



National Bank of Slovakia

**REPORT ON MONETARY DEVELOPMENT IN THE SR FOR THE FIRST  
HALF OF 2006**

**September 2006**

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## **INTRODUCTION**

In the first half of 2006 the National Bank of Slovakia continued to carry out monetary policy in accordance with the inflation targeting strategy in ERM II. In the Monetary Programme until 2008 the inflation target was set for the end of 2006 as a year-on-year rate of inflation measured by the harmonised index of consumer prices at below 2.5%. The inflation targets set for the end of 2007 and 2008 are to achieve inflation below 2%.

Economic and monetary development over the course of the first half year was characterised by an acceleration in price growth, particularly in connection with energy resources, as well as with a further acceleration of the rate of economic growth and growth in the rate of employment. In comparison with the corresponding period of previous year the trade deficit in the first half of 2006 increased, when growth both in imports and exports accelerated significantly. The relatively dynamic development of the economy was accompanied also by continuing growth in lending activities both to households and the business sector.

The year-on-year growth in consumer prices was influenced to a great extent by regulated prices, which were increased in the last quarter of 2005, and at the beginning of 2006. At the end of the first half of the year the annual rate of inflation (HICP) reached 4.5%, while without the impact of energy prices this rate would have been only 2.2%. In price development a gradual acceleration of the year-on-year growth in inflation was seen. This was primarily due to the faster growth in food prices, as well as prices of industrial goods excluding energy. These goods recorded year-on-year falls in the first months of the year, though from April their prices grew again on a year-on-year basis.

After a relatively dynamic development of the economy in 2005, a further acceleration in economic growth occurred in the first half of 2006, reaching 6.5% at constant prices. From the viewpoint of use, the structure of economic growth in the first half of 2006 was influenced by foreign and domestic demand. The growth in domestic demand, compared to the corresponding period of previous year, was lower, which was connected primarily with the lower stockbuilding. By contrast, the fixed capital formation accelerated moderately, occurring primarily in the non-financial corporations sector. Growth in consumer demand also accelerated, in consequence of development in final consumption of general government. Households consumer demand compared with the corresponding period of previous year recorded a slowing in the rate of growth, though continued to reflect wage growth, employment growth, as well as the availability of credits in the economy. Even though the Slovak economy in the first half of 2006 was characterised by relatively high import intensity, the negative contribution of net exports has significantly diminished due to the improvement in the economy's export performance.

The relatively dynamic growth of the economy was reflected also in a rise in employment and a fall in unemployment. In the first half of 2006 the relatively high growth in nominal wages persisted, though with regard to the regulated prices adjustments, the rate of real wage growth decreased. While in 2005 real wage growth outstripped labour productivity growth, in the first half-year wage growth fell below the level of productivity growth.



The continuing high economic activity is documented also by the rates of growth in imports and exports, which in the first half of 2006 exceeded 20%. This development reflected both the Slovak economy's high export performance, but also the growth in domestic demand and the development of raw material prices on world markets. With regard to the faster rate of growth of imports over exports the trade balance deficit in the first half of 2006 compared to the corresponding period of previous year rose from 4.5% of GDP to 5.9% of GDP. The share of the balance of payments current account deficit in GDP reached 8% in a year-on-year increase of 0.8 percentage points. Its level, however, was influenced to a large degree by reinvested profit, which on the other hand represents an inflow of FDI, as well as by dividend payment. Without the impact of these two items the current account deficit would have reached 3% of GDP.

Economic growth was also accompanied by continuing growth of lending activities. While in 2005 the growth in loans was concentrated primarily in the household sector, in the first half of 2006 relatively high rates of growth were recorded also in loans to non-financial corporations. The highest growth was recorded in investment loans, which mirrors the development of the structure of economic growth. Within the households sector the growth in lending activities remained concentrated on housing loans. The demand for this type of loan reflected the households' positive expectations regarding future development, and also favourable interest rates, which at the start of the year reached historic lows. Growth, however, was recorded also in consumer lending.

Monetary policy in the first half of 2006 was focused on achieving medium-term inflation targets and meeting the Maastricht inflation criterion. Since the last quarter of 2005 price development was influenced by growing prices of energy resources, with an impact on fuel prices, and also by regulated prices, where the probability of their further additional adjustments concurrently rose. Both January and April NBS medium-term projections indicated that the inflation target for 2006 would be exceeded. Even if regulated prices represent a cost-based and one-off factor of price development, which is defined as an exception from inflation targeting and is outside the scope of monetary policy, their high rate of growth can adversely influence inflation expectations in the economy. This risk is increased in an environment of fast economic growth, accompanied by growth in employment, wages, household consumption and high investment activity, i.e. factors pointing to a boom in the economic cycle. With the aim of eliminating inflation risks and minimising the room for the transmission of secondary effects of adjustments to regulated prices, the NBS has in the first half of 2006 raised the base rate twice, in total by 1 percentage point. The increase in NBS key rates began gradually to be reflected also in the prices of loans and interest rates on deposits from the business sector, as well as from households. The report also includes a comparison of interest rates on selected types of deposits and loans against those in the euro area.

Exchange rate policy was conducted in the framework of the ERM II exchange rate mechanism, which the Slovak koruna entered on 28 November 2005. Central parity was set at the level of 38.4550 SKK/EUR, and the koruna uses a standard fluctuation band of  $\pm 15\%$ . Slovakia did not adopt a unilateral commitment to maintain a narrower fluctuation band. The agreement on participation of Slovakia in the ERM II is based on the commitment of Slovakia to pursue sound fiscal policies and promote wage developments that are kept in line with productivity growth. This policy is in conformity



with the Convergence Programme of the Slovak Republic and the Monetary Programme of the NBS. Throughout almost the whole of the first half of 2006 the Slovak koruna has been traded on the strong side of the standard ERM II fluctuation band. Until the beginning of March the Slovak koruna continued to experience appreciation, which stopped thereafter and since May the exchange rate has depreciated to the central parity level. This development was a consequence of regional influences and political instability. The depreciation of the exchange rate and its volatility were not in line with economic fundamentals. The NBS therefore undertook foreign exchange interventions aimed at stabilising the exchange rate and eliminating the influence of non-economic factors.

In the coming period monetary policy will remain aimed at meeting the NBS inflation targets and creating favourable conditions for fulfilling the Maastricht criteria and Slovakia's entry to the euro area.

For the first time the Report on Monetary Development in the SR for the First Half of 2006 does not contain information on development of the banking sector, since the NBS, at the same date, is submitting the Report on the State and Development of the Slovak Financial Market for discussion by the SR Parliament, on the basis of its obligation resulting from Article 1(3)(e) of Act No 747/2004 Coll. on financial market supervision as amended.



## 1. ECONOMIC DEVELOPMENT

### 1.1 Price development

#### *Inflation measured by the harmonised index of consumer prices (HICP)*

The year-on-year rate of inflation in June 2006, as measured by the harmonised index of consumer prices (HICP), reached 4.5%, which against December 2005 (3.9%) meant a growth of 0.6 percentage points. Prices of goods were 5% higher on a year-on-year basis and prices of services 3.6% higher. Core inflation, which in the concept of HICP represents the aggregate excluding prices of energy and non-processed foods, recorded a year-on-year growth of 2.2% (1.2% in December 2005). The average rate of inflation in the first half of 2006 reached 4.4% (2.5% in the corresponding period of previous year) and average 12-month inflation reached 3.7% at the end of the first half of 2006.

The level of overall inflation during the first half of 2006 was considerably influenced by regulated prices, forming more than 50% of the price growth. Over the course of the first half of 2006 the year-on-year rate of inflation gradually accelerated. This was primarily due to an acceleration in the year-on-year rate of growth in food prices, as well as the development in prices of industrial goods excluding energy. Prices of industrial goods excluding energy in the first 3 months of the year recorded year-on-year falls and from April they grew on a year-on-year basis. On the other hand the year-on-year rate of growth in the prices of services slowed.

Consumer prices according to HICP (year-on-year change in %)

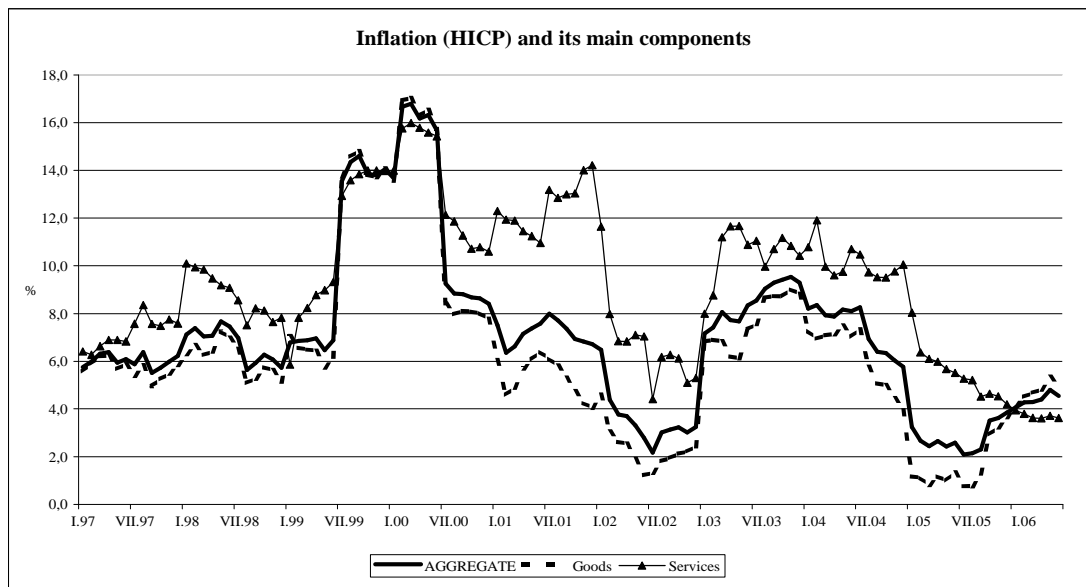
	2005	2006					
	Dec.	Jan.	Feb.	March	April	May	June
Aggregate	3.9	4.1	4.3	4.3	4.4	4.8	4.5
Goods	3.7	4.1	4.5	4.7	4.8	5.4	5.0
Industrial goods	6.0	6.8	6.8	6.7	6.6	7.0	6.8
Industrial goods (excl. energy)	-0.9	-0.4	-0.5	-0.4	0.0	0.3	0.2
Energy	15.5	16.4	16.6	16.3	15.4	16.1	15.6
Food	-0.3	-0.3	0.6	1.3	1.7	2.6	2.1
Food – processed (incl. alcohol and tobacco)	-1.6	-1.0	-0.1	0.4	0.3	0.8	0.9
Food – unprocessed	2.7	1.3	2.1	2.9	4.3	5.8	3.9
Services	4.2	3.9	3.8	3.6	3.6	3.7	3.6
Core inflation (aggregate excl. energy and unprocessed food)	1.2	1.7	1.8	1.8	2.0	2.2	2.2
Aggregate excl. energy	1.4	1.5	1.7	1.8	2.1	2.4	2.2

Source: Statistical Office of the SR and NBS calculations based on data from the Statistical Office of the SR

Consumer prices according to HICP (year-on-year change in %)

	1 <sup>st</sup> half-year 2005	2005	Q1 2006	Q2 2006	1 <sup>st</sup> half-year 2006
Aggregate	2.5	2.8	4.2	4.6	4.4
Goods	0.9	1.6	4.4	5.0	4.7
Services	6.3	5.5	3.8	3.6	3.7
Core inflation (aggregate excl. energy and unprocessed food)	2.0	1.7	1.8	2.1	1.9





Source: Statistical Office of the SR

### Goods

In the first half of 2006 the growth in prices of goods, prices of industrial goods, and food prices were the driving element. At the start of 2006 prices of regulated items (water, electricity, gas and other energies) grew, which was reflected also in a high year-on-year growth in energy prices throughout the whole of the first half of 2006. In connection with the considerable growth of oil prices on world markets, fuel prices also grew at a high rate. Their rate of growth however recorded a gradual slowdown over the course of the half year. The main factors influencing the price development of industrial goods excluding energy was on the one hand the slowdown in the year-on-year fall in prices of durable goods (mainly prices of motor vehicles) and on the other hand an acceleration in the year-on-year growth in prices of non-durable goods, primarily in consequence of the growth in regulated prices of pharmaceutical products.

Food prices in the first half of 2006 gradually accelerated the rate of year-on-year growth, culminating in May. The development of food prices was also influenced by an acceleration in the year-on-year growth of prices of unprocessed food, as well as the development in prices of processed food. Prices of processed food recorded a fall on a year-on-year basis in the first 2 months of 2006 and from March their rate of growth gradually quickened. In prices of processed food the greatest impact on the acceleration of their year-on-year growth came from the development of bread and cereals prices, as well as those of non-alcoholic drinks. The development of prices of alcoholic drinks was influenced by the change in excise duty from January 2006, which however was reflected in consumer prices for alcoholic drinks only in the second quarter after old supplies had been exhausted.

### Services

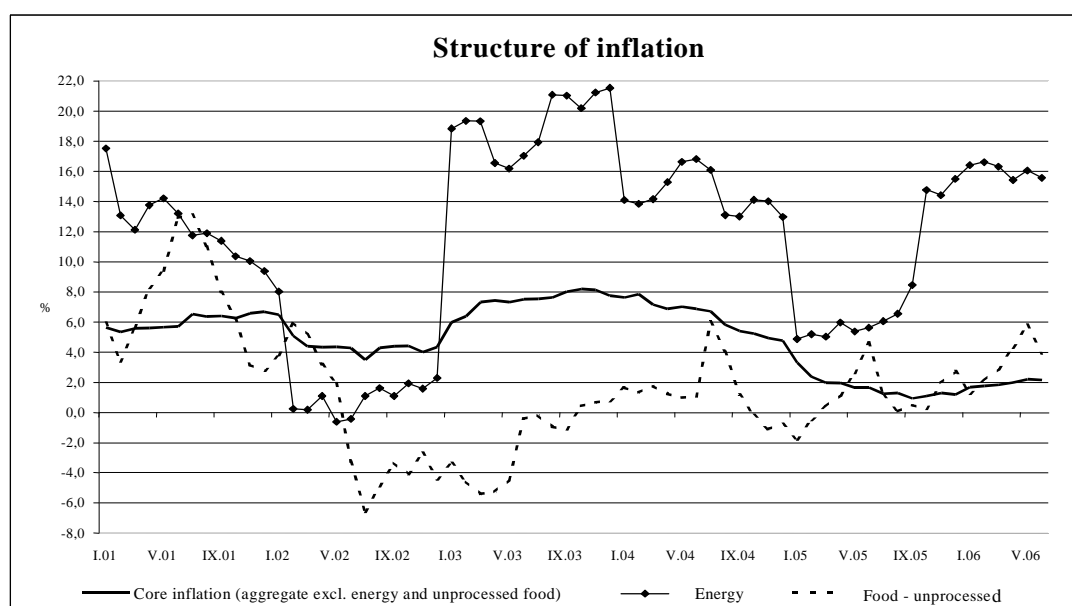
In prices of services the fastest growth on a year-on-year basis was recorded in prices of housing (at an average of 5.7%) as well as in prices of other services (6.9%). Prices of housing throughout the first half of 2006 maintained approximately the same rate of



growth. In prices of housing sewerage prices grew significantly at the start of the year. A slowdown in the year-on-year growth was recorded in prices for transport, recreation and personal services and other services. An acceleration in the year-on-year rate of price growth was recorded also in postal and telecommunications services.

### Core inflation

The year-on-year rate of core inflation (aggregate excluding energy and non-processed foods) in June 2006 compared with December 2005 rose by 1.0 percentage points to 2.2%. Within core inflation an acceleration was seen in the rate of growth in prices for processed food, as well as those for industrial goods excluding energy. Conversely, prices for services recorded a moderate fall in their year-on-year rate of growth.



Source: Statistical Office of the SR

### Inflation as measured by the consumer price index (CPI)

The price level, measured by the consumer price index (CPI) grew on a year-on-year basis in June 2006 by 4.6%. In comparison with the end of last year the growth in consumer prices quickened by 0.9 percentage points. On average over the first six months of 2006 inflation reached 4.5% and the average 12-month inflation reached 3.6% at the end of the first half of 2006.

The quickening in the year-on-year rate of consumer price growth in the first half of 2006 was due to the acceleration in the rate of price growth in all basic sectors of the consumer basket (food prices, fuel prices, market services) and the slowdown in the fall in tradable goods excluding fuels. The most significant component of price growth was the sector of regulated prices. In the first half of 2006 growth occurred primarily in prices for electricity, gas, heat, water and sewerage, as well as prices in the field of health care.





## Core inflation

The year-on-year rate of core inflation in June 2006 reached 2.5%, having risen in comparison with December last year by 0.8 percentage points. Within its structure the year-on-year growth in food prices over the course of the first half year grew gradually up until May, which was connected with the gradual slowdown in the fall of processed food prices and the quickening growth in prices for unprocessed food. Over the course of the first half year aggregate prices for tradable goods were affected by the volatile development of fuel prices. Prices of tradable goods excluding fuel prices throughout the first half year recorded a slowdown in their year-on-year fall. The year-on-year rate of growth in prices for market services was influenced in the first half year by the increase in prices for cost services at the start of the year, which was connected also with the secondary effects of adjustments to regulated prices.

Development of consumer prices (year-on-year change in %)

Structure of consumer basket	Dec. 2005	2006					
		Jan.	Feb.	March	April	May	June
<b>Aggregate in %</b>	<b>3.7</b>	<b>4.1</b>	<b>4.4</b>	<b>4.5</b>	<b>4.5</b>	<b>4.8</b>	<b>4.6</b>
<b>Regulated prices in %</b>	<b>11.1</b>	<b>11.5</b>	<b>11.5</b>	<b>11.2</b>	<b>11.3</b>	<b>11.3</b>	<b>11.3</b>
<i>share in aggregate in % points</i>	2.44	2.89	2.83	2.77	2.76	2.75	2.73
<b>Impact of changes in indirect taxes on non-regulated prices – share in aggregate in % points</b>	<b>0.00</b>	<b>0.08</b>	<b>0.08</b>	<b>0.08</b>	<b>0.08</b>	<b>0.08</b>	<b>0.08</b>
<b>Core inflation in %</b>	<b>1.7</b>	<b>1.9</b>	<b>2.2</b>	<b>2.4</b>	<b>2.4</b>	<b>2.8</b>	<b>2.5</b>
<i>share in aggregate in % points</i>	1.29	1.15	1.49	1.60	1.62	2.00	1.76
of which:							
Food prices in %	-0.2	-0.6	0.0	0.5	0.9	1.8	1.0
<i>share in aggregate in % points</i>	-0.03	-0.13	-0.03	0.04	0.10	0.27	0.12
Tradable goods in % <sup>1</sup>	-0.2	0.0	0.2	0.3	0.2	0.7	0.4
<i>share in aggregate in % points</i> <sup>1</sup>	-0.06	-0.05	0.02	0.02	0.02	0.19	0.08
Market services in % <sup>1</sup>	5.1	5.8	6.2	6.2	6.1	6.2	6.1
<i>share in aggregate in % points</i> <sup>1</sup>	1.37	1.32	1.51	1.53	1.51	1.53	1.56
<b>Net inflation (excluding effect of changes in indirect taxes) in %</b>	<b>2.1</b>	<b>2.5</b>	<b>2.9</b>	<b>2.9</b>	<b>2.8</b>	<b>3.1</b>	<b>2.9</b>
<i>share in aggregate in % points</i>	1.32	1.28	1.53	1.55	1.53	1.72	1.64

Source: Statistical Office of the SR

<sup>1</sup> NBS calculations from Statistical Office of the SR source data

Development of consumer prices according to CPI (year-on-year change in %)

	1 <sup>st</sup> half year 2005	2005	Q1 2006	Q2 2006	1 <sup>st</sup> half year 2006
Aggregate	2.7	2.7	4.3	4.6	4.5
Regulated prices	7.6	8.2	11.4	11.3	11.4
Core inflation	1.1	1.1	2.2	2.6	2.4
Net inflation (excluding effect of changes in indirect taxes)	1.2	1.8	2.8	2.9	2.9

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

## Producer prices

### Industrial producer prices for domestic market

Industrial producer prices in the first half of 2006 rose in comparison with the corresponding period of previous year on average by 9.6%, due to the growth in prices of



all 3 basic subcategories. Prices of manufacturing products grew on a year-on-year basis by 2.3%, prices for electricity, gas, steam and hot water by 16.8% and prices of mining and quarrying products by 45%.

The year-on-year growth in industrial producer prices was caused mainly by the growth in oil prices on world markets (an increase roughly from an average of 50 USD/barrel in the first half of 2005 to almost 66 USD/barrel in the first half of 2006), which in the first half of this year brought an almost quadrupling of energy prices compared to the first half of 2005. Energy prices (given their approximately one-third weighting within of industrial producer prices) contributed significantly in the first half of 2006 to an increase in the average price of industrial producer prices (more than 70%) in comparison with previous year (almost 56%).

Development of producer prices (year-on-year change in %)

	2005	2006					
	Dec.	Jan.	Feb.	March	April	May	June
Industrial producer prices (domestic market)	7.0	8.7	9.8	9.9	9.8	9.9	9.1
<i>prices of manufacturing products</i>	1.0	1.7	2.4	2.2	1.7	2.9	3.1
<i>prices of mining and quarrying products</i>	35.4	41.4	41.4	45.9	46.5	48.5	46.4
<i>prices of electricity, gas, steam and hot water</i>	13.3	15.9	17.8	17.8	18.1	16.7	14.5
Industrial producer prices (export)	3.2	3.2	4.6	3.9	1.9	3.2	4.9
Construction prices	3.6	3.6	3.9	3.9	3.9	3.7	3.8
Building material prices	1.2	0.8	1.1	0.7	1.3	1.6	2.4
Agricultural product prices	-1.3	-1.1	-1.5	-2.2	-1.9	-1.0	-1.1
<i>prices of plant products</i>	-4.1	-11.5	-12.5	-10.9	-8.3	-6.3	-5.6
<i>prices of animal products</i>	0.8	1.0	0.8	-0.8	-1.2	-0.5	-0.6

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

Development of producer prices (year-on-year change in %)

	1 <sup>st</sup> half year	
	2005	2006
Industrial producer prices (domestic market)	3.3	9.6
<i>prices of manufacturing products</i>	2.7	2.3
<i>prices of mining and quarrying products</i>	-1.1	45.0
<i>prices of electricity, gas, steam and hot water</i>	4.5	16.8
Industrial producer prices (export)	7.6	3.5
Construction prices	4.9	3.8
Building material prices	7.0	1.3
Agricultural product prices	-0.4	-1.5
<i>prices of plant products</i>	-15.7	-9.8
<i>prices of animal products</i>	2.3	-0.2

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

The significant year-on-year increase in energy prices in the first half of 2006 (by 16.8% compared to 4.5% in the first half of 2005) was primarily due to the growth in prices for gas production and gas fuel pipeline distribution (by 31.7% compared to 10.8%). Prices for the supply of steam and hot water also grew more significantly than in previous year (by 19.3% compared to 4.2%), as did electricity generation and distribution prices (by



8.5% compared to 0.5%). Water treatment and distribution prices grew in the first half of 2006 more slowly (by 9.4%) than in the same period of previous year (by 13.4%).

Refined oil product prices in 2006 were a determining factor in the growth in the average price of manufacturing products (growing on average by 28.6% compared to 17.1% in the first half of 2005). Prices of paper and paper products, of machinery and equipment, and of electrical and optical equipment grew moderately. On the other hand prices of food products had a counter-inflationary effect (falling by 1.6%), as did prices of base metals and finished metal products (falling by 0.2%, having recorded an increase of 13% in the first half of 2005).

Prices of mining and quarrying products, even despite their significant increase (45%), contributed relatively little to the growth in average industrial producer prices, given their relatively low weighting within the aggregate category.

#### *Industrial producer prices for export*

Prices of manufacturing products intended for export recorded in the first half of 2006 only half the year-on-year growth of that in the first half of 2005 (growing on average by 3.5% compared to 7.6%). This was caused primarily by the fact that prices of base metals and finished metal products, which have a significant weighting within the average producer export price, following high growth in the first half of 2005 (by 24.1%) fell in the first half of 2006 (by 6.5%). A further cause of the lower growth in producer export prices compared to the same period of previous year was the deepening fall in prices for transport vehicles (falling by 6.4% compared to 5.7% in previous year). Prices of chemical products after having risen by 11.7% in the first half of 2005 grew in the first half of 2006 by 1.1%. Prices of food products also contributed in a certain degree to the lower rate of growth in producer export prices, when in the first half of 2006 they fell by 0.9%, having risen in the same period of previous year by 2.4%. Conversely, oil product refinery export prices had a strong pro-inflationary effect (growing by 41.3%, compared to 24.5% in previous year), as did prices of electrical and optical equipment (growing by 20.3% compared to 5.8% in previous year) and prices of machinery and equipment (growing by 2.6% compared to 0.8% in previous year). Changes in the export prices of other commodities had a minimal influence on the average export price of industrial production prices in the first half of 2006.

#### *Agricultural production prices*

The aggregate fall in prices of agricultural output products in the first half of 2006 in comparison with the same period of previous year deepened on average by 1.1 percentage points to 1.5%. Prices of agricultural primary output products were lower in consequence of a fall of both in crop production prices (by 9.8%), and of livestock production product prices (by 0.2%).

The fall in agricultural primary output products was not reflected appropriately in the development of consumer prices for food, which in the first half of 2006 grew on average on a year-on-year basis by 0.6% (CPI methodology). Food prices for the consumer are influenced not only by primary producer prices, but also by food processor prices, import



prices and point-of-sale pricing policy. Within the structure of foods in the first half of 2006, prices of unprocessed food grew on average (whereas prices of processed foods declined moderately), which was probably influenced by a growth in prices of imported crop products.

The decrease in prices of plant output products did not reach the level of previous year, primarily due to the lower fall in prices for cereals (by 10.7% compared to 17.9%), as well as by prices for potatoes (by 8.5% compared to 8.8%) and fruit prices (by 3.3% compared to 3.8%). Prices of vegetables rose by 1.5%, having fallen by 2.3% in the first half of 2005.

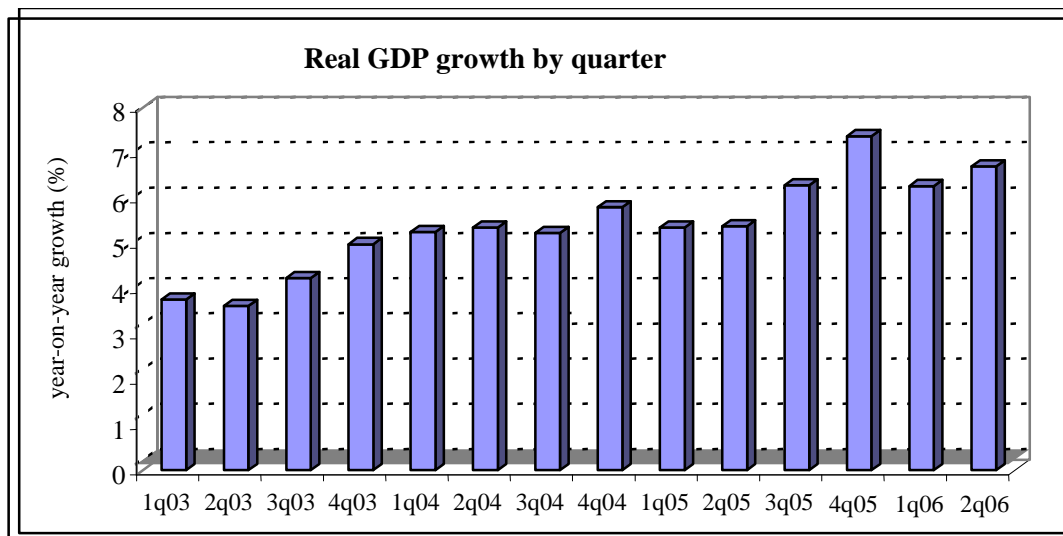
While in the first half of 2005 animal output product prices rose by 2.3%, for the same period in 2006 their prices fell by 0.2%. This was caused by a deepening fall in the price of slaughter poultry (by 6.5% compared to 3.4%) and a decrease in prices of raw cow's milk (by 0.7% compared to an increase of 3.5% in the first half of 2005). Prices of slaughter pigs grew slower than in previous year (by 0.4% compared to 9.4%), as did prices of slaughter cattle including calves (by 3.1% compared to 4.9%).

## **1.2 Gross domestic product**

Gross domestic product (GDP) grew in the first half of 2006 according to revised data from the Statistical Office of the SR by 6.5% at constant 2000 prices. In comparison with the first half of 2005 its rate of growth quickened by 1.1 percentage points. Economic growth came from an increase in both domestic and foreign demand. From the production aspect it was connected with the growth in value added, particularly in trade services, financial services and public services. The nominal volume of created GDP represented SKK 772.6 billion, which was 9.6% more than in previous year.

From the aspect of individual quarters real economic growth gradually accelerated from 6.3% in the first quarter to 6.7% in the second quarter. The rate of real GDP growth quickened in the second quarter of 2006 on a year-on-year basis by 1.3 percentage points, due in part to net export and domestic demand. In domestic demand the year-on-year increase in final consumption was caused primarily by development in the general government sector. Investment activity in the individual sectors of the economy supported real economic growth by 1.9 percentage points in the second quarter of 2006, even if it did not achieve the rate of growth from previous year.

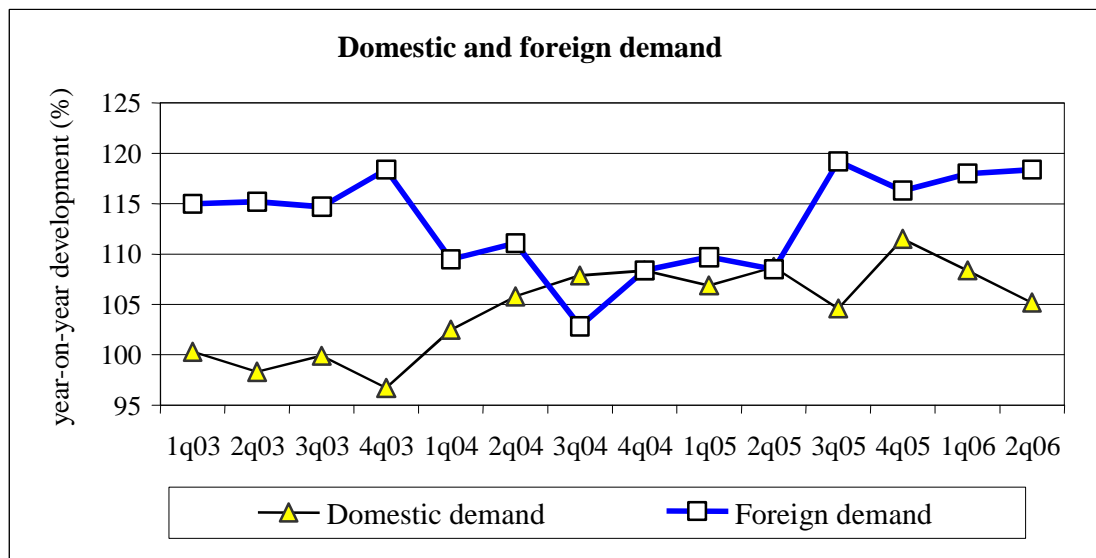




Source: Statistical Office of the SR

### Demand

From the aspect of use the structure of economic growth in the first half of 2006 was influenced by foreign and domestic demand. Growth of foreign demand (18.2% at constant prices) exceeded by almost triple the rate of growth in domestic demand (6.7%) having a stimulatory effect on the overall performance of the domestic economy. All components of domestic demand had a pro-growth effect on economic growth.



Source: SR Statistical Office of the SR

Domestic demand in the first half of 2006 did not achieve the rate of growth from previous year (7.8%), which was connected primarily with the lower growth in supplies. The consumption element of domestic demand rose on a year-on-year basis by 6.1%, which meant a moderate acceleration (of 0.7 percentage points) in its rate of growth compared to the first half of 2005. This development was influenced in particular by the consumption expenditures of general government, which grew on a year-on-year basis by



6.0% (having grown in the first half of 2005 by 0.2%), while consumption by non-profit institutions serving households fell on a real basis and household consumption grew more slowly than in the first half of 2005.

Gross domestic product by use (index, same period of previous year = 100, constant 2000 prices)

Indicator	2005		2006		
	1 <sup>st</sup> half year	year	Q1 06	Q2 06	1 <sup>st</sup> half year
Gross domestic product	105.4	106.1	106.3	106.7	106.5
Domestic demand	107.8	108.0	108.4	105.2	106.7
Final consumption	105.4	105.3	106.6	105.7	106.1
Households	107.3	107.2	106.6	105.9	106.3
General government	100.2	100.5	106.7	105.5	106.0
Non-profit inst. serv. h'holds.	98.8	97.0	100.5	95.6	98.0
Gross capital formation	114.1	115.3	113.4	104.1	108.0
Gross fixed capital formation	108.8	113.8	116.1	106.9	110.8
Export of goods and services	109.1	113.5	118.0	118.4	118.2
Import of goods and services	112.0	115.5	120.8	115.1	117.8

Source: Statistical Office of the SR

The growth in gross capital formation (8% at constant prices) was influenced by fixed investments, which grew on a year-on-year basis by 10.8%. The balance of supplies rose in the first half of 2006 in absolute terms by SKK 21.1 billion at constant prices, though did not achieve the rate of growth seen in previous year. This fact was reflected in the lower rate of growth in gross capital in comparison with the corresponding period of previous year. The structure of gross fixed capital formation indicates an increase in capital investment productivity and subsequently also of the economy's performance in the future, since businesses allocated their investment funds in purchasing new fixed assets (a growth of 11.9% at constant prices), while the volume of acquired used non-current assets fell (by 5.5%).

As viewed from the national accounts sectors the growth in the fixed assets was influenced most by the investments of non-financial corporations, which was connected with foreign and domestic investments. They were probably supported also by the financial management results of non-financial corporations, the profitability of which grew on a year-on-year basis in the first half of 2006 by more than 17% (by more than 13% in previous year) The largest volume of capital investment funds (71% of the total volume) was used by non-financial corporations to procure new fixed assets. The investment activity of individual subjects was relatively equally distributed across the spectrum of industrial branches, where investments grew on a real basis in almost all sectors, with the exception of mineral raw material extraction, the production of coke and oil products. Businesses invested most in building, in the production of metal products and in trade. The real growth in gross fixed capital formation came in part thanks to also the investment activity of households and the general government sector, which was connected primarily with a growth in state budget capital expenditures.



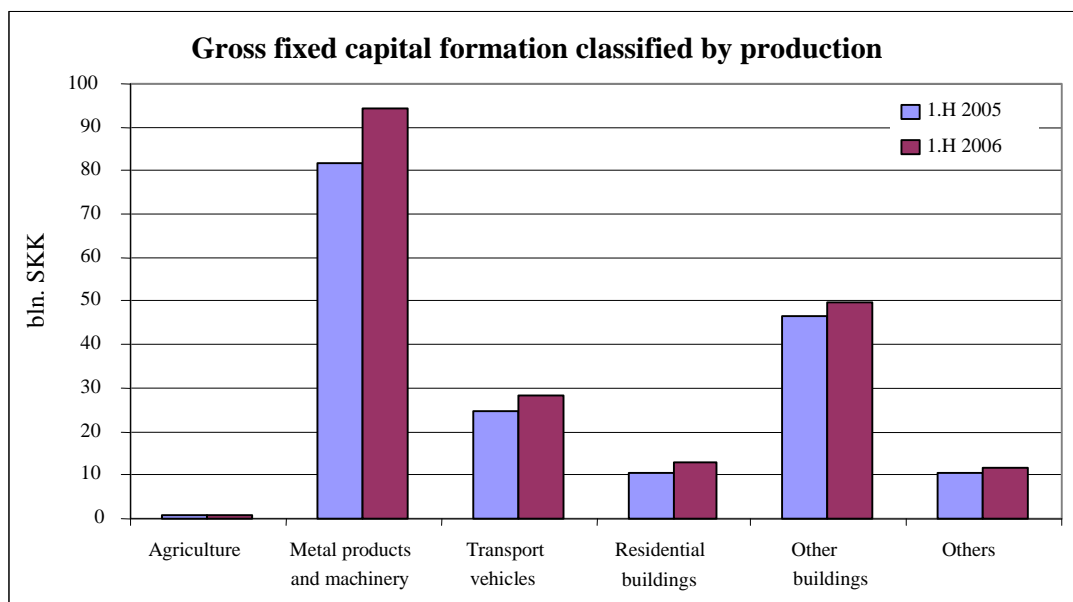
Structure of gross fixed capital formation for the first half of 2006

	Gross fixed capital formation (SKK mill.)	Share (%)	Index
			$\frac{1^{\text{st}} \text{ half 2006}}{1^{\text{st}} \text{ half 2005}}$
Economy of the SR in total	<b>197 823</b>	<b>100.0</b>	<b>110.8</b>
<i>of which by sector:</i>			
Non-financial corporations	138 294	69.9	115.2
Financial corporations	3 430	1.7	101.2
General government	12 381	6.3	103.5
Households	43 221	21.8	101.6
Non-profit institutions	497	0.3	90.6
<i>of which by production classification:</i>			
Machinery	<b>122 478</b>	<b>61.9</b>	<b>113.1</b>
of which: metal products and machines	94 216	47.6	113.4
transport equipment	28 262	14.3	112.4
Buildings and structures	<b>62 616</b>	<b>31.7</b>	<b>106.0</b>
of which: buildings for housing	13 005	6.6	115.5
other buildings	49 611	25.1	103.9

Source: Statistical Office of the SR

Note: Volume and share at current prices, indices at constant 2000 prices.

In the first half of 2006 investments grew on the real basis in all categories of production. The fastest growth in investment was seen in machinery, which was connected with extensive creation of added value and with capital investment activity in industrial production (13.6% at constant prices). Building investment grew more slowly compared to investment in machinery, whereby its share in gross fixed capital formation fell on a year-on-year basis by almost 1 percentage point to 31.7%. Within building investment, investments in buildings for housing grew fastest, which was probably connected with the development of the investment activities of households and general government.



Source: Statistical Office of the SR



From the aspect of the financing of capital investment demand the share of domestic funds in its financing fell. The savings rate in the economy in the first half of 2006 fell in comparison with the value for the corresponding period of previous year by 1.4 percentage points to 24.4%. At the same time however the rate of investment in gross capital grew slightly (from 29.1% in the first half of 2005 to 29.4% in the first half of 2006). In consequence of this development the gap between savings as the unconsumed part of GDP and gross investment widened. While in the same period in 2005 domestic savings managed to cover 88.9% of gross investment, in the first half of 2006 this figure was almost 6 percentage points lower.

Investment and savings	(%)		
	1 <sup>st</sup> half of 2005	2005	1 <sup>st</sup> half of 2006
<i>current prices</i>			
Savings rate <sup>1</sup>	25.8	24.0	24.4
Gross investment rate <sup>2</sup>	29.1	28.4	29.4
Fixed investment rate <sup>3</sup>	24.8	26.0	25.6
Coverage of investments by savings <sup>4</sup>	88.9	84.3	83.0
<i>constant 2000 prices</i>			
Savings rate <sup>1</sup>	27.2	25.4	27.5
Gross investment rate <sup>2</sup>	29.8	29.6	30.2
Fixed investment rate <sup>3</sup>	25.7	27.2	26.7
Coverage of investments by savings <sup>4</sup>	91.4	85.7	91.0

<sup>1</sup> share of gross domestic savings (GDP less total final consumption) in GDP

<sup>2</sup> share of gross capital formation in GDP

<sup>3</sup> share of gross fixed capital formation in GDP

<sup>4</sup> proportion of gross domestic savings and gross investment

The growth in final consumption was primarily due to households and general government. Consumption expenditures of non-profit institutions fell. An accelerating element of total consumption were expenditures on final consumption in the general government sector, the rate of growth of which grew on a year-on-year basis by 5.8 percentage points to 6.0%. The growth in final consumption by general government was connected primarily with a growth in wages and employment in general government, but also with more extensive purchases of goods and services from businesses and with the growing volume of social transfers in kind from the state.

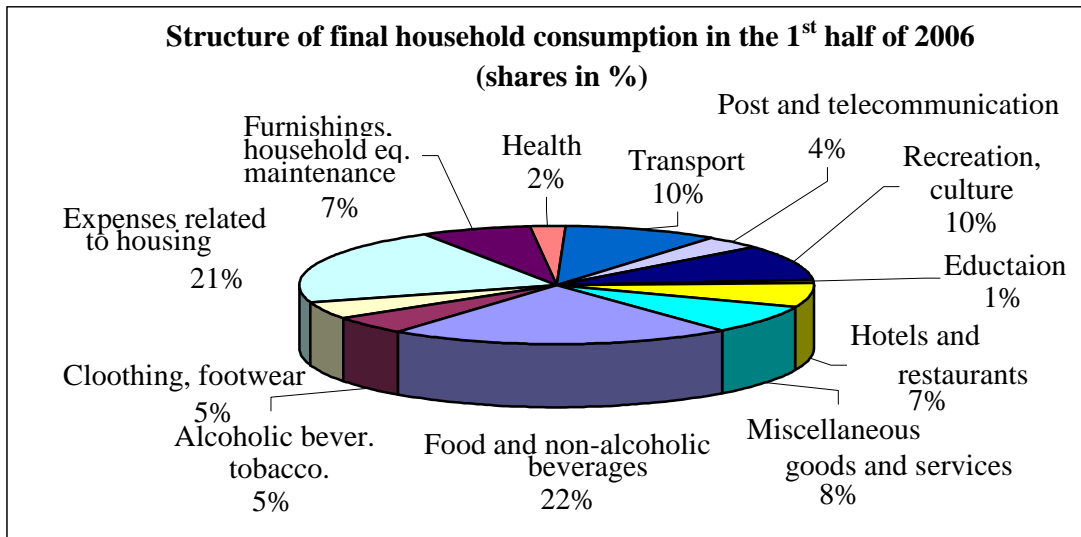
Final consumption by households grew on a year-on-year basis by 6.3% in the first half of 2006, its share in total GDP reaching 55%. The development of final consumption by households was influenced by a growth in wages and employment, as well as continued borrowing. The share of total loans, provided by monetary financial institutions (MFIs) to households in final consumption by households reached 23.5% at the end of the first half of 2006 (compared to 19% at the end of the first half of 2005).

From the aspect of year-on-year growth in the first half of 2006 the greatest increases in households' expenditures were on restaurants and hotels; on furniture, furnishings and ordinary house maintenance; post and telecommunications as well as clothing and footwear. In evaluating the development of the consumer behaviour of households, a certain qualitative shift is discernable in the preferences and possibilities of individuals to spend more on services, or household furnishings. The greatest share in consumption



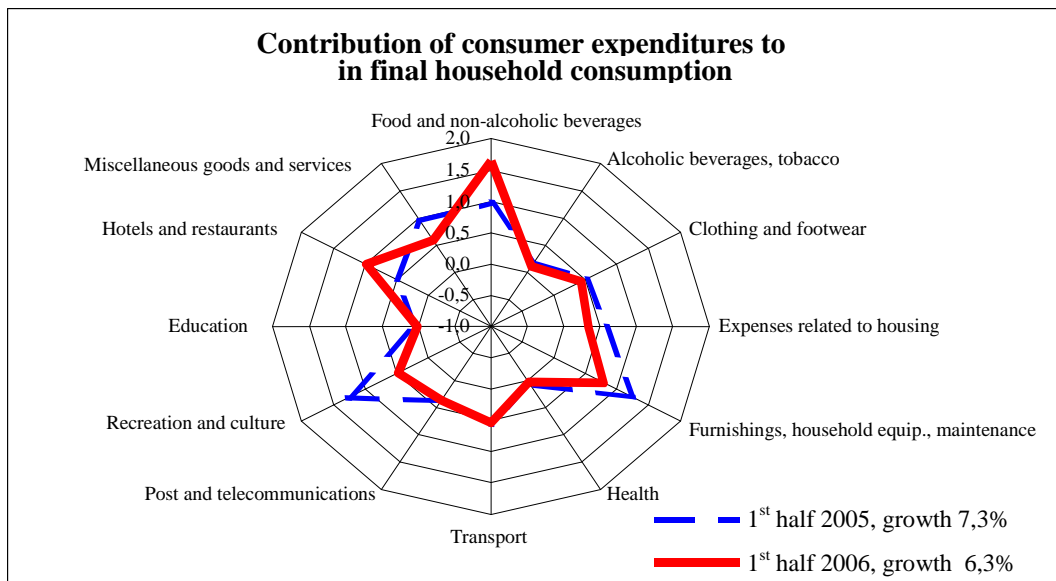


(22%) was formed by expenditures on foods and non-alcoholic drinks and expenditures connected with housing (21%).



Source: Statistical Office of the SR

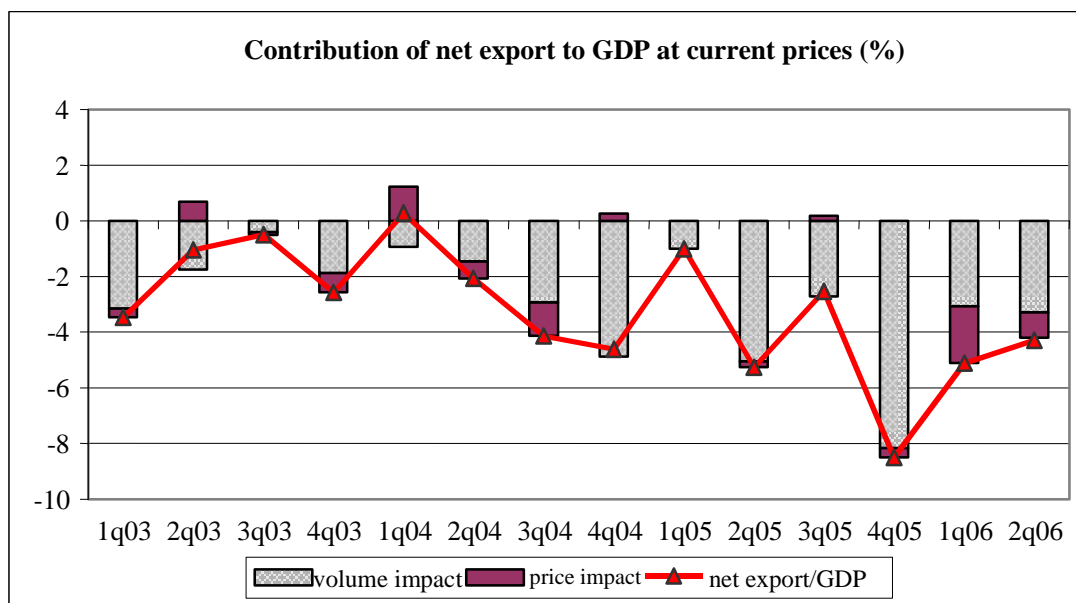
As regards relative contributions, the growth in final household consumption was founded primarily on higher consumption expenditures on foods and non-alcoholic beverages; hotels and restaurants and furnishings household equipment and routine maintenance of dwellings.



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

The rate of growth in the export and import of products and services reached double figures in the first half of 2006, where a higher rate of growth in imports (at current prices) over exports was manifested in a year-on-year worsening in the balance of trade deficit. The nominal net export reached a deficit of SKK 36.1 billion (compared to

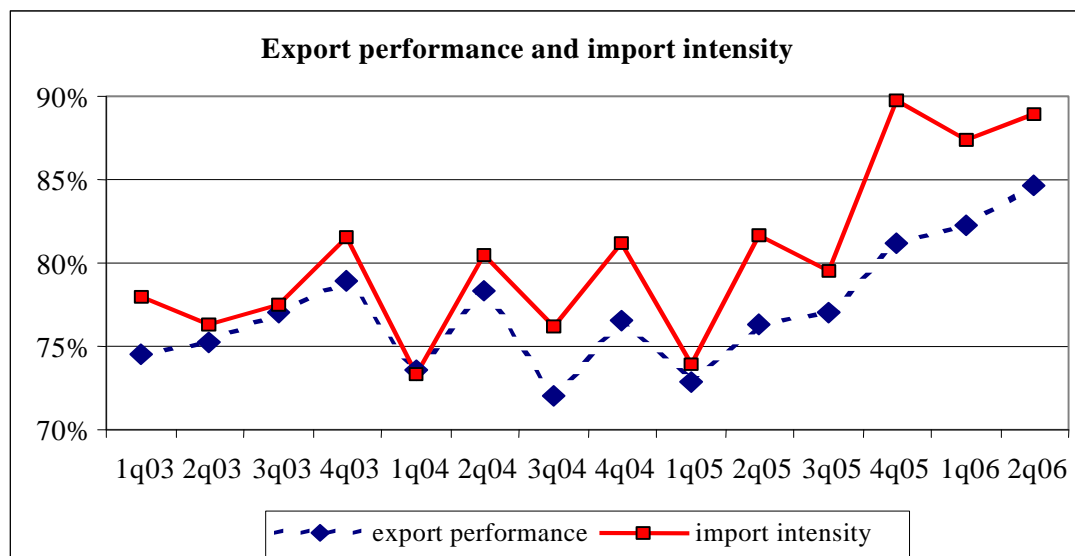
SKK 22.7 billion in the first half of 2005). This deepening in the nominal deficit was caused by the growth in imports of products and services, primarily in connection with imports of technology for investment needs in individual sectors.



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

The development of import prices in foreign trade expressed by deflators for the import of products and services was connected primarily with growing energy raw material prices. Prices of exported goods and services likewise grew, though to a lesser degree than import prices, since these were dampened by the fall in export prices for transport vehicles. From the preliminary quarterly national accounts it can be seen that approximately one third of the balance of trade deficit at current prices is caused by the adverse development of foreign trade relations.

The Slovak economy's export performance in the first half of 2006 improved on a year-on-year basis, when the share of exports of products and services in GDP at constant prices reached 83.5% (compared to 74.7% in the first half of 2005). With the growing export performance the import intensity also grew, which on a year-on-year basis grew even faster, reaching 88.1% (compared to 77.9% in previous year). The Slovak economy's openness, measured as the share of exports and imports of products and services in nominal GDP increased on a year-on-year basis in the first half of 2006 by 19 percentage points to reach 171.6%.



Source: Statistical Office of the SR

The supply side of the economy reacted to the higher foreign demand by faster creation of added value and a growth in imports. The net export at constant prices, after taking account of the development on foreign markets, in the first half of 2006 reached a deficit of SKK 14.9 billion (compared to SKK 14.6 billion in the first half of 2005). The result of foreign trade was a slightly negative contribution from the net export to GDP in the amount of 0.1 percentage points. Domestic effective demand contributed 7.2 percentage points to GDP growth, the change in level of supplies, including statistical discrepancy had a dampening effect of 0.6 percentage points.

Contributions to GDP growth (percentage points, constant 2000 prices)

Indicator	2005		2006		
	1 <sup>st</sup> half yr	year	Q1 06	Q2 06	1 <sup>st</sup> half yr
Gross domestic product	5.4	6.1	6.3	6.7	6.5
Domestic demand	7.8	8.2	8.4	5.4	6.8
Final consumption	4.0	4.0	4.9	4.1	4.4
Households	3.9	3.9	3.8	3.2	3.5
General government	0.0	0.1	1.1	0.9	1.0
Non-profit inst. serv. h'olds	0.0	0.0	0.0	0.0	0.0
Gross capital formation	3.9	4.2	3.5	1.3	2.4
Gross fixed capital formation	2.2	3.5	3.7	1.9	2.8
Change in balance of supplies	1.7	0.7	-0.2	-0.6	-0.4
Net export	-2.5	-2.0	-2.5	2.2	-0.1
Export of goods and services	7.6	11.2	15.5	16.1	15.8
Import of goods and services	10.1	13.3	18.0	13.9	15.9
Statistical discrepancy	0.0	0.0	0.4	-0.9	-0.3

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

Note: Deviations in subtotals are due to rounding.

### Supply

GDP creation in the first half of 2006 was connected with the development of added value, which grew on a year-on-year basis by 8.7% at constant 2000 prices (compared to 4.7% in the same period of previous year). Net taxes, which include value-added tax,



excise duty, import duty after removing subsidies fell by 8.4% (compared to the increase of 10.3% in previous year).

The creation of added value was influenced by higher gross production and a growth in intermediate consumption. In consequence of almost equal growth in gross production and intermediate consumption the rate of value added in the SR economy stayed at approximately the same level as in previous year, reaching 40.4% at constant prices (40.3% in the first half of 2005).

Gross domestic product creation and its components

(index, same period of previous year = 100, constant 2000 prices)

	2005		2006		
	1 <sup>st</sup> half yr	year	Q1 06	Q2 06	1 <sup>st</sup> half yr
Gross production	102.8	103.6	108.3	108.8	108.6
Intermediate consumption	101.6	102.8	108.0	108.9	108.5
Value added	104.7	104.8	108.6	108.8	108.7
Other <sup>1)</sup>	110.3	116.3	90.4	92.7	91.6

1) Value-added tax, excise duty, import duty less subsidies

Source: Statistical Office of the SR

With the exception of industry, construction, healthcare and social care all sectors achieved growth in value added. A high rate of growth in value added was recorded in trade (35.2%), transport, posts and telecommunications (24.3%) and in hotels and restaurants (21.7%), which was reflected in a significant growth in value added in trade services. Value added also grew dynamically in the sectors real estate, renting and business services (12.6%), where from among the public service sectors value added grew in the fields of other social and personal services (33.8%) and in public administration, defence and compulsory social security (13.1%).

Gross domestic product by sector

(index, same period of previous year= 100, constant 2000 prices)

Sector of economic activity	2005	2006			
	1 <sup>st</sup> half yr	year	Q1 06	Q2 06	1 <sup>st</sup> half yr
GDP	105.4	106.1	106.3	106.7	106.5
of which:					
Agriculture, hunting, forestry and fishing	107.9	110.5	103.2	104.5	103.9
Industry in total	111.0	108.6	97.4	98.1	97.7
Mining and quarrying	124.8	108.8	51.2	73.2	62.3
Manufacturing	112.6	109.6	104.0	101.9	102.9
El., gas and water supply.	102.7	102.6	75.2	75.5	75.3
Construction	120.5	118.1	80.0	115.2	98.6
Services in total	98.4	100.1	122.7	115.5	118.8
Business services	100.8	105.9	142.5	121.3	130.3
Financial services	94.4	94.4	106.4	115.0	110.7
Public services	99.9	98.0	114.4	105.3	109.4
Other <sup>1)</sup>	110.3	116.3	90.4	92.7	91.6

1) Value-added tax, excise duty, import duty less subsidies

Trade services: trade; hotels and restaurants; transport, warehousing, posts and telecommunications

Financial services: financial intermediation; real estate, rental and business activities

Public services: general government and defence, compulsory social security; education; health care and social assistance; other social and personal services

Source: Statistical Office of the SR, data revised in September 2006



The fall in value added in industry (by 2.3%) was primarily due to the significant fall in added value in the production and distribution of electricity, gas and water (by 24.7%). Conversely, the creation of value added in industrial production grew (by 2.9%), resulting mainly from the production of foods, drinks and tobacco products, the production of metals and metal products, and the production of machinery, electrical equipment and transport vehicles.

Gross domestic product by sector (contribution to growth, % points)

Sector of economic activity	2005		2006		
	1 <sup>st</sup> half yr	year	Q1 06	Q2 06	1 <sup>st</sup> half yr
GDP	100.0	100.0	100.0	100.0	100.0
of which:					
Agriculture, hunting, forestry and fishing	0.4	0.5	0.1	0.2	0.2
Industry in total	3.4	2.6	-0.9	-0.6	-0.7
Construction	1.1	1.1	-1.2	1.0	-0.1
Services in total	-0.8	0.1	9.5	7.1	8.2
Business services	0.2	1.2	7.1	4.4	5.7
Financial services	-0.9	-0.9	1.0	2.1	1.5
Public services	0.0	-0.2	1.4	0.6	1.0
Other <sup>1)</sup>	1.3	1.8	-1.2	-0.9	-1.1

1) Value-added tax, excise duty, import duty less subsidies

Trade services: trade; hotels and restaurants; transport, warehousing, posts and telecommunications

Financial services: financial intermediation; real estate, rental and business activities

Public services: general government and defence, compulsory social security; education; health care and social assistance; other social and personal services

Note: Contributions are rounded to one decimal place, due to which summary lines do not correspond to the contributions total.

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

### 1.3 Labour market

#### *Wages, labour productivity*

The average monthly nominal wage of an employee in the SR economy in the first half of 2006<sup>1</sup> grew by 8.0% on a year-on-year basis to SKK 17 822. Its rate of growth slowed by 1.1 percentage points compared to the first half of 2005. Over the course of the half year nominal wage growth accelerated from 7.1% in the first quarter to 8.8% in the second quarter.

The fastest nominal wage growth in the first half of 2006 was recorded in the sectors: financial intermediation (11.3%), education (10.3%), agriculture (9.3%), general government, defence and compulsory social security (9.1%), real estate, rental and business activities (8.9%) and trade and repair activities (8.7%).

<sup>1</sup> Since 2006 a methodological change has been made in reporting of the monthly wage, according to which incomes of the armed forces are included in wages. This methodological change is reflected both in the overall level of the average monthly nominal wage in the SR economy, as well as in the sector general government, defence and compulsory social security. The Statistical Office of the SR published data for the second quarter of 2006 and retrospectively recalculated the data only for the first quarter of 2006.



From the aspect of the form of ownership business sector employees in enterprises with 20 or more employees achieved nominal wage growth of 7.9%, in small enterprises of up to 19 employees 10.4%, in government organisations 10.1%, and in government-subsidised organisations 8.4%.

Real wage growth slowed significantly compared to the first half of 2005 (from 6.3% to 3.3%), which was influenced not only by a slowdown in nominal wage growth, but also by higher average inflation than in previous year. Over the course of the half year real wage growth accelerated from 2.7% in the first quarter to 4.0% in the second quarter of 2006.

Real wage growth in the first half of 2006 was recorded in all sectors of the economy. The fastest growth was seen in the financial intermediation (6.5%), education (5.6%), agriculture (4.6%), general government, defence and compulsory social security (4.4%), real estate, rental and business activities (4.2%) and trade and repair activities (4.0%).

Average monthly wages and labour productivity in the SR economy

(index same period of previous year = 100)

	2005		2006		
	1 <sup>st</sup> half yr	year	Q1	Q2	1 <sup>st</sup> half yr
Nominal wage (index)	109.1	109.2	107.1	108.8	108.0
Real wage	106.3	106.3	102.7	104.0	103.3
Labour productivity, current prices	105.4	106.3	106.2	107.9	107.2
Labour productivity, constant prices	102.6	103.8	103.9	104.3	104.2
Real labour productivity minus real wage (% points)	-3.7	-2.5	1.2	0.3	0.9
<i>Consumer prices (average for period)</i>	<i>102.7</i>	<i>102.7</i>	<i>104.3</i>	<i>104.6</i>	<i>104.5</i>

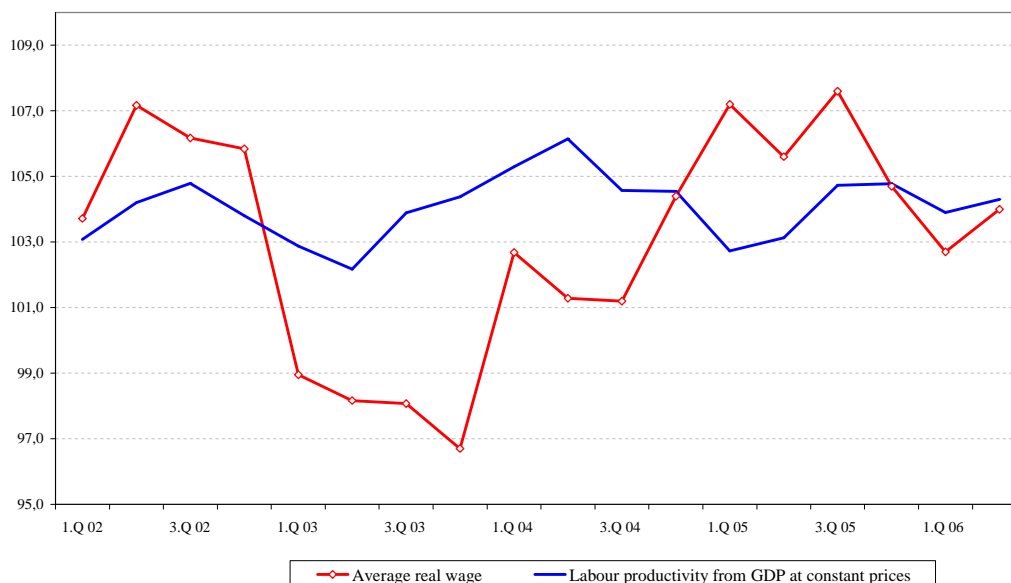
Source: Statistical Office of the SR and NBS calculations based on data from the Statistical Office of the SR

Labour productivity calculated from revised GDP and employment data according to quarterly statistical reports

Labour productivity (GDP per employee) in the first half of 2006 grew in nominal terms by 7.2%, in real terms by 4.2%. Compared to the first half of 2005 the rate of labour productivity growth accelerated in nominal terms by 1.8 percentage points and in real terms by 1.6 percentage points. The rate of real labour productivity growth exceeded real wage growth in the first half of 2006 by 0.9 percentage points. Whereas in the first quarter labour productivity exceeded the real wage by 1.2 percentage points, in the second quarter this gap fell to 0.3 percentage points.



Real wages and real labour productivity



Indices: same period of previous year = 100

Data source: Statistical Office of the SR, NBS calculations

Real labour productivity as broken down by sector, calculated from data in the ESA 95, recorded growth in most sectors. Within the service sector the fastest growth was achieved in the field of other social and personal services (30.5%), trade and repair activities (27.2%), transport, posts and telecommunications (24.2%) hotels and restaurants (11.7%). In the production sector the fastest real labour productivity growth occurred in manufacturing (4.6%) and agriculture, forestry and fishing (4.8%). Conversely, a significant fall in labour productivity was recorded in mining and quarrying (35.0) electricity, gas and water supply (23.6%) and construction (10.3%). A comparison of real labour productivity and real compensation per employee shows that in electricity, gas and water supply, financial intermediation and public services, compensation growth in the first half of 2006 outstripped labour productivity growth, while the reverse occurred in other sectors.

Real labour productivity and compensation per employee in the first half of 2006

(index same period of previous year = 100)

	real labour productivity (ESA)	real compensation per employee
National Economy in total	104.2	102.6
Agriculture, forestry and fishing	104.8	99.3
Industry Total	99.4	100.7
mining and quarrying	65.0	101.1
manufacturing	104.6	100.0
electricity, gas and water supply	76.4	107.3
Construction	89.7	96.9
Wholesale and retail trade, repair activities	127.2	109.1
Hotels and restaurants	111.7	100.7
Transport, storage, post and telecommunications	124.2	102.0
Financial intermediation	106.5	108.0
Real estate, renting and business activities	106.7	94.9
Public administration, defence, compulsory social security	107.9	110.0
Education	99.8	102.8
Health and social services	101.6	107.8
Other community, social and personal services	130.5	89.2
HICP (1 <sup>st</sup> half year 2006)		104.4

Source: Statistical Office of the SR, NBS calculations

### ***Household incomes and expenditures***

According to preliminary revised data from the Statistical Office of the SR current household incomes rose in the first half of 2006 on a year-on-year basis by 11.0% to reach SKK 602.3 billion, representing real growth of 6.5%. The growth in nominal current incomes was 3.2 percentage points faster than in the corresponding period of previous year. Households' current expenditures (expenditures paid by individuals to other sectors and not directly consumed) grew on a year-on-year basis by 5.5% (in real terms by 1.0%) to SKK 127.9 billion. In the corresponding period of previous year current expenditures grew by 1.8%.

The faster growth in current incomes was influenced mainly by the significant growth in the volume of the gross mixed income<sup>2</sup> (by 16.4%), higher growth in employee compensation and growth in annual income from property. Only the rate of growth in social security benefits recorded a slowdown.

With the exception of other current transfers (the growth of which slowed), all other expenditure items contributed to the acceleration in the rate of growth in current expenditures, where a third fastest growth was recorded in expenditures connected with incomes from property and current taxes on income and property.

<sup>2</sup> The gross mixed income of households includes profit and annual income from business by small enterprises, it also includes the value of households self-supplying with agricultural products, imputed rent and households contribution to their own individual house construction.





Generation and use of incomes in the households sector (current prices)						
Item	SKK billion		index <sup>1</sup>		share in %	
	Q1-2	Q1-2	Q1-2 05	Q1-2 06	Q1-2	Q1-2
	2005	2006	Q1-2 04	Q1-2 05	2005	2006
Compensation of employees (all sectors)	270.9	294.9	106.5	108.9	49.9	49.0
of which: gross wages and salaries	213.0	235.8	109.3	110.7	39.2	39.2
Gross mixed income	158.1	184.0	111.6	116.4	29.1	30.6
Incomes from property – received	14.2	15.7	85.5	110.3	2.6	2.6
Social security benefits	81.3	88.2	112.9	108.5	15.0	14.6
Other current transfers – received	18.2	19.6	98.0	107.2	3.4	3.2
<b>Current income in total</b>	<b>542.7</b>	<b>602.3</b>	<b>107.8</b>	<b>111.0</b>	<b>100.0</b>	<b>100.0</b>
Incomes from property – paid	3.9	4.5	101.6	117.1	3.2	3.5
Current taxes on incomes, property, etc.	16.7	17.6	94.2	105.5	13.8	13.8
Social security contributions	82.4	86.5	102.3	105.1	68.0	67.7
Other current transfers – paid	18.2	19.2	107.1	105.2	15.1	15.0
<b>Current expenditure in total</b>	<b>121.2</b>	<b>127.9</b>	<b>101.8</b>	<b>105.5</b>	<b>100.0</b>	<b>100.0</b>
<b>Gross disposable income</b>	<b>421.6</b>	<b>474.5</b>	<b>109.7</b>	<b>112.5</b>	<b>x</b>	<b>x</b>
Adjustment for changes in the net equity of households in the reserves	1.6	1.4	121.6	89.3	x	x
Final household consumption	399.0	446.2	109.8	111.8	x	x
gross savings of households	24.2	29.7	108.9	122.7	x	x

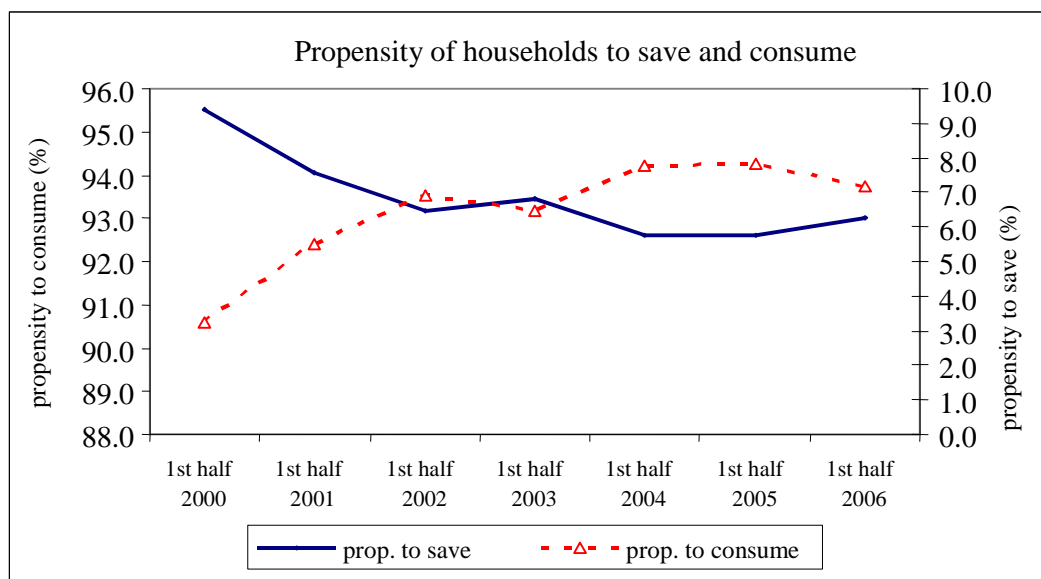
<sup>1</sup>Indices calculated from values expressed in SKK million

Data source: Statistical Office of the SR

After settling current expenditures from current incomes households had gross disposable income of SKK 474.5 billion for further use, representing a growth of 12.5% (compared to 9.7% in previous year). Of their disposable income households used 93.7% for final consumption, directing the remainder into gross savings. The dynamic growth in households gross savings (22.7%) was clearly influenced by the low comparison base for the corresponding period of previous year, though probably also by the growth in households incomes, particularly the gross mixed income. The influence of pension savings in the second and third pillar on the creation of households' gross savings decreased compared to the first half of 2005 (SKK 1.4 billion compared to SKK 1.6 billion). The overall increase in the rate of gross savings, which exceeded the growth in gross disposable income, was reflected in the households' gross savings rate (6.3%), which was slightly higher than in previous year (5.7%).

	Gross disposable income (index same period of previous year = 100, current prices)				
	2005		2006		
	1 <sup>st</sup> half year	year	Q1	Q2	1 <sup>st</sup> half year
Gross disposable income	109.7	110.6	112.8	112.3	112.5
Final household consumption	109.8	110.0	112.2	111.5	111.8
Gross household savings	108.9	118.4	123.6	121.9	122.7
Gross savings as a share of gross disposable income (%)	5.7	7.8	5.7	6.8	6.3





## Employment

In the first half of 2006 employment recorded dynamic development, when according to statistical surveys and the ESA 95 national accounts methodology, its growth reached 2.2% (2.1% in the first quarter, 2.3% in the second quarter). The year-on-year growth in employment according to Labour Force Sample Survey (LFSS) reached 4.1%, which was almost twice as fast as a year earlier. The acceleration in the rate of employment according to LFSS was due to increased demand for labour in the domestic part of the economy, when the number of persons working in the SR economy grew by 2.7% (compared to 1.1% in previous year), as well as the growth in the number of persons working aboard by 28.9% (25.3% in the first half of 2005).

### Rate of employment and unemployment

(average for the period)

	2005		2006		
	1 <sup>st</sup> half yr	year	Q1	Q2	1 <sup>st</sup> half yr
Employment according to statistical reports*					
'000 persons	2 057.9	2 075.0	2 097.1	2 140.1	2 130.9
index, same period of previous year =100	102.4	102.2	102.3	102.3	102.2
Persons working according to LFSS					
'000 persons	2 187.1	2 216.2	2 257.5	2 294.6	2 276.1
index, same period of previous year =100	102.2	102.1	103.7	104.5	104.1
Employment according to ESA 95					
'000 persons	2 066.0	2 084.0	2 101.5	2 121.8	2 111.7
index, same period of previous year =100	101.4	101.4	102.1	102.3	102.2
Unemployment according to LFSS					
'000 persons	443.6	427.5	395.8	357.1	376.5
index, same period of previous year =100	88.6	88.9	85.7	84.0	84.9
Rate of unemployment according to LFSS in %	16.9	16.2	14.9	13.5	14.2
Rate of registered unemployment in % **	12.2	11.6	11.6	10.7	11.1

\* since 2006 includes armed forces: indices are calculated from revised data

\*\* NBS calculation from monthly data from the Office of Labour, Social Affairs and the Family

Source: Statistical Office of the SR



The fastest year-on-year growth in employment (according to the ESA 95 methodology) was recorded in the first half of the year in construction, when demand for labour in services also grew, which was manifested in a growth in employment, particularly in hotels and restaurants, trade and in real estate, rental and business activities. Employment in general government and defence, including compulsory social security also recorded high growth, while education recorded a turnaround in its declining employment observed last year to a growth this year. On the other hand a lower rate of employment than last year was recorded in industry (mainly in consequence of the fall in employment in industrial production), financial intermediation, healthcare, and the long-term decline in employment in agriculture persisted.

Employment by sector (ESA 95 methodology)	(index, same period of previous year = 100)				
	2005		2006		
	1 <sup>st</sup> half yr	Year	Q1	Q2	1 <sup>st</sup> half yr
Total	101.4	101.4	102.1	102.3	102.2
Agriculture, hunting and forestry	95.4	95.3	99.3	98.9	99.1
Industry	100.2	98.7	98.9	97.8	98.3
Mining and quarrying	93.8	93.9	94.1	97.7	95.9
Manufacturing	100.6	98.9	99.0	97.8	98.4
Electricity, gas and water supply	96.3	97.0	98.9	97.8	98.5
Construction	105.5	104.0	112.2	107.9	109.9
Trade	104.3	107.8	103.4	109.2	106.3
Hotels and restaurants	103.9	102.3	105.0	113.2	109.0
Transport, storage, posts and telecoms	101.0	97.9	99.3	100.8	100.1
Financial intermediation	101.3	99.2	96.3	100.1	98.2
Real estate, renting and business activities	104.2	106.9	106.2	104.8	105.5
Public administration, defence; compulsory social security	103.2	104.2	107.9	101.8	104.8
Education	95.0	96.3	100.9	101.8	101.3
Health and social services	98.1	96.7	96.0	94.5	95.2
Other social services	105.6	102.2	104.4	100.7	102.5

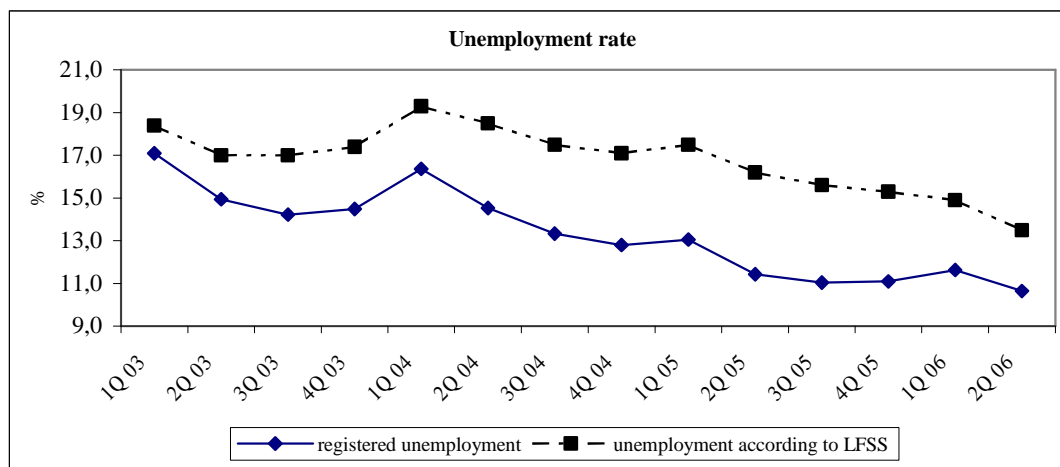
Source: Statistical Office of the SR

### ***Unemployment***

Continuing demand for labour was reflected in the development of unemployment. The year-on-year fall in the number of unemployed persons from the previous quarter (according to the Labour Force Sample Survey methodology) became more marked in the second quarter, representing a 15.1% fall on average for the first half year (compared to a fall of 11.4% in previous year). The declining trend in the rate of unemployment was manifested in the second quarter in its lowest value since 1998 (13.5%) and on the average for the first half year represented 14.2%. In comparison with the first half of 2005 the rate of unemployment fell by 2.7 percentage points.

The declining trend in unemployment is confirmed also by results according to the registered unemployment method. According to the registers of Offices of Labour, Social Affairs and the Family, the rate of unemployment in the second quarter of 2006 averaged 10.7% and in the first half year stood at 11.1%, with a year-on-year fall of 1.1 percentage points.





Source: Office of Labour, Social Affairs and the Family and the Statistical Office of the SR

The long-term year-on-year growth in the labour supply (i.e. persons in productive and post-productive age) was reflected in the first half of 2006 particularly in higher growth in the number of economically inactive persons (i.e. persons not on the labour market). This was manifested in a rate of economic activity that for the first half of the year averaged 59.0% (compared to 59.4% in previous year). The increase in the share of working persons in the economically active population was reflected in the growing rate of employment, which in the first half year recorded year-on-year growth of 2 percentage points to 59.1%.

#### 1.4 Financial results of corporations

According to preliminary results of the SR Statistics Office non-financial and financial corporations in the first half of 2006 achieved a profit of SKK 142 billion (compared to SKK 131.8 billion in the corresponding period of previous year), representing a year-on-year growth of 7.7%. The majority of the profit created came from non-financial corporations (89.2%), where their profit grew on a year-on-year basis by 17.4%. The profit of financial corporations fell on a year-on-year basis by 35.8%.

The indicator for financial corporations' economic result was affected by the negative economic result reported by the NBS (SKK 1.4 billion). Financial corporations excluding the NBS achieved a profit of SKK 16.7 billion, in a year-on-year growth of 16.7%.

##### Corporate financial results

(SKK billion, current prices)

	1 <sup>st</sup> half yr 2005	1 <sup>st</sup> half yr 2006	index $\frac{1^{\text{st}} \text{ half yr 2006}}{1^{\text{st}} \text{ half yr 2005}}$
<b>Economic result (before tax)</b>			
Non-financial and financial corp's in total	131.8	142.0	107.7
of which:			
Non-fin. and financial corp's, excl. NBS	122.3	143.4	117.2
Non-financial corporations	107.9	126.7	117.4
Financial corporations	23.8	15.3	64.2
of which:			
NBS	9.5	-1.4	x
Financial corporations excluding NBS	14.3	16.7	116.7

Source: Statistical Office of the SR, NBS calculations



In the non-financial sector all sectors other than agriculture achieved a positive economic result. A substantial part of the profit (35.8%) was created in industrial production, in the production and distribution of electricity, gas and water (23.1%) and in trade (18.5%). Of the main sectors in industrial production the highest year-on-year growth in profit was recorded in the production of textiles and footwear, and the production of electrical and optical equipment.

Number of non-loss-making and loss-making corporations

	1 <sup>st</sup> half year 2005	1 <sup>st</sup> half year 2006	change
Non-financial corporations in total	6 645	6 347	- 298
Non-loss-making corporations	4 016	3 980	- 36
Loss-making corporations	2 629	2 367	- 262

Source: Statistical Office of the SR

Of the total number of 6 347 corporations in the non-financial sector (enterprises with 20 or more employees) 3 980 were non-loss-making, and created a profit of SKK 124.3 billion, representing a year-on-year growth of 14.3%. The number of loss-making enterprises totalled 2367, reporting an aggregate loss of SKK 22.7 billion, almost equal to the figure for the first half of 2005.

Financial results of financial corporations

(SKK billion, current prices)

	1 <sup>st</sup> half year 2005	1 <sup>st</sup> half year 2006	index $\frac{1^{\text{st}} \text{ half year } 2006}{1^{\text{st}} \text{ half year } 2005}$
Financial result (before tax)	14.3	16.7	116.7
Financial corporations, excl. NBS	8.3	9.1	109.6
Other financial intermediaries	4.7	4.5	95.7
Insurance corporations and pension funds	1.4	3.1	221.4

Source: Statistical Office of the SR, NBS calculations. Differences in subtotals are due to rounding.

As regards financial corporations (excluding the NBS) the highest profit growth in the first half of 2006 in comparison with the first half of 2005 was recorded at insurance corporations and pension funds, while the profitability of financial institutions also improved. Profit reported by other financial intermediaries fell slightly.



## 2. BALANCE OF PAYMENTS

### 2.1 Current account

The balance of payments current account deficit for the first half of 2006 reached SKK 61.9 billion and compared to the corresponding period of previous year rose by SKK 11.4 billion. Its growth was influenced by a year-on-year worsening in the trade balance and in the income balance. Conversely, the balance of services and current transfers reported better results than in the first half of 2005. The share of the current account deficit in GDP at current prices reached 8.0%, representing an increase on a year-on-year basis of 0.8 percentage points (the share of the current account deficit excluding dividends and reinvested earnings reached 3.0%, representing a year-on-year increase of 0.9 percentage points). The share of the trade balance deficit to GDP in the first half of 2006 grew to 5.9% (compared to 4.5% in the corresponding period of previous year).

Balance of payments current account

SKK billion	1 - 6 / 2006	1 - 6 / 2005
Trade balance	-45.5	-31.5
export	567.9	461.3
import	613.4	492.8
Balance of services	8.2	5.2
Income balance	-28.6	-24.9
of which: investment income	-43.4	-39.8
of which: reinvested earnings	-16.9	-14.4
Current transfers	4.0	0.7
Current account total	-61.9	-50.5
Share of current account to GDP in %	-8.0	-7.2
Share of current account (excluding dividends and reinvested earnings) in GDP in %	-3.0	-2.1

Source: NBS, Statistical Office of the SR (GDP)

The trade balance recorded a deficit of SKK 45.5 billion, representing a year-on-year growth of SKK 14.0 billion. The growth in the trade deficit was due to the higher rate of growth in imports compared to that of exports, where both the growth of imports and exports accelerated significantly in comparison with the corresponding period of previous year.

According to preliminary data from the Statistical Office of the SR goods in the value of SKK 567.9 billion were exported in the first half of 2006, which was 23.1% (in USD 20.9%, in EUR 26.5%) more than for the corresponding period of previous year .

Year-on-year change in the SR export and its individual segments and the contributions of these segments to the change in the export

	1 <sup>st</sup> half year	1 <sup>st</sup> half year	Contribution	Contribution
	2006	2005	1 <sup>st</sup> half yr 2006	1 <sup>st</sup> half yr 2005
	SKK billion	SKK billion	in percentage points	in percentage points
Raw materials	16.2	1.5	3.5	0.4
Chemical products & semifinished goods	25.9	25.6	5.6	6.8
Machinery and transport equipment	58.7	-7.7	12.7	-2.0
of which: machinery	40.6	22.3	8.8	5.9
transport equipment	18.1	-30.0	3.9	-7.9
Finished products	5.7	1.5	1.2	0.4
Total export	106.5	20.9	23.1	5.5



The export of goods outstripped last year's rate of growth by more than 17 percentage points, primarily in consequence of the growth in exports in the groups machinery and transport equipment, and raw materials.

In contrast to the previous year, in which exports in the group machinery and transport equipment fell significantly, in the first half of 2006 these exports grew, particularly in consequence of the growth in exports of cars, car parts and components. Besides transport vehicles, the growth in the total group machinery and transport equipment was supported also by higher exports of machinery and instruments, the year-on-year growth of which increased significantly compared to the corresponding period of previous year. The year-on-year growth in exports in the subgroup machinery and equipment was caused mainly by exports of television sets, broadcasting devices, boilers, electrical motors, videophone devices, etc.

The highest year-on-year rate of growth was recorded in the export of raw materials. The growth in raw material exports is connected with the significant rise in oil and natural gas prices on world markets, which was manifested particularly in higher exports of processed oil and of natural gas.

Despite the fact that the year-on-year growth in exports of finished products is the lowest of all the groups of goods, exports in this group did record an acceleration in their year-on-year growth compared with the first half of 2005. Higher exports of finished products comprised particularly the increased export of furniture and agricultural products (sugar, cereals).

Exported production in the group of chemical products and semifinished goods maintained stable growth similar to that last year growth. On world markets best performance was recorded in export of certain semifinished goods, such as aluminium, copper, paper and paper products, and products from iron and steel. In chemical products the largest export growth was recorded in products from plastic and rubber, which was connected with the gradual rise in the oil price.

The volume of imported goods in the first half of 2006 represented SKK 613.4 billion, a year-on-year growth of 24.5% (in USD 22.2%, in EUR 27.9%).

Year-on-year change in the SR import and its individual segments and the contributions of these segments to the change in the import

	1 <sup>st</sup> half year	1 <sup>st</sup> half year	Contribution	Contribution
	2006	2005	1 <sup>st</sup> half yr 2006	1 <sup>st</sup> half yr 2005
	SKK billion	SKK billion	in percentage points	in percentage points
Raw materials	32.4	18.6	6.6	4.6
Chemical prod's & semifinished goods	19.9	8.4	4.0	2.1
Machinery and transport equipment	45.2	0.1	9.2	0.0
Finished products	23.3	14.1	4.7	3.5
of which: agricultural and industrial products	10.5	9.0	2.1	2.2
personal cars	2.6	0.7	0.5	0.2
engineering & electrotechnical consumption products	10.2	4.4	2.1	1.1
<b>Total import</b>	<b>120.8</b>	<b>41.2</b>	<b>24.5</b>	<b>10.1</b>



In imports of goods in the first half of 2006 the highest rate of import growth was recorded in raw materials. Similarly as in the case of exports, the rise in the oil price and subsequently also the gas price caused the rate of growth in imports in this group of goods to exceed the year-on-year growth of the total import, reaching almost 50%.

The high year-on-year growth in imports of machinery and transport equipment was partially caused by low imports in this group of goods in the previous year, when lower imports of commodities for the automobile industry reduced the import in the group machinery and transport equipment. Conversely, since the start of this year imports of components for the automobile industry have grown, where within the whole group this growth is accompanied by higher imports of other groups of goods. In the subgroup of machinery import growth in comparison with the corresponding period of previous year was recorded particularly in lifting and handling equipment, automatic data-processing equipment and moulding machinery, as well as electronic integrated circuits and micro assemblies, etc.

An acceleration of the year-on-year growth was also recorded in the import of chemical products and semifinished goods. Growth in the import of semifinished goods was concentrated in the increased imports of iron and steel, products from iron and steel, copper, wood and wood products. In the group chemical products the largest growth in imports was recorded in the import of plastics and organic chemical products.

The growth in imports comprised also imports of the group of finished products, which also grew faster than in the previous year. Within the whole group a growth in imports was seen mainly in industrial products (pharmaceutical products, clothing and footwear) and consumer electronics. Car imports also grew faster than in the previous year.

In the trade in services a surplus of SKK 8.2 billion was created in the first half of 2006 (representing a year-on-year growth of SKK 3.0 billion). Receipts from the export of services grew by SKK 9.9 billion and payments for their import by SKK 6.9 billion. The increase in the balance of services surplus was due to surpluses recorded in transport services and travel services, whereas “other services total” remained unchanged on a year-on-year basis.

Balance of services

SKK billion	1 <sup>st</sup> half year 2006	1 <sup>st</sup> half year 2005
Transportation	8.1	6.4
Travel	6.1	4.8
Other services total	-6.0	-6.0
Balance of services	8.2	5.2

Revenues from the international transport of goods and people reached SKK 26.6 billion, (representing a year-on-year growth of SKK 3.0 billion) and expenditures reached SKK 18.5 billion (a growth of SKK 1.3 billion). From the aspect of size, the largest item within transport services remained revenues from gas and oil transit, which totalled SKK 13.8 billion. Despite the fact that revenues from oil and gas transit grew on a year-on-year basis by 9.5%, their share in total transport revenues fell on a year-on-year basis to less than 52% for the first half of 2006 (this indicator having been more than 53% a year





earlier). The growth in this type of revenue was partially supported by the weakening of the SKK/USD exchange rate, which caused a growth in transit fees following conversion to SKK.

In international transport services excluding transit (road, rail, air and water) and including transport related services the deficit reached SKK 5.7 billion (representing an improvement in the deficit by SKK 0.5 billion), where 86% was formed by payments for other freight services including trade costs and 14% expenditures for personal transport, mainly air. The year-on-year improvement in the balance of transport services excluding transit was caused in particular by the improvement in the balance of personal air transport (the growth in incomes for air transport services provided and the fall in the expenditures of Slovak residents for services provided by non-residents are connected with the development of air transport in the SR) as well as higher revenues for road freight transport services provided. Conversely, revenues for rail freight transport services provided were lower than in the previous year.

The positive balance of travel grew on a year-on-year basis by SKK 1.3 billion to reach SKK 6.1 billion. Foreign exchange receipts from foreign travel reached SKK 20.3 billion, representing a growth of SKK 3.3 billion compared to the first half of 2005. This growth in foreign exchange receipts was facilitated despite the Slovak koruna's exchange rate appreciation by a higher number of foreign visitors, as well as a growth in the number of foreign tourists accommodated. Expenditures of Slovak citizens on foreign tourism (including consumption by Slovak citizens working abroad) reached SKK 14.2 billion, representing a growth of SKK 2.0 billion.

The balance "other services total" (telecommunications, construction services, insurance services, financial services, rental, computer equipment services, advertising, trade services, technical services, etc) resulted in deficit, which remained unchanged on a year-on-year basis. Incomes from and expenditures on services provided grew identically on a year-on-year basis by SKK 3.7 billion.

In the first half of 2006 in comparison with the corresponding period of previous year the most favourable development was recorded in computer equipment services, legal, accounting and advisory services, where faster growth in incomes over expenses resulted in a lower deficit. Telecommunications also had a positive effect on the overall deficit, where the growth in incomes caused an increase in last year's surplus. On the other hand a growth in the deficit occurred mainly in consequence of this year's worse development in financial and construction services and services in other activities (particularly in processing services and repairs and technical services).

In the first half of 2006 the income balance ended with a deficit of SKK 28.6 billion, representing a deterioration to the corresponding period of previous year of SKK 3.7 billion. Receipts grew by SKK 2.8 billion and payments by SKK 6.5 billion. The balance of revenues excluding reinvested earnings ended with a deficit of SKK 11.7 billion, which was SKK 1.2 billion lower than last year's deficit.



Income balance

SKK billion	1 <sup>st</sup> half year 2006	1 <sup>st</sup> half year 2005
Compensation of employees	14.9	14.9
Direct investments	-40.0	-35.3
of which: reinvested earnings	-16.9	-14.4
Portfolio and other investments	-3.5	-4.5
Income balance	-28.6	-24.9

During short-term work stays abroad Slovak nationals earned, according to NBS calculations, SKK 14.9 billion. The slight growth in Slovak nationals incomes abroad was compensated out by the growth in foreign nationals' incomes in the SR, which led only to a minimal year-on-year change in the positive balance of employee compensations.

In the first half of 2006 enterprises with foreign equity capital were paid dividends of SKK 22.4 billion, while the figure for the previous year was SKK 21.0 billion. Businesses' higher profitability was seen also in the earnings reinvested by foreign direct investors in the SR. The year-on-year growth in reinvested earnings reached SKK 2.5 billion in the first half of 2006.

Investment in foreign securities brought domestic investors a profit of SKK 9.7 billion, representing a year-on-year growth of SKK 2.2 billion. Revenue from the purchase of Slovak bonds by foreigners represented SKK 7.6 billion, which was SKK 0.6 billion less than in the corresponding period of previous year. The growth in receipts and fall in payments resulted in a change from last year's deficit balance of portfolio investments to a surplus of SKK 2.0 billion. In comparison with the corresponding period of previous year the balance improved by SKK 2.8 billion.

The balance of other investments ended in a negative balance of SKK 5.5 billion, representing a year-on-year deterioration of SKK 1.7 billion. The deepening deficit was caused by a significant growth in interest payments of enterprises on short-term trade credits .

Current transfers created a surplus of SKK 4.0 billion. In a year-on-year comparison the positive balance grew by SKK 3.3 billion, which was caused mainly by a growth in incomes in government transfers. The surplus in government transfers grew on a year-on-year basis by SKK 3.8 billion, which was influenced by the fact that incomes from the EU budget exceeded contributions to the EU budget by more than SKK 8.7 billion. Conversely, the last year's deficit in the balance of private transfers deepened slightly (by SKK 0.5 billion).

## **2.2 Capital and financial account of the balance of payments**

The capital and financial account ended in a surplus of SKK 63.9 billion, which compared to the corresponding period of previous year represented a fall of SKK 46.2 billion. The structure of inward financial flows also changed. While in the first half of 2005 a decisive role in the capital inflow was played by short-term capital from the banking sector, which partially contributed also to covering the current account deficit, in the first half of 2006 an increased inflow of portfolio investments and direct investments was recorded, while other short-term investments recorded an outflow. Thus the structure



of the capital and financial account of the balance of payments improved compared to the previous year, when part of the current account deficit was covered by an inflow of short-term capital.

Capital and financial account of the balance of payments

SKK billion	1 <sup>st</sup> half year 2006	1 <sup>st</sup> half year 2005
Capital account	-0.2	0.0
Direct investment	59.0	32.2
SR abroad	-5.7	-1.2
of which: equity capital	-5.2	0.2
reinvested earnings	-0.6	-0.6
in the SR	64.8	33.4
of which: equity capital	38.0	6.5
of which: privatisation FDI	31.0	0.0
reinvested earnings	17.5	15.0
Portfolio investments and financial derivatives	48.2	-14.4
SR abroad	-5.8	-20.9
in the SR	54.0	6.5
Other long-term investments	18.0	-9.7
Assets	-0.4	-0.6
Liabilities	18.4	-9.1
Short-term investments	-61.1	102.0
Assets	-51.1	-17.2
Liabilities	-10.0	119.2
<b>Capital and financial account total</b>	<b>63.9</b>	<b>110.1</b>

The FDI balance reached SKK 59.0 billion, growing on a year-on-year basis by SKK 26.8 billion, which was influenced in particular by the inflow of privatisation funds.

In comparison with the first half of 2005 the demand among the Slovak businesses for investments abroad increased. The increase in Slovak investors' assets involvement abroad in the form of direct investments, rising by SKK 5.4 billion, was only partially compensated by a slight inflow of other capital.

The inflow of equity capital and reinvested earnings into the SR reached SKK 55.5 billion, significantly exceeding (by SKK 34 billion) the level for the corresponding period of previous year. Foreign investors' equity capital involvement in the SR rose in the first half of 2006 by SKK 31.4 billion, exceeding several times the inflow for the corresponding period of previous year. On the other hand, the estimate of reinvested profit, forming a contra entry to the income balance on the current account, grew on a year-on-year basis only slightly, reaching at the end of June SKK 17.5 billion. The year-on-year increase in equity capital inflow was almost wholly (SKK 31 billion) due to the inflow of funds from the firm Enel for the privatisation of the Slovak power company Slovenské elektrárne in April.

In the field of portfolio investments the trend of outflow recorded in the corresponding period of previous year changed to one of inflow. Holdings of foreign securities from the side of Slovak nationals fell by SKK 15.1 billion. Domestic investors, both enterprises and banks, reduced their investments in long-term foreign bonds. The fall in investments to debt securities was partially offset by greater demand for equity securities, where Slovak residents invested SKK 7.8 billion more than in the first half of 2005.



The positive balance of portfolio investments in the SR grew from last year's SKK 6.5 billion to SKK 54.0 billion. The Government's activities played a significant role in their structure. Despite the fact that demand from foreign investors for government securities issued in Slovak koruna fell, the Government's new issue of Eurobonds caused a significant inflow of portfolio funds in the government sector, rising from last year's SKK 1.1 billion to SKK 49.8 billion.

The balance of the other investments recorded a negative value, when the outflow of funds abroad reached SKK 43.1 billion. The change in the trend from inflow to outflow was caused by the development of short-term liabilities in the banking sector.

Other long-term investments recorded an inflow of funds in the volume of SKK 18.0 billion. The inflow of long-term capital occurred mainly on the liabilities side, where the inflow of funds from financial loans drawn by enterprises grew significantly. The drawing of long-term enterprises financial loans reached SKK 25.5 billion, which was 55.5% more than in the corresponding period of previous year. Increased drawing of loan funds was recorded particularly in the industry sector, where this was connected in particular with new automobile manufacturers' preparations for production. Repayment of financial loans in the enterprises sector reached SKK 12.3 billion and, in contrast to their drawing, repayment funds fell by 25.9% in comparison with the previous year. The year-on-year growth in long-term liabilities was due also to lower repayment in the government and NBS sector, which was influenced by last year's repayment of a debt towards the bank ČSOB.

Short-term capital recorded an outflow of SKK 61.1 billion, while in the first half of 2005 the inflow of short-term capital totalled SKK 102.0 billion. Commercial banks were the main factor in the change from last year's inflow to outflow, where this outflow of capital occurred mainly as a reduction in non-residents deposits at commercial banks (the increase in non-residents' deposits at commercial banks in the SR in the first half of 2005 was brought about by expectations connected with an appreciation in the Slovak koruna exchange rate). On the side of assets the outflow of funds was manifested particularly in a growth in financial loans provided and a growth in the volume of Slovak banks' short-term deposits on accounts abroad. A significant inflow of short-term capital in comparison with last year occurred only in the enterprises sector and was connected with the drawing of import loans from abroad (these loans grew under the influence of growing imports).

### **2.3 Foreign exchange reserves**

The NBS's foreign exchange reserves as at the end of June 2006 reached USD 16 128.9 million. Since the start of the year they grew by USD 649.4 million. A decisive factor positively influencing the field of incomes were incomes connected with the March issue of Eurobonds. The field of expenditures was determined primarily by the Government's debt servicing repayments and the central bank's interventions on the interbank forex market. The development of the NBS's foreign exchange reserves was influenced in the first half of the year also by the development of the mutual exchange rates of freely convertible currencies on world financial markets. The surplus balance of incomes and expenditures in the period monitored (USD 237.1) was accompanied by positive foreign



exchange differences (USD 412.3 million), which arose due to the euro strengthening against the American dollar on world financial markets.

The income part of foreign exchange reserves in the period was determined by the following factors:

- revenues from deposits and securities in the NBS's portfolio in the amount of USD 191.2 million,
- incomes from the issue of Eurobonds in the amount of USD 1 202.5 million,
- NBS incomes resulting from repo operations carried out (positive balance of USD 2.5 million).

The side of foreign exchange expenditures in the period was influenced by:

- government debt servicing repayments totalling USD 201.6 million, of which interest repayments on government Eurobonds issued in previous years represented USD 102.1 million,
- an outflow of funds due to interventions and direct trades on interbank forex market totalling USD 760.6 million,
- NBS debt servicing repayments in the amount of USD 0.7 million,
- other net expenditures of the NBS in the amount of USD 80.8 million (negative balance), resulting in particular from incomes and payments within foreign payments for NBS clients,
- In accordance with the decision of the NBS Bank Board of 25 April 2006 on optimising the level of NBS foreign exchange reserves the National Bank of Slovakia sold off in the first half of the year USD 115.4 million.

Foreign exchange reserves of the NBS at the end of June 2006 were sufficient for covering a 4.4-multiple of the average monthly import of goods and services into the Slovak Republic for the first six months of the year.

Commercial banks' foreign exchange reserves as at the end of the first half of 2006 reached USD 1 775.8 million, having grown since the start of the year by USD 233.5 million. The balance of foreign exchange reserves in the banking sector as a whole, including the NBS, at the close of June achieved USD 17 904.7 million.

## **2.4 Foreign debt of the SR**

The total gross foreign debt as at the end of June 2006 according to preliminary estimates stood at USD 31.5 billion, or EUR 25.1 billion, having grown since the start of 2006 by USD 4.6 billion, or EUR 2.4 billion. Total long-term foreign debt in the period monitored grew by USD 3.5 billion, while total short-term foreign debt grew by USD 1.1 billion.

Within total long-term foreign debt in the period a significant increase of USD 1.9 billion was recorded in the balance of foreign payables in the item government and NBS, where this was primarily due to the issue of foreign bonds in March in the value of EUR 1.0 billion (USD 1.3 billion), as well as increased demand for purchasing koruna-denominated government securities. Within the commercial sector businesses' payables grew in the period monitored by USD 1.2 billion, while commercial banks' payables grew by USD 0.4 billion.



Businesses' total short-term foreign debt recorded a growth against the beginning of the year in the value of USD 1.7 billion, while commercial banks' foreign liabilities fell by USD 0.5 billion.

Total gross foreign debt per capita in the SR at the end of June totalled USD 5 856 against USD 5 000 at the beginning of the year. The share of total short-term foreign debt in total gross foreign debt in the SR fell over the period monitored from 56.3% to 51.7% at the close of June 2006.

	USD million		EUR million		SKK million	
	1.1.2006	30.6.2006	1.1.2006	30.6.2006	1.1.2006	30.6.2006
Total foreign debt SR	26 897.6	31 501.2	22 704.5	25 140.4	859 324.5	963 432.7
1) Long-term foreign debt	11 759.5	15 229.2	9 926.3	12 154.1	375 692.5	465 769.9
Government and NBS <sup>1)</sup>	5 578.3	7 445.5	4 708.7	5 942.1	178 215.5	227 713.2
Commercial banks	866.7	1 238.3	731.6	988.3	27 689.3	37 872.2
Businesses	5 314.5	6 545.4	4 486.0	5 223.7	169 787.6	200 184.5
2) Short-term foreign debt	15 138.1	16 272.0	12 778.2	12 986.3	483 632.0	497 662.8
Government and NBS	4.4	0.0	3.7	0.0	140.6	0.0
Commercial banks	9 360.4	8 822.0	7 901.2	7 040.6	299 046.1	269 812.0
Businesses	5 773.3	7 450.0	4 873.3	5 945.7	184 445.4	227 850.8
Foreign assets	25 455.3	28 653.4	21 487.2	22 867.7		
Net foreign debt	1 442.3	2 847.8	1 217.3	2 272.7		
Exchange rate USD, or EUR	31.948	30.584	37.848	38.322		
EUR/USD cross exchange rate			1.185	1.253		

Source: NBS.

1) includes government agencies and municipalities

Net foreign debt, calculated as the difference between gross foreign debt of USD 31.5 billion (NBS and government liabilities, commercial banks' liabilities and business sector liabilities – excluding capital participation) and foreign assets of USD 28.7 billion (NBS foreign exchange reserves, commercial banks' foreign assets, business sector foreign assets – excluding capital participation) at the end of June 2006 reached a debtor position of USD 2.8 billion.



### **3. PUBLIC SECTOR**

#### ***Assessment of general government budgetary management using ESA 95 methodology***

On the basis of known data on the development of general government budgetary management for the first half of 2006 the year-end share of the deficit in GDP using ESA 95 methodology could result in a favourable outcome below the approved budget. For 2006 the SR Government approved a public finance deficit of 2.9% of GDP, where it forecasted that the introduction of the 2<sup>nd</sup> pillar in the pension system will represent additional net costs at the level of 1.3% of GDP. The forecasted attainment of a positive balance is founded on higher collection of cash taxes for the first half of 2006 under the influence of a more favourable economic development than had been anticipated at the time of compiling the general government budget for 2006. The deficit should be mitigated also by the influence of one-off incomes sourced from the cancellation of anonymous deposits. The higher incomes resulted from dividends should strengthen the income side of the state budget. On the expenditure side a saving of the interest costs on the public debt should be realized. The saving . This saving has already been offset partially in the first half of the year by drawing of unbudgeted expenditures. This concerned for example expenditures on floods in 2006 (SKK 194 million) and on completing the Slovak National Theatre building (SKK 160 million). It is expected that the budgetary management of municipalities and higher territorial units (VÚC) will lead towards a deepening of the public finance deficit.

#### ***State budget (cash principle)***

Budgetary management in the SR in the first half of 2006 was characterised by two countervailing trends: over the course of the first four months, in consequence of dynamic tax collection and strict budgetary policy on the expenditure side, the state budget reported surpluses. However, in the period leading up to the parliamentary elections budgetary discipline was loosened, leading to a slowdown in tax revenues and thus to a switch into deficit results. In the second half of June the state budget deficit (on a cash principal) reached approximately SKK 27 billion. Tax collection at the end of the month together with the transfer of the part of dividends of Slovak gas company SPP (Slovenský plynárenský priemysel, a.s.) from the National Property Fund to the state budget (of SKK 4 billion) decreased the state budget deficit to SKK 10.3 billion (18% of the annual budget).

On 30 June 2006 the total budget income reached SKK 138.0 billion (50.6% of the budgeted amount for the year as a whole). Tax revenues developed favourably, particularly corporate income tax, which for the first half of the year reached 70.7% of the expected annual amount. On 30 June 2006 the total tax revenues on the cash principle reached SKK 113.4 billion, representing 52.6% of the annual budget (in 2005 this figure was SKK 111.5 billion, i.e. 55.2% of the annual budget). Budgetary expenditures were drawn in the volume of SKK 148.3 billion (44.9% of the annual budget). The total incomes of the state budget included also transfers from the European Union, which for the first half year were drawn in the volume of SKK 8.8 billion (31.5% of the annual budget).



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

NBS monetary policy in the first half of 2006 was conducted in an environment of continuing economic, wage and employment growth. This fact was reflected in final household consumption, which could result in the emergence of demand-side inflationary pressures. Following current development of inflation, which would exceed the target set for 2006 and 2007, the NBS tightened monetary policy. In the first four months of 2006 the state budget reported a surplus, but under the influence of the pre-electoral period this changed in May and June and the state budget switched to deficit. The NBS was active on the interbank forex market, when the Slovak koruna exchange rate against the reference currency euro recorded volatile development under the influence of domestic political uncertainty and regional development. With regard to the fact that the exchange rate depreciation did not correspond to economic fundamentals, the NBS at the end of June performed two foreign exchange interventions.

This development of main economic indicators resulted in a trend towards a tighter monetary policy from the NBS and a growth in its key interest rates in the first half of the year (in total by 1 percentage point), when it raised them in two steps: in March and May, each time by 0.50 percentage points.

##### **4.1 Monetary aggregates and counterparts of the M3 monetary aggregate**

The monetary aggregate M3 (using ECB methodology) reached SKK 861.2 billion at the end of the first half of year 2006 and increased by SKK 29.7 billion since the beginning of the year. The year-on-year growth<sup>3</sup> rate of M3<sup>3</sup> was 11.2% in June 2006.

The year-on-year growth rate of M3 during the six months of the first half of the year 2006 rose almost continually (with the exception in April) and since December 2005 increased in total by 3.4 percentage points. This acceleration in the annual dynamic of money-circulation corresponds to the growth environment of the economy, along with a slightly rising rate of inflation. The development of the money supply was influenced in a pro-growth manner by the continuing development of commercial banks' lending activities, where as yet there has been no reaction to the tightening of monetary policy. With the rise in interest rates, the demand for further investment into mutual funds decreases, as a result of which there is no outflow of funds from the money supply in comparison with the corresponding period of previous year. decreases and the banks' credit activities increase.. This results in acceleration of the dynamics of money circulation.

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<sup>3</sup> The year-on-year growth rate of monetary aggregates and their contra items is calculated from reported month-end balances without abstracting from non-transactions, which include all movements in balance-sheet items resulting from valuation changes of tradable instruments, reductions/depreciations to the value of a loan, exchange rate differences, reclassifications and other changes.





<b>M3 and its main counter positions in the 1<sup>st</sup> half of 2006 and 2005</b>	balance as at 30.6. (SKK billion)	change from start of year * (SKK billion)	change from start of year * (%)
<b>1<sup>st</sup> half year 2006</b>			
M3	861.2	+29.7	+3.6
Main counter positions of M3			
Long-term financial liabilities	192.9	-0.4	-0.2
Receivables of MFIs & securities	833.1	+37.7	+4.7
of which: General government	248.9	-24.5	-9.0
Other residents	584.2	+62.2	+11.9
<b>1<sup>st</sup> half year 2005</b>			
M3	774.3	+3.1	+0.4
Main counter positions of M3			
Long-term financial liabilities	189.1	+8.2	+4.5
Receivables of MFIs & securities	724.7	+15.6	+2.2
of which: General government	261.1	-34.0	-11.5
Other residents	463.6	+49.7	+12.0

Source: NBS

Note: \*) With regard to the fact that under ECB methodology monetary aggregates and counter positions to the M3 monetary aggregate are not compiled at 1 January of the given year, the reported balance as at 31 December of the preceding year is taken as the initial level of the first half year in the table and in the following text.

The development of M3 in the first half of 2006 followed the standard seasonal pattern, the main factors of which were the March deadline for personal and corporate income tax payments for the 2005 tax period and the related fall decrease in M3 in favour of the public sector, as well as the payment of business sector dividends, which was reflected in a decrease in businesses' deposits in favour of the public sector and non-residents.

In comparison with development in the same period of the previous year the total increase in M3 in the first half of 2006 reached a substantially higher level, to which the rate of growth also corresponded. Within the structure of M3 in the first half of 2006 the transfer of some businesses' spare funds continued, prevalingly in the form of the shortest term deposits (day deposits, classified in ECB methodology as deposits repayable on demand, forming a component of M1). A part of deposits with an agreed maturity and a part of deposits repayable on demand thus regularly fluctuated mutually, influencing the volatility of M1.

The volume of less liquid components in M3 in the first half of 2006 decreased in total by SKK 6.5 billion, which represented a significant change against the growth of SKK 8.7 billion for the same period in 2005. A decisive factor in this development was primarily the decrease in clients' investments into the money market mutual funds of SKK 7.3 billion (against a growth of SKK 13.7 billion in the first half of 2005).

Within the total volume of monetary financial institutions (MFI) receivables towards residents (including securities issued by clients in the holding of the MFI sector) a contrary development of its components persisted, when MFIs' falling receivables towards general government were fully offset by a growth in MFIs' receivables towards the private sector. Although the fall in receivables towards general government in the first half of 2006 was lower than in the corresponding period of previous year, the growth in



receivables towards other residents further intensified, which resulted in a growth in total loans of more than double the mid-year rate (4.7% against 2.2%).

Of the total growth of SKK 61.9 billion in financial institutes' receivables towards the private sector (excluding securities) in the first half of the year it was primarily the growth in loans provided to non-financial businesses and households (a growth of SKK 27.7 billion) which was decisive, when the growth in loans towards financial corporations reached SKK 6.3 billion (11.5% growth since the start of the year). The year-on-year rate of growth in loans towards financial corporations in June 2006 reached 38.2%.

Within the structure of long-term financial liabilities there persisted the long-term trend of a decline in the volume of deposits having a term of notice above 3 months, despite the change in the course of NBS interest rates in the first half of 2006. Conversely, the volume of deposits and loans taken with an agreed maturity of above 2 years and debt securities issued for over 2 years grew slightly in the first half year, in contrast to the previous year.

#### 4.2 Structure of the money supply

The year-on-year rate of growth in the money supply following a slowdown in the 2<sup>nd</sup> half of 2005 again accelerated to above 10% and M3 at the end of the first half year reached SKK 861.2 billion. On the side of money supply components, contributions to the growth in M3 increased in the case of the most liquid components (currency in circulation, deposits and received loans repayable on demand). The relatively low level of interest rates had a significant influence also on the counterparts of M3, where dynamic development was recorded in the field of MFI loans to the private sector.

##### Monetary aggregates

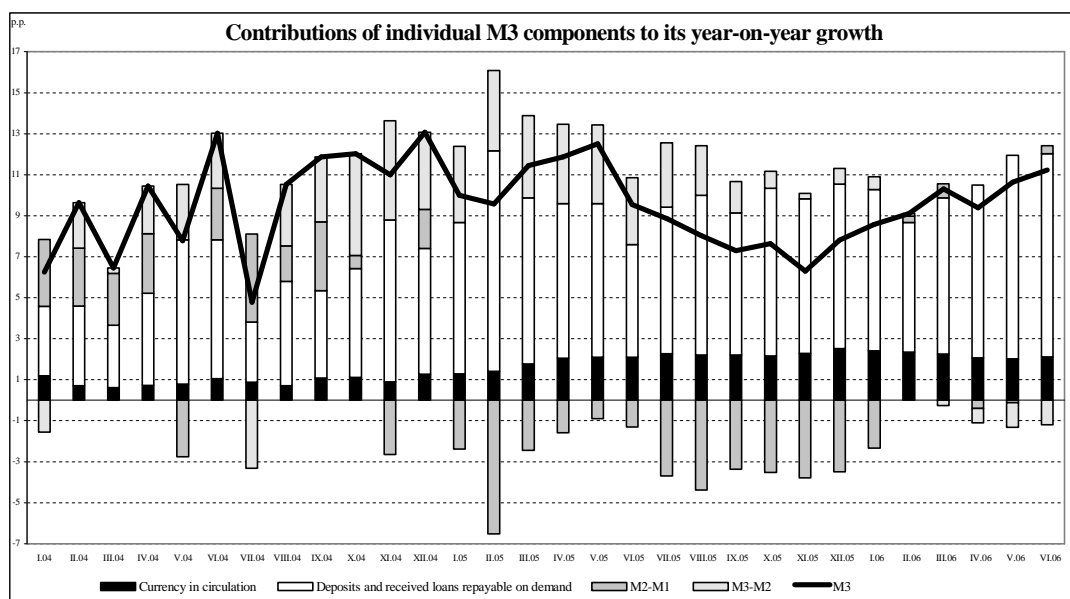
Monetary aggregates	Balance as at 30.06.2006	Year-on-year change in SKK billion	Contributions to M3 growth in percentage points
Currency in circulation	124.46	16.38	2.11
Deposits and received loans repayable on demand	397.24	76.79	9.92
<b>M1</b>	<b>521.70</b>	<b>93.16</b>	<b>12.03</b>
Deposits and received loans with an agreed maturity of up to 2 years	287.29	5.61	0.72
Deposits redeemable at notice of up to 3 months	13.23	-2.61	-0.34
<b>M2-M1</b>	<b>300.52</b>	<b>2.99</b>	<b>0.39</b>
<b>M2</b>	<b>822.22</b>	<b>96.16</b>	<b>12.42</b>
Money market fund shares/units	38.59	-7.82	-1.01
REPO operations	0.00	-0.44	0.00
Issued debt securities of up to 2 years	0.37	-1.02	-0.13
<b>M3-M2</b>	<b>38.95</b>	<b>-9.27</b>	<b>-1.20</b>
<b>M3</b>	<b>861.18</b>	<b>86.88</b>	<b>11.22</b>

A substantial part of M1 is formed by deposits and received loans repayable on demand. Their contribution to the growth in the money supply has been rising since 2005 compared to the preceding period. Deposits and received loans of households and non-financial corporations repayable on demand also contributed to their growth. The other component of the M1 monetary aggregate is currency in circulation. The first half of 2006



saw a slowdown in the year-on-year rate of growth of currency in circulation and a decrease in its contribution to M3 growth.

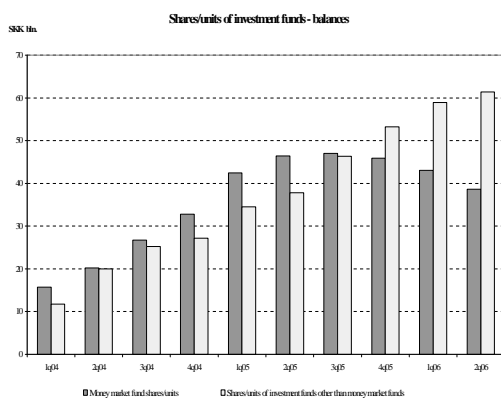
Less liquid components of the money supply (M2-M1) comprise deposits and received loans with an agreed maturity of up to 2 years and deposits redeemable at notice of up to 3 months. Their volume was decreasing throughout the course of the preceding year. This trend halted at the beginning of 2006 and their contribution to M3 growth changed from negative values to positive, mainly under the influence of a growth in deposits and received loans with an agreed maturity of up to 2 years. This was connected with growing interest rates on term deposits and a decline in investment in money market fund shares/units.



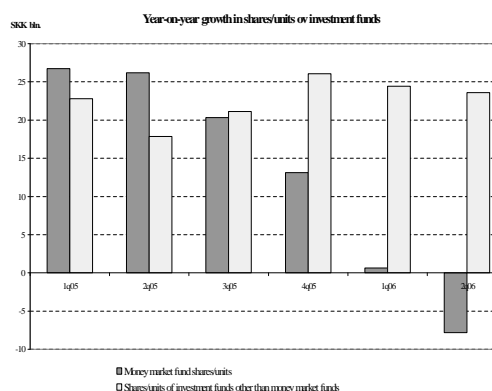
Source: NBS

The smallest share in the money supply volume was formed by marketable instruments (M3-M2). This is the least liquid component, the main part of which is formed by money market fund shares/units. Following their high growth in 2004 their volume was decreasing in the second half of 2005. The decrease was influenced by the demand for investing in shares/units of investment funds other than money market funds, mainly from the side of households, and shifts of households' funds to term deposits. A further part of marketable instruments comprises repo operations and debt securities issued for up to 2 years, the share of which in the total money supply also was decreasing and hence also their contribution to the year-on-year rate of M3 growth.





Source: NBS

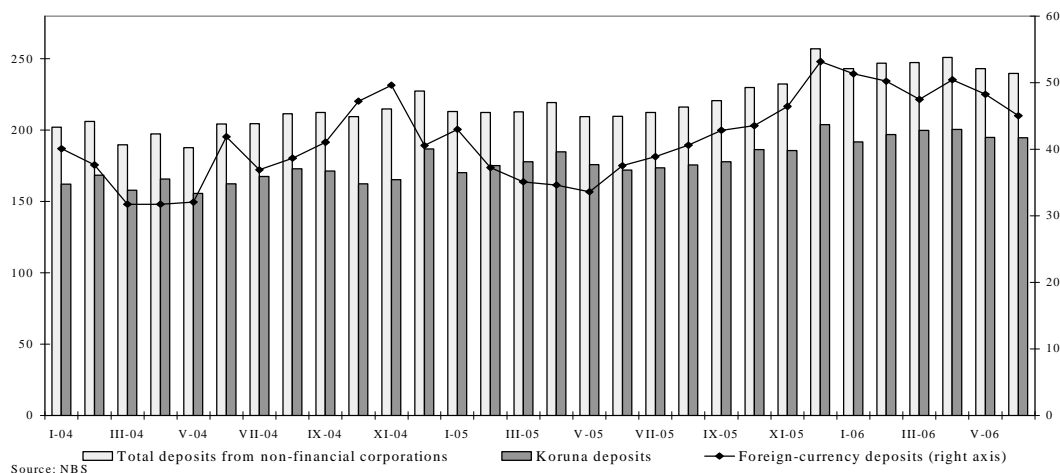


Source: NBS

### Deposits from non-financial corporations

Non-financial corporation deposits recorded in comparison with December 2005 a fall of SKK 17.4 billion and their volume reached SKK 239.7 billion at the end of June 2006. This development was influenced by the development of non-financial corporation foreign-currency deposits, which recorded a fall over the first half of 2006 of SKK 8.1 billion. Koruna deposits, which form a substantial part of deposits from non-financial corporations, contributed positively to the overall year-on-year growth in non-financial corporation deposits throughout the whole period.

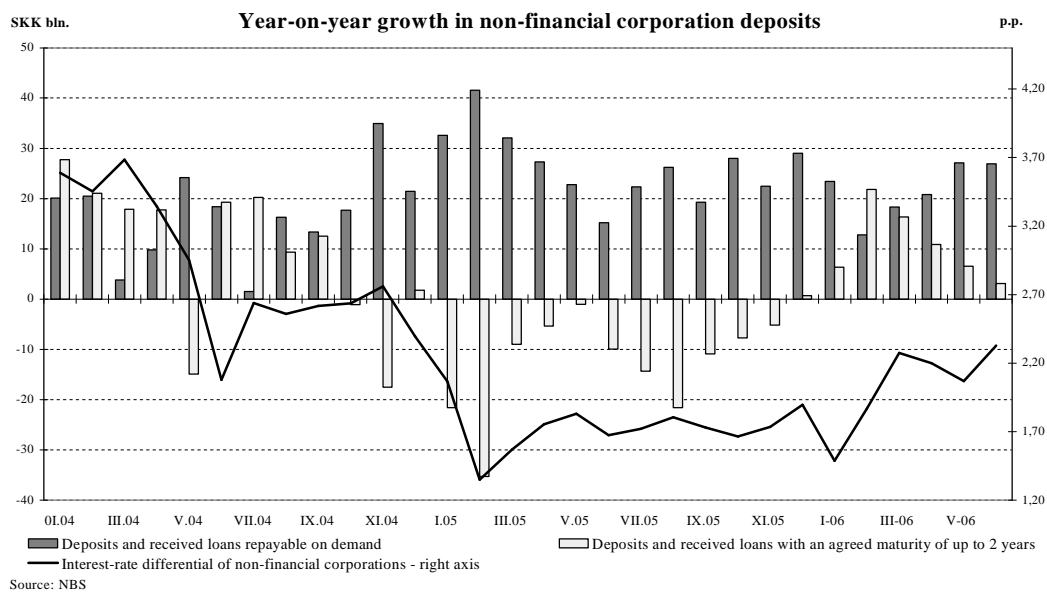
Non-financial corporation deposits in SKK bln.



Source: NBS

From the aspect of liquidity non-financial corporations prefer the most liquid form of deposits, therefore as much as 60% of total deposits are formed by deposits and loans repayable on demand. While in 2005 the interest rate on term deposits was close to the interest rate on deposits repayable on demand, in 2006 interest rate on term deposits began to increase. This could have been reflected in a renewal of demand for saving funds in term deposits. These had fallen on a year-on-year basis throughout almost the whole of 2005, in the first half of 2006, however, they recorded a slight growth. Deposits redeemable at notice of up to 3 months form a negligible part of non-financial corporations deposits' and their development throughout the period was stable.

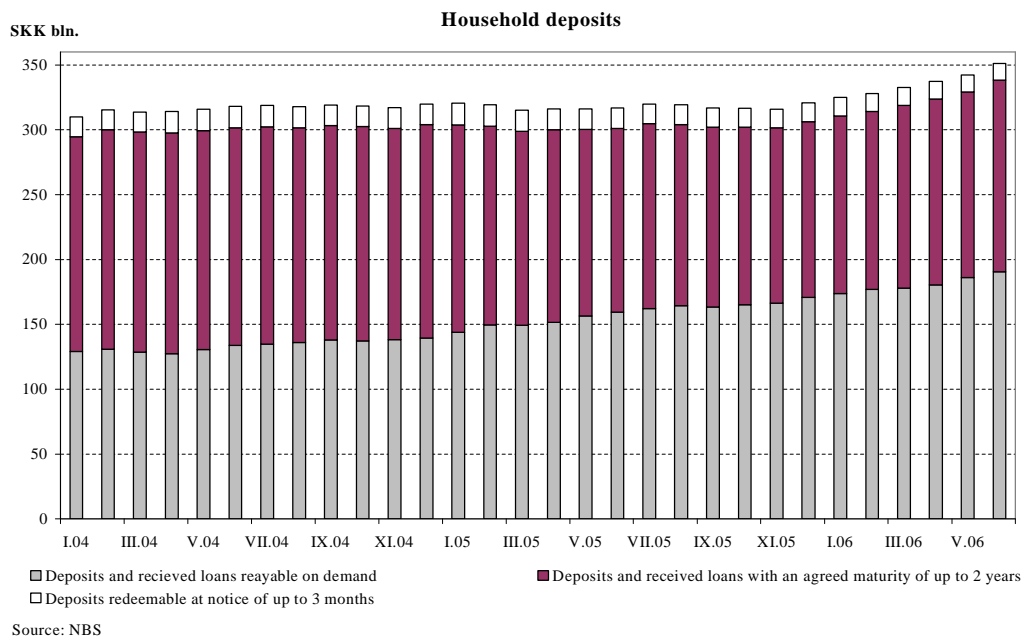




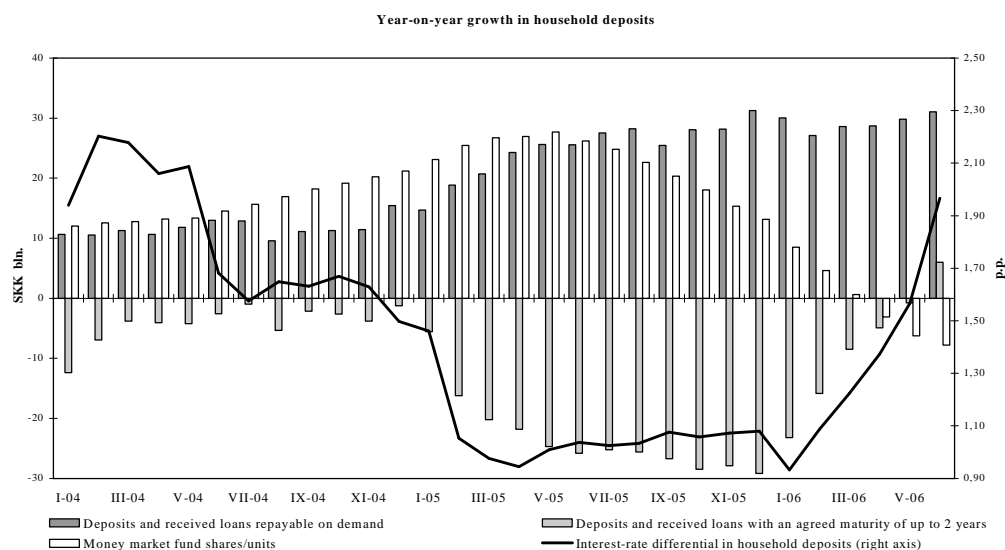
Note: The interest-rate differential represents the difference in the interest rate between the less liquid M2 items (deposits and loans with an agreed maturity of up to 2 years and deposits redeemable at notice of up to 3 months) and deposits and loans repayable on demand.

### Household deposits

In household deposits an increase was recorded in the year-on-year rate of growth from the beginning of the year to 10.9% in June 2006 (the average year-on-year growth in 2005 reached 0.5%). The total year-on-year growth of SKK 34.4 billion was mainly due to household deposits and received loans repayable on demand, which grew year-on-year by SKK 31.1 billion.



Similarly as in the case of non-financial corporations, in the case of households, little difference in the interest rates between term deposits and deposits repayable on demand was recorded. This difference began to increase from the beginning of 2006. Consequently the fall in household deposits and received loans with an agreed maturity of up to 2 years slowed and then recently changed to growth (SKK 6.0 billion year-on-year). The growth in deposits was probably influenced also by the lower demand for investing in money market funds shares/units. This form of investment was also replaced in part by investment in shares/units of investment funds other than money market funds (a year-on-year growth of 70.8% in the second quarter of 2006).



Source: NBS

Note: The interest-rate differential represents the difference in the interest rate between the less liquid M2 items (deposits and loans with an agreed maturity of up to 2 years and deposits redeemable at notice of up to 3 months) and deposits and loans repayable on demand.

From the aspect of currency structure the development of household deposits is influenced primarily by koruna deposits, which accounted for almost 90% (SKK 307.7 billion) of all household deposits. Following a slowdown in the previous year, the year-on-year rate of growth in koruna deposits accelerated from the beginning of 2006 to 11.4% in June 2006 (in comparison with 1.7% in December 2005). The growth in household deposits occurred partially also due to a lessening in the decline and then subsequent growth in foreign-currency deposits from the second quarter of 2006.

### **Deposits not included in M3**

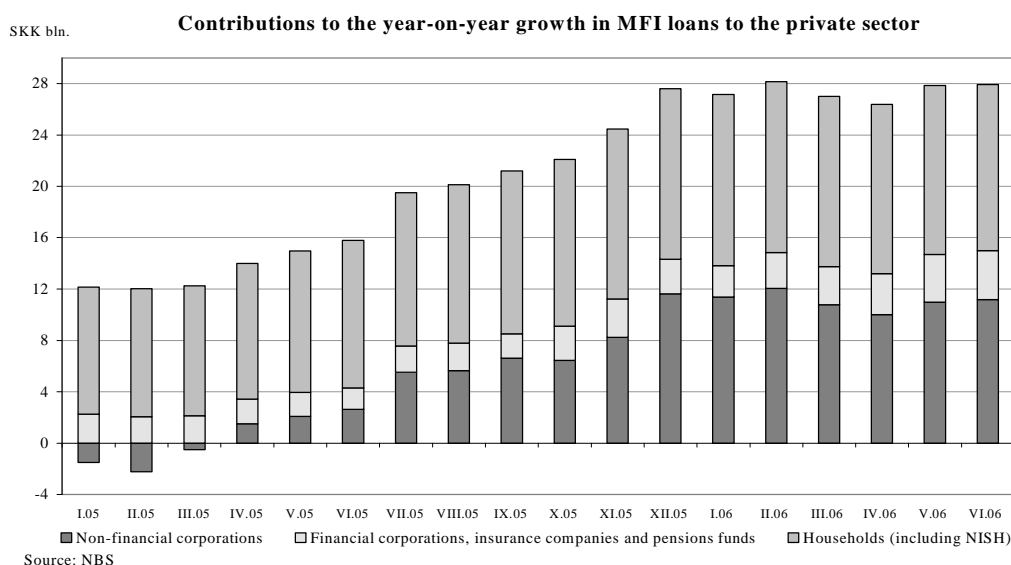
In deposits not included in M3, only household deposits with an agreed maturity of above 2 years grew slightly, while the trend of a declining volume of household deposits redeemable at notice of above 3 months continued. Non-financial corporations' deposits not included in M3 accounted for an insignificant part of non-financial corporation total deposits and their development throughout the period was stable.



### 4.3 Monetary financial institutions loans to the private sector

MFI loans to the private sector (excluding securities) reached SKK 569.1 billion at the end of June 2006, recording a growth of SKK 61.9 billion in comparison with 2005. This development was due to both loans in SKK (a growth of SKK 49.8 billion), as well as loans in EUR (a growth of SKK 12.3 billion). Loans in other foreign currencies recorded a slight decrease (of SKK 0.5 billion). As at the end of the first half of 2006 the currency structure had not changed significantly. In the total volume of loans, koruna loans accounted for 77.9%, loans in EUR 20.8%, and loans in other foreign currencies accounted for 1.3% (as at the end of 2005 loans in SKK accounted for 77.5%, loans in EUR 20.9%, and in other foreign currencies 1.6%).

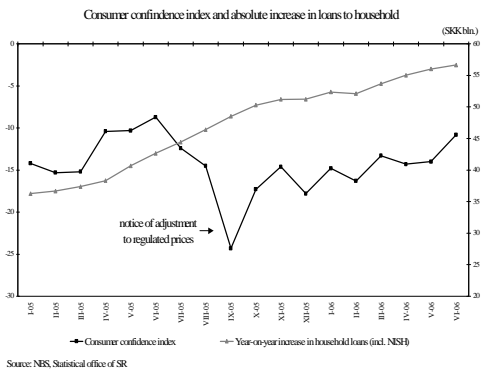
The year-on-year rate of growth in loans to the private sector reached 27.9% for the first half of 2006. Loans to households<sup>4</sup> contributed most to the year-on-year growth in loans, where they accounted for 12.9 percentage points in the year-on-year growth (a growth of SKK 57.6 billion). The contribution of loans to non-financial corporations reached 11.2 percentage points (a growth of SKK 49.8 billion). In comparison with December 2005 the contribution of loans to financial corporations also grew slightly by 1 percentage point to 3.8 percentage points (a growth of SKK 17.0 billion).



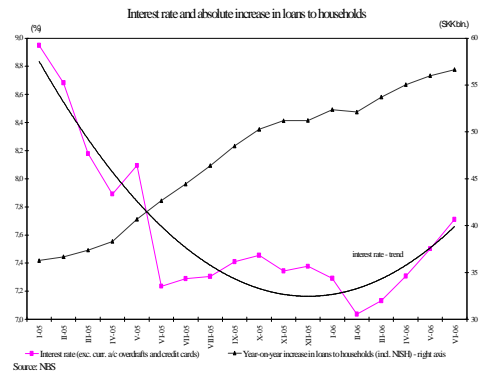
MFI loans to households continued in their growth trend from the preceding year, recording an absolute year-on-year growth of SKK 57.6 billion at the end of June 2006 and their year-on-year rate of growth reached 38.1%. Whereas the rate of growth in loans slowed slightly under the influence of high growth in loans in the preceding year, the absolute year-on-year increase in loans to households increased throughout the whole period. Demand for loans has probably reflected also the development of the consumer confidence indicator, which, following a decline in the second half of 2005 (caused by the announcement of an increase in regulated prices), began to grow slightly.

<sup>4</sup> Includes non-profit institutions serving households (NISH)



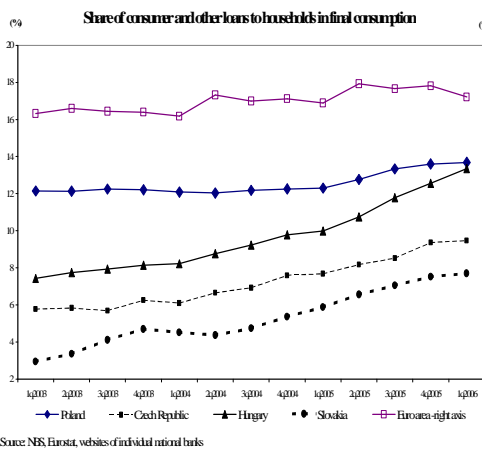


Source: NBS, Statistical Office of the SR

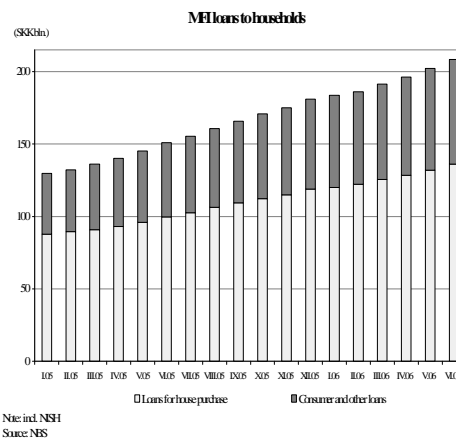


Source: NBS

In the total volume of loans to households, loans in SKK accounted for 99%. Similarly as in 2005 households used loans in the first half of 2006 mainly for long-term investments. From the aspect of the purpose structure of loans to households, loans for house purchase<sup>5</sup> recorded the highest year-on-year increase, of SKK 36.4 billion, (in 2005 by SKK 31.0 billion), contributing 24.1 percentage points to the year-on-year growth in loans to households. In January 2006 the reporting of “American mortgages” was changed. These loans began to be reported in individual types of loans according to purpose of use (until December 2005 they had been reported in other loans). In consequence of this change a growth in the consumer loans and a fall in other loans was recorded, therefore the aggregate of consumer and other loans provides a more consistent view of the purpose structure of loans. Its absolute year-on-year increase did not accelerate throughout the whole of the half year, though did remain high (reaching SKK 21.1 billion at the end of the half year). This growth in loans could have been one of the factors that contributed to the growth in final consumption by households. The share of households’ consumer and other loans in their final consumption increased by 8.2% in the first half of 2006. However, in comparison with the euro area and with other new Member States is this share still low.



Source: NBS, Eurostat, websites of individual national banks



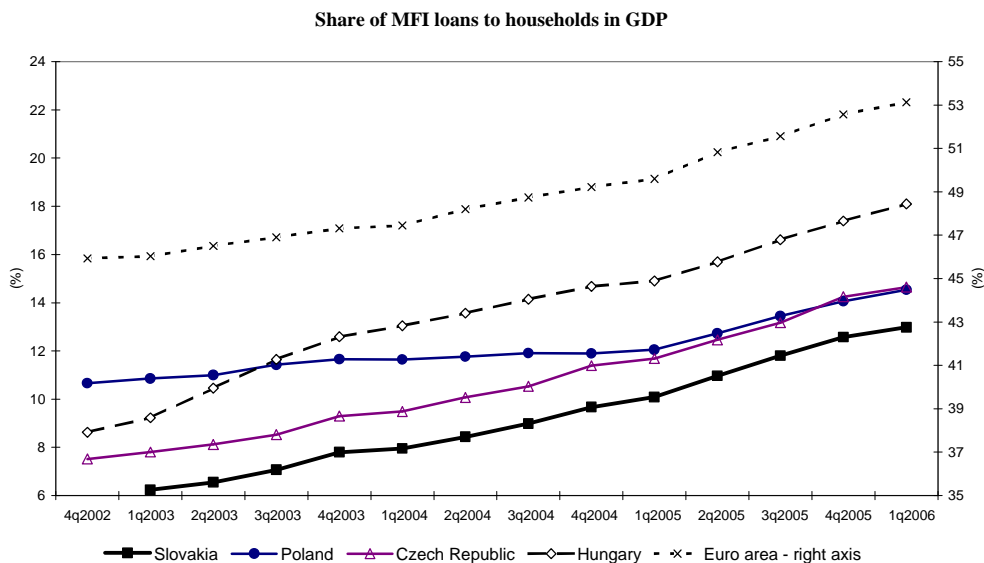
Note: incl. NISH  
Source: NBS

<sup>5</sup> Loans to households (including non-profit institutions serving households, NISH) from the aspect of purpose are divided into loans for house purchase, consumer loans and other loans.





The growth in MFI loans to households was accompanied by a growth in indebtedness (expressed as the share of loans to households in GDP), which grew to 13.7% in the first half of 2006. A similar development relating to the process of real convergence is seen also in other new Member States, where household indebtedness was significantly lower in comparison with the euro area (53.8% in the first half of 2006).

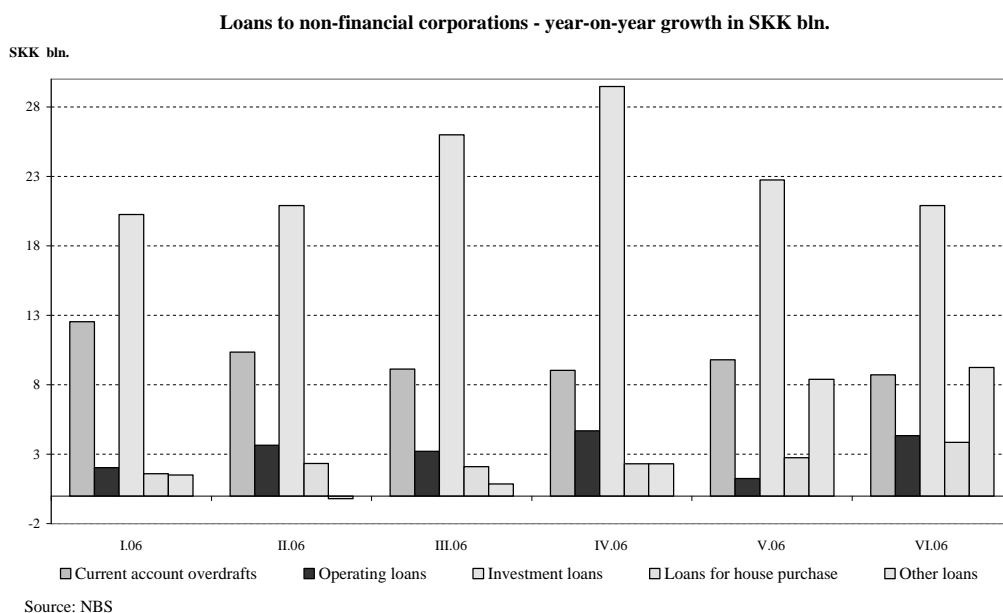


Source: NBS, Eurostat, websites of individual national banks

The development of loans in the non-financial corporations sector was less dynamic than the household sector. Loans to non-financial corporations maintained a constant year-on-year growth of almost 20% throughout the whole of the first half year (a year-on-year growth of SKK 49.8 billion in June 2006).

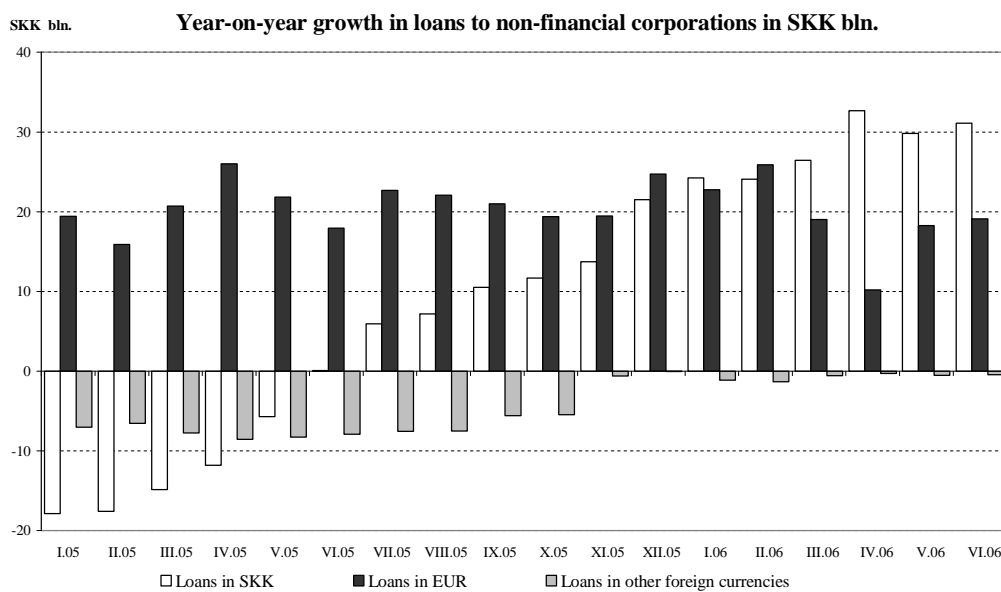
Since January 2006 loans at a rate of 0% have been reported in individual loan types according to their purpose, whereas up until December 2005 they had been reported as a separate group. In consequence of this methodological change the rates of growth for individual types of loan according to purpose are partially distorted. The greatest influence of the methodological change was recorded in other loans (a year-on-year increase of SKK 9.2 billion in June 2006), which accounted for the most substantial part of loans at a rate of 0%. In a breakdown by purpose the largest year-on-year increases were recorded in investment loans (SKK 20.9 billion); loans for house purchase also grew, on a year-on-year basis by SKK 3.7 billion. Year-on-year increases in the current account overdrafts fell over the period from the beginning of the year, to SKK 8.7 billion at the end of the first half of 2006.





From the aspect of time, loans to non-financial corporations of up to 1 year (year-on-year by SKK 24.7 billion) and above 5 years (year-on-year by SKK 22.7 billion) grew the fastest. Loans from 1 to 5 years recorded a fall in the first quarter of 2006, and began to grow slightly in the second quarter (year-on-year by SKK 2.4 billion).

From the aspect of currency structure koruna loans to non-financial corporations reached SKK 190.9 billion at the end of the first half year and euro-denominated loans SKK 101.2 billion. Their development continued the trend from the second half of 2005, when the year-on-year growth in koruna-denominated loans rose further (by SKK 31.1 billion in June 2006) while the growth in euro-denominated loans to non-financial corporations was relatively lower (SKK 19.1 billion). The volume of loans in other foreign currencies recorded a slight decline.



## 4.4 Interest rates

### *Customer interest rates*

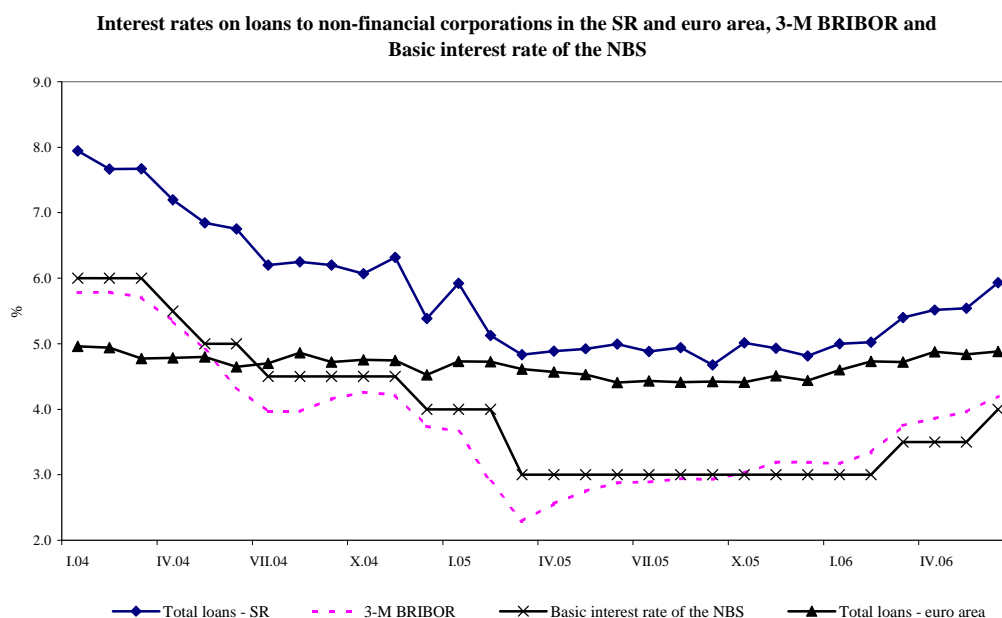
The development of customer interest rates was influenced in the first half of 2006 primarily by the increase in NBS key rates from the end of February and May (in total by 1 percentage point).

### *Interest rates on loans to non-financial corporations*

The development of interest rates on loans to non-financial corporations was characterised by a gradual growth from the end of last year. This development reflected the growth in NBS key rates, which was reflected also in interest rates on the money market. Since more than 97% of loans to non-financial corporations are formed by loans with a floating interest rate and initial rate fixation of up to 1 year, the change in market rates is relatively quickly passed on into client rates on loans to non-financial corporations. This is documented also by development in the first half year, when the increase in NBS key rates was reflected in market interest rates and subsequently also in the interest rate on loans to non-financial corporations (increase of 1.1 percentage points). With regard to the faster growth of the NBS basic rate than that of the ECB, the difference in interest rates on loans to non-financial corporations in the SR and in the euro area has also increased slightly.

Even though interest rates on loans to non-financial corporations increased slightly, a relatively dynamic growth in loans to non-financial corporations was recorded in the first half year (almost 20%) in comparison with the corresponding period a year earlier.

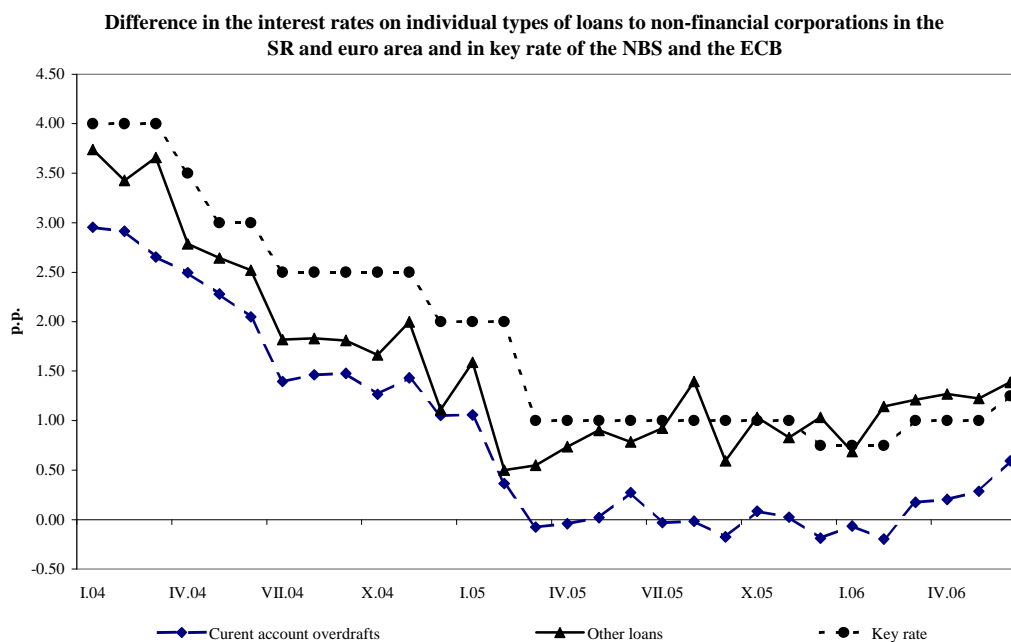




Source: NBS

In a breakdown by loan purpose the interest rate on operating loans grew fastest in the first half year (by 1.2 percentage points) along with current account overdrafts and investment loans (both by 1.1 percentage points).

Interest rates on loans to non-financial corporations are at a higher level in Slovakia than in the euro area, though this difference corresponds to the higher NBS basic rate compared to the ECB key rate. If, however, we compare our interest rates on current account overdrafts, non-financial corporations in Slovakia had relatively better conditions.



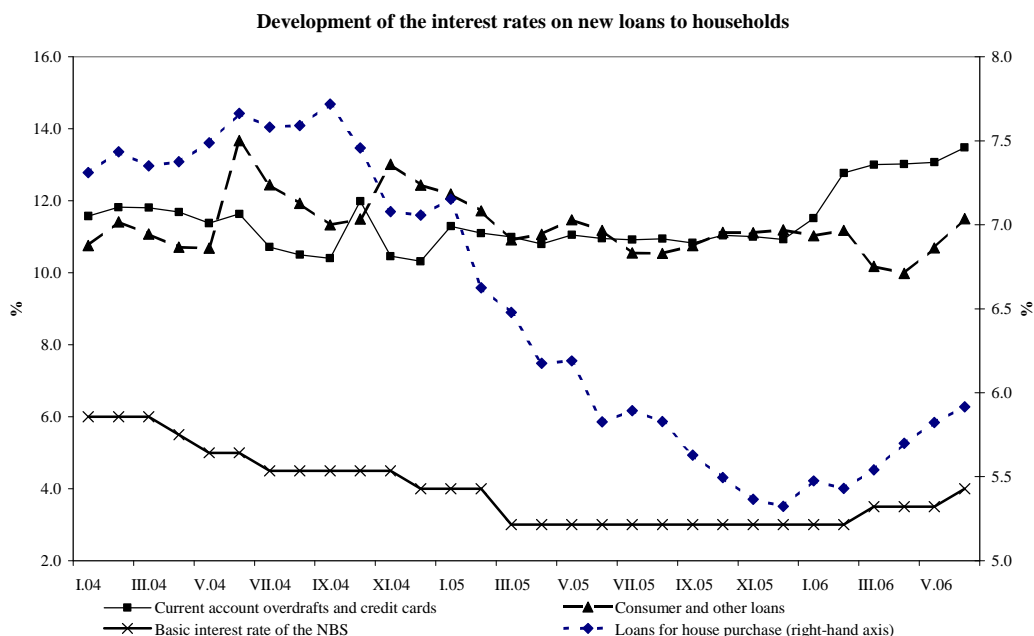
Source: NBS



*Interest rates on loans to households*

Interest rates on loans to households in the first half year recorded a growing trend (growing by 1.69 percentage points against December 2005), which reflected the increase in NBS key rates, as well as the increase in long term rates on the government securities market. Interest rates on loans for house purchase are influenced in particular by long-term market rates (government bond yields). Despite the rise in interest rates on loans to households, the relatively high demand for loans continued.

Expectations of a rise in NBS key rates from the end of 2005 were reflected first in a growth in short-term interest rates (current account overdrafts and credit cards), which grew significantly in the first 2 months. This resulted particularly in a growth in interest rates on loans with a variable interest rate and initial rate fixation of up to 1 year (an increase of 2.25 percentage points compared to December 2005). The interest rate on loans with an initial rate fixation of over 5 and up to 10 years also grew slightly (by 0.66 points). The long-term decline in interest rates on loans for house purchase came to a halt at the end of 2005, and since the beginning of 2006 interest rates on real estate loans have been gradually increasing.

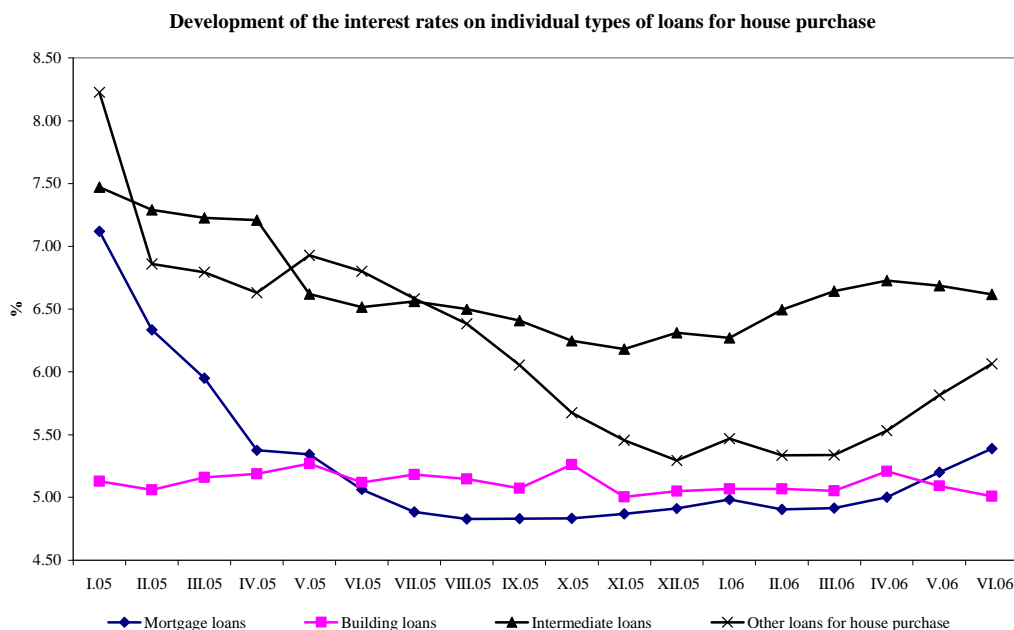


Source: NBS

Within the loans for house purchase the biggest growth in the price was recorded primarily in other loans for house purchase (by 0.77 percentage points compared to December 2005) and of mortgage loans (an increase of 0.48 percentage points in comparison with December 2005). The interest rate on intermediate loans also increased slightly (by 0.31 percentage points), whereas the interest rate on building loans stagnated. The increase in NBS key rates has however not yet been fully reflected in the interest rates on loans for house purchase, particularly in consequence of the short time period from the last increase in key rates (from the end of May) and also probably under the



influence of competition in the banking sector and banks' marketing strategies attracting clients to low interest rates with a floating rate or short fixation period. Interest rates agreed in this way are as a rule reconsidered in the case of a change in conditions on the money market, or on the government securities market.

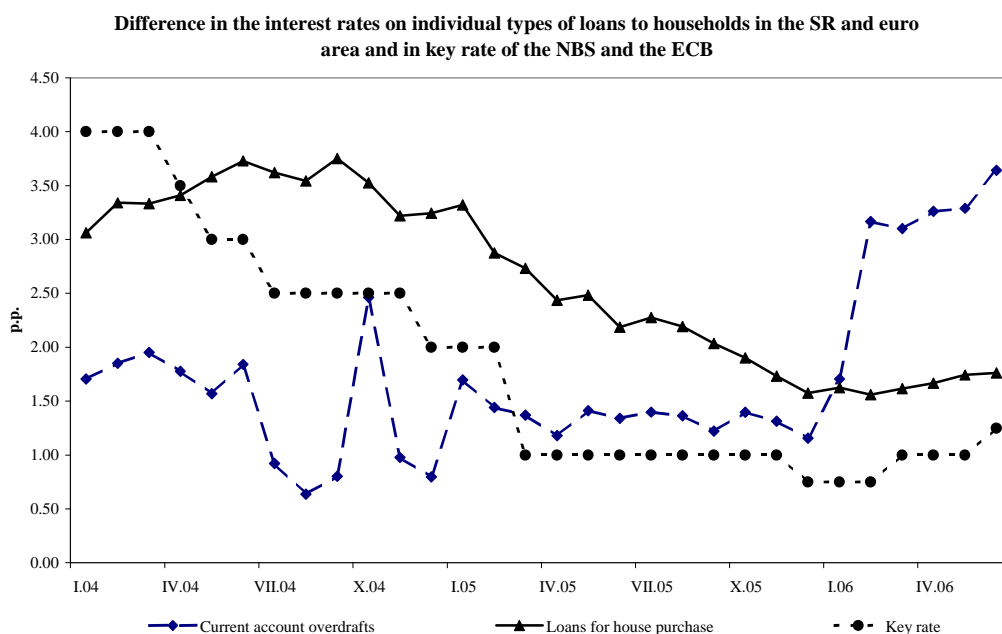


Source: NBS

Interest rates on loans for consumption also partially reflected the increase in NBS key rates. The interest rate on special-purpose consumer loans and on consumer loans without special-purpose grew significantly (an increase of 0.71, and 0.50 percentage points respectively). Interest rates on American mortgages and on the other loans increased only slightly (by 0.24, and 0.21 percentage points respectively).

In the course of the first half year the difference between interest rates on current account overdrafts and credit cards in Slovakia and those in the euro area increased significantly. This development was influenced primarily by the growth in the interest rate on these types of loans at the beginning of the year in Slovakia. In the last months the difference in the price of loans for house purchase increased only slightly, even though key rates in Slovakia grew faster. Since interest rates on consumer loans in Slovakia reported significantly volatile development also in the first half year, it is not possible to analyse and compare the differentials in the interest rates in Slovakia and euro area. It must be emphasised that the difference in interest rates on consumer loans is significant and in June 2006 reached approximately 6.75 percentage points.

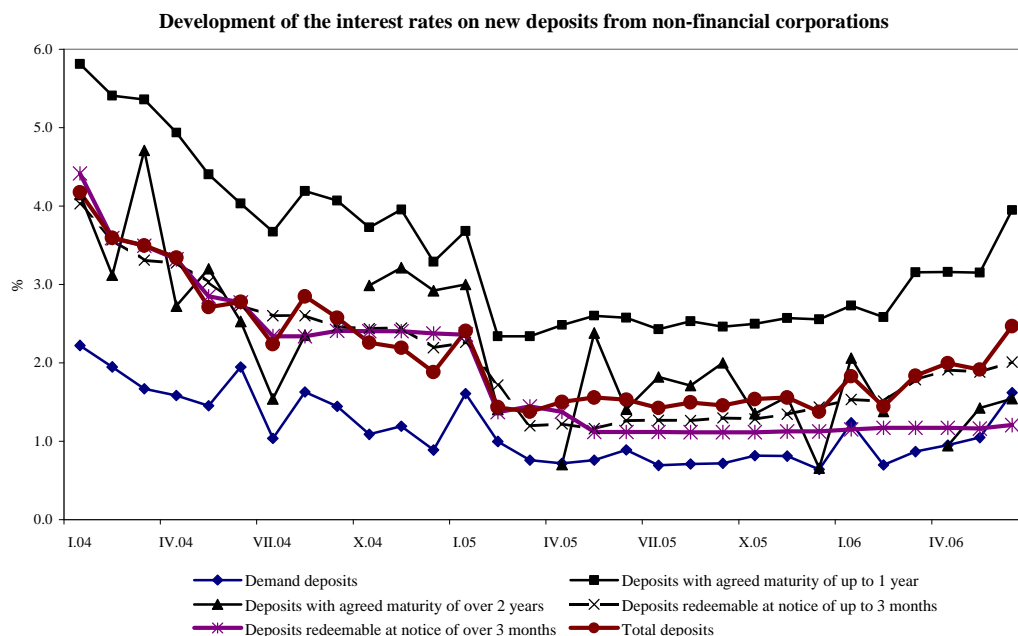




Source: NBS

### *Interest rates on deposits from non-financial corporations*

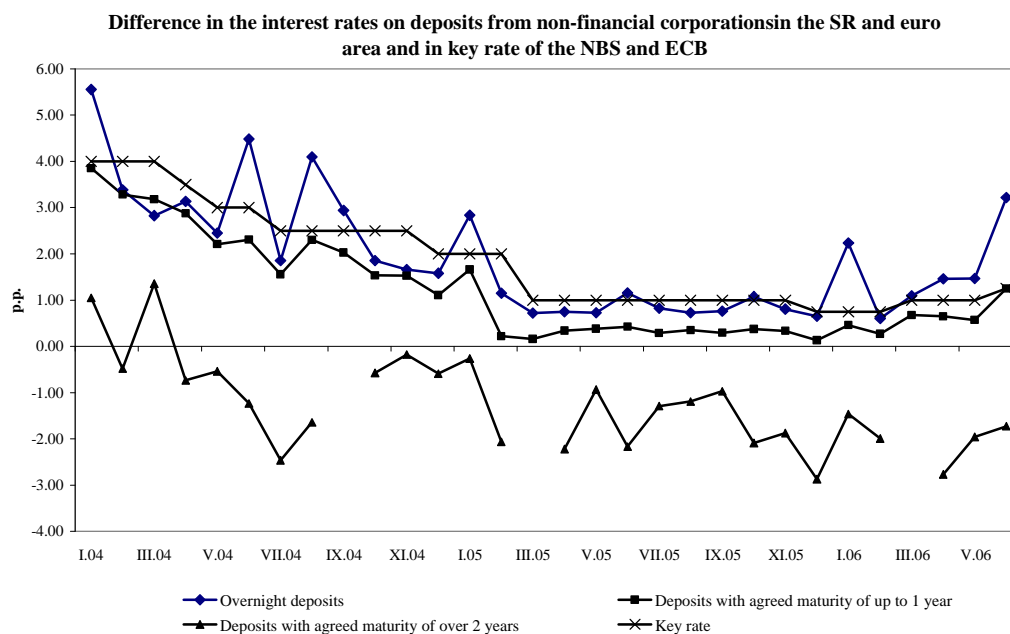
Interest rates on deposits from non-financial corporations recorded significant growth in the first half of the year (by 1.11 percentage points), which reflected the growth in NBS key rates. The reaction of customer interest rates to this development was relatively flexible, when interest rates grew on almost all types of deposit. The interest rates on deposits with an agreed maturity of up to 1 year recorded the most significant increase in the first half of the year (growing by 1.4 percentage points). The interest rate on demand deposits grew by 0.98 percentage points, on deposits with an agreed maturity of over 2 years by 0.88 percentage points, and on deposits redeemable at notice of up to 3 months by 0.57 percentage points.



Source: NBS

Note: In September 2004, March 2005 and March 2006 no new deposits from non-financial corporations with an agreed maturity above 2 years were received.

The difference in interest rates on deposits from non-financial corporations in the SR and in the euro area at present roughly corresponds to the difference in key interest rates, with the exception of long-term deposits (deposits with an agreed maturity of above 2 years). Since the ECB does not report other types of deposits in its statistics, these are not evaluated and compared.



Source: NBS

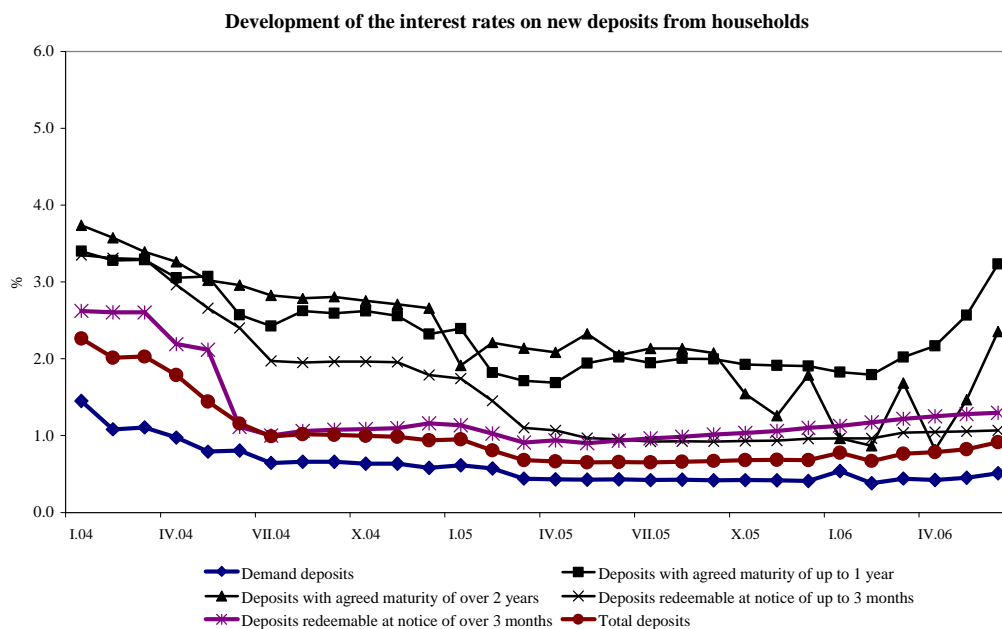




Note: In September 2004, March 2005 and March 2006 no new deposits from non-financial corporations with an agreed maturity above 2 years were received in Slovakia.

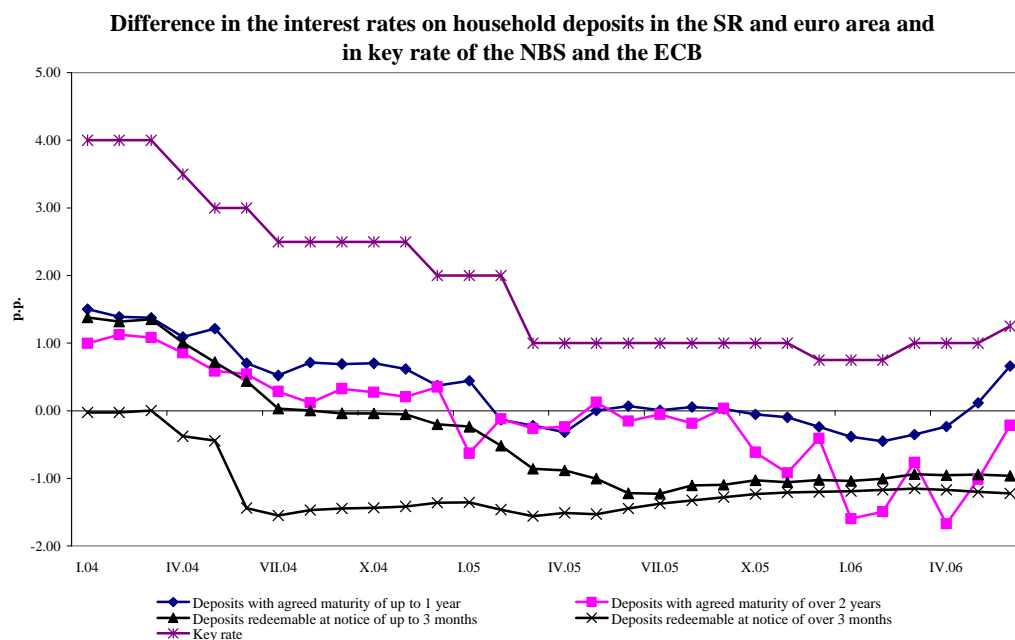
### Interest rates on household deposits

Following long-term stagnation, interest rates on households' deposits recorded a slight growth in the first half of the year, reflecting the increase in NBS key rates. This reaction is visible primarily in the case of deposits with an agreed maturity, when interest rates on deposits of up to 1 year rose by 1.33 percentage points and on those of over 2 years by 0.56 percentage points. On the other hand the reaction of interest rates on the other types of deposits is still quite small. Only slight growth was recorded in the case of interest rates on deposits redeemable at notice (above 3 months by 0.20 percentage points and up to 3 months by 0.11 percentage points) and also in the case of demand deposits (0.10 percentage points).



Source: NBS

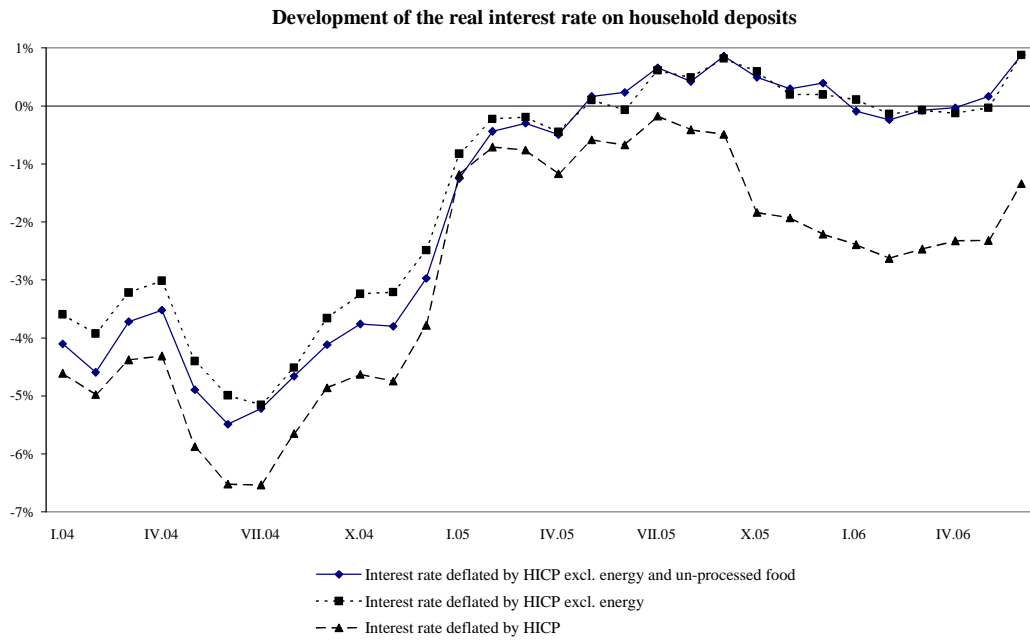
In contrast to non-financial corporations, interest rates on households' deposits have for a long time been lower interest-yielding than the same deposits in the euro area, where key interest rates in Slovakia over the first half of 2006 were higher by 0.75 to 1.25 percentage points comparing to the rates in the euro area. In the period monitored the interest rate difference decreased significantly only in the case of deposits with an agreed maturity of up to 1 year and in the last months also in the case of deposits with an agreed maturity of above 2 years. In the case of deposits redeemable at notice the difference in interest rates remains more or less stable at a negative value of approximately 1 percentage point (i.e. interest rates on these deposits are higher in the euro area).



Source: NBS

Interest rates on deposits from households and non-financial corporations in Slovakia are probably influenced also by commercial banks' liquidity, when the central bank sterilises a significant volume of liquidity.

The real interest rate calculated by deflating the interest rate on the volume of households' one-year deposits by inflation measured by the HICP had a slightly growing trend in the first half of 2006. This was, in particular, in consequence of the growth in the interest rates on households' one-year deposits. On the other hand, the growth in inflation rate exerted contrary influence. The real interest rate using HICP excluding energy, or HICP excluding energy and unprocessed food, however, at the end of June 2006 reached positive values close to 1%.



Source: NBS, Statistical Office of the SR

## **5. FINANCIAL MARKETS**

### **5.1 Money Market**

#### *Interest rates*

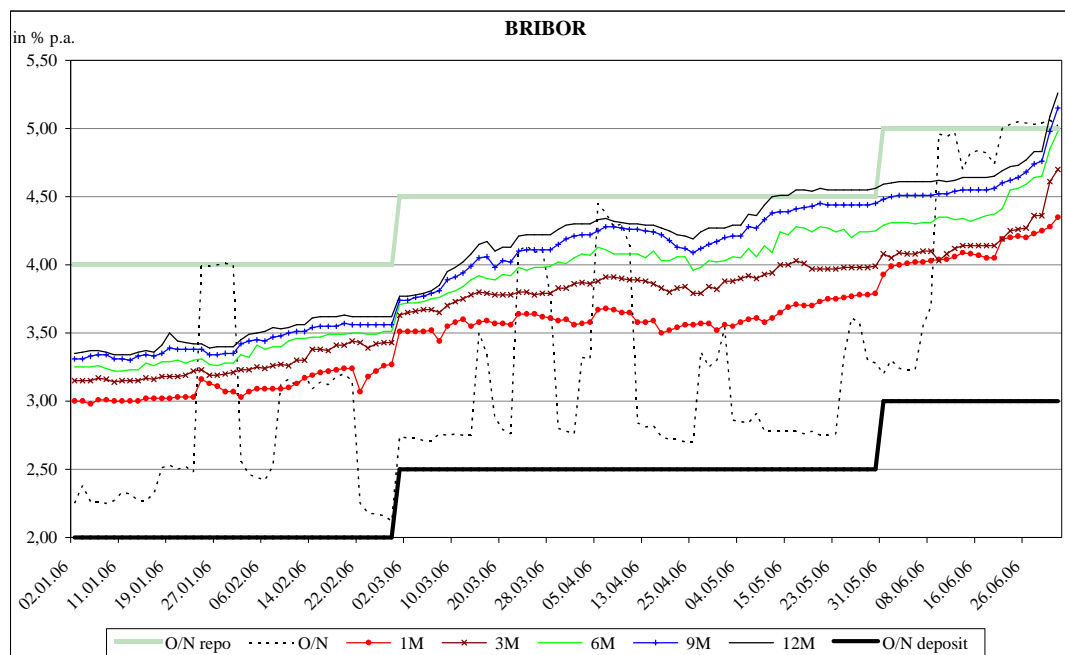
The initial stable development of interest rates at the start of the half year was interrupted by a growth in the price of koruna funds with a long maturity, which was connected with the change in commercial banks' expectations as a reaction to the meeting of the NBS Bank Board at the end of January. Although the Bank Board decided to leave the current interest rates unchanged, its comments and voting on an increase in rates indicated the possibility of monetary policy being soon tightened.

The weakening of the Slovak koruna in February at the time of negotiations on early elections led to a growth in the long end of the yield curve. The growth in rates was supported also by the publication of data on the foreign trade deficit for December and on the January inflation rate, which raised expectations of a growth in key rates at the end of February.

The increase in NBS rates by 0.5 percentage points with effect from 1 March 2006 led the money market to react with an upward shift in the yield curve at the start of March. The reason was the fact that banks had only partially calculated the increase into the yield curve. A larger growth was recorded in the case of medium maturities, which grew by 20 to 25 base points. The long end of the yield curve rose to a lesser degree. Despite the Slovak koruna's subsequent strengthening, long maturities continued to grow.

In March under the influence of increased demand among foreign banks for purchasing funds, particularly through swaps, the yield curve again shifted upwards at a time of the Slovak koruna's weakening. The growth in activities caused a gradual increase in the price of rates from 1 to twelve months. The reaction to the publication of February data on inflation, which was worse than the market had expected, was a growth in prices of medium and long maturities. The growth in these rates was influenced also by the Slovak koruna's weakening exchange rate in consequence of the closing of koruna positions through funds being purchased by non-residents through swaps. The growth in interest rates continued also following the publication of foreign trade results for January and revised data on the trade deficit for 2005, which was worse than the market had expected. A further weakening in the exchange rate contributed to the increase in prices of medium and long maturities. Only with the publication of the HICP index for February, which was in line with expectations, did this trend come to a halt.





The significant strengthening of the Slovak koruna at the end of March due to the return of foreign short-term capital to the region and accompanied by sales of koruna funds brought down the price of medium and long rates, as well as the price of derivatives based on money market rates.

Leaving key rates at their original level at the end of March was in line with the banking sector's expectations. Interest rates for longer maturities received a new impulse in the form of the Slovak koruna's weakening exchange rate and from the resultant closing of koruna positions by non-residents, contributing to a rise in rates.

The publication of March HICP results, which were better than expected, accompanied by a strengthening of the Slovak koruna in April, together led to a temporary fall in interest rates.

Ahead of the NBS Bank Board meeting on rates at the end of May the price of longer maturities rose. The impulse for their growth was the continuing demand for purchasing koruna funds, with trades also being realised in FRA contracts and IRSs. The reaction to the increase in NBS key rates was recorded most notably primarily in maturities from 1 week to 3 months, which were thus set at a new level. The shift however was not so significant, because the banking sector had already partially included in the interest rate increase.

The largest changes were recorded in money market interest rates at the end of the half year. Following the publication of political negotiations on the new government coalition a significant rise in rates occurred. This was due to foreign investors' closing of koruna positions at a time of the Slovak koruna weakening.



### Interbank liquidity

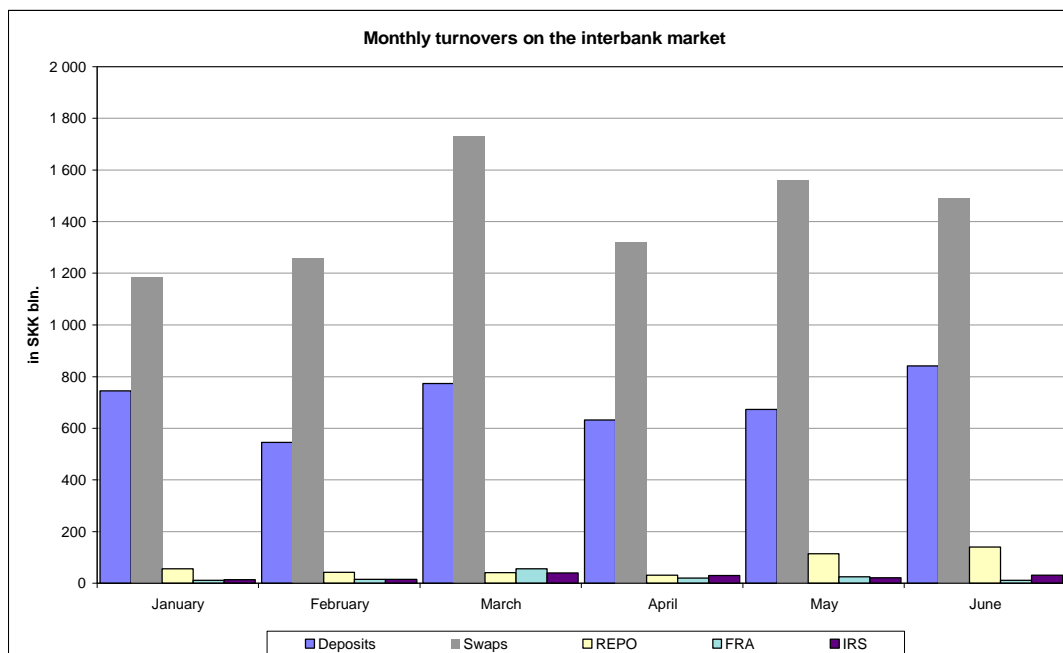
The volume of interbank liquidity recorded changes in both directions over the course of the first half year. February saw a fall in the need for sterilisation due to a transfer of State Treasury funds from accounts held at commercial banks to an account at the NBS. A further significant change occurred in the middle of the monitored period following a transfer of State Treasury funds from accounts held at the NBS to accounts at banks at the end of March. The change was fully reflected in April when the total volume of sterilised funds rose to SKK 416.7 billion, the highest value in the first half year. A foreign exchange intervention realised at the end of the first half year drew liquidity off from the interbank market, whereby the need for sterilisation fell to SKK 406.3 billion.

### Trading between banks

The volume of interbank trades recorded a growth in traded volume comparable to that of the preceding period. The largest share in total traded volume was recorded by trades in the swaps (63.43%) and deposits (31.24%). Next in order came repo trades (3.16%) and smaller shares were recorded by FRAs (1.04%) and IRSs (1.13%).

Concerning individual types of trades, the most traded deposits were overnight (85.5%) and maturities from 7 to 14 days (10.3%). In the case of swaps the shortest terms again predominated. These formed 82.0%, followed by maturities of up to 7 days (9.3%). Trading in FRA contracts was concentrated particularly on maturities from 1 to 3 months (86.9%) and in the case of IRSs, trades up to 1 year (42.1%).

Foreign banks formed the majority of the total volume of interbank trades, with a share of 68.9%. In individual types of trades, non-residents dominated in IRSs (80.9%), swaps (78.8%), deposits (53.2%) and FRAs (52.5%). Domestic banks formed a majority in the case of repo trades (73.4%).



### Open market trades

The NBS continued in using standard instruments on the money market, namely overnight deposits and repo refinancing trades, 2-week repo tenders and issues of 3-month NBS bills.

In individual forms of trades on the open market, repo tenders continued to predominate, where at the end of the half year their share moved around 95.5%, followed by NBS bills with 2.2%, overnight deposits 1.7% and overnight repo refinancing trades 0.6%.

Average daily influence of individual forms of open-market trades on banking sector liquidity

(SKK million)

	2005		2006					
	1 <sup>st</sup> half year	2 <sup>nd</sup> half year	January	February	March	April	May	June
O/N deposit	- 61 370	- 4 587	- 2 066	- 10 221	- 8 969	- 7 857	- 8 539	- 4 989
O/N repo	1 156	387	3 695	554	532	392	295	8 512
Repo tender	- 274 190	- 315 548	- 377 021	- 364 523	- 373 086	- 407 655	- 406 895	- 392 820
NBS bills	- 57 099	- 87 084	- 14 722	- 11 354	- 8 649	- 1 561	- 510	- 16 986
Total	- 391 503	- 406 832	- 390 114	- 385 544	- 390 172	- 416 681	- 415 649	- 406 283

In comparison with the preceding period the share of repo tenders grew significantly at the expense of NBS bills. The reason for this was the change in the shape of the money market yield curve from inverse to standard and banks' resultant requirements for a higher yield in comparison with the main NBS rate for 2-week repo tenders.

### Compulsory minimum reserves

As regards the calculation and formation of compulsory minimum reserves (CMR) no change to the rate for the formation of CMR by banks and branches of foreign banks occurred in 2006 compared with 2005. The rate thus remained at 2%. Actual fulfilment of the CMR for the banking sector as a whole in the first half of 2006 was settled with a significant volume in April. Against a background of significant excess liquidity in the banking sector and continuing NBS sterilisation activities via open-market trades the set CMR volume was met each month in the first half of 2006 by means of open-market trades. Average monthly excess reserves ranged from SKK 0.02 billion to SKK 0.6 billion.

Fluctuations in daily financial reserves against the CMR set ranged in individual periods from SKK 31.2 billion excess reserves through to insufficient reserves of SKK 18.8 billion. The largest variability as measured by standard deviation in the development of financial reserves over the first half of 2006 was recorded in April and June. More detailed data concerning the fulfilment of compulsory minimum reserves is given in the table below.

(SKK billion and %)

	Prescribed CMR	Actual fulfilment of CMR		
		Average	% Fulfilment	Standard deviation
January	22.06	22.12	100.28	8.03
February	22.06	22.08	100.10	6.60
March	21.52	21.60	100.36	12.59
April	21.93	22.53	102.73	16.77
May	22.85	22.89	100.18	11.81
June	22.91	22.98	100.29	14.29



In the first half of 2006 non-fulfilment of the set compulsory minimum reserves occurred once.

### ***SR Treasury bills***

For the first half year the SR Ministry of Finance planned 1 issue of treasury bills, which was carried out on 31 May 2006. Treasury bills with a maturity of 364 days, in a total volume of SKK 32 billion were issued into the own portfolio. The Debt and Liquidity Management Agency (ARDAL) is considering, depending on the development of the state budget, carrying out individual repo trades via an issue.

## **5.2 Capital market**

### ***Primary market***

#### *Government bonds*

Apart from the fact that ARDAL continued in 2006 in increasing 4 issues of government bonds opened in previous years, it introduced to the market a new 20-year issue with a fixed coupon of 4.50% and a standard target sum of SKK 40 billion. This is also the longest maturity of an issue on the domestic market.

ARDAL held in total 11 auctions of government bonds in the first half of 2006, of which only 4 were successful. One of the reasons for the auction bids being rejected by the issuer was the favourable development of the state budget against expectations. The second reason was the possibility to borrow more cheaply from other sources, primarily from temporarily spare funds at the State Treasury. In March a 15-year issue on foreign markets in the value of EUR 1 billion also provided an important alternative source of funds. Moreover, demand among investors for purchasing government bonds on the primary market was falling over the course of the first half year, given the persistent rejection of bids from the side of ARDAL. Issues in the first half of 2006 totalled SKK 22.5 billion. In comparison with the corresponding period of previous year this represented a decrease in the issue of government bonds by 38.5%, meaning a fall of SKK 14.1 billion.

Structure of government bond issues by maturity

	1 <sup>st</sup> half year 2005 (SKK bln)	1 <sup>st</sup> half year 2006 (SKK bln)
5-year, variable coupon (12M BRIBOR)	7.9	9.7
5-year, fixed coupon	18.7	-
7-year, zero-coupon	2.2	3.8
10-year	4.1	0.0
15-year	3.7	3.6
20-year	-	5.4

Total demand for treasury bonds in the first half of 2006 reached SKK 59.3 billion, which compared to the same period of 2005 represents a fall of 45.6%.

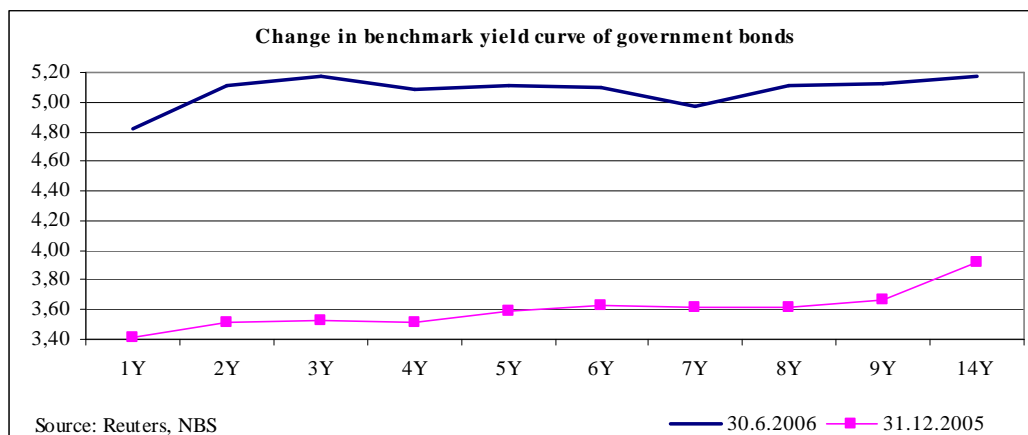
#### *Benchmark yield curve for government bonds*

Throughout practically the whole period monitored an upward trend prevailed in the development of government bond yields, where this was influenced primarily by the





increase in the NBS base rate, or by expectations of this step, as well as by the domestic currency weakening. The situation on the domestic political scene significantly influenced yields in the post-electoral period in the second half of June. The yield curve for benchmark government bonds shifted upwards over the course of the first half of 2006 on average by 148 base points.



#### *Government bond redemption and instalments*

In the first half of 2006 revenues on government bonds were paid out in the total sum of SKK 10.2 billion (SKK 11.5 billion in the first half of 2005), of which almost SKK 2.5 billion was paid to foreign investors (SKK 2.6 billion in the first half of 2005), SKK 7.4 billion to domestic investors (SKK 9.0 billion in the first half of 2005), and SKK 0.33 billion to bond creditors (SKK 1.2 billion in the first half of 2005).

In the first half of 2006 one issue was repaid in the amount of SKK 35.4 billion, which is almost twice as high as the same figure for the same period in 2005. The nominal value paid out to foreign investors was SKK 0.6 billion (1.7% of the total nominal value paid out), while SKK 34.8 billion was paid out to domestic investors (98.3%). Bond creditors did not feature in the payout of nominal value.

Overall, revenues and the nominal value paid out in the first half of 2006 totalled SKK 45.6 billion (SKK 29.9 billion in the first half of 2005), which compared to the corresponding period of previous year was 52.5% more.

#### *Non-government bonds*

In the first half of 2006 the NBS made 18 issues of non-government bonds in the total value of SKK 7.6 billion, of which 1 issue of mortgage bonds was denominated in EUR (in the value of EUR 60 million). Of the total value of issues made mortgage bonds represented SKK 5.4 billion (in total 7 issues). Mortgage bond issuers were Tatra Banka, Slovenská Sporiteľňa, OTP Banka, VÚB and Istrobanka.

#### *Secondary market*

A significant change in the capital market, which occurred in the period monitored, was the transfer of shares in the SR Central Depository (CDCP) to the asset accounts of the



Bratislava Stock Exchange, whereby the central depository became a 100% subsidiary of the Bratislava Stock Exchange (BSSE). The transfer was realised in 2 stages. In the first (30 January 2006) the CDCP shares were transferred from the asset account of the SR Ministry of Finance to the account of the National Property Fund. In the second stage (16 March 2006) the shares were transferred to the account of the BCPB. A further step in the privatisation project of CDCP, namely the offering of a package of shares to interested investors, was not made because the SR Government suspended the realisation of all privatisation projects in its resolution on 25 January 2006 “Declaration of the Government of the Slovak Republic on the Non-Adoption of Decisions on Privatisation in the 3<sup>rd</sup> Electoral Period”.

#### *General overview of trading on the Bratislava Stock Exchange*

In the first half of 2006 the BSSE in the course of 121 working days and in 4 660 transactions achieved a traded volume of SKK 313.4 billion, which in a year-on-year comparison represented a fall of 36.7%. On an annual basis the number of trades fell by 29.4%.

As at the end of the first half of the year the BSSE registered on its markets in total 391 issues of securities (shares, mutual fund certificates and bonds). That included 34 issues on the listed main markets, 68 on the listed parallel market and 289 issues on the open market.

The main share of the annual traded sum (98.96%) comprised direct transactions, with a value of SKK 310.1 billion (a year-on-year fall of 36.6%). The price-making function of the main organiser of the Slovak capital market weakened by 43.2% in the first half of 2005, while the sum of SKK 3.3 billion pertained to price-setting transactions.

The share of trades realised by non-residents in the total volume of transactions in the period monitored represented 49.6%, of which 53.6% were purchases and 45.7% were sales.

#### *Bond trading*

The volume of bonds traded in the first half of 2006 reached SKK 312.7 billion, representing a fall of 36.7% in comparison with the corresponding period of previous year. Trading in government bonds again recorded the largest financial volume. The total financial volume of their trading reached SKK 311.2 billion (1158 transactions), representing 99.5% of the total volume of trades at the Bratislava Stock Exchange in the first half of 2006.

The market capitalisation of debt issues as at the last day of trading in the period monitored represented SKK 411.1 billion, (a growth of 3.2% on an annual basis), of which SKK 389.1 billion pertained to listed issues, representing a 3.3% growth on an annual basis.



### *Index SDXGroup*

SDXGroup indices closed the first half year at the following values:

Sector	SDX Group indices		Yield to maturity	Duration (years)
	Price	Development		
<b>Public</b>	<b>100.5</b>	<b>111.9</b>	<b>4.934%</b>	<b>5.250</b>
Subindex SDXG (<=5)	99.7	110.0	5.216%	2.606
Subindex SDXG (>5)	101.6	114.4	4.856%	7.298
<b>Private (corporate bonds + mortgage bonds)</b>	<b>99.9</b>	<b>115.7</b>	<b>4.645%</b>	<b>3.707</b>
Subindex SDXG (<=5)	99.8	116.4	4.516%	1.897
Subindex SDXG (>5)	103.1	114.7	4.694%	5.840

Source: Bratislava Stock Exchange

### *Equity trading*

As at the last day of trading in June it was possible to conclude trades in 295 share issues (221 issuers) including issues of mutual fund certificates, of which 5 issues were on the main listed market, 8 issues on the listed parallel market and 282 issues on the free market. As at the end of June 2006 the listed new market was without a single issue of shares.

Over the course of the half year the BSSE did not register any new equity issues on its markets.

The market capitalisation of all marketable issues of equities registered on the stock exchange markets recorded an 8.5% year-on-year fall to SKK 153.1 billion. The real market capitalisation, i.e. market capitalisation of that part of shares in which at least one price-setting trade was conducted, with the exception of investment fund shares and mutual fund certificates, fell by 7.0% and at the last day of trading represented SKK 142.6 billion. The market capitalisation of the listed market represented SKK 79.3 billion, which on a year-on-year basis represented a fall of 13.6%.

Equities were purchased or sold in the volume of SKK 680.9 million, which corresponded to 1.5 million shares transferred in 3 403 transactions (including obligatory public offers to take over). The year-on-year fall in the volume of trades on the equities market thus reached 49.7%, alongside a 28.1% fall in the number of transactions concluded. Trades within obligatory public offers to take over, the volume of which reached SKK 18.0 million, forming a 2.6% share in the total volume of equity trades in the period monitored.

The most successful listed equities from the aspect of financial volume traded were the shares of Všeobecná úverová banka (74.3 million, 702 trades), Slovnaft (SKK 69.4 million, 342 trades) and the shares of Istrokapitál (SKK 7.0 million, 2 trades). On the regulated free market of the BSSE dominated shares of the issuer Železiarne Podbrezová with a volume of SKK 232.8 million, reached in 660 transactions. The highest number of transactions in the period monitored (702) occurred in the shares of Všeobecná úverová banka. The most active shares in price-setting trades (638 concluded transactions, in the value of SKK 90.7 million) were those of Železiarne Podbrezová.



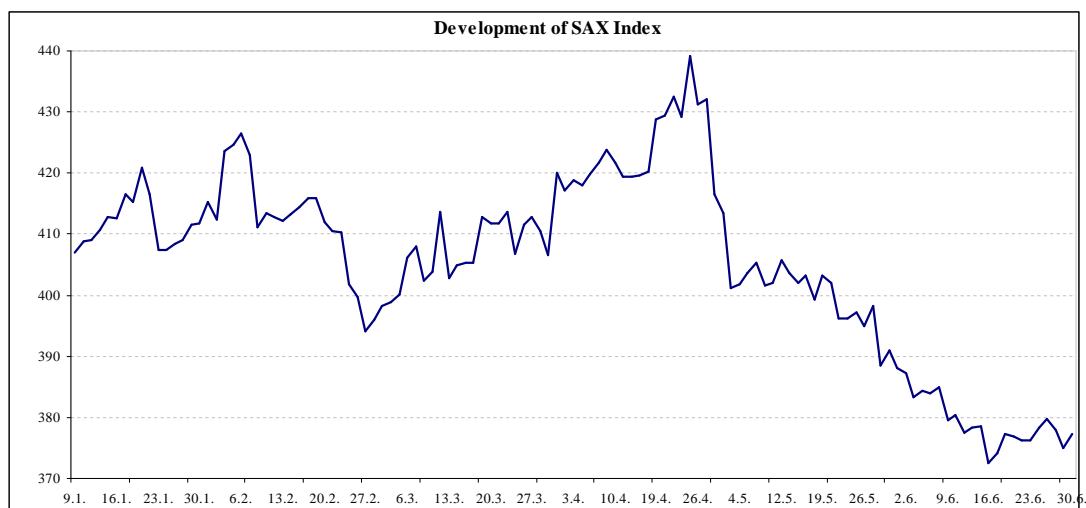
In the first half of 2006 five obligatory public offers to take over offers expired. Eight obligatory public offers to take over offers were declared in the period monitored, where the financial volume of trades in obligatory public offers totalled SKK 18.0 million in 16 transactions and formed to 2.6% of the total volume and 0.4% of the number of all share transactions.

As at the end of June no share issues were recorded in the market makers module.

### SAX Index

The SAX index ended the first half of 2006 at 377.21 points, which in comparison with its level at 23 December 2005 represents a fall of 8.7% (36.10 points). On a year-on-year basis the SAX registered a significant loss of as much as 13.5% (58.89 points).

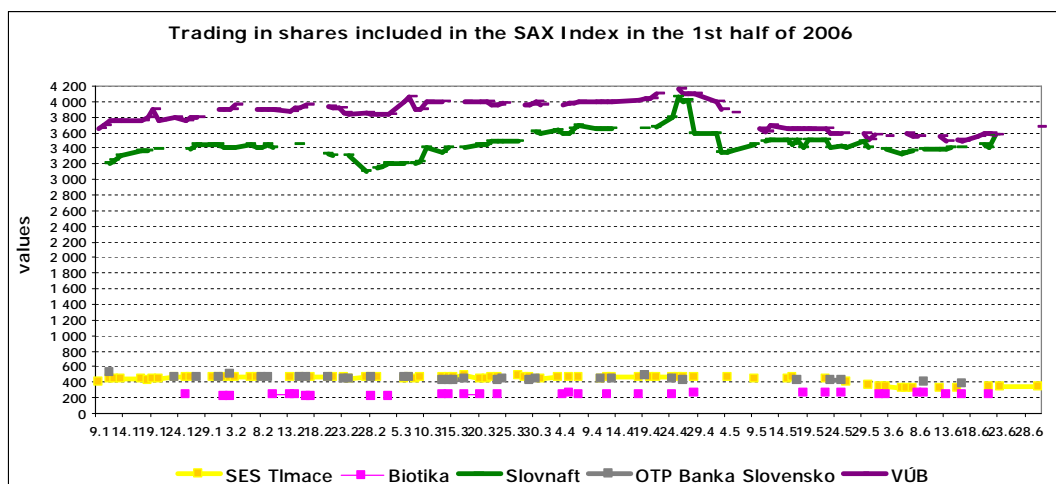
The development of SAX at the start of the year gave no suggestion that the index would bring negative figures. On 27 February SAX reached its lowest point for this year at 394.10 points. The reason for this adverse result in the index development lied most with the fall in the closing prices of base titles of OTP Banka Slovensko (a loss of 12.6%) and of the Slovnaft refinery with a loss of 10.1%. Subsequently the index entered a recovery phase until 25 April. The publication of good economic results for 2005, as well as the decisions by the general assemblies of Slovnaft and Všeobecná úverová banka concerning dividend payments brought increased demand among investors for purchasing these shares, which directly stimulated also a growth in prices. This fact was positively reflected also in the SAX index, which on 25 April reached its half year maximum at 439.15 points. The most significant contribution to the rise in the SAX index in the period monitored came from a strengthening in the Slovnaft share price (30.6%), as well as from the Biotika share price with a strengthening of 11.6% and Všeobecná úverová banka with a profit of 7.8%. The closing prices for the base components of OTP Banka Slovensko and SES Tlmače remained at an unchanged level against 27 February. After reaching a half year maximum the SAX began to fall and on 16 June fell to the index's second lowest of 372.43 points. As at the end of the half year the SAX stood at 377.21 points.



Source: Bratislava Stock Exchange



Over the course of the first half of 2006 a fall was seen in the share prices of OTP Banka Slovensko (28.9%), SES Tlmače (22.7%) and VÚB (2.1%). Share prices rose at Biotika (25.0%) and Slovnaft (4.4%).



Source: Reuters

The commission for the SAX index at its meeting on 31 January corrected the weighting of the base titles so that the weighting of any one company did not exceed the 30% limit.

**Weightings of base titles in the sax index at the close of the month in 2006**

Company	Weighting (%)					
	January	February	March	April	May	June
Biotika, a.s	2.59	2.64	2.77	2.83	3.24	3.10
OTP Banka Slovensko, a.s	27.04	29.70	27.89	26.40	28.22	26.23
SES Tlmače, a.s.	7.74	8.50	7.93	8.11	7.09	6.70
Slovnaft, a.s.	29.52	28.27	31.16	31.21	31.81	32.49
Všeobecná úverová banka, a.s.	33.10	30.89	30.25	31.45	29.64	31.49

Source: Bratislava Stock Exchange

### 5.3 Foreign exchange market

#### *Foreign exchange market operations*

The Slovak koruna exchange rate against the euro weakened by 1.3% during the first six months of 2006, depreciating from SKK/EUR 37.848 (at the end of December 2005) to SKK/EUR 38.322 (at the end of June 2006). The average exchange rate for the first six months strengthened by 2.7% in comparison with the corresponding period of previous year. In the first half year the Slovak koruna deviated most from its parity (SKK/EUR 38.4550) on 3 March 2006, when the NBS reference rate was set at SKK/EUR 36.948, representing an appreciation of 3.92% from the central parity. Against the American dollar the Slovak koruna strengthened by 4.3% (from SKK/USD 31.948 to SKK/USD 30.584), while the average exchange rate fell by 1.9%.

Balance of foreign banks' spot trades towards domestic banks was positive (USD 1 047.28 million), meaning that foreign banks purchased more foreign exchange and sold SKK.



During the first half year the National Bank of Slovakia intervened twice to support the Slovak koruna. Via direct foreign exchange interventions the NBS sold EUR 1 335 million.

In June the exchange rate was significantly volatile and its trend of appreciation was influenced by a change in the development of economic fundamentals, but also by the development of the other CEE currencies and by uncertainty resulting from the developments on the domestic political scene.

The SKK/EUR exchange rate opened on 21 June at 38.280<sup>6</sup>, from which it weakened to SKK/EUR 38.565. This level was also the maximum for the day. Subsequently the NBS began a foreign exchange intervention in favour of the Slovak koruna and over the course of the intervention sold EUR 605 million. The koruna exchange rate strengthened during the intervention to the level SKK/EUR 38.150 (the minimum level for the day). Following the end of the intervention the exchange rate stabilised slightly above this level and ended the day at SKK/EUR 38.192. The NBS reference rate was set that day at the level SKK/EUR 38.518.

In the evening hours of 28 June the Slovak koruna began to weaken against the reference euro and continued in this trend on 29 June, when the opening level of SKK/EUR 38.460 weakened to the maximum level for the day SKK/EUR 38.520. The NBS reacted to the Slovak koruna weakening by a further foreign exchange intervention, during which it sold EUR 730 million. The koruna exchange rate strengthened during the intervention to SKK/EUR 38.200 (the minimum level for the day), where following subsequent stabilisation it closed the day at SKK/EUR 38.325. The NBS reference rate for the day was set at SKK/EUR 38.322.

In accordance with the decision of the NBS Bank Board on 25 April 2006 on optimisation of the balance of NBS foreign exchange reserves, the National Bank of Slovakia sold EUR 134 million during the course of the first half of the year.

Change in the koruna exchange rate against EUR and USD

	change for 1 <sup>st</sup> half year (at close of June)	<u>average June 06</u> average June 05	<u>average (Jan-Jun) 06</u> average (Jan-Jun) 05
	%	%	%
EUR/SKK	1.3	-1.3	-2.7
USD/SKK	-4.3	-5.0	1.9

- means an appreciation of SKK

+ means a depreciation of SKK

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

The total volume traded on the interbank forex market in the first half of 2006 reached USD 558 090.6 million (USD 329 670.9 million in the second half of 2005), representing a growth compared to the previous half year of 69.3%. Concerning types of trades, 90.4% comprised swap transactions, out of which the prevailing part was made in USD (94.9%). Spot trades contributed a share of 8.6% to the total volume, where 98.0% of

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<sup>6</sup> The EUR/SKK exchange rate levels reached are set on the basis of prices of trades, performed by means of the Reuters Matching 3000 system.



these trades were made in EUR. The average daily turnover on the spot market was USD 381.4 million, with the size of 1 trade averaging USD 2 million.

The volume of all trades between domestic commercial banks grew from USD 44 108.0 million to USD 68 312.3 million. The largest portion of the trading occurred in USD with a 65.7% share (65.6% in the second half of 2005), followed by EUR with a share of 33.7% (33.5% in the second half of 2005) and other currencies formed only 0.6% of the total turnover between domestic commercial banks.

In the total interbank foreign exchange market, trading by commercial banks formed a 12.4% share, compared to 13.4% in the preceding year. From the aspect of the types of trades, 85.9% (83.8% in the second half of 2005) of the total volume of trades between domestic banks was made in the form of swap operations, with spot trades forming a 13.9% share (16.1% in the second half of 2005).

Trading with foreign banks grew by 71.3% from USD 285 436.0 million to USD 488 921.0 million. The maximum sum was likewise conducted in USD, with a share of 88.7% (87.7% in the second half of 2005), followed by trading in EUR with a share of the 11.0% (11.5% in the second half of 2005) and trading in other countries formed 0.3%. The sum of trades with foreign banks continued to form a substantial part of the total foreign exchange market, with a share of 87.6%.

As in the case of trades between domestic banks, in trading with foreign banks almost the whole volume was formed by swap operations, representing a 91.1% share (90.6% in the second half of 2005), with spot operations forming a 7.8% share (8.8% in the second half of 2005) and forwards forming a negligible part of the overall forex market. Option trades formed 1% of the trading with foreign banks.



## 6. TEXT ANNEXES

### 6.1 Monetary policy instruments

#### 1. Interest rate policy

*NBS base rate*<sup>7</sup> (interest rate for two-week repo tenders)

from 1. 3. 2005	3.00 %
from 1. 3. 2006	3.50 %
from 31. 5. 2006	4.00 %

*interest rate for overnight refinancing operations*

from 1. 3. 2005	4.00 %
from 1. 3. 2006	4.50 %
from 31. 5. 2006	5.00 %

*interest rate for overnight sterilisation operations*

from 1. 3. 2005	2.00 %
from 1. 3. 2006	2.50 %
from 31. 5. 2006	3.00 %

#### 2. Monetary policy instruments of the NBS

##### 2.1 Operations on the open market

a) *main instruments – standard repo tender with a two-week maturity*

Performed by the NBS with commercial banks regularly once a week, as a rule on Tuesday. The NBS at the same time declares an interest rate for these standard operations (the base interest rate).

b) *instrument for longer-term liquidity management – issue of three-month NBS bills into commercial banks' portfolios*

The NBS holds American auctions of NBS bills as a rule once a month.

c) *fine tuning instrument – quick tender*

An NBS instrument serving for gentle operative adjustment of commercial banks' liquidity.

This instrument was not used in the first half of 2006.

d) *structural operations – individual trades*

An NBS instrument enabling the direct purchase or sale of government securities and NBS bills to and from the NBS portfolio.

This instrument was not used in the first half of 2006.

e) *currency swap*

An instrument serving for the transitional adjustment of liquidity in the koruna field using foreign exchange transactions with future settlement.

This instrument was not used in the first half of 2006.

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<sup>7</sup> On 12 December 2002 the NBS Bank Board decided to set the NBS base rate with effect from 1 January 2003. The NBS base rate is identical to the limit interest rate for NBS standard two-week repo tenders. If in law the term “discount rate of the National Bank of Slovakia”, or “Discount Rate of the State Bank of Czechoslovakia” is used, this means the base rate of the National Bank Slovakia.





## **2.2 Standing facilities**

### *a) overnight refinancing operations*

Commercial banks have automatic access to funds (under the condition of sufficient acceptable securities) at a declared interest rate.

### *b) overnight sterilisation operations*

Commercial banks have the possibility to deposit surplus funds in the form of non-collateralised deposits at a declared interest rate

## **3. Other instruments**

### *a) redistribution loan*

Repayment of a redistribution loan continues.

### *b) short-term loan for at maximum 3 months*

With the purpose of maintaining liquidity the NBS may in exceptional cases provide a bank by this loan.

This instrument was not used in the first half of 2006.

## **4. Compulsory minimum reserves**

Since 1 January 2005 Commercial banks, branches of foreign banks, savings banks and electronic money institutions have created compulsory minimum reserves of 2% of:

- non-term deposits, term deposits and loans received in Slovak koruna and foreign currencies,
- deposits and loans received with a notice of termination in Slovak koruna and in foreign currencies,
- issued debt securities in Slovak koruna and foreign currencies other than mortgage bonds,

The period for evaluating compulsory minimum reserves is 1 month. Compulsory minimum reserves held at the NBS on a bank's financial reserve account bear interest at the rate of 1.5% p.a., up to the amount set for compulsory minimum reserves for the respective month.

## **5. Exchange rate and foreign exchange policy**

### *a) exchange rate regime*

Following the agreement between the Ministers of Finance of the euro area countries, the President of the ECB and Ministers of Finance and central bank Governors of Cyprus, Denmark, Estonia, Latvia, Lithuania, Malta, Slovenia and Slovakia on 25 November 2005, the Slovak koruna has been included in the exchange rate mechanism ERM II since 28 November 2005. The koruna's central parity against the euro was set at 1 euro = SKK 38.4550. In ERM II the koruna will use the standard fluctuation band of  $\pm 15\%$  around central parity. The lower compulsory intervention rate is 32.6868 SKK/EUR and the upper intervention rate is 44.2233 SKK/EUR.

Upon entering the ERM II Slovakia committed to pursue sound fiscal policies and to promote wage developments that are kept in line with productivity growth. This policy is in conformity with the Convergence Programme of the Slovak Republic and the Monetary Programme of the NBS. Entry to ERM II is a significant step in the process of the euro adoption in the SR. Entry to ERM II marks the beginning of the second stage of this process. This stage should end with the fulfilment of the Maastricht



Convergence Criteria. The culmination of the whole process will be the adoption of the euro as the legal tender in the Slovak Republic.

*b) Nominal exchange rate of the SKK*

The nominal exchange rate of the Slovak koruna against euro over the course of the first half of 2006 depreciated by 1.3%, where as of 30 June 2006 it reached the value of 38.322 SKK/EUR. Conversely, under the influence of the development of the cross exchange rate USD/EUR on the world markets the Slovak koruna exchange rate against the American dollar nominally appreciated by 4.3% when at the end of the half year it had reached the level of 30.584 SKK/USD.

*c) Nominal and real effective exchange rate of the SKK<sup>8</sup>*

The development of the nominal effective exchange rate index of the Slovak koruna (NEER) during the first half of 2006 was influenced by the annual rate of depreciation towards the American dollar (of 1.9% compared to the year-on-year depreciation of 8.6% in the same period of 2005) as well as the Slovak koruna falling rate of depreciation towards the euro (2.7% compared to 4.3%). The year-on-year rate of growth in the average values of the NEER indices slowed from 2.8% in the first half of 2005 to 0.8%.

The real effective exchange rate (REER) index on the basis of the producer price index appreciated on a year-on-year basis by 4.8%, while in the first half of 2005 it depreciated by 1.1%. The rate of the REER depreciation on the basis of the producer price index (i.e. excluding mineral raw material and energy prices) reached -1.8% compared to -1.7% in the previous year.

*d) evaluation of the currency structure of foreign exchange receipts and payments of the Slovak Republic*

The total turnover of foreign exchange receipts and payments in convertible currencies under payment title groups 1 to 6 for the first half of 2006 represented SKK 1050.1 billion. The average monthly turnover reached SKK 175.0 billion, growing against the first half of 2005 by 21.0%. The deficit balance of SKK 51.6 billion deepened significantly from SKK 8.8 billion in the corresponding period of previous year.

The EUR and USD currencies have for a long time formed a decisive share, in the first half of 2006 together they represented 88.9% of total turnover. While against the same period of 2005 the share of EUR decreased slightly (by 0.3 percentage points), the share of USD grew (by 0.9 percentage points). The share of CZK continued in long-term decline, though at a faster rate, when it was 1.2 percentage points lower. The share of other currencies rose by 0.6 percentage points.

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<sup>8</sup> The methodology of calculating indices of the nominal and real effective exchange rate of Slovak koruna (NEER and REER) is taken from the IMF. This uses the average monthly exchange rates of the Slovak koruna and currencies of partners against the dollar. It is founded on the basis of the producer price index PPI, of the base year 1999 and sixteen important trading partners of the SR, representing together roughly 86% to 89% of the Slovak foreign trade turnover in 1993-2004: Germany, the Czech Republic, Italy, Austria, France, the Netherlands, the USA, Great Britain, Switzerland, Poland, Hungary, the Ukraine, Russia, Japan, China and Turkey.



Currency structure of foreign exchange receipts and payments 2003 to 2006

	2003	2004	1 <sup>st</sup> half yr 2005	2005	1 <sup>st</sup> half yr 2006
total turnover (SKK billion)	1 536.8	1 657.5	868.0	1 892.5	1 050.1
of which: EUR	69.8%	70.2%	68.4%	69.0%	68.1%
CZK	7.8%	7.5%	7.6%	7.3%	6.4%
USD	19.0%	18.8%	19.9%	19.6%	20.8%
other currencies 1)	3.3%	3.6%	4.1%	4.1%	4.7%
Share of turnover in GDP (at current prices) 2)	126.7%	122.3%	123.1%	128.6%	136.2%

1) HUF, DKK, NOK, SEK, CHF, GBP, AUD, JPY, CAD and other currencies,

2) recalculation for Q2 2006 on the basis of the Medium-Term Projection (P3Q-2006, or GDP data), 25 July 2006.

Source: NBS



## **6.2 Monetary calendar**

### **January**

- Activity of the Financial Market Authority - its supervisory and regulatory powers, competences and responsibility, including employees, passed to the National Bank of Slovakia as of 1 January 2006.
- The Bank Board selected three designs from the results of a public competition held for the creation of the motifs for the Slovak euro coins: Double cross on a triple peak, Bratislava Castle and the Kriváň mountain.

### **February**

- the Bank Board of the National Bank of Slovakia at its meeting on 28 February 2006 decided to raise key rates by 0.5 percentage points as of 1 March 2006. The limit interest rate for two-week repo tenders rose to 3.5%, the overnight refinancing rate to 4.5% and the overnight sterilisation rate to 2.5%.

### **March**

- The international rating agencies Fitch Ratings and Standard & Poor's Ratings Services assigned Slovak Eurobonds, to be issued in the framework of the Euro Medium Term Note programme, the rating A with stable outlook.

### **May**

- The Bank Board of the National Bank of Slovakia decided to increase key rates by 0.5 percentage points. The limit interest rate for two-week repo tenders will from 31 May 2006, under the NBS Bank Board decision, be 4.0%, the overnight refinancing rate 5.0% and the overnight sterilisation rate 3.0%.

### **June**

- Following the parliamentary elections the National Bank performed 2 interventions in the course of the month, which were a reaction to the too rapid weakening of the domestic currency against the euro unfounded on the economy development.



### **6.3 Foreign exchange licensing activity of the NBS and performance of foreign exchange supervision**

The National Bank of Slovakia fulfils the roles of a foreign exchange authority, which result to it from the Act of the National Council of the SR No 202/1995 Coll. (Foreign Exchange Act), as well as from the Act of the National Council of the SR No 566/1992 Coll. on the National Bank of Slovakia.

After completing the process of liberalising the foreign exchange regime and cancelling regulation of individual operations in the field of the current and capital account of the balance of payments by means of foreign exchange licences, certain business activities continued to remain regulated by foreign exchange regulations, where these activities concerned funds in Slovak and foreign currencies in cash or non-cash form (bureau de change, trading in foreign exchange values and foreign exchange financial services). The National Bank of Slovakia grants foreign exchange licences for these activities.

#### ***Licensing activity***

In the first half of 2006 the National Bank of Slovakia on the basis of an objective assessment of applications as well as of attached documents granted in total 34 foreign exchange licences as follows:

- 19 licences for purchasing funds in a foreign exchange for the Slovak currency in cash (of which 10 juristic entities and 9 natural persons),
- 9 licences for the sale of funds in a foreign exchange for the Slovak currency (of which 5 juristic entities and 4 natural persons),
- 1 licence for cash-free trades in foreign exchange funds.

In three cases it decided to extend the scope of granted foreign exchange licences to cash-free trading in foreign exchange values.

The volume of foreign currencies purchased in cash in the first half of 2006, according to purchase deductions, totalled SKK 16.44 billion. The quantity of foreign exchange sold in cash, according to sale deductions, totalled SKK 14.56 billion. In the case of cash-free trades in foreign exchange funds the total volume of foreign currencies purchased represented SKK 3.24 billion and the total volume of foreign currencies sold SKK 3.21 billion.

#### ***Performance of foreign exchange supervision***

In accordance with the objective, foreign exchange supervision by the National Bank of Slovakia was focused on checking compliance with notification obligations under foreign exchange regulations and the fulfilment of conditions set in foreign exchange licences.

In total 17 foreign exchange supervision audits were performed.



## **6.4 Methodological notes to selected indicators**

### **Monetary statistics**

#### ***1. Monetary aggregate statistics (ECB method)***

Harmonised statements of monetary and banking statistics, which the NBS introduced in 2003, are used as the data source in implementing the ECB method. Monetary aggregates according to the ECB method were calculated in 2003 and 2004 on the basis of the harmonised balance from the monthly statement M (NBS) 1-12 – statistical balance, from which the NBS compiles aggregated and consolidated balance for the MFI sector. The MFI sector comprised in 2003, similarly as in the national method, the National Bank of Slovakia, commercial banks seated in the SR, savings banks and branches of foreign banks. Since January 2004 the MFI sector, pursuant to the ECB method, has been extended to include also money market mutual funds, which since this time have had a monthly reporting duty towards the NBS (the list of all MFIs monitored in the framework of NBS reporting is regularly updated on the National Bank of Slovakia website)<sup>9</sup>.

An aggregate balance is compiled from the monthly statistical balances of all resident MFIs, where this represents a summary of MFIs' statistical balances for all currencies and asset and liability items. From the aggregated balance for MFIs a consolidated balance for MFIs is created by netting positions between MFIs, where this serves as the base for calculating monetary aggregates and counter positions in the M3 monetary aggregate. In consolidation mutual relations of MFIs are excluded from the aggregated balance as follows:

- payables resulting from debt securities issued are reduced by debt securities issued by MFIs in the ownership of MFIs,
- deposits and loans received from MFIs are reduced by receivables towards MFIs,
- payables resulting from equities issued are reduced by shares and other ownership interests of MFIs in the ownership of MFIs.

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<sup>9</sup> The current list of financial institutions, as well as more detailed methodological information on the harmonised monetary and banking statistics are available at the National Bank of Slovakia website (<http://www.nbs.sk>) in the section "Harmonised Monetary and Banking Statistics" in the menu "Banking Sector in the SR"



**Overview of the calculation of monetary aggregates according to NBS and ECB methodologies**

NBS METHODOLOGY	ECB METHODOLOGY
	<i>(items featuring in individual sub-aggregates jointly in SKK and in the foreign exchange)</i>
MONEY IN CIRCULATION OUTSIDE BANKS [M0]	money in circulation outside banks [M0]
+	+
NON-TERM DEPOSITS (in SKK)	overnight deposits and loans received
= MONEY [M1 = narrow money]	= M1 (narrow money)
TERM DEPOSITS (all maturities, in SKK)	+ deposits and loans received with a maturity of up to 2 years
+	+ deposits and loans received with a maturity of up to 3 months
FOREIGN EXCHANGE DEPOSITS	= M2 (intermediate money)
= QUASI MONEY [QM]	+ repo trades
	+ shares and money market mutual fund certificates
	+ debt securities issued with the maturity of up to 2 years and other money market products
MONEY SUPPLY M2 (=M1+QM)	M3 (broad money)

**Main differences between the individual methodologies**

- **from the aspect of the definition of monetary financial institutions:**
  - the ECB methodology works with an extended set of MFIs, which includes the NBS, commercial banks and money market mutual funds – money market mutual fund deposits at commercial banks in this sense are understood as interbank operations and are not directly included in monetary aggregates,
  - the NBS methodology includes in the monetary aggregates only the liabilities of the NBS and commercial banks – money market mutual fund deposits at commercial banks therefore feature in the commercial banks' balance as client deposits from financial institutions and thus directly enter into the M2 to money supply;
  
- **from the aspect of the nature and liquidity of funds:**
  - the ECB methodology monitors liquidity by means of the broader aggregate M3, which includes also repo trades, mutual fund certificates of open money market mutual funds and debt securities, which feature, from the aspect of liquidity and yield, as a substitute of banking deposits. From the aspect of maturity the ECB monetary aggregates do not include liabilities with the maturity of more than 2 years,
  - the NBS methodology monitors the money supply measured by the aggregate M2, which comprises money funds in the form of money in circulation and bank deposits irrespective of maturity;
  
- **from the aspect of the definition of deposits and loans:**
  - the ECB methodology takes as a component of deposits also subordinated debt in the form of a deposit, payables in the framework of repo operations and non-marketable securities issued by a bank in the holding of a client



- (in the case of loans there are included also non-marketable securities issued to clients in the holding of a bank, subordinated debt in the form of a loan, receivables in the framework of repo operations and traded loans),
- the NBS methodology works with a narrower definition of loans and deposits, i.e. only with the volume of funds reported by MFIs as loans (inclusive of classified loans) and deposits;
  - **from the aspect of economic sectors included in the monetary aggregates:**
    - the ECB methodology (in abstracting money market mutual fund deposits from client deposits) includes, besides the abovementioned sectors also the deposits from the sectors local government (S.1313) and social security funds (S.1314)<sup>10</sup>,
    - the NBS methodology includes in the M2 money supply the deposits from the following sectors:
      - § *non-financial corporations (S.11),*
      - § *financial corporations (S.123 and S.124) – including money market mutual fund deposits,*
      - § *insurance companies and pension funds (S.125),*
      - § *non-profit institutions serving mainly households (S.15),*
      - § *households (S.14 – sole traders),*
      - § *individuals (S.14 – individuals' accounts);*
  - **from the aspect of domicile of economic subjects:**
    - the ECB methodology takes into consideration only the funds of residents (in SKK and foreign exchange),
    - the NBS methodology monitors in monetary aggregates also the koruna deposits from non-residents;
  - **from the aspect of timing differences in assets and liabilities:**
    - the ECB methodology abstracts in the monetary aggregates from time differences,
    - in the NBS methodology timing differences are a component of clients' deposit and loan accounts;
  - **from the aspect of seasonal adjustment of time series:**
    - in contrast to the ECB methodology, the NBS methodology does not seasonally adjust data<sup>11</sup>.

## **2. Monetary aggregate statistics (NBS methodology – Monetary Overview)**

In 2005 the National Bank of Slovakia completed the harmonisation process in implementing the reporting and monitoring of monetary aggregates according to the European Central bank (ECB) methodology. During the transitional period in 2005 the NBS evaluated the development of monetary aggregates concurrently according to both the ECB methodology and the national methodology, where greater emphasis was placed

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<sup>10</sup> The NBS method abstracts in the M2 money supply from public sector deposits, which are evaluated separately in the framework of net loans to general government.

<sup>11</sup> Reporting of seasonally adjusted data according to the ECB method is currently under preparation at the NBS.





on the evaluation of the M3 monetary aggregate and its counter positions under the ECB methodology.

Since February 2006, when the one-year transitional period ended, the NBS has published monetary aggregates and evaluated their development exclusively according to the ECB methodology.

### ***3. Statistics on client interest rates on new business (ECB methodology)***

Since the start of 2005 the ECB methodology has been used in evaluating client interest rates, where interest rates on provided loans<sup>12</sup> and accepted deposits (new contracts) are reported. Under this methodology interest rates on new business are monitored. New loans and new deposits are deemed to mean contracts signed for the first time setting the interest rate between the bank and the client and new negotiated contracts with the client's active participation.

Interest rates on loans to and deposits from households and non-financial corporations as defined in European Central Bank Regulation No 63/2002<sup>13</sup> concerning statistics on interest rates are evaluated in a sectoral classification.

The focus on evaluating interest rates on loans to and deposits from households and non-financial corporations should provide more precise information on the working of the transmission mechanism, since in evaluating interest rates those sectors having a specific standing towards the banking sector, i.e. insurance companies, pension funds and general government, are not taken into account.

The ECB methodology makes it possible to monitor interest rates according to initial rate fixation (IRF) and in the case of non-financial corporations also according to lending volumes. Initial rate fixation is the period during which the agreed interest rate is fixed. On the basis of IRF loans are divided into loans with a variable rate and IRF of up to 1 year inclusive, loans with IRF above 1 year and up to 5 years inclusive, loans with IRF above 5 years to 10 years inclusive and loans with the IRF above 10 years. Loans to non-financial corporations are broken down by volume into loans of up to EUR 1 million and above EUR 1 million.

Loans to households are divided according to purpose into:

- current account overdrafts
- working capital loans (only sole traders),
- investment loans
- consumer loans
- real estate loans  
    mortgage loans

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<sup>12</sup> The term "provided loan" is equivalent to the term "new loan"

<sup>13</sup> According to paragraph 2, Article 1 of European Central Bank Regulation No 63/2002 of 20 December 2001 concerning statistics on the interest rates supplied by monetary financial institutions concerning deposits and loans vis-à-vis households and non-financial corporations and from the definition in Annex A to the European Communities Regulation No 2223/96 of 25 June 1996 on the European System of National and Regional Accounts (ESA 95) the term households is deemed to mean the households sector – S.14 (i.e. individuals and free traders) and the sector non-profit institutions serving households – S.15 and the term non-financial corporations is deemed to mean the sector S.11.



- construction loans
- bridging loans
- other real estate loans
- other loans

Loans to non-financial corporations are divided according to purpose into:

- current account overdrafts
- investment loans
- working capital loans
- real estate loans
  - mortgage loans
  - construction loans
  - bridging loans
  - other real estate loans
- other loans

Breakdown of deposits (identical for households and non-financial corporations):

- deposits repayable on demand
  - non-term deposits
  - daily deposits
- deposits with an agreed maturity
  - of up to 1 year
    - up to 7 days
    - up to 1 month
    - up to 3 months
    - up to 6 months
    - up to 1 year
  - above 1 year
    - up to 2 years
    - above 2 years
- savings deposits
  - redeemable at notice of up to 3 months
  - redeemable at notice of above 3 months

The interest rate on loans and deposits is calculated as the weighted arithmetic average of all interest rates on loans/deposits for each category separately. Weighted information for new loans represents the total sum written in a contract regardless of whether the given volume is drawn in the monitored month or not.

Subsidies provided to clients by third parties are not taken account of in setting the interest rate, since the bank does not pay or receive the subsidy. For example the interest rate on mortgage loans with a state premium is reported exclusive of the state subsidy.



#### **4. Breakdown of loans from the viewpoint of evaluating their quality**

##### **In 2005:<sup>14</sup>**

**Loans were classified from the viewpoint of evaluating their quality for the purpose of reporting for statistical purposes into the following categories:**

- a) standard loans
- b) standard loans with conditions,
- c) non-standard loans,
- d) doubtful loans,
- e) loss-making loans and
- f) unclassified loans
  1. with arrears of up to 30 days,
  2. with arrears of 31 to 90 days,
  3. with arrears of 91 to 180 days,
  4. with arrears of 181 to 360 days,
  5. with arrears of above 360 days.

According to the Decree of the National Bank of Slovakia of 26 November 2004 No 13/2004 on the classification of assets and liabilities of banks and branches of foreign banks, on their valuation, on the formation and dissolution of reserves and related reporting (hereinafter simply the NBS Decree) receivables are classified as follows:

A receivable is deemed a standard receivable if

- the debtor has been in arrears with its payment at most 30 days, fulfils other obligations under the contract and on the basis of an analysis of the debtor's economic situation it is expected that the receivable will be repaid in full and on time

A receivable is deemed a standard receivable with conditions if

- the debtor has been in arrears with its payment more than 30 days, but not more than 90 days,
- the debtor has not fulfilled a certain other obligation under the contract besides repayment of his liability, for example he has not submitted information required under the contract, or on the basis of an analysis of the debtor's economic situation a loss is expected for the bank due to the fact that it will not be repaid in time
- a provision has been created in the amount of at least 1%, but less than 20% of the unsecured value of the standard receivable with conditions

A receivable is deemed a non-standard receivable if

- the debtor has been in arrears with its payment more than 90 days, but not more than 180 days,
- the debtor is in liquidation,
- the receivable arose through fulfilment from collateral provided for the debtor, or on the basis of an analysis of the debtor's economic situation it is expected that the larger part of the receivable will be repaid

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<sup>14</sup> Until 2004 receivables had been classified as standard loans, standard loans with conditions, non-standard loans, doubtful and loss-making.



- a provision has been created in the amount of at least 20%, but less than 50% of the unsecured value of the non-standard receivable

A receivable is deemed a doubtful receivable if

- the debtor has been in arrears with payment of the receivable more than 180 days, but less than 360 days,
- the debtor is in settlement proceedings,
- a petition for bankruptcy against the debtor's assets has been lodged and a preliminary bankruptcy trustee has been appointed, or on the basis of an analysis of the debtor's economic situation it is expected that the lesser part of the receivable will be repaid.
- a provision has been created in the amount of at least 50%, but less than 95% of the unsecured value of the doubtful receivable

A receivable is deemed a loss-making receivable if

- the debtor has been in arrears with its payment more than 360 days,
- a petition for bankruptcy on the debtor's assets has been rejected for lack of assets,
- bankruptcy has been declared on the debtor's assets,
- bankruptcy on the debtor's assets has been cancelled due to the fact that the assets are insufficient for settling bankruptcy costs,
- the receivable is towards a person having a special relationship to the bank, or who had control over the bank and is in arrears with its payment more than 90 days, or on the basis of an analysis of the debtor's economic situation it is expected that the receivable will not be repaid even partially,
- a provision has been created in the amount of 100% of the unsecured value of the loss-making receivable

Loans in the **portfolio of receivables** created under Article 8 of the NBS Decree are deemed **unclassified loans**.

**Since January 2006** there has been in force the new NBS Decree No 7/2005 of 6 December 2005 amending National Bank of Slovakia Decree No 13/2004 on the classification of assets and liabilities of banks and branches of foreign banks, on their valuation, on the creation and cancellation of reserves and related reports and on the basis of which the classification of loans with regard to evaluation of their quality is substantially changed.

On the basis of a change in banks' accounting according to International Accounting Standards the manner of valuing financial assets changed and NBS Decree No 13/2004 with effect from 1 January 2006 changed in nature from regulatory (for the purpose of valuing selected types of assets) to audit. From the aspect of the NBS Decree conceived in this manner selected financial assets are, **for the purposes of banking supervision, broken down as follows:**

Receivables valued **on an individual basis** towards juristic entities

- free of identified devaluation
- with reduced value
  - § within the interval of not more than 20% devaluation
  - § within the interval of more than 20% but not more than 50% devaluation
  - § within the interval of more than 50% but not more than 95% devaluation
  - § within the interval of more than 95% devaluation
- failed



Receivables valued **on a portfolio basis** towards juristic entities

- significant
- not significant

**For the purposes of statistical reporting individual receivables are broken down as follows:**

Category I means assets valued *individually free of identified devaluation*

Category II means assets valued *on a portfolio basis (free of identified devaluation on an individual basis)*.

Category III means assets valued *individually with identified devaluation*.

Assets are stated as ***failed receivables*** if the bank has identified a devaluation of more than 50% or if the debtor is in arrears with payment more than 90 days.

In reporting interest rate statistics to the ECB, the harmonised methodology reports loans without the category “failed”, terming these “bad loans” instead.

