobacco (a rise of 1.7%, compared with 7.7% in 2001), the development of which was connected with energy prices and the situation in agricultural primary production. Prices in food processing underwent two different stages in 2002: they showed a moderate fall in dynamics over the first half of year, then accelerated steadily from July, to 2.0% in December.

The stable development of external cost factors (the price of oil, pulp, and metals on the world market) and the appreciation of the Sk vis-à-vis the US\$ also contributed to the positive trend in industrial producer prices, mainly the prices of industrial products. With the exception of the first two months, the price of oil fluctuated during the year within the band of US\$ 22–28/barrel set by OPEC, as a result of which the average price of refined oil products remained unchanged (after rising by 0.1% in 2001). The price of metals and finished metal products rose by 1% (in 2001 by

8.6%), while paper products were 0.7% cheaper on average (the price was 3% higher in 2001).

**Construction prices**

Construction prices increased year-on-year by 5.1% in 2002 (in 2001 by 6.8%), due to a rise in the price of repair and maintenance work in construction (5.5%) and work on new construction, modernisation, and reconstruction projects (5.0%). In new construction projects, the steepest price increases were recorded in civil engineering projects (mainly railways), and to a lesser extent in non-residential construction.

The prices of materials and products used in construction increased on a year-on-year basis by 3.2% (in 2001 by 6.8%), when the price of materials used in new construction, modernisation, and reconstruction projects showed the same dynamics, and the price of materials used in repair and maintenance work rose year-on-year by 3.1%.

**Agricultural prices**

Agricultural prices fell by an average of 0.7% in 2002 (after rising by 7.8% in 2001), due to a fall in the price of plant products (1.2%, compared with 11.2% in 2001) as well as animal products (0.6%, compared with 6.6% in 2001).

**Development of the GDP deflator**

(average for the period, same period a year before = 100)

	2000	2001	2002				Year
			Q1	Q2	Q3	Q4	
Consumer prices	112.0	107.3	104.7	103.1	102.5	103.1	103.3
Industrial producer prices	110.8	106.5	102.1	101.9	102.1	102.2	102.1
GDP deflator	106.4	105.4	103.8	103.9	103.8	104.3	104.0
Export deflator	112.4	105.4	102.7	98.3	101.1	100.7	100.7
Import deflator	112.0	108.4	103.8	98.9	99.1	98.0	99.8

The fall in the price of plant products was due mainly to cereal prices (falling by 3.9%), which were affected throughout the year by a permanent excess of supply over demand (due to bumper crop in 2001). Vegetable prices also fell on a year-on-year basis. At the same time, the prices of other plant products increased (the price of oil-seed by 9.2% and that of potatoes by 7.9%). The prices of animal products were affected mainly by a fall in the price of pigs (3.2%) and cattle (0.4%) as a result of increased supply backed by cheap imports.

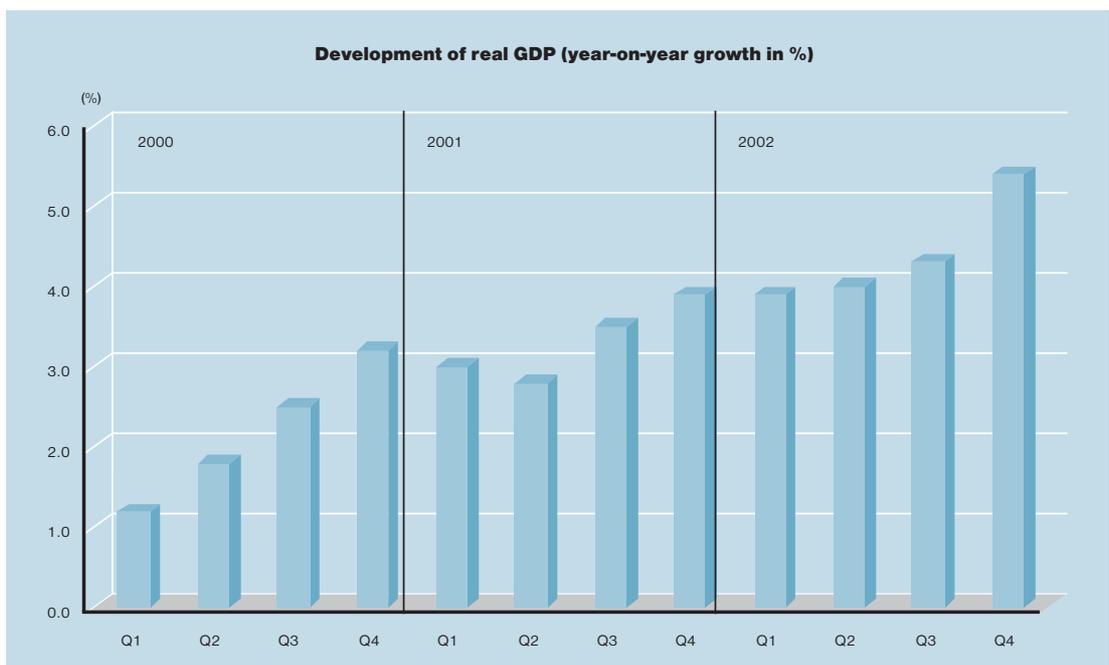
**GDP deflator**

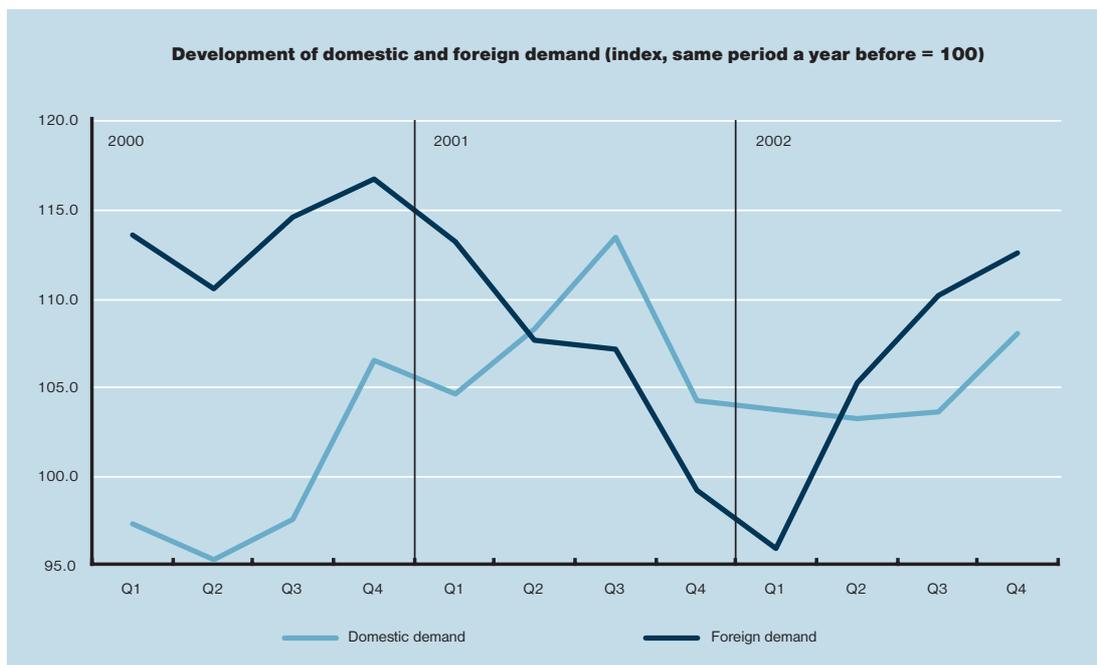
The increase in GDP deflator slowed, in line with the fall in the dynamics of consumer and domestic producer prices, from 5.4% in 2001 to

4.0% in 2002. This figure represented an all-time low, but exceeded the rate of increase in consumer and industrial producer prices.

The GDP deflator was affected by the deflator of domestic demand and the relationship between the export and import deflators. The increase in the domestic demand deflator (2.5%) was due to growth in the final consumption deflator and that of gross investment. The relatively marked change in prices in the segment of gross investment was due to increase/decrease in inventories in terms of price. The increase in the deflator of final household consumption (2.4%) reached its lowest level ever recorded, emulating the rate of inflation.

An upward effect on the GDP deflator was exerted by the development of foreign trade





deflators. Export prices developed in line with the fall in dynamics of industrial producer prices. The fall in import prices was due mainly to exchange rate effects and the prices of imported commodities.

## 1.2. Gross domestic product

The development of gross domestic product (GDP) in 2002 followed the trend of acceleration in the rate of economic growth in Slovakia. Compared with the previous year, GDP increased by 4.4% at constant prices (compared with 3.3% in 2001). The rate of economic growth accelerated gradually, from 3.9% in the 1st quarter and 4.0% in the 2nd quarter to 4.3% in the

3rd quarter and 5.4% in the final quarter. Thus, the rate of GDP growth reached the highest figure in the last five years. The volume of GDP at current prices amounted to Sk 1,073.6 billion, which was 8.5% more than a year earlier.

The structure of GDP by use showed a favourable tendency in 2002. Domestic demand increased by 4.7% (compared with 7.5% in 2001). Foreign demand (exports of goods and services) grew at a faster rate (5.9%, compared with 6.5% in 2001) than domestic demand.

The development of domestic and foreign demand led to growth in aggregate demand (4.8% at constant prices, compared with 6.9% in 2001). Within the structure of aggregate demand, the

### Aggregate demand and coverage

(constant 1995 prices)

	Volume in billions of Sk			Structure in %		
	2000	2001	2002	2000	2001	2002
Aggregate demand	1,205.6	1,288.8	1,350.8	100.0	100.0	100.0
Domestic demand <sup>1/</sup>	686.4	736.0	765.2	56.9	57.1	56.6
Foreign demand	519.2	552.8	585.6	43.1	42.9	43.4
Coverage of aggregate demand						
Domestic supply	684.8	707.3	738.4	56.8	54.9	54.7
Foreign supply	520.8	581.5	612.4	43.2	45.1	45.3

<sup>1/</sup> Including statistical discrepancy.

share of domestic demand decreased year-on-year by 0.5 of a percentage point, while the share of foreign demand increased in the same measure.

### Supply side of GDP

The creation of added value was affected by growth in gross production as well as intermediate consumption. As a result of faster real growth in intermediate consumption than in gross production, the share of added value in gross production decreased slightly, from 38.1% in 2001 to 37.9% in 2002. Economic growth was also supported by the strong dynamics of indirect taxes.

The persistently large share of intermediate consumption is connected with the fact that the accelerated growth in GDP was generated in an economy with a virtually unchanged structure and a relatively smaller share of services, while the long-term trend of increase in the share of services to the detriment of industry continued.

The services sector created 4.2% more GDP than in 2001 (at constant prices), which was connected with a marked increase in GDP in banking and insurance (40%); public administration (15.2%); other community, social, and personal services (16.4%); and with increased GDP creation in education. Agriculture, construction, and industry also contributed to the overall growth in GDP.

The creation of GDP in industry grew by 4.0%, mainly in the production and distribution of ele-

ctricity, gas, and water (an increase of 33.4%) and in industrial production (an increase of 2.6%). However, it should be noted that the marked year-on-year increase in electricity, gas, and water supply was affected, first and foremost, by the low basis of comparison in 2001. In industrial production, year-on-year growth in added value was recorded in chemical, refined oil, and rubber products (8.9%); machinery, electrical equipment, and transport vehicles (4.3%); and in food processing (4.8%). On the other hand, the creation of added value fell significantly in the production of metals and metal products (12.1%).

### Agriculture

After showing modest dynamics in 2001, gross domestic product in agriculture grew year-on-year by 12.3% at constant prices in 2002. Its share in total GDP increased by 0.4 of a percentage point, to 4.6%.

Relatively dynamic growth was recorded in the receipts of agricultural companies, which exceeded the level of the previous year by 6.4% at constant prices in 2002. Almost two thirds of the receipts were proceeds from the sale of animal products, which increased year-on-year by 4.3%. Proceeds from the sale of plant produce increased by 10.1%. The volume of receipts was affected substantially by the number of animals and sales of selected animal and plant products. In 2002, stocks of cattle and sheep continued to decline. The stocks of other animals recorded a moderate increase. Except potatoes, the sales

**Creation of gross domestic product and components (Sk billions, constant 1995 prices)**

	2000	2001	2002	Indices <sup>1/</sup>		
				2000/99	2001/00	2002/01
Gross production	1,623.1	1,672.9	1,753.5	103.5	103.1	104.8
Intermediate consumption	1,007.2	1,035.3	1,088.6	104.3	102.8	105.1
Added value	615.9	637.6	664.9	102.3	103.5	104.3
Other <sup>2/</sup>	68.8	69.7	73.6	101.4	101.3	105.5
Gross domestic product	684.8	707.3	738.4	102.2	103.3	104.4

1/ Indices based on figures expressed in millions of Sk.

2/ Value added tax, excise duties, import taxes, subsidies.

of which fell on a year-on-year basis, the sales of other basic types of plant and animal products increased, mainly of cereals, fruit, beef and poultry (live animals), and milk.

A persistent problem in agricultural production for the food industry in 2002 was the deficit in foreign trade. Foreign trade in food commodities was affected by increased imports of soya beans, food products, animal feed, cigarettes and tobacco goods, subsidised pork, pigs and poultry (live animals), pastry, chocolate, and foods containing cocoa. On the other hand, foreign trade was affected favourably by exports of malt and oil-seed (rape and sunflower).

### Industry

Industry showed relatively strong dynamics in 2002. The volume of GDP created in industry grew year-on-year by 4.0% at constant prices (compared with 3.6% in 2001). The sector accounted for 25.9% of total GDP, the same figure as in the previous two years.

The favourable trend in GDP in industry was connected, at a stable level of intermediate con-

sumption, with growth in manufacturing, which reached virtually the same year-on-year dynamics in 2002 as a year earlier (6.6% at constant 2000 prices). Of the main industrial sectors, growth was recorded in manufacturing (8.6%), as well as mining and quarrying (28.6%). In electricity, gas, and water supply, output remained below the level of the previous year (a fall of 5.8%).

In manufacturing, faster than average growth was recorded in the key, largely export-oriented sectors of the economy. These sectors included the manufacture of transport vehicles, production of rubber and plastic goods, refined oil products, nuclear fuels, metals, and part of light industry (leather processing and the manufacture of leather goods).

Gradual restructuring of the industrial base led to growth in labour productivity. Productivity in manufacturing increased year-on-year by 6.4% at constant prices. This increase was accompanied by a moderate growth in employment (0.2%). In 2002, the average nominal monthly wage in industry increased year-on-year by 7.3% and the real wage by 3.9%. According to preliminary data, gross profit achieved in the sector increased year-

### Breakdown of gross domestic product by sector (Sk billions, constant 1995 prices)

	2000	2001	2002	Indices <sup>1/</sup>			Proportions		
				2000/99	2001/00	2002/01	2000/99	2001/00	2002/01
<b>Gross domestic product (GDP)</b>	684.8	707.3	738.4	102.2	103.3	104.4	100.0	100.0	100.0
<b>of which:</b>									
<b>Agriculture, forestry, and fishing</b>	35.5	33.7	37.4	99.8	95.0	110.9	5.2	4.8	5.1
<b>of which: agriculture</b>	29.6	29.9	33.6	107.9	101.0	112.3	4.3	4.2	4.6
<b>Industry</b>	177.7	184.1	191.4	94.5	103.6	104.0	25.9	26.0	25.9
<b>of which: mining and quarrying</b>	6.4	5.9	5.1	89.3	92.1	86.1	0.9	0.8	0.7
<b>industrial production</b>	151.4	166.9	171.2	98.0	110.2	102.6	22.1	23.6	23.2
<b>electricity, gas, and water</b>	19.9	11.3	15.1	75.5	56.9	133.4	2.9	1.6	2.0
<b>Construction</b>	24.3	23.9	26.5	102.7	98.5	111.0	3.5	3.4	3.6
<b>Services</b>	386.5	404.3	421.3	107.6	104.6	104.2	56.4	57.2	57.1
<b>of which: trade</b>	99.0	101.3	99.5	105.4	102.4	98.2	14.5	14.3	13.5
<b>transport, posts and telecom.</b>	65.4	74.2	71.6	102.2	11.5	96.5	9.5	10.5	9.7
<b>real estate and leasing services</b>	89.7	86.5	86.1	112.3	96.5	99.5	13.1	12.2	11.7
<b>Other <sup>2/</sup></b>	60.8	61.4	61.8	95.3	100.9	100.7	9.0	8.6	8.3

1/ Indices based on figures expressed in millions of Sk.

2/ Value added tax, excise duty, import tax, subsidies, imputed production of banking services.

-on-year by 18.5%, due to a marked increase in earnings in the production and supply of electricity, gas, and water, and a fall in profits in manufacturing, mining, and quarrying.

### **Construction**

Gross domestic product in the construction sector grew at constant prices by 11.0% during 2002 (after falling by 1.5% a year earlier). The share of the sector in total GDP had, since 1999, been fluctuating around 3.5% and reached 3.6% in 2002.

The revival in construction was also reflected in the values of other indicators. The output of the construction sector recorded an increase in year-on-year dynamics in 2002 (by 3.3 percentage points, to 4.1% at constant prices), compared with the previous year. The level of output was affected by growth in domestic production and, in the last two months, by growth in construction work abroad as well. As for domestic production, growth was recorded in new construction, reconstruction, and modernisation projects, as well as maintenance and repair work.

The increased demand for construction work stimulated growth in job opportunities. After falling in 2001, the level of employment in construction companies rose year-on-year by 1.6%, representing the second highest increase within the entire Slovak economy. Labour productivity per employee (in construction) grew by 2.5% at constant prices and exceeded the growth in real wages by 1.3 percentage points. This can be attributed to the slow rate of growth in the average nominal monthly wage in construction (4.5%),

which was the slowest of all sectors. In 2002, construction organisations achieved favourable financial results, and the gross profit of the sector increased, according to preliminary data, by 83.0% compared with the previous year.

### **Services**

In 2002, the services sector generated an increase of 4.2% in GDP at constant prices (compared with 4.6% a year earlier), and contributed almost the same share to total GDP as a year earlier (57.1%). Marked slowdown in GDP growth in comparison with 2001 was recorded in market services (71.8% of the volume of GDP in the services sector), when the year-on-year dynamics weakened in comparison with the previous year by 2.4 percentage points, to 1.8 %.

In sectors specialising in market services, receipts from own-output and goods also followed a less favourable trend than in 2001. An exception was represented by the retail trade, where receipts increased year-on-year by 5.8% at constant prices (compared with 4.5% a year earlier). In the retail trade, receipts were affected mainly by their growth in non-specialised retail stores (hyper- and supermarkets), retail trade in foodstuffs, cosmetics, and pharmaceuticals.

Fall in the year-on-year dynamics of receipts (from 23.5% in 2001 to 9.9% in 2002 at constant prices) was recorded by organisations specialising in the sale and maintenance of motor vehicles and the retail sale of fuels. With regard to the relatively dynamic growth in receipts from the maintenance of motor vehic-

**Absolute year-on-year increases in GDP with contributions (constant 1995 prices)**

	2000		2001		2002	
	Sk billion contribution		Sk billion contribution		Sk billion contribution	
<b>GDP</b>	14.7	2.2	22.6	3.3	31.1	4.4
<b>Domestic demand</b>	-6.3	-0.9	51.2	7.5	34.1	4.8
<b>Statistical discrepancy</b>	6.4	0.9	-1.5	-0.2	-4.9	-0.7
<b>Net exports</b>	14.6	2.2	-27.1	-4.0	1.9	0.3

les and the sale of fuels, this was due mainly to slower growth in receipts from the sale of motor vehicles.

After growing dynamically in 2001 (by 26.4%), the receipts of organisations specialising in transport and storage services increased year-on-year by only 1.5% (at current prices) in 2002. This was due to a fall in the volume/number of goods/persons transported in almost all transport sectors except road haulage, the output of which increased. Receipts in transport were affected by their growth in rail transport (due to the introduction of charges for the use of the transport infrastructure), and by decline in road transport and in secondary and auxiliary activities in transport.

Receipts in real estate, leasing, and other business services, which recorded a moderate year-on-year increase in 2002 (0.6% at constant prices, compared with 1.6% a year earlier), were marked by lower demand for investments. Within the sector, growth was recorded only in receipts from the leasing of machines and equipment and from computer engineering and related activities, while receipts in real estate and other business services fell.

## **Demand side of GDP**

In the structure of gross domestic product by use, the increase in GDP at constant prices was generated mostly by domestic demand. However, its contribution to growth in GDP diminished, from 7.5% in 2001 to 4.8% in 2002. The contribution of net exports changed during the year, from negative to positive, and increased the rate of GDP growth in 2002 by 0.3 of a percentage point in relative terms. This change was stimulated by growth in foreign demand in the 2nd half of the year and a slowdown in the rate of growth in imports of goods and services.

### **Domestic demand**

The growth in domestic demand (4.7% at constant prices) was due primarily to increased consumer demand and growth in inventories. Investment demand remained below the level of the previous year and reduced the rate of overall growth in domestic demand.

#### *Domestic consumer demand*

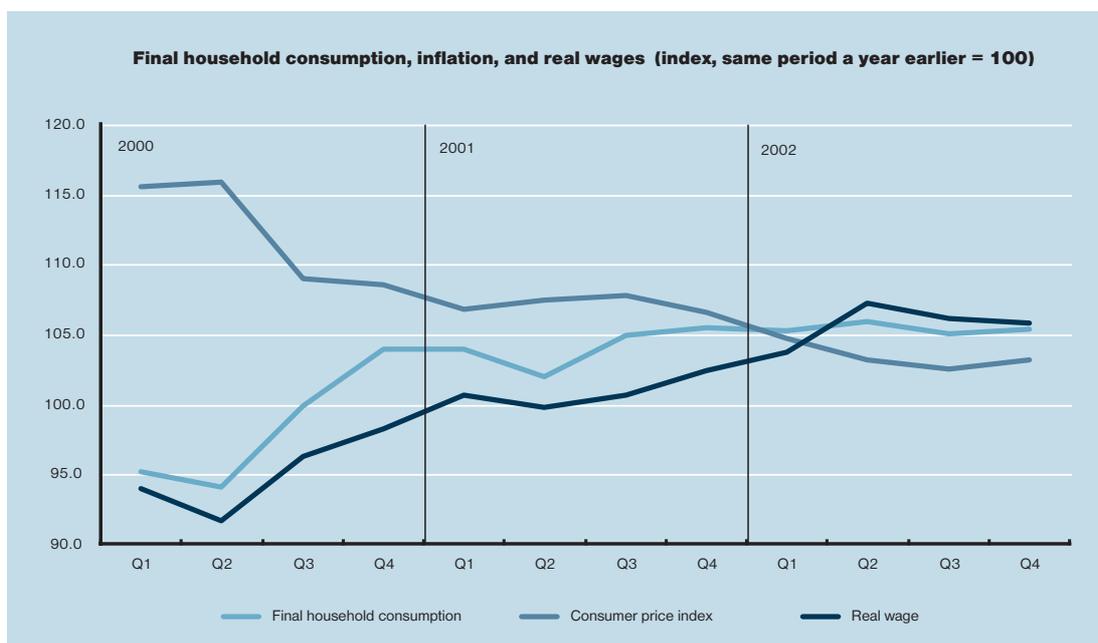
Final consumption in 2002 continued to contribute positively to the creation of GDP, while

### **Gross domestic product by use**

**(Sk billions, constant 1995 prices)**

	2000	2001	2002	Indices <sup>1/</sup>		
				2000/99	2001/00	2002/01
<b>Gross domestic product</b>	684.8	707.3	738.4	102.2	103.3	104.4
<b>Domestic demand</b>	680.0	731.1	765.2	99.1	107.5	104.7
<b>of which:</b>						
<b>Final consumption in total</b>	498.3	519.5	544.9	99.0	104.2	104.9
<b>Households</b>	354.6	368.9	388.7	98.2	104.0	105.4
<b>Non-profit institutions</b>	6.2	6.0	6.0	98.5	96.6	99.0
<b>General government</b>	137.5	144.5	150.3	101.3	105.1	104.0
<b>Gross capital formation</b>	181.6	211.7	220.3	99.3	116.5	104.1
<b>Gross fixed capital</b>	196.1	214.8	213.0	101.2	109.6	99.1
<b>Change in inventories</b>	-14.5	-3.2	7.3	x	x	x
<b>Net exports</b>	-1.6	-28.7	-26.8	x	x	x
<b>Exports of goods/services</b>	519.2	552.8	585.6	113.8	106.5	105.9
<b>Imports of goods/services</b>	520.8	581.5	612.4	110.2	111.7	105.3
<b>Statistical discrepancy</b>	6.4	4.9	0.0	x	x	x

1/ Indices based on figures expressed in millions of Sk.



its dynamics strengthened slightly on a year-on-year basis, by 4.9% at constant prices. Consumer demand was in large part stimulated by final household consumption (71%), which increased by 5.4% and exceeded the rate of growth from 2001 by 1.4 percentage points. The relatively balanced development of private demand in the individual quarters was supported mainly by the low inflation rate, growth in real wages, growth in the volume of consumer loans, and by new products such as credit sales.

The structure of final household consumption was dominated by purchases of foodstuffs (28%); spending on housing (20.6%); clothing, furniture, and household equipment (11.5%). The most rapid increases were recorded in the expenses of households on miscellaneous goods and services (13.5%), communications (13.3%), and health services (11.3%).

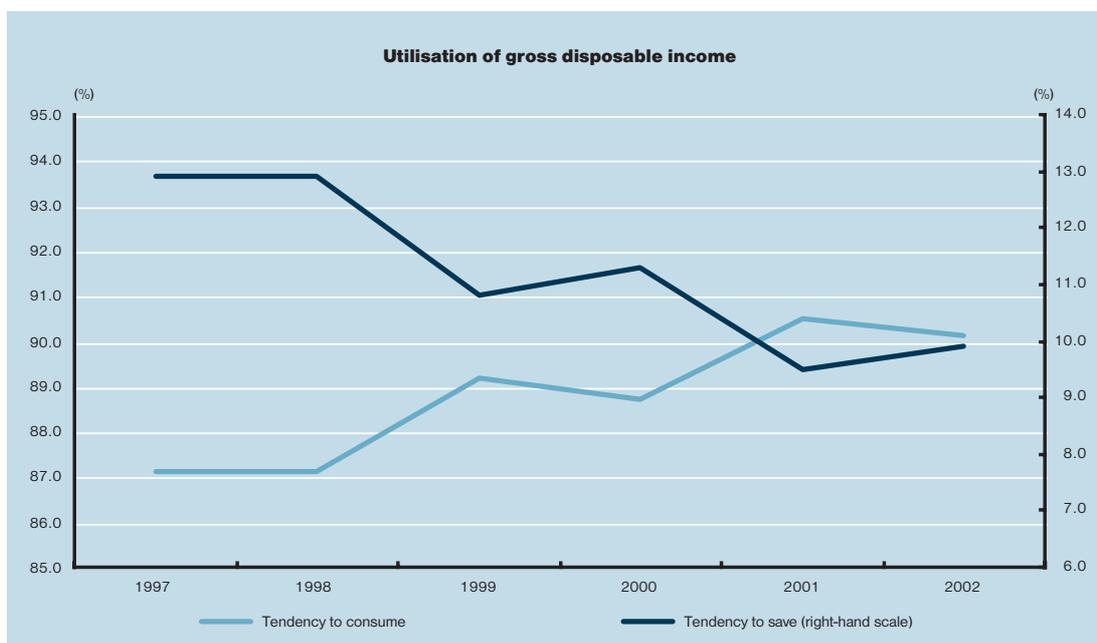
Although private consumption showed strong dynamics, the tendency of households to consume weakened noticeably in 2002, while the tendency to save strengthened, with the share of gross household savings in gross disposable income increasing year-on-year by 0.4 of a percentage point, to 9.9% (gross savings include the investment activities of

citizens and small entrepreneurs, in addition to koruna deposits).

Final consumption of general government increased by 4.0% at constant prices (in 2001 by 5.1%). The moderate fall in the dynamics of public consumption was associated with developments in the 2nd half of 2002, when the rate of growth was dampened by saving measures, to 1.9% (from 6.8% in the 1st half).

#### *Domestic investment demand*

In 2002, gross capital formation (including changes in the volume of inventories) increased year-on-year by 4.1% at constant prices (in 2001 by 16.5%), and was affected by a fall of 0.9% in the level of gross fixed capital formation (compared with an increase of 9.6% in 2001), as a result of which the share of fixed investments in GDP decreased year-on-year by 1.6 percentage points, to 28.8%. Growth in gross capital was also stimulated by a change in inventory volume, which reached, after falling for four years, a positive figure (Sk 7.3 billion). The marked increase in inventories in comparison with previous years, may be to some extent associated with output that is produced but not exported, and with the fact that inventories may



include items that are of an investment nature (leasing).

In the financing of investment demand, the share of domestic funds in financing decreased slightly in 2002. In contrast with 2001, however, the gap between gross domestic savings (the unused part of GDP) and gross investments deepened only to a negligible extent, when the coverage of investments by savings decreased by only 1 percentage point, to 87.8%.

Within the structure of investments, there was a shift from demand for buildings to demand for machines in 2002, when the proportion of investment in machines to gross fixed capital formation increased year-on-year by 3.6 percentage points, to 57.7%. Although the total volume of fixed investments remained below the level of the previous year, a positive achievement was the growth in investment in machines (1.4%), within the scope of which, investment in metal products and machines also increased. Investment in construction declined by 8.2%, due mainly to a downturn in investment in other

#### Investments and savings

(%)

	2000	2001	2002
<b>Constant 1995 prices</b>			
Rate of savings <sup>1/</sup>	27.2	26.6	26.2
Rate of gross investments <sup>2/</sup>	26.5	29.9	29.8
Rate of fixed investments <sup>3/</sup>	28.6	30.4	28.8
Coverage of investments by savings <sup>4/</sup>	102.6	88.8	87.8
<b>Current prices</b>			
Rate of savings <sup>1/</sup>	24.0	23.4	23.8
Rate of gross investments <sup>2/</sup>	27.1	32.0	30.9
Rate of fixed investments <sup>3/</sup>	29.5	31.3	29.8
Coverage of investments by savings <sup>4/</sup>	88.6	73.1	77.0

1/ Share of gross domestic savings (GDP less final consumption in total) in GDP.

2/ Share of gross capital formation in GDP.

3/ Share of gross fixed capital formation in GDP.

4/ Share of gross domestic savings in gross investments.

### Structure of gross fixed capital formation in 2002

	Gross fixed capital formation (Sk millions)	Share in the Slovak economy (%)	Index 2002/01
<b>Economy of the SR in total</b>	319,751	100.0	99.1
<b>of which (by production):</b>			
<b>Buildings</b>	112,495	35.2	91.8
<b>of which: residential buildings</b>	19,697	6.2	104.8
<b>other structures</b>	92,798	29.0	89.5
<b>Machinery</b>	184,458	57.7	101.4
<b>of which: metal goods and machinery</b>	140,617	44.0	102.3
<b>transport equipment</b>	43,841	13.7	98.8
<b>of which (by sector):</b>			
<b>Non-financial corporations</b>	201,896	63.1	98.7
<b>Financial corporations</b>	43,071	13.5	105.1
<b>General government</b>	26,186	8.2	92.9
<b>Households</b>	46,888	14.7	100.5
<b>Private non-profit institutions</b>	1,710	0.5	80.2

Note: The volumes are at current prices, the indices at constant 1995 prices.

buildings (halls and buildings for production and services, other industrial facilities, bridges, roads, and other civil engineering works, flood control dykes, and other water engineering structures). Within the structure of investments in construction, investment in residential buildings grew by 4.8%, due to the availability of new forms of financing (mortgage loans, home savings, and government loans).

In a breakdown by sector, the greatest decline in gross fixed capital formation occurred in general government (7.1% at constant prices), while a moderate fall and/or stagnation in investment demand was reported by non-financial corporations (a fall of 1.3%) and households (an increase of 0.5%). Financial corporations invested more than in the previous year (by 5.1% at constant prices).

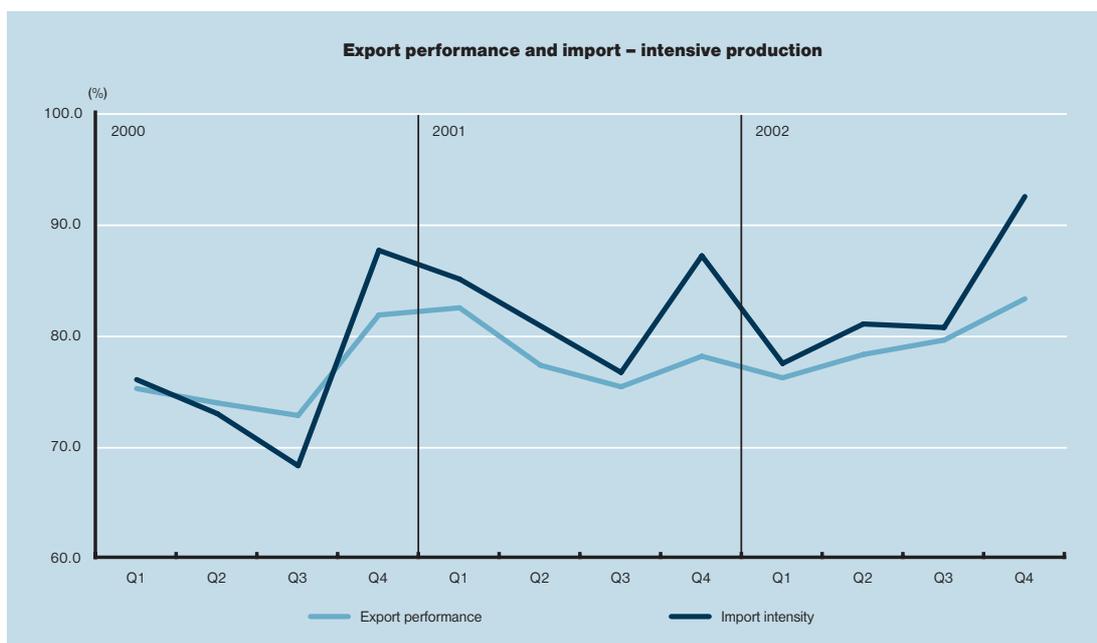
Demand for investments increased in the group of medium-term companies (with 50 to 999 employees), while gross fixed capital formation in other groups of companies remained below the level of the previous year.

### Net exports

In 2002, net exports resulted in a deficit of Sk 26.8 billion (at constant prices), representing a modest decrease (Sk 1.9 billion) in comparison with the previous year. The improvement in the balance of trade in goods and services, including a statistical estimate of the non-registered economy, was due to faster year-on-year growth in exports (5.9%) than imports (5.3%).

In the 2nd half of 2002, the increase in the volume of goods and services imported/ exported indicated a two-digit rate of growth. In the 4th quarter, exports showed record growth (12.4% at constant prices), which was accompanied by a record increase in imports (11.9%). Exports were largely dependent on imported goods and services throughout the year; a positive trend was the excess of export dynamics over the rate of growth in imports in each quarter.

The improvement in foreign trade resulted partly from the trend of year-on-year convergence in the indicators of functional openness of the economy in 2002. Export performance, expressed in terms of the ratio of exports of goods and services to GDP (at constant prices), increased



year-on-year by 1.1 percentage points, to 79.3%. The increased share of exports in GDP was probably a sign of revival in the economies of Slovakia's major trading partners, which created room for growth in exports, especially in the second half of 2002. The increase in export dynamics led to growth in the import-intensity of the economy. Import-intensive production increased year-on-year by 0.7 of a percentage point, with the volume of imported goods and services accounting for 82.9% of GDP.

### ***Income and expenditure of households***

According to preliminary data from the Statistical Office, the current income of households increased year-on-year in nominal terms by 7.9% and in real terms by 4.5% in 2002 (in 2001 by 0.7% in real terms). The current expenditure of households (paid to other sectors and not used for direct consumption) increased in nominal terms by 6.9% and in real terms by 3.5% (a year earlier by 2.5% in real terms).

The level of current income was affected mainly by an increase in income from work and business activity – compensation of employees

and gross mixed household income, which includes the receipts of tradesmen spent by their households as well as their business profits. In 2002, the share of these receipts in total current income increased year-on-year by 0.2 of a percentage point, to 79.7%.

In comparison with 2001, the volume of social benefits (pensions, social insurance, and unemployment benefits) grew at an accelerated rate, due mainly to pensions, which increased year-on-year by 8.4% (and accounted for almost 70% of the total amount paid in welfare benefits).

Current expenditure was affected mainly by social security contributions and current taxes on income and property, which together accounted for 88.3% of the volume of current expenditure. The dynamics of current expenditure weakened in comparison with the previous year, due probably to slower growth in employment, gross wages and salaries, and gross mixed income within the structure of current income.

After reducing current income by current expenditure, the gross disposable income of households amounted to Sk 657.7 billion. The

**Income and expenditure of households <sup>1/</sup>****(current prices)**

	Sk billions		Indices		Share in %	
	2001	2002	2001/00	2002/01	2001	2002
Compensation of employees (all sectors)	407.3	442.2	109.1	108.6	51.5	51.8
of which: Gross wages and salaries	315.8	342.7	109.3	108.5	40.0	40.2
Gross mixed income	220.5	237.2	113.1	107.5	27.9	27.8
Property income	31.9	31.3	81.1	98.3	4.0	3.7
Social benefits	109.5	118.7	104.1	108.4	13.9	13.9
Other current transfers - received	21.1	23.5	110.5	111.4	2.7	2.8
<b>Current income in total</b>	<b>790.3</b>	<b>852.9</b>	<b>108.0</b>	<b>107.9</b>	<b>100.0</b>	<b>100.0</b>
Property expense	4.8	5.4	106.3	113.4	2.6	2.8
Current tax on income, property, etc.	33.8	35.8	109.7	105.9	18.5	18.4
Social contributions	128.2	136.4	109.2	106.4	70.2	69.9
Other current transfers - paid	15.8	17.5	110.9	111.2	8.6	9.0
<b>Current expenditure in total</b>	<b>182.5</b>	<b>195.1</b>	<b>109.4</b>	<b>106.9</b>	<b>100.0</b>	<b>100.0</b>
<b>Gross disposable income</b>	<b>607.8</b>	<b>657.7</b>	<b>107.6</b>	<b>108.2</b>	<b>100.0</b>	<b>100.0</b>
Adjustment for the change in net equity of households in pension funds	1.8	2.7	144.1	146.9	x	x
<b>Final household consumption</b>	<b>552.0</b>	<b>595.4</b>	<b>109.9</b>	<b>107.9</b>	<b>90.8</b>	<b>90.5</b>
<b>Gross savings of households</b>	<b>57.6</b>	<b>65.0</b>	<b>90.2</b>	<b>112.9</b>	<b>9.5</b>	<b>9.9</b>
<b>Rate of gross household savings</b>	<b>9.48</b>	<b>9.89</b>	<b>x</b>	<b>x</b>	<b>x</b>	<b>x</b>

1/ Based on data given in millions of Sk.

increase in gross disposable income (8.2%) was due to faster growth in income than expenditure, which subsequently led to dynamic growth in final consumption and savings.

Of the gross disposable income of households, 90.5% was used for final consumption (0.3 of a percentage point more than a year earlier), the remainder went on gross savings, which include the investment activities of citizens and small entrepreneurs in addition to their koruna deposits. Their share in gross disposable income (the rate of gross household savings) reached 9.9%, representing an increase of 0.4 of a percentage point in comparison with the figure for 2001.

**1.3. Labour market development****Employment and unemployment**

In 2002, there were 2,008.9 thousand employees in the Slovak economy (on average), which represented a fall of 1.4 percentage points in growth dynamics (to 0.1%) in comparison with 2001. The trend of slowdown in the rate of growth in employment had been foreshadowed by developments as early as in the 4th quarter of 2001, when employment increased by 0.1 %.

**Gross disposable income****(index, same period a year before = 100, current prices)**

	2001	2002				Year
		Q1	Q2	Q3	Q4	
<b>Gross disposable income</b>	107.6	107.6	108.0	108.8	108.4	108.2
<b>Final household consumption</b>	109.9	108.5	108.8	106.8	107.4	107.9
<b>Gross savings of households</b>	90.2	100.0	96.8	157.7	114.7	112.9
<b>Share of gross savings in gross disposable income (%)</b>	9.5	9.2	5.9	6.2	16.9	9.9

In the individual sectors, employment followed a different course. The steepest year-on-year increase in employment took place in finance and insurance (1.8%); construction (1.6%); and in the wholesale and retail trade, including repair services (1.2%), which made the greatest contribution to growth in employment.

The level of employment fell in numerous sectors, especially in other community, social, and personal services (by 3.6%); hotels and restaurants (by 2.1%); and in transport, storage, posts, and telecommunications (by 1.2%).

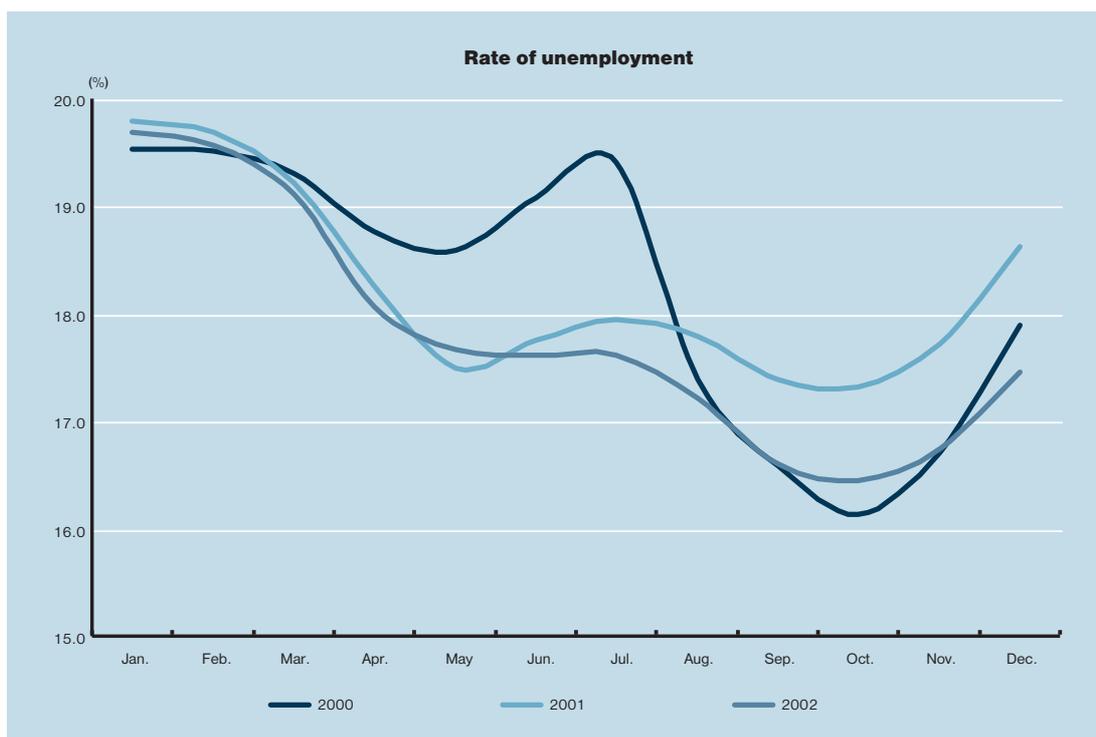
Unemployment followed a relatively favourable trend in 2002. The number of unemployed registered at labour offices at the end of the year, stood at 504 thousand (compared with 533.7 thousand in 2001). Compared with the same period a year earlier, the rate of registered unemployed fell by 1.18 percentage points, to 17.45%. The average rate for 2002 fell year-on-year by 0.43 of a percentage point, to 17.82%.

The course of unemployment during the year was characterised by an increase in the number of unemployed at the beginning of the year (due

to the return of people employed on public works in 2001 to unemployment status) and a gradual decrease during the spring months (due to seasonal factors). In June and July, the fall in unemployment was dampened slightly by the registration of school-leavers at labour offices, but continued until October, when unemployment reached an annual minimum. In November and December, the rate of unemployment again increased slightly, due to the end of seasonal works.

Apart from traditional seasonal factors (construction and agriculture, school-leavers signing on at labour offices in the summer months), the increase in the number of unemployed was affected by the fact that, in 2002, fewer out-of-work people were employed in public works than in the previous two years. This led to an increase in the number of long-term unemployed, which accounted for 47.3% of the total number of registered unemployed at the end of the year.

Unemployment was favourably affected by the relatively small increase in the country's economically active population and the increased use of active labour market policy instruments



(retraining, agreements with employers, public works, support of self-created employment, etc.), through which jobs were created for 70 thousand registered unemployed during 2002. The number of new job applicants totalled 436 thousand, representing the second lowest inflow since 1998. Over the same period, almost 466 thousand persons were deleted from the registers, representing the second largest outflow since 1997.

The fall in unemployment was also affected positively by the number of vacancies, which had increased year-on-year by 7.2 thousand (i.e. 70.9%) by the end of the year. This was accompanied by a fall in the number of registered unemployed per vacancy, to 29 at the end of December, from 53 a year earlier. In 2002, the total number of registered vacancies exceeded, for the first time, the level of 225 thousand.

A chronic problem was the high average length of registration, which reached 13.7 months at the end of the year. As for the structure of unemployed by education, the registers of labour offices were dominated by persons with elementary and secondary vocational education. The regional differences in unemployment persisted. The difference between the districts with the highest and lowest unemployment rates increased during 2002, to 34.1 percentage points in December (from 31.7 in December 2001). However, the number of districts with unemployment over 20% decreased, from 38 in December 2001 to 31 at the end of 2002.

## Wages and labour productivity

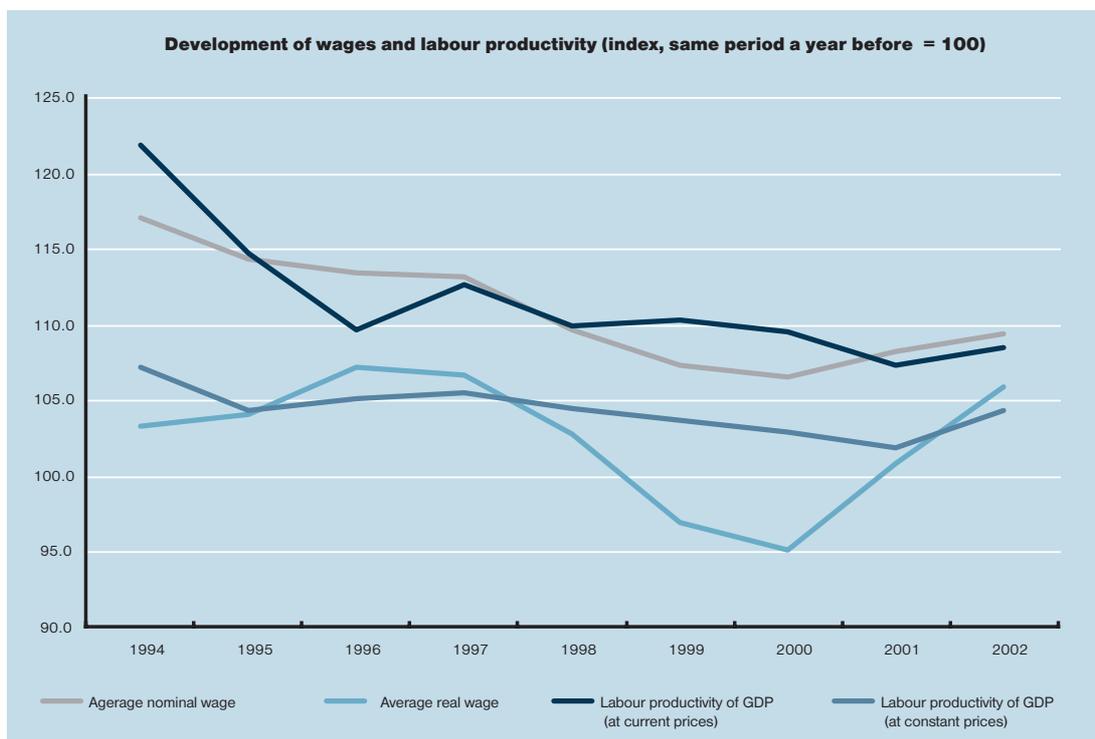
In 2002, the average monthly nominal wage of an employee in the Slovak economy reached Sk 13,511, representing a year-on-year increase of 9.3%. The rate of growth was 1.1 percentage points faster than in 2001. Real wages increased by 5.8%, representing an acceleration of 5 percentage points in the 12-month rate of growth. The increase in real wages (the largest since 1997) was connected with the growth in nominal wages and the low level of inflation.

Wages increased in all sectors of the economy, in both nominal and real terms. However, in production and service sectors, especially in public services, wages followed a different course. In comparison with 2001, the rate of growth in nominal wages slowed mainly in agriculture, industry, transport, posts and telecommunications, while wage dynamics in public administration, education, health care, and in other community, social, and personal services, increased by an average of 15.4% (according to NBS estimates).

The relatively steep wage increase in the public sector was connected mainly with the enactment of laws on state and public services and, in other community, social, and personal services, combined with the reduced number of public work jobs available (compared with 2001). Despite a marked year-on-year increase in wages in public services, wage levels remained below

Labour market indicators	2001	(same period a year before = 100)				
		2002				Year
		Q1	Q2	Q3	Q4	
Nominal wage (Sk)	12,365	12,287	13,329	13,146	15,266	13,511
Nominal wage (index)	108.2	108.6	110.6	108.8	109.1	109.3
Labour productivity of GDP (index, curr. p.)	107.3	107.3	108.2	108.0	110.0	108.4
Real wage (index)	100.8	103.7	107.2	106.1	105.8	105.8
Labour productivity of GDP (index, const. p.)	101.8	103.3	104.1	104.1	105.5	104.3
Wage minus productivity (percent. points)	-1.0	0.4	3.1	2.0	0.3	1.5
Employment (index)	101.5	100.5	99.9	100.2	100.1	100.1
Registered unemployment rate (%) <sup>1/</sup>	18.6	19.1	17.6	16.6	17.4	17.4
Consumer prices (average index)	107.3	104.7	103.1	102.5	103.1	103.3

1/ End-of-period figures.



the average wage in the Slovak economy (with the exception of public administration, defence, and compulsory social insurance).

Wages continued to show marked differences in the individual sectors. The highest average monthly nominal wage (in banking and insurance) was 2.6 times higher than the lowest wage (in other community, social, and personal services), compared with 2.7 times a year earlier. Lower than average wages were recorded in five sectors.

The accelerated growth in real GDP, accompanied by a slowdown in the rate of growth in employment, led to a relatively steep year-on-year increase in labour productivity. In nominal terms, labour productivity increased by 8.4% (1.1 percentage points more than a year earlier), and in real terms by 4.3% (compared with 1.8% in 2001). However, the relatively dynamic growth in labour productivity did not suffice to cover the wage increase. In 2001, real wages remained behind labour productivity by 1 percentage point; in 2002, this relationship changed and the wage increase exceeded the growth in labour productivity by 1.5 percentage points.

#### **1.4. Financial results of the commercial sector**

The financial results of financial and non-financial institutions for 2002 showed marked deterioration in comparison with the previous year. According to preliminary data from the Statistical Office of the SR, the gross profit generated by the two sectors together was 9.1% less than a year earlier. Marked year-on-year deterioration in financial performance was recorded by financial corporations, which closed the year 2002 with a total loss of Sk 5.5 billion. Financial institutions (savings banks and banks, including the NBS) suffered a loss of Sk 12.1 billion (after a profit in 2001), while insurance companies, pension funds, and other financial intermediaries achieved a positive financial result.

After pronounced growth in 2001, non-financial corporations recorded a year-on-year increase of 3.6% in earnings. Positive financial results were achieved in almost all key sectors. The largest profits were generated in industrial production, trade, electricity generation and distribution, gas and water supply (more than 75% of the total

**Financial results****(current prices)**

	<b>Sk millions</b>		<b>Index</b>
	<b>2001</b>	<b>2002</b>	<b>2002/01</b>
<b>Financial result (before taxation)</b>			
Non-financial and financial corporations in total	147,068	133,685	90.9
Non-financial corporations	134,303	139,138	103.6
Financial corporations	12,765	-5,453	x
<b>Number of non-financial corporations (with 20 or more employees)</b>			
	<b>2001</b>	<b>2002</b>	<b>Difference</b>
In total	6,242	6,127	-115
Non-loss-making corporations	4,356	4,426	70
Loss-making corporations	1,886	1,701	-185

Source: Statistical report on the basic trends of development in the economy of the SR.

profit). The most significant increases in profits took place in electricity generation and distribution, gas and water supply, trade, real estate, leasing, and business services. The most unfavourable factor was a fall in profits in industrial production, transport, posts and telecommunications, mining and quarrying.

Of the total number of companies (6,127) in the non-financial sector (with 20 or more employees), 4,426 were profitable (72.2%) and 1,701 sustained a loss. While the total number of entities decreased by 115 during the year, the number of profitable companies increased by 70 and that of loss-making firms fell by 185, which indicates that the process of restructuring and closure of loss-making operations continued in 2002. The majority of loss-making companies were involved in industry, agriculture, and hunting.

## 2. BALANCE OF PAYMENTS

### 2.1. Current account

The dynamic growth in domestic demand and the level of imports, coupled with a slowdown in the pace of economic growth in EU countries, were the reasons behind the persistently large deficit in the balance of payments on current account. Although the trade deficit diminished slightly, the shortfall in the current account

increased to Sk 87.9 billion (from Sk 84.4 billion a year earlier), due to growth in the negative balance of income and fall in the positive balances of services and current transfers. The ratio of the current account deficit to GDP decreased to 8.2% (from 8.5% in 2001).

In 2002, the current account deficit was caused mainly by the balance of trade, which resulted in a deficit of Sk 96.6 billion (representing 9.1% of GDP, compared with 10.4% in 2001).

In comparison with the previous year, the dynamics of imports and exports weakened, while the year-on-year rate of growth in exports (6.5%; i.e. 13.6% in USD or 8.1% in EUR) exceeded the figure for imports (4.7%; i.e. 11.7% in USD or 6.2% in EUR).

### Balance of payments on current account

**(Sk billions)**

	<b>2002</b>	<b>2001</b>
<b>Balance of trade</b>	-96.6	-102.8
<b>Balance of services</b>	20.7	23.2
<b>Balance of income</b>	-20.7	-15.1
<b>Unilateral transfers</b>	8.7	10.1
<b>Current account in total</b>	-87.9	-84.4
<b>Current account as a share of GDP in %</b>	-8.2	-8.5

One of the most unfavourable trends in Slovak exports is the persistent structure dominated by commodities with a low added value (the share of raw materials and semi-finished goods in Slovak exports decreased gradually, from 45.7% in 2000

### Year-on-year changes in Slovak exports by category

	Year-on-year change				Contribution	
	Sk billions		%		%	
	2002	2001	2002	2001	2002	2001
<b>Raw materials</b>	-1.1	2.7	-2.1	5.5	-0.2	0.5
<b>Chemical goods and semi-products</b>	8.7	22.7	3.8	11.3	1.4	4.1
<b>Machinery and transport equipment</b>	21.0	21.2	8.5	9.4	3.4	3.8
<b>Finished product (agricultural and industrial products)</b>	11.3	16.2	12.8	22.1	1.9	3.0
<b>Exports in total</b>	39.9	62.8	6.5	11.4	6.5	11.4

to 45.1% in 2001 and 43.5% in 2002). The production largely dependent on energy and raw material inputs, and the high share of products intended for intermediate consumption (with a low degree of processing) in total exports, represent a distinct threat to the long-term sustainable competitiveness of the Slovak economy.

Lower than expected growth in EU countries, coupled with the above defects in the commodity structure of exports, led to a slowdown in the year-on-year rate of growth in exports in 2002, when the increase in exports reached only 63.5% of the growth in 2001 and 32% of the figure for 2000. This took place mostly in the category 'semi-finished goods', which represented a marked potential for growth in exports in previous years.

Exports of raw materials, semi-finished goods, and chemical products increased by 2.7% in comparison with 2001. Apart from a fall in exports of mineral raw materials (oil and oil products), decline was also recorded in 2002 in the exports of certain semi-finished goods (iron and steel, aluminium, aluminium products, lime and cement, etc.). Increases in exports in the category 'semi-finished goods' were recorded in smaller amounts in iron and steel products, timber and wooden products, and glass and glass products. Stagnation in the export of semi-finished goods, which belong to the major export commodities of Slovak industry, indicates that the pronounced sensitivity of exports to price factors and changes in external demand, especially to business cycles in EU countries, constitutes a threat to long-term competitiveness and sustainable external balance. Exports of chemical products grew as

a result of increased exports of rubber and rubber products, plastics and plastic goods.

Despite these problems, the year 2002 saw some improvement in the commodity structure of Slovak exports, with the fastest rate of growth being maintained in the exports of finished products (12.8%) throughout the year. Within the category 'finished products', the most significant increases were recorded in the exports of furniture, clothing, footwear, and selected agricultural goods, e.g. cereal and sugar products, etc.

Increased exports in the category 'machinery and transport equipment' were generated mostly by companies with foreign capital participation, based in the SR. As a result of growth in exports in the automobile and electrical industries, the rate of growth in the category 'machinery and transport equipment' reached 8.5%, exceeding the dynamics of total exports, while the growth in exports accounted for 53% of the total increase in exports in 2002.

In addition to the export of automobiles, above-average dynamics were maintained in the export of machinery, and electrical machines and equipment. The year-on-year growth in exports of electrical machines and equipment was, in terms of volume, twice as large as that of machinery, and took place in the form of increased exports in the category 'cables, strip lighting, and electrical transformers.'

In 2002, the growth dynamics of Slovak imports weakened considerably in comparison with 2001 (from 21.0% to 4.7%). This was largely due to developments in the prices of mineral raw

### Year-on-year changes in Slovak imports by category

	Year-on-year change				Contribution	
	Sk billions		%		%	
	2002	2001	2002	2001	2002	2001
<b>Raw materials</b>	-11.1	8.8	-8.8	7.5	-1.6	1.5
<b>Chemical goods and semi-products</b>	19.7	36.9	9.5	21.5	2.8	6.3
<b>Machinery and transport equipment</b>	15.3	43.9	6.9	24.8	2.1	7.4
<b>Finished products</b>	9.9	34.2	6.3	27.5	1.4	5.8
<i>of which:</i>						
<b>Agricultural and industrial products</b>	7.8	17.6	8.4	21.6	1.1	2.9
<b>Automobiles</b>	-0.4	7.5	-1.6	52.8	-0.1	1.4
<b>Machine and electrical-engineering consumables</b>	2.5	9.1	6.2	29.1	0.4	1.5
<b>Imports in total</b>	33.8	123.8	4.7	21.0	4.7	21.0

materials, and to exchange rate developments, which were reflected in the lower value of raw material imports. Other imports (excluding raw materials) recorded a faster rate of growth (7.6%) than total imports.

In addition to a fall in oil and gas prices, which had a significant impact on the import of mineral-based fuels and certain chemical products, the dynamics of imports also weakened in the case of investment and consumer goods.

Raw materials represented a category, where imports fell on a year-on-year basis throughout the year. Imports of raw materials were determined by their price, while oil and gas prices followed a different course. The price of gas in Slovak koruna (i.e. including the effect of the exchange rate) fell throughout the year, by 20.6% on a year-on-year basis. Despite a moderate increase in imports in terms of physical volume, the marked fall in the price of gas caused a year-on-year decline of Sk 8.4 billion in the imports of this raw material. Due to a year-on-year fall of 4.3% in oil prices (from September to December, the price of oil rose year-on-year by 10.3%), accompanied by a moderate increase in oil imports in terms of physical volume, the imports of this raw material fell by only Sk 0.7 billion in 2002.

The year-on-year increase in the imports of chemical products was concentrated mainly in plastics and rubber compounds. The increase was connected with growth in the exports of

plastic and rubber products (a problematic development was a fall in the export price of plastics and plastic products, accompanied by a rise in import prices). Dynamic growth was also recorded in the imports of semi-finished goods. The increased imports in comparison with 2001 in nearly all categories of semi-finished goods (iron and steel, iron and steel products, aluminium, timber, and paper) indicate that economic growth in 2002 was achieved at the cost of increased demand for material inputs.

After dynamic growth in previous years, the dynamics of imports of machinery and transport equipment weakened considerably as a result of stagnation in investment demand. The rate of growth in the imports of machinery and transport equipment (excluding automobiles and consumer goods) fell from 24.8% in 2001 to 6.9% in 2002 (in terms of volume, the increase in these imports in 2002 accounted for roughly one third of the figure for the previous year). In the category 'transport equipment' (excluding motor vehicles used in freight transport), a significant increase in imports was also recorded in the sub-category 'spare parts, components, and accessories of motor vehicles', which was probably connected with the import of components for the production of motor vehicles.

The increase in machine imports was split more or less equally between the sub-category of machines coming under the category 'machinery and equipment for production' (mainly the import

of engines and electrical components for machines) and that of technological equipment for the individual sectors of the national economy. In the structure of machine imports by purpose, decline was recorded mainly in the size of year-on-year increases in imports intended for the modernisation of industrial sectors (machines and equipment for power generation, metal working machines, machinery and equipment used in industry, and data processing machines).

Despite a marked increase in real wages in 2002, imports of finished products grew at a slower rate than in 2001. The year-on-year dynamics of imports weakened, from 27.5% in 2001 to 6.3% in 2002 (the year-on-year increase diminished from Sk 34.2 billion to Sk 9.9 billion). Within the structure of industrial and agricultural products, the most significant increase in imports took place in pharmaceuticals and clothing. Slowdown in comparison with 2001 was recorded in the import of industrial products, such as furniture and textiles, where imports decreased.

Trade in services resulted in a surplus of Sk 20.7 billion in 2002, with receipts from exports increasing by 4.9% and payments for imports by 8.9%.

<b>Balance of services</b>	<b>(Sk billions)</b>	
	<b>2002</b>	<b>2001</b>
<b>Balance of services</b>	20.7	23.2
<b>Transport</b>	25.5	24.3
<b>Tourism</b>	12.8	17.0
<b>Other services in total</b>	-17.6	-18.1

The positive balance of services was generated mostly in transport, the surplus of which increased slightly in comparison with the past year, to Sk 25.5 billion. Receipts from the export of transport services reached Sk 52.6 billion and their year-on-year growth was due to increased receipts from international freight transport, especially rail. Income from the transit of gas and oil from the Russian Federation (RF) to the Czech Republic and Western Europe via Slovakia reached Sk 31.5 billion in 2002, somewhat less than a year earlier. Expenditure on imports of transport services increased to Sk 27.1 billion,

due to growth in international railway transport (as in the case of receipts). In expenditures, other transport services remained below the level of the previous year, which was connected with the weaker dynamics of imports.

After increasing in the previous two years, net receipts from foreign tourism fell by almost 25% in 2002. The fall in the positive balance of tourism was due to increased purchases of foreign exchange by Slovak citizens, which exceeded the growth in foreign exchange receipts from foreign tourists. The amount of foreign exchange drawn by Slovak citizens increased by 43.3%, to Sk 20.0 billion. The steep increase in foreign exchange drawings (accompanied by a moderate decrease in the number of tourists travelling abroad) was probably connected with the strengthening of the Slovak koruna, which led to increased interest in foreign currencies on the part of Slovak citizens (this led to growth in the foreign currency deposits of households, which had an upward effect on income from tourism). Receipts from foreign tourists grew in 2002 by 5.9%, to Sk 32.8 billion. The fact that the growth in receipts from foreign tourists was achieved despite the appreciation of the Slovak koruna and decrease in the number of visitors to Slovakia, is an indication of a qualitative change in foreign tourism (in 2002, the number of accommodated visitors increased, while the share of one-day and transit visits to Slovakia fell in favour of longer-term stays).

The balance of 'other services in total' (direct re-export; technical, construction, business, insurance, financial, telecommunications, leasing, computer engineering, and advertising services, etc.) remained in deficit as in previous years. In 2002, the deficit in the balance of 'other services in total' reached Sk 17.6 billion, roughly the same level as a year earlier. The persistence of a large deficit in this category indicates that these services are becoming more and more important for the economy. At the same time, it is a sign of disharmony between the production structure of services and the actual requirements of the market. Within the structure of these services, permanent negative balance was recorded in

a whole series of sectors, the only exceptions in 2002 being communications and construction services. Of services where receipts are exceeded by payments every year, the most evident in 2002 were services of a financial nature (legal, accounting, auditing, financial, and insurance services). In these services, the size of the deficit increased on a year-on-year basis. On the other hand, services tending to increase the effectiveness and competitiveness of material production (business services, agency services, advertising, licensing services, processing services, etc.), which belong to services with a permanent shortfall, recorded a modest decrease in the size of the deficit in 2002.

The balance of income resulted in a deficit of Sk 20.7 billion, representing a year-on-year increase of Sk 5.6 billion. Receipts from investments reached Sk 15.6 billion, roughly the same level as in 2001. Within the structure of receipts, there was a shift in dominance from interest receipts from deposits abroad to interest receipts from portfolio investments – securities. This was due to an increase in income from NBS reserves, which are invested in securities, while the level of yields was affected by the structure of securities and the payment of coupons. The lower level of interest receipts from other investments was due to a fall in interest on the short-term deposits of commercial banks abroad, which fell by nearly 60% during 2002. The increase in the income balance deficit was generated by growth in expenditure on interest payments, which reached Sk 36.2 billion. This was due mainly to increased payments of yields on property and Sk-denominated domestic securities held by non-residents, to direct investors. In the government sector (including the NBS), interest payments, especially on government bonds, remained at the level of the previous year.

In 2002, the balance of current transfers generated a surplus of Sk 8.7 billion, which was Sk 1.4 billion (almost 14%) less than in 2001. This was due to a fall in the receipts of companies based in the SR from unilateral transfers abroad, which was reflected in the transfers of corporate entities (e.g. benefits, damages, compensation from non-life

insurance, etc.). The fall in net income from current transfers in dollar terms (8.8%) indicates that, in addition to exchange rate developments, the balance was affected by the reduced inflow of such funds from abroad in real terms.

## **2.2. Capital and financial account**

The capital and financial account resulted in a surplus of Sk 234.3 billion, representing an increase of Sk 151.2 billion (more than 187%) in comparison with the same period a year earlier. The increase in the surplus was due mainly to growth in receipts from foreign direct investment as a result of the sale of State holdings to foreign entities.

Despite the sterilisation of privatisation proceeds at the NBS and the growing deficit in the trade balance and subsequently in the balance of payments on current account, the exchange rate of the koruna appreciated, mainly in the second half of the year, due to favourable expectations in respect of Slovakia (the election results, invitation to join NATO and the EU). The strengthening of the koruna vis-à-vis the euro was dampened by the activities of the NBS on the foreign exchange and money markets, since the pressure for currency appreciation was not in harmony with the actual economic situation.

The inflow of funds via the financial account in the amount of Sk 229.4 billion was ascribable mostly to the official sector (Government and the NBS). Including the proceeds of the National Property Fund (NPF) from the privatisation of state-owned companies, the official sector accounted for 63.6% of the total inflow of funds into the financial account. The inflow of funds into the banking sector (representing 26.8%) was due mainly to a fall in the deposits and other assets of Slovak banks abroad. The corporate sector absorbed 9.6% of the funds. The main reason behind the low inflow was the excess of repayment of old loans over the drawing of new long-term financial credits in the corporate sector

**Capital and financial account of the balance of payments****(Sk billions)**

	<b>2002</b>	<b>2001</b>
Capital account	4.9	3.8
Direct investment	181.7	72.0
Slovak capital abroad	-0.1	-2.0
Foreign cap. in the SR	179.8	58.6
of which: privatisation	152.0	33.9
Other capital	2.0	15.4
Portfolio investment	25.1	-12.5
SR abroad	12.3	-24.4
In the SR	12.8	11.9
Other long-term investment	-4.9	-10.3
Assets	12.5	-0.5
Liabilities	-17.4	-9.8
Short-term investment	27.6	30.1
Assets	19.8	1.9
Liabilities	7.8	28.2
Capital and financial account	234.3	83.1

(due partly to the repayment of government guarantees through the NPF).

The capital account, which comprises capital transfers of unilateral nature, resulted in a surplus of Sk 4.9 billion. The revenue side was dominated by funds granted to Slovakia through the PHARE, ISPA, SAPARD, and similar programmes.

Foreign direct investment (FDI) in Slovakia can be divided into three basic categories: the first category comprises the privatisation activities of the Government through the National Property Fund, where the volume reached Sk 152.0 billion, of which proceeds from the privatisation of SPP (Slovak Gas Industry) accounted for Sk 121.9 billion; proceeds from the privatisation of the Power Industry of Western Slovakia Sk 8.3 billion; proceeds from the privatisation of Slovenská poisťovňa (Slovak Insurance Co.) Sk 6.4 billion; proceeds from the privatisation of the Power Industry of Central Slovakia Sk 5.9 billion; proceeds from the privatisation of Transpetrol Sk 3.5 billion; the final payment for the privatisation of VÚB (General Credit Bank) accounted for Sk 3.3 billion; and the final payment for the privatisation of Slovenská sporiteľňa (Slovak Savings Bank) Sk 2.6 billion.

Secondly, foreign direct investment destined for increases in the equity capital of companies and banks in the SR, which belongs to the second category of FDI, reached Sk 27.8 billion. Of this amount, 37% was employed in individual sectors of industry, where the said amount was distributed over a large number of companies. Of individual sectors, significant investments were made only in the production of metals, plastics, foodstuffs and beverages. The increase in foreign holdings in the machine and electrical engineering industries, which accounted for only 6% of total investment in equity capital, indicates that, in 2002, Slovakia again failed to attract foreign investors to sectors which are subject to restructuring and modernisation, with the focus on new high-tech products with a higher added value, and which are expected to ensure the future growth of exports. In 2002, the share of trade and related services in the total increase in equity capital was less (31%) than the proportion of industry. The continued interest in this sector was still connected with the expansion of supermarkets in the SR. The remaining amount was invested in the banking, financial, and insurance sectors.

The third category of FDI was formed by other capital, including receivables from and payables to direct investors. After making a significant contribution to FDI in 2001, other capital as a whole played an insignificant role in 2002. The year-on-year increases in long-term loans provided to subsidiary companies based in Slovakia, indicate a gradual revival in lending activity and the use of this source of finance. The contribution of these funds to the coverage of investment demand is reduced by the structure of loans by sector, dominated by trade, trade-related services, transport, telecommunications, etc.

Portfolio investment, as part of the balance of payments on financial account, include transactions in equity and debt securities issued by the Government and the NBS, banks, and companies. Equity securities (shares) represent the ownership of property, while the investor's share in the property is less than 10%. Debt securities include bonds, bills of exchange, money market instruments, and financial derivatives.

In trading in foreign debt securities (assets), the strategy applied was changed in comparison with the past year, when commercial banks gradually reduced their holdings of foreign bonds purchased in previous years. In contrast with commercial banks, non-bank entities invested, though only to a limited extent, in the purchase of foreign securities. As a result of these transactions, the holdings of foreign securities fell by Sk 12.4 billion.

Foreign investors increased their holdings of domestic debt securities by Sk 12.8 billion. Their structure was dominated by government and corporate bonds. Corporate bonds were issued on foreign markets and were directed mainly to transport. Koruna-denominated government bonds were traded, as in the previous year, in large volumes, though these transactions followed a rather volatile course of development during the year. The inflow of capital through the sale of government bonds amounted to Sk 5.5 billion.

Other long-term investments recorded an outflow of funds in the amount of Sk 4.9 billion, which was due mainly to the smaller volume of drawings and the consequent excess of repayments over drawings.

In the corporate sector, financial credits were drawn in the amount of Sk 19.5 billion, which was only slightly more than 50% of the figure for the previous year. The amount drawn (the smallest since 1995) indicates a fall in interest in the use of foreign funds in the corporate sector. In 2002, interest continued to diminish in the generation and distribution of electricity, gas and water supply, transport and communications, in favour of trade and trade-related services, finance and insurance, and partly industry. Due to the large share of trade and trade-related services (more than 50%), drawings took place in smaller amounts and almost 40% of the funds was used for operating purposes.

Due to the large volume of credits drawn in the area of electricity generation and distribution, water and gas supply, transport, telecommunications, and the production of fuels in previous years, the structure of repayments by structure changes only very slowly (the above sectors accounted for 60% of the total volume repaid in 2002), as well as the excess of repayments over drawings. Although the repayment of financial credits in the corporate sector fell in comparison with the same period a year earlier by 30%, the net outflow of corporate funds of this type increased, from Sk 6.6 billion in 2001 to Sk 10.3 billion in 2002.

Long-term transactions in the government sector, including government agencies and the NBS, were connected mostly with the repayment of loans drawn in previous years, which reached almost Sk 17.0 billion. The repayment of government and NBS loans was accompanied by the drawing of a loan for the State Road Fund in the amount of Sk 1.2 billion. The inflow of funds into the government sector took place on the assets side and resulted from the repayment of part of the debt owed by the Russian federation, which

was assigned to Slovakia after the dissolution of the Czecho-Slovakia.

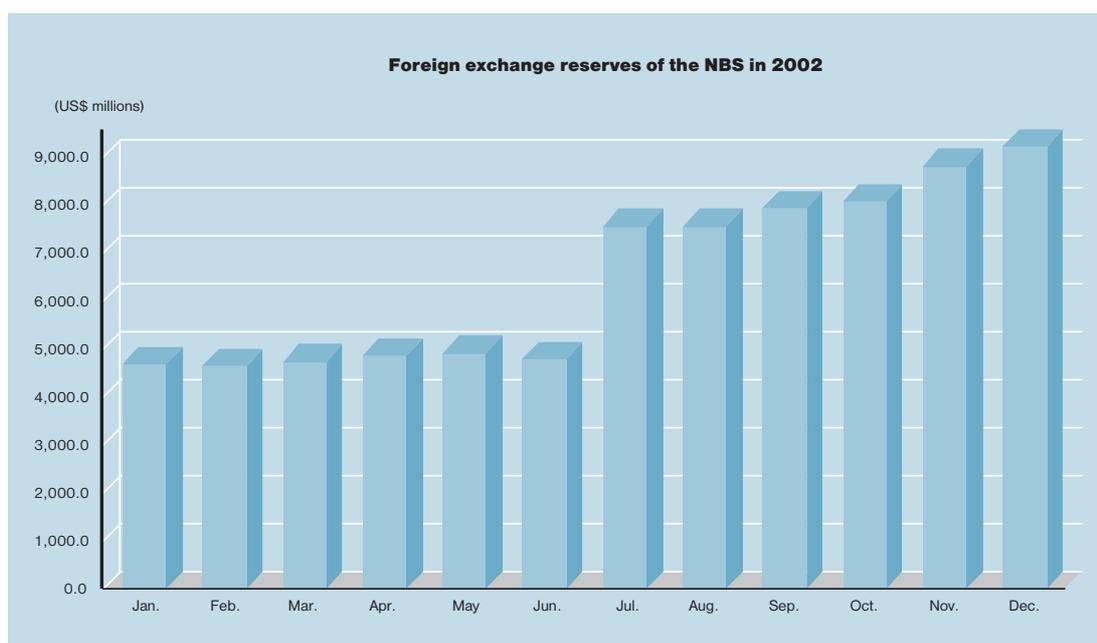
Short-term capital, which showed increased volatility during the year (on both sides of the balance sheet), recorded an inflow of Sk 27.6 billion. In short-term assets, a significant role was played by the deposits of commercial banks abroad and other receivables from abroad, which recorded a marked fall in volume (as a result of transactions), representing an inflow of Sk 26.8 billion. The decision of commercial banks to reduce short-term deposits and sell securities within the scope of portfolio investment, arose from the expected appreciation of the exchange rate, since the achievement of short-term foreign exchange positions (within the limits of banking supervision) increases their profits. Lending activity showed the opposite tendency, when new credits provided to non-residents by the corporate (commercial credits) and banking sectors (financial credits) exceeded repayments by Sk 6.9 billion.

The volume of short-term liabilities was affected substantially (a fall of Sk 9.5 billion) by the activities of the NBS. The repayment of liabilities arising from repo operations conducted within the scope of foreign exchange reserve

control, led to an outflow of funds in the amount of Sk 7.8 billion. The volume of short-term capital in the banking sector was affected, throughout the year, by a fall in the deposits of non-residents at commercial banks in the SR (which was due partly to the use of funds deposited at commercial banks in connection with the process of privatisation after audit). Repayments were also exceeded by drawings in the case of short-term commercial credits in the corporate sector and other short-term liabilities of commercial banks (subsides and similar funds, provided by parent banks to their subsidiaries).

### 2.3. Foreign exchange reserves

At the end of 2002, the foreign exchange reserves of the NBS reached US\$ 9,195.5 million, representing an increase of US\$ 4,404.4 million compared with the figure for 31 December 2001. The key factors positively affecting revenues were proceeds from the privatisation activities of the Government. Expenditures were determined by debt service payments effected on behalf of the Government and central bank interventions. The Bank's foreign exchange reserves were also affected during the year by



the exchange rates of fully convertible currencies on international financial markets. The surplus in the balance of revenues and expenditures in 2002 (US\$ 3,645.7 million) was accompanied by positive exchange rate differentials (US\$ 758.7 million), which resulted from the strengthening of other fully convertible currencies (especially the euro) in relation to the US dollar on international financial markets (the euro appreciated against the dollar by 18.1%).

The revenue side of foreign exchange reserves was determined in 2002 by the following factors:

- proceeds from the privatisation activities of the Government in the amount of US\$ 3,380.2 million (75.7% of the total revenue);
- yields from deposits and securities held in the portfolio of the NBS in the amount of US\$ 183.6 million;
- the drawing of government loans from foreign financial institutions in the amount of US\$ 26.1 million;
- receipts from interventions in the amount of US\$ 469.6 million and unblockings of foreign claims in the amount of US\$ 266.2 million;
- other revenues of the NBS in the amount of US\$ 140.9 million.

The expenditure side of foreign exchange reserves was affected in 2002 by:

- debt service payments on behalf of the Government in the amount of US\$ 282.1 million (30% of total expenditure), of which the payment of interest on government eurobonds issued in previous years accounted for US\$ 134.6 million;
- debt service payments on behalf of by the NBS in the amount of US\$ 41.3 million;
- the discharge of liabilities arising from repo operations in the amount of US\$ 172.7 million;
- other expenditures of the NBS in the amount of US\$ 325 million, were incurred mostly in connection with the realisation of cross-border payments for NBS clients (US\$ 163.3 million).

At the end of 2002, the foreign exchange reserves of the NBS were 5.9 times greater than the volume of average monthly imports of goods

and services to Slovakia during 2002. The foreign exchange reserves of commercial banks reached US\$ 1,185.2 million at the end of 2002. The volume of foreign exchange reserves in the banking sector, including the NBS, stood at US\$ 10,380.6 million at the end of the year.

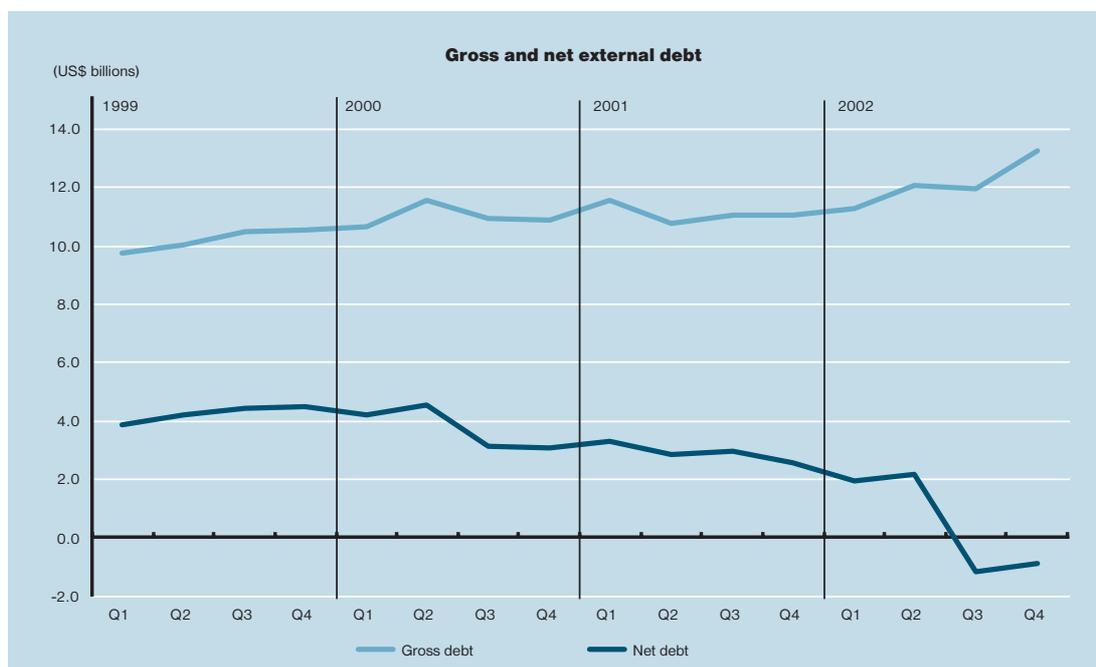
#### **2.4. External debt of the SR**

In accordance with the new methodology of reporting, the external debt of Slovakia includes, with effect from 1 January 2002, liabilities arising from gold swaps (part of the medium and long-term liabilities of the NBS) and repo operations conducted by the NBS (part of the Bank's short-term debt), as a result of which the official and total gross external debt of the Slovak Republic increased by US\$ 338 million.

Since 1 January 2002, the liabilities of the State Road Fund (roughly US\$ 350 million) have been included in the direct external debt of the Slovak Government. Until 31 December 2001, these liabilities had been reported as part of the liabilities of government agencies. The change in the classification of these liabilities had no impact on the total external debt of Slovakia.

Total gross external debt reached, according to preliminary data, US\$ 13.2 billion at the end of December 2002. Despite the growth in total gross external debt, its share in GDP (expressed in koruna) decreased by 4.9 percentage points, to 49.2%. The year-on-year increase in foreign debt (US\$ 1.8 billion) was due to exchange rate developments, mainly in the EUR/USD rate. The level of external debt (at fixed exchange rates from 1 January 2002) confirms that exchange rate differentials accounted for 66% of the total increase in foreign debt in 2002.

In the structure of total gross external debt, gross medium- and long-term foreign liabilities accounted for US\$ 9.0 billion. Short-term debt amounted to US\$ 4.2 billion at the end of December 2002. The share of short-term debt in



the country's total gross external debt reached 32.1% at the end of the year. Per-capita gross foreign debt stood at US\$ 2,452 at the end of December (compared with US\$ 2,116 at the beginning of the year).

Net external debt – expressed as the difference between gross external debt, i.e. US\$ 13.2 billion (liabilities of the Government and the NBS, liabilities of commercial banks, and liabilities in the corporate sector – except equity capital), and foreign assets, i.e. US\$ 14.1 billion (foreign exchan-

ge reserves of the NBS, foreign assets of commercial banks, and foreign assets in the corporate sector – except equity capital), reached US\$ 0.9 billion (creditor position) at the end of 2002, compared with US\$ 2.0 billion (debtor position) at the beginning of 2002.

## 2.5. Licensing activity of the NBS

In 2002, the licensing activity of the NBS took place in accordance with the country's foreign

### External debt of the SR

(US\$ millions)

	1. 1. 2002 <sup>1/</sup> current rate	31. 12. 2002 current rate	31. 12. 2002 fixed rate at 1. 1. 2002
<b>Total external debt of the SR</b>	11,380.5	13,188.2	12,001.3
<b>Long-term external debt</b>	8,143.0	8,951.5	8,109.1
<b>Government and the NBS <sup>2/</sup></b>	3,625.1	3,740.2	3,303.1
<b>Commercial banks</b>	95.2	245.7	222.8
<b>Entrepreneurial entities</b>	4,422.7	4,965.6	4,583.2
<b>Short-term external debt</b>	3,237.5	4,236.7	3,892.1
<b>Government and the NBS</b>	168.6	0.0	0.0
<b>Commercial banks</b>	779.6	1,289.5	1,169.5
<b>Entrepreneurial entities</b>	2,289.3	2,947.2	2,722.6

1/ New methodology in effect from 1 January 2002.

2/ Including government agencies and municipalities.

exchange regulations, which included provisions liberalising certain operations in foreign securities in comparison with the previous year.

By 31 December 2002, foreign exchange permits and licences had been issued as follows:

- foreign exchange permits: 409 permits and 14 extensions;
- foreign exchange licences: 69 licences and 43 extensions.

#### **Structure of investment by country**

<b>Country</b>	<b>Number of permits</b>	<b>Investments (in thousands of Sk)</b>
Ukraine	4	11,088.7
Libya	1	8,007.2
Bosnia-Herzegovina	1	4,799.7
Byelorussia	1	1,501.4
Yugoslavia	5	1,343.6
Croatia	1	101.8
Kazakhstan	1	40.0
<b>Total</b>	<b>14</b>	<b>26,882.4</b>

#### **Foreign exchange permits**

##### ***Investment abroad***

In 2002, the NBS issued 14 foreign exchange permits for direct investment in countries that are not members of the OECD or the European Economic Area (EEA), in the amount of Sk 26,882.4 thousand. Direct investment in OECD and EEA countries has been liberalised.

##### ***Trading in foreign exchange assets***

The NBS issued 39 foreign exchange permits for the exchange of foreign shares for foreign participation certificates.

##### ***Trading in financial derivatives***

The NBS issued 281 foreign exchange permits for the writing of option contracts for the purchase of employee shares or other preferential foreign securities, including 94 foreign exchange permits

for the opening of accounts at foreign banks and 1 foreign exchange permit for the coverage of import operations.

#### ***Opening of foreign-currency accounts at foreign banks***

The NBS issued:

- 44 foreign exchange permits and 7 extensions for the opening of accounts at foreign banks, for the purpose of covering necessary expenses incurred in connection with construction, assembly, and repair work abroad, in the total amount of Sk 1,148,399.0 thousand (estimated on the basis of contracts);
- 17 foreign exchange permits and 2 extensions for the opening of accounts for residents at foreign banks and for exemption from the transfer requirement in connection with the acceptance of financial credits from non-residents, in the amount of Sk 4,546,321.2 thousand, for payments for goods and services abroad, the construction of shopping centres in the SR, and in connection with the repayment of these credits from receipts abroad;
- 3 foreign exchange permits and 2 extensions in connection with the issue of bank guarantees; 1 foreign exchange permit for the financing of re-exports, 5 foreign exchange permits and 2 extensions for the provision of services abroad (tourism, installation of payment systems); 2 foreign exchange permits and 1 extension for the placement of funds in the accounts of foreign brokers (for dealers in securities); and 2 permits for participation in the system of financing applied within a specific group of companies.

#### **Foreign exchange licences**

The NBS issued:

- 61 foreign exchange licences and 41 extensions for trading in foreign currencies and traveller's cheques (non-bank exchange offices);
- 8 foreign exchange licences for transactions in foreign securities (for dealers in securities) and 2 extensions for the provision of financial services to and from abroad.

### **3. PUBLIC SECTOR**

#### **Budgetary performance**

Budgetary performance in 2002 was regulated by Act No. 586/2001 Z. z. on the State Budget, with total revenue projected in the amount of Sk 219.9 billion and total expenditure estimated at Sk 257.9 billion. The budget deficit was set at Sk 38 billion for 2002 (Article 1), but Article 11 of the above Act allowed the deficit to be increased by the amount of funds obtained from government bonds issued for the financing of bank restructuring (up to Sk 9.5 billion Sk), the amount of credit provided by the World Bank for the issue of government bonds for the financing of bank restructuring (up to Sk 3.2 billion) and the coverage of liabilities arising from government guarantees (up to Sk 2.8 billion), i.e. by Sk 15.5 billion in total, to Sk 53.5 billion.

At the end of 2002, the State Budget resulted in a total deficit of Sk 51.7 billion. The deficit in current budgetary performance amounted to Sk 37.1 billion, i.e. the actual annual deficit accounted for 97.6% of the budgeted figure.

Total budget revenue reached Sk 220.4 billion, i.e. 100.2% of the figure budgeted for 2002 (Sk 15.0 billion more than in 2001). The most significant contribution (Sk 188.8 billion) to the growth in budget revenue was made by tax revenues (app. 85.7%). Total tax revenue exceeded the budgeted level by Sk 8.1 billion, i.e. the budget was fulfilled to 104.5%. Compared with the same period a year earlier, tax revenue increased by Sk 23.4 billion, with the strongest year-on-year growth being recorded in revenue from value-added tax. Non-tax revenues remained roughly Sk 7 billion below the budgeted level and were lower than a year earlier. Their volume reached Sk 21.3 billion (of which, cash receipts from the unblocking of Russia's debt to the SR accounted for Sk 6.1 billion), representing 75% of the annual budget. Other revenues totalled Sk 10.3 billion.

The most significant contribution to the growth in budget revenues was derived from corporate income tax, which exceeded the budgeted level by Sk 5.1 billion and figure for the previous year by Sk 7.6 billion.

Revenue from personal income tax was also above the budgeted figure at the end of the year (the budget was fulfilled to 104.6%) and exceeded the level of 2001 by Sk 2.1 billion.

Revenue from value-added tax corresponded roughly to the budgeted figure (100.3%). In comparison with the previous year, the annual revenue increased by Sk 8.7 billion.

Revenue from excise duties exceeded the budgeted level by Sk 1.2 billion, and was Sk 3.6 billion higher than in 2001.

Budget expenditure totalled Sk 272.0 billion, representing 105.5% of the budgeted figure. At the end of December, total expenditure exceeded the budgeted level by Sk 14.1 billion, due to expenditure on bank restructuring. Budget expenditure was Sk 22.3 billion higher than in 2001.

#### **Government guarantees**

In accordance with Act No. 586/2001 Z. z. on the State Budget, the limit for government guarantees for 2002 was set at 13% of the budget revenue, and amounted to Sk 28.6 billion.

In 2002, government guarantees were provided in the total amount of Sk 16.8 billion, representing 58.9% of the limit. The largest beneficiaries were Železnice SR (Slovak Railways, receiving 74% of the guarantees); Železničná spoločnosť, a.s. (Railway Co., plc. – 17.8%); METRO Bratislava, a.s.; Slovenský vodohospodársky podnik, š.p., Banská Štiavnica (Slovak Water Resources Management Co., state comp.); Slovenská rozvojová a záručná banka, a.s., Bratislava (Slovak Guarantee and Development Bank, plc.); and Slovenské lodenice Komárno, a. s. (Slovak Shipyards, plc.).

Over the year under review, government guarantees were paid in the total amount of Sk 4.6 billion, for Vodohospodárska výstavba, š.p., Bratislava (Water Resources Management Co., state comp.); Papierenská továreň Žilina, a. s. (Paper Factory, plc.); Imuna, š.p., Šarišské Michaľany; and Slovenské lodenice Komárno, a.s. The guarantee commitments were settled from the budget of the NPF SR (from privatisation proceeds), since there was no reserve for this purpose in the State Budget for 2002.

### **Relationship between the NBS and the State Budget of the SR**

At the same time the amended version of the National Bank of Slovakia Act (No. 149/2001 Z. z.) came into effect, an agreement was signed between the NBS and the Ministry of Finance of the SR (MF SR) on the payment of interest on the credit balance of the summary memorandum account of the Slovak Republic, at a rate corresponding to the overnight sterilisation rate of the NBS, with effect from 1 May 2001. The agreement was implemented continuously over the course of 2002. The regular quarterly payment of interest was effected at the level of the NBS sterilisation rate, which was modified on two occasions during the year (with effect from 27 April 2002 and 18 November 2002).

Interest paid on the balance of the summary memorandum account of the Slovak Republic held by the NBS, reached Sk 600.7 million during the year. The possibility of selling time deposits at a more advantageous rate of interest (at the level of the relevant BRIBOR rate) was not utilised by the MF SR in 2002.

During the year, funds obtained from the privatisation of SPP (Slovak Gas Industry) were deposited in a special one-year account at the NBS in the amount of Sk 61.7 billion. The funds were earmarked for the pension reform, with the interest being capitalised, hence the interest costs of the NBS reached Sk 2.3 billion.

According to Act No. 586/2001 Z. z. on the State Budget, the NBS was to transfer Sk 4.7 billion of its remaining profit to the State Budget in 2002, but in fact no transfer was made due to the loss recorded in the NBS overall budgetary performance.

### **State financial assets and liabilities**

State financial assets in the form of deposits with the NBS amounted to Sk 8.9 billion at the end of the year, representing a year-on-year increase of Sk 6.2 billion.

The increase in state financial assets was due mainly to the repayment of part of a revolving loan to ČSOB (in the amount of Sk 6 billion), which was provided at the beginning of 2000 in the total amount of Sk 10 billion.

State financial liabilities reached zero value at the end of 2002.

### **State funds in 2002**

Special tasks, financed in part from the State Budget, were performed only by three State funds in 2002. Two of them operated throughout the year: the State Housing Development Fund and the State Fund for the Liquidation of Nuclear Power Engineering Facilities and Handling of Spent Fuels and Radioactive Waste. The third, i.e. the Fund for Alimony Compensation, was established only for a period of one month. For the settlement of justified claims, the Fund received Sk 5 million from the National Property Fund.

The resources of State funds amounted to Sk 10.5 billion at the end of 2002. Excluding funds which were allocated from the State Housing Development Fund to individual entities but remained unused, State funds had Sk 8.9 billion at their disposal at the end of the year. This represented an increase of Sk 2.5 billion over the beginning of the year.

### **National Property Fund (NPF)**

Despite attempts to redeem all NPF bonds, 13,471 NPF bonds remained unredeemed (on 31 December 2002), due to inaccurate identification data having been provided by the persons concerned and unfinished inheritance proceedings. Of this figure, 87 bonds worth Sk 13,740 were held by corporate entities and foreign natural persons, and 13,384 bonds worth Sk 11,496 were owned by domestic natural persons.

In 2002, the budgetary performance of the NPF resulted in a surplus of Sk 1.4 billion. Total income reached Sk 163.8 billion and was dominated by proceeds from the sale of shares of power engineering companies and from bank privatisation. The largest income was derived from the sale of 49 % of the shares in SPP (Slovak Gas Industry) for USD 2.8 billion (Sk 123.6 billion) to a consortium of Ruhrgas, Gaz de France, and Gazprom. At the same time, the Power Industry of Western Slovakia, a.s., Bratislava; Power Industry of Central Slovakia, a.s., Žilina; and the Power Industry of Eastern Slovakia, a.s., Košice were privatised. The dominant part of privatisation proceeds was used for the pension reform, government bond redemption, and for the repayment of loans secured by government guarantee.

### **Budgetary performance in public finance**

The public budget of the SR consists of the following components: the State budget, the budgets of State funds, the budgets of municipalities, the budget of the Social Insurance Institution, the budgets of health insurance companies, the budget of the National Labour Office, the budget of the National Property Fund of the Slovak Republic, and the budget of the Slovak Land Fund. For 2002, the deficit in the public budget was set at Sk 36.8 billion, i.e. 3.5% of GDP (in accordance with Article 1 paragraph 2 of the State Budget Act of 2002). The actual budget

deficit (excluding the costs of bank restructuring) reached Sk 29.8 billion in 2002, i.e. 2.8% of GDP. The deficit is based on the so-called 'cash principle'.

With the approaching entry of Slovakia into the European Union, it became necessary to harmonise the system of data compilation and reporting in the area of public finance with the ESA 95 methodology. According to this methodology, the fiscal deficit in the public sector reached Sk 77.8 billion in 2002, i.e. 7.2% of GDP. Since the deficit was not budgeted according to this methodology in 2002, it cannot be compared with the budget objectives.

## **4. MONETARY POLICY AND MONETARY DEVELOPMENTS**

In 2002, the NBS implemented its monetary policy in an environment marked by falling inflation, persistent economic growth, appreciation of the exchange rate of the koruna, and improvement in the country's trade balance in comparison with 2001, especially in the second half of the year.

The National Bank of Slovakia continued to apply a qualitative method of monetary policy implementation in 2002, based on the setting of key interest rates. In the area of monetary policy instruments, the harmonisation of the Bank's monetary policy instruments with those applied by the ECB continued.

During 2002, the Bank Board of the NBS decided, on the basis of an analysis of actual macro-economic developments and a forecast for the coming period, to modify its key interest rates on three occasions. With effect from 27 April 2002, the Bank Board raised the key rates by 0.5 of a percentage point, i.e. the limit rate for two-week repo tenders to 8.25%, the rate for overnight refinancing to 9.50%, and that for overnight sterilisation to 6.50%. In so doing, the NBS responded to the deepening external

economic imbalance, mainly the continued growth in the trade deficit, increase in the internal imbalance, and the absence of adequate measures for the elimination of risks involved in this development.

Commercial banks reacted to the increase in key NBS rates by raising the corresponding rates for all maturities on interbank market. The change in key interest rates was also reflected, with a time delay of one month (i.e. in June), in customer interest rates, mainly in rates for new loans.

At its meeting on 29 October 2002, the Bank Board pointed out that, in view of the potential impact on demand and, indirectly, on inflation, the risks associated with the development of public finance in 2002 were diminishing, there was a strong probability that measures would have to be taken for the elimination of risk factors in 2003, and that the trade balance for the past twelve months in cumulative terms had recorded a fall in the size of the deficit in the second half of 2002. Due to the above, the Bank Board decided to lower the limit rate for two-week repo tenders by 0.25 of a percentage point (to 8.0%), while leaving the rates for overnight transactions unchanged (i.e. the rate for overnight sterilisation at 6.5% and that for overnight refinancing at 9.5%).

The results of parliamentary elections, coupled with progress in the area of accession talks with the EU and NATO, led to growth in the positive expectations of foreign investors. This development was supported by an improvement in the rating of Slovakia (by Moody's and Fitch Ratings). This led to growing pressure for appreciation in the exchange rate of the Slovak koruna in the first half of November. This exchange rate development was caused mostly by non-economic and speculative factors, and was not in accordance with the actual course of economic development. For that reason, the NBS intervened in the foreign exchange market against appreciation of the currency and, with regard to the intensity of speculation, lowered all the key interest rates by 1.5 percentage points (with effect from 18 November 2002) in support of the effect of

foreign exchange interventions. The limit rate for two-week repo tenders was reduced to 6.5%, the rate for overnight sterilisation transactions to 5.0%, and that for overnight refinancing to 8.0%.

The changes in key interest rates were reflected in interbank rates in full and subsequently in rates for primary customers. After the second reduction in key interest rates, interbank deposit rates fluctuated below the level of 6.50% (especially the rates for longer-term deposits), while their fall in the consequence of the cut in key interest rates was also supported by the surplus of liquidity and expected reduction in the ratio of required reserves, with effect from 1 January 2003.

In 2002, the NBS continued to implement its monetary policy in an environment marked by an excess of liquidity, so the focus remained on sterilisation. In comparison with 2001, however, the Bank's sterilisation activity increased in terms of quantity. The volume of funds sterilised through open market operations (i.e. direct sterilisation) grew, from Sk 58.1 billion at the beginning of 2002 to Sk 143.9 billion at the end of the year. The average sterilisation position of the NBS vis-à-vis the banking sector increased by Sk 35.8 billion during 2002, to Sk 91.5 billion.

Including the proceeds from the sale of State holdings held in a special account of the National Property Fund and in a time deposit account of the Ministry of Finance at the NBS, earmarked for the reform of social insurance (indirect sterilisation), the total volume of sterilisation reached Sk 209.1 billion on 31 December 2002.

#### **4.1. Monetary aggregates**

The rate of growth in M2 (at fixed 1993 exchange rates) slowed to 4.7% in 2002, from 11.9% in 2001 and 14.2% in 2000. In contrast with the previous year, growth in the money supply was stimulated primarily by net foreign assets, while net domestic assets declined. This

development was due mainly to an inflow of privatisation proceeds from abroad in the second half of the year (mainly in July 2002).

Net foreign assets in the banking sector (at fixed 1993 exchange rates) increased from the beginning of the year by Sk 111.4 billion in absolute terms. This increase was due to proceeds from privatisation, the unblocking of part of Russia's debt in September, and to interventions on the foreign exchange market through which the NBS sterilised part of the inflow of speculative foreign capital.

Net domestic assets fell in comparison with the beginning of the year by Sk 81.1 billion, due to improvement in net credit to the government and the NPF, resulting from an inflow of privatisation proceeds. However, the growth in net foreign assets was not offset fully by the fall in net domestic assets, due primarily to an increase in the budget deficit and the use of privatisation proceeds for consumption. Furthermore, the structure of net domestic assets was affected by another non-standard factor, i.e. the closure (without liquidation) of Konsolidačná banka, š. p. ú., in February and its take-over by Slovenská konsolidačná, a. s., which was placed by the Statistical Office, on the proposal of the Ministry of Finance, under the public administration sector. As a result of this change, the statistically recorded volume of loans to households and enterprises fell by Sk 31.5 billion and net credit to the Government increased by Sk 11.4 billion in February.

Excluding the statistical fall in the loans of Konsolidačná banka, the volume of loans to households and enterprises recorded an increase of 9.2% (according to the method of ex-ante adjustment) and 13.8% (according to the method of ex-post adjustment) in 2002, compared with 5.4% and 8.3%, respectively, in 2001.

Privatisation played an important part in moderating the government's indebtedness vis-à-vis the banking sector, when net credit to the government (at fixed 1993 exchange rates) fell in comparison with the beginning of the year by Sk

73.9 billion in absolute terms. Proceeds from the privatisation of SPP; Transpetrol; Slovenská poisťovňa; the energy distribution facilities of Slovenské elektrárne, including the release of fixed deposits from the sale of Slovenská sporiteľňa and VÚB, totalled roughly Sk 150 billion in 2002. Of this amount, pressure for a fall in net credit to the government was exerted by funds earmarked for the pension reform, held in a time deposit account of the MF SR at the NBS, in the amount of Sk 63.7 billion (as at the end of the year, including interest net of tax).

#### **4.2. Structure of the money supply**

In 2002, the M2 money supply (at fixed 1993 exchange rates) increased by Sk 30.3 billion, to Sk 681.5 billion at the end of December. The increase was concentrated in the final quarter, when the money supply grew in volume by Sk 24.3 billion. The year-on-year dynamics of M2 slackened from 11.9% in December 2001 to 4.7% in December 2002.

During the year, the volume of currency in circulation outside banks grew by Sk 3.2 billion, while the year-on-year rate of growth slowed, from 20.9% in December 2001 to 4.0% in December 2002. In the first quarter, currency in circulation was characterised by a trend of increase in year-on-year dynamics (to 22.7% in March), which was followed by a marked slowdown in the rate of growth from the second quarter. The slowdown was partly due to growth in the popularity of non-cash payments, which was indicated by an increase in both the number of cash cards issued in 2002 (25%, i.e. 500 thousand, compared with an increase of 15% in 2001) and the volume of transactions concluded via payment cards.

Slovak-koruna deposits (demand and time deposits in total) grew by Sk 18.2 billion from the beginning of the year, and their year-on-year growth dynamics diminished from 10.6% in December 2001 to 3.7% in December 2002. The increase in Sk deposits took place in both

### Year-on-year changes in deposits

	Year-on-year change in %			Year-on-year change in Sk billions		
	2000	2001	2002	2000	2001	2002
<b>Household deposits</b>	8.3	7.8	1.4	26.4	26.7	5.1
demand deposits	33.4	24.3	8.9	13.5	13.1	6.0
time deposits	5.0	2.4	-2.3	12.0	6.0	-5.9
in foreign currency	2.4	19.0	10.2	0.9	7.6	5.0
<b>Corporate deposits</b>	27.3	16.8	11.1	36.2	28.4	22.0
demand deposits	18.6	21.5	10.4	10.4	14.2	8.4
time deposits	30.4	18.3	10.8	17.7	13.9	9.7
of which: insurance companies	23.1	9.1	-22.4	3.9	1.9	-5.1
in foreign currency	43.8	1.1	14.2	8.1	0.3	3.9

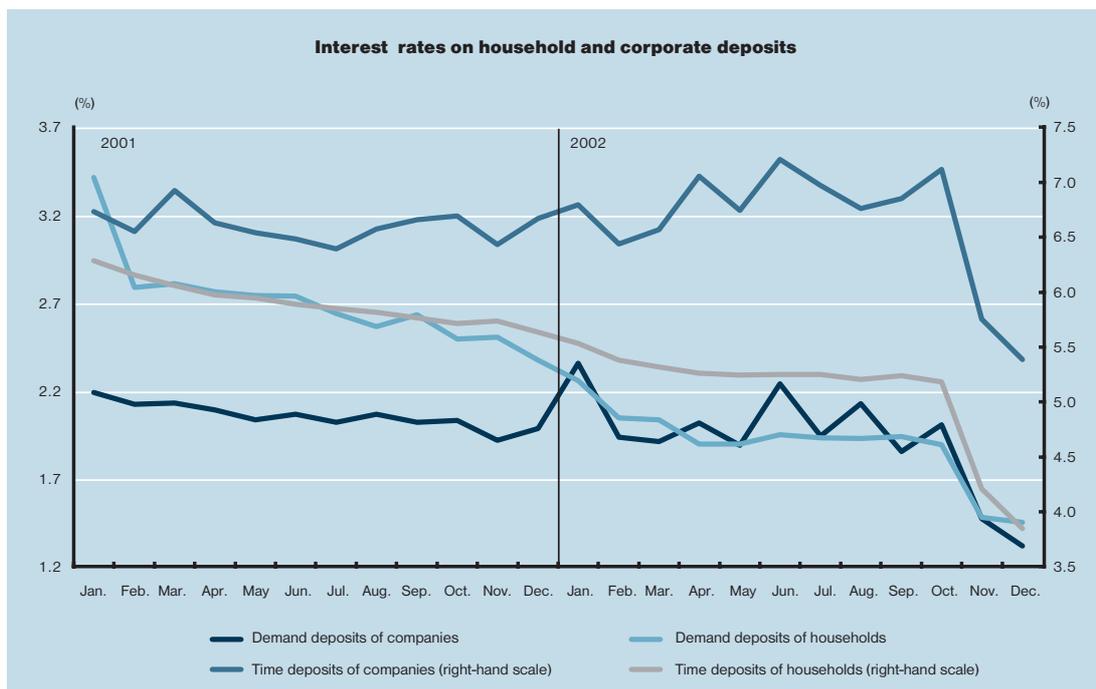
demand (Sk 14.4 billion) and time deposits (Sk 3.8 billion). The rate of year-on-year growth in demand deposits slowed considerably, by 12.9 points (to 9.8%), and the dynamics of time deposits by 5.0 points (to 1.1%). The year-on-year increase in Sk deposits took place mostly in corporate deposits. Household deposits in Sk followed an atypical course of development in 2002, when their volume remained virtually unchanged on a year-on-year basis (for the first time in 1993).

The development of koruna deposits in 2002 continued to be characterised by a trend of preference for short-term and demand deposits in the individual sectors of the economy. This trend was apparent mainly in the deposits of corporate entities, of which demand and short-term deposits in total accounted for roughly 97% (their share was stable and remained virtually unchanged during the year). Within the structure of corporate deposits, the most significant increases were recorded in the most liquid deposits, i.e. demand deposits (Sk 8.4 billion), time deposits with a maturity of up to one month (Sk 7.8 billion) and up to three months (Sk 2.7 billion), while six-month deposits fell in volume by Sk 2.0 billion. Longer-term deposits remained virtually unchanged, except two-year time deposits, which fell in volume by Sk 1.1 billion (the fall was probably due to a cut of 3.0 points in the rate of interest). The interest rate differential between demand and time deposits diminished by 0.6 points (to 4.1 points), with the average

rate for time deposits falling at a faster rate (1.3 points) than the rate for demand deposits (0.7 points).

The trend of preference for highly liquid assets also persisted in the household sector. In comparison with December 2001, the share of demand and short-term deposits in total household deposits in Sk increased by 1.9 points (to 79%), due primarily to an increase in demand deposits. The time deposits of households fell by Sk 5.9 billion in 2002. The fall took place predominantly in longer-term deposits: long-term savings deposits fell by Sk 3.0 billion (of which home savings deposits by Sk 2.0 billion), medium-term savings deposits by Sk 2.2 billion, and time deposits with an agreed maturity of up to 3 years, by Sk 1.1 billion. Short-term deposits remained virtually unchanged, but their structure underwent a distinct change. The fall in one-month deposits (Sk 3.8 billion) was offset by an increase in six-month deposits (Sk 2.2 billion), nine-month deposits (Sk 0.8 billion), and other short-term savings deposits (Sk 0.6 billion). The interest rate differential, i.e. the difference between interest rates on demand and time deposits for households, diminished by 0.9 points (to 2.4 points) as a result of a greater fall in interest rates on time deposits (1.8 points) than in demand deposits (0.9 points).

The atypical development of Sk deposits in the household sector in 2002 was probably connected with the growing utilisation of alternative investment opportunities (e.g. trust funds) as



a result of a fall in customer interest rates. At the same time, the diminishing interest rate differential tended to reduce the attractiveness of time deposits in comparison with demand deposits.

If we compare the rates of interest on household and corporate deposits in Sk, two tendencies become apparent in 2002. While in the case of demand deposits, the interest rate differential diminished during the year (and the rates reached roughly the same level at the end of 2002), in the case of time deposits, the differential increased still further (in December 2001, corporate deposits attracted an interest rate 1 percentage point more than household deposits; the rate in December 2002 was 1.5 percentage point higher).

In 2002, deposits in foreign currency grew in volume by Sk 8.9 billion (i.e. 11.6%), but their year-on-year dynamics weakened in comparison with December 2001 (Sk 7.9 billion, i.e. 11.9%). The increase took place in both household (Sk 5.0 billion) and corporate deposits (Sk 3.9 billion). Within the structure of foreign-currency deposits, the trend of preference for demand and short-term deposits also applied, as in the case of Sk deposits, to the corporate and household sectors, which accounted for almost 100% of total

deposits in foreign currency. The year-on-year rate of growth in household deposits in foreign currency slowed, from 19.0% in December 2001 to 10.2% in December 2002. The year-on-year dynamics of corporate deposits in foreign currency increased, from 1.1% in December 2001 (the low rate of growth was connected with the high basis of comparison in 2000 caused by an inflow of foreign capital) to 14.2% in December 2002. Since foreign-currency deposits showed the most dynamic growth in 2002 among the components of the money supply, their proportion of total deposits increased from 11.5% to 12.5%.

### 4.3. Lending activities

Loans in Sk and foreign currency provided to the entrepreneurial sector, households, central and local authorities for extra-budgetary purposes, are loans reported by the banking sector according to the rules of statistical reporting. They are not adjusted for data on banks which have been closed, accounting transfers connected with restructuring from previous years, and from a procedural point of view, they are not to be confused with loans to households and enterprises according to the methodology of the monetary survey, which does not include the government sector.

The volume of loans in Sk and foreign currency provided to the entrepreneurial sector, households, central and local authorities for extra-budgetary purposes, and to non-residents by commercial banks and the NBS, grew year-on-year by Sk 13.2 billion. Slovak-koruna loans increased by Sk 11.4 billion and loans in foreign currency by Sk 1.8 billion. At the end of the period, the total volume of loans reached Sk 351.5 billion, of which Sk loans accounted for Sk 291.5 billion and loans in foreign currency Sk 60.0 billion.

The development of koruna loans was affected by the closure (without liquidation) of Konsolidačná banka, š. p. ú. (Consolidated Bank, state financial institution), and its take-over by Slovenská konsolidačná a. s. (Slovak Consolidated, plc.) – an agency, which is not a bank and comes under the public administration sector. As a result, the volume of loans fell by Sk 31.7 billion (loans to non-financial organisations by Sk 31.5 billion and loans to the public administration sector by Sk 0.2 billion). At the same time, however, loans to the public administration sector grew in volume by Sk 11.5 billion (a redistribution loan granted by the NBS to Konsolidačná banka changed from an interbank loan into a loan to the public administration sector). Leaving this change out of account, loans in Sk increased by Sk 31.6 billion in 2002.

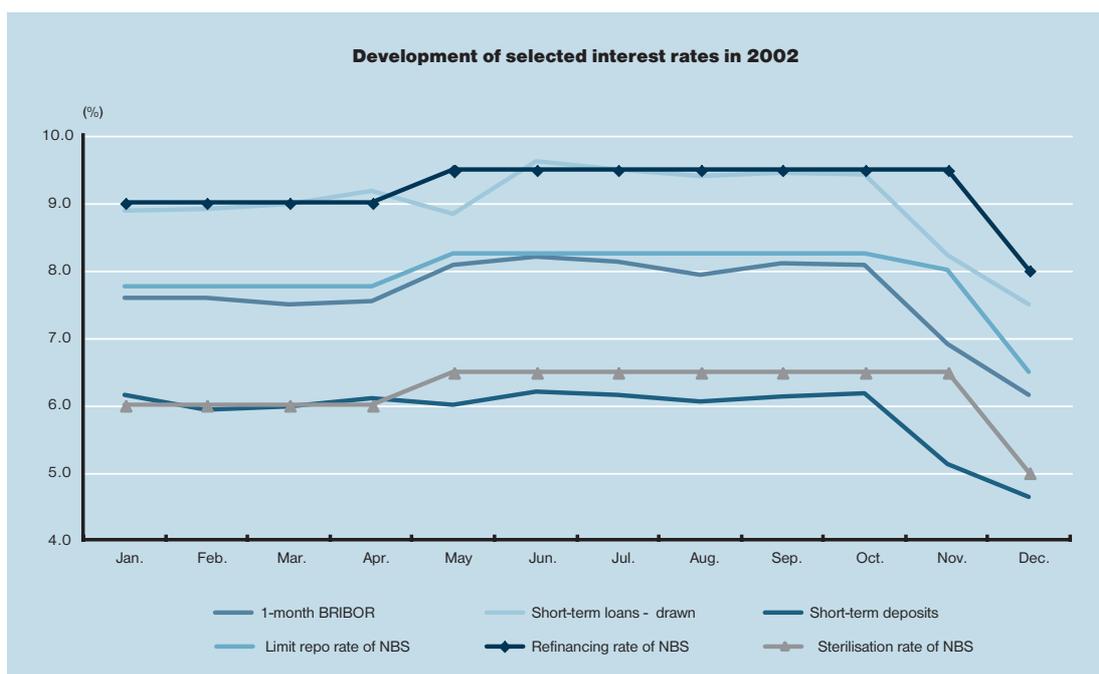
Within the structure of Sk loans by term (based on adjusted time series), short-term loans increased by Sk 9.9 billion, medium-term loans by Sk 5.9 billion, and long-term loans by Sk 15.6 billion in 2002. Short-term loans in foreign currency declined by Sk 0.2 billion, medium-term loans grew by Sk 2.8 billion, and long-term loans fell by Sk 0.9 billion.

Of the total volume of new loans provided in 2002 (Sk 731.8 billion), loans to the entrepreneurial sector accounted for 92.9% and were predominantly under foreign control. Most new loans were short-term loans (87.5%). Households accounted for 4.5% of the total volume of new loans.

As for the structure of new loans by purpose, operating loans accounted for 66.8% and overdraft facilities 14.0% of the volume of new loans in 2002.

#### 4.4. Interest rate developments

During 2002, the level of customer interest rates was determined by the key interest rates of the NBS. Their increase at the end of April (by 0.5 of a percentage point) led to a rise in primary interest



rates on new loans (mainly short-term loans). The reaction of average interest rates was less pronounced. In October, the NBS lowered the limit rate for two-week repo tenders by 0.25 of a percentage point, and in November, all key interest rates by 1.5 percentage points, which affected the rates of interest on new loans and deposits.

The average interest rate on new loans fell during the year by 1.2 percentage points, to 7.8%. Interest rates on new loans were, to a considerable extent, affected by changes in the refinancing rate of the NBS.

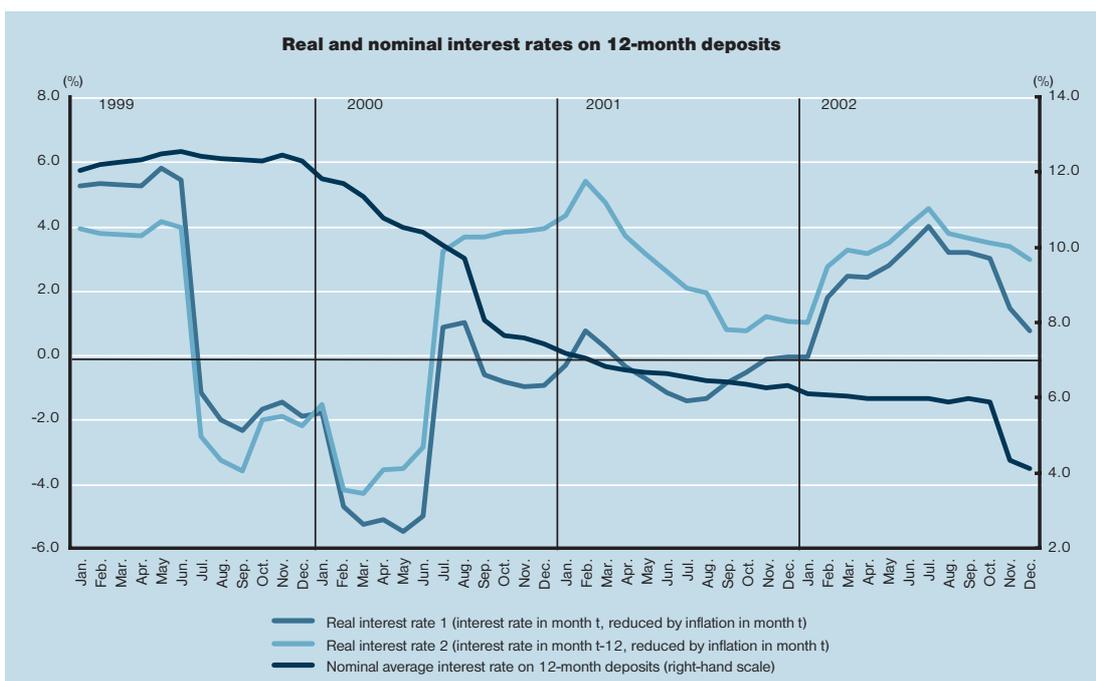
The most pronounced reaction to changes in the refinancing rate was recorded in the average rate for new short-term loans, which fell year-on-year by 1.3 percentage points, to 7.5%. With regard to their large share in the total volume of new loans (87.5%), short-term loans had the most significant effect on bank lending.

Medium-term loans recorded a fall in the average rate of interest (0.4 of a percentage point, to 9.5%), while their share in total new loans was 8.4%. The average interest rate on long-term loans fell by 1.7 percentage points, to 8.4%, while the proportion of these loans was only 4.2%.

Within the structure of new loans by purpose, interest rates fell in 2002 on all types of loans with the exception of consumer loans for households and other loans. The most pronounced fall occurred in interest rates on bills-of-exchange loans and overdraft facilities, to 8.5% and 9.3% respectively. New loans were dominated by operating loans (66.8% in cumulative terms), with the average interest rate falling by 1.6 percentage points, to 6.8%.

The average interest rate on the total volume of loans (excluding loans with zero interest rate) fell by 1.0 percentage point during the year, to 8.8%. The average rate for short-term loans fell by 1.4 percentage points (to 8.9%) and that for medium-term loans by 0.8 of a percentage point (to 9.4%). The average interest rate on long-term loans fell by 0.8 of a percentage point, to 8.1%. The reaction of interest rates on total loans to increases in key NBS rates was moderate and remained below the level of the change in key interest rates. On the other hand, the cuts in NBS rates in October and November triggered pronounced reactions on the part of interest rates on the volume of loans.

Average interest rates on deposits reacted to the increase in key NBS interest rates at the end of April with a change in the price of short-term



deposits at a month's delay, when they fell further in May. Average deposit rates reacted more intensely to the second cut in key NBS rates in November, i.e. with a marked fall, which continued in December. On a year-on-year basis, the average interest rate on total deposits fell by 1.4 percentage points, to 3.5%. The average rate for time deposits fell by 1.6 percentage points (to 4.4%) and that for demand deposits by 0.9 of a percentage point (to 1.6%).

The average interest rate on short-term deposits fell significantly in comparison with the figure for the end of 2001, by 1.5 percentage points, to 4.6%. Within the structure of short-term deposits, the greatest fall took place in average interest rates on deposits with an agreed maturity of up to 1 year (2.2 percentage points, to 4.1%) and deposits redeemable at a period of notice of up to 7 days (2.0 percentage points, to 4.0%).

Compared with December 2001, the average interest rate on medium-term deposits fell by 3.5 percentage points, to 3.8% in December 2002. The fall took place mostly in deposits with an agreed maturity of up to 2 years (3.7 percentage points, to 2.8%) and up to 3 years (3.5 percentage points, to 6.8%). The average rate for long-term deposits fell year-on-year by 0.8 of a percentage point, to 3.0%.

The real interest rate (the average interest rate compared with the 12-month rate of inflation in 2002) on one-year deposits reached a positive value of 0.7% in December 2002, representing an increase of 0.8 of a percentage point in comparison with the figure for the end of 2001. This was due to a fall in year-on-year inflation (from 6.4% to 3.4%), which was more pronounced than the fall in the average interest rate on one-year deposits (from 6.3% to 4.1%).

If we compare the average rate for one-year deposits in December 2001 and the 12-month inflation rate in December 2002, the real interest

rate reaches 2.9% (positive value). On a year-on-year basis, the real interest rate rose by 1.9 percentage points, due to a fall in inflation in December 2002 (3.0 percentage points in comparison with December 2001), well exceeding the fall in the average rate for one-year deposits in December 2001 (1.1 percentage points compared with December 2000).

#### **4.5. Monetary policy instruments**

##### **Interest rate policy**

###### *a) Limit rate for standard two-week repo tenders conducted by the NBS <sup>1/</sup>*

from 26 March 2001	7.75%
from 27 April 2002	8.25%
from 30 October 2002	8.00%
from 18 November 2002	6.50%

###### *b) Interest rate for overnight refinancing operations between the NBS with commercial banks:*

from 26 March 2001	9.00%
from 27 April 2002	9.50%
from 18 November 2002	8.00%

###### *c) Interest rate for the overnight deposits of commercial banks with the NBS:*

from 26 March 2001	6.00%
from 27 April 2002	6.50%
from 18 November 2002	5.00%

###### *d) Discount rate:*

from 13 January 1996	8.80%
from 1 January 2002 corresponds to the limit rate for standard two-week NBS repo tenders;	
from 1 January 2003 base rate of the NBS <sup>2/</sup>	

##### **Monetary policy instruments of the NBS**

###### **Open market operations**

###### *a) Main instrument:*

*Standard repo tender with a maturity of two weeks – conducted by the NBS with*

<sup>1/</sup> On 12 December 2002, the Bank Board of the NBS decided to introduce a base rate for the National Bank of Slovakia with effect from 1 January 2003. The base rate of the National Bank of Slovakia is the Bank's interest rate 14-day repo tenders.

<sup>2/</sup> In generally binding legal regulations, the term 'discount rate of the National Bank of Slovakia' or 'discount rate of the State Bank of Czecho-Slovakia' refers to the base rate of the National Bank of Slovakia.

commercial banks at regular weekly intervals. The NBS set a limit rate for such operations.

- b) *Instrument for longer-term liquidity control: Issue of NBS bills* bills for the portfolios of commercial banks – an instrument of the NBS for longer-term liquidity control in the banking sector. Auctions in NBS bills were conducted at irregular intervals, by using the Dutch auction technique.
- c) *Fine-tuning instrument: Quick tender* – an instrument of the NBS for fine-tuning the level of liquidity in the banking sector (was not applied in 2002).
- d) *Structural operations: Individual transactions* – an instrument of the NBS enabling a direct purchase or sale of government securities for or from the portfolio of the NBS (not applied in 2002).

### **Automatic operations (standing facilities)**

- a) *Overnight refinancing operations:* Commercial banks have automatic access to sources of finance (provided they have a sufficiency of acceptable securities) at the rate of interest announced.
- b) *Overnight sterilisation operations:* Commercial banks are allowed to deposit excess funds in the form of non-collateralised deposits, at the rate of interest announced.

### **Other instruments**

- a) *Redistribution loans:*
- Traditional: interest rate = rate for two-week repo tender + 0.5%;
- Soft loans: interest rate = rate for two-week repo tender - 2% + 0.5%.
- b) To maintain a bank's liquidity, the National Bank of Slovakia may provide, in exceptional cases, a short-term loan to the bank for a period of up to three months. Such a loan was not provided over the course of 2002.

### **Reserve requirements**

In 2002, commercial banks were required to maintain minimum reserves in the amount of 4% of primary koruna and foreign-currency deposits (from residents and non-residents); of koruna and foreign-currency deposits of non-resident banks; of bills of exchange issued, bonds, and other liabilities to non-bank customers. The ratio of required reserves for home savings banks was 3%. Maintained reserves were evaluated on a monthly basis. Required minimum reserves attracted an interest rate of 1.5%.

### **Exchange-rate and foreign-exchange policies**

- a) *Exchange rate system:* The National Bank of Slovakia applies a floating exchange rate regime. The exchange rate of the Slovak koruna is pegged to a reference currency, which is the euro (EUR), and its value depends on the exchange rate of EUR to USD on world markets, and the level of supply of, and demand for, the koruna on the foreign exchange market. The National Bank of Slovakia may intervene in the foreign exchange market in the event of excessive volatility in the exchange rate of the Slovak koruna.
- b) *Nominal exchange rate of the SKK:* In relation to the euro, the nominal exchange rate of the Slovak koruna appreciated by 2.43% during 2002, to SKK/EUR 41.722 on 31 December 2002. Over the period under review, the exchange rate of the koruna appreciated in relation to the US dollar by 17.4%, to SKK/USD 40.036.
- c) *Nominal and real effective exchange rates of the SKK<sup>3/</sup>* In 2002, the nominal effective exchange rate of the Slovak koruna (NEER) was affected mostly by the marked appreciation of the Sk

3/ The methodology applied for the calculation of the nominal and real effective exchange rates of the Slovak koruna (NEER and REER) is that used by the IMF. It is based on the consumer price index (CPI) and producer price index (PPI) from the year 1990, for eight and/or nine major trading partners of Slovakia, accounting together for 65 to 70% of the total turnover of Slovak foreign trade in the years 1993–2002: Germany, Czech Republic, Italy, Austria, France, Netherlands, USA, United Kingdom, and Switzerland.

vis-à-vis the US\$. The Slovak koruna achieved a higher rate of appreciation than most of the currencies of Slovakia's trading partners.

By the end of the year, the NEER index had appreciated year-on-year by +0.6% (in the case of 9 trading partners, including the CR) or by +3.6% (in the case of 8 trading partners, excluding the CR).

The real effective exchange rate of the koruna (REER), calculated on the basis of the producer price index, had appreciated year-on-year by 2.7% (for 9 partners) or by 4.5% (for 8 partners) by the end of December.

d) *Evaluation of the currency structure of*

*foreign exchange receipts and payments in the Slovak Republic:*

Turnover of receipts and payments in convertible currencies in payment categories 1 to 6 reached Sk 1,385.6 billion in 2002 (i.e. 129.1% of GDP at current prices), with the average monthly turnover (Sk 115.5 billion) increasing year-on-year by 8.4%. In 2002, foreign exchange receipts and payments resulted in a negative balance of Sk 24.1 billion.

Turnover took place mostly in EUR (63.6%) and USD (23.2%). During the year, the proportion of the EUR increased partly as result of the replacement of the currencies of EMU member states (12 currencies) with the single European currency, and partly to the detriment of the share of the USD. The proportion of the former national currencies of EMU member states (in connection with withdrawal from circulation in February 2002) decreased considerably, to 0.1%. The share of the CZK reached 9.3%, while other currencies (HUF, DKK, NOK, SEK, CHF, GBP, AUD, JPY, CAD, etc.) accounted for 3.8% of the total turnover.

## **4.6. Chronology of monetary developments**

### **January**

- With effect from 1 January, the euro becomes legal tender in the 12 countries of the euro area.
- Slovak President R. Schuster appoints Mr. Ivan Šramko as a Vice-Governor of the NBS.

### **February**

- Fitch Ratings, the international rating agency, confirms the long-term liability rating of the Slovak Republic at the level of BB+ for foreign exchange liabilities and at BBB+ for crown liabilities. The rating for the country's short-term liabilities denominated in foreign currency remains at the level of B. The outlook for Slovakia's long-term foreign exchange and koruna liabilities remains positive. The rating of the Slovak Republic remains in the speculative zone.

### **March**

- The IMF mission completes the Staff-Monitored Programme (SMP). According to the final report, the programme has fulfilled all expectations in the area of fiscal and monetary policies.
- In its financial sector assessment programme (FSAP), the World Bank concludes that the NBS meets the strict standards concerning the principle of transparency in the area of monetary policy formulation and implementation.

### **April**

- OTP Bank of Hungary acquires a majority share of Investičná a rozvojová banka (IRB; Investment and Development Bank). With the approval of shareholders, the bank's name is changed to OTP Banka Slovensko (OTP Bank Slovakia).

- The Bank Board of the NBS decides to raise the limit rate for two-week repo tenders to 8.25%, the rate for overnight deposits to 6.5%, and that for refinancing to 9.5%.

### **May**

- The National Council of the SR passes a law on the State Treasury as an institution administering the funds of State authorities and organisations. At the same time, the NC approves the establishment of an Agency for Debt and Liquidity Management.
- The Bank Board of the NBS approves the Revised Monetary Programme for 2002.

### **June**

- The National Council of the SR takes notice of the Report on Monetary Developments in Slovakia during 2001.
- The National Council of the SR approves Act No. 456, amending and supplementing Act No. 202/1995 Z.z., Foreign Exchange Act with subsequent amendments; Act No. 372/1990 Zb. on infringements; and Act No. 229/1991 Zb. pertaining to ownership rights to land and other agricultural property. The provisions of the amendment liberalising transactions in financial derivatives and removing the remaining restrictions on trade in securities becomes effective on 1 January 2003. The provisions cancelling the repatriation requirement and those liberalising operations in the deposit accounts of non-residents abroad and foreign exchange operations are expected to take effect on 1 January 2004. The provisions concerning the acquisition of ownership rights to real estate in the SR for companies and individuals from EEA and OECD countries, with the exception of real estate for which a temporary derogation has been granted (a 7-year transition period for the acquisition of agricultural and forest land by non-residents, except self-employed farmers who have cultivated the land for at least 3 years) are

expected to become effective on the date of entry into the EU, i.e. 1 May 2004.

### **July**

- Payment for 49% of the shares of Slovenský plynárenský priemysel, a. s. (Slovak Gas Industry, plc.) is transferred to the account of the National Property Fund of the SR (NPF) in the amount of US\$ 2.7 billion, the equivalent of almost Sk 121 billion. The funds have become part of the foreign exchange reserves of the NBS. Part of these funds was used for debt servicing (Sk 50 billion) and part deposited in a special account of the NBS maintained for the pension reform (Sk 61.7 billion).
- In its regular report, Fitch Ratings confirmed the rating for Slovakia's long-term foreign exchange liabilities at the level of BB+ and that for koruna liabilities at BBB+. One of the reasons behind the unchanged rating was the expectation that the country's budget deficit would increase to 5.5% of GDP in 2002, or 7.5% of GDP including the costs of bank restructuring and government guarantees.

### **August**

- The NBS officially announces the new address of its head office, from Štúrova 2 to Imricha Karvaša 1, 813 25 Bratislava.

### **September**

- The NBS receives US\$ 460 million from the unblocking of the Russian federation's debt to the SR (30% of the amount due). The funds are transferred to the account of State Financial Assets at the NBS.
- Parliamentary elections are held in Slovak Republic. Mandate to form a new Slovak government is given to M. Dzurinda.

## **October**

- At the Brussels summit, the European Union recommends Slovakia and the other nine candidate countries for admission to the EU in 2004.
- The Bank Board of the NBS decides to lower the limit rate for two-week repo tenders by 0.25 percentage point (to 8.0%), while leaving the rates for overnight sterilisation and refinancing operations unchanged (at 6.5% and 9.5% respectively).
- Fitch Ratings, the international rating agency, improves the rating for the long-term foreign exchange liabilities of Slovakia to BBB-, from BB+. The rating for long-term liabilities in Slovak currency remains at BBB+, while that for short-term liabilities is raised from B to A3. The outlook for long-term liabilities remains positive.

## **November**

- Moody's Investors Service, the international rating agency, improves its ratings for the foreign exchange liabilities of Slovakia and the other seven candidate countries of Central and Eastern Europe, which are expected to join the European Union in 2004. The rating of the Slovak Republic is increased from Baa3 to A3.
- The Bank Board of the NBS decides to lower all NBS interest rates by 1.5 percentage points. The limit rate for two-week repo tenders is reduced to 6.5%, the rates for overnight sterilisation and refinancing operations to 5.0% and 8.0% respectively.

## **December**

- In its annual report on Slovakia (Slovakia: Global Credit Research), Moody's Investors Service points out that the rating for Slovakia's koruna and foreign-exchange liabilities (A3) and the country's stable outlook indicate that Slovakia is making substantial

progress towards economic and financial integration into the European Union, and will therefore be invited to join the Union in 2004.

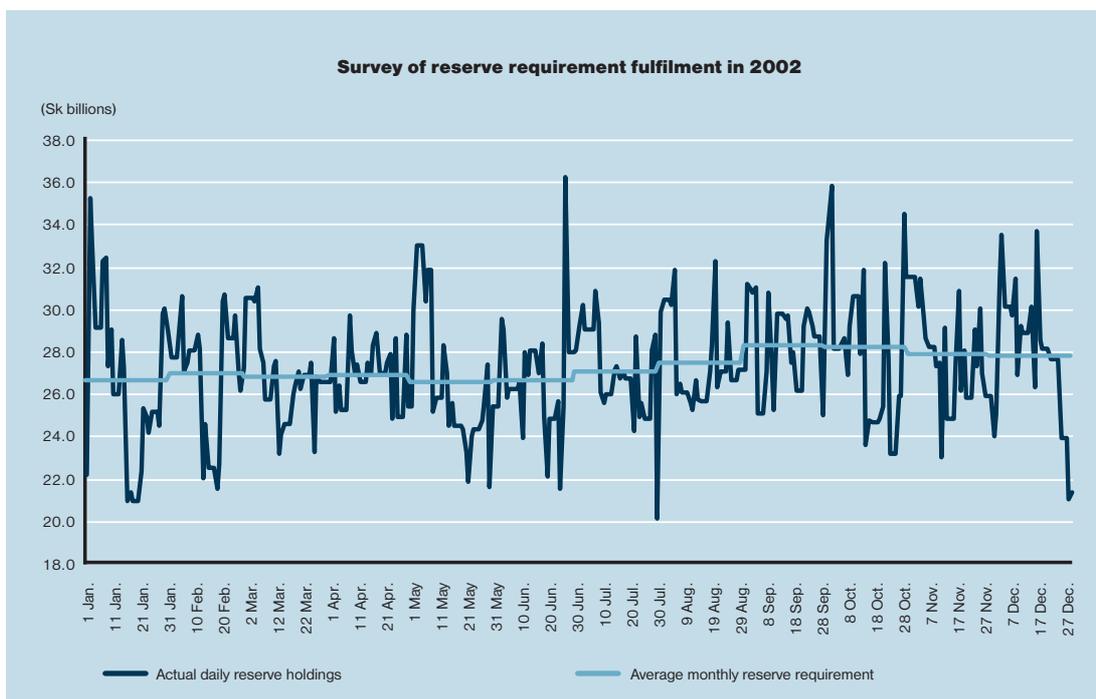
- The National Council of the SR approves the State Budget for 2003, with a deficit of Sk 57.6 billion. The costs of bank restructuring (Sk 10.7 billion) are included in the budget expenditure, as well as in the size of the budget deficit.
- The Bank Board of the NBS decides to introduce a base rate with effect from 1 January 2003. The basis rate of the National Bank of Slovakia corresponds to the interest rate of the NBS for 14-day repo tenders. The term 'discount rate of the National Bank of Slovakia' or 'discount rate of the State Bank of Czechoslovakia', used in generally binding legal regulations, corresponds to the base rate of the National Bank of Slovakia.
- The Bank Board approves the Monetary Programme of the NBS for 2003.
- The Slovak Republic, together with the other 9 candidate countries, completes the talks on EU enlargement and accepts the invitation to join the Union.

## **5. FINANCIAL MARKETS**

### **5.1. Money market**

#### **Operations of the NBS on the money market**

Monetary policy implementation focussed on two-week repo tenders and the provision of overnight refinancing and sterilisation facilities. Auctions in NBS bills, held at relatively regular intervals during the year, remained a supplementary instrument. Other monetary policy instruments, which, however, remained unused in 2002, included ad-hoc intervention in money market developments through so-called 'quick tenders' and/or individual transactions. In accordance with the Monetary Programme, the set of monetary policy instruments was modified



to some extent, with effect from 1 January 2002. The (unused) Lombard loan was cancelled and bills-of-exchange dealing (conducted at the discount rate in a limited amount) suspended. For the sake of continuity, the discount rate was set as an equivalent of the limit rate of the NBS for two-week repo transactions with commercial banks. Among the changes, the situation on the money market was most affected by a cut in ratio of required reserves, from 5% to 4%, and the consequent inflow of excess liquidity in the amount of Sk 5.7 billion.

The excess of liquidity and the sterilisation nature of monetary policy persisted throughout the year. The volume of sterilised funds more than doubled during the year, from an average of ca Sk 56 billion in 2001 to almost Sk 92 billion in 2002. The greatest contribution to growth in the volume of sterilisation came from an inflow of funds from privatisation and/or increase in the holdings of foreign investors in enterprises and banks. Of the total volume of privatisation proceeds, the largest amounts were used for the repayment of the internal debt (Sk 49.3 billion); the repurchase of restructuring government bonds from VÚB (Sk 9.1 billion); the settlement of liabilities arising from NPF bonds (Sk 5.0

billion); the compensation of municipalities for costs incurred in connection with the construction of gas supply facilities (Sk 4.1 billion); the settlement of liabilities of public health institutions and health insurance companies (Sk 3.7 billion); and for the discharge of debts in passenger railway traffic (Sk 2.9 billion).

Marked pro-liquidity effect was also exerted by the foreign exchange interventions of the NBS to avoid undue appreciation of the Slovak currency, which increased the surplus of liquidity by Sk 24 billion in the last quarter.

As for the forms of sterilisation applied, the average share of liquidity sterilised on a two-week basis increased during the year (from 65.00% in 2001 to 79.41% in 2002), while the proportion of sterilisation through issues of central bank bills for the portfolios of commercial banks decreased (from 33.68% in 2001 to 18.22% in 2002).

Of the monetary policy tools of the NBS, standard two-week repo tenders maintained a dominant share in liquidity sterilisation throughout the year. During the year, 52 repo tenders were conducted in American style with a set limit rate. The volume accepted at individual tenders

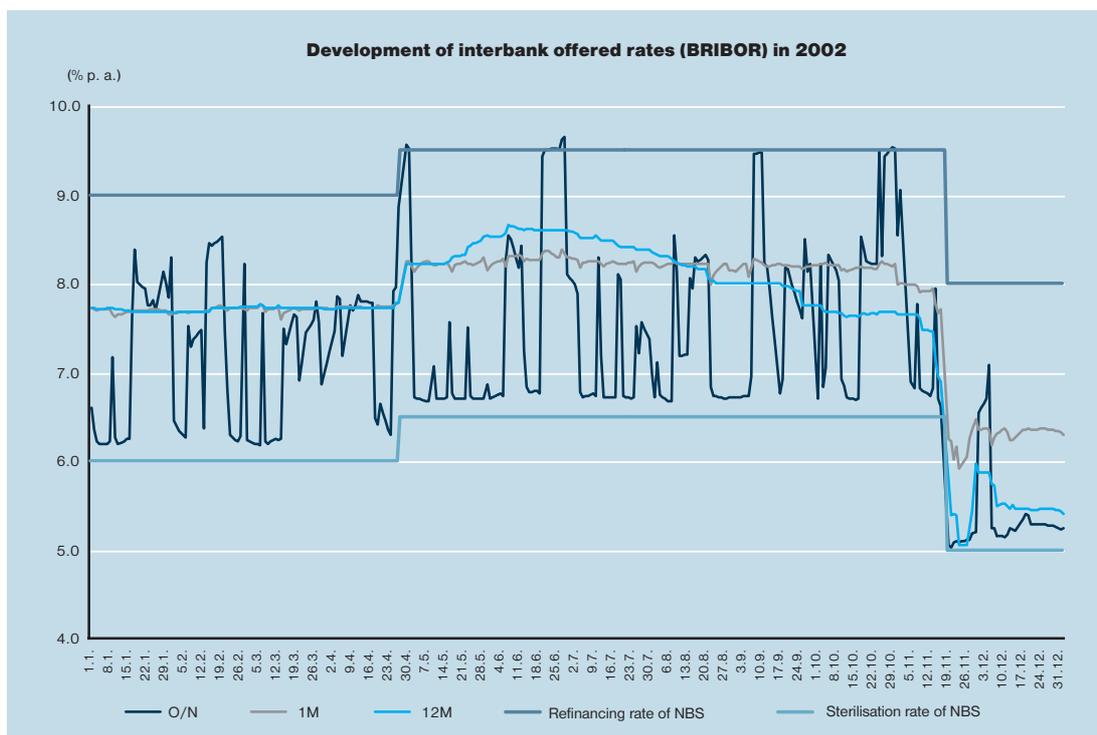
fluctuated within a relatively wide range, from Sk 14.7 billion to Sk 61.2 billion. The interest rates achieved at the tenders fluctuated around the current limit rate of the NBS, and deviated from its level by 2 to 5 base points as per normal. The NBS intervened in the results of tenders by cutting demand only in exceptional cases, mainly when the banking sector as a whole overestimated its capacities in trying to deposit as much funds as possible at the NBS. Of the total number of tenders, the volume demanded was reduced in eight cases in line with the actual liquidity situation in the sector.

The second largest share in sterilisation was maintained by issues of NBS bills, which were made at relatively regular intervals. In total, 15 auctions were conducted in bills for the portfolios of commercial banks. The standard maturity of this liquidity absorbing instrument was 12 weeks. The preference of longer-term sterilisation through NBS bills was connected with the holdings of government securities in the portfolios of banks and, in particular, with the expectations of banks in respect of interest rate developments on the money market. This led to an increase in the contribution of NBS bills to sterilisation over the first quarter, due mainly to the limited amount of government bonds and similar securities in the portfolios of banks (to more than 26% of the applied instruments by the end of April). Subsequently, however, there were expectations of a further increase in key interest rates, which led to a fall in demand for NBS bills. Hence, the share of this instrument in the total volume of sterilisation decreased to 6% in August. A change in expectations in the second half of the year, especially in the last quarter, led to a revival of interest in long-term sterilisation, with the share of NBS bills increasing to 29% in December. At the auctions, the NBS accepted all the bids below or at the current limit rate for standard two-week repo tenders. Despite the fact that the auctions were conducted without a formally set limit rate, the banking sector accepted this, and the NBS curtailed total demand only at two auctions.

Sterilisation and/or refinancing transactions with a maturity of one day, which were, in contrast with the previous two instruments, initiated by banks, represented the less significant instrument in terms of volume. Banks made use of the possibility of sterilising surplus funds by placing overnight deposits with the NBS, in the event of a sudden and unpredicted inflow of liquidity, in periods between two standard tenders or issues of NBS bills. During a usual month, most overnight deposits were made towards the end of the month, when banks replenished their minimum reserves in this way. Despite the persistent surplus of liquidity in the banking sector throughout the year, banks also conducted overnight repo transactions for refinancing purposes on an individual basis. Such deals were conducted mainly when banks entered into longer-term investments and in the case of a short-term shortage of funds. The increased drawing of credit from the NBS in this way may well be associated with the period of expected interest rate reduction, when banks markedly increased their participation in auctions in NBS bills, despite any need for short-term refinancing. Apart from such cases, which occurred mostly in June and October, overnight refinancing transactions were conducted only sporadically. In total, individual sterilisation and refinancing transactions accounted for less than 5.5% (the maximum in December) and represented only a supplementary instrument to tenders and NBS bills. In terms of significance for the interbank market, overnight sterilisation and refinancing transactions played an essential role in the creation of a so-called 'corridor for interest rate fluctuation'.

### **Developments in money market rates**

During 2002, money market rates for maturities of up to one year fluctuated within the above corridor, the upper limit of which was given by the rate for overnight refinancing and the lower limit by the rate for overnight deposits with the NBS. An exception was represented by overnight interbank offered rates (BRIBOR,



BRIBID), which exceeded the upper limit of the corridor on three occasions. These short-term deviations were caused mainly by banks lacking acceptable securities for conducting refinancing transactions with the NBS. The spread between the upper and lower limits of the corridor, was left by the NBS at the level of three percent throughout the year. This relatively wide corridor for fluctuation was used mainly by short-term rates, especially rates for overnight transactions. Though these rates reacted most sensitively to changes in the current level of liquidity in the banking sector, they still made up the most substantial part of transactions in interbank deposits. With regard to the excess of liquidity in the banking sector, interest rates fluctuated in the lower part of the corridor, close to the rate for overnight sterilisation transactions with the NBS.

Developments in rates for other maturities were determined by the limit rate for standard two-week repo tenders. Rates for one-week and two-week deposits were directly connected with the current level of the limit rate of the NBS, and/or with the results of sterilisation tenders. The level of rates exceeding the maturity of repo tenders, was affected by the expected changes

in the limit repo rate, rather than by its actual level. The anticipated developments in interest rates, which were mirrored in the shape of the money market rate curve, were derived by banks primarily from the values of basic economic indicators and the reaction of the NBS to the current level and course of the exchange rate of the domestic currency. In this connection, an important part was played by the balance of trade. Other factors affecting interest rates, directly or indirectly, included developments connected with the integration of Slovakia, and in particular the results of elections in the current year.

The expectations of the banking sector at the beginning of the year were affected by the favourable course of accession talks with the EU on the one hand, and by the risks involved in fiscal developments on the other. Thus, the interest rate curve maintained, despite an initial fall in comparison with the same period a year earlier, a balanced course over the first quarter. The risks involved in further macro-economic developments as a result of a potential loss of budget revenue and uncertainty about the use of privatisation proceeds, led to a rise in interbank market rates and the return of the yield curve to

the initial level. The increase in key NBS rates at the end of April (by 0.5 of a percentage point in response to the accumulation of risks in the fiscal area and the unfavourable trend in the trade balance), had not been foreseen by the banking sector and caused a further rise in interest levels for all maturities, to over 8%. The upward trend persisted during the following months, until the middle of the year. In June, deposit rates recorded a yearly maximum and the average rates for 9-month and 1-year funds reached their highest values since the introduction of interest rate monitoring (June 2000). The interest rate curve followed a pronounced positive trend during that period and anticipated a further rise in interest levels.

The inflow of funds from the privatisation of SPP (Slovak Gas Industry) and their use caused a sudden increase in the surplus of liquidity in the middle of the year. The attempt to make the best use of these funds by the banking sector brought the rise in interest rates to a halt and, during the following period, the level of interest rates fell steadily. From August, the interest rate curve followed an inverse course, which became even more noticeable during the rest of the year. A positive effect on the further fall in interest levels was exerted, first and foremost, by the results of parliamentary elections in September. The rate of fall was accelerated to some extent by the appreciation of the domestic currency, stimulated by increased interest abroad in the Slovak koruna, and the subsequent placement of Sk resources on the domestic market via swap operations.

The growing interest in the Slovak currency and attempt to profit from the interest rate differentials between koruna and euro/dollar rates, pushed the interest level below 8% in October. The trend of further fall was supported by an improvement in the country's credit rating by Moody's in connection with the overall positive attitude after the general elections. This trend was also supported by a change in the limit repo rate by the NBS, from 8.25% to 8.00%.

The level of money market rates was also affected by continued pressure for appreciation

of the Slovak koruna. This was due partly to the intense intervention activity of the NBS, through which further liquidity was added to the market. In the middle of November, foreign exchange interventions were supported by a cut of 1.5% in all key interest rates, which reduced the attractiveness of the interest rate differential between domestic and foreign rates. This change was fully reflected in interbank market rates, with the level of rates for the longest maturities falling below 6%. Interest rates remained at this level up to the end of the calendar year, while the yield curve continued to have a pronounced inverse shape with a breaking point at funds with a maturity of three months. This shape was an indication of positive expectations of a further reduction in key interest rates.

### **Money market developments**

The money market continued to develop positively throughout the year, especially the derivatives market. A positive role was played by the connection between the domestic and foreign exchange markets as a result of a growth in faith in the domestic currency on the part of foreign entities. The market for currency swaps grew steadily and progress was also recorded in interest rate derivatives, forward rate agreements (FRA), and interest rate swaps (IRS). In line with the trend of development in these forms of trade, the share of deposit transactions decreased on the money market in percentage terms. At the beginning of the year, trading was dominated by transactions in deposits, but by the end of the year, their proportion had fallen below the level of 50%. This trend, which is a phenomenon accompanying money market development in the neighbouring transition economies as well, is expected to continue in the period to come. A positive step towards improvement in the transparency of the situation on the koruna-based interbank market, was also represented by the introduction of monitoring of the weighted average of overnight deposit rates, published as SKONIA (Slovak OverNight Index Average), with effect from June. It is highly probable that this

rate, being a key indicator of the liquidity situation on the money market for central banks, will also be used in future for commercial purposes.

### Primary market for Treasury bills

In 2002, Treasury bills were sold by auction, with an unlimited issue-amount and unlimited minimum price. Over the course of the year, 33 auctions were held in Treasury bills, one of which resulted in zero acceptance. Total sales of Treasury bills reached a nominal value of Sk 89.9 billion, representing 40.2% of total demand (Sk 223.5 billion). Of the primary purchase of Treasury bills, foreign investors accounted for 79.1% and domestic banks 20.7%. The share of other domestic investors was negligible.

Fourteen issues, floated over the period March to July with a nominal value of Sk 50.4 billion, were repaid during the month of July. The reason behind the choice of shorter maturities was income from privatisation, a significant portion of which was used for the repayment of the internal debt. During the period July to November, the issuer had floated 364-day Treasury bills for financing the budget deficit by the end of the year. The total nominal value of these issues

reached Sk 39.5 billion, which represented a book value of Sk 36.8 billion (with an average yield of 7.36%). The high demand for Treasury bills was due mainly to a surplus of liquidity and shortage of other low-risk assets, particularly government bonds in the second half of the year.

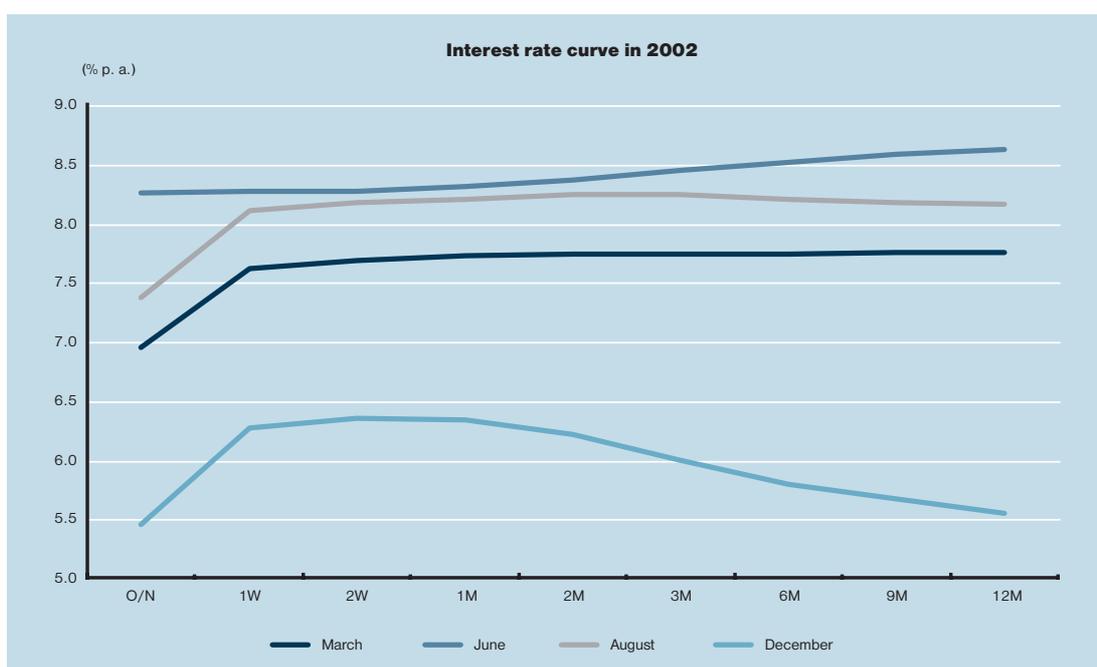
Yields on Treasury bills showed a marked tendency to fall, mainly during the 2nd half of the year. They were affected, first and foremost, by changes in money market rates, which reacted to changes in the basic interest rates of the NBS. The issuer succeeded in realising Treasury bills below the level of money market rates with comparable maturities. This trend was evident mainly in the case of 364-day Treasury bills, which were issued at 24 base points below the level of the annual BRIBOR rate.

## 5.2. Capital market

### Primary market

#### Government bonds

In 2002, twenty-five government bond issues were floated in the total amount of Sk 60.9



billion, representing a fall of 63.9% (Sk 108.0 billion) in comparison with 2001. The issues were all placed on the primary market via American-style auction, with a limited issue rate (at or above the nominal value) and a limited total amount.

In terms of maturity, there were thirteen issues of 1-year bonds (45.8%); four 2-year bonds (18.4%); two 3-year bonds (2.1%); three 5-year bonds (19.5%); and three 10-year bonds (14.2%). In 2001, 1-year issues accounted for 49.0%; 2-year issues 22.8%; 3-year issues 20.2%, and 10-year issues 16.1% of the total issue-amount.

In 2002, total demand for government bonds reached Sk 78.8 billion, representing a fall of 25.9% compared with the figure for 2001 (Sk 106.3 billion). The average issue-amount was Sk 2.4 billion, compared with Sk 6.8 billion in 2001. The marked fall in the average issue-amount was caused by the 6 issues of government bonds for restructuring in 2001 (in the total amount of Sk 105.0 billion); excluding bonds for restructuring, the average issue-amount reached Sk 3.4 billion.

Demand for government bonds was high, especially in the first quarter, when its level reached Sk 52.3 billion (67.2% of total demand). There was enormous interest in all issues in January, when supply reached Sk 17.0 billion, demand Sk 27.8 billion, and its satisfaction 61.2%. The highest demand was for Issue No. 167 (Sk 4.7 billion), of which Sk 2.0 billion was accepted. The great interest in these issues underlined the trend of preference for short maturities among investors. This was due to the fact that, in the given period, no Treasury bills were issued and there was a marked surplus of liquidity in the banking sector. The second quarter of 2002 saw a rise in the level of yields required, as a reaction to an increase in NBS rates, while some influence was also exerted by uncertainty arising from the expected decision on the utilisation of proceeds from the privatisation of SPP. The change in the nominal value, from Sk 1.0 million to Sk 100.0 thousand, was intended to create better

conditions for the purchase of government bonds by small investors on the secondary market.

At 31 December 2002, there were 20 foreign investors (representing 2.74% of the total figure) registered on the primary market for government bonds.

### **Non-government bonds**

The volume of non-government bonds issued increased in 2002. In total, 68 issues were floated during the year, 18 more than in 2001. The total volume of non-government bond issues reached Sk 4.7 billion, representing a year-on-year increase of Sk 0.6 billion. In foreign currency, seven issues of non-government bonds were made in the amount of EUR 19.9 million, compared with one issue in 2001 (EUR 0.7 million).

### **Secondary market**

In 2002, during the same number of trading days as in 2001 (243), 16,264 transactions were conducted on the Bratislava Stock Exchange (BCPB). Compared with 2001 (20,169 transactions), the number of transactions fell 19.4%. The total volume of trading reached Sk 643.2 billion, representing a year-on-year increase of 63.5% (from Sk 393.5 billion). The upward trend was recorded mainly in trading in bonds. Bonds were traded on the BCPB floor in the total amount of Sk 608.3 billion, which was 74.9% more than in 2001. Thus bonds continued to comprise a substantial proportion of turnover on the BCPB, with government bonds accounting for as much as 86.0% (Sk 523.2 billion) of the total volume of bond transactions. In 2002, foreign investors accounted for 28.3% of the total turnover, i.e. 33.2% of sales and 23.5% of purchases (as in 2001).

### **Bonds**

At the end of the year, 79 bond issues were available for trading on the stock market: 59 on the main quoted market, 5 on the parallel quoted

market, and 15 on the open market (of which, 2 issues on the open market were eurobonds).

During the year, the BCPB accepted 3 issues of corporate bonds for trading, in the amount of Sk 0.7 billion; 4 issues of bank mortgage bonds in the amount of Sk 2.9 billion; and 22 issues of government bonds in the amount of Sk 60.9 billion. At the end of the year, the market capitalisation of debt securities amounted to Sk 290.9 billion (a fall of 0.9% in comparison with the figure for 2001), of which Sk 243.8 billion was in quoted issues (an increase of 1.7% compared with 2001). During the year, 29 new issues of bonds and 3 existing issues (transferred from the open market) were traded on the market for quoted securities.

In connection with bond repayment, 18 issues of bonds ceased to be quoted and traded on the market for quoted securities during the year. Restructuring bonds of Issue No. 150 were repaid before the due date, in the amount of Sk 9.1 billion.

In connection with bond repayment, trading concluded with 15 issues of corporate bonds (Sk 4.4 billion) and 4 issues of municipal bonds (Sk 655 million) on the open market.

Price-setting transactions in bonds recorded a year-on-year increase of 129.6%, to Sk 53.5 billion, while direct transactions grew in volume by 71.0%, to Sk 554.8 billion. Most trading took place in government bonds.

The Slovak Bond Index (SDX) for bank and corporate bonds closed the last trading day of 2002 with a year-on-year increase of 10.7%, at 222.9% of the nominal value of its portfolio, with an average yield of 7.8% to maturity and a duration of 1.5 years. The index reached a minimum on 7 January (201.3%) and a maximum on 20 December (222.9%). At the end of the year, the average price of the government-bond portfolio in the SDX base stood at 208.4% (a year-on-year increase of 11.9%), while the average yield amounted to 6.3% and duration 1.6 years. This

component of SDX recorded a minimum on 7 January (186.5%) and a maximum on 18 December (208.5%).

### **Shares**

The stock market was not very active in 2002, the total volume of trading reaching only Sk 34.9 billion (a decline of 23.7% in comparison with 2001), of which price-setting transactions accounted for Sk 1.1 billion, representing a year-on-year fall of 55.6%. In terms of financial volume, the best performers were the quoted shares of Slovnaft (Sk 7.8 billion), the Slovak Insurance Corporation (Sk 3.1 billion), and the East-Slovak Ironworks – VSŽ (Sk 3.1 billion). On the open market, most trading took place in the shares of Doprastav (Sk 2.8 billion), Slovak Shipping Company (Sk 2.2 billion), and the Restitution Investment Fund (Sk 2.6 billion). In 2002, the BCPB accounted for 93.78% of the total volume of trading in shares on the Slovak capital market, 98.17% in price-setting and 98.03% in direct transactions. In the market-maker system, three share issues were traded at the end of the year – the shares of Slovnaft, Slovakofarma, and the Podbrezová Iron Works. The volume of trading on the market-maker system reached Sk 1.4 million (in 16 transactions), representing a negligible 0.1% share of the total volume of price-setting contracts in shares.

The Slovak Share Index (SAX) followed a downward trend over the first quarter of 2002, then stabilised in the second and third quarters. This development took place in virtually all the basic shares included in the index. The last quarter saw an increase in the value of SAX, due mainly to the publication of news about the continued privatisation of Slovnaft, a.s. On 26 November, SAX reached a yearly and almost five-year maximum, at 149.60 points. With effect from 1 February 2002, a new base was introduced for the setting of the SAX index, together with new rules for the inclusion of an issue in the base of the index. According to these rules, only shares from the main or parallel quoted markets may be used

included in the base, though originally the base also included shares on the open market.

### **5.3. Foreign exchange market**

#### **Operations on the foreign exchange market**

During the year, the exchange rate of the Slovak koruna to the euro appreciated by 2.4% (from SKK/EUR 42.760 to SKK/EUR 41.722). The strongest value for the exchange rate of the SKK was reached on 12 November (SKK/EUR 41.136) and the weakest on 23 July (SKK/EUR 44.886). The average exchange rate was SKK/EUR 42.699.

The exchange rate of the Slovak koruna to the US dollar appreciated by 17.4%, from SKK/USD 48.467 to SKK/USD 40.036. The exchange rate of the koruna to the dollar is calculated from the EUR/USD cross-currency rate, and the NBS cannot influence it directly by its activities on the interbank foreign exchange market.

The total volume of foreign exchange sold in direct interventions for the support of the Slovak koruna in 2002 reached EUR 205.0 million (June 2002) and the volume purchased at the end of the year amounted to EUR 663.0 million (of which EUR 135.0 million was obtained in individual transactions and EUR 528.0 million in direct interventions).

#### **Interbank foreign exchange market**

The total volume traded on the interbank exchange market (excluding foreign exchange interventions by the NBS) reached USD 215,226.5 million, representing an increase of 89.8% in comparison with the figure for 2001 (of which transactions in USD accounted for 77.7%, in EUR 20.6%, and in other currencies 1.8%). Within the structure of transactions, currency

swaps accounted for 86.7% (compared with 86.5% in 2001), spot operations 13.2% (13.2% in 2001), and forward transactions 0.1% (0.3% in 2001).

The average daily turnover on the spot market amounted to USD 113.5 million. The market was dominated by trading in EUR, which accounted for 97.2% of the total volume, due to the euro being the reference currency. Trading between Slovak banks and between Slovak and foreign banks on the spot market confirmed the trend of increased activity on the part of foreign banks on the Slovak foreign exchange market (38% of the total turnover was in favour of Slovak banks and 62% in favour of foreign banks). In 2002, the overall balance of transactions of foreign banks as against local banks was negative (USD 796.4 million), i.e. foreign banks sold more foreign currency and purchased more Slovak crowns.

The volume of transactions between domestic commercial banks increased by 57.6%, to USD 53,055.3 million. Trading took place mostly in USD (70.5%; compared with 73.8% in 2001), followed by EUR with a share of 28.9% (25.6% in 2001), and other currencies accounting for 0.6%. Trading between domestic banks accounted for 24.9% (29.7% in 2001) of the total interbank foreign exchange market.

In the structure of transactions, 79.9% of the total volume of trading between domestic banks took place in the form of swap operations (78.9% in 2001) and spot transactions accounted for 20.1% (21% in 2001).

Trading with foreign banks also recorded a marked year-on-year increase (103.5%), to USD 162,193.8 million. Most trading took place in USD (80.4%, compared with 83.9% in 2001), followed by EUR with a share of 17.5% (15.3% in 2001) and other currencies accounting for 2.1%. The volume of transactions with foreign banks represented a substantial part of the foreign exchange market, i.e. 75.1%.