Foreword

During 1998, the monetary policy of the National Bank of Slovakia was implemented under economic conditions similar to the previous years, which were characterised by deterioration in the existing internal and external imbalances.

The chief priority of monetary policy was to restore the balance of the country's economy and to renew the trend of long-term growth, so that the process of activation would be stimulated and covered by domestic resources rather than foreign funds. Elimination of the existing imbalances represented a vital condition for the fulfilment of the Bank's primary objective, the maintenance of currency stability.

The external economic and financial environment had a significant effect on the development of the Slovak economy. During the year under review, the world economy showed rather unbalanced development, marked by a slowdown in the dynamics of growth. The countries of Asia adopted some measures for economic stabilisation, but their basic economic indicators failed to improve. The financial turbulence in Russia culminated during the summer months, then it spread, together with other problems in Asia, and had affected the economic performance of most countries in the world by the end of the year. In September, it became apparent that the situation in Russia, Asia, and subsequently in Latin America, would affect not only the emerging economies, but advanced industrial countries as well, as was later confirmed.

The slow process of transformation in the Slovak economy, especially the delayed restructuring of resource-generating sectors, was also responsible for the slowdown in the output of the domestic economy, which recorded a 4.4% rate of year-on-year growth, the lowest figure since 1994. The structure of domestic demand, which was - along with foreign demand - the engine of growth in gross domestic product, remained unsatisfactory. The dynamics of domestic demand were stimulated by the growth of final consumption in the household sector and the developing activities of the public sector in the area of investment, both directly and indirectly, through the provision of government guarantees for loans.

The fiscal deficit of the Government reached its highest level since 1993, both in absolute value and in terms of dynamics of growth. The expansive fiscal policy absorbed a large part of the country's limited domestic resources, and had a restrictive effect on the economic activities of entrepreneurial entities. With regard to the growth in investment demand and consumption, the resources generated on the domestic market in 1998 were not large enough, leading to increased borrowing from abroad. The persistence and strengthening of negative trends, particularly the deficit in public finance and the shortfall in the current account of the balance of payments, combined with the absence of systemic measures in economic policy, led to reassessment of the country's credit rating and inclusion in the non-investment grade by international rating agencies. As a result, the access of companies to foreign resources was limited in 1998: loans from abroad could only be obtained at higher rates of interest and with shorter maturities.

Despite accelerating growth in the external debt of the Slovak economy, expressed in terms of a double increase in net foreign debt (US$ 2.3 billion), for the first time, the capital and financial account failed to fully cover the deficit in the balance of payments current account; this was combined with a decline in the foreign exchange reserves of the NBS, which were 2.3 times greater than the average volume of monthly imports of goods and services to Slovakia in 1998. The inflow of foreign capital was insufficient in terms of volume, with regard to the size of the deficit in the current account. Apart from domestic factors, the inflow of capital from abroad was negatively affected by the external environment, particularly the financial crisis in Russia.

The increased deficit in the balance of foreign trade in 1998 was due to the inappropriate structure of exports, when the acceleration in their year-on-year dynamics was offset by an increase in the volume of imports. Another factor was the continued slow rate of economic growth, and/or decline in the economies of our main trading partners, which restricted the market for Slovak products abroad.

The above facts had the effect of intensifying the devaluation expectations among domestic entities, which culminated before the parliamentary elections in September 1998, and led to the conversion of crown assets into foreign-currency assets, increased purchases of goods for long-term consumption, premature payments for imports and delayed collections for exports. After the elections, the fear of devaluation persisted despite the fact that the NBS had intervened in the money and foreign exchange markets in support of the existing fixed exchange rate regime, by using almost US$ 1 billion of its official reserves. On 1 October 1998, the Bank Board of the NBS decided to cancel the system of fixed exchange rates against a basket of two currencies with a fluctuation band and to replace it with a floating exchange rate regime. At the same time, the National Bank of Slovakia announced that the exchange rate of the Slovak crown would be determined by the level of supply and demand on the interbank foreign exchange market, in which the NBS would intervene only to mitigate the volatility of the crown's exchange rate.

Over the course of 1998, the exchange rate of the crown (in relation to the original currency basket) depreciated by 10%. Despite this development and the adoption of the floating rate system, the annual rate of inflation did not increase in comparison with 1997. The rate of depreciation in the value of the Slovak crown was less than had been expected. The original goals of the NBS relating to the internal stability of the currency were met, when the annual rate of inflation reached the level of 5.6%. The favourable development of consumer prices was positively affected by the cancellation of the import surcharge, the absence of deregulation in the sector of goods and services with regulated prices, and the world-wide downward trend in price levels.

In 1998, the financial and capital account of the balance of payments continued to be liberalised. With effect from 1 April 1998, the surrender requirement (obligation of business entities to sell foreign currency holdings) was cancelled in the intent of ensuring better provision against exchange rate risks. The limit on the purchase of foreign exchange by private individuals was also removed. The liberalisation of trade in foreign securities had no marked effect on economic development in the SR, but is expected to make a significant contribution to the revival of the Slovak capital market.

At the end of 1998, twenty-seven banking entities were operating in the Slovak banking sector, i.e. 25 banks, 2 branches of foreign banks, and 9 representative offices of foreign banks. Of this number, four banks were licensed to conduct mortgage transactions.

During the year under review, the volume of subscribed capital in the banking sector of the SR, including funds permanently provided to branches of foreign banks (excluding NBS), increased by Sk 2,598.8 million, to Sk 34,624.6 million. The share of foreign investors in the total volume of subscribed capital of banks and funds permanently provided by foreign banks to their branch offices, ranged between 35.5% and 39.2%.

The banking sector ended the year with a profit of Sk 350.9 million. The total assets of banks operating on the Slovak money market increased during the year by 3%. The share of the balance sum of transforming banks in the total balance of the banking sector showed a tendency to decrease, due mainly to delay in the process of restructuring the banking sector. Deterioration in the financial situation of entrepreneurial entities led to growth in the volume of outstanding loans with a negative effect on the quality of the loan portfolios of banks. Classified assets increased at a number of banks and the creation of reserves and provisions also began to fall behind.

Despite an increase in internal and external imbalances in 1998, the monetary policy of the NBS, in addition to acting as a stabilising factor on price development, served to ameliorate existing macroeconomic inadequacies as well. One of the goals of monetary policy was to stabilise the country's money market. The fulfilment of this goal was, however, disturbed during the year by government borrowing activities, the fear of currency devaluation among the population, and by the attempt of the Bank to dispel this. Actual events show that a prerequisite for the stabilisation of economic conditions and the elimination of imbalances is the coordination of macroeconomic policies and the accelerated restructuring of banks and the microsphere. Macro-economic development in 1998 showed that the long-term ignorance of these factors leads to inadequacies in economic processes and improper behaviour on the part of those involved.

May 1999

Vladimír Masár
Governor

Members of the Bank Board

from left:
Ján Mathes, Executive Director, Currency Division
Jozef Mudrík, Vice-Governor
Vladimír Masár, Governor
Marián Jusko, Vice-Governor
Elena Kohútiková, Executive Director, Monetary Division
Jozef Magula, Director, General Relations Department