

MEETINGS OF THE NBS BANK BOARD

The 34th Meeting of the Bank Board of the National Bank of Slovakia was held on 28 July 2005 chaired by Elena Kohutikova, Deputy Governor.

- The Bank Board of the National Bank of Slovakia discussed the Situation Report on Monetary Development of the Slovak Republic in June 2005 and decided on leaving the interest rates unchanged at 2.0% for overnight sterilization transactions, 4.0% for overnight refinancing transactions and 3.0% for the two-week repo tenders with commercial banks.

- The Bank Board of the NBS approved themes for the mint of three commemorative coins for the year 2007.

The first theme will be the 200th anniversary of the birth of Jozef Maximilian Petzval, a physicist, mathematician, university professor, inventor and a significant representative of the Slovak science and technology in the 19th century.

The second theme will be the defence fortress system in Komárno, which represents the top art of fortress building in the Slovak territory. In the second half of the 19th century, it was the biggest and strongest defence structure in the Austrian-Hungarian monarchy, and owing to its architectural and historical value it ranges among the most significant structures of this kind all over the world.

The third theme will be the 1100th anniversary of the first written mention of Bratislava. The entry is recorded in Salzburg Annals in which the battle near Bratislava in 907 has been described, which gives evidence of the already existing name of our present capital city.

The Bank Board of the NBS discussed and approved the Financial Stability Report for 2004. The Report is focussed on the assessment of financial sector stability and on the identification of potential risks threatening financial stability in the Slovak Republic in the light of the international economical development and development of the Slovak economy. The Bank Board states that the overall situation which is reflected in the financial stability has improved when compared with the previous period.

- The Bank Board of the NBS discussed the document The Analysis of the Slovak Economy Convergence to the European Union.

The document analyses the present state of the convergence process in the Slovak Republic and judges the feasibility of the Maastricht criteria for entering the euro area within the planned deadline of accession as at 1 January 2009. Based on the cur-

rent estimates of the economic development for the years 2006 to 2008, Slovakia will meet these criteria in 2007. This document will be published on the web site of the NBS.

- The Bank Board of the NBS discussed the document The Analysis of Economical and Financial Equilibrium of the Slovak Economy.

- The Bank Board of the NBS approved for the year 2006 the print of 10 million pieces of banknotes in nominal value of SKK 500, 13 million pieces of banknotes in nominal value of SKK 200 and 30 million pieces of banknotes in nominal value of SKK 20 in the unchanged design.

- The Bank Board of the NBS also approved the mint of 10 million pieces of coins in nominal value of SKK 1 and 20 million pieces of coins in nominal value of SKK 0.50. It also approved the mint of coins for the 2006 Slovak coins sets in the amount up to 42,000 pieces.

- The Bank Board of the NBS approved Decree of the National Bank of Slovakia No / 2005, which stipulates the particulars of an application for prior approval pursuant to Article 28 (1) of Act No 483/2001 Coll. on Banks and on changes and amendments to certain laws as amended. This Decree was elaborated as an implementing rule on the basis of the enabling clause of Article 28 (7) of Act No 483/2001 Coll. on Banks and on changes and amendments to certain laws as amended.

Rationale behind the decision of the Bank Board of the NBS on the set levels of the interest rates of the NBS

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The Bank Board of the National Bank of Slovakia at its 34th Meeting held on 28 July 2005 discussed the Situation Report on Monetary Development in Slovakia in June and the Medium-term Prediction until 2008.

In June consumer prices, measured by the harmonized index of consumer prices (HICP), increased on a month-on-month basis. Their development was slightly faster than the NBS expected and it was affected in particular by higher prices of unprocessed foodstuffs. The NBS expects that there will be a seasonal fall in the prices of these items. Within the HICP structure, however, the growth rate of prices of servi-



ces decelerated. The higher rise in prices of foodstuffs in June may affect the development of headline inflation until the end of the year. This influence, however, should not be significant and depend on whether the seasonal fall in prices of foodstuffs during the two following months will compensate for the price rise in June. Even though the development of the food prices may result in the higher rate of growth of inflation, the average inflation in 2005 will be markedly below the levels set in the Monetary Programme of the NBS for 2005.

In June the SKK exchange rate appreciated on the average; the NBS did not consider it necessary to react using activities on the foreign-exchange market.

Owing to both the revised data on foreign trade as well as the repayment of dividends, the cumulative deficit on the current account of the balance of payments increased in May, which could be reflected in the higher level of deficit at the end of the year.

When discussing the results of the medium-term forecast for July, the Bank Board of the NBS stated that the GDP growth in the first quarter of 2005 was in line with the NBS's expectations. Within its internal structure, however, there was slightly higher growth in final consumption of households, which was due to the higher wage growth than the NBS expected. Having considered this factor, the current forecast assumes moderate growth acceleration in terms of the final consumption of households followed by the economic growth in 2005. The Bank Board, however, considers this development in the area of nominal and real wages as short-time and specific for 2005, and therefore it should not represent any risk in terms of pushing prices upwards.

The real wages growth is partially affected by lower-than-expected level of average inflation. The acceleration of its growth rate was, however, influenced by rise in nominal wages. The fact that the wage development did not adjust to lower inflation announced by the National Bank of Slovakia in its monetary programme may have reflected the fact that the development of inflation in the previous period was considered in the process of industrial negotiations. In the period to come, however, the NBS expects that both the current disinflationary process as well as the expected stabilization of the average inflation at low level will be considered.

In terms of medium-term forecast it was concluded that the growth rate of consumer prices was favourable in the first half of 2005. When compared with the April medium-term forecast, lower rise in prices was recorded, this also due to the lasting effect of the Slovak koruna appreciation from the first quarter of 2005. Depreciation of the exchange rate in the

second quarter of 2005 did not have a negative impact on the price developments. As compared with the April medium-term forecast, the ongoing competition in retail sector resulted in the lower price rise. The given factors should have an anti-inflationary impact in the following months of 2005 and in 2006 also. When compared with the April medium-term prediction, this should show in lower growth rate of inflation at the end of 2005 and 2006. The inflation should thus be at lower levels below the target range of the NBS. In terms of medium-term forecast the Bank Board of the NBS discussed the possible impact of the requested rise in certain regulated prices. Owing to the fact that the Regulatory Office for Network Industries has not issued any decision in regard of the regulated prices yet and it is not known when and to what extent these may rise, the development of inflation was computed in variants in the medium-term forecast, and this excluding or including the impact of changes in regulated prices. The estimated preliminary impact of rise in regulated prices of natural gas and heating, if in effect from 1 October 2005, would accelerate the growth rate of headline inflation by more than one percentage point. The rise in consumer prices this December could then end at the level of 3.9% against originally estimated level of 2.6%. On the average, the inflation measured by HICP as compared with the presented basic variant could increase in 2005 by 0.3 percentage point to 2.7%, which level is identical with that presented in the April medium-term forecast.

Although the different development of regulated prices, when compared with the April forecast, should affect price development, it would be a one-off cost factor that cannot be influenced by monetary policy and is defined as an exception from the meeting of the inflationary target. Therefore the NBS will not react to the direct impact of the regulated prices growth on inflation, however, in conducting monetary policy it will take care to prevent secondary effects of the regulated prices increase on the price development.

In spite of the pro-growth effect of the possible increase of regulated prices, the average inflation in this year and the years to come will move on low levels against the previous two years, and that means a significant decrease.

With regard to the fact that the inflation in Slovakia in the following years will be very close to that in the euro area, a sufficient space will be created for the growth of real wages also in the environment of relatively low growth of nominal wages. However, in case that the development of wages will not accommodate to the expected stabilization at low inflation levels, pressures may arise on the growth of prices.



From the viewpoint of monetary policy, the Bank Board of the NBS, when discussing the medium-term forecast for July, stated that the exchange rate depreciation at the end of the first and second quarter 2005 brought about loosening of monetary conditions in this period. The NBS, however, considers this change temporary and, owing to this, it did not change the interest rates to tighten monetary policy. Within the latest medium-term forecast it is expected that the overall monetary conditions for 2005 should be of a neutral to slightly restrictive character.

Based on the assessment of the July medium-term forecast results and after considering newest information which will be fully reflected in the future, i.e. October, forecast, the Bank Board of the NBS decided on leaving its interest rates unchanged.

In general, when discussing the current economic development and current medium-term forecast, the Bank Board of the NBS stated that from the viewpoint of the expected inflation development there exists uncertainty in the area of the range and timing of regulated prices increase. If the adjustment in regulated prices took place as late as in 2006, the year-

end inflation level could be shifted above the set target. However, this will not influence the meeting of the inflationary target in the years 2007 and 2008. The Bank Board of the NBS at the same time determined as a risk inflationary factor in the medium-term if the wage growth rate overrun the productivity growth, which could bring about macroeconomic imbalance. With this in view, the linkage between wage development and productivity development will continue to be the focus of the NBS's attention. At the same time the central bank expects that in wage negotiations the inflation growth rate, which approaches the euro area level in all the medium-term since 2005, will be taken into consideration.

Based on the above mentioned assessment of the expected and current macroeconomic developments, the Bank Board of the NBS at present does not see any room for the change in monetary policy and therefore leaves the current levels of interest rates unchanged.

Press Department of the NBS