

MEETINGS OF THE NBS BANK BOARD

The 17th Meeting of the Bank Board of the National Bank of Slovakia was held on 9 September 2004, chaired by Marian Jusko, Governor.

- The Bank Board of the NBS approved the draft of the Decree on the second issue of circulation banknotes in a nominal value of SKK 20, according to the 1995 series.

The banknotes are identical with those issued in previous years and will be put into circulation on 15th October 2004. Compared to the original issue of banknotes, the second edition differs only in the back side of the banknote where the former name "BA BANKNOTE" was replaced by the name of the Canadian printing works "BA INTERNATIONAL INC" printed in a fine print on a 5mm-wide strip.

All the banknotes of the nominal value SKK 20, issued by the National Bank of Slovakia remain valid.

The 18th meeting of the Bank Board of the National Bank of Slovakia was held on 24 September 2004, chaired by Marian Jusko, Governor.

- The Bank Board discussed the Situation Report on Monetary Development in Slovakia in August 2004 and decided on maintaining the overnight sterilization rate at 3.0%, overnight refinancing rate at 6.0%, and the limit rate for two-week REPO tenders with commercial banks at 4.5%.

The Bank Board of the NBS discussed and approved the 2003 Financial Stability Report. The report integrates the assessment of developments in economy, financial markets, market infrastructure and financial institutions, and is also focused on the identification of potential risks threatening the country's financial stability vis-à-vis the international and domestic economy developments.

The Bank Board of the NBS approved the Report on Monetary Development in Slovakia in the first half of 2004 and the Report on the Slovak Balance of Payments Development in the first half of 2004.

The Bank Board of the NBS approved the Report on the Development of the Banking Sector in the Slovak Republic and the Assessment of the Prudential Conduct of Banking Business in the Banking Sector as at 30 June 2004.

As at 30 June 2004, there were 18 banks and 3 branches of foreign banks operating in the Slovak banking sector. In relation to the Slovakia's accession to the European Union in May 2004, the Banking Supervision of the NBS recorded, to the end of the

monitored period, nine notifications of foreign supervisory authorities on the intention of foreign banks to freely provide cross-border banking services. The respective banks have their registered offices in Denmark, Austria and the United Kingdom. In confirming notifications of individual entities, the National Bank of Slovakia judges whether such a foreign bank will provide in Slovakia the type of activities to which a single banking licence applies. If the foreign bank's intention is to conduct mortgage transactions and/or depository functions under a special regulation, the NBS will inform in writing that a special permit is required for the conduct of these activities and that the foreign bank can conduct them only via its own branch. At the same time, the NBS requests from each foreign bank, whose notification has been approved, to send regular half-year information minimally concerning the deposits of residents; volume of asset operations with them; number of customers; volume of off-balance sheet operations with residents; volume of investment in securities on the bank's own account; volume of trading on the bank's own account, or the customer's account, in capital market financial instruments in the Slovak koruna and foreign currency; and volume of the issues of securities, participation in the issues of securities and provision of related services.

Of fifteen universal banks in the Slovak banking sector, nine banks and one branch of a foreign bank were granted a licence to perform mortgage transactions. So far, the banks have entered into almost 50 thousand contracts on mortgage loans with their customers and have approved loans in the amount of SKK 39.6 billion. Up to now, 88% of this volume has been disbursed to customers. At the same time, until the end of June, the banks issued 34 mortgage bonds in the total face value of SKK 21.1 billion. Total assets of the banking sector did not change substantially; the banks administered more than one thousand billion of assets and produced a profit of almost SKK 7 billion. In the banks' portfolios there were more than 400 billions of loans, of which the classified ones were not quite 8%.

The banking sector as a whole can be characterized as stabilized in terms of its capital and financial base. Almost 90% of subscribed equity capital is in hands of foreign investors, only two banks have local majority owners.

The Banking Supervision Division has continued in



risk-based supervision. As scheduled, four complex and one follow-up inspections were conducted. The inspections assessed the risk management quality and the rate of risks in banking activities. Four off-site inspections have been started. In the last quarter of 2004, the Banking Supervision Division will start a new supervisory cycle in which the complex inspections will be replaced with the inspections targeted on individual risks (credit, market and operational risks). The inspection target will ensue from the results of the last complex inspection conducted within the individual supervisory plan of the first cycle.

The cooperation with foreign supervisory authoriti-

es has been increasing. As at 30 June, in order to ensure the conduct of banking supervision over banks and branches of foreign banks, the National Bank of Slovakia closed and signed nine bilateral Memoranda of Understanding in the area of banking supervision cooperation, and two Letters of Cooperation with the American Office of the Comptroller of the Currency.

The Banking Supervision Division, within its proactive approach, has issued new and amended older acts of primary and secondary legislation concerning the prudential conduct of banking business and licensing activities.

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

The Bank Board of the NBS discussed the Situation Report on Monetary Development of Slovakia in August 2004. As part of the discussion on the Report, the Bank Board also assessed the current indicators of macroeconomic development in Slovakia in the first six months of 2004 published by the Statistical Office of the Slovak Republic. The Bank Board concluded that the dynamic economic growth of Slovakia was supported both by domestic and external demand. The growth of domestic demand was also backed by the recovered investment activities after their two-year stagnation. The Bank Board further confirmed that in the environment of relatively dynamic economic growth the current development, as well as short-term projections, of inflation is in line with the Updated Monetary Programme of the NBS. Based on the available indicators and updated projections, the Bank Board confirmed that the monetary and macroeconomic situation in Slovakia does not require any changes to the monetary policy setting, and decided on maintaining the current levels of key interest rates.

When deciding on interest rates, the Bank Board of the NBS considered the following factors:

In accordance with the NBS' expectations, the annual growth of consumer prices slowed down in August as compared with the previous month. The accelerated growth of core inflation was due to the combination of the basis effect and the continued pro-growth influence of cost factors. The foodstuff prices reported a significant month-on-month decrease in August, resulting from the seasonal development in prices of certain commodities. As compared with the previous year, the main reason for the foodstuff price growth is the accession to the single European market and the application

of the Common Agricultural Policy. This influence has resulted in sudden adjustments to prices, unlike expected by the Updated Monetary Programme. Downward corrections to prices can be expected in several types of foodstuffs in months to come, caused by the intensified retail competition. Prices for tradable goods have continued to dampen the total price development, despite an increase in fuel prices. The updated short-term inflation projections of the NBS for the end of the year, which also consider price developments in individual price segments of the consumer basket, expect the programmed headline and core inflation figures to be achieved.

Further, the Bank Board discussed the effect of Slovakia's accession to the EU on the price development. After the first four months of the accession, the most intense impact was observed in foodstuff prices, which in consequence of accepting the Common Agricultural Policy increased by 0.3 percentage points. As compared with the total increase in consumer prices since the beginning of the year of 6.1 %, it is clear that the impact of our membership of the EU on prices growth has been minimal. The influence of the Common Agricultural Policy in the months to come will depend on the speed and rate of price adjustments in other commodities to the expected price levels, as well as on the influence of competition on the market, which may dampen the foodstuff price development. Detailed information about the effects of the Common Agricultural Policy on foodstuff prices will be later published by the NBS.

The current data on the real economy development indicate that a relatively fast economic growth continued in the second quarter of 2004. The structure of economic growth was balanced, the Slovak economic performance intensified as a result of an increase both in external and domestic demand. Recovery in investment demand was a positive factor in the internal structure of



domestic demand. The growth rate of private consumption in the second quarter of 2004 decreased against the first quarter figures, and in the first six months of 2004 equalled only half the amount of the GDP growth. Although the decisive growth factor in the private consumption was a dynamic increase in wages, it was covered by the labour productivity growth.

The current account of the balance of payments of Slovakia reported a higher deficit in the first six months of 2004, as compared with the same period previous year. This was mainly due to the increased deficit in income and decreased surplus in current transfers. On the other hand, however, improvement was reported in the trade balance and the balance of services. The total income was debited by dividend payments on foreign direct investment, and this factor will determine the balance of payments current account also in the future. The current account deficit was largely offset by the inflow of funds on the capital and financial account of the balance of payments in the first six months of 2004. The external trade in July reported a year-on-year deficit showing reduced export due to the increased seasonal influence of taking holiday. In accordance with the NBS' expectations, despite the recovered export in the period to come, the expected faster growth in import should determine the trend of a gradual increase in the 12-month moving deficit of external trade.

The Bank Board of the NBS also discussed the projections for the main macroeconomic indicators development until the end of the year. As to inflation, the NBS expects its development in the set band, particularly in its upper part. Based on the current development of the balance of payments current account, the NBS projects deficit slightly over the formerly expected

figures, due mainly to the income and current transfers balance and trade balance developments. However, the current account deficit to GDP should not exceed 3 %. As concerns the accelerated GDP growth rate in the first six months of 2004, the Bank Board believes this trend shall continue in the following quarters of the year. As a result, the real economy growth in 2004 should be approximately 1 % higher than projected in the Updated Monetary Programme.

No corrections by the NBS were needed in relation to the Slovak koruna exchange rate developments in August and September. The NBS has been monitoring the situation on the foreign exchange market and if any imbalance occurs, the bank is prepared to apply any available tools to eliminate it.

The current indicators of macroeconomic and monetary development in Slovakia have confirmed a dynamic economic growth and its balanced structure, and inflation has moved within the programmed interval of the Updated Monetary Programme. The development in the foreign trade balance has been balanced and its deficit is covered by the surplus on the capital and financial account of the balance of payments. Despite dynamic growth in wages supported by the profitability of corporations in the previous and current years and by legislative amendments in the area of direct taxes, the labour productivity grew faster than wages. Having assessed the overall macroeconomic development, no risk of a possible source and spread of demand pressures has been identified. The Bank Board of the NBS thus considers the current monetary policy setting as appropriate.

Press Department of the NBS