National Bank of Slovakia

REPORT ON MONETARY DEVELOPMENTS IN SLOVAKIA IN THE FIRST HALF OF 2005

September 2005

REPORT ON MONETARY DEVELOPMENTS IN SLOVAKIA IN THE FIRST HALF OF 2005

INTRODUCTION

The implementation of monetary policy over the first half of 2005 was significantly influenced by a change in the monetary-policy strategy of the NBS, adopted by the Bank Board as part of the Monetary Programme until the Year 2008. The NBS introduced this change in connection with the planned entry of Slovakia into the euro area and the related prerequisite to meet the Maastricht criteria. For monetary policy and the NBS as such, a time frame has been outlined, within which the NBS will be responsible for fulfilment of the Maastricht inflation and exchange rate criteria. Therefore, the NBS has undertaken to define an unambiguous framework for its monetary policy in the medium term. The Bank's monetary-policy strategy was defined as inflation targeting in the conditions of ERM II, with the main anchor of monetary policy being the setting of a target figure for inflation. In the Monetary Programme of the NBS until the Year 2008, the 12-month inflation rate target, expressed in terms of the Harmonised Index of Consumer Prices, was set below 2.5% for December 2006 and below 2% for December 2007 and 2008. The value of year-end inflation for December 2005, set at 3.5% ±0.5 percentage points, is also used as a target, and at the same time, this figure reflects the extent of administrative adjustments to regulated prices and is in line with the medium-term inflation target. In connection with the change in the monetary-policy strategy, a change was also made in the communication of the Bank's monetary policy to the general public, according to the 'Communication Strategy of the NBS for the Period until 2009' approved at the beginning of 2005. The monetary programme has been replaced by a quarterly published medium-term forecast, in which the decisions of the NBS concerning its key rates are presented in the form of rationales. With effect from May 2005, the voting ratio from the last NBS Bank Board meeting on monetary development is also published by the NBS.

Overall macroeconomic development in the first half of 2005 was affected by the favourable trend in the real economy, resulting primarily from the relatively dynamic economic growth, accompanied by a fall in inflation and growth in employment. The situation in the area of foreign trade showed a certain deterioration in comparison with the corresponding period a year earlier. Positive developments were also recorded in public finances, where the pension reform introduced in January 2005 is expected to contribute to the sustainability of public finances in the long term.

Price inflation, measured in terms of the Harmonised Index of Consumer Prices (HICP), recorded a slowdown in year-on-year dynamics almost throughout the first half of 2005, due to the persistent appreciation of the Slovak koruna against the euro in particular, growing competition in retail trade in connection with the opening of the markets after the EU enlargement, the unchanged level of indirect tax rates, and the slower increase in energy prices administered by the Office for the Regulation of Utility Sectors (regulated prices), compared with the previous year. Compared with the end of 2004, the year-on-year rates of headline and core inflation fell equally by 3.3 percentage points, to 2.5% and 1.5% respectively. Core inflation followed a positive trend of development, with the year-on-year fall in industrial goods prices (excluding energy and processed food prices) being accompanied by a slowdown in the rate of increase in services prices. However, the level of headline inflation was also affected by the volatile developments in fuel prices, resulting from the situation on international oil markets and the appreciation of the dollar against the Slovak koruna.

The dynamic growth in the real economy continued in the first half of 2005, when real gross domestic product (GDP) increased year-on-year by 5.1% (according to a revised estimate from the Statistical Office of the SR), which represented a slowdown of 0.3 of a percentage point in comparison with the same period a year earlier. The dynamic and balanced growth in the economy over the first half of 2005 (at a rate of 5.1% in both quarters) was supported by both domestic and foreign demand. While the year-on-year dynamics of foreign demand showed a diminishing tendency in the long term, the growth in domestic demand accelerated in the second quarter, mainly as a result of an increase in the growth rate of gross capital. The dynamic growth in investment demand was stimulated by a steep increase in fixed investments and a further positive increase in inventories. The consumption component of domestic demand recorded an increase of 4.5% (2.5% in the first half of 2004), due to accelerated growth in private consumption and stabilised growth in public consumption. In the first half of 2005, the rate of growth in private consumption almost doubled in comparison with the same period a year earlier (to 5.6%) and reached, after weakening for two years, the same level as before the imposition of administrative restrictions on demand in 2003. The accelerated growth in private consumption was mainly stimulated by wage developments. The dynamic wage growth created adequate conditions not only for the maintenance of growth in consumption at levels recorded before the imposition of administrative restrictions on demand, but also for the revival of growth in gross savings in the household sector. The faster growth in the imports of goods and services in comparison with their exports, led to a decrease in the positive balance of net exports at constant prices. Thus, net exports had a dampening effect on GDP growth.

The year-on-year growth in real wages increased more than threefold in comparison with the same period last year. Their dynamics were mainly affected by a marked fall in inflation, while the growth in nominal wages was more moderate than a year earlier. Thus, after a long period, the growth in real wages over the first half of 2005 exceeded the growth in labour productivity, which slowed in comparison with the same period last year. The persistence of unfavourable relations between wages and labour productivity for an extended period is expected to have a negative effect on price developments and/or the balance of trade.

In the first half of 2005, the deficit in the balance of payments on current account increased in comparison with the same period a year earlier. The ratio of the current account deficit to GDP reached 6.9%, compared with 3.5% at the end of 2004. This negative development was due partly to the growing negative cumulative balance of trade and partly to the balance of income. Since the increase in the income balance deficit in the area of paid dividends was mostly concentrated in the first six months, the proportion of the current account deficit is expected to decrease in the annual evaluation. Within the scope of foreign trade, imports showed stronger dynamics than exports. Imports grew in volume as a result of an increase in the share of raw materials in connection with the rise in oil and gas prices, while the decline in exports was influenced by the reduced exports of automobiles. According to the new methodology, reinvested earnings are included in the balance of income, which increases the negative balance on current account (without reinvested earnings, the ratio of the current account deficit to GDP was 4.8% in the first half of the year). The current account deficit was covered by a surplus on the capital and financial account more than twofold. With regard to the capital and financial account structure, however, the balance of foreign direct investments did not suffice to cover the current account deficit as in the same period a year earlier, since the most significant inflow of foreign capital took place in the banking sector, in the form of short-term funds. In the long term, such development in the capital and financial account structure cannot be classified as favourable.

In the first half of the year, monetary policy was implemented in an environment marked by relatively volatile developments in the koruna exchange rate, influenced mostly by the situation on the foreign exchange markets of the neighbouring economies. The appreciating trend in the exchange rate continued at the beginning of 2005, when the National Bank of Slovakia reacted to the excessive appreciation of the Slovak koruna by conducting direct interventions on the foreign exchange market using money market instruments. At the end of February, when the impact of various factors contributing to the dynamic appreciation of the koruna against the euro still persisted, the Bank Board of the NBS decided to lower its key interest rates, to 3% for two-week repo tenders, 4% for overnight refinancing transactions, and 2% for overnight sterilisation operations (with effect from 1 March). The continuing appreciating tendency was caused by short-term capital inflows, stimulated by expectations of a further appreciation of the koruna against the euro and by positive exchange rate differentials, and thus was in contrast with the equilibrium exchange rate of the koruna. The excessive appreciation of the koruna may cause an excessive and unjustified fall in inflation to the detriment of economic growth, and may hamper the achievement of the inflation target in the medium term. At the end of the first quarter, volatile developments were recorded on the foreign exchange markets as a result of depreciating trends in the currencies of neighbouring countries, hence the NBS made direct interventions in support of the Slovak koruna in April. Thus, the stability of the koruna exchange rate had been restored by the end of the first half of the year.

1. ECONOMIC DEVELOPMENTS

1.1. Price Developments

Inflation in terms of the Harmonised Index of Consumer Prices (HICP)

The year-on-year inflation rate, expressed in terms of the Harmonised Index of Consumer Prices (HICP), reached 2.5% in June 2005, representing a fall of 3.3 percentage points compared with the figure for December 2004 (5.8%). The prices of goods and services rose by 1.1% and 5.5% respectively. Core inflation, which covers all prices except for energy and non-processed food prices (in the HICP concept), stood at 1.5%. The average 12-month inflation rate reached 2.5% in the first half of 2005 (compared with 8.1% in the same period a year earlier).

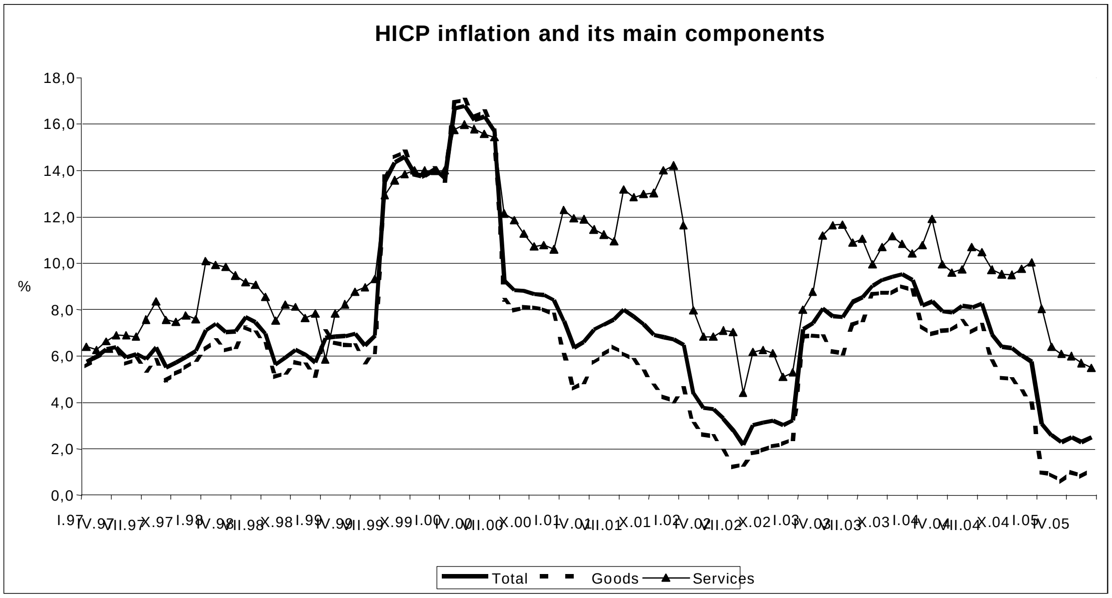
In terms of inflation, the first half of 2005 was characterised by marked disinflation at the beginning, followed by stabilisation in the rate of price increase. This development was mainly caused by a slower increase in regulated energy prices compared with the previous year, coupled with the effect of appreciation in the Slovak koruna on the prices of industrial goods, excluding energy prices. Fuel prices were affected by the rise in oil prices on the world markets and the appreciation of the koruna in relation to the US dollar. The prices of services followed a disinflationary trend throughout the period, mainly as a result of disinflation in prices for services related to housing and other recreational and personal services (prices for canteen meals and hairdresser's services).

Harmonised Index of Consumer Prices (year-on-year changes in %)

	Dec. 2004	Jan. 2005	Feb. 2005	Mar. 2005	Apr. 2005	May 2005	Jun. 2005
Total	5.8	3.1	2.6	2.3	2.5	2.3	2.5
Goods	3.9	1.0	0.9	0.6	1.0	0.8	1.1
Industrial goods	5.4	1.9	2.1	1.5	1.7	1.4	1.5
Industrial goods (excl. energy)	0.2	-0.3	-0.3	-1.1	-1.4	-1.4	-1.4
Energy	13.0	4.9	5.2	5.0	6.0	5.4	5.6
Foodstuffs	1.8	-0.4	-0.9	-0.9	-0.3	-0.3	0.5
Processed food (including alcohol and tobacco)	2.8	-0.1	-1.3	-1.6	-1.1	-1.7	-1.7
Non-processed food	-0.8	-1.8	-0.5	0.4	1.2	2.6	4.6
Services	10.0	8.0	6.4	6.1	6.0	5.7	5.5
Core inflation (excluding energy and non-processed food prices)	4.8	3.1	2.2	1.8	1.8	1.5	1.5
Total, excluding energy	4.3	2.7	2.0	1.7	1.7	1.6	1.8

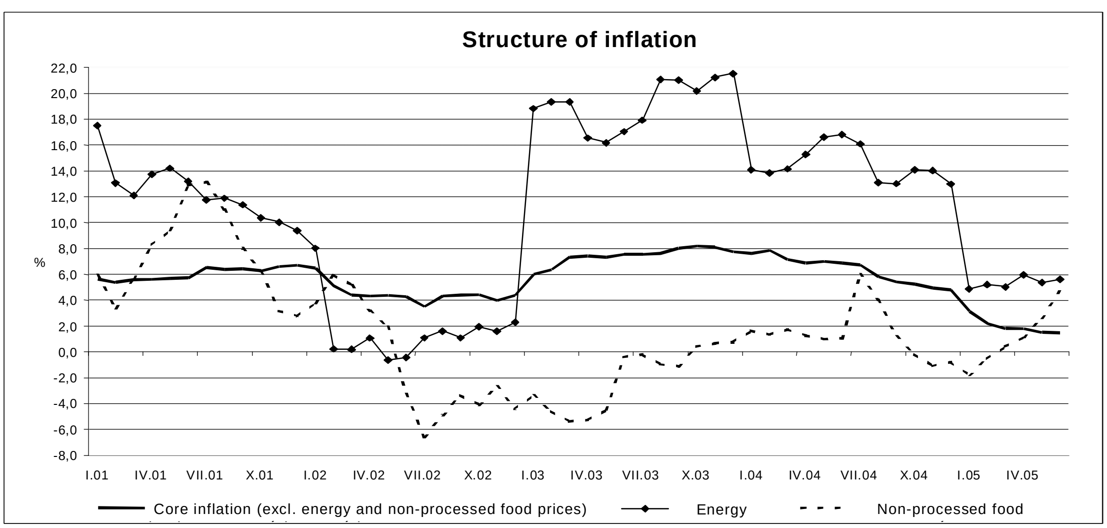
Harmonised Index of Consumer Prices (year-on-year changes in %)

	2004	Q1, 2005	Q2, 2005	1st half, 2005
Total	7.4	2.6	2.4	2.5
Goods	6.2	0.8	0.9	0.9
Services	10.1	6.8	5.7	6.3
Core inflation (excluding energy and non-processed food prices)	6.4	2.4	1.6	2.0



Compared with December 2004, the year-on-year core inflation rate dropped by 3.3 percentage points, to 1.5% in June 2005.

Within the scope of core inflation, a similar trend as in services prices was recorded in the prices of processed foodstuffs and industrial goods (excluding energy), but in contrast with services prices, these prices experienced deepening deflation. Due to the opening of new markets for these commodities after the enlargement of the EU and the situation in primary plant production in agriculture, the rate of fall in processed food prices gradually accelerated, to 1.7% in June 2005. Among industrial goods (excluding energy), drops were mostly recorded in the prices of durable goods (motor vehicles and consumer electronics) and semi-durable goods (clothes, footwear, and mobile phones). The prices of non-durable goods increased somewhat.



Inflation in terms of the Consumer Price Index (CPI)

The price level, expressed in terms of the Consumer Price Index (CPI), rose year-on-year by 2.5% in June 2005. Thus, the consumer price increase slowed by 3.4 percentage points compared with the end of 2004. Over the first six months of 2005, the average inflation rate reached 2.7%.

The fall in the year-on-year dynamics of consumer prices during the first half of 2005 (compared with the same period a year earlier) was caused by a slowdown in the rate of price increase, or continued year-on-year fall, in all basic categories of the consumer basket. The most significant slowdown occurred in regulated prices. The only sector to record an increase in year-on-year dynamics was that of 'food prices'. Of the total increase in consumer prices (2.5%), core inflation accounted for 0.9 of a percentage point. Administrative adjustments to regulated prices contributed 1.61 percentage points to the overall consumer price increase. The first six months of 2005 saw no changes in excise duties.

Consumer price developments (year-on-year changes in %)

Structure of the consumer basket	Dec.	2005					
	2004	Jan.	Feb.	Mar.	Apr.	May	Jun.
Total in %	**5.9**	**3.2**	**2.7**	**2.5**	**2.7**	**2.4**	**2.5**
Regulated prices in %	**15.1**	**8.8**	**7.6**	**7.4**	**7.5**	**7.2**	**7.1**
Share of total, in percentage points	*3.71*	*2.05*	*1.75*	*1.70*	*1.70*	*1.63*	*1.61*
Impact of changes in indirect taxes on non-regulated prices – share of total, in percentage points	*1.13*	*0.10*	*0.09*	*0.09*	*0.08*	*0.00*	*0.00*
Core inflation in %	**1.5**	**1.4**	**1.1**	**0.9**	**1.2**	**0.9**	**1.1**
Share of total, in percentage points	*1.09*	*1.04*	*0.89*	*0.72*	*0.96*	*0.76*	*0.90*
of which: Food prices in %	-2.1	-1.2	-1.6	-1.3	-0.5	-0.5	0.1
Share of total, in percentage points	*-0.41*	*-0.24*	*-0.31*	*-0.26*	*-0.10*	*-0.10*	*0.00*
Tradable goods in % [1]	-0.2	0.0	-1.3	-1.5	-0.5	-1.2	-1.3
Share of total, in percentage points [1]	*-0.07*	*-0.33*	*-0.34*	*-0.59*	*-0.50*	*-0.65*	*-0.58*
Market services in % [1]	8.2	7.7	6.9	6.9	6.8	6.5	6.3
Share of total, in percentage points [1]	*1.57*	*1.60*	*1.54*	*1.56*	*1.55*	*1.51*	*1.49*
Net inflation (excluding the impact of changes in indirect taxes) in %	**2.8**	**2.3**	**2.1**	**1.7**	**1.8**	**1.4**	**1.5**
Share of total, in percentage points	*1.50*	*1.21*	*1.10*	*0.89*	*0.93*	*0.75*	*0.77*

Source: Statistical Office of the Slovak Republic.
1) NBS estimates based on data from the Statistical Office of the SR.

Producer prices

Industrial producer prices for the domestic market

Over the first half of 2005, industrial producer prices increased by 0.5 of a percentage point in comparison with the same period a year earlier, to 3.3%, with the prices of manufacturing products rising year-on-year by 2.7% and those of electricity, gas, steam, and hot water by 4.5%. On the other hand, mineral raw materials prices dropped year-on-year by 1.1% and thus remained below the level of the first half of 2004.

The increase in industrial producer prices was mainly caused by external cost factors (the rise in oil prices on the world markets and the appreciation of the US dollar against the Slovak koruna). Within the scope of domestic cost factors, inflationary pressure was exerted by the increased dynamics of energy prices in comparison with the corresponding period a year earlier, while the falling purchase prices of food production inputs had an anti-inflationary effect in the period under review.

Producer price developments (average year-on-year changes in %)

	1st half	
	2004	2005
Industrial producer prices (for the domestic market)	2.8	3.3
-*Prices of manufacturing products*	1.9	2.7
-*Prices of mineral raw materials*	7.9	- 1.1
-*Prices of electricity, gas, steam, and hot water*	3.8	4.5
Industrial producer prices (for export)	- 2.0	7.6
Construction prices	5.7	4.9
Building materials prices	3.7	7.0
Agricultural prices	2.0	- 0.4
- *Prices of plant products*	15.1	- 15.7
- *Prices of animal products*	0.0	2.3

The year-on-year increase in energy prices (4.5%) was generated mostly by a rise in prices for water treatment and distribution (13.4%) and a rise in prices for gas production and the distribution of gaseous fuels by pipeline (10.8%). Prices for steam and hot water production and distribution increased at a slower rate, and prices for electricity generation and supply recorded only a negligible rise.

The accelerated increase in manufacturing products prices in the first half of 2005 was mainly caused by a marked year-on-year rise in the prices of refined oil products (17.1%), base metals and finished metal products (13%), and chemical products (6.2%). On the other hand, the increase was dampened by the falling prices of food products (an average of 3%). The average price of textiles and textile products was also lower than a year earlier (by 0.9%), as well as the price of timber and wood products (by 0.8%).

Industrial producer prices for export

In the first half of 2005, the prices of manufacturing products for export rose year-on-year by 7.6%, mainly due to increases in the prices of refined oil products (24.5%), metals and finished metal products (24.1%), chemical products (11.7%), electrical and optical equipment (5.8%), and food products (2.4%). The sharpest drops in comparison with the same period a year earlier took place in the prices of transport vehicles (3.7%).

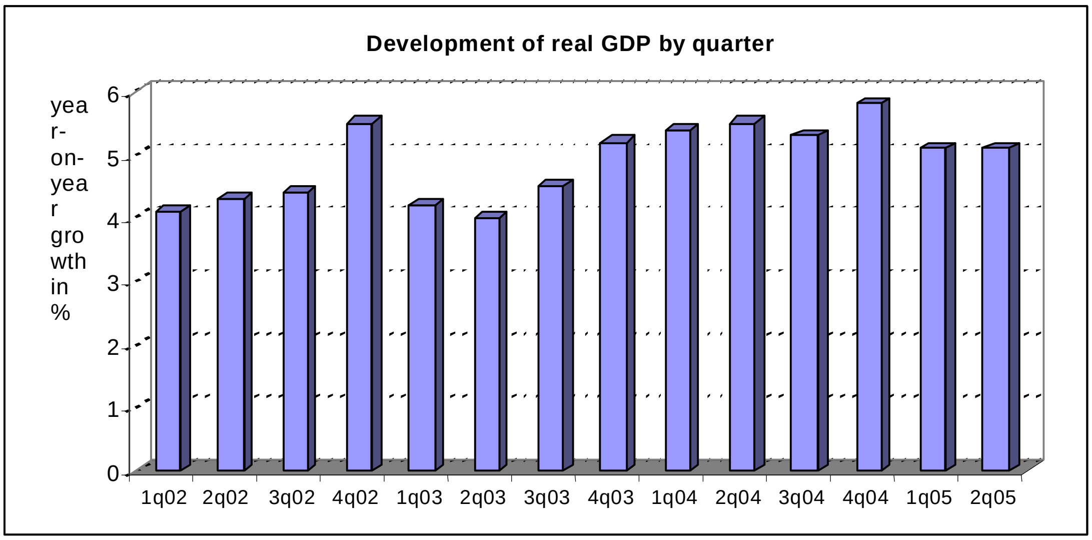
Agricultural prices

Prices in agricultural primary production in the first half of 2005 were 0.4% lower than a year earlier, when the prices of plant products fell by 15.7% and those of animal products rose by 2.3%. The fall in the prices of plant products was mainly caused by drops in cereal prices (17.9%, of which wheat prices accounted for 22.7%), potato prices (8.8%), fruit prices

(3.8%), and vegetable prices (2.3%). The rise in animal products prices was due to increases in the prices (for live animals) of pork (9.4%), beef and veal (4.9%), and unpasteurised cow milk (3.5%).

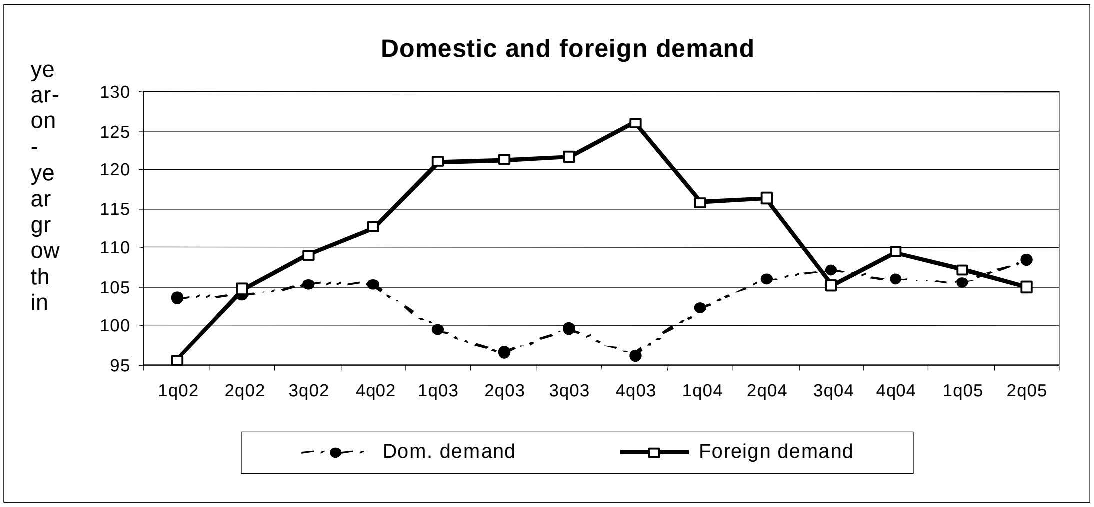
1.2. Gross Domestic Product

In the first half of 2005, gross domestic product (GDP) increased year-on-year by 5.1% in real terms (according to the revised estimate of the Statistical Office of the SR), representing a slowdown of 0.3 of a percentage point when compared with the figure for the first half of 2004 (5.4%). The dynamic and balanced growth in the economy over the first half of 2005 (at a rate of 5.1% in both quarters) was supported by both domestic and foreign demand. Domestic supply reacted to the growth in aggregate demand with increased added-value creation, mainly in construction; agriculture, including forestry and fishing; trade; transport; and manufacturing. The volume of GDP created over the period under review amounted to Sk 690.2 billion (at current prices), which was 8% more than a year earlier.



Demand

In a breakdown by demand, the structure of economic growth was relatively balanced in the first half of 2005, when domestic demand grew by 7% (in the same period a year earlier by 4.2%) and foreign demand by 6% (a year earlier by 16.1%). After a long period of persistent decline in the exports of goods and services, both components of aggregate demand showed balanced dynamics. The decelerating growth in foreign demand in the second quarter of 2005 was accompanied by accelerating growth in domestic demand, which reached the highest rate (8.4%) in the past three and a half years.



The increase in domestic demand was primarily caused by an acceleration in the rate of growth in gross capital formation, from 8% in the first quarter to 18% in the second quarter of 2005. During the first half of 2005, gross capital formation in the economy increased by 13.5% (compared with 8.7% in the first half of 2004). The consumption component of domestic demand recorded an increase of 4.5% (2.5% in the first half of 2004), due to accelerated growth in private consumption and stabilised growth in public consumption in comparison with last year.

Gross domestic product by use (index, same period a year earlier = 100, constant 1995 prices)

Indicator	Q1-2, 04 / Q1-2, 03	**2004 / 2003**	Q1, 05 / Q1, 04	Q2, 05 / Q2, 04	Q1-2, 05 / Q1-2, 04
Gross domestic product	105.4	**105.5**	105.1	105.1	105.1
Domestic demand	104.2	**105.5**	105.5	108.4	107.0
Final consumption	102.5	**102.8**	104.6	104.3	104.5
Households	102.9	**103.5**	105.5	105.6	105.6
General government *	101.2	**101.1**	101.8	100.7	101.2
Non-profit institutions serving households	105.0	**105.8**	105.1	103.2	104.1
Gross capital formation	108.7	**113.1**	108.0	118.0	113.5
Gross fixed capital formation	102.4	**102.5**	105.8	110.7	108.6
Exports of goods and services	116.1	**111.4**	107.2	105.0	106.0
Imports of goods and services	114.6	**112.7**	107.9	106.9	107.3

** Data on final consumption in the general government (2nd quarter, 2005) are the estimates of the Statistical Office of the SR.*

Investment demand

The dynamic growth in investment demand was stimulated by a steeper increase in fixed investments and continuing positive increases in inventories. The growth in inventories was primarily caused by an increase in work-in-progress. Fixed investments grew by 8.6% at constant prices (during the first half of 2004 by 2.4%). Fixed capital formation was mainly affected by investment in new fixed assets, while the volume of acquired used long-term property decreased. For the acquisition of gross fixed capital, the non-financial corporations sector spent 12.9% more than a year earlier, due to its positive financial results. Investment activity in the public sector, which invested 4.2% more than in the same period a year earlier, also increased. Investment activity in the household sector increased only slightly, by 0.7%.

Investment by financial corporations and non-profit institutions serving households remained below the level of the previous year.

The year-on-year rate of growth in gross investments in buildings and structures (11% at constant prices) exceeded the dynamics of investments in machinery (7.5%). Investments in buildings and structures also grew as a result of increased allocation of investment funds for residential buildings, which achieved the fastest rate of year-on-year growth (12.7%) within the classification of production. The dominant part of investments in buildings and structures took place in 'other structures', which grew at a relatively fast rate (10.7%). In machinery, investments continued to grow in metal products and machines (8.3%) and transport equipment (5.2%).

Structure of gross fixed capital formation in the first half of 2005 *

	Gross fixed capital formation (Sk millions)	Share (%)	Index Q1-2, 2005 / Q1-2, 2004
Economy of the SR in total:	**172,375**	**100.0**	**108.6**
of which (by production):			
Buildings and structures	**56,138**	**32.6**	**111.0**
of which: residential buildings	10,319	6.0	112.7
other structures	45,819	26.6	110.7
Machinery	**105,067**	**61.0**	**107.5**
of which: metal products and machines	80,513	46.7	108.3
transport equipment	24,554	14.2	105.2
of which (by sector):			
Non-financial corporations	114,769	66.6	112.9
Financial corporations	21,298	12.4	99.3
General government	12,265	7.1	104.2
Households	23,848	13.8	100.7
Non-profit institutions	195	0.1	85.4

* Volumes and proportions are at current prices, indices at constant prices.

As far as the financing of investment demand is concerned, the share of domestic resources in the financing of investments decreased. In the first half of the year, the savings ratio remained at the level of the same period in the previous year (26.1%). At the same time, the ratio of investment in gross capital increased by 2.4 percentage points (from 26.6% in the first half of 2004 to 28.9% in the first half of 2005). As a result of this development, the gap between savings (unconsumed part of GDP) and gross investments widened. While domestic savings in the first half in 2004 managed to cover 98.1% of gross investments, the first half of the current year saw a decrease of 8 percentage points in this figure.

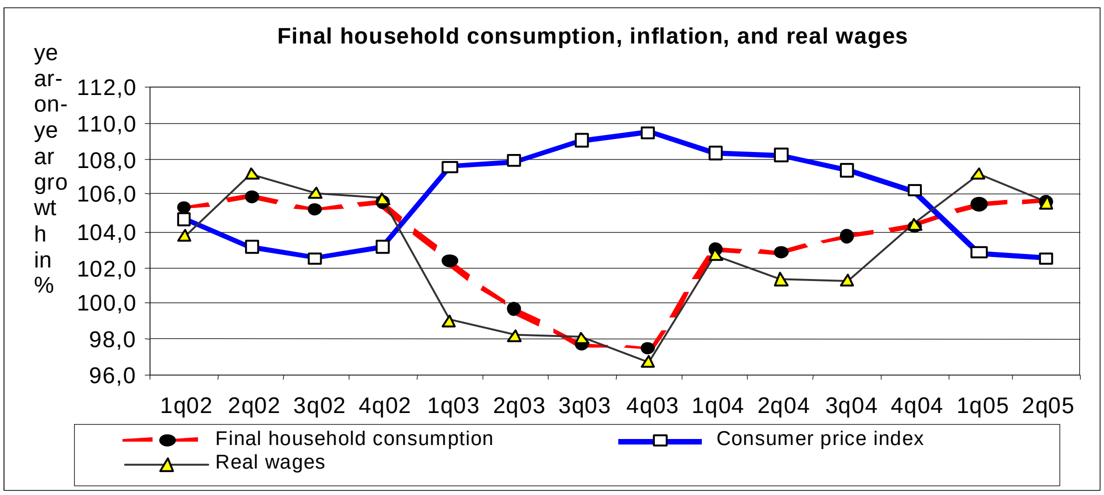
Investments and savings (%)

	1st half of 2004	2004	1st half of 2005
Constant 1995 prices			
Savings ratio [1]	31.6	29.5	32.0
Gross investment ratio [2]	26.8	26.8	28.9
Fixed investment ratio [3]	23.8	24.5	24.6
Coverage of investments by savings [4]	118.0	110.1	110.6
Current prices			
Savings ratio [1]	26.1	23.9	26.1
Gross investment ratio [2]	26.6	26.3	28.9
Fixed investment ratio [3]	24.1	24.7	25.0
Coverage of investments by savings [4]	98.1	90.9	90.1

1/ Ratio of gross domestic savings (GDP less final consumption in total) to GDP.
2/ Ratio of gross capital formation to GDP.
3/ Ratio of fixed capital formation to GDP.
4/ Ratio of gross domestic savings to gross investments.

Consumer demand

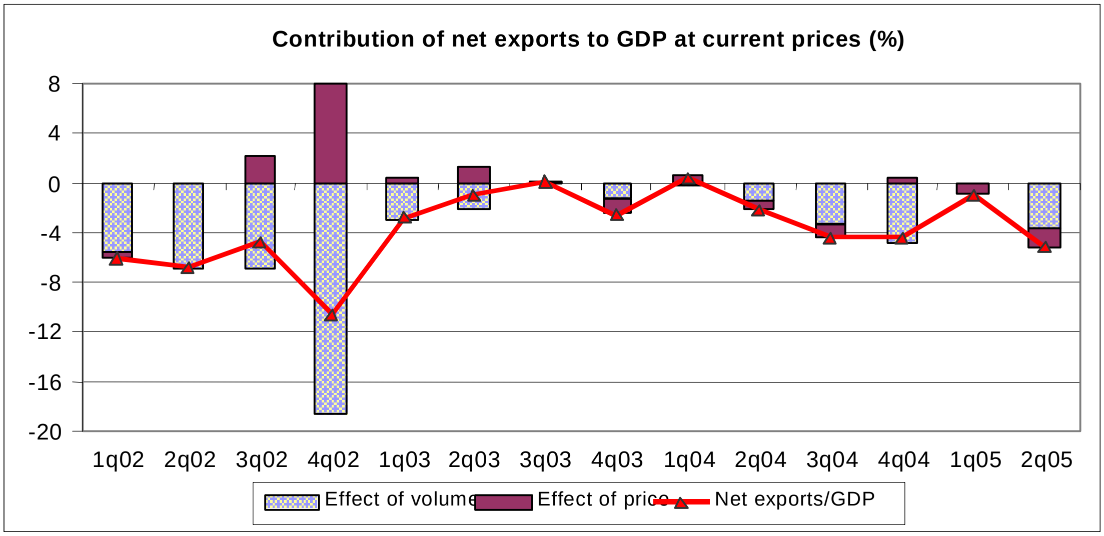
The accelerated growth in final consumption took place mostly in the household sector, while contributions from the public sector and non-profit institutions were minimal. In the first half of 2005, the rate of growth in private consumption almost doubled in comparison with the figure for the same period in 2004 (2.9%) and reached 5.6% at constant prices (5.5% in the first quarter and 5.6% in the second quarter). After weakening for two years, the growth in private consumption reached its usual level, recorded before the imposition of administrative restrictions on demand in 2003. The accelerated growth in private consumption was mainly stimulated by wage developments and was also supported by the continuing drawing of credit resources. The dynamic wage growth created adequate conditions not only for the maintenance of growth in consumption at levels recorded before the imposition of administrative restrictions on demand, but also for the revival of growth in gross savings in the household sector. Within the structure of private consumption, the strongest growth (22.6% at constant prices) was recorded in expenditures on furnishings, household appliances, and routine household maintenance, accounting for approximately 7% of the total consumer expenditure in the household sector.



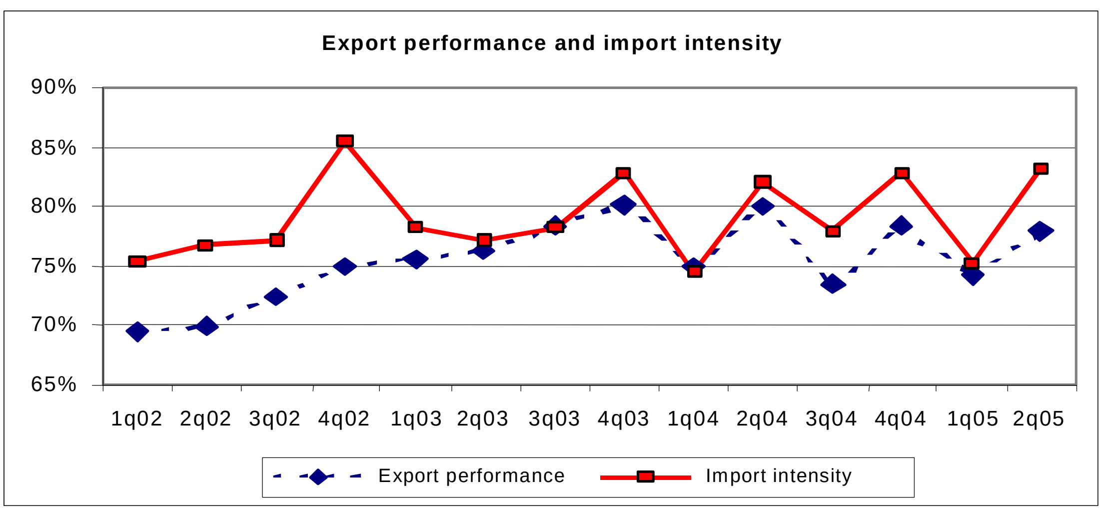
Net exports

The imports of goods and services reacted to the growth in demand with a nominal increase of 9.2% year-on-year, exceeding the export dynamics by 3.2 percentage points (6% at current prices). The growth in imports in nominal terms reflected the increase in the volume of imported goods and services, which accounted for 80% of the recorded nominal growth in imports, the remaining 20% was caused by a rise in import prices (mainly in the prices of energy-producing raw materials). Compared with the first half of 2004, when imports and exports reached two-digit rates of growth, the first half of 2005 saw a decrease in the intensity of trading abroad. Exports recorded a more significant slowdown than imports. As a result of this development, the trade deficit increased in nominal terms, from Sk 5.5 billion in the first half of 2004 to Sk 21.8 billion this year.

Without price developments being taken into account, imports increased by 7.3%. Since the prices of exported goods and services remained unchanged on average, the rate of export growth in real terms corresponded to the figure in nominal terms and reached 6%. The excess of imports over exports at constant prices amounted to 1.3 percentage points. With price developments on foreign markets taken into account, the real balance of trade resulted in a surplus of Sk 11.8 billion, which was Sk 4 billion less than in the same period in 2004. The deterioration in the semi-annual results was mainly due to the less favourable trade balance in the second quarter of the year.



The Slovak economy maintained a relatively high export performance (76.2% at current prices), though it was 1.4 percentage points lower than in the same period in 2004. Import intensity increased by 0.8 of a percentage point, to 79.3%. The openness of the Slovak economy, expressed in terms of the ratio of exports and imports to nominal GDP, diminished slightly, to 155.5% (from 156.1% in the same period a year earlier).



Trading abroad resulted in a negative contribution of 1 percentage point, by net exports to the real GDP. Domestic demand contributed 6.7 percentage points to the rate of real GDP growth. The difference between this figure and final GDP dynamics (5.1%) represented a statistical discrepancy.

Contributions to gross domestic product* (percentage point, constant 1995 prices)

Indicator	Q1-2, 04 / Q1-2, 03	**2004 / 2003**	Q1, 05 / Q1, 04	Q2, 05 / Q2, 04	Q1-2, 05 / Q1-2, 04
Gross domestic product	5.4	**5.5**	5.1	5.1	5.1
Domestic demand	4.1	**5.3**	5.2	8.0	6.7
Final consumption	1.8	**2.1**	3.2	2.9	3.1
Households	1.5	**1.8**	2.9	2.8	2.8
General government	0.2	**0.2**	0.3	0.1	0.2
Non-profit institutions serving households	0.0	**0.1**	0.0	0.0	0.0
Gross capital formation	2.3	**3.3**	2.0	5.1	3.6
Gross fixed capital formation	0.6	**0.6**	1.3	2.7	2.0
Change in inventories	1.7	**2.6**	0.7	2.4	1.6
Net exports	1.7	**-0.8**	-0.3	-1.6	-1.0
Exports of goods and services	14.4	**10.6**	6.9	5.0	5.9
Imports of goods and services	12.7	**11.4**	7.2	6.7	6.9
Statistical discrepancy	-0.3	**1.0**	0.2	-1.3	-0.6

* Calculated from GDP figures (in millions of Sk), the values of net exports and GDP are reduced by the contributions of imports of goods and services; the differences in the subtotals are due to rounding.

Supply

The real GDP growth was connected with an increase in value added generation, mainly in construction (12.3%); agriculture, forestry, hunting, and fishing (10.8%); trade (8.9%); transport and communications (8.9%); and industry (7.1%). The creation of value added declined most significantly in non-market services, which are currently in the process of restructuring (education, health services, and social care). Hotels and restaurants and financial intermediation also remained below the level of last year.

Development of GDP by sector (index, same period a year earlier = 100, constant 1995 prices)

Economic sector	Q1-2, 04 / Q1-2, 03	**2004 / 2003**	Q1, 05 / Q1, 04	Q2, 05 / Q2, 04	Q1-2, 05 / Q1-2, 04
Gross domestic product of which:	105.4	**105.5**	105.1	105.1	105.1
Agriculture, forestry, hunting and fishing	106.5	**109.6**	114.2	108.0	110.8
Industry in total of which:	108.2	**111.5**	107.9	106.5	107.1
Manufacturing	106.7	**111.9**	107.4	108.7	108.1
Electricity, gas, and water supply	121.1	**111.3**	110.5	85.3	101.4
Construction	107.0	**111.8**	110.8	113.7	112.3
Services in total of which:	101.0	**103.0**	103.9	104.0	104.0
Wholesale and retail trade, repairs	110.6	**111.3**	114.6	105.0	108.9
Financial intermediation	135.9	**130.1**	100.6	97.5	99.1
Real estate, renting, and business activities	109.6	**108.3**	103.8	104.8	104.3
Public administration, defence, social security	93.8	**93.8**	102.8	105.4	104.2
Other [1]	127.0	**98.5**	96.8	102.5	99.7

1/ Value added tax, excise duty, tax on imports, minus subsidies and imputed production of banking services.

The strengthening position of the construction sector in the Slovak economy was confirmed by continued dynamic growth in value added generation, which caused an increase in fixed capital on the demand side. Value added in agriculture, forestry, hunting and fishing also continued to grow at a two-digit rate, due to the participation of Slovakia in the re-allocation of funds within the European Union.

The continuing growth in value added in industry was a result of foreign direct investment in manufacturing production and was also supported by mining and quarrying, electricity, gas and water supply. In manufacturing, the growth in value added accelerated mostly in food production, the manufacture of machinery, electrical and transport equipment, and the production of metals and metal products.

Within the scope of services, value added increased most significantly in wholesale trade, retail trade, and the repair of vehicles and consumer goods. The continuing growth in value added in this sector was a reaction to an increase in consumer demand in the household sector. After growing dynamically and having a high basis of comparison last year, value added creation in financial intermediation recorded a decline.

The total contribution of services to GDP creation amounted to 2.2 percentage points. Industry in total contributed 2 percentage points, agriculture, including forestry, hunting and fishing 0.5 of a percentage point, and construction 0.4 of a percentage point.

Contributions to gross domestic product by sector (percentage points, constant 1995 prices)

Economic sector	Q1-2, 04 / Q1-2, 03	**2004 / 2003**	Q1, 05 / Q1, 04	Q2, 05 / Q2, 04	Q1-2, 05 / Q1-2, 04
Gross domestic product (GDP) of which:	5.4	**5.5**	5.1	5.1	5.1
Agriculture, forestry, hunting and fishing	0.3	**0.5**	0.6	0.4	0.5
Industry in total of which:	2.3	**3.0**	2.3	1.8	2.0
Manufacturing	1.6	**2.7**	1.7	2.1	1.9
Electricity, gas, and water supply	0.7	**0.3**	0.5	-0.4	0.1
Construction	0.2	**0.4**	0.4	0.5	0.4
Services in total of which:	0.6	**1.7**	2.1	2.2	2.2
Wholesale and retail trade, repairs	1.4	**1.5**	1.7	0.8	1.2
Financial intermediation	1.7	**1.4**	0.0	-0.1	-0.1
Real estate, renting, and business services	0.9	**0.9**	0.4	0.5	0.4
Public administration, defence, social security	-0.4	**-0.5**	0.2	0.3	0.3
Other [1]	2.1	**-0.1**	-0.3	0.2	0.0

1/ Value added tax, excise duty, import tax, minus subsidies and imputed production of banking services.

1.3. Labour Market Developments

Wages

In the first half of 2005, the average monthly nominal wage in the Slovak economy showed relatively dynamic growth (9.1%), and reached Sk 16,381. The rate of growth was 1.2 percentage points slower than in the same period a year earlier. Over the six months under review, the rate of nominal wage growth slowed, from 10.2% in the first quarter to 8.2% in the second quarter.

Nominal wages were higher than in the first half of 2004 in all sectors of the economy. The strongest year-on-year growth in nominal wages was recorded in electricity, gas, and water supply (10.4%), public administration and defence (10%), and education (10%). Growth at the level of the economy, i.e. 9.1% was achieved by wages in manufacturing; other sectors recorded wage growth at a slower rate. The slowest wage growth took place in hotels and restaurants (4.4%); financial intermediation (4.9%); real estate, renting, and business activities (5.0%); and other community, social, and personal services (5.2%).

In a breakdown by form of ownership, dynamic year-on-year growth in nominal wages was recorded in the corporate sector, in small enterprises with up to 19 employees (13.8%), while wages in companies with 20 and more employees increased by 6.3%. Rapid wage growth was achieved in budgetary organisations (11%), while the weakest wage growth was recorded in subsidised organisations (an average of 5.5% in the first half of the year).

Real wages grew year-on-year by 6.2%, a rate more than three times faster than the figure for the same period a year earlier. Developments in real wages were affected first and foremost by a marked slowdown in average consumer price dynamics (from 8.2% in the first half of 2004 to 2.7% in the first half of 2005), since the rate of increase in nominal wages was slower than a year earlier. Similar to nominal wages, real wages recorded a slowdown in the rate of growth over the first half of the year (from 7.2% in the first quarter to 5.6% in the second quarter). Real wages increased in all sectors of the economy.

Average monthly wages and labour productivity in the Slovak economy
(index, same period a year earlier = 100)

	2004		2005		
	1st half	year	Q1	Q2	1st half
Nominal wage (Sk)	15,008	15,825	16,022	16,737	16,381
Nominal wage (index)	110.3	110.2	110.2	108.2	109.1
Real wage	101.9	102.5	107.2	105.6	106.2
Labour productivity (current prices)	111.8	110.1	104.9	105.9	105.4
Labour productivity (constant prices)	105.8	105.2	102.4	102.8	102.6
Real labour productivity - real wages (percentage points)	3.9	2.7	-4.8	-2.8	-3.6
Consumer prices (average for the period)	*108.2*	*107.5*	*102.8*	*102.5*	*102.7*

Labour productivity (GDP per employee, according to statistical reports) increased in nominal terms by 5.4% and in real terms by 2.6%. Compared with the first half of 2004, the rate of growth in productivity slowed in nominal terms by 6.4 percentage points and in real terms by 3.2 percentage points. This was due partly to the slower growth in GDP than a year earlier (in both nominal and real terms) and partly to the different trend in employment, which increased over the first half of the year by more than 2%, after decreasing somewhat a year earlier. After a longer period (for the last time in the second quarter of 2002), the growth in labour productivity remained well behind the growth in wages, in both nominal and real terms (by 3.7 and 3.6 percentage points respectively).

Developments in real labour productivity in the individual sectors indicate that the year-on-year growth in productivity took place mostly in production sectors and selected services (trade, repair services, transport, storage, and post and telecommunications). In other sectors, labour productivity decreased. The decline in financial intermediation was affected by the high basis of comparison from the previous year (an increase of almost 33%). In real estate, renting, and business services, the rate of GDP growth slowed, while employment showed relatively dynamic growth. As in the same period a year earlier, labour productivity fell in all branches of the public sector, even in branches with a persistent decline in employment (education, health care).

Real productivity grew at a faster rate than real wages in most production sectors and in selected market services (transport, storage, post and telecommunications). Labour productivity grew at the same rate as wages in trade and repair services, while other services recorded an increase in real wages, accompanied by a fall in productivity.

Labour productivity and wages by sector in the first half of 2005
(index, same period a year earlier = 100)

	Nominal		Real	
	labour productivity	wage	labour productivity	wage
Economy of the SR in total:	105.5	109.1	102.6	106.2
of which:				
Agriculture, forestry, and fishing	114.0	107.6	115.8	104.8
Industry	102.4	108.8	103.6	105.9
Mining and quarrying	108.4	108.5	112.4	105.6
Manufacturing	102.0	109.1	103.4	106.3
Electricity, gas, and water supply	111.5	110.4	109.0	107.5
Construction	105.3	106.7	105.3	103.9
Trade and repair activities	107.4	107.3	104.5	104.5
Transport, post and telecommunications	112.1	107.9	110.6	105.1
Financial intermediation	102.4	104.9	98.3	102.1
Real estate, renting, business activities	105.5	105.0	97.5	102.2
Public administration and defence, social security	100.9	110.0	98.2	107.1
Education	111.4	110.0	90.7	107.1
Health and social services	111.6	106.8	93.4	104.0
Other community, social, and personal services	102.9	105.2	99.8	102.4

Source: NBS estimates based on data from the Statistical Office of the SR.

Income and expenditure of households

According to preliminary data from the Statistical Office of the SR, the current income of households reached Sk 525.7 billion in the first half of 2005, representing a year-on-year increase of 7.5% in nominal terms (4.7% in real terms). The rate of growth remained virtually unchanged, at the level of the first half of 2004 (7.4%). Current household expenditure (paid to other sectors and not used for direct consumption) totalled Sk 123.3 billion, representing a year-on-year increase of 3.3% (0.6% in real terms). The rate of growth accelerated in comparison with the first half of 2004 by 1.9 percentage points.

Generation and allocation of incomes in the household sector (current prices)

	Sk billions		Indices[1]		Share in %	
	H1 2004	H1 2005	H1, 2004 / H1, 2003	H1, 2005 / H1, 2004	H1 2004	H1 2005
Compensation of employees (all sectors)	249.3	269.5	108.3	108.1	51.0	51.3
of which: gross wages and salaries	186.5	205.3	108.4	110.1	38.1	39.1
Gross mixed income	134.4	153.0	108.8	113.8	27.5	29.1
Income from property - received	14.2	9.5	97.0	67.1	2.9	1.8
Social security benefits	74.0	77.0	105.2	104.1	15.1	14.7
Other current transfers - received	17.1	16.7	103.5	97.6	3.5	3.2
Current income in total	489.0	525.7	107.4	107.5	100.0	100.0
Income from property - paid	4.4	5.9	155.9	134.0	3.7	4.8
Current tax on income, property, etc.	21.6	17.7	92.8	81.9	18.1	14.3
Social security contributions	79.5	84.7	101.1	106.5	66.6	68.7
Other current transfers - paid	13.9	15.0	106.2	108.0	11.6	12.2
Current expenditure in total	119.4	123.3	101.4	103.3	100.0	100.0
Gross disposable income	369.7	402.4	109.5	108.9	100.0	100.0
Adjustment for changes in the net equity of households in the reserves of pension funds	1.3	3.3	78.3	249.5	x	x
Final household consumption	356.9	388.0	110.3	108.7	96.5	96.4
Gross savings of households	14.1	17.7	90.1	125.8	3.8	4.4

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

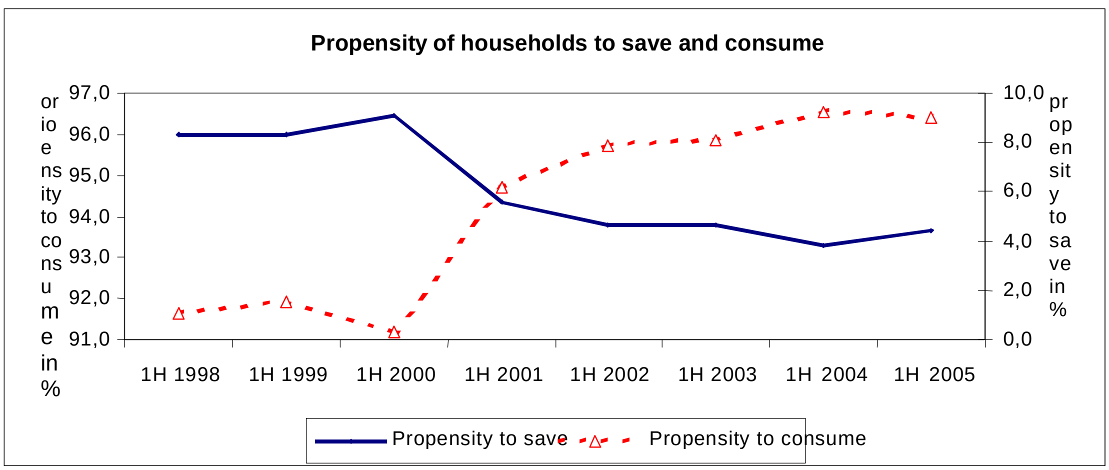
The growth in current income was favourably affected by increases in gross mixed income and employee compensation, while a dampening effect was exerted by the declining income from property. Income from property comes from the ownership of financial assets, i.e. deposits, bonds, etc. or the ownership of land, underground resources, etc., which are given by the owner at the disposal of another institutional unit.

The year-on-year growth in current expenditure was mainly connected with the growth in social contributions and other current transfers paid. On the other hand, current tax on income and property decreased. The growth in social contributions was probably affected by the new legal regulations adjusting the basis of assessment for compulsory contributions to social funds (depending on the level of the average and/or minimum wage) and by the growth in employment.

Gross disposable income of households by use (index, same period a year earlier = 100, current prices)

	2004		2005		
	1st Half	Year	Q1	Q2	1st Half
Gross disposable income	109.5	110.2	109.3	108.5	108.9
Final household consumption	110.3	110.7	108.6	108.9	108.7
Gross savings of households	90.1	101.7	128.4	123.4	125.8
Share of gross savings in gross disposable income in %	3.8	6.2	4.3	4.5	4.4

With current expenditure being deducted from current income, the gross disposable income of households amounted to Sk 402.4 billion, representing a year-on-year increase of 8.9% (compared with 9.5% a year earlier). Of the gross disposable income of households, 96.4% was used for final consumption (96.5% in the first half of 2004), the remainder went to gross savings, which include the deposits of households and small entrepreneurs, as well as their investment activities (tangible and intangible investments, and additional retirement insurance). The dynamic growth in gross household savings in the first half of the year (25.8%) was apparently affected by a marked increase in additional retirement insurance since the beginning of the year, growth in household incomes, and by the low basis of comparison last year. The accelerated growth in gross savings was reflected in the trend of development in gross household savings, which started to increase again in the second half of 2004.



Employment

The dynamic economic growth in the first two quarters of 2005 was also reflected in the creation of new jobs. Employment grew at a rate of more than 2% in both quarters (with a certain slowdown in the second quarter). In the first half of 2005, the number of people working in the Slovak economy, determined on the basis of a labour force sample survey (LFSS), increased year-on-year by 2.2% (after decreasing a year earlier by 0.5%), due to an increase in the number of entrepreneurs (15.1%) as well as employees (0.5%).

Employment and unemployment (average for the period)

	2004		2005		
	1st Half	Year	Q1	Q2	1st Half
Employment (according to statistical reports) in thousands	2,009.4	2,030.3	2,049.5	2,066.4	2,057.9
(index, same period a year earlier = 100)	99.6	100.3	102.6	102.2	102.4
Unemployment according to LFSS in thousands	2,140.4	2,170.4	2,177.4	2,196.8	2,187.1
(index, same period a year earlier = 100)	99.5	100.3	102.3	102.1	102.2
Rate of registered unemployment in % *	15.5	14.3	13.1	11.4	12.2
Unemployment according to LFSS in thousands	500.5	480.7	461.9	425.3	443.6
(index, same period a year earlier = 100)	107.7	104.7	90.3	86.9	88.6
Unemployment rate according to LFSS in %	18.9	18.1	17.5	16.2	16.9

* Estimates of the NBS.

The positive trend in employment in the first half of the year was also confirmed by data from statistical reports. In a breakdown by sector, the most rapid growth in employment was achieved in real estate, renting, and business services; construction; public administration, defence, and social security; other community, social, and personal services; trade; and industry. The level of employment continued to fall in agriculture, health services, education, transport, and post and telecommunications.

Developments in employment by sector * (index, same period a year earlier = 100)

	2004		2005		
	1st Half	Year	Q1	Q2	1st Half
Total	99.6	100.3	102.6	102.2	102.4
Agriculture, hunting, and forestry	88.9	91.0	95.4	96.0	95.7
Industry	99.4	100.4	103.4	103.4	103.4
Mining and quarrying	90.1	91.2	94.8	93.4	94.1
Manufacturing	100.1	101.1	104.5	104.5	104.5
Electricity, gas, and water supply	94.3	95.0	92.8	93.3	93.0
Construction	103.1	102.7	106.4	106.7	106.6
Wholesale and retail trade; repair of motor vehicles, motorcycles, and consumer goods	99.5	101.0	104.6	103.7	104.2
Hotels and restaurants	101.9	101.9	103.2	103.5	103.3
Transport, storage, post and telecommunications	97.7	98.8	98.9	98.2	98.5
Financial intermediation	102.3	101.6	101.3	100.3	100.8
Real estate, renting, and business activities	102.9	103.4	107.7	106.3	107.0
Public administration and defence, compulsory social insurance	101.3	101.3	103.2	108.9	106.1
Education	99.3	97.8	98.7	96.6	97.6
Health and social services	98.7	98.8	97.6	97.2	97.4
Other community, social, and personal services	103.6	103.6	108.0	102.3	105.1

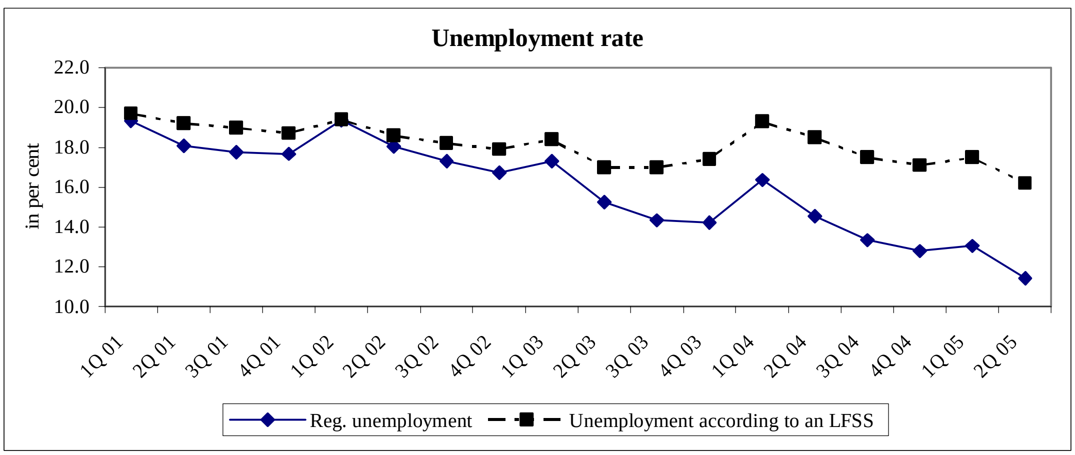
* According to statistical reports.

Unemployment

The increased creation of new jobs was also reflected in the rate of unemployment. The year-on-year drop in the number of unemployed determined on the basis of a labour force sample survey in the first quarter of 2005 (9.7%) deepened further in the second quarter (to 13.1%), thus the average figure for the first half of the year was 11.4%. The unemployment rate in the first quarter stood at 17.5%, then fell to 16.2% in the second quarter, which represented a six-month average of 16.9% (compared with 18.9% in the same period a year earlier).

The marked downward trend in unemployment persisting since the beginning of the year was also confirmed by data on registered unemployment. According to the registers of Offices for Labour, Social Affairs, and Family, the average unemployment rate in the first half of 2005 was 12.2% (13.1% in the first quarter and 11.4% in the second quarter). This figure is below the level determined by a sample survey, which can be explained by the differences between the applied methodologies and by differing definitions of unemployment.

A factor affecting developments on the labour market was the reduced workforce supply. According to a labour force sample survey, the number of economically active persons decreased in the first half of 2005 by almost 16,000 on a year-on-year basis. The decrease took place mostly in younger age groups, i.e. persons aged 15 to 29 and 35 to 39 years. The number of economically active persons in these age groups dropped year-on-year by almost 56,000 and their share in the country's total economically active population decreased to 39.6% (from 41.5% in the same period a year earlier). At the same time, a steep year-on-year increase in the number of economically active persons was recorded among persons aged 50-64 years (35,000), whose share of the total number increased in comparison with the same period a year earlier by 1.5 percentage points, to 19.1%.



1.4. Financial Results of Corporations

According to preliminary data from the Statistical Office of the SR, financial and non-financial corporations ended the first half of 2005 with a total pre-tax profit of Sk 131.8 billion. This represented a year-on-year improvement of over 38% and was a result of positive developments in the financial performance of non-financial corporations, which accounted for Sk 107.9 billion of the total profit (13.5% more than a year earlier). Marked improvement was also reported by financial corporations, which achieved a profit of Sk 23.9 billion (after producing negative financial results for three successive years).

Financial results of corporations (Sk millions, current prices)

	1st half of 2005	Index 1st half of 2005 / 1st half of 2004
Financial result (before taxation)		
Non-financial and financial corporations in total	131,811	138.4
Non-financial corporations	107,948	113.5
Financial corporations*	23,863	194.0 x

* The x indices in the columns are multiple marks.

In the non-financial sector, a large part of the profit was generated in industrial production (37.5%); electricity, gas, and water supply (24.1%); and trade (18.5%). Agriculture sustained a loss of Sk 4.1 billion. The strongest year-on-year growth was achieved in manufacturing, mainly in the production of metals and metal products. Profits increased considerably in transport, storage, post and telecommunications, wholesale and retail trade.

The results of financial corporations improved to a significant extent in the first half of 2005, when they generated a total profit of Sk 23.9 billion. The positive turn in performance resulted from a change in the results of financial institutions (mainly the NBS), which achieved a profit of Sk 17.8 billion (after sustaining losses for three years). Financial intermediaries generated a profit of Sk 4.7 billion, representing a modest improvement in comparison with last year, and insurance corporations and pension funds earned Sk 1.4 billion.

2. BALANCE OF PAYMENTS

2.1. Current Account

In the first half of 2005, the balance of payments on current account resulted in a deficit of Sk 47.7 billion, which was Sk 32.3 billion more than in the previous year. This increase was largely due to a year-on-year deterioration in the trade balance, income balance[1], and the balance of current transfers. The only item to show improvement in comparison with the first half of 2004 was the balance of services. The current account deficit as a share of GDP at current prices reached 6.9% (the share of the current account deficit, excluding reinvested earnings, was 4.8%). This figure is expected to be smaller in the annual evaluation, since the increase in the income balance deficit in the area of paid dividends is concentrated in the first six months. Over the first half of 2005, the trade deficit as a share of GDP increased to 4.2%, from 1.7% in the same period a year earlier.

Balance of payments on current account

Sk billions	1 - 6 / 2005	1 - 6 / 2004*
Balance of trade	-29.1	-10.1
Exports	461.3	436.6
Imports	490.4	446.7
Balance of services	5.2	4.3
Balance of income	-24.5	-12.7
of which: income from investment	-39.4	-18.8
of which: reinvested earnings	-14.4	0.0
Current transfers	0.7	3.1
Current account in total	-47.7	-15.4
Current account as a share of GDP in %	-6.9	-2.4

* Foreign trade in 2004, according to the methodology for 2005.
GDP – source: Statistical Office of the SR.

The trade balance resulted in a deficit of Sk 29.1 billion, representing a year-on-year increase of Sk 19.0 billion. The increase in the trade deficit was a result of faster growth in imports than in exports.

According to preliminary data from the Statistical Office of the SR, goods were exported over the first half of 2005 in the amount of Sk 461.3 billion, which was 5.6% more than in the same period a year earlier (15.6% in USD and 10.4% in EUR).

Year-on-year changes in Slovak exports by segment and the contributions of individual segments to the growth /decline in exports

	1st half 2005 (Sk billions)	1st half 2004 (Sk billions)	Contribution 1st half, 2005 (% points)	Contribution 1st half, 2004 (% points)
Raw materials	1.8	5.4	0.4	1.4
Chemicals and semi-finished goods	26.0	10.6	5.9	2.8
Machines and transport vehicles	-5.0	42.2	-1.1	11.2
of which: machines	22.8	18.5	5.2	4.9
transport vehicles	-27.8	23.7	-6.3	6.3
Finished products	1.9	3.1	0.4	0.9
Exports in total	24.7	61.3	5.6%	16.3%

* The structure of exports in the 1st half of 2005 was calculated according to the structure of exports in January to June 2005.

[1] The increase in the negative balance of payments on current account was partly due to the inclusion of reinvested earnings in the income balance in line with the new methodology. The applied methodology is explained in more detail in Annex 7.4. 'Methodological Notes to Selected Indicators', Part 2 'Balance of Payments'.

On a year-on-year basis, the exports of goods recorded a slowdown in dynamics of 10.6 percentage points, mainly as a result of a decline in the exports of machines and transport vehicles. Growth in exports was mainly stimulated by developments in the ‘chemical products and semi-finished goods’ category. Year-on-year increases were again recorded in the exports of certain semi-finished goods, such as iron and steel, iron and steel products, timber and selected wood and paper products, while iron and steel exports were also affected by the prices of these products on the world markets. Among chemical products, the strongest growth took place in the exports of plastics and rubber, which was connected with steady the rise in oil prices.

In contrast with the previous year, when exports in the ‘machinery and transport equipment’ category grew to a significant extent, the first half of 2005 saw a decline in exports as a result of a downturn in automobile exports. Unlike transport vehicles, machines and instruments recorded a steeper year-on-year increase in exports than in the same period a year earlier. The year-on-year growth in exports in the ‘machines and equipment’ sub-category took place in automatic data processing machines, machines for selected industries, television sets, videophones, bearings, pumps, etc.

Exported production in the form of finished products followed a more or less stable course of development. Its growth was not rapid in the first half of 2005 and took place in agricultural products and pharmaceuticals. On the other hand, the exports of furniture, toys, footwear, and clothes recorded a year-on-year decline.

The volume of goods imported during the six months under review totalled Sk 490.4 billion, representing a year-on-year increase of 9.8% (corresponding to 20.1% in USD and 14.7% in EUR).

Year-on-year changes in Slovak imports by segment and the contributions of individual segments

	1st half 2005 (Sk billions)	1st half 2004 (Sk billions)	Contribution 1st half, 2005 (% points)	Contribution 1st half, 2004 (% points)
Raw materials	19.4	3.5	4.4	0.9
Chemicals and semi-finished goods	9.0	16.9	2.0	4.4
Machines and transport vehicles	1.1	27.4	0.2	7.1
Finished products	14.2	11.0	3.2	2.8
of which: Agricultural and industrial products	9.3	6.0	2.1	1.6
Automobiles	0.9	1.8	0.2	0.3
Machines and electrical consumer goods	4.0	3.2	0.9	0.9
Imports in total	43.7	58.8	9.8%	15.2%

* The structure of imports in the first half of 2005 was calculated according to the structure of imports in January to June 2005.

In commodity imports, the first half of 2005 saw a marked increase in the proportion of raw materials. Due to the rise in oil and gas prices, the dynamics of imports in this category reached 31%, exceeding the rate of overall year-on-year growth.

The imports of finished products grew at a faster rate than last year and were mainly boosted by the growing imports of food products (meat, milk, fruit, vegetables, beverages) and consumer electronics (radio and television sets, voice recording media, etc.).

Part of the increase in total imports took place in chemical products and semi-finished goods, though the year-on-year increase in this category was smaller than a year earlier. In semi-finished goods, the growth in imports was concentrated in iron and steel, iron and steel products, and non-ferrous metals. In the ‘chemical products’ category, the increase in imports took place mostly in organic chemical products.

The reduced imports of commodities for the automobile industry, including selected types of machines, caused only a very modest year-on-year increase in the ‘machines and transport vehicles’ category. Within the scope of machines, the imports of technological equipment for the individual sectors of the economy also decreased in comparison with the same period a year earlier. This may have a direct impact on economic restructuring with future effects on the growth of imports (according to NBS estimates, the share of technology imports in total imports decreased year-on-year to 7.2%, from 7.7% last year). The decrease took place mostly in the imports of machines for the metallurgical, machine, chemical, and glass industries, where imports had recorded a marked increase a year earlier.

Trade in services during the first half of 2005 resulted in a surplus of Sk 5.2 billion (a year-on-year increase of Sk 0.9 billion). Receipts from exports of services grew by Sk 6.6 billion and payments for imported services increased by Sk 5.7 billion. The increase in the positive balance of services took place in ‘other services in total’ and ‘travel services’, while transport services recorded a decrease in the surplus.

Balance of services

Sk billions	1st half of 2005	1st half of 2004
Transport	6.4	9.4
Tourism	4.8	1.7
Other services in total	-6.0	-6.8
Balance of services	5.2	4.3

Receipts from the international transport of goods and persons amounted to Sk 23.6 billion (a year-on-year fall of Sk 1.6 billion) and expenses totalled Sk 17.2 billion (an increase of Sk 1.4 billion). In terms of volume, the largest item in transport services was still income from the transport of gas and oil, which reached Sk 12.6 billion (almost 54% of the total receipts from transport). The strengthening of the Slovak koruna against the US dollar (the average cumulative exchange rate appreciated by 8.6%) caused a modest fall in transit charges in SKK, despite an increase in transit charges in USD.

In international transport services (road, railway, air, and water-borne transport, excluding transit), including services related to transport, a deficit of Sk 6.2 billion was recorded (a year-on-year increase of Sk 2.0 billion), 60% of which took place in payments for other freight services, including commercial expenses, and 40% in increased payments for passenger transport, mainly air service.

The positive balance of foreign tourism increased year-on-year by Sk 3.1 billion, to Sk 4.8 billion. Foreign exchange receipts from foreign tourism reached Sk 17.0 billion, representing an increase of Sk 5.0 billion compared with the first half of 2004. Despite the appreciation of the Slovak koruna, the increase in foreign exchange receipts can be attributed to the growing number of visitors from abroad, growing number of accommodated foreign tourists, and the growing volume of foreign-currency deposits held by legal and natural persons (corporate and personal deposits in foreign currency are part of the income from tourism).

The expenses of Slovak citizens on foreign travel (including the expenses of Slovak citizens working abroad) reached Sk 12.2 billion, representing an increase of Sk 1.9 billion.

Although the balance of ‘other services in total’ (telecommunications, construction, insurance, financial, leasing, computer engineering, advertising, business, and technical services, etc.) remained in deficit, the size of the deficit diminished year-on-year by Sk 0.8 billion. Receipts from such services increased year-on-year by Sk 3.1 billion, while expenses grew by Sk 2.3 billion.

Compared with the same period a year earlier, the first half of 2005 saw the most favourable developments in telecommunications, mediating services, and services related to culture, where exports grew at a faster rate than imports. The overall balance was also affected positively by insurance, legal, accounting, consulting, and business services, where imports declined to greater extent than exports. On the other hand, the increase in the deficit took place mostly in financial and construction services.

In the first half of 2005, the income balance resulted in a deficit of Sk 24.5 billion, representing a deterioration of Sk 11.8 billion compared with the same period a year earlier. Excluding reinvested earnings, the balance of income produced a deficit of Sk 10.1 billion. Receipts increased by Sk 11.4 billion and payments by Sk 23.2 billion.

Balance of income

Sk billions	1st half of 2005	1st half of 2004
Compensation of employees	14.9	7.2
Direct investments	-35.3	-13.7
of which: reinvested earnings	-14.4	0.0
Portfolio and other investments	-4.1	-6.1
Balance of income	-24.5	-12.6

During short-term stays abroad, Slovak citizens earned a total of Sk 15.5 billion (according to NBS calculations). Apart from the increased number of people working abroad, the year-on-year growth in the positive balance of employee compensations (Sk 7.7 billion) was affected by a change in the methodology employed for calculating the compensation of employees[2] (the methodological change caused an increase of Sk 3.8 billion in received employee compensation).

In the first half of 2005, dividends to companies with foreign capital participation were paid in the amount of Sk 21.0 billion, representing a year-on-year increase of Sk 7.2 billion. The yields of foreign investors from paid-in capital in the SR (dividends) reached approximately 5.3% and yields from basic capital (dividends and reinvested earnings) accounted for 9.2%.

[2] The applied methodology is explained in more detail in Annex 7.4. ‘Methodological Notes to Selected Indicators’, Part 2 ‘Balance of Payments’.

For domestic investors, investment in foreign securities yielded a profit of Sk 7.3 billion, which was Sk 2.4 billion more than a year earlier. Income from the purchase of Slovak bonds by non-residents amounted to Sk 7.6 billion, which was Sk 0.6 billion more than in the corresponding period last year. Thus, the balance of portfolio investments resulted in a deficit of Sk 0.3 billion, representing an improvement of Sk 1.9 billion compared with the same period a year earlier.

The balance of other investments produced a deficit of Sk 3.8 billion, roughly corresponding to the figure recorded a year earlier, with both receipts and payments remaining unchanged. While the receipts side was dominated by interest on short-term loans provided to non-residents by Slovak banks, the payments side was formed by interest on long-term loans in the corporate sector, used mostly for the coverage of their investment needs.

Current transfers generated a surplus of Sk 0.7 billion. On a year-on-year basis, the positive balance diminished by Sk 2.4 billion (according to the 2004 methodology, the positive balance of current transfers increased by Sk 1.3 billion), mainly as a result of a shortfall in private transfers. Owing to a change in the methodology of employee compensation[3], private transfers resulted in a deficit of Sk 4.2 billion. The surplus in government transfers was produced by an excess of receipts from the EU budget over transfers to the EU budget (by almost Sk 5.0 billion).

2.2. Capital and Financial Account

The capital and financial account resulted in a surplus of Sk 110.1 billion, which was Sk 80.6 billion more than in the same period a year earlier. The structure of capital inflow also changed, from an increased inflow of direct and portfolio investments in the first half of 2004 to a dominant inflow of short-term capital into the banking sector in the first half of 2005, contributing to the coverage of the current account deficit. Such a trend in the capital and financial account structure cannot be regarded as favourable in the long term.

Capital and financial account of the balance of payments

Sk billions	1st half of 2005	1st half of 2004
Capital account	0.0	0.7
Direct investments	31.8	31.3
SR abroad	-1.2	7.7
of which: equity capital abroad	0.2	0.3
reinvested earnings	-0.6	0.0
In the SR	33.0	23.6
of which: equity capital in the SR	6.5	19.9
of which: FDI for privatisation	0.0	2.9
reinvested earnings	15.0	0.0
Portfolio investments and financial derivatives	-14.4	32.7
SR abroad	-20.9	-12.2
In the SR	6.5	44.9
Other long-term investments	-9.7	-16.7
Assets	-0.6	-3.5
Liabilities	-9.1	-13.3
Short-term investments	102.3	-18.5
Assets	-17.2	0.2
Liabilities	119.5	-18.7
Capital and financial account in total	**110.1**	**29.5**

[3] The applied methodology is explained in more detail in Annex 7.4. ‘Methodological Notes to Selected Indicators’, Part 2 ‘Balance of Payments’.

The balance of foreign direct investments (FDI) reached Sk 31.8 billion, representing a year-on-year increase of Sk 0.6 billion.

In the first six months of 2005, Slovak companies showed little interest in investment abroad. A marked change occurred in 'other capital', where the first half of the year saw a certain outflow – after an inflow a year earlier (the inflow of other capital within the structure of direct investments abroad in the first half of 2004 was caused by a loan provided to a domestic enterprise by its subsidiary from abroad).

The inflow of equity capital and reinvested earnings into the SR reached Sk 21.5 billion and slightly exceeded the level of the same period a year earlier. The structure of the inflow in a breakdown by property capital and reinvested earnings, differed. The capital interests of foreign investors in the SR increased by Sk 6.5 billion over the first half of 2005 and reached only a third of the inflow in the same period last year. On the other hand, reinvested earnings, which form a counterpart in the balance of income on current account, were estimated at Sk 15 billion (in previous years, this item showed very low values)[4].

Compared with the same period a year earlier, the trend in portfolio investments changed, from an inflow to an outflow. The holdings of foreign securities by Slovak entities increased by Sk 20.9 billion. Domestic investors, especially non-bank entities, invested their free funds in long-term foreign bonds, which accounted for more than 70% of total assets in portfolio investments and financial derivatives.

The balance of portfolio investments in the SR decreased to Sk 6.5 billion, from Sk 44.9 billion last year. Their structure was dominated by government activities. Although demand among foreign investors for Sk-denominated government securities increased somewhat, the repayment of government eurobonds (which was not accompanied by a new issue as last year) caused a decline in the inflow of portfolio investments in the government sector, from Sk 44.6 billion last year to Sk 1.1 billion.

Other investments resulted in an inflow of funds from abroad in the amount of Sk 92.6 billion. The change in trend from outflow to inflow was caused by developments in short-term liabilities in the banking sector.

Other long-term investments recorded an outflow of funds in the amount of Sk 9.7 billion. The outflow of long-term capital took place mostly on the liabilities side, which was affected by debt service payments in the government (a debt repayment to ČSOB) and corporate sectors.

Corporate loans were drawn in the amount of Sk 16.4 billion, which was 36.9% more than in the same period a year earlier. The increased borrowing was connected with a revival of interest in obtaining foreign resources in the area of electricity, gas, and water supply and financial mediation. The inflow of credit resources into the individual industries was very small; notable lending activity was only recorded in the manufacture of non-metal products

[4] The applied methodology is explained in more detail in Annex 7.4. 'Methodological Notes to Selected Indicators', Part 2 'Balance of Payments'.

and machines. After increasing last year, loan repayments in the corporate sector reached Sk 16.6 billion, and continued to follow the trend from the previous years.

Short-term capital resulted in an inflow of Sk 102.3 billion. The level of short-term liabilities was substantially affected (an increase of Sk 119.5 billion) by commercial banks (an increase of Sk 115.4 billion), which recorded increased capital inflows, mainly in the form of increases in the deposits of non-residents at commercial banks (67% of the increase in the short-term capital of commercial banks took place in foreign currency and 33% in domestic currency). The increase in non-resident deposits at commercial banks in the SR took place mostly in February and March, and was caused by expectations concerning the appreciation of the Slovak koruna. The inflow of short-term capital in the corporate sector (Sk 4.1 billion) was connected with the drawing of import credits and bank loans from abroad.

2.3. Foreign Exchange Reserves

At the end of the first half of 2005, the foreign exchange reserves of the NBS reached USD 15,590 million, representing an increase of USD 679.9 million from the beginning of the year. The National Bank's total foreign exchange reserves were affected by numerous factors during the six months under review. The key factors positively affecting revenues were proceeds from central bank interventions in the foreign exchange market. Expenditures were mainly determined by debt service payments made on behalf of the Government. The foreign exchange reserves of the NBS were also affected during the first half of the year by the cross rates of fully convertible currencies on international financial markets. The surplus in the balance of revenues and expenditures in the period under review (USD 2,479.4 million) was partly offset by negative exchange rate differentials (USD 1,802 million), which resulted from the weakening of the euro in relation to the US dollar on international financial markets.

The revenue side of foreign exchange reserves was determined by the following factors:
– yields from deposits and securities held in the portfolio of the NBS (USD 192.4 million);
– net revenues from interventions and direct transactions on the interbank foreign exchange market (USD 3,556.2 billion);
– revenues of the NBS from repo operations (a positive balance of USD 7.7 million);
– other revenues of the NBS (USD 741.2 million).

The expenditure side of foreign exchange reserves was affected by:
– debt service payments on behalf of the Government (USD 1,185.5 million), of which the payment of principal and interest on government eurobonds issued in previous years accounted for USD 1,064.1 million;
– debt service payments by the NBS (USD 1.8 million);
– other expenditures of the NBS (USD 831.1 million), incurred mostly in connection with cross-border payments effected for NBS clients (USD 753.2 million).

At the end of the first half of 2005, the volume of foreign exchange reserves was 5 times greater than the volume of average monthly imports of goods and services to Slovakia, over the first six months of the year. The foreign exchange reserves of commercial banks reached USD 1,576.7 million at the end of June 2005. The total volume of foreign exchange reserves in the banking sector, including the NBS, stood at USD 17,165.7 million at the end of June 2005.

2.4. External Debt of the SR

At the end of the first half of 2005, the total gross external debt of Slovakia stood at USD 26.2 billion (EUR 21.8 billion), representing an increase of USD 1,584.0 million compared with the beginning of the year. Total long-term foreign debt dropped by USD 1,628.9 million, while total short-term foreign debt increased by USD 3,212.9 million. Within the scope of long-term foreign liabilities, Slovakia's total gross external debt had increased by 1 January 2005, due to the inclusion of a foreign liability owed by the Ministry of Finance of the SR to ČSOB, a.s. Prague, in the amount of Sk 25.1 billion (USD 881.4 million).

Within the scope of short-term foreign debt, the short-term foreign liabilities of commercial banks increased over the period under review, by USD 3,151.8 million. A substantial part of this increase took place in short-term foreign liabilities in the following items: cash and deposits (USD 2,159.2 million), loans (USD 531.4 million), and other liabilities (USD 461.2 million). Over the same period, the short-term foreign liabilities of entrepreneurial entities increased by USD 208.4 million.

Within the scope of long-term external debt, the liabilities of the Government and the NBS decreased from 1 January 2005 to 30 June 2005 by USD 1,359.3 million, mainly in connection with the redemption of two-year foreign bonds by the MF SR, in the amount of EUR 750 million (USD 1 billion). Loans accounted for USD 503.5 million of the decrease in the long-term foreign liabilities of entrepreneurial entities (USD 564.4 million). The foreign liabilities of commercial banks grew over the period under review by USD 294.9 million, of which USD 207.2 million took place in 'cash and deposits'.

At the end of June 2005, Slovakia's per-capita gross foreign debt stood at USD 4,876, compared with USD 4,581 on 1 January 2005 (an increase of USD 295). The share of short-term debt in the country's total gross external debt increased over the past six months by 9.7 percentage points, to 52.1%.

	In millions of USD			In millions of EUR		
	31.12.2004	1.1.2005	30.6.2005	31.12.2004	1.1.2005	30.6.2005
Total external debt of the SR	23,763.6	24,645.0	26,229.0	17,421.1	18,102.0	21,755.0
1) Long-term external debt	13,315.8	14,197.2	12,568.3	9,747.1	10,428.0	10,424.5
Government and NBS*	6,691.4	7,572.8	6,213.5	4,881.5	5,562.3	5,153.6
Commercial banks	496.3	496.3	791.1	364.6	364.6	656.2
Entrepreneurial entities	6,128.1	6,128.1	5,563.7	4,501.1	4,501.1	4,614.7
2) Short-term external debt	10,447.8	10,447.8	13,660.7	7,674.0	7,674.0	11,330.5
Government and NBS*	209.3	209.3	62.1	153.8	153.8	51.5
Commercial banks	5,380.2	5380.2	8,531.9	3,951.8	3951.8	7,076.6
Entrepreneurial entities	4,858.3	4,858.3	5,066.7	3,568.4	3,568.4	4,202.4
Foreign assets	23,367.0	23,367.0	25,757.6	17,163.3	17,163.3	20,534.5
Net external debt	396.6	1,278.0	1,471.4	257.9	938.7	1,220.5
SKK/USD and SKK/EUR rates:	28.496	28.496	31.825	38.796	38.796	38.370
EUR/USD cross exchange rate:				1.361	1.361	1.206

* Including government agencies and municipalities.

The net external debt of Slovakia - expressed as the difference between gross foreign debt, i.e. USD 26.2 billion (liabilities of the NBS, Government, commercial banks, and the corporate sector – excluding capital participation), and foreign assets, i.e. USD 24.8 billion (foreign exchange reserves of the NBS, foreign assets of commercial banks, foreign assets of the corporate sector – excluding capital participation), reached USD 1.5 billion (debtor position) at the end of June 2005, representing an increase of USD 1.1 billion compared with the beginning of the year.

3. PUBLIC SECTOR

Budgetary performance in the first half of 2005

Budgetary performance in 2005 is governed by the State Budget Act (No. 740 of 9 December 2004), in which total revenue for 2005 was budgeted at Sk 257.2 billion and total expenditure at Sk 318.7 billion. Within the structure of revenues, Sk 26.5 billion is to be obtained by Slovakia from the budget of the European Union, in the form of foreign transfers. Transfers to the EU budget, included in the expenditure side of the state budget, amounted to Sk 13.2 billion. The budget deficit was set at Sk 61.5 billion.

The state budget for 2005 was drawn up with respect to the changes resulting from fiscal decentralisation. In connection with the approved project of fiscal decentralisation, the distribution of tax revenues among public sector entities was changed in comparison with 2004. With effect from 2005, personal income tax is a proportionate tax, except for the withholding tax. Thus, municipalities receive 70.3%, higher territorial units 23.5%, and the state budget retains 6.2% of the total tax revenue. In this connection, the ‘Overall Financial Relations’ chapter of the state budget, from which municipalities and higher territorial units had previously been financed through subsidies, was cancelled. Changes arising from fiscal decentralisation have a neutral effect on tax revenues in the public finance sector, since only the distribution of revenues between the central government and regional self-governments is subject to change.

With regard to the new law on budgetary rules for the public sector, the main income category, i.e. income from credit and loan repayments and the sale of ownership interests (financial operations), is not part of the budget revenue, but is included in financial operations in state financial assets.

On 30 June 2005, the state budget recorded a shortfall of Sk 1.1 billion, which represented 1.7% of the total deficit budgeted for the year. Thus, the size of the deficit diminished year-on-year by Sk 11.3 billion.

Budget revenue reached Sk 126.5 billion at the end of June (49.2% of the budgeted figure), representing a year-on-year increase of Sk 5.8 billion. Tax revenues reached 55.2% of the budget, due to increased corporate tax payments (85.3% of the budgeted amount, representing a year-on-year increase of Sk 6.5 billion). Most funds were collected in value added tax, i.e. Sk 58.6 billion, corresponding to a year-on-year increase of Sk 7.7 billion (49.9% of the budgeted amount). Excise tax receipts increased year-on-year by Sk 3 billion, to Sk 22.3 billion (49.3% of the budgeted amount).

Personal income tax revenues totalled Sk 1.5 billion, representing 74% of the budgeted figure. The amount collected in personal income tax decreased year-on-year by Sk 9.6 billion (due to fiscal decentralisation, as a result of which a significant part of this tax is assigned to municipalities and regions).

Non-tax revenues amounted to Sk 9.6 billion, accounting for approximately 62% of the budgeted amount. Grants and transfers totalled Sk 5.3 billion (fulfilling the budget to 13.5%).

Foreign transfers from the budget of the European Union remained low over the first half of the year, when only Sk 5 billion was drawn of the total amount budgeted for the year (Sk 26.5 billion).

Low budget fulfilment was also recorded in the case of domestic grants and transfers, since enterprises with state capital participation had paid no dividends before 30 June 2005. Receipts from domestic transfers cannot be expected earlier than the second half of the year, since they come in dividends from companies whose shares are owned by the National Property Fund (NPF), which are paid only after the financial results of these companies for the previous fiscal year are approved.

Total budget expenditure reached Sk 127.6 billion in the first half of the year (40% of the budgeted expenditure), which represented a saving of Sk 31.7 billion compared with the figure budgeted for the first half of the year. This expenditure was Sk 5.8 billion smaller than in the same period a year earlier.

Government guarantees in 2005

The limit for the provision of government guarantees in 2005 was set at Sk 10.8 billion (pursuant to Act No. 386/2002 Z.z.), i.e. corresponding to the volume of due principal on loans with government guarantees for 2005 according to the schedule of due dates (updated as at 31 December 2004).

Of this limit, Sk 0.13 billion had been drawn by the end of June 2005 for the Slovak Water Supplies Management Co., state enterprise, Banská Štiavnica, in the last tranche of a loan from the Development Bank of the Council of Europe (F/P 1354) for the project 'Elimination of the Consequences of Floods and Preventive Measures' (approved by the Loan and Guarantee Committee in 2001).

Reserves for the realisation of government guarantees from NPF resources were set aside in the amount of Sk 2.5 billion for 2005, while payments are only expected on behalf of Slovak Railways and Metro Bratislava, a.s. Over the first half of 2005, Sk 1.2 billion was used from these reserves.

State financial assets and liabilities in the first half of 2005

State financial assets (excluding the deposits of the Finance Ministry earmarked for the pension reform) reached approximately Sk 0.7 billion at the end of June 2005. At the beginning of the year, state financial assets amounted to Sk 16.0 billion.

During February, state financial assets (SFA) were used in the amount of Sk 16.0 billion for repaying part of a liability to Československá obchodná banka a.s. Praha, in line with the Settlement Agreement between the SR and ČSOB a.s. Praha. The payment was made on the basis of the Government's Decision No. 100 of 9 February 2005. The resulting decrease in state financial assets was partly offset by funds on the SFA account earmarked for the repayment of refundable financial aids, in the amount of Sk 0.7 billion. State resources earmarked for the payment of principal on refundable financial aids became part of the state financial assets (with effect from 1 January 2005), in accordance with Article 13 of Act. No. 523/2004 Z.z. on budgetary rules for the public sector.

State funds

Special tasks, financed fully from the State Budget, were performed by three specialised State funds in the first half of 2005. These funds were: the State Fund for the Liquidation of Nuclear Power Engineering Facilities and the Handling of Spent Nuclear Fuel and Radioactive Waste (under the authority of the Ministry of Economy), the State Housing Development Fund (under the authority of the Ministry of Construction and Regional Development), and the Environmental Fund established on 1 January 2005 (under the authority of the Ministry of Environment).

At the end of June 2005, the resources of these funds on accounts at the SR Treasury and commercial banks totalled Sk 19.3 billion.

National Property Fund of the SR as at 30 June 2005

In the first half of 2005, the National Property Fund of the SR (NPF) recorded a revenue of Sk 12.0 billion. This amount was dominated by income from dividends, amounting to Sk 11.6 billion. The remainder came in privatisation proceeds (Sk 0.28 billion), interest income from financial institutions (Sk 0.064 billion), and other receipts (Sk 0.039 billion). Including funds from previous years (Sk 3.2 billion), the NPF had disposable funds in the total amount of Sk 15.2 billion. On 30 June 2005, the expenditures of the NPF reached Sk 1.6 billion, of which Sk 1.2 billion was spent for the realisation of government guarantees pursuant to Decision No. 963/04 of the SR Government.

4. MONETARY POLICY AND MONETARY DEVELOPMENTS [5]

In the first half of 2005, the NBS implemented its monetary policy in an environment characterised by continuing economic growth, falling inflation and unemployment rates, relatively volatile developments in the exchange rate of the Slovak koruna against the reference currency (euro), positive developments in public finances, and less favourable balance of trade developments in comparison with the first half of 2004.

In line with the Monetary Programme of the NBS for the Period until 2008 and the shift in the Bank's monetary-policy strategy to inflation targeting, the NBS began to monitor and use the Harmonised Index of Consumer Prices (HICP) instead of the Consumer Price Index (CPI), with effect from January 2005. At the same time, the NBS replaced its monetary programme with a medium-term forecast published on a quarterly basis, on the basis of the results of a quarterly model forecast. In February, the Bank Board of the NBS extended its plan of meetings to include a regular meeting on Tuesdays, devoted to the current situation on the financial market and the results of regular repo tenders conducted for sterilisation purposes. In February, the Bank Board also approved the Communication Strategy of the NBS, designed to ensure the conduct of monetary policy in a transparent manner.

At the beginning of the year, the determining factor in domestic money market developments was the appreciation of the Slovak koruna in nominal terms. The excessive appreciation of the koruna was mainly caused by an inflow of short-term capital, connected with the so-called 'convergence play' and the expectation of a further appreciation in the exchange rate. Hence, in its fight against the strong koruna, the NBS used direct foreign exchange market interventions, in combination with a less standard instrument: it rejected all the bids at the regular two-week repo tenders. This led to an implicit fall in interest rates and an increase in the level of uncertainty on the foreign exchange market. Consequently, the Bank Board lowered the key NBS rates to a significant extent on 29 February, i.e. by 1 percentage point.

Subsequent to the interest rate reduction, the Bank Board decided to accept part of the bids at standard 2-week repo tenders and, later in March, fully renewed the sterilisation of free funds through repo tenders, and thus replaced the placement of overnight sterilisation deposits with the NBS. The exchange rate of the Slovak koruna against the euro ceased to appreciate in the middle of March, and then began to weaken as a result of regional sentiments on Central European markets, mainly the depreciation of the Polish zloty. At the end of April, the weakening of the koruna led the NBS to intervene in support of the Slovak currency.

4.1. Monetary Aggregates

The M3 monetary aggregate (according to the ECB methodology) increased by Sk 2.1 billion in comparison with the figure for 31 December 2004, to Sk 773.4 billion at the end of June 2005. The year-on-year rate of M3 growth[6] reached 9.4% at the end of the first half of 2005.

[5] In the Monetary Programme of the NBS for the Period until 2008, the National Bank of Slovakia informed the public that, with effect from 2005, developments in monetary aggregates (deposits and loans) and customer interest rates will be evaluated according to the methodology of the European Central Bank, in line with the ongoing process of harmonisation. The methodology applied is explained in more detail in Annex 7.4 'Methodological Annex', Part 1 'Monetary Statistics'.

The weaker year-on-year dynamics of M3 in June 2005 (9.4%), compared with the average figure for the first five months (11.7%), can be ascribed mainly to the base effect of the previous period. If we disregard the effect of non-standard factors, which increased the volatility of M3 particularly in 2004, the year-on-year dynamics of the aggregate in the first half of 2005 may be regarded as adequate. In an environment characterised by falling inflation and interest rates, a slowdown in the 12-month rate of growth in the volume of currency in circulation in the coming period is expected to have no negative effect on the flow of funds in the economy.

The cut in the key rates of the NBS in the first half of 2005 led to a further fall in interest rates on the less liquid M2 components (deposits and received loans with an agreed maturity of up to 2 years and deposits redeemable at a period of notice of up to 3 months) and in the interest rate differential between these deposit products in comparison with deposits and loans repayable on demand. Thus, the relative cost of holding funds in liquid forms continued to fall, which led to a flow of funds between fixed-term deposits and deposits repayable on demand. This tendency is apparent in the deposits of both households and non-financial corporations.

Developments in monetary aggregates in the 1st halves of 2005 and 2004	Volume at June 30 (Sk billions)	Change since the beginning of year* (Sk billions)	Change since the beginning of year* (%)
1st half of 2005			
- M1 monetary aggregate	428.5	+23.8	+5.9
- M2 monetary aggregate	725.2	-6.5	-0.9
- M3 monetary aggregate	773.4	+2.1	+0.3
1st half of 2004			
- M1 monetary aggregate	374.9	+20.7	+5.8
- M2 monetary aggregate	681.6	+13.4	+2.0
- M3 monetary aggregate	706.8	+36.2	+5.4

Note: */ Since monetary aggregates and the counterparts of the M3 monetary aggregate (according to the ECB methodology) are not evaluated as at 1 January of the given year, the values recorded as at 31 December of the previous year are regarded in the table and the further text as initial values for the first half of the year.

The M3 monetary aggregate maintained its standard seasonal course over the first half of 2005. The main factors that affected its development during the period under review were the March deadline for the payment of personal and corporate income taxes for the previous calendar year, when the level of M3 fell in favour of the public sector, as well as the payment of dividends in the corporate sector, as a result of which the bank deposits of enterprises decreased in favour of public sector deposits and non-resident deposits. The M3 monetary aggregate was stagnant in the last month of the first half of 2005, mainly as a result of slower growth in its less liquid components.

Compared with the same period a year earlier, the M3 aggregate increased to a lesser extent this year. The steeper increase in M3 in the first half of 2004 was caused by non-standard

[6] The year-on-year growth dynamics of monetary aggregates and their counterparts are calculated from end-of-month data, including non-transaction operations, which comprise all movements in the balance-sheet items, resulting from changes in the valuation of marketable instruments, the depreciation/write-off of loans, exchange rate differentials, reclassification, and other changes.

seasonal developments in June 2004, when the M3 aggregate recorded a marked month-on-month increase as a result of an inflow of funds from a bond issue in the corporate sector, allocated mostly to short-term time deposits.[7]

Within the structure of the M3 aggregate, part of the free funds of corporate customers, held predominantly in the form of short-term deposits, were removed in the first half of 2005. Since time deposits with the shortest maturity (overnight deposits) are classified in the ECB methodology as deposits repayable on demand (which are part of the M1 aggregate), the first half of the year saw fluctuation in deposits with agreed maturity and deposits repayable on demand, which led to increased volatility in the M1 aggregate.

Developments in the less liquid components of the M3 aggregate were characterised in the first half of 2005 by a gradual slowdown in the rate of growth. The determining factor was investments in money market fund shares/units, which showed slower growth in the second quarter (after a relatively steep increase in the first quarter).

Within the total credits of monetary financial institutions (MFIs) to residents (including securities issued by clients and held by MFIs), the individual components recorded conflicting developments, when the decreasing trend in MFI credits to the private sector (a fall of Sk 34.0 billion compared with 31 December 2004) was offset by an increase in MFI receivables from the general government, which totalled Sk 49.7 billion in the first half of 2005. The total increase in MFI credits to the private sector was dominated by an increase in loans provided to non-financial corporations (Sk 24.3 billion, mostly with a maturity of up to 1 and over 5 years) and households (Sk 22.8 billion, half of which took place in loans for housing purposes), while the volume of loans to financial corporations and insurance companies remained virtually unchanged.

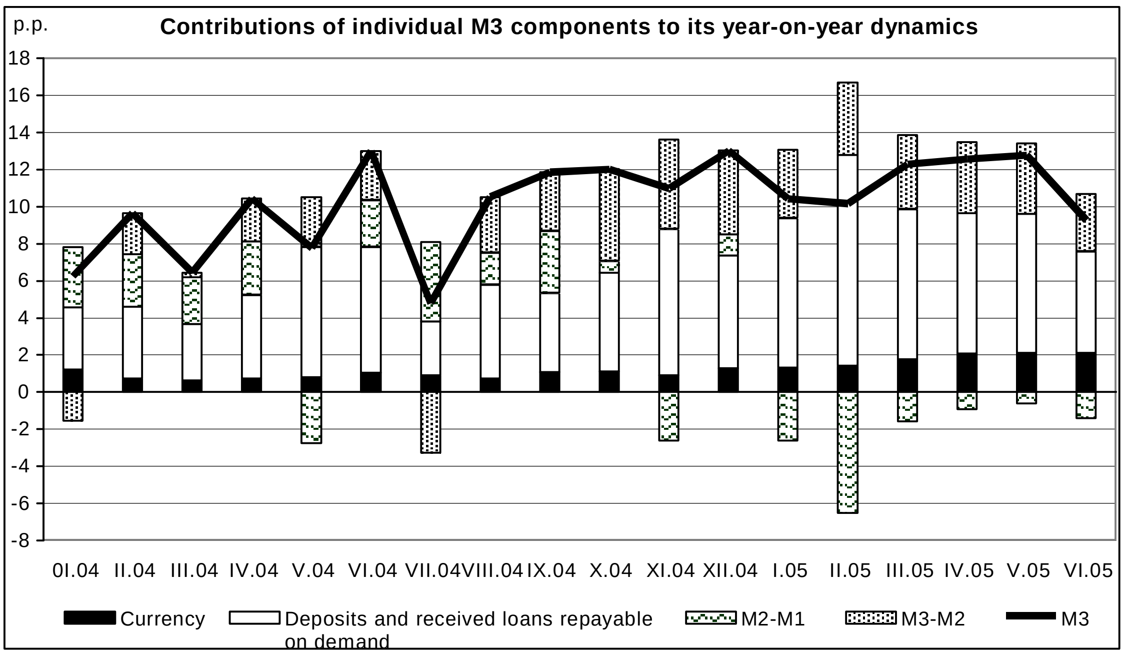
Long-term financial liabilities as counterparts of M3 were characterised by a persistent medium-term decreasing trend in the volume of deposits redeemable at a period of notice of over 3 months, which fell in volume by Sk 5.6 billion in comparison with 31 December 2004 (over the first half of 2004 by Sk 10.3 billion), while the volume of deposits and received loans with an agreed maturity of over 2 years and issued debt securities maturing in more than 2 years recorded no marked changes.

Net foreign assets decreased in comparison with the end of 2004 by Sk 43.0 billion in absolute terms, when foreign liabilities increased by Sk 41.9 billion, while foreign assets remained virtually unchanged (decreased by only Sk 1.1 billion). The volume of foreign assets was mainly affected by an increase in the foreign exchange reserves of the NBS in the first quarter of 2005, caused by NBS interventions and direct transactions on the interbank foreign exchange market. Owing to the repayment of government eurobonds, the Bank’s foreign exchange reserves recorded a fall in May 2005, and thus approached their initial level.

[7] The steeper increase in M3 in the first half of 2004 was also affected to some extent by the methodology used for evaluating the monetary aggregates in 2003, when data on issued money market fund shares/units were not available for monetary and banking statistics, i.e. issued money market fund shares/units were not part of the M3 aggregate as at 31 December 2003.

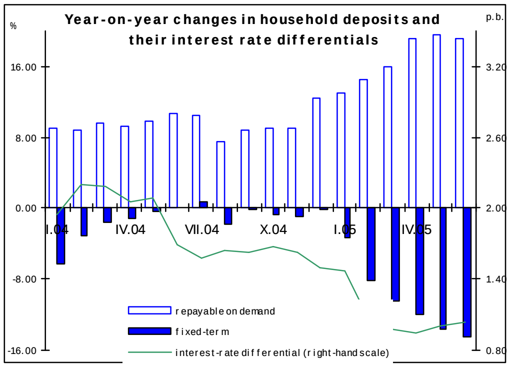
4.2. Structure of the Money Supply

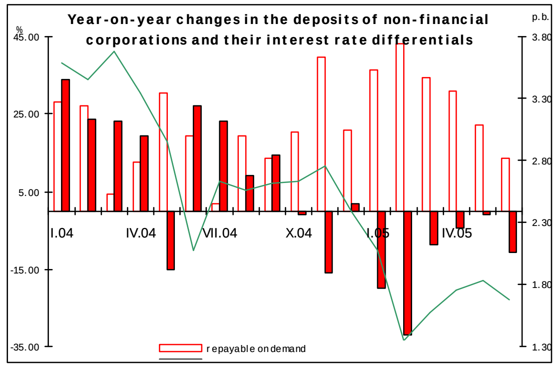
The M3 money supply grew over the first half of 2005 by Sk 2.5 billion, to Sk 773.4 billion at the end of June. The average year-on-year rate of money supply growth slowed, from 12% in the fourth quarter of 2004 to 11.6% in the second quarter of 2005. The year-on-year growth in M3 was affected by conflicting developments in its components. The relatively low level of interest rates reduced the cost of holding funds in liquid instruments (compared with the cost of less liquid instruments) and thus stimulated the growth of M1. The rate of M1 growth accelerated and its contribution to the money supply growth increased, while the less liquid components of M2 decreased on a year-on-year basis. The positive contribution of marketable M3 instruments also diminished to some extent.



Compared with the fourth quarter of 2004, the average rate of growth in the M1 sub-aggregate (currency in circulation outside banks and deposits repayable on demand) increased by 2.9 percentage points, to 18.0% in the second quarter of 2005. Currency in circulation outside banks grew in volume by Sk 7.6 billion in the first half of 2005, with its average year-on-year dynamics increasing, from 8.1% in the fourth quarter of 2004 to 11.2% in the first quarter of 2005 and 15.8% in the second quarter of 2005. A similar trend was recorded in the first half of the year in the dynamics of deposits and loans provided to households in Slovak koruna, repayable on demand. Relatively dynamic growth was also shown by deposits and received loans repayable on demand in the non-financial corporations sector, but the rate of growth slowed towards the end of June as a result of an increased outflow of funds through dividends in comparison with the same period a year earlier.

The less liquid M2 components (deposits and received loans with an agreed maturity of up to 2 years and deposits redeemable at a period of notice of up to 3 month) responded to the cut in key NBS rates with a fall in interest levels during the first half of 2005. Since interest rates for the most liquid deposits remained virtually unchanged, the interest rate differential between the less liquid components of M2 and deposits and loans repayable on demand diminished. Thus, holdings of liquid resources remained relatively cheap. This led to a flow of funds between fixed-term deposits and deposits repayable on demand, on the accounts of both households and non-financial corporations.





Note: Interest rate differential represents the difference between interest rates on less liquid M2 components (deposits and received loans with an agreed maturity of up to 2 years and deposits redeemable at a period of notice of up to 3 months) and deposits and received loans repayable on demand.

The less liquid M2 components, comprising deposits and received loans with an agreed maturity of up to 2 years and deposits redeemable at a period of notice of up to 3 months (M2-M1), continued to decline. Their average year-on-year decline deepened in comparison with the fourth quarter of 2004 by 1.9 percentage points, to 2.4% in the second quarter of 2005. The rate of decline in short-term household deposits – with fixed maturities – accelerated throughout the six months under review. The deposits of non-financial corporations also decreased, while their year-on-year dynamics showed increased volatility in comparison with household deposits.

The less liquid component of the M3 aggregate are the so-called 'marketable instruments', which include money market fund shares/units, repo operations, and debt securities issued with a maturity of up to 2 years (M3-M2). The development of this sub-aggregate is determined by money market fund shares/units (they account for more than 90% of the sub-aggregate), whose volume increased over the first half of the year by Sk 13.7 billion (Sk 5 billion more than in the first half of 2004). Their growth dynamics weakened, owing to a lower basis of comparison from last year. The other components of marketable instruments – repo operations and debt securities issued for up to 2 years – decreased in volume over the first half of the year.

Deposits from non-financial corporations and households

The deposits of non-financial corporations were affected in the first half of 2005 by the continuing preference for liquid resources. The individual components of deposits from non-financial corporations recorded volatile developments in the individual months. The total volume of deposits from non-financial corporations decreased by Sk 17.8 billion (after increasing in the first half of 2004 by Sk 0.2 billion), when koruna deposits declined by Sk 14.7 billion (they fell in the first half of 2004 by Sk 7.5 billion). Within the scope of koruna deposits in the non-financial corporations sector, deposits and received loans repayable on demand increased by Sk 3.5 billion (in the first half of 2004, they grew by Sk 3.4 billion). On the other hand, koruna deposits and received loans with an agreed maturity of up to 2 years decreased by Sk 18.2 billion (in the first half of 2004, they dropped by Sk 10.9 billion). The foreign-currency deposits of non-financial corporations decreased in the first half of 2005 by Sk 3 billion (after growing in the first half of 2004 by Sk 7.6 billion).

Household deposits were also characterised by a persistent preference for highly liquid instruments. The total volume of household deposits decreased by Sk 3.0 billion (after increasing over the first half of 2004 by Sk 13.2 billion), while koruna deposits grew by Sk 1.7 billion (in the first half of 2004 by Sk 18.0 billion). Within the scope of household deposits in Slovak koruna, deposits and received loans repayable on demand increased by Sk 21.0 billion (over the first half of 2004 by Sk 11.0 billion), while deposits and received loans with an agreed maturity of up to 2 years decreased by Sk 19.1 billion (in the first half of 2004, they increased by Sk 5.3 billion). Koruna deposits redeemable at a period of notice of up to 3 months fell in volume by Sk 0.2 billion (after growing in the first half of 2004 by Sk 1.6 billion). Household deposits in foreign currency decreased over the first half of 2005 by Sk 4.7 billion (the same figure was recorded in the first half of 2004).

Deposits from non-financial corporations and households

The quarterly data are average figures. Differences in the sums are due to rounding.	Volume as % of M3 June 2005	Year-on-year change (in %)					
		2004 Q2	2004 Q3	2004 Q4	2005 Q1	2005 Q2	2005 June
Household deposits	41.0	3.5	3.4	3.8	1.7	0.1	-0.4
Deposits and received loans, repayable on demand	20.6	9.9	9.0	10.1	14.5	19.3	19.1
- of which: in SKK	18.3	12.6	13.1	15.8	20.8	26.1	25.7
Deposits and received loans with an agreed maturity of up to 2 years	18.3	-2.1	-1.7	-1.5	-8.7	-14.3	-15.4
- of which: in SKK	15.4	2.4	2.0	1.9	-6.4	-13.3	-14.4
Deposits redeemable at a period of notice of up to 3 months	2.0	19.2	15.1	10.2	8.2	-4.3	-5.4
- of which: in SKK	1.9	25.6	18.0	13.4	9.5	-3.4	-4.7
Household deposits in Slovak koruna	35.7	7.6	7.3	8.2	5.7	3.5	3.1
Household deposits in foreign currency	5.3	-13.4	-13.7	-16.1	-18.1	-18.0	-18.7
Deposits of non-financial corporations	27.1	14.7	13.2	9.6	7.0	8.5	2.6
Deposits and received loans, repayable on demand	16.7	20.8	11.5	26.8	37.9	22.2	13.4
- of which: in SKK	12.8	24.3	18.7	26.8	44.6	25.1	18.7
Deposits and received loans with an agreed maturity of up to 2 years	10.4	10.5	15.6	-5.1	-20.4	-5.6	-11.0
- of which: in SKK	9.5	10.6	11.8	-9.9	-19.8	-2.7	-7.5
Deposits redeemable at a period of notice of up to 3 months	0.0	43.5	8.4	17.7	29.6	20.5	13.3
- of which: in SKK	0.0	43.5	6.8	17.7	29.6	20.5	13.3
Koruna deposits of non-financial corporations	22.3	16.0	14.5	5.4	7.3	10.2	5.9
Foreign-currency deposits of non-financial corporations	4.9	10.5	8.3	28.3	5.6	1.2	-10.4

Of deposits not included in the M3 aggregate, koruna deposits and received loans with an agreed maturity of over 2 years increased in the household sector by Sk 1.3 billion over the first six months (of which Sk 0.6 billion took place in home-savings bank deposits). Koruna deposits and loans provided to households with a maturity of over 3 months decreased by Sk 5.3 billion. The deposits of non-financial corporations, which are not included in the M3 aggregate, were negligible in terms of volume.

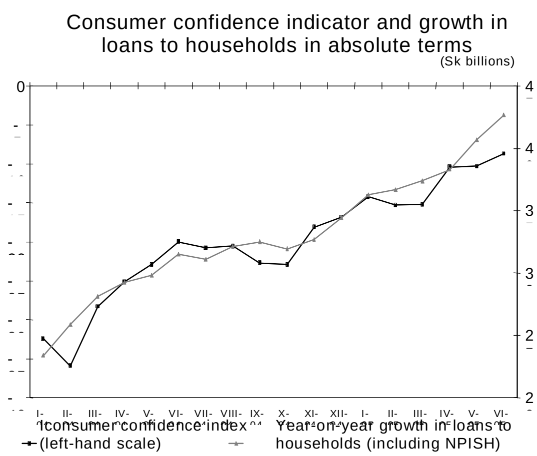
4.3. Loans of Monetary Financial Institutions to the Private Sector

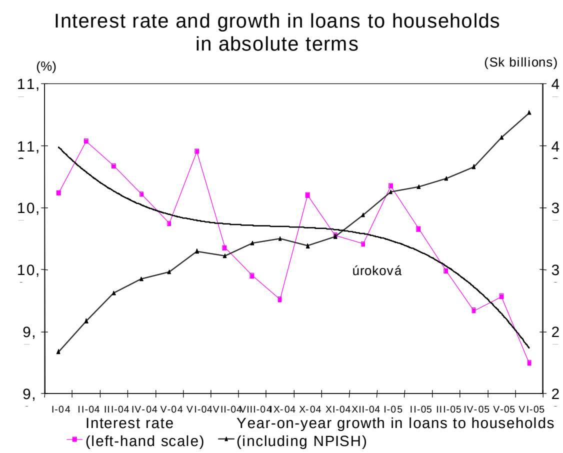
From 31 December 2004 to 30 June 2005, the total loans of monetary financial institutions (MFI) to the private sector (excluding securities) grew in volume by Sk 47.2 billion, due to increases in loans in both SKK (Sk 31.2 billion) and EUR (Sk 16.2 billion). Loans in other foreign currencies recorded a modest decrease. At the end of the first half of 2005, koruna loans accounted for 77.6%, receivables in euro 20.6%, and loans in other foreign currencies 1.8% of the total volume of MFI loans to the private sector (Sk 444.9 billion).

The increase in loans in the first half of 2005 was more than twofold larger than the total increase in 2004 (during the first half of 2004, loans grew by Sk 7.9 billion, and over the second half of 2004 by Sk 13.5 billion). Dynamic growth was mainly recorded in loans to households[8] (an increase of Sk 22.8 billion) and receivables from non-financial corporations (an increase of Sk 24.3 billion). Loans to financial corporations, insurance companies, and pension funds increased only slightly.

The marked absolute increase in loans to the private sector in the first half of 2005 was accompanied by a steady acceleration in their year-on-year growth, which reached 15.8% at the end of June (in 2004, except in December, their year-on-year dynamics ranged from 8% to 13%). The increase in year-on-year dynamics was mainly caused by loans to households, which accounted for 11.5 percentage points of the growth. The increase in loans to non-financial corporations contributed 2.6 percentage points to the overall year-on-year growth dynamics and loans to financial corporation 1.6 percentage points.

The increase in consumer confidence, accompanied by growth in real wages and decline in interest rates, led to a gradual increase in the size of absolute year-on-year increases in loans to households. The intense lending activity in the household sector was connected with the increased orientation of the banking sector to this market segment.





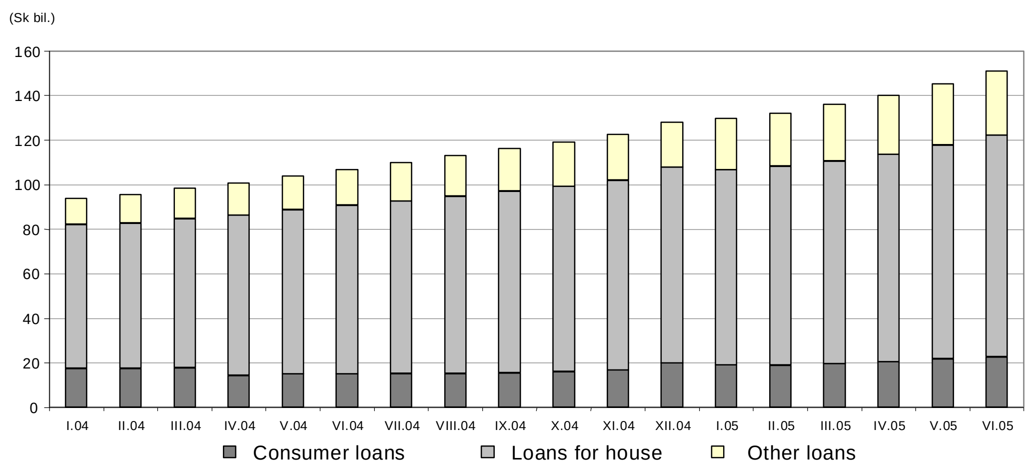
Within the structure of loans to households, the first half of 2005 saw the most dynamic growth in loans granted for house purchase. From the beginning of the year, they grew in

[8] Including non-profit institutions serving households (NPISH).

volume by Sk 11.7 billion and their year-on-year dynamics fluctuated over the first half of 2005 between 29% and 37%. Mortgage loans and home-savings bank loans continued to contribute most significantly to the overall growth in bank lending for housing purposes.

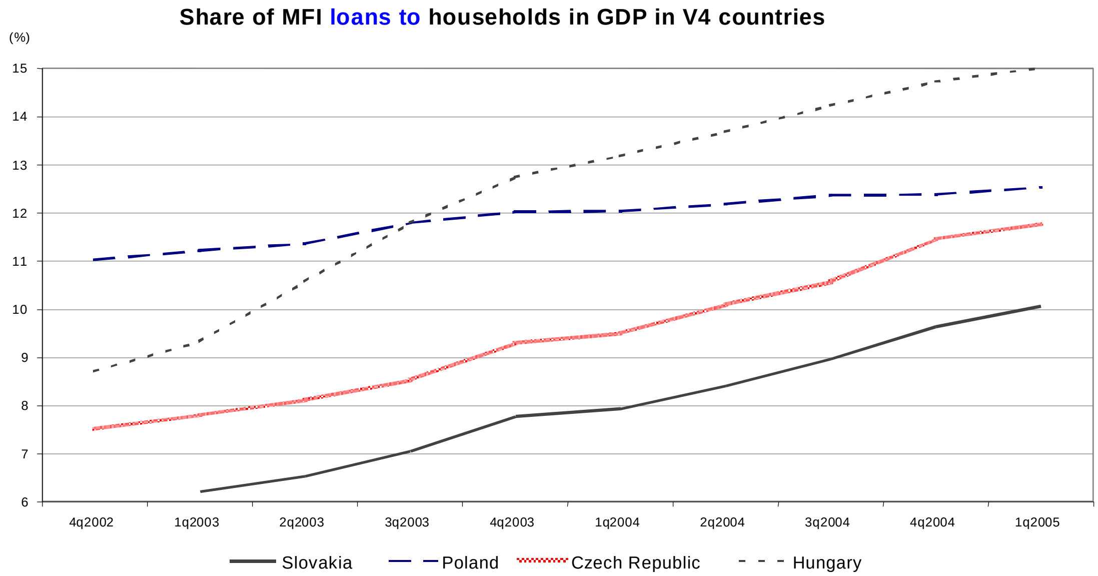
Relatively steep increases were also recorded in ‘other loans’ (Sk 8.3 billion) and ‘consumer loans’ (Sk 2.8 billion). The year-on-year dynamics of these types of loans were highly volatile during the period under review, fluctuating in the case of consumer loans from 8% in the first months of the year to 51% in June 2005. This was probably connected with the incorrect recording of these loans by some of the commercial banks at the beginning of 2004, when part of ‘other loans’ was included in the ‘consumer loans’ category. Hence, a more consistent picture is given by the year-on-year rate of growth in consumer loans and other loans, which accelerated over the period under review, from 44.3% in January 2005 (a year-on-year increase of Sk 12.9 billion) to 64.8% at the end of June 2005 (a year-on-year increase of Sk 20.2 billion).

MFI loans to households



Note: Including non-profit institutions serving households.

At the same time, the relatively strong growth in loans to households is to some extent connected with the standardisation of the market environment and may be regarded as part of the process of real convergence. Very similar developments are currently recorded in the new member states of the EU. In comparison with the Czech Republic, Poland, and Hungary, the indebtedness of Slovak households, expressed in terms of the ratio of loans to households to GDP, is still at the lowest level.



In the non-financial corporations sector, loans showed less dynamic growth than in the household sector: their year-on-year dynamics reached only 4.2%. This rate of growth can be ascribed exclusively to loans with a maturity of over 5 years (a year-on-year rate of 13.4%) and loans maturing in up to 1 year (6.3% year-on-year). Loans with a maturity of 1 to 5 years recorded a year-on-year decline of 10.6%.

Of the total increase in loans to non-financial corporations in the first half of 2005 (Sk 24.3 billion), Sk 14.6 billion took place in loans in euro and Sk 9.9 billion in koruna loans. The volume of loans in other foreign currencies decreased somewhat. Marked month-on-month increases in euro loans to non-financial corporations were recorded in the period until April 2005 (except in February 2005). This was probably connected with the attempt to minimise the costs of debt service by making use of the appreciating trend in the Slovak koruna. After the koruna had weakened slightly and/or the exchange rate began to stagnate, the indebtedness of non-financial corporations in euro ceased to grow.

4.4. Interest Rate Developments

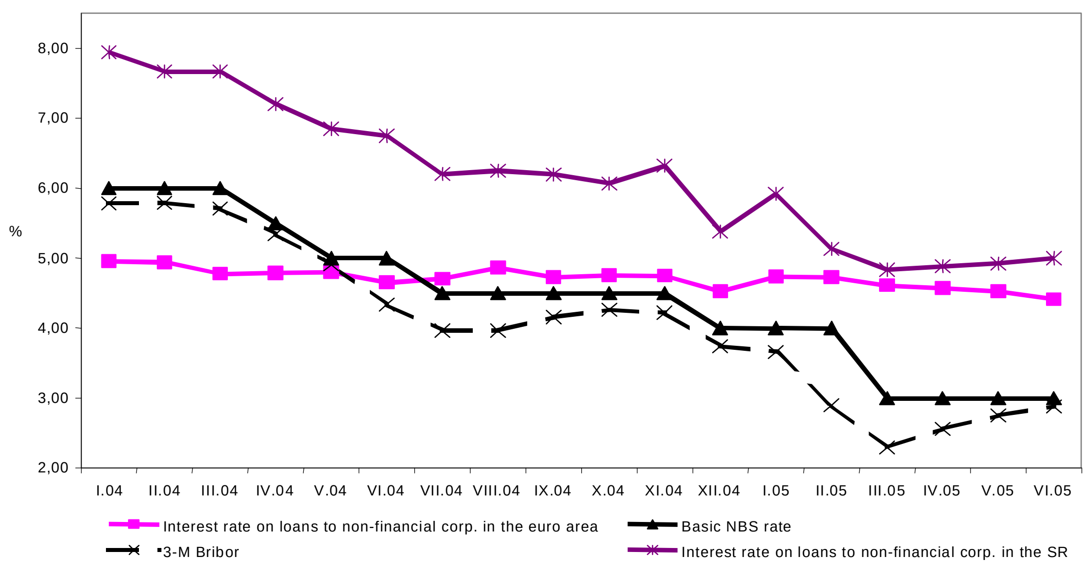
Customer interest rates

Developments in customer interest rates were mostly affected in the period under review by the cuts in the key NBS rates in 2004 (by 2 percentage points in cumulative terms) and in the first half of 2005 (by 1 percentage point, with effect from 1 March 2004).

Interest rates on loans to non-financial corporations

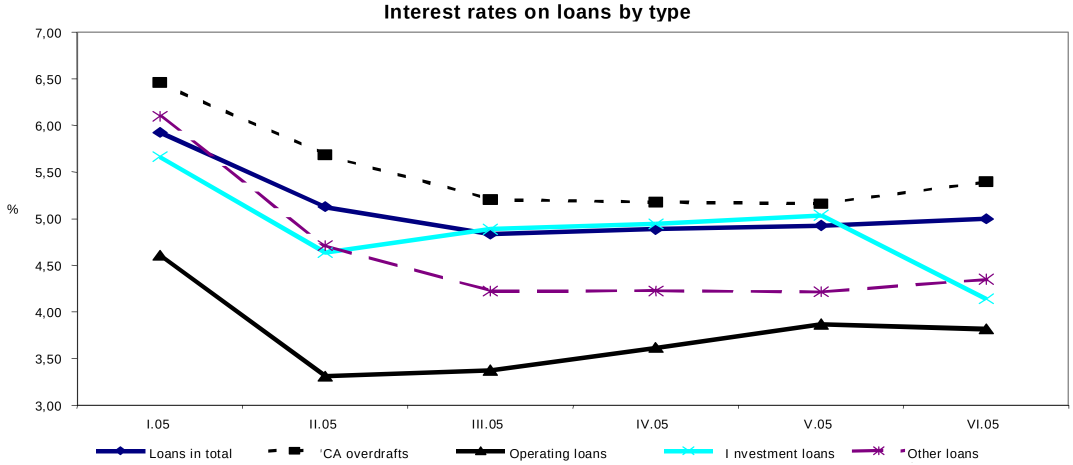
Interest rates on loans to non-financial corporations were characterised by a marked fall in February, followed by stagnation and/or a modest increase. Despite the cut in the key NBS rates with effect from 1 March 2005, the fall in interest rates on loans to non-financial corporations came to a halt. This was probably connected with developments in money market rates, and the fact that lending rates for non-financial corporations had already approached the level of euro area rates. Most loans granted to non-financial corporations were short-term loans (their average share in total loans to non-financial corporations in the first half of the year was 96%), hence they reacted to changes in money market rates relatively sensitively. This was also confirmed by developments in the last few months, when the gradual increase in three-month BRIBOR rates (to the level of the basic rate of the NBS) led to a modest rise in interest rates on loans to non-financial corporations.

Interest rates on loans to non-financial corporations, BRIBOR, and the basic NBS rate



In a breakdown by purpose, the first half of the year saw the most significant drops in interest rates on investment loans (1.52 points) and current account overdrafts (1.06 points). The average interest rate on loans to non-financial corporations was mainly affected by rates for short-term loans (with a floating rate and an initial rate fixation of up to 1 year). Developments in interest rates on the individual types of loans indicate that short-term lending rates (rates for current account overdrafts, operating loans, and other loans) followed a similar course.

Interest rates on loans by type

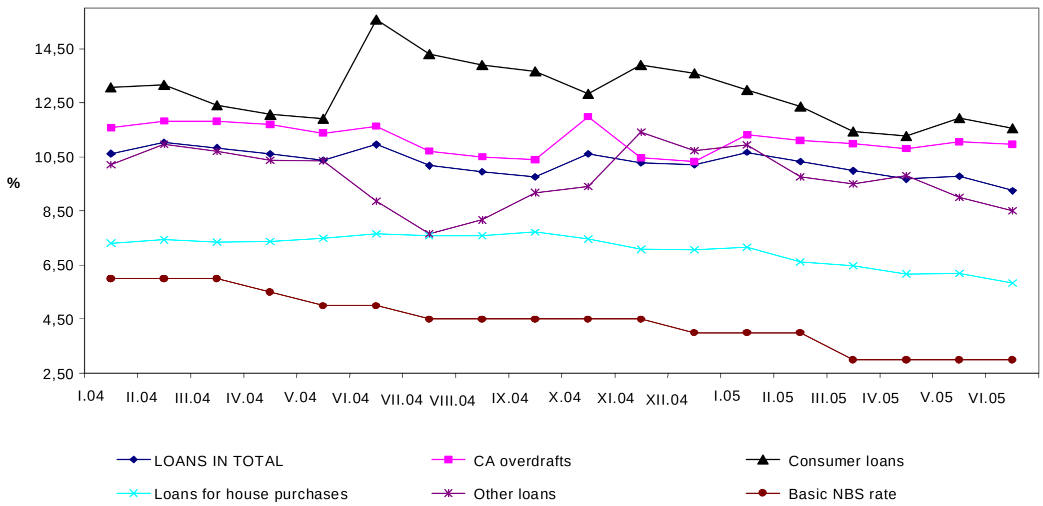


Interest rates on loans to households

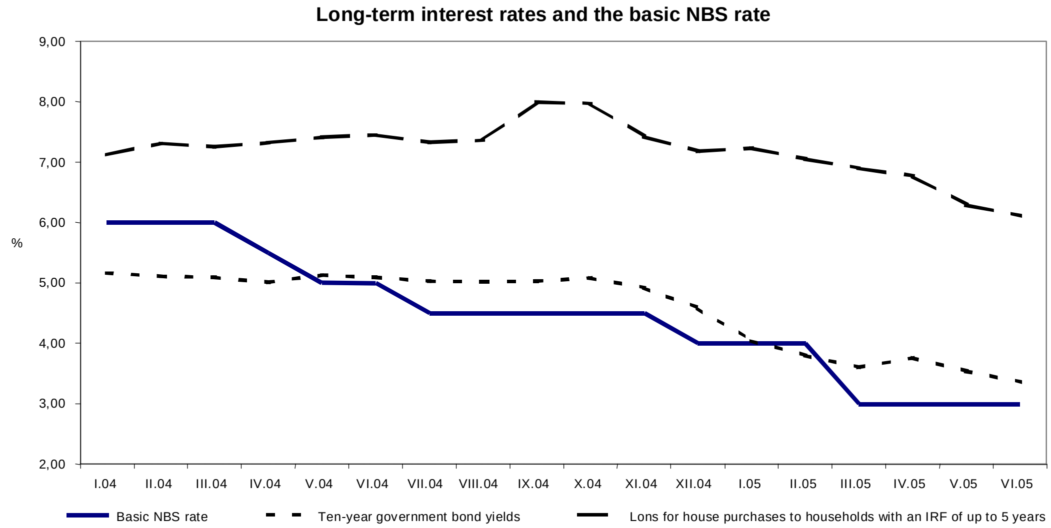
Interest rates on loans to households were characterised over the first half of the year by a falling tendency, which reflected the cuts in key NBS rates and the decline in long-term rates on the market for government securities. The reduction in the price of loans led to continued growth in their volume.

The sharpest fall in lending rates for households was recorded in consumer loans (2.04 points), which, however, remained the most expensive type of loans for household. The price of real estate loans also fell to a significant extent (by 1.23 points).

Interest rates on loans to households by type



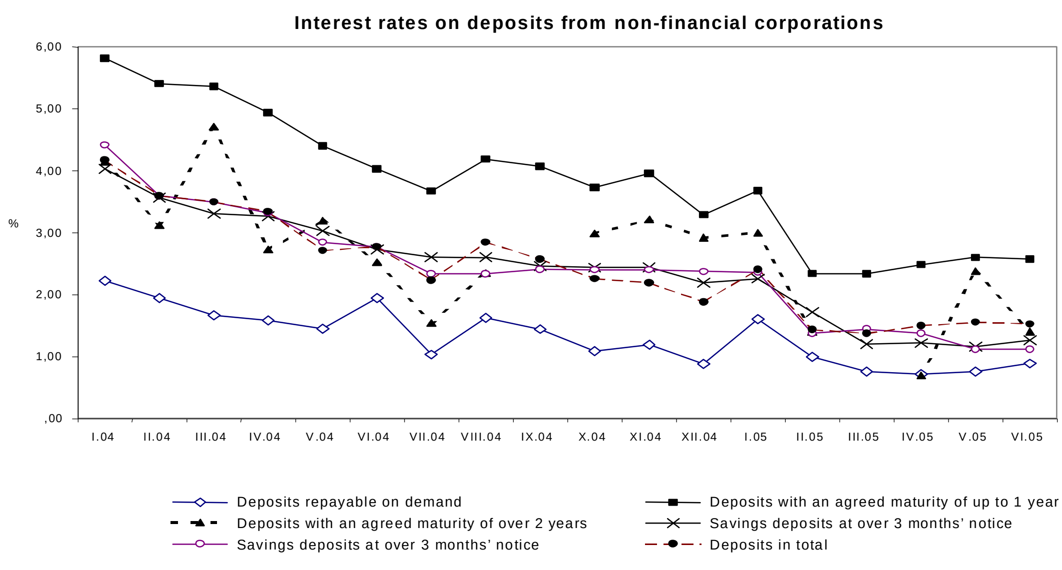
Within the scope of loans for house purchase, the most significant fall occurred in the price of mortgage loans (1.70 percentage points, compared with December 2004). Although most loans for house purchase are granted with a floating rate and/or an initial rate fixation of up to 1 year, these interest rates are influenced by developments in long-term rates on the market for government securities. They react to changes in the key NBS rates less flexibly. This was confirmed by developments in 2004, when the cumulative 2 percentage-point cut in the basic rate of the NBS was not reflected in interest rates on loans for house purchase. These rates began to fall later, in line with the gradual reduction in ten-year government bond yields.



In a breakdown by the period of initial rate fixation (IRF), the sharpest drops were recorded in interest rates on loans with an IRF of over 5 years (1.73 points for loans with an IRF of over 10 years and 1.37 points for loans with an IRF of over 5 and up to 10 years) and loans with a floating rate and an IRF of up to 1 year (0.68 points).

Interest rates on deposits from non-financial corporations

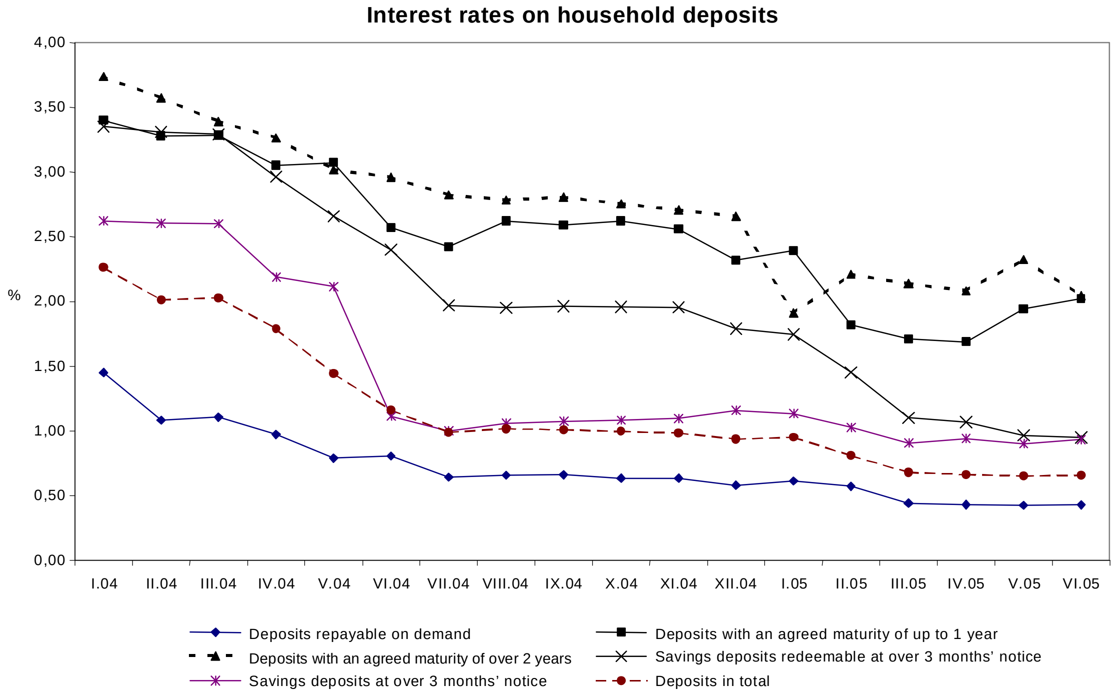
After rising in January 2005 to a significant extent, interest rates on deposits from non-financial corporations continued to follow a downward trend again in the next month. This trend, however, came to a halt in the following period and, since that time, interest rates have been more or less stable. The current situation is that short-term and demand deposits earn interest at a higher rate than longer-term deposits with an agreed maturity and/or deposits redeemable at notice.



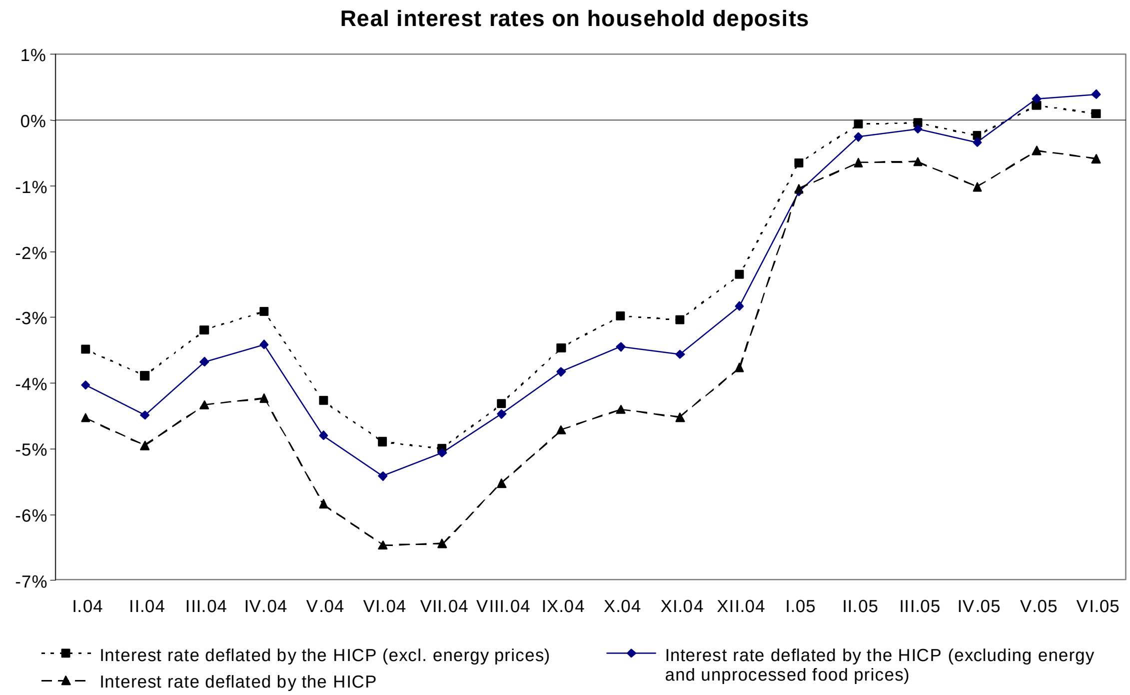
Note to the chart: In September 2004 and March 2005, no new deposits were accepted from non-financial corporations with an agreed maturity of over 2 years.

Interest rates on household deposits

At the beginning of the first half of 2005, interest rates on household deposits reacted relatively flexibly to the fall in money market rates and to the subsequent cut in the key NBS rates (with effect from 1 March 2005). In the following months, the deposit rates were more or less stagnant. Interest rates fell most significantly over the first six months on savings deposits redeemable at a period of notice of up to 3 months (by 0.84 of a percentage point). Deposits repayable on demand and longer-term deposits redeemable at notice recorded smaller changes. The highest interest was earned by deposits with an agreed maturity of up to 1 year and over 2 years.



The rise in real interest rates (calculated by deflating the rate of interest on the volume of one-year household deposits by HICP inflation) was mostly affected in the first half of 2005 by a fall in inflation. Despite the fall in nominal interest rates, real interest rates showed a slightly rising tendency over the first half of 2005.


Real interest rates on household deposits
1%
0%
-1%
-2%
-3%
-4%
-5%
-6%
-7%
I.04
II.04
III.04
IV.04
V.04
VI.04
VII.04
VIII.04
IX.04
X.04
XI.04
XII.04
I.05
II.05
III.05
IV.05
V.05
VI.05
Interest rate deflated by the HICP (excl. energy prices)
Interest rate deflated by the HICP
Interest rate deflated by the HICP (excluding energy and unprocessed food prices)

5. FINANCIAL MARKETS

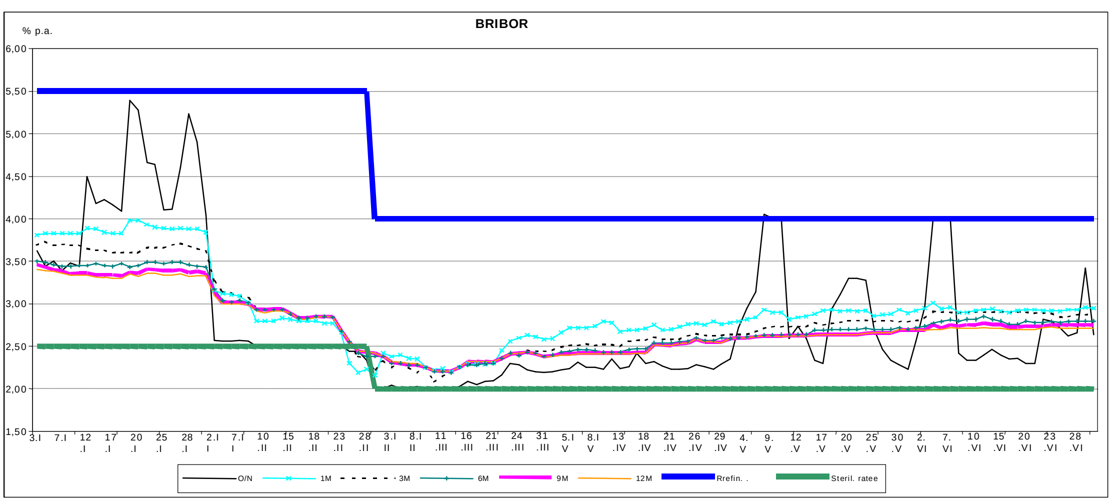
5.1. Money Market

Interest rate developments

Developments in money market rates recorded marked changes over the first half of 2005, when the initial volatility of longer-term rates was caused by foreign exchange market developments.

The NBS reacted to the excessive appreciation of the Slovak koruna at the beginning of the year by intervening in the foreign exchange market and, later in February, by using money market instruments as well. In so doing, the NBS rejected all bids at four successive repo tenders and cancelled two auctions in NBS treasury bills. The rejection of bids at the tenders caused a sharp fall in money market rates.

The large surplus of daily liquidity, supplemented by converted funds from foreign exchange interventions, caused the yield curve to fall as a whole at the end of February, below the level of the rate for overnight sterilisation operations. Trading on the interbank deposit market was restricted at that time to transactions with one-day to one-week maturities. In the area of overnight transactions, trading activity was minimal and it often happened that no transactions were concluded at all. As a result of NBS activities on the money market, interest rates lost their reporting ability and thus expectations could only be derived from changes in the money market yield curve, the actual FRA prices, or from the swap curve. The Bank Board reacted to developments in the koruna exchange rate and its persistent appreciating tendency by lowering the key rates of the NBS at the end of February, to 2.0% for overnight sterilisation operations, 4.0% for overnight refinancing transactions, and 3.0% for two-week repo tenders with commercial banks, as a result of which the gap between overnight NBS rates contracted from 3 to 2 percentage points.



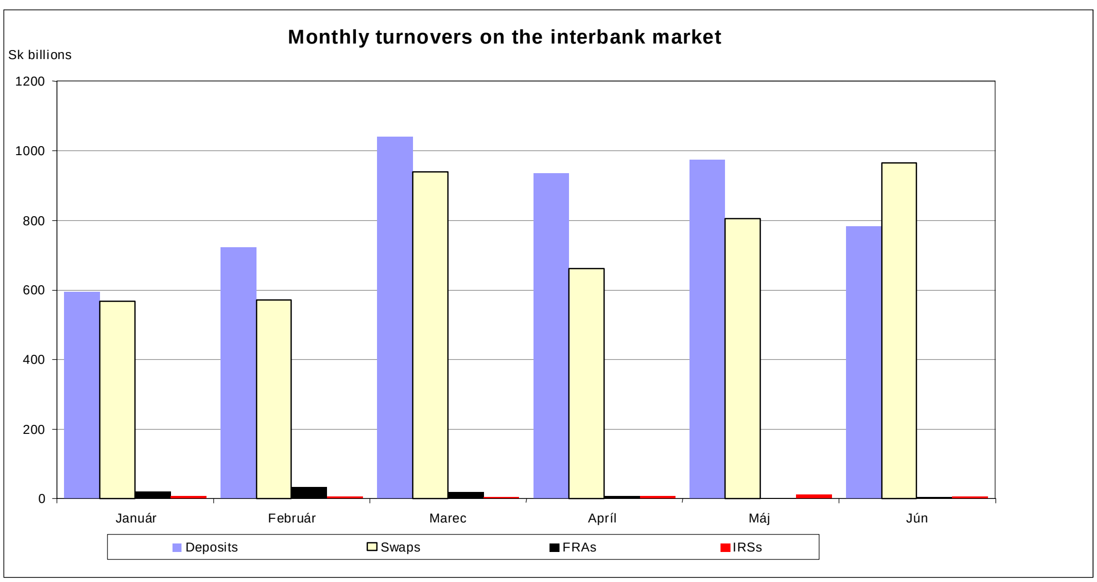
After lowering its key interest rates, the NBS began accepting part of the bids at tenders, to which the interbank market responded with a revival. The stabilisation of the money market situation led to a steady rise in the level of deposit prices. The upward changes in interest rates towards the level of the rate set for repo tenders were also supported by the closing of koruna positions on the part of foreign entities and the statement of the NBS concerning its preparedness to intervene against the excessive appreciation of the Slovak koruna. Due to concern about the possible negative effects of certain economic parameters on the level of inflation, the banking sector gradually re-assessed its expectations in respect of a further cut in NBS rates in the second quarter of the year. The money market rate curve ceased to have a markedly inverse shape and stabilised within a relatively narrow range (2.5 - 3.0%). The quoted values of FRA contracts confirmed that further downward interest rate adjustments were anticipated by commercial banks for the end of the third and/or fourth quarters of the year.

Interbank transactions on the money market

Interbank transactions recorded an increase in the trading volume compared with the previous period. Most transactions were concluded in deposits (52.0%) and swaps (46.6%). Trading in forward rate agreements (FRAs) and interest rate swaps (IRSs) accounted for 0.9% and 0.5% respectively.

Within the individual types of transactions, most trading took place in overnight deposits (74.4%) and deposits with a maturity of 7 to 14 days (12.4%). Swaps were also dominated by the shortest maturities (83.1%), while deals with a maturity of up to 7 days accounted for 6.4%. Trading in FRA contracts was concentrated in 1 to 3-month maturities (91.3%), while IRS contracts were concluded with a maturity of 2 to 5 years (39.4%).

Foreign banks accounted for 74.6% of the total volume of interbank transactions. Within the structure of transactions by type, non-residents led the way in IRSs (82.4%), swaps (79.4%), and deposits (70.7%), while their share in FRAs reached 47.8%.



Money market operations of the NBS

The NBS continued using standard money market instruments, with a temporary interruption at the beginning of the period under review. With effect from 1 February 2005, the Bank Board of the NBS decided to extend its plan of meetings to include a regular meeting on Tuesdays. At these meetings, the Bank Board usually evaluates the current situation on the financial market and approves the results of regular sterilisation repo tenders.

Among the individual forms of open market operations, repo tenders maintained their dominant share (except in February), and closed the first half of the year around the level of 75%.

In order to maintain the share of NBS bills at the level of ca 25% of the total volume of sterilisation, the NBS increased the amount to be accepted to Sk 35 billion after the issuance of NBS bills was renewed in April.

In overnight transactions, both parties achieved record values in the first half of the year (i.e. the highest values since 2000). At the time when bids were rejected at repo tenders, banks deposited Sk 342.5 billion with the NBS at the end of February. In overnight refinancing transactions, the maximum amount was achieved in May (Sk 27.3 billion), after an unexpected transfer of a large amount of funds from the accounts of the SR Treasury to the NBS.

Structure of open-market operations (average values in millions of Sk)

	2004		2005					
	1st half	2nd half	January	February	March	April	May	June
O/N deposits	- 3,500	- 1,436	- 784	- 248,602	- 116,548	- 14,656	- 1,580	- 702
O/N repos	521	376	1,177	0	0	0	4,394	1,216
SRT	- 123,603	- 202,628	- 237,242	- 42,100	- 271,154	- 397,085	- 366,734	- 313,601
NBS bills	- 68,017	- 53,804	- 61,774	-52,143	- 31,452	- 30,333	- 64,355	- 102,667
TOTAL	- 194,599	- 257,492	- 298,623	- 342,845	- 419,154	- 442,074	- 428,275	- 415,754

Banking sector liquidity

In the first half of 2005, the monetary policy of the NBS maintained its sterilisation nature. The sterilisation position of the NBS vis-à-vis the banking sector markedly deepened, mainly in the first quarter, and then gradually moderated in the second quarter. The major part of the excess liquidity was sterilised through NBS operations on the open market.

A major source of increase in the banking sector’s liquidity were NBS interventions in the foreign exchange market against the unreasonable appreciation of the Slovak koruna vis-à-vis the reference currency (mainly in February and March), whose cumulative volume reached Sk 99.3 billion in the first half of 2005 (EUR 2.7 billion).

Over the period under review, the reserves of the banking sector were also increased by transfers of public sector deposits from the NBS to the accounts of the SR Treasury. They included a time deposit of the Treasury at the NBS, earmarked for the pension reform, the remaining deposits of non-budgetary funds of state authorities, the deposits of regional self-governments, and the summary memorandum account of the Government at the NBS.

The pro-liquidity effect of the above factors was partly offset in April by foreign exchange interventions, aimed at strengthening the exchange rate of the koruna, and in May by an outflow of liquidity from the banking sector, caused by a transfer of Treasury funds to the NBS for the purpose of servicing the external debt of the SR.

Due to the dominance of liquidity-providing factors, the sterilisation position of the NBS vis-à-vis the banking sector increased over the first half of 2005, from Sk 289.4 billion (at 31 December 2004) to Sk 426.6 billion (at 30 June 2005), and its average level during the six months under review stood at Sk 391.4 billion.

Fulfilment of reserve requirements

In accordance with the harmonisation of NBS monetary-policy instruments with those of the ECB, the required-reserve ratio for the banking sector was set at 2% (corresponding to the reserve ratio set by the ECB), with effect from January 2004. During the first half of 2005, the actual reserve-requirement fulfilment was balanced throughout the banking sector, with a marked surplus in February. In the conditions of a marked liquidity surplus in the banking sector and continuing NBS operations for sterilisation purposes, the prescribed level of required reserves was maintained throughout the first half of 2005 and was not exceeded to a significant extent. After the NBS operations, the average monthly excess reserves ranged from Sk 0.02 billion to Sk 0.13 billion.

The maximum changes in the daily reserve holdings in the individual periods ranged from a surplus of Sk 25.87 billion to a shortage of Sk 18.12 billion. The largest deviations from the reserve requirements in the first half of 2005 were recorded in May and June.

Fulfilment of reserve requirements (in billions of Sk and %)

	Required reserves	Actual reserve holdings		
		Average	Fulfilment in %	Standard deviation
January	17.75	17.83	100.44	5.53
February	17.75	17.88	100.73	2.74
March	18.67	18.69	100.11	7.28
April	19.25	19.38	100.63	8.30
May	20.86	20.87	100.08	12.12
June	21.08	21.10	100.11	10.46

In the first half of 2005, one case of failure in reserve-requirement fulfilment was reported from the banking sector.

SR Treasury bills

In the Issuing Schedule for 2005, two issues of SR Treasury bills were planned for the first half of the year (for June). With regard to the favourable trend in the State Budget of the Slovak Republic, both issues were cancelled by the Agency for Debt and Liquidity Management (ARDAL).

5.2. Capital Market

Primary market

Government bonds

With effect from 1 January 2005, auctions in government securities started to be conducted by the Agency for Debt and Liquidity Management (ARDAL), using the Reuters system. In line with the Issuing Schedule for 2005, ARDAL continued to increase four government-bond issues opened in 2004 and launched a new seven-year issue, with a zero coupon and a standard issue-amount as in 2004 (i.e. Sk 40 billion).

In the first half of 2005, eleven government-bond auctions were held on the domestic capital market for the purpose of debt coverage, with nine of them being successful. At two auctions, ARDAL rejected the bids of investors concerning the level of yields. The total amount issued in the first half of 2005 reached Sk 43.6 billion (a year-on-year increase of 39.6%, i.e. Sk 14.5 billion).

Structure of government-bond issues by maturity

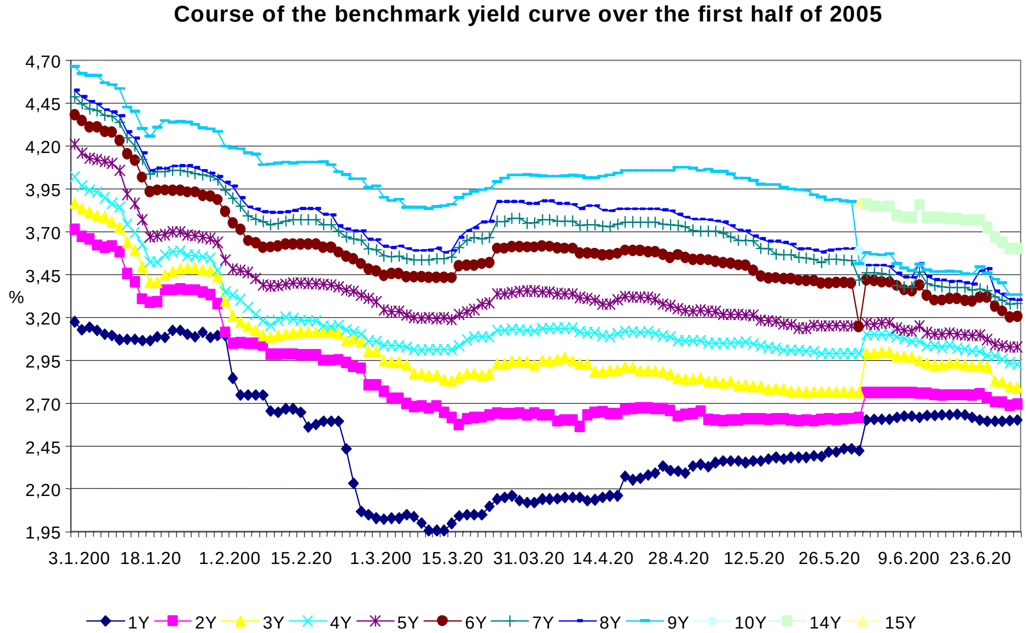
	1st half, 2004 (Sk billions)	Number of issues	1st half, 2005 (Sk billions)	Number of issues
3-year	25.9	1	-	-
5-year, floating coupon (12M BRIBOR)	2.3	1	13.7	1
5-year, fixed coupon	7.7	1	18.7	1
7-year, zero coupon	-	-	2.2	1
10-year	4.8	1	4.1	1
15-year	7.3	1	4.9	1

In the period under review, bond issues were dominated by five-year bonds: 51.0% took place in 5-year issues with a fixed coupon and 21.6% in 5-year issues with a floating coupon (12M Bribor). They were followed by 10-year issues (11.3%), 15-year issues (10.1%), and a newly opened 7-year issue (6.0%).

Total demand for government bonds reached Sk 109.0 billion in the first half of 2005 (a year-on-year increase of 39.6%). The average issue-amount was Sk 5.1 billion, compared with Sk 3.7 billion in the first half of 2004. The marked increase in the size of issues in comparison with the first half of 2004 was due to the absence of Treasury-bill issues.

Benchmark yield curve

The benchmark yield curve for the first half of 2005 was affected by a cut in the key interest rates of the NBS (with effect from 1 March 2005). The categorisation of government bonds by maturity was updated in June. In this connection, there was an appreciation in the valuation of the individual maturities of debt securities. This was due to a technical change in the benchmark system (exchange of the benchmark portfolio), i.e. the bonds representing the individual maturities were changed.



Coupon payment and bond repayment

In the first half of 2005, coupons and principals were repaid in the total amount of Sk 29.9 billion. Of this amount, coupon payments accounted for Sk 11.5 billion, 78.3% of which (Sk 9.0 billion) was paid to domestic investors and 21.7% (Sk 2.5 billion) to foreign investors. The period under review saw year-on-year increases in coupon payments to foreign and domestic investors (44.4% and 14.3% respectively). In the first half of 2005, the total amount of paid government-bond coupons exceeded the figure for the same period a year earlier (Sk 9.7 billion) by 18.6%.

Over the period under review, three issues were repaid in the total amount of Sk 18.4 billion, 25% of which (Sk 4.6 billion) went to foreign investors and 75% (Sk 13.8 billion) to domestic investors. In the first half of 2005, the total principal was 40.8% smaller than in the same period in 2004, which led to decreases in coupon payments to foreign and domestic investors (43.9% and 39.7% respectively).

Non-government bonds

In the first half of 2005, seventeen non-government bond issues were floated in the total amount of Sk 8.4 billion (a year-on-year decrease of 4 issues, i.e. Sk 1.1 billion).

Of the total number of issues made in the first half of 2005, seven issues took place in mortgage bonds in the amount of Sk 5.4 billion. Compared with the same period in 2004, the number of issues dropped by 4 (Sk 2.1 billion). The issuers were Tatra banka, Slovenská sporiteľňa, OTP Banka, VÚB, Unibanka, and Istrobanka. Corporate bonds were issued in the amount of Sk 3.3 billion (10 issues). On a year-on-year basis, the number of issues increased by one issue (Sk 1 billion). Over the first half of the year, no issue was made in foreign currency.

Secondary market

In the first half of 2005, the Bratislava Stock Exchange (BCPB) was open for 122 days. The total trading volume reached Sk 495.0 billion (a year-on-year increase of more than 207.3% in 6,600 transactions). The volume of transactions in equity securities totalled Sk 1.35 billion (a year-on-year drop of 92.7%), with a 0.3% share in the total volume. Price-setting transactions amounted to Sk 5.8 billion (a year-on-year fall of 59.5%), with a 1.2% share in the total volume.

Trading in bonds

The total volume of trading in bonds over the first half of 2005 reached Sk 493.6 billion, representing an increase of 246.1% compared with the same period a year earlier. Trading in government bonds accounted for 99.8% of the total volume of bond transactions, and reached Sk 492.8 billion (in 1,749 contracts). On the listed market, most trading took place in government bonds – issues Nos. 142, 188, and 144. Among listed non-government bonds, the best performers were VÚB XIV mortgage bonds and B.O.F. bonds. On the regulated free market, the best performing corporate bond was a bond issued by Technologické centrum (Technological Centre). In price-setting transactions, the largest volume was traded in government bonds, Issue No. 203.

In the market-maker system, 10 government-bond issues, 4 corporate-bond issues, and 4 mortgage-bond issues were available for trading on the last trading day of the first half of 2005. The volume of trading reached Sk 3.4 billion (in 31 transactions), representing 62.7% of the volume of all price-setting transactions in bonds.

On the last trading day in the first half of 2005, the market capitalisation of debt securities amounted to Sk 398.2 billion (a year-on-year increase of 19.1%), of which Sk 376.6 billion was in listed issues (a year-on-year increase of 20.9%).

The SDXG index for the public sector, represented by government bonds, closed the first half of 2005 at 110.60 (price component) and 117.80 (performance component), with a yield of 3.10% to maturity and a duration of 4.6 years. The SDXG(≤5) sub-index reached 107.3 (for price) and 113.2 (for performance), with a yield of 2.70% to maturity and a duration of 2.6 years, and the long-term SDXG(>5) sub-index stood at 114.1 (for price) and 122.6 (for performance), with a yield of 3.30% to maturity and a duration of 7.3 years.

The SDXG for the private sector, represented by corporate and mortgage bonds, closed the first half of the year at 103.5 (price component) and 113.2 (performance component), with a yield of 3.57% to maturity and a duration of 3.1 years. The value of the short-term SDXG(≤5) sub-index reached 102.0 (for price) and 112.1 (for performance), with a yield of 3.31% to maturity and a duration of 2.0 years, and the long-term SDXG(>5) sub-index stood at 109.1 (for price) and 115.9 (for performance), with a yield of 4.8% to maturity and a duration of 6.6 years.

SDX index

The Slovak Bond Index (SDX) for bank and corporate bonds closed the last trading day of June at 266.7% of the nominal value of its portfolio, with an average yield of 3.73% to maturity and a duration of 1.4 years. On a year-on-year basis, the index appreciated by 9.33% compared with the figure for the end of the first half of 2004. The index reached a minimum on 10 January (259.7%) and a maximum on 23 June 2005 (266.9%).

At the end of June, the average price of the government-bond portfolio in the SDX base stood at 254.0% (a year-on-year increase of 11.4%), while the average yield amounted to 2.88% and duration 4.3 years. This component recorded a minimum on 10 January (239.5%) and a maximum on 29 June (254.0%).

Trading in shares

By the last trading of the first half of 2005, transactions had been concluded in 360 share issues (from 269 issuers), including issues of unit certificates. Six issues were traded on the listed market, eight on the parallel listed market, and 346 on the free market. On the new listed market, no share issue had been traded by the end of June 2005.

The market capitalisation of negotiable issues of equity securities registered on the stock market increased year-on-year by 53.1%, to Sk 167.3 billion. Real market capitalisation, i.e. the market capitalisation of shares in which at least one price-setting transaction was concluded, except for investment fund shares and unit certificates, grew by 75.2%, to Sk 153.4 billion on the last trading day. The market capitalisation of listed bonds increased year-on-year by 129.1%, to Sk 91.8 billion.

In the market-maker system (MMS), no share issue had been traded by the end of the first half of 2005.

SAX index

The Slovak Share Index (SAX) opened the year 2005 at 325.87 points (a fall of 0.2% compared with the figure for the end of 2004). At the end of the first half of the year, the SAX index stood at 436.11 points, representing a year-on-year appreciation of 122.9%, i.e. an increase of 246.5 points in absolute terms. Compared with the beginning of 2005, the SAX index appreciated by 33.8%.

5.3. Foreign Exchange Market

Operations on the foreign exchange market

By the end of June 2005, the exchange rate of the Slovak koruna against the euro had strengthened by 1.1% (from SKK 38.796/EUR as at 31 December 2004 to SKK 38.370/EUR as at 30 June 2005), while the average rate had appreciated by 2.9%. In relation to the US dollar, the koruna weakened by 11.7% (from SKK 28.496/USD at 31 December 2004 to SKK 31.825/USD at 30 June 2005), while appreciating in average terms by 5.1%.

Spot transactions between foreign and domestic banks resulted in a negative balance (USD-132.52 million), i.e. foreign banks purchased mostly Slovak koruna and sold foreign currency.

Over the first half of the year, the National Bank of Slovakia intervened in the foreign exchange market on several occasions, and purchased EUR 3,020 million (in January, February, and March) and sold EUR 315 million (in April).

Changes in the SKK/EUR and SKK/USD exchange rates

	30 June 2005 / 31 Dec. 2004	Average June 2005 / Average Dec. 2004	Average 1st half, 2005 / Average 1st half, 2004
	%	%	%
SKK/EUR	-1.1	-1.1	-2.9
SKK/USD	11.7	8.8	-5.1

-- Appreciation of the SKK

+ Depreciation of the SKK

Interbank foreign exchange market

The volume of trading on the interbank foreign exchange market totalled USD 324,037.9 million, representing an increase of 49.1% compared with the figure for the second half of 2004 (USD 217,331.4 million). Within the structure of transactions, swap transactions accounted for 83.2% and took place mostly in USD (94.6%). Spot transactions accounted for 13.6% of the total turnover (98.2% of the deals were in EUR). The average daily turnover on the spot market reached USD 344.8 million and the average volume per transaction amounted to USD 2.08 million.

The volume of transactions between domestic commercial banks increased from USD 37,279.9 million to USD 43,258.9 million. Trading took place mostly in USD (56.2%; compared with 74.2% in the second half of 2004), followed by EUR with a share of 41.2% (25.1% in the second half of 2004), and other currencies accounting for 2.5%.

Trading between domestic banks accounted for 13.4% (17.2% in the second half of 2004) of the overall interbank foreign exchange market. Of the total volume of transactions between domestic banks, swap operations accounted for 77.5% (89.1% in the second half of 2004) and spot transactions 22.3% (10.9% in the second half of 2004).

The volume of trading between domestic and foreign banks increased by 55.9%, from USD 180,051.5 million to USD 280,779.1 million. The largest volume was traded in USD (81.1%; compared with 84.7% in the second half of 2004), followed by EUR (18.1%; compared with 12.8% in the second half of 2004), and other currencies (0.8%). Trading between domestic and foreign banks accounted for 86.6% of the country’s foreign exchange market.

Trading with foreign banks was also dominated by swaps (84.0%; compared with 91.6% in the second half of 2004), followed by spot transactions (12.4%; compared with 8.3% in the second half of 2004) and forward dealings accounting for only 0.2% (0.1% in the second half of 2004).

6. BANKING SECTOR

6.1. Banking Sector

As at 30 June 2005, the Slovak banking sector comprised:
– eighteen banks;
– four branch offices of foreign banks;
– eighty-one entities providing cross-border banking services (freely, without opening a local branch), including 79 banks and 2 electronic money institutions;
– nine representative offices of foreign banks.

Of these eighteen banks, three were home-savings banks: ČSOB stavebná sporiteľňa, a.s.; Prvá stavebná sporiteľňa, a.s.; and Stavebná sporiteľňa VÚB-Wüstenrot, a.s. As at 30 June 2005, a licence to provide mortgage banking services was held by nine banks and one branch office of a foreign bank (HVB Bank Slovakia, a.s.; Dexia banka Slovensko, a.s.; Istrobanka, a.s.; Ľudová banka, a.s.; OTP Banka Slovensko, a.s.; Slovenská sporiteľňa, a.s.; Tatra banka, a.s.; UniBanka, a.s.; Všeobecná úverová banka, a.s.; and the branch office of Československá obchodní banka, a.s. in the Slovak Republic.

Over the period under review, no changes were recorded in the banking sector (compared with data from the end of 2004). The share of foreign investors in the total subscribed share capital of banks and funds provided by foreign banks to their branch offices remained unchanged in comparison with the end of 2004, at 89.5% (as at 30 June 2005). Ľudová banka, a.s. recorded some changes in the shares of foreign investors, which, however, had no effect on the total share of foreign investors in the registered capital of the above banks.

On 25 April 2005, the National Bank of Slovakia granted prior approval to Citibank (Slovakia), a.s. to move its registered office to Mlynské nivy 43, Bratislava. On 8 June 2005, the bank sent an extract from the Companies Register, documenting the entry of this change.

On 1 June 2005, a branch of HSBC Bank plc commenced operations in Slovakia. The National Bank of Slovakia informed the branch office of the terms and conditions of operation in the SR as a branch of a foreign bank on the basis of a banking licence (hereinafter called ‘notification’), in a letter of 24 March 2005. The branch office in question is a contributor to the Deposit Protection Fund of the SR.

The National Bank of Slovakia also sent notification to Banco Mais, S.A., in a letter of 1 July 2005. The local branch of this foreign bank has not yet commenced operations. The branch office is a contributor to the Deposit Guarantee Fund of Portugal.

On 14 April 2005, the National Bank of Slovakia confirmed receipt of notification from Niederösterreichische Landesbank- Hypothekenbank Aktiengesellschaft, Austria, of the establishment of a representative office in the SR. Thus, the number of representative offices of foreign banks increased to nine (as at 30 June 2005).

On the basis of notifications received from foreign supervisory authorities in accordance with Article 11 paragraph 2 of the Banking Act and Article 21 paragraph 2 of Directive No. 2000/12/EC on the Establishment and Operation of Credit Institutions of the intention of foreign banks to conduct banking activities and/or provide banking services (which are listed in Annex 1 to the said Directive), the Banking Supervision Division registered 81 foreign financial institutions providing cross-border banking services freely, without opening a local branch (as at 30 June 2005), comprising 79 banks and 2 electronic money institutions (see the table below – structure by country).

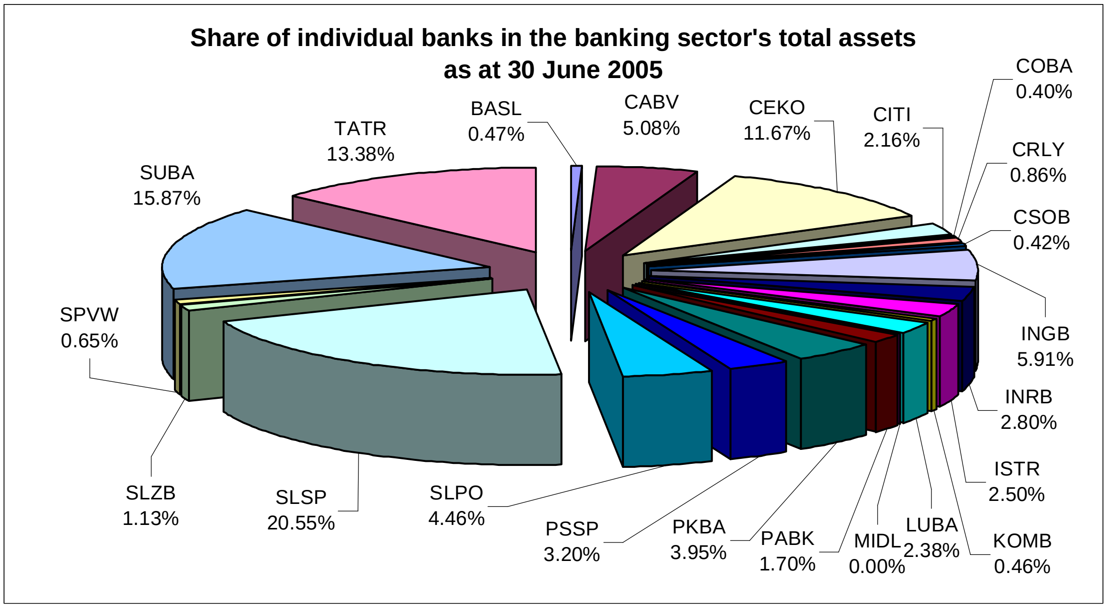
EU member state	Number of foreign banks	Number of foreign electronic money institutions
Cyprus	2	
Czech Republic	2	
Denmark	2	
France	5	
Netherlands	2	
Ireland	5	
Liechtenstein	1	
Luxembourg	4	
Hungary	2	
Germany	11	
Austria	20	
United Kingdom	20	2
Sweden	1	
Italy	2	

The volume of subscribed share capital of banks (excluding the NBS) increased by Sk 0.1 billion compared with the figure for 31 December 2004, from Sk 41.4 billion to Sk 41.5 billion. This development was influenced by an increase in the share capital of Tatra banka, a.s.

6.2. Economic Results of the Banking Sector

The balance-sheet total (total assets in net terms) of twenty-two banks representing the banking sector of Slovakia increased in comparison with the end of 2004 by Sk 170 billion (14.7%), to Sk 1,333.3 billion as at 30 June 2005.

The development of the banking sector's total assets was affected by increases in both secondary (Sk 98.3 billion) and primary resources (Sk 46.2 billion). Due to an amendment to the deposit protection law, the volume of non-anonymous deposits decreased by Sk 16.7 billion (3.9%), to Sk 406.6 billion



The volume of earning assets reported by the banking sector increased in comparison with the end of 2004 by Sk 155.2 billion, to Sk 1,246.2 billion. The share of earning assets in total assets slightly decreased over the first half of 2005, to 93.5% (by 0.3% compared with the end of 2004).

Total loans reported by banks as at 30 June 2005 amounted to Sk 481 billion. Classified loans increased by Sk 1.7 billion (5.2%), to Sk 33.4 billion. Banks created Sk 25.8 billion in loan-loss provisions. At the end of the period under review, classified loans were covered by provisions to 77.3%. The share of classified loans in total loans increased to 7.5%.

As at 30 June 2005, banks reported a net profit of Sk 7.6 billion. This represents a year-on-year increase of Sk 0.6 billion (9.4%). One bank reported a loss for the current period ending 30 June 2005 (at 30 June 2004, no bank reported a loss).

Banking sector of the SR	31.12.2004	30.6.2005	Difference 06/05-12/04	% change 06/05-12/04
Number of employees	19,720	19,568	-152	-0.77%
Number of banks in the SR	18	18	0	0.00%
Number of branches of foreign banks in the SR	3	4	1	33.33%
of which: on the basis of an NBS licence	1	1	0	0.00%
under the single passport regime	2	3	1	50.00%
Number of representative offices of foreign banks in the SR	7	9	2	28.57%
Number of branches in the SR	587	654	67	11.41%
Number of sub-branches in the SR	526	446	-80	-15.21%
Number of branches in other countries	1	1	0	0.00%
Number of sub-branches in other countries	0	0	0	0.00%
Number of representative offices in other countries	1	0	-1	-100.00%
Number of free providers of cross-border banking services	48	81	33	68.75%
of which: electronic money institutions	0	2	2	0.00%
Slovak banks freely providing cross-border banking services abroad	1	1	0	0.00%
of which: electronic money institutions	0	0	0	0.00%
Total assets	1,162,935,361	1,333,281,583	170,346,222	14.65%
Earning assets	1,090,962,975	1,246,163,280	155,200,305	14.23%
Total interbank assets	378,117,213	502,055,391	123,938,178	32.78%
Total foreign exchange assets	167,212,165	183,868,910	16,656,745	9.96%
Securities	377,791,590	410,298,509	32,506,919	8.60%
Total loans	442,361,143	480,956,640	38,595,497	8.72%
of which: classified loans	31,703,394	33,360,045	1,656,651	5.23%
loans to households	116,806,841	138,132,683	21,325,842	18.26%
loans to non-financial entrepreneurial entities	225,925,388	251,429,616	25,504,228	11.29%
Share of classified loans in total loans (%)	7.17	6.94	-0.23	x
Uncovered expected loss	10,355	8,524	-1,831	-17.68%
Provisions for loss	25,489,675	25,771,270	281,595	1.10%
Reserves for losses	6,961,072	6,568,068	-393,004	-5.65%
Registered share capital	41,433,475	41,450,201	16,726	0.04%
Own funds	100,626,465	101,198,408	571,943	0.57%
Secondary funds	183,301,896	281,583,997	98,282,101	53.62%
Primary funds	791,384,116	837,595,768	46,211,652	5.84%
- of which: non-anonymous deposits	423,290,430	406,639,649	-16,650,781	-3.93%
Current period profit*	12,287,442	7,581,098	656,575	9.48%
Current period loss*	6,614	3,251	3,251	0.00%
Net profit / loss*	12,280,828	7,577,847	653,324	9.43%
Cumulative profit / loss*	37,722,258	34,674,253	-8,290	-0.02%
Capital adequacy ratio (%)	18.68	14.78	-2.91	x

** Year-on-year data.*

6.3. Banking Supervision and Compliance with the Rules of Prudential Banking Business

The main task and mission of banking supervision is to ensure the stability and sound development of banks, the banking system, and to safeguard the interests of depositors.

In support of its pro-active approach to banking supervision, the Banking Supervision Division of the NBS issued a methodological instruction (No. 3/2005), regulating the system and process of internal inspection at banks and branches of foreign banks, pursuant to Article 23 paragraph 1 of Act No. 483/2001 Z.z. on banks and on amendments to certain laws as amended by subsequent regulations. The purpose of this methodological instruction was to set uniform rules for the conduct of internal inspection at banks and branches of foreign banks. The said directive is available on the NBS website and in the Official Journal of the NBS.

Within the scope of its licensing activity, the Banking Supervision Division had issued 71 decisions by 30 June 2005.

An overview of inspections carried out by the Banking Supervision Division in the first half of 2005 is presented in the following table:

	1st quarter		2nd quarter		1st and 2nd quarters	
Inspections	commenced	completed	commenced	completed	plan	actual state
Full-scope						
Follow-up						
Thematic	2		3	2	5	5
Total	2		3	2	5	5

One of the basic regulatory tools of banking supervision is a set of rules governing the prudential conduct of banking business and limits set on the basis of these rules.

At the end of June 2005, the adequacy of own funds ratio of the Slovak banking sector reached 14.78%. This figure was 3.90% below the level as at 31 December 2004. The adequacy of own funds limit (8%) was observed by all banks over the first half of 2005, since the values of the ratio fluctuated from more than 10% to less than 40%.

A new NBS decree on banks‘ large exposures (Decree No. 2/2004), amending NBS Decree No. 8/2002, entered into effect on 31 January 2004. Under Article 31 paragraph 9 and Article 32 paragraph 5 of the Banking Act No. 483/2001 as amended by subsequent regulations, banks are obligated to ensure compliance with the following large exposure limits:

The limit for a bank’s large asset exposure to a parent or subsidiary company, or a group of economically connected persons whose member the bank is (20% of own funds) was met by all banks in the first half of 2005.

The limit for a bank’s large exposure to another person, a group of economically connected persons, or to countries and central banks (25% of own funds), was not observed over the first half of the year by three banks; at 30 June 2005, the limit was met by all banks.

The limit for the sum of a bank’s large exposures (800% of own funds) was complied with by all banks in the first half of 2005.

The ratio of large exposure to a natural person in relation to the bank’s own funds (no more than 2%), was maintained by all banks over the first half of 2005.

The ratio of large exposure to a juristic person (except banks based in a Zone A country) in relation to the bank’s own funds (no more than 10%), was maintained by all banks over the first half of 2005.

The ratio of large exposure to all persons with a special relationship with the bank in relation to the bank’s own funds (no more than 40%), was maintained by all banks over the first half of 2005.

6.4. International Cooperation

Bilateral agreements on cooperation in the area of banking supervision

In order to ensure a smooth exchange of information between the supervisory authorities of individual countries and to boost the safe and sound operation of financial institutions, the Banking Supervision Division of the NBS closely cooperates with foreign supervisory institutions.

Negotiations are currently underway on the conclusion of a memorandum of understanding with the supervisory authorities of Belgium, Latvia, and Estonia.

On 1 July 2005, a memorandum of understanding entered into effect in respect of cooperation between supervisory authorities, central banks, and ministries of finance within the EU in times of financial crisis. The memorandum was signed with a view to strengthening the stability of the financial system.

7.1. Monetary Policy Instruments

1. Interest rate policy

Basic interest rate of the NBS [9]*(rate for two-week repo tenders):*

from 29 November 2004	4.00%
from 1 March 2005	3.00%

Interest rate for overnight refinancing operations:

from 29 November 2004	5.50%
from 1 March 2005	4.00%

Interest rate for overnight sterilisation operations:

from 29 November 2004	2.50%
from 1 March 2005	2.00%

2. Monetary policy instruments of the NBS

2.1. Open market operations

a) Main instrument - standard repo tender with a maturity of two weeks:
The NBS conducts standard repo tenders with commercial banks on a weekly basis, usually on Tuesdays. The NBS also sets an interest rate for such operations (the basic interest rate).

b) Instrument for longer-term liquidity control – issue of 84-day NBS treasury bills for the portfolios of commercial banks:
The NBS generally conducts auctions in NBS bills once a month, by using the American auction technique (the auctions planned for February and March 2005 were cancelled with regard to the situation on the foreign exchange market).

c) Fine-tuning instrument – quick tender:
An instrument of the NBS for fine-tuning the liquidity of commercial banks on an ad hoc basis. This instrument was not used in the first half of 2005.

d) Structural operations - individual transactions:
An instrument of the NBS enabling a direct purchase or sale of government securities and NBS bills for and from the NBS portfolio. This instrument was not used in the first half of 2005.

e) Foreign exchange swaps:
An instrument for fine-tuning the level of liquidity in the koruna area on a temporary basis, through forward exchange transactions. This instrument was not used in the first half of 2005.

2.2. Automatic operations (standing facilities)

a) Overnight refinancing operations:

[9] On 12 December 2002, the Bank Board of the NBS decided to introduce a basic NBS interest rate with effect from 1 January 2003. The basic interest rate of the NBS is identical with the limit rate for standard two-week NBS repo tenders. The term 'discount rate of the National Bank of Slovakia', or 'discount rate of the State Bank of Czecho-Slovakia', used in generally binding legal regulations, corresponds to the basic interest rate of the National Bank of Slovakia.

Commercial banks have automatic access to sources of finance (provided they have a sufficient amount 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.

3. Other instruments

a) *Redistribution loans:*

Redistribution loans were not granted in the first half of 2005.

b) *Short-term loans (as a last resort):*

This instrument was not used in the first half of 2005.

4. Reserve requirements

With effect from 1 January 2005, commercial banks, branches of foreign banks, home savings banks, and electronic money institutions are required to maintain minimum reserves in the amount of 2%:

– of demand deposits, time deposits and loans received in Slovak koruna or foreign currency;

– of deposits redeemable at notice and loans received in Slovak koruna or foreign currency;

– of debt securities issued in Slovak koruna or foreign currency, except for mortgage bonds.

Maintained reserves were evaluated on a monthly basis. Required minimum reserves held at the NBS on money reserve accounts were remunerated at a rate of 1.5% p.a.

5. Exchange-rate and foreign-exchange policies

a) *Exchange rate system:*

The National Bank of Slovakia used a floating exchange-rate regime in the first half of 2005. The exchange rate of the Slovak koruna was determined in relation to the euro, being the reference currency. The National Bank of Slovakia intervened in the foreign exchange market in the event of excessive volatility in the exchange rate of the Slovak koruna, and/or if the exchange rate did not correspond to the fundamentals of macro-economic development.

b) Nominal exchange rate of the SKK:

In relation to the euro, the nominal exchange rate of the Slovak koruna appreciated during the first half of 2005 by 1.1%, to SKK 38.370/EUR as at 30 June 2005. As a result of developments in USD/EUR cross-rate on the world markets, the exchange rate of the koruna depreciated against the US dollar by 11.7% in nominal terms, to SKK 31.825/USD at the end of the first half of 2005.

c) *Nominal and real effective exchange rates of the SKK[10]:*

[10] The methodology applied for calculating the nominal and effective exchange rates of the Slovak koruna (NEER and REER) is the same one used by the IMF. It uses the average monthly exchange rates of the Slovak koruna and the currencies of partner countries against the US dollar. The methodology is based on the producer price index, PPI (manufacturing products price index, PPI manufacturing). The initial year for the calculation is 1999, and the weights selected correspond to the structure of foreign trade with the sixteen

The nominal effective exchange rate of the Slovak koruna (NEER) was influenced in the first half of 2005 by the slowing rate of appreciation in the average exchange rate of the koruna against the US dollar (8.6%, compared with a year-on-year growth of 12.7% in the same period in 2004), and by the accelerating rate of appreciation in the koruna vis-à-vis the euro (4.3%, compared with 2.8%). The average year-on-year rate of growth in the NEER index slowed to 2.8%, from 5.5% in the first half of 2004.

The real effective exchange rate of the koruna (REER), based on the producer price index, depreciated year-on-year by an average of 1.1% (after appreciating in the first half of 2004 by 4.2%). On the basis of manufacturing products prices (excluding energy and mineral resources prices), the rate of depreciation in the REER index reached 1.7%, after increasing by 3.2% in the previous year.

d) Evaluation of the currency structure of foreign exchange receipts and payments in the Slovak Republic:

The total turnover of receipts and payments in convertible currencies in the payment categories 1 to 6 reached Sk 868.0 billion in the first half of 2005. The average monthly turnover stood at Sk 144.7 billion, which was 12.7% more than in the first half of 2004. Foreign exchange receipts and payments resulted in a negative balance of Sk 8.8 billion, as opposed to a surplus of Sk 13.2 billion in the first half of 2004.

In the long term, the currency structure of the total turnover is dominated by EUR and USD, with a total share of approximately 88-90% (from the introduction of the single currency in 1999). From 1999 to 2004, the share of the euro was on increase, while that of the US dollar and the Czech koruna decreased.

The increase in the share of the euro came to a halt last year, due to the rise in oil prices and consequent developments in the cross-rate of the dollar on the world markets. In 2005, the share of the dollar in foreign-currency payments and the total turnover continued to increase, together with the share of other currencies.

Currency structure of foreign exchange receipts and payments in 2002 to 2005

	2002	2003	2004 1st half	2004	2005 1st half
Total turnover (in billions of Sk)	1,385.6	1,536.8	770.4	1,657.5	868.0
of which: EUR (incl. former EMU currencies)	63.7%	69.8%	70.7%	70.2%	68.4%
CZK	9.3%	7.8%	7.5%	7.5%	7.6%
USD	23.2%	19.0%	18.5%	18.8%	19.9%
Other currencies*	3.8%	3.3%	3.3%	3.6%	4.1%
Turnover as a share of GDP (at current prices)	126.1%	127.9%	120.6%	125.1%	125.8%**

* HUF, DKK, NOK, SEK, CHF, GBP, AUD, JPY, CAD, and other currencies.

** Based on preliminary data = a quick estimate of GDP for Q2, 2005 (Statistical Office SR, 15 August 2005).

major trading partners of Slovakia, representing roughly 86 to 89% of the total turnover of foreign trade in 1993 - 2004. These countries are Germany, Czech Republic, Italy, Austria, France, the Netherlands, the USA, Great Britain, Switzerland, Poland, Hungary, Ukraine, Russia, Japan, China, and Turkey.

7.2. Chronology of Monetary Developments

January

- The President of the Slovak Republic appoints Ing. Ivan Šramko as Governor of the National Bank of Slovakia. Prior to his appointment (from 11 January 2002 to date), Mr. Ivan Šramko held the position of Vice-Governor of the NBS.
- The President of the Slovak Republic appoints Ing. Martin Barto, CSc. as Vice-Governor of the National Bank of Slovakia.
- With effect from January 2005, a pension reform is launched in Slovakia. On the one hand, the reform contributes to the sustainability of public finances, but in the short term, its costs represent a burden for public finances before the planned entry into the euro area.
- Moody's Rating Agency increases the long-term foreign exchange liability rating of Slovakia, from A3 to A2, as well as the rating of short-term liabilities, from P-2 to P-1. The Agency justifies this step with the ongoing government reforms, which are expected to lead to a gradual decrease in the deficit in public finances. The rating outlook is positive in both cases.

February

- The Bank Board of the National Bank of Slovakia discusses and approves the Communication Strategy of the NBS for the Period until 2009, which formulates the main goals, defines the target groups, and proposes tools for the achievement of these goals. The Strategy is devoted to communication with the general and professional public in the area of monetary policy in connection with the fulfilment of the 'Monetary Programme of the NBS for the Period until 2008'. The goal of the communication strategy is to keep the public informed, in an active and purposeful manner, of the Bank's decisions concerning monetary policy and/or the stability of the financial sector in the Slovak Republic, in order to boost people's confidence in the National Bank of Slovakia.
- With effect from 1 February 2005, the Bank Board of the NBS extends its plan of meetings to include a regular meeting on Tuesdays, devoted to the current situation on the financial market and approval of the results of regular repo tenders conducted for sterilisation purposes.
- An agreement is signed on the settlement of a dispute between the SR and Československá obchodná banka (ČSOB), a. s., Praha, by the Ministry of Finance of the SR, represented by Ivan Mikloš, and ČSOB, represented by Pavel Kavánek, Chairman of the Board, and Petr Knapp, Member of the Board of ČSOB. Under this agreement, Slovakia shall pay the bank almost Sk 25 billion. Of this amount, Sk 16 billion is to be paid to the Czech party by 11 February 2005; the funds are available in the form of state financial assets. The remaining Sk 8.8 billion is due pursuant to the agreement on 1 January 2006. This obligation caused an increase in the level of public debt.
- At its meeting on 28 February 2005, the Bank Board decides to reduce the key interest rates of the NBS to 2.0% for overnight sterilisation operations, 4.0% for overnight refinancing transactions, and 3.0% for two-week repo tenders with commercial banks (with effect from 1 March 2005). In view of the ongoing trend in the koruna exchange rate, the Bank Board of the NBS acknowledges that the appreciation of the Slovak koruna against the euro is still unreasonably fast.

March

- The European Union's finance ministers approve the reform of the Stability and Growth Pact, which sets the rules of budgetary discipline within the Union. The key provisions of the Pact – the limits for the budget deficit (3% of GDP) and the public debt (60% of GDP) – remain unchanged. The reform tightens the Pact in respect of good times, by requiring the member states to save when economic development is favourable. On the other hand, the amended Pact contains more flexible provisions for times of economic hardships, when countries will be allowed to slightly exceed the 3% deficit limit (in justified cases).

April

- The Bank Board approves the results of the first round of an anonymous public tender for the designs of the Slovak (reverse) sides of euro coins, which are to present the history, cultural and natural values of Slovakia, and are to be comprehensible to the citizens of other EU countries as well. Thirty-six designs were selected for the second round.

June

- Japan's R&I (Rating and Investment Information) agency increases the long-term liability rating of Slovakia for koruna liabilities, to BBB+ with a stable outlook.
- The Bank Board discusses and approves the 'National Euro Changeover Plan for the SR', which contains detailed solutions for the technical and organisational aspects of the euro introduction in the SR. The National Plan was elaborated by the NBS and the SR Ministry of Finance, in cooperation with some of the central institutions of Slovakia. It contains plans for the individual steps that are to be taken in the interest of the smooth and successful adoption and use of the single currency in the Slovak economy. The planned date for the introduction of the euro for both cash and cash-free payments, is 1 January 2009.

7.3. Licensing Activity of the NBS and Foreign Exchange Supervision

The National Bank of Slovakia performs the tasks of a foreign exchange authority, laid down in the Foreign Exchange Act (Act No. 202/1995 Z.z. of the National Council of the SR), and tasks prescribed by the National Bank of Slovakia Act (No. 566/1992 Zb.).

Despite the liberalisation of the country's foreign exchange system and the cancellation of the regulation of balance of payments operations on current and capital accounts through foreign exchange permits, foreign exchange regulations still apply to certain entrepreneurial activities related to operations in Slovak and foreign currency in cash or non-cash form (i.e. trade in foreign exchange assets and foreign exchange services), and to the conduct of foreign exchange operations on the financial market (which are rather risky and are not covered by the law on securities, i.e. financial derivatives). These activities are subject to a foreign exchange licence issued by the National Bank of Slovakia.

Licensing activity

In the first half of 2005, the National Bank of Slovakia issued foreign exchange licences as follows:

- 28 licences for the purchase of funds in foreign currency for Slovak currency in cash (to 8 legal entities and 20 natural persons);
- 33 licences for the sale of funds in foreign currency for Slovak currency (to 17 legal entities and 16 natural persons);
- 2 licences for cash-free transactions in financial means.

Foreign exchange supervision

In line with its approved strategy, the National Bank of Slovakia focussed its supervising activity on monitoring whether the reporting requirement is met by all entrepreneurial entities, and whether the conditions and tasks stipulated by foreign exchange regulations and those laid down in foreign exchange licences are fulfilled.

In total, 27 inspections were carried out within the scope of foreign exchange supervision.

7.4. Methodological Notes to Selected Indicators

1. Monetary statistics

1.1. Statistics of monetary aggregates (ECB methodology)

The methodology of the ECB is implemented on the basis of data from harmonised statements of monetary and banking statistics, which were introduced by the NBS in 2003. According to ECB methodology, monetary aggregates were calculated in 2003 and 2004 on the basis of a harmonised balance from the ‘M (NBS) 1-12 – Statistical Balance‘ monthly statement, from which the NBS compiles aggregated and consolidated balances for the ‘monetary financial institutions‘ (MFI) sector. In 2003, as in the national methodology, the MFI sector was composed of the National Bank of Slovakia, commercial banks with a registered office in the SR, home savings banks, and the local branches of foreign banks. With effect from January 2004, in accordance with the ECB methodology, the MFI sector was extended to include money market investment funds, which are now required to report to the NBS on a monthly basis (the list of all MFIs monitored by the NBS is regularly updated on the website of the National Bank of Slovakia)[11].

From the monthly statistical balances of resident MFIs, an aggregated balance sheet is compiled, as a summary of statistical balances of MFIs for assets and liabilities in all currencies. Then, a consolidated balance sheet is compiled from the aggregated balance sheet of MFIs, through the compensation (netting) of positions between the MFIs, as a basis for the calculation of monetary aggregates and the main counterparts of the M3 aggregate. During consolidation, the mutual relations of MFIs are excluded from the aggregated balance sheet as follows:

- liabilities arising from issued debt securities are reduced by debt securities issued by MFIs in the holdings of MFIs;
- deposits and loans received from MFIs are reduced by receivables from MFIs;
- liabilities arising from issued equity securities are reduced by MFI shares and other equities held by MFIs.

[11] The actual list of monetary financial institutions (MFIs) and detailed methodological information on harmonised monetary and banking statistics are available on the website of the National Bank of Slovakia (http://www.nbs.sk), in the ‘Harmonised Monetary and Banking Statistics’ section, within the ‘Banking Sector in the SR’ menu.

Calculation of monetary aggregates according to ECB and NBS methodologies

Methodology of the NBS	**Methodology of the ECB**
	(the items are included in the individual sub-aggregates in both Slovak koruna and foreign currency)
CURRENCY OUTSIDE BANKS [M0]	currency in circulation [M0]
+	+
DEMAND DEPOSITS (in SKK)	overnight deposits and received loans
= MONEY [M1 — 'narrow money']	**= M1 ('narrow money')**
TIME DEPOSITS (all maturities, in SKK)	+ deposits and received loans with an agreed maturity of up to 2 years
+	+ deposits and received loans redeemable at a period of notice of up to 3 months
FOREIGN CURRENCY DEPOSITS	**= M2 ('intermediate money')**
= QUASI-MONEY [QM – 'quasi money']	+ repurchase operations
	+ money market fund shares/units
	+ debt securities with a maturity of up to 2 years, and other money market products
M2 MONEY MARKET (=M1+QM)	**M3 MONETARY AGGREGATE ('broad money')**

The main differences between the individual methodologies are as follows:

- **in the definition of monetary financial institutions:**
  - the ECB methodology uses an extended file of monetary financial institutions (MFIs), which includes the NBS, commercial banks, and money market funds – the deposits of money market funds (MMFs) in commercial banks are treated in this sense as interbank operations and are not directly included in the monetary aggregates;
  - the NBS methodology includes only NBS and commercial bank liabilities in the monetary aggregates – hence the deposits of money market funds (MMFs) in commercial banks appear in the balance sheets of commercial banks as customer deposits of financial institutions and are directly included in the M2 money supply;

- **in the nature and liquidity of the resources:**
  - the ECB methodology monitors liquidity through the broader M3 aggregate, which also includes repo operations, the unit certificates of open-end money market investment funds, and debt securities, which represent, in terms of liquidity and profitability, a substitute for bank deposits (with regard to maturity, ECB liabilities with a maturity of over 2 years are not included in the monetary aggregates);
  - the NBS methodology monitors the money supply measured in terms of the M2 aggregate, which is composed of currency in circulation and bank deposits irrespective of the time of maturity;

- **in the definitions of deposits and loans:**
  - the ECB methodology extends the definition of deposits to include also subordinated debt in the form of deposits, liabilities arising from repo operations, and non-negotiable securities issued by banks and held by clients (in the case of loans, they also include non-marketable securities issued by

  clients and held by banks, subordinated debt in the form of loans, receivables in respect of repo operations, and tradable loans);
  - the NBS methodology uses a so-called ‘narrow definition’ for both loans and deposits, i.e. they only correspond to the amount of funds recorded by MFIs as loans (including classified loans) and deposits;

- **in the structure of monetary aggregates by sector:**
  - the ECB methodology (with the deposits of MMFs being deducted from customer deposits) covers the above sectors, as well as the deposits of local government (S.1313) and social insurance funds (S.1314)[12];
  - the NBS methodology includes deposits in the M2 money supply from the following economic sectors:
    - *non-financial corporations (S.11);*
    - *financial corporations (S.123 and S.124) – including MMF deposits;*
    - *insurance companies and pension funds (S.125);*
    - *non-profit institutions mainly serving households (S.15);*
    - *households (S.14 - sole traders);*
    - *households (S.14 - accounts of citizens).*

- **in respect of the residence of economic entities:**
  - the ECB methodology exclusively takes into account the funds of residents (in Slovak koruna as well as foreign currency);
  - the NBS methodology also monitors the koruna deposits of non-residents as part of the monetary aggregates;

- **in respect of accrued assets and liabilities:**
  - in the ECB methodology, accrued assets and liabilities are excluded from the monetary aggregates;
  - in the NBS methodology, accrued assets and liabilities are included in the deposit and loan accounts of clients;

- **in respect of the seasonal adjustment of time series:**
  - unlike the ECB methodology, the NBS methodology uses seasonally unadjusted data[13].

1.2 Statistics of monetary aggregates (NBS methodology – Monetary Survey)

In 2005, the reporting of credits to enterprises and households was affected by a methodological change, which resulted from the ruling of the International Center for the Settlement of Investment Disputes (ICSID) in Washington, settling the long-lasting trade dispute between ČSOB and the Slovak Republic (with regard to the fact that the claim of ČSOB on Slovenská inkasná, s.r.o., was originally classified in the Monetary Survey as a credit to enterprises). Since Slovenská inkasná, s.r.o. was placed under bankruptcy proceedings on 6 May 1998 and its liabilities were removed from the statistical records of the

[12] In the methodology of the NBS, the M2 money supply excludes public sector deposits, which are monitored separately as part of net credit to the general government.

[13] In the conditions of the NBS, the recording of seasonally adjusted data according to ECB methodology is currently in the stage of preparation.

NBS with effect from April 1998, the statistically recorded volume of credits to enterprises in the Monetary Survey was increased by the last known amount of ČSOB's receivable from Slovenská inkasná, s.r.o. in order to maintain the continuity of the time series concerned. As this receivable (including interest) has become a liability for the SR Government under the ruling of the international tribunal, it is currently monitored in the Monetary Survey separately, as part of 'Net Credit to General Government', without a need for further methodological adjustments to the statistically recorded volume of credits to enterprises and households (with effect from 1 January 2005).

In order to maintain the consistency of time series, credits to enterprises recorded in the Monetary Survey were revised in 2004 so that only the statistically recorded volume of loans is included, as in 2005 (excluding the claim of ČSOB on Slovenská inkasná).

1.3. Statistics of customer interest rates on new business volumes (ECB methodology)

As of the beginning of 2005, customer interest rates are evaluated according to ECB methodology, where interest rates are monitored on loans granted[14] and deposits received (new contracts). According to this methodology, the subjects of monitoring are interest rates on new business volumes. New loans and new deposits are understood to be contracts signed for the first time, fixing the rate of interest agreed between the bank and the customer, and new contracts negotiated with the active participation of the customer.

In a breakdown by sector, lending and deposit rates for households and non-financial corporations will be analysed in the way these sectors are defined in Directive No. 63/2002[15] of the European Central Bank, concerning interest rate statistics.

The monitoring of interest rates on loans to and deposits from households and non-financial corporations is expected to provide more detailed information on the functioning of the transmission mechanism, since interest rates are analysed irrespective of the sectors that have a special position vis-à-vis the banking sector, i.e. insurance companies, pension funds, and the general government sector.

The methodology of the ECB makes it possible to monitor interest rates according to the period of initial rate fixation (IRF) and, in the case of non-financial corporations, according to the volume of loans as well. The initial rate fixation is the period for which an agreed interest rate is fixed. According to IRF, loans are divided into loans with a floating rate and an IRF of up to 1 year (inclusive), loans with an IRF of over 1 and up to 5 years (inclusive), loans with an IRF of over 5 and up to 10 years (inclusive), and loans with an IRF of more than 10 years. According to volume, loans to non-financial corporations are divided into loans amounting to up to EUR 1 million and loans amounting to over EUR 1 million.

[14] The term 'granted loan' is an equivalent of the term 'new loan'.

[15] According to Article 1 paragraph 2 of Decree No. 63/2002 of the European Central Bank of 20 December 2001, concerning the statistics of interest rates of monetary financial institutions on loans to and deposits from households and non-financial corporations, the term 'households' as defined in Annex A in Directive No. 2223/96 of the European Communities of 25 June 1996 on the European System of National and Regional Accounts (ESA95) means the household sector – S.14 (i.e. households and sole traders) and non-profit institutions serving households – S.15, and the term 'non-financial corporations' means sector S.11.

Loans to households are classified by purpose as follows:

- current account overdrafts
- operating loans (for sole traders only)
- investment loans
- consumer loans
- loans for house purchase
    - mortgage loans
    - building loans
    - intermediate loans
    - other loans for house purchase
- other loans

Loans to non-financial corporations are classified by purpose as follows:

- current account overdrafts
- investment loans
- operating loans
- loans for house purchase
    - mortgage loans
    - building loans
    - intermediate loans
    - other loans for house purchase
- other loans

Classification of deposits (for both households and non-financial corporations):

- deposits repayable on demand
    - demand deposits
    - overnight deposits
- deposits with agreed maturity
    - up to 1 year
        - up to 7 days
        - up to 1 month
        - up to 3 months
        - up to 6 months
        - up to 1 year
    - over 1 year
        - up to 2 years
        - over 2 years
- deposits
    - redeemable at a period of notice of up to 3 months
    - redeemable at a period of notice of over 3 months

Interest rates on loans and deposits are calculated as a weighted arithmetical average of all interest rates on loans/deposits for each category separately. The weight of new loans represents the total amount laid down in contracts, regardless of whether the given amount is drawn within the month under review or not.

Subsidies granted to clients by third parties are not taken into account in determining the level of interest rates, because banks neither pay nor receive subsidies. For example, interest rates on mortgage loans with government bonuses were recorded last year without the state subsidies.

With effect from this year, the NBS will also monitor interest rates on new loans and new deposits in euros; they will be evaluated when a sufficiently long time series is available for the NBS (at least 12 months).

2. Balance of payments

Two methodological changes were introduced in 2005 in respect of the balance of payments.

One of them is a change in the methodology used for calculating the compensation of employees, consisting in a shift from data on the net income of people working abroad to their gross income (employee compensation comprises, unlike in previous years, the income of persons working abroad, including taxes and social contributions paid in the host country). Since taxes and social contributions paid in the host country, by which income from employee compensation is increased, are included in paid current transfers in the same amount as counterparts, the said change will have no impact on the overall balance of the current account.

The second change against the methodology applied in previous years is the reporting of reinvested earnings as part of the income balance. The Balance of Payments Department decided to extend the balance of payments to include reinvested earnings from foreign direct investments with effect from 2005, in accordance with the international standards. Before 2005, reinvested earnings were not included in the balance of payments on current account. Reinvested earnings were only recorded in the financial account as part of ‘foreign direct investments’, on the basis of data reported from the corporate sector in the DEV 1-12 monthly report (annual data from this report contained figures at the level of several millions and/or tens of millions of Slovak koruna). The 2005 estimate of reinvested earnings (ca Sk 30.0 billion) is based on data obtained from the new annual report on foreign direct investments in 2003, in which reinvested earnings are recorded according to the international accounting standards. With regard to the fact that the inflow of foreign capital into Slovakia in the form of direct investments exceeds its outflow several times, the use of data from this report will mean an increase in the current account deficit. Reinvested earnings will enter the balance via the capital and financial account, as part of ‘foreign direct investments’, and will cause no increase in the external imbalance of the Slovak economy.

* * *