NÁRODNÁ BANKA SLOVENSKA

Annual Report 2001

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Imricha Karvaša 1
813 25 Bratislava
Slovakia

National Bank of Slovakia
Public Relations Department
Tel.: +421 / 2 / 5787 2141, 5865 2149
Fax: +421 / 2 / 5787 1128

Internet: http://www.nbs.sk

Contents

Foreword

In 2001, the institutional and legislative framework for the conduct of monetary policy was modified through an amendment to the National Bank of Slovakia Act. According to the amendment, the chief priority of the National Bank of Slovakia is to maintain price stability, instead of currency stability as required under the original Act. In addition, the amendment lays down the principle of central bank independence and prohibits the financing of the deficit in public finances by the National Bank of Slovakia. These legislative changes were part of the process of harmonisation of Slovak laws with those of the European Union and the relevant provisions of the Maastricht Treaty.

The rate of overall inflation fell in 2001 to 6.5%, from 8.4% in 2000. The slowdown in the rate of year-on-year increase in consumer prices took place in all basic sectors of the consumer basket. Core inflation fell from 4.6% in 2000 to 3.2% in 2001. Fewer administrative interventions were made in price developments, which led to a fall in inflation as early as the first two months of the year. The slowdown in price dynamics in that period was also affected by the positive trend in core inflation. In the following months, the rate of price increase accelerated temporarily as a result of developments in the prices of energy-producing raw materials on foreign markets and an accelerated increase in food prices. In that period, food prices were affected by the increased costs of producers and the import of certain agricultural commodities to compensate for the domestic crop failure in 2000. From the middle of the year, however, the cost-based stimuli weakened and food price dynamics fell, causing a downward trend in both core and overall inflation. The slowdown in the rate of increase in consumer prices was amplified by a marked fall in the prices of energy-producing raw materials after the September events in the USA. The course of inflation was affected favourably during the whole year by the growing competition in the retail trade and the stable exchange rate of the Slovak crown.

The continued disinflation process was accompanied by an acceleration in the rate of economic growth (from 2.2% in 2000 to 3.3% in 2001), which was primarily due to a revival in domestic demand, particularly in investment. Consumer demand also increased gradually in public administration and the household sector. The fiscal deficit reached the budgeted level (3.9% of GDP excluding the costs of bank restructuring), but in comparison with the previous year increased (2.0% of GDP in 2000). Current budget revenues in excess of the budgeted level, were used for spending rather than reducing the size of the deficit. The growth in final consumption in the household sector and public administration, as well as investment, coupled with the limited ability of domestic production to satisfy the increased domestic demand, led to growth in imports. On the other hand, the slowdown in the rate of economic growth in the countries of our trading partners led to a fall in export dynamics and an increase in the negative contribution of net exports to the pace of economic growth.

The structure of growth in the Slovak economy, the low flexibility of the domestic production base, and the related high import intensity of the economy, together with a slowdown in the rate of economic growth in the world, were the main reasons behind the marked increase in the trade deficit (from 4.8% of GDP in 2000 to 10.8% in 2001) and the shortfall in the balance of payments on current account (from 3.7% of GDP in 2000 to 8.8% in 2001).

The growth in imports was due, for the most part, to an upturn in investment demand. Contributing significantly to imports in this category was the inflow of foreign capital in the form of direct investment in previous years, growth in earnings in the corporate sector, the fall in interest rates, and a downturn in investment activity in 1999 and 2000. In connection with the revival of growth in final consumption, which was accompanied by an increase in real wages and growth in the deficit of public finances, however, the imports of consumer goods showed an increase in dynamics.

Despite the large deficit in the current account, there was no marked pressure on the exchange rate of the Slovak crown over the course of 2001. The exchange rate of the crown to the reference currency (euro) was characterised by a moderate appreciation throughout the year. In contrast to the end of 2000, the exchange rate of the crown to the euro appreciated by 2.8% (while the average SKK/EUR rate depreciated by 1.7% in 2001). The National Bank of Slovakia intervened in the foreign exchange market only in January, with the aim of eliminating excessive fluctuations in the exchange rate.

Monetary policy in 2001 was implemented in a relatively complex macro-economic environment, which was characterised, on the one hand, by continued disinflation and a standstill or appreciation in the exchange rate of the crown to the euro, and on the other hand by growth in the trade deficit and the negative balance of payments on current account, and an increase in the shortfall of public finances. The monetary policy was implemented through the key interest rates of the NBS, i.e. the limit rate for standard two-week REPO tenders and the rates for overnight sterilisation and refinancing operations. In 2001, the application of these instruments again contributed to further stabilisation of the money market. With regard to the favourable development of consumer prices during the first two months of the year and the favourable forecast for inflation until the end of December, the Bank Board of the NBS decided to lower the key interest rates by 0.25 of a percentage point (on 26 March 2001). Thus, the limit rate for standard two-week REPO tenders was reduced to 7.75%, the overnight rate for refinancing to 9.00% and that for sterilisation to 6.00%. With regard to the deepening deficit in the current account, there was no room for a further cut in key interest rates in the following period, despite the favourable course of inflation. In connection with the harmonisation of monetary-policy instruments with those of the European Central Bank, the ratio of required reserves was reduced and the period for their evaluation extended from 14 days to one month, with effect from the beginning of 2001.

Restructuring of the banking sector of Slovakia came to an end in 2001. The removal of loss-making loans and their replacement with government bonds led to the recovery of banks and, together with the gradual restructuring of the corporate sector, paved the way for economic growth. During the privatisation of banks with a controlling State interest, several foreign investors acquired interest in Slovak banks. This contributed another element of stabilisation and forward momentum, especially to the development of bank lending.

During the year under review, substantial changes were made in banking legislation, which strengthened the position of the National Bank of Slovakia in the area of banking supervision and brought the Slovak banking legislation into harmony with the relevant directives of the European Union.

At the end of 2001, the National Bank of Slovakia officially declared its strategy in the area of monetary integration. With the entry of Slovakia into the European Union, the National Bank of Slovakia would prefer to become a member of the European Monetary Union as soon as possible. This strategy is conditional on the consolidation of public finances, which has often had a destabilising effect on economic development in the past. Restricting the size of the deficit in the public sector would provide a real stimulus to convergence. This would lead to a fall in interest rates, transaction costs, and the elimination of exchange rate risks in relation to the euro. These factors should lead to a fall in inflation and an upturn in economic activity. The strategy is also in line with the main objective of the NBS, which is the maintenance of price stability.

Jusko

May 2002

Marián Jusko
Governor

Members of the NBS Bank Board in 2001

First row, from left to right:
Elena Kohútiková, Deputy-Governor
Marián Jusko, Governor
Jozef Mudrík, Vice-Governor (till 22 May 2001)

Second row, from left to right:
Karol Mrva, Chief Executive Director, Trade and Foreign Exchange Division
Jozef Magula, Director, General Relations Department (till 3 February 2001)
Ján Mathes, Chief Executive Director, Currency Division
Jozef Košnár, Professor at the University of Economy in Bratislava
Eugen Jurzyca, Director of the Central European Institute
for Economic and Social Reforms (till 31 December 2001)