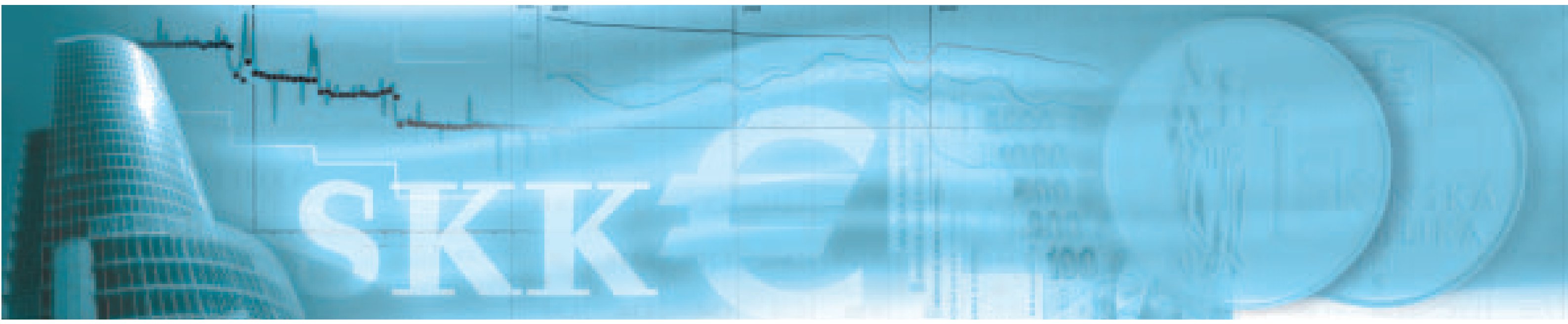
B. REPORT ON MONETARY DEVELOPMENTS IN THE SR IN 2003



1. ECONOMIC DEVELOPMENTS

Macroeconomic and monetary developments in the Slovak Republic were affected by the implementation of measures, which were directly or indirectly connected with the forthcoming entry of Slovakia into the European Union. These measures included the elimination of price anomalies through adjustments to regulated prices, changes in indirect taxes, and the commencement of consolidation in public finances. The implementation of these measures was to improve the quality of the market environment in the Slovak economy and to create conditions for the gradual achievement of the level of advanced EU countries.

Price developments in 2003 were determined first and foremost by a marked increase in regulated prices and excise duties, which led to an acceleration in the 12-month inflation rate, from 3.4% in December 2002 to 9.3% in December 2003. Administrative adjustments accounted for more than 75% of the rise in consumer prices. Due to the absence of demand-based pressures, however, the profound impact of cost factors on price levels had no marked secondary effects, which is documented by the relatively low level of core inflation (3.0%). In addition to a fall in effective demand, the price increase was also dampened by an appreciation in the exchange rate of Slovak koruna, mainly against the US dollar, but in relation to the euro as well.

The increase in the expenses of household on goods and services with regulated prices, accompanied by a fall in real wages, resulted in a drop in final household consumption. This, coupled with continuing decline in investment demand, led to a fall in domestic demand. Despite this development, the Slovak economy showed relatively dynamic growth (4.2%. The rate of growth was, in contrast with the previous year, determined exclusively by foreign demand. In 2003, the excess of export performance over import intensity led to a marked improvement in the balance of net exports at constant prices.

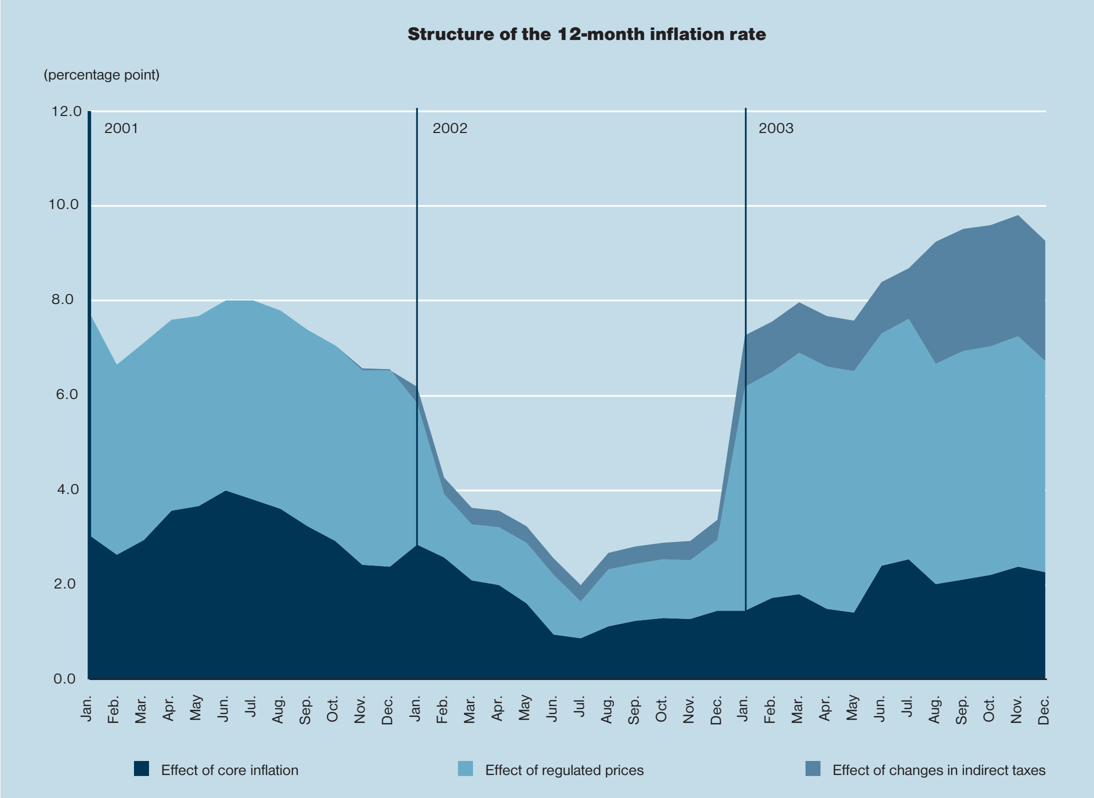
In the balance of payments, the current account deficit as a share of GDP dropped from 8.1% in 2002 to 0.9% in 2003. This development was affected primarily by a favourable trend in the trade balance, mainly a dynamic growth in exports, achieved despite a downturn in economic activity in the countries of our most significant trading partners. The increase in Slovakia's export performance was closely connected with foreign direct investment in previous years, with the most dynamic growth in exports being recorded in the automobile industry.

A stabilising factor of the Slovak economy in 2003 was the launch of the process of consolidation in public finances, when the ratio of their deficit to GDP decreased to 3.6%, from 5.7% in 2002. This, together with the preparation of further reforms in health services, the pension, social security, and tax systems, helped to improve the attractiveness of Slovakia, which was confirmed by an increase in the country's rating and growing interest among foreign investors.

Under conditions of renewed price deregulation and increased indirect tax rates, the task of the Bank's monetary policy in 2003 was to prevent these administrative measures from producing marked secondary effects. The impact of administrative measures on effective demand in the household sector and the marked excess of growth in labour productivity over growth in real wages, however, prevented the emergence of demand-based pressures on prices and imports. The stagnation of private consumption, coupled with a fall in investment demand, led to decline in domestic demand. In view of the absence of demand-based pressures in the economy and with the aim to maintain the positive trends of development in the Slovak economy including its balanced growth, the Bank Board of the NBS decided to lower its key interest rates in September and December, equally by 0.25 percentage point.

In 2003, the National Bank of Slovakia continued harmonising its monetary-policy instruments with those applied by the ECB, by reducing the

Chart B1



ratio of required reserves to 3% (with effect from January 1). With effect from 1 January 2004, the reserve ratio was cut further, to 2%, corresponding to the figure applied in the euro area. At the same time, uniform conditions were set for banks and branches of foreign banks.

1.1. Price developments

Consumer prices

In 2003, consumer prices increased more dynamically than in 2002, with the 12-month inflation rate, expressed in terms of the Consumer Price Index, reaching 9.3% in December (compared with 3.4% in the same period a year earlier). The average rate of consumer-price inflation stood at 8.5% in 2003 (compared with 3.3% in 2002).

The acceleration in the year-on-year rate of consumer price increase in 2003 was caused by an increase in price dynamics in all basic categories of the consumer basket. Of the total increase in consumer prices, core inflation accounted for 2.27 percentage points. As in previous years, the price increase was due primarily to administrative adjustments, which contributed 4.45 percentage points to the total increase in consumer prices, while changes in indirect tax rates accounted for 2.54 percentage points.

Price developments in 2003 were determined mostly by domestic factors. Price levels were affected by administrative measures, i.e. increases in regulated prices and excise duties in January, coupled with a change in VAT rates and another increase in excise duties in August. Administrative measures accounted for more than 75% of the overall price increase. The measures in the area of regulated prices (especially the increase in energy prices) had a secondary effect in the form of a marked increase in prices for market services. Another domestic factor that affected the price level was an increase in the dynamics of food prices. External factors had a dampening effect on the price increase. The appreciation of the Slovak koruna vis-à-vis the euro and the US dollar was reflected in fuel prices (which fell by

0.5% net of changes in indirect taxes). The exchange rate of the koruna also had an impact on price levels in the form of low imported inflation, which led to a slowdown in the dynamics of tradable goods prices.

Regulated prices

Regulated prices rose year-on-year by 18.7% and accounted for almost half of the overall price increase. January saw an increase in regulated prices for electricity, gas, heating, bus and railway fares, water supply and sewage disposal. Price levels also increased for meals at school canteens and accommodation at university dormitories. The following months saw increases in rents for state-owned and municipal flats, the price of municipal public transport fares, and in prices for health services.

Changes in indirect taxes

With effect from January 2003, excise duties on tobacco, beer, mineral oils, and wine were increased, while value added tax rates were also adjusted (from 23% to 20% and from 10% to 14%). A further increase in excise duties on tobacco, beer, and mineral oils was effected in August. These changes contributed a total of 2.54 percentage points to the consumer price increase in 2003.

Core inflation

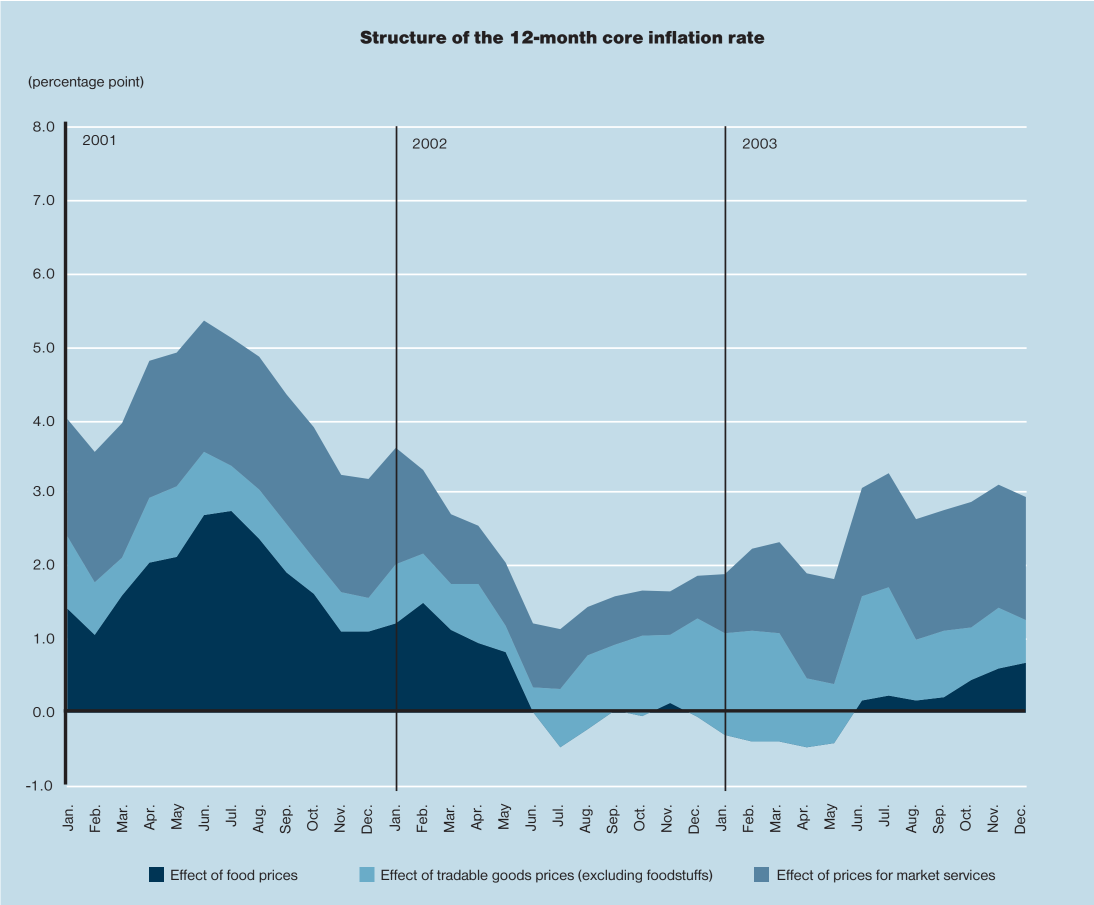
In December 2003, core inflation reached 3.0%, representing an increase of 1.1 percentage points in comparison with the same period in 2002. Its course during the year was characterised on the one hand by an accelerated increase in food and market services prices and, on the other hand, by a slowdown in the dynamics of tradable goods prices, mainly as a result of a marked year-on-year drop in the price of tobacco and tobacco products (by more than 13%). This development probably resulted from the efforts of the producers and distributors of these products to partly offset the impact of increased excise duties. The slowdown in the

Table B1 **Consumer price developments** **(year-on-year change)**

Structure of the consumer basket	2001	2002	2003			
	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.
Total (in %)	**6.5**	**3.4**	**8.0**	**8.4**	**9.5**	**9.3**
Regulated prices (in %)	**17.2**	**6.5**	**22.0**	**21.3**	**20.5**	**18.7**
Share of total, in percentage points	*4.17*	*1.50*	*5.09*	*4.92*	*4.82*	*4.45*
Impact of changes in indirect taxes on non-regulated prices – share of total, in percentage points	***-0.03***	***0.41***	***1.07***	***1.07***	***2.56***	***2.54***
Core inflation (in %)	**3.2**	**1.9**	**2.4**	**3.1**	**2.8**	**3.0**
Share of total, in percentage points	*2.39*	*1.46*	*1.80*	*2.40*	*2.13*	*2.27*
of which:						
Food prices (in %)	3.7	-0.2	-1.4	0.7	0.8	2.6
Share of total, in percentage points	*0.83*	*-0.04*	*-0.29*	*0.15*	*0.16*	*0.54*
Tradable goods (in %) [1/]	1.0	2.8	3.1	3.0	1.9	1.2
Share of total, in percentage points [1/]	*0.35*	*1.05*	*1.15*	*1.10*	*0.71*	*0.44*
Market services (in %) [1/]	7.7	2.5	5.2	6.2	6.8	7.0
Share of total, in percentage points [1/]	*1.22*	*0.45*	*0.96*	*1.15*	*1.27*	*1.30*
Net inflation (excluding the impact of changes in indirect taxes) in % [1/ 2/]	**3.0**	**2.7**	**3.8**	**4.0**	**3.5**	**3.1**
Share of total, in percentage points [1/]	*1.56*	*1.50*	*2.09*	*2.25*	*1.97*	*1.73*

Source: Statistical Office of the Slovak Republic
1/ Estimates of the NBS, based on data from the Statistical Office of the SR.
2/ Net inflation – includes price increases in tradable goods (excluding foods) and market services.

Chart B2



dynamics of tradable goods prices was also affected by the strengthening of the Slovak koruna.

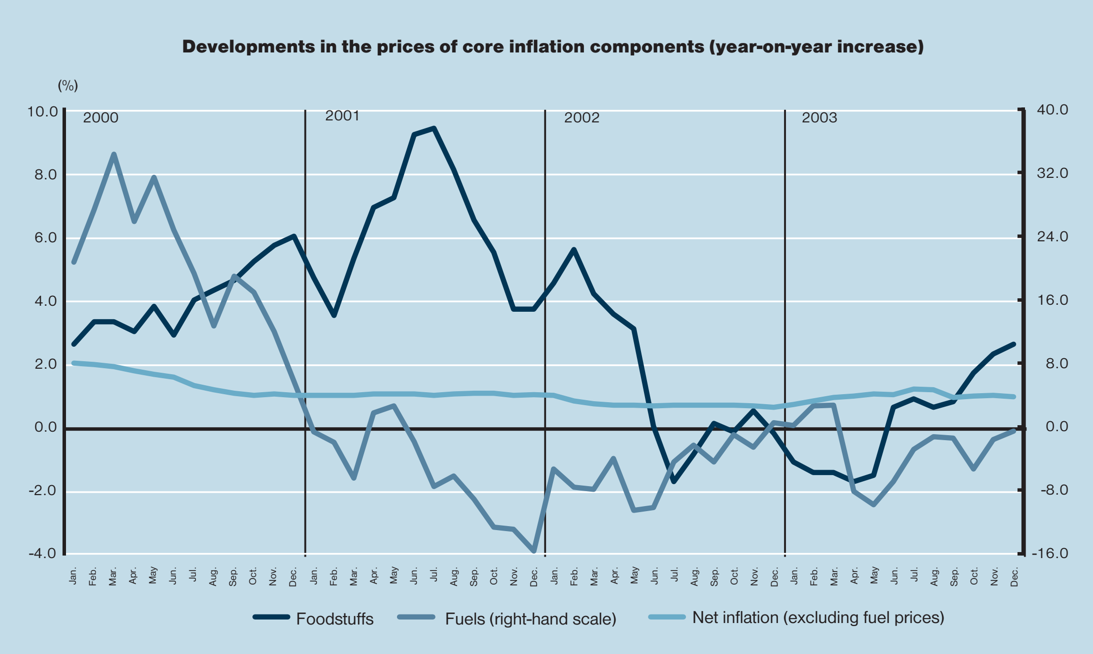
The upward trend in core inflation was connected with the cost stimuli on the input side, mainly the increase in regulated prices (energy prices).

Within the basic structure of core inflation, prices for market services were the determining factor (making the most significant contribution to the rise in core inflation) in the price increase, for they reflected the secondary effects of increase in regulated prices (energy prices in particular).

At the end of 2003, food prices (excluding non-alcoholic beverages) recorded a year-on-year increase of 2.6%, compared with a fall of 0.2% in 2002. This increase was caused, on the one hand, by market-based factors, i.e. the imbalance between the supply of, and demand for, certain agricultural commodities (milk, dairy products, and meat). On the other hand, the increase was caused by attempts on the part of primary producers to unite (in marketing associations) and exert pressure for an increase in selling prices, and attempts on the part of manufacturers to include the costs incurred in connection with the fulfilment of technological and hygienic standards in line with the EU requirements, in the prices of products. Processed food prices recorded an increase in year-on-year dynamics, especially in the second half of the year.

The rate of core inflation was stabilised by the prices of tradable goods, the year-on-year dynamics of which reached 1.2% in December. The slow rate of price increase in the tradable sector was due to several factors. The severe competition in the retail trade and the slack domestic demand, coupled by a fall in real wages, exerted no upward pressure on the price level. The slowdown in price dynamics in the tradable sector was also supported by the appreciation of the Slovak koruna in relation to the euro and the US dollar.

Chart B3



In the tradable goods sector, certain volatility was recorded in fuel prices, which reacted to the changes in oil prices, the exchange rate of the koruna against the dollar, and to developments in fuel prices on the commodity markets. In the first two months of the year, the price of oil hovered around the level of USD 30/barrel. After the completion of military operations in Iraq, oil prices fell to a level of approximately USD 25/barrel. From June to December, the price of oil increased, above the level of USD 29/barrel in December. The exchange rate of the koruna against the US dollar appreciated throughout the year. Over the course of 2003, except for the first three months, fuel prices declined on a year-on-year basis.

The prices of market services, which were determined mostly by domestic cost factors in the form of increased regulated prices, advanced at a faster rate than prices in other core inflation categories. Prices for marker services showed a tendency to rise throughout the year. At the end of 2003, the year-on-year rate of price increase in market services reached 7.0%, which was 4.5 percentage points more than in the same period a year earlier. The steepest increases were recorded in prices in transport, education, and in prices for housing-related services.

Producer prices

Industrial producer prices

Industrial producer price developments in 2003 were affected by growing pressures exerted by domestic and external cost factors. Price developments were dominated by internal factors, when electricity, gas, steam, and hot water prices increased significantly as a result of continued price deregulation. The elimination of price anomalies was more intense than in 2002, which contributed significantly to the dynamic increase in industrial products prices. The prices of mineral raw materials also increased on a year-on-year basis, but to a smaller extent than in the previous year.

The increase in industrial products prices was generated partly by domestic energy prices and partly by the high price of oil on the world markets. They generated price increases mainly in sectors specialising in the processing of energetic raw materials, when the steepest increases were recorded in the price of refined oil products (4.4%) and that of base metals and finished metal products (2.9%).

Prices in the category ‘foodstuffs, beverages, and tobacco’ also recorded a steep increase

Table B2 Producer price developments (index, same period a year earlier = 100, average for the period)

	2001	2002	2003				
			Q1	Q2	Q3	Q4	Year
Industrial producer prices	106.6	102.1	108.5	108.1	108.1	108.5	108.3
Prices of mineral raw materials	108.5	107.4	106.9	101.3	102.2	105.3	103.9
Prices of industrial products	104.5	100.7	103.6	102.3	101.9	102.3	102.6
Prices of electricity, gas, steam, and hot water	116.6	106.7	116.7	117.7	118.4	118.7	117.9
Construction prices	106.8	105.1	104.9	105.4	105.2	105.2	105.2
Building materials prices	106.8	103.2	103.7	103.6	103.2	103.7	103.6
Agricultural prices	107.8	99.3	93.9	92.1	96.6	97.0	95.2
Prices of plant products	111.2	98.8	96.5	92.9	99.9	102.1	99.7
Prices of animal products	106.6	99.4	93.4	92.0	94.5	94.1	93.5

Same period a year earlier = 100.

(2.8%). Their course was affected by conflicting price developments in the individual groups of processed foods, when the prices of dairy products, beverages, and processed fruit and vegetables increased on a year-on-year basis, while the prices of meat and meat products, flour products, industrially prepared animal fodder, and tobacco dropped.

Construction prices

Construction prices increased year-on-year by 5.2% in 2003, due to a rise in the price of repair and maintenance work in construction (5.5%) and work on new construction, modernisation, and reconstruction projects (5.1%). In new construction projects, the steepest price increases were recorded in civil engineering projects (mainly railways), and the smallest in residential construction.

The cost prices of materials and products used in construction increased in comparison with the previous year by 3.6%, when the price of materials used in repair and maintenance work rose year-on-year by 4.4% and that of materials used in new construction, modernisation, and reconstruction projects increased by 3.4%.

Agricultural prices

Agricultural prices fell in 2003 by an average of 4.8%, due to drops in the prices of both animal and plant products. In animal production, most products recorded a fall in price, especially the price of pork (18.5% for live animals), the sharp decline of which did not stop even when the Agricultural Intervention Agency intervened through purchase support. The drop in the price of plant products took place exclusively in cereal prices (falling by an average of 1.7%). This was due to the excess of supply over demand, resulting from the fact that manufacturers purchased cereals in smaller amounts, owing to the availability of ample reserves. The prices of other plant products recorded a year-on-year increase (mainly the price of potatoes, which rose by 7.4%).

GDP deflator

The GDP deflator increased in 2003 by 4.7%, compared with 4.0% in 2002. The development of the GDP deflator was connected with the steep increase in consumer and industrial producer prices, accompanied by a modest appreciation in the exchange rate of the Slovak koruna.

The GDP deflator was affected by the deflator of domestic demand and the relationship between the export and import deflators. The increase in the domestic demand deflator (6.4%) was due largely to growth in the deflators of final household consumption and final consumption of the general government. The relatively marked price-related change in final household consumption (7.8%) resulted from adjustments of regulated prices and indirect taxes.

Table B3 **GDP deflator** **(index, same period a year earlier = 100, average for the period)**

	2001	2002	2003				
			Q1	Q2	Q3	Q4	Year
Consumer prices	107.3	103.3	107.6	107.9	109.1	109.5	108.5
Industrial producer prices	106.5	102.1	108.5	108.1	108.1	108.5	108.3
GDP deflator	104.2	104.0	104.7	103.6	104.3	106.1	104.7
Export deflator	105.4	100.7	98.0	97.0	97.1	94.9	96.7
Import deflator	108.4	99.8	97.2	95.6	96.9	96.7	96.6

A downward effect on the GDP deflator was exerted by the development of foreign trade deflators. The export deflator developed in line with the decline in the price index of industrial products for export, which was connected with the appreciation of the Slovak koruna. The fall in import prices was due primarily to exchange rate effects.

1.2. Gross domestic product

In 2003, the dynamic growth in the Slovak economy continued, when gross domestic product (GDP) increased in comparison with the previous year by 4.2% at constant prices (in 2002 by 4.4%). The rate of economic growth slowed slightly on a temporary basis, from 4.1% in the 1st quarter to 3.8% in the 2nd quarter, then accelerated gradually to 4.2% in the 3rd quarter and 4.7% in the final quarter. The volume of GDP created during the year amounted to Sk 1,195.8 billion (at current prices), which was 9.1% more than a year earlier.

In a breakdown by use, GDP growth was stimulated exclusively by foreign demand, while domestic demand tended to reduce its level (due mainly to changes in inventories). Foreign demand grew year-on-year by 22.6% (at constant prices), representing the most rapid growth since 1994.

Developments of domestic and foreign demand led to growth in aggregate demand (8.5% at constant prices, compared with 4.8% in 2002). Within the structure of aggregate demand, the share of domestic demand decreased year-on-year by 5.6 percentage points (to 51.2%), while the proportion of foreign demand increased in the same measure.

Chart B4

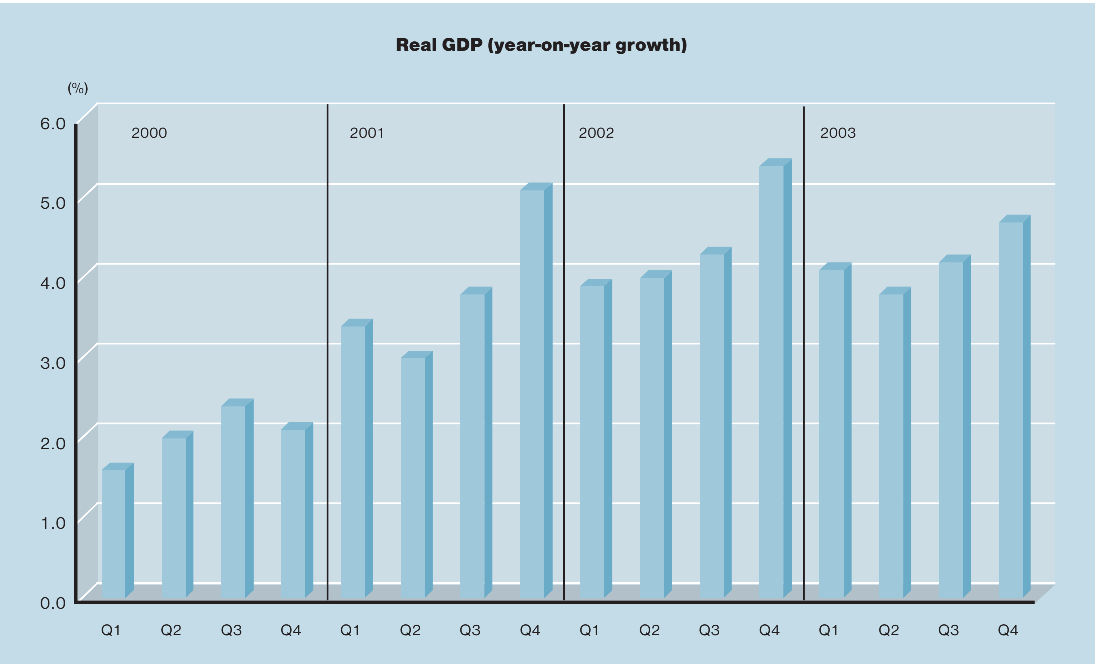


Chart B5

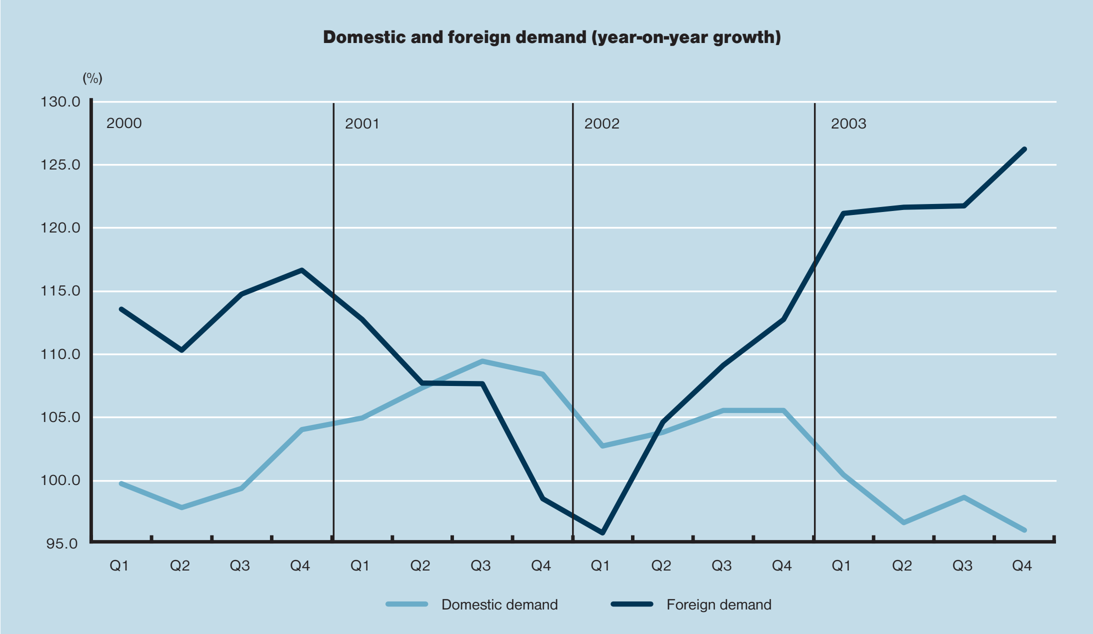


Table B4 **Aggregate demand and its coverage** **(constant 1995 prices)**

	Volume in billions of Sk			Structure in %		
	2001	**2002**	**2003**	**2001**	**2002**	**2003**
Aggregate demand	*1,303.6*	*1,365.9*	*1,482.6*	*100.0*	*100.0*	*100.0*
Domestic demand [1/]	744.3	775.8	759.1	57.1	56.8	51.2
Foreign demand	559.3	590.0	723.4	42.9	43.2	48.8
Coverage of aggregate demand						
Domestic supply	716.8	748.4	779.9	55.0	54.8	52.6
Foreign supply	586.8	617.5	702.7	45.0	45.2	47.4

1/ Including the statistical discrepancy.

Supply side of GDP

The creation of value added was affected by growth in output as well as intermediate consumption. The faster real growth in output than in intermediate consumption led to improvement in the structure of the economy, when the share of added value increased slightly (from 37.9% in 2002 to 38.1% in 2003).

The persistently large share of intermediate consumption is connected with the fact that the dynamic growth in GDP was achieved in an economy, which has a relatively small share of

Table B5 **Breakdown of GDP creation by component** **(Sk billions, constant 1995 prices)**

	2001	2002	2003	Index [1/]		
				2001/00	**2002/01**	**2003/02**
Output	1,703.2	1,780.0	1,861.7	104.9	104.5	104.6
Intermediate consumption	1,056.9	1,104.6	1,152.6	104.7	104.5	104.3
Value added	646.3	675.5	709.1	105.1	104.5	105.0
Net taxes on products [2/]	70.6	72.9	70.7	92.8	103.3	97.0
Gross domestic product	716.8	748.4	779.9	103.8	104.4	104.2

1/ Indices based on figures expressed in millions of Sk.
2/ Value added tax, excise duties, import taxes, subsidies.

sectors with a high rate of value added in comparison with EU countries. Despite the continued long-term trend of increase in the share of services to the detriment of industry, the share of services in the creation of value added in the SR (62%) is still below the average of EU countries (70%).

In 2003, the services sector created 3.2% more GDP than in 2002 (at constant prices), which was connected with a marked increase in GDP in financial intermediation (29.4%) and in education (17.3%). Modest year-on-year growth was achieved in public administration, defence, social security, other community and social services, and in health care. In trade, GDP creation remained approximately at the level of the previous year. GDP continued to decline in hotels and restaurants, transport and storage, post and telecommunications, and after growing in the previous year, in real estate, leasing, and other business services.

The overall growth in GDP was ensured mainly in industry, construction, and agriculture, where GDP growth exceeded the overall performance of the economy.

The dynamic growth in industry was stimulated by GDP growth in the production and distribution of electricity, gas, and water supply (50.7%) and in manufacturing (6.6%). However, it should be noted that the impressive year-on-year growth in electricity, gas, and water supply was affected, first and foremost, by the low level of value added created in this sector in 2001 and 2002. In manufacturing, a year-on-year increase in value added was recorded in the production of metals and metal goods, machines, electrical equipment, and transport vehicles. On the other hand, the creation of value added diminished in food processing and the production of chemicals, rubber, and plastic products.

Table B6 **Gross domestic product by sector** **(Sk billions, constant 1995 prices)**

	2002	2003	Index1/		Share of GDP in %	
			2002/01	2003/02	2002	2003
Gross domestic product	748.4	779.9	104.4	104.2	100.0	100.0
of which:						
Agriculture, forestry, and fishing	37.4	39.1	98.4	104.4	5.0	5.0
of which: agriculture	33.6	35.5	109.9	105.6	4.5	4.5
Industry in total	191.4	209.6	99.7	109.5	25.6	26.9
Mining and quarrying	5.1	4.3	86.7	85.7	0.7	0.6
Manufacturing	171.2	182.5	98.8	106.6	22.9	23.4
Electricity, gas, and water supply	15.1	22.7	116.6	150.7	2.0	2.9
Construction	25.8	27.5	109.3	106.9	3.4	3.5
Services in total	432.7	446.6	107.7	103.2	57.8	57.3
Wholesale and retail trade, repair	99.5	99.6	97.8	100.1	13.3	12.8
Hotels and restaurants	7.7	6.1	95.3	78.7	1.0	0.8
Transport, storage, post and telecommunications	71.6	68.9	95.7	96.2	9.6	8.8
Financial intermediation	37.7	48.8	147.5	129.4	5.0	6.3
Real estate, leasing, business activity	84.9	84.8	107.8	99.8	11.3	10.9
Public administration, defence, social security	59.3	61.8	110.6	104.2	7.9	7.9
Education	22.3	26.1	120.0	117.3	3.0	3.3
Health and social services	29.5	30.0	124.7	101.7	3.9	3.8
Other community, social, and personal services	20.1	20.5	120.6	101.9	2.7	2.6
Other 2/	61.2	57.1	99.3	93.3	8.2	7.3

1/ Indices based on figures expressed in millions of Sk.
2/ Value added tax, excise duty, import tax, subsidies, imputed production of banking services (FISIM).

Agriculture

In 2003, the economic results of the agricultural sector were negatively influenced by the adverse weather conditions, which affected the sowing, the vegetation period, and consequently the crop of cereals in particular.

The difficult farming conditions and the opened price scissors between the rising price of inputs and the falling price of agricultural products (persisting for the second consecutive year) caused the growth dynamics of real GDP in agriculture to weaken in comparison with 2002 by 4.3 percentage points, to 5.6%. However, the share of agriculture in GDP creation remained unchanged, at 4.5% as in the previous year (at constant prices).

Despite the difficult conditions, the receipts of agricultural organisations from the sale of own products remained at the level of the previous year (at constant prices). The total volume of receipts was affected by a moderate increase in proceeds from the sale of animal products (they accounted for more than 60% of the receipts) and a fall in proceeds from the sale of plant products as a result of poor crop.

With the exception of fruit and vegetables (in plant products) and pigs (in animal products), the sales of other plant and animal products fell on a year-on-year basis. In 2003, the stocks of cattle and pigs continued to decline. The stocks of poultry and sheep recorded a moderate increase. Milk production declined as result of slack demand among consumers.

Industry

In 2003, the volume of GDP created in industry grew year-on-year by 9.5% at constant prices (after falling by 0.3% in the previous years). The relatively rapid growth was reflected in the increased share of industry in the total volume of real GDP, which reached 26.9% (compared with 25.6% in 2002).

Compared with the previous year, industrial production recorded a moderate slowdown in dynamics in 2003 (from 6.8% to 5.7%), which was caused by a year-on-year decline in production in mining and quarrying, electricity, gas and water supply. On the other hand, industrial production was positively affected by the continuing growth in manufacturing, mainly in export-oriented sectors. This took place in the production of transport vehicles, rubber and plastic goods, electrical and optical equipment, other machines and equipment, and metals and metal products. The fall in domestic demand was reflected mainly in the production of chemicals, chemical fibres, and other chemical goods; foodstuffs, beverages, and tobacco products; and refined oil products and nuclear fuels, the production of which declined in comparison with the previous year.

The continued restructuring of industrial companies led to a reduction in overemployment (mainly in mining and quarrying, electricity, gas and water supply), while the favourable trend in manufacturing had a pro-growth effect on overall employment in industry. The number of employees in industry increased year-on-year by 0.5%, which was less than the average figure for the SR. This development affected the average level of nominal monthly wages in the sector, which rose by 7.3% in 2003 and exceeded the rate of growth in the average nominal wage in the economy as a whole.

Construction

The creation of gross domestic product in the construction sector followed a trend of growth in 2003, with the 12-month dynamics reaching 6.9% at constant prices (compared with 9.3% in 2002). The share of the sector in total GDP was relatively stable and hovered around the level of 3.5%.

The relatively dynamic growth in the sector is documented by data on the volume of construction work, which grew year-on-year by 6% at constant prices (a year earlier by 4.1%). The output of the construction sector was affected by a modest growth in production in new construction, reconstruction, and modernisation projects (having a dominant share in the output) and a rapid growth in the volume of construction repair and maintenance work. After decline in the previous year, dynamic growth was achieved in construction abroad, but with regard to its small share in total production and the low basis of comparison, it had no significant effect on the total output of the sector.

The increased demand for construction work was reflected in the level of employment, which increased in the construction sector by 4.0% in 2003 and well exceeded the average figure for the SR. This fact was to some extent responsible for the persistent slow growth in nominal wages in construction, which reached 3.9% and remained well behind the average rate of wage growth in Slovakia.

Services

The services sector reacted to the decline in domestic demand with a more than twofold slowdown in the year-on-year growth rate of GDP (at constant prices from 7.7% in 2002 to 3.2% in 2003). As a result, the share of services in the total volume of real GDP decreased against the previous year by 0.5 percentage point, to 57.3%.

The decline in domestic demand in 2003 led to a year-on-year fall in receipts from own-output and goods in all market services sectors. An exception was represented by the receipts of organisations specialising in the sale of motor vehicles and fuels, which increased at constant prices by 1.9%, and receipts in post and telecommunications, which rose by 8.5% at current prices.

In 2003, the level of employment in the services sector rose by 1.1%, after falling in 2002 by 0.1%. This development was connected with a dynamic growth in employment in financial intermediation; public administration, defence, compulsory social security; real estate, leasing, and business services; and in health and social services. Wage developments in services followed a different course: the growth in nominal wages in some sectors remained behind (in health services, real estate, transport, public administration) and/or exceeded (in education, other public services, hotels, financial intermediating) the average growth in the economy as a whole.

Demand side of GDP

In the structure of GDP by use, the 2003 increase in GDP at constant prices was generated exclusively by foreign demand. Its contribution to growth in GDP was greater than in the previous year, i.e. 6.4 percentage points (2002 saw a zero contribution). The contribution of domestic demand changed on a year-on-year basis, from positive to negative, and reduced the rate of GDP growth by 2.4 percentage points in relative terms. This change was caused mainly by a fall in gross capital formation, and a decline in private consumption in real terms.

Domestic demand

In 2003, domestic demand fell year-on-year by 2.3% at constant prices. It increased slightly in the first quarter, but then remained below the level of the previous year in the following quarters. Domestic demand was affected by a decline in both gross capital formation and final household consumption. It followed a volatile course of development during 2003, due to

Table B7 **Absolute year-on-year increases in GDP with contributions (constant 1995 prices)**

	2001		2002		2003	
	Sk billions	Contribution	Sk billions	Contribution	Sk billions	Contribution
Gross domestic product	26.1	3.8	31.5	4.4	31.5	4.2
Domestic demand	51.6	7.5	32.1	4.5	-17.8	-2.4
Statistical discrepancy	0.0	0.0	-0.6	-0.1	1.1	0.2
Net exports	-25.4	-3.7	0.0	0.0	48.2	6.4

Table B8 **Gross domestic product by use** **(Sk billions, constant 1995 prices)**

	2001	2002	2003	Index 1/		
				2001/00	2002/01	2003/02
Gross domestic product	716.8	748.4	779.9	103.8	104.4	104.2
Domestic demand	744.3	776.4	758.6	107.4	104.3	97.7
of which:						
Final consumption in total	536.5	564.0	566.7	104.7	105.1	100.5
Households	384.4	404.8	402.4	104.9	105.3	99.4
Non-profit institutions	6.2	6.4	7.1	95.7	103.5	111.9
General government	145.9	152.8	157.1	104.6	104.7	102.9
Gross capital formation	207.8	212.4	191.9	115.2	102.2	90.3
Gross fixed capital	201.9	200.1	197.8	113.9	99.1	98.8
Change in inventories	5.9	12.3	-5.9	x	x	x
Net exports	-27.5	-27.5	20.7	x	x	x
Exports of goods/services	559.3	590.0	723.4	106.3	105.5	122.6
Imports of goods/services	586.8	617.5	702.7	111.0	105.2	113.8
Statistical discrepancy	0.0	-0.6	0.6	x	x	x

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

changes in inventories. The decline in domestic demand was moderated by growth in final consumption of the general government and in non-profit institutions serving households.

Domestic consumer demand

Final consumption in total contributed to GDP growth only slightly in 2003, when its year-on-year dynamics reached 0.5% at constant prices. The increase in final consumption took place mostly in general government, while final household consumption (71% of consumer demand) declined year-on-year by 0.6%.

In the structure of final household consumption, purchases of foodstuffs (26.4% at constant prices) and expenses on housing, water, electricity, and gas (22.3%) accounted for almost 50% of consumer spending. The most rapid growth

Chart B6

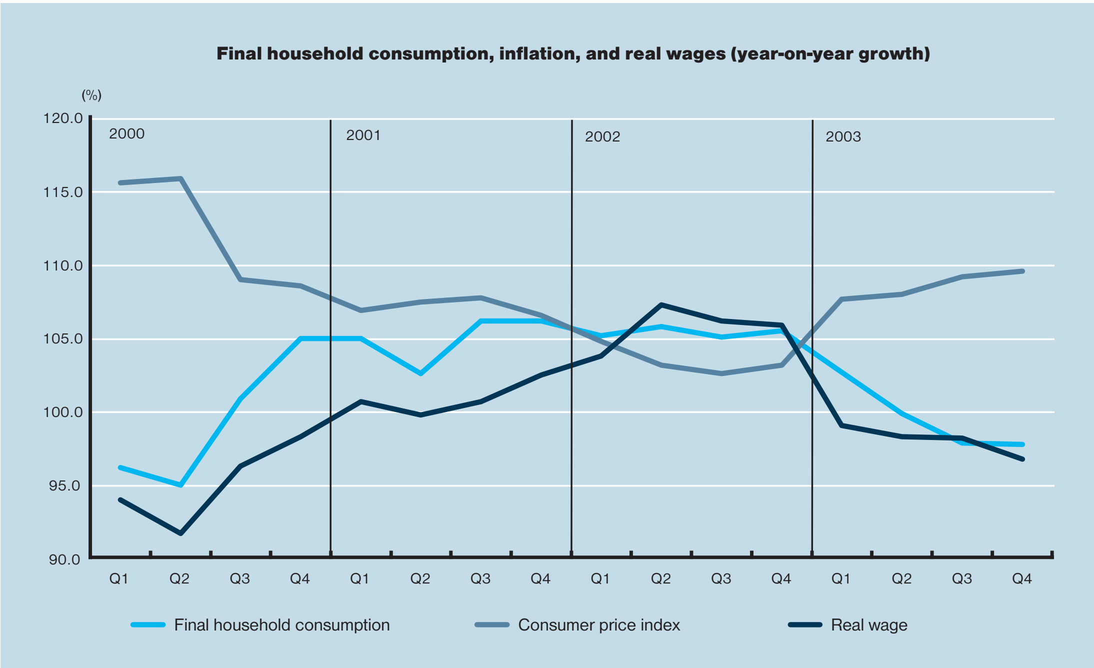
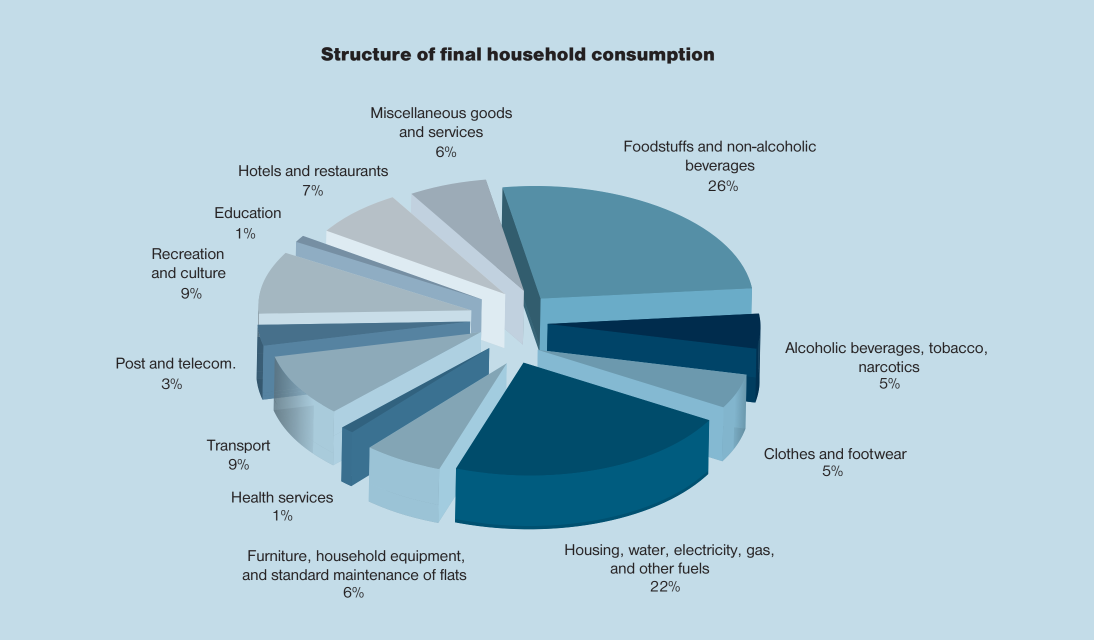


Chart B7



was recorded in spending on health services (12.9%) and education (8.1%), but if we take into account the weights of individual categories of consumer expenses, the most significant increase took place in spending on housing, water, electricity, and gas.

As a result of increased electricity, gas, and water prices and increased indirect taxes, households were probably forced to reallocate their consumer expenditures according to their disposable incomes. The increased expenses on housing and energy were partly offset by a real fall in other expenses, especially in consumer spending on recreation, culture, alcoholic beverages, tobacco, and narcotics.

Final consumption in general government increased year-on-year by 2.9%. The individual quarters saw different trends of development in public consumption: a moderate decline in the first three quarters, followed by dynamic growth in the fourth quarter. This development was caused probably by the lower expenses of budgetary institutions in the first three quarters, compared with the budgeted amounts, and by the postponement of their drawing until the end of the year.

Income and expenditure of households

According to data from the Statistical Office of the SR, the current income of households increased year-on-year in nominal terms by 6.0% in 2003, while falling in real terms by 2.3%. The rate of growth was 2.4 percentage points slower than in 2002. The current expenditure of households (paid to other sectors and not used for direct consumption) increased in nominal terms by 5.5% (a year earlier by 8.5%), representing a slowdown in dynamics. In real terms, current expenditure decreased year-on-year by 2.8%.

The level of current income was affected mainly by an increase in income from work and business activity, when the gross mixed income of households (which includes the receipts of tradesmen spent by their households as well as their business profits) increased by 9.0% (in 2002 by 8.4%) and income from work, i.e. compensation of employees, grew by 5.9% (in 2002 by 8.1%). The fall in the year-on-year dynamics of current income was caused mainly by a slowdown in the rate of growth in gross wages and salaries (due to their large weight).

Table B9 Generation and use of incomes in the household sector **(current prices)**

	Sk billions		Index [1/]		Share in %	
	2002	2003	2002/01	2003/02	2002	2003
Compensation of employees (all sectors)	466.6	494.0	108.1	105.9	51.4	51.3
of which: Gross wages and salaries	348.8	368.3	108.1	105.6	38.4	38.3
Gross mixed income	242.9	264.9	108.4	109.0	26.8	27.5
Income from property – received	32.3	28.1	98.3	87.1	3.6	2.9
Social benefits	134.3	143.9	109.0	107.2	14.8	14.9
Other current transfers – received	31.9	32.0	121.7	100.4	3.5	3.3
Current income in total	908.0	962.9	108.4	106.0	100.0	100.0
Income from property – paid	5.5	6.5	115.9	118.7	2.3	2.6
Current taxes on income, property, etc.	47.8	50.3	112.4	105.2	20.1	20.0
Social security contributions	160.1	170.3	106.6	106.4	67.3	67.8
Other current transfers – paid	24.6	24.1	112.5	97.8	10.4	9.6
Current expenditure in total	238.1	251.3	108.5	105.5	100.0	100.0
Gross disposable income	669.9	711.6	108.3	106.2	100.0	100.0
Adjustment for the change in net equity of households in pension funds	2.7	3.3	139.6	122.2	x	x
Final household consumption	623.1	667.5	107.9	107.1	93.0	93.8
Gross savings of households	49.4	47.4	115.2	96.1	7.4	6.7

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

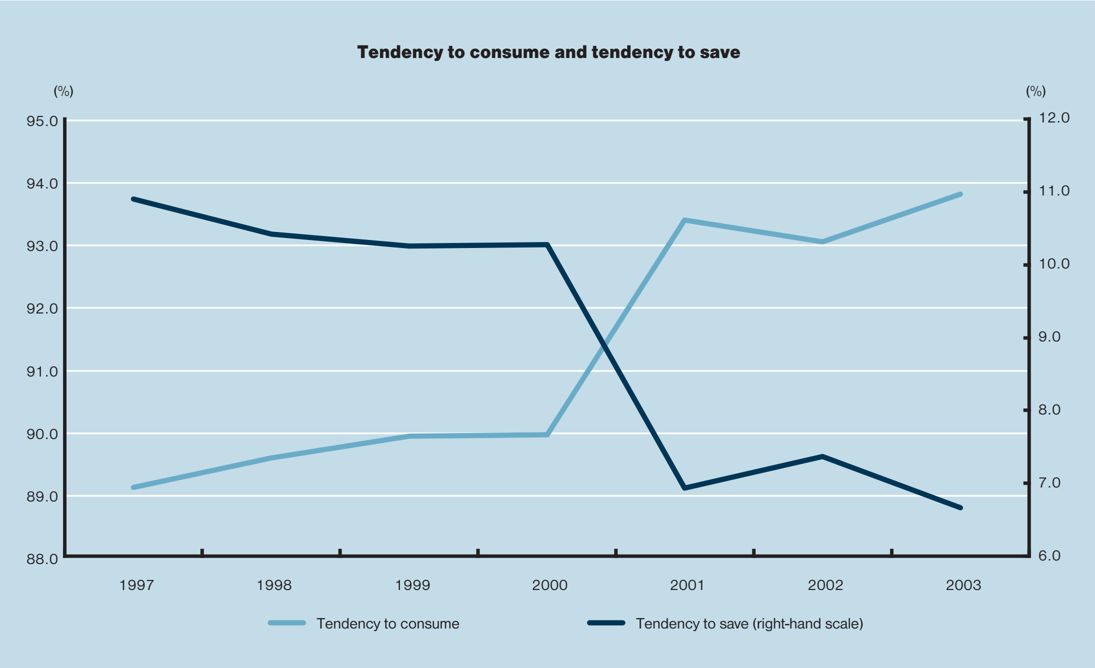
The year-on-year growth in the volume of welfare benefits (pensions, social security benefits, and unemployment benefits) was mainly due to an increase in pensions, which accounted for more than 60% of the total amount paid in welfare benefits. The only income item that recorded a year-on-year decline was income from property (arising from the ownership of financial assets, i.e. deposits, bonds, etc., or the ownership of land, underground resources, etc., if placed by the owner at the disposal of another institutional unit). We may assume that the decline in this income item, persisting since 2000, was affected mainly by the continuing fall in interest rates on household deposits, for interest represents a substantial part of income from property.

Current expenditure was affected mainly by social security contributions and current taxes on income and property, which together accounted for 87.8% of the volume of current expenditure. The weaker dynamics of current expenditure in comparison with the previous year, was probably connected with the relatively slow growth in gross wages and salaries.

Faster growth than a year earlier was recorded only in income from property paid. Its strong dynamics, persisting for the third consecutive year, was apparently due to an increase in charges for the administration of financial assets for households, particularly in bank charges.

The slowdown in the rate of growth in current income and current expenditure in the household sector was reflected in the development of gross disposable income, which represents the difference between current income and current expenditure. Its dynamics diminished in comparison with the previous year by 2.1 percentage points, to 6.2%. Of the gross disposable income of households, Sk 667.5 billion was used for final consumption, the remainder went on gross savings, which include not only the bank deposits of citizens and small entrepreneurs but their investments and supplementary annuity insurance as well. They fell in volume by 3.9% year-on-year and their share in gross disposable income (the rate of gross household savings) reached 6.7%, representing a decrease of 0.7 percentage point in comparison with the figure for 2002. In the long term, the tendency of households to

Chart B8



consume is on the increase, while their tendency to save is in decline.

Domestic investment demand

Gross capital formation (including a change in inventories) declined in 2003 by 9.7% at constant prices. Its development was affected first and foremost by a fall in the volume of inventories (by Sk 5.9 billion) The lower level of inventories in the Slovak economy may be connected with the attempt of enterprises to improve their efficiency and to increase exports. The decline in gross investment was caused in part by gross fixed capital formation, which fell on a year-on-year basis for the second successive year (in 2003 by 1.2%).

In 2003, the share of domestic funds in the financing of investment demand increased, since the gap between gross domestic savings, i.e. unconsumed part of GDP, and gross investments narrowed. There were more than 90 hellers worth of gross savings in the national economy for one koruna worth of gross investments in 2003, compared with approximately 70 hellers in previous years.

Gross fixed capital formation declined in almost all sectors in 2003. An exception was constituted by households, which invested heavily in the construction of flats and houses. Within the structure of investments in construction, investment in residential buildings increased, due to the availability of new forms of financing (mortgage loans, home saving, and government loans). Despite intense investment activity on the part of household, the total volume of investment in structures declined year-on-year by 4.2%, due to a downturn in investment in other structures (halls and buildings for production and services,

Table B10 **Investments and savings** **(%, current prices)**

	2001	2002	2003
Rate of savings 1/	21.8	22.3	23.3
Rate of gross fixed investments 2/	30.0	29.3	25.3
Rate of fixed fixed investments 3/	28.8	27.4	25.8
Coverage of investments by savings 4/	72.8	76.2	92.1

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

Table B11 **Structure of gross fixed capital formation in 2003**

	Gross fixed capital formation (Sk millions)	Share in the Slovak economy (%)	Index 2003/02
Economy of the SR in total:	308,404	100.0	98.8
of which (by production):			
Structures	103,978	33.7	95.8
Residential buildings	19,144	6.2	101.1
Other structures	84,834	27.5	94.7
Machinery	182,983	59.3	100.9
Metal products and machinery	135,388	43.9	99.4
Transport equipment	47,595	15.4	105.4
of which (by sector):			
Non-financial corporations	182,259	59.1	99.0
Financial corporations	43,107	14.0	97.6
General government	30,597	9.9	96.8
Households	51,830	16.8	101.0
Non-profit institutions serving households	611	0.2	72.1

Note: The volumes are at current prices, the indices at constant 1995 prices.

other industrial facilities, bridges, roads, and other civil engineering works, flood control dykes, and other water engineering structures). Investment in machinery increased somewhat on a year-on-year basis (by 0.9%) as a result of investments in the category 'transport equipment'.

Net exports

The growth in the exports of goods and services in 2003, accompanied by a moderate growth in imports, led to improvement in the trade balance. The deficit in net exports at current prices reached Sk 17.9 billion in 2003, representing an improvement of Sk 60 billion compared with the previous year. Including the negative year-on-year increa-

Chart B9

ses in the deflators of foreign trade (caused mainly by exchange rate developments), net exports at constant prices, including a statistical estimate of the unregistered economy, resulted in a surplus of Sk 20.7 billion (compared with a deficit of Sk 27.5 billion in 2002).

The improvement in foreign trade resulted partly from the trend of year-on-year convergence between the functional openness indicators of the economy in 2003. Export performance, expressed in terms of the exports of goods and services as a share of GDP (at current prices), increased year-on-year by 6.2 percentage points, to 78.0%. The increased share of exports in GDP was primarily a consequence of growth in the exports of transport equipment. The increase in export dynamics led to growth in the import-intensity of the economy. Import demand increased year-on-year by 0.6 percentage point, with the volume of imported goods and services accounting for 79.5% of GDP.

1.3. Labour market developments

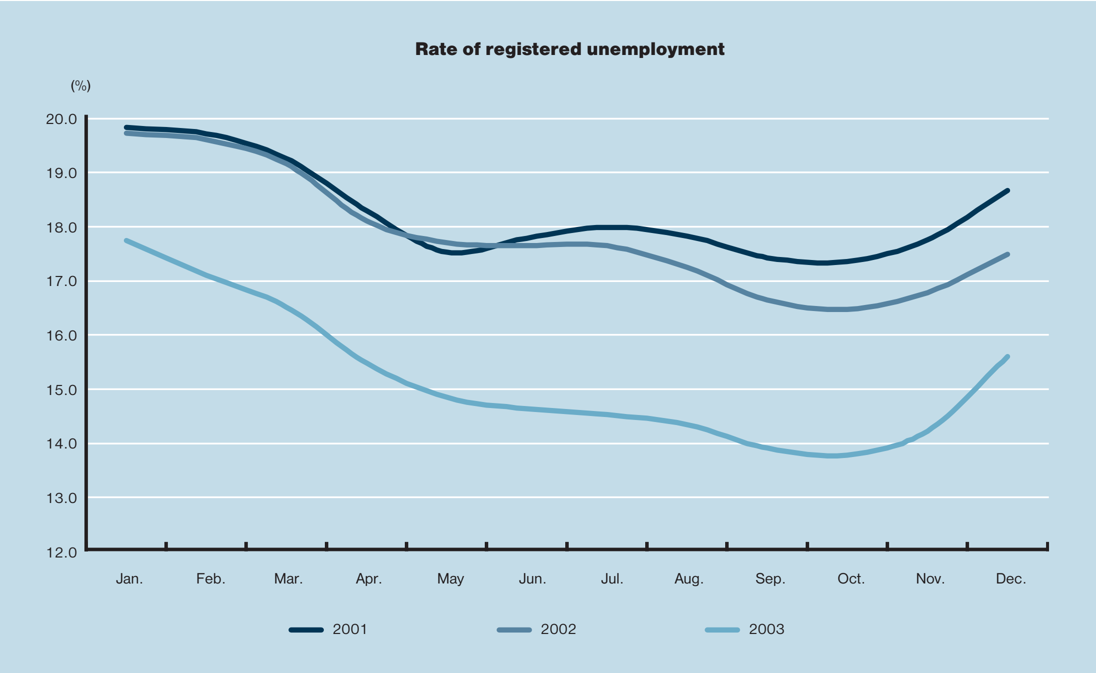
Employment and unemployment

The main factors determining the level of employment and unemployment were economic growth, demographic factors, which were responsible for the smaller increases in the number of economically active population, and administrative measures in the registration of job applicants. In 2003, employment maintained an upward trend for the third consecutive year. According to statistical records, there were 2,025,000 employees in the Slovak economy (on average), which represented a year-on-year increase of 0.8% and an acceleration of 0.7 percentage point in the rate of growth in comparison with 2002.

The increase in employment took place mostly in financial intermediating (an increase of 5.5%), construction (4.0%), public administration, defence, and compulsory social insurance (3.9%), and in real estate, leasing, and business services (3.2%). On the other hand, the level of employment fell in agriculture, hunting, and forestry, and in transport, storage, post and telecommunications.

Unemployment showed a tendency to fall over the course of 2003. At the end of the year, the number of unemployed registered at labour offices stood at 452,000 (compared with 504,000 in 2002). Compared with December 2002, the rate of unemployment, based on the number of registered unemployed, dropped by 1.9 percentage

Chart B10



points, to 15.6%. The average figure for 2003 dropped year-on-year by 2.6 percentage points, to 15.2%, representing the lowest figure in the last five years.

The course of unemployment during the year was affected mostly by the adoption of administrative measures and the enactment of an amendment to the Act on Employment with effect from January 2003, which tightened the conditions for the registration of job seekers and placed them under the obligation to contact the labour office at biweekly intervals with some evidence of active co-operation. This fact was reflected in the falling rate of unemployment, from January to October. In November and December, the unemployment rate again increased, which was connected with the re-registration of persons who had been excluded from the registers of labour offices at the beginning of the year due to unwillingness to co-operate, and with the absence of seasonal work.

Over the course of the year, more than 402,000 new job applicants signed on at labour offices, while almost 455,000 persons were deleted from the registers. During the same period, more than 297,000 registered unemployed were placed into jobs.

The other indicators also showed a favourable tendency: the average number of job seekers per vacancy dropped to 23 in 2003, from 34 a year earlier. In 2003, the average period of registration was reduced to 15.2 months, from 17.8 months in 2002.

Wages and labour productivity

In 2003, the average monthly nominal wage in the Slovak economy reached Sk 14,365, representing a year-on-year increase of 6.3%. The rate of growth was 3 percentage points slower than in 2002. Wage developments, mainly in the 4th quarter, were probably affected by the shift of the flexible part of wages to 2004 in connection with the implementation of the tax reform with effect from 1 January 2004. Real wages fell year-on-year by 2.0%, after increasing in 2002 by 5.8%. The fall in real wages was caused by a slowdown in the rate of growth in nominal wages and a rise in average consumer prices, the dynamics of which increased from 3.3% in 2002 to 8.5% in 2003.

A slowdown in the year-on-year dynamics of nominal wages and a fall in real wages were recorded in most sectors. The slowest nominal wage growth occurred in trade a repair services (2.4%), health and social services (3.4%), and construction (3.9%), while the steepest increases were recorded in education (9.6%), other community and social services (8.8%), and in hotels and restaurants (7.5%). Nominal wages in industry grew at the same rate as in 2002 (7.3%). The slowdown in wage dynamics in numerous non-market services sectors was a result of the low basis of compari-

Table B12 **Labour market indicators** **(same period a year earlier = 100)**

	2002	2003				
		Q1	Q2	Q3	Q4	Year
Nominal wage (Sk)	13,511	13,082	14,118	14,066	16,180	14,365
Nominal wage (index)	109.3	106.5	105.9	107.0	106.0	106.3
Labour productivity of GDP (index, curr. prices)	108.4	108.0	106.0	108.3	110.4	108.2
Nominal wage (index)	105.8	99.0	98.2	98.1	96.7	98.0
Labour productivity of GDP (index, const. prices)	104.3	103.1	102.4	103.9	104.1	103.4
Wage minus productivity (percent. points)	1.5	-4.1	-4.2	-5.8	-7.4	-5.4
Employment (index) 1/	100.1	100.9	101.4	100.3	100.6	100.8
Rate of registered unemployment (%) 2/	17.8	17.1	15.0	14.2	14.5	15.2
Consumer prices (average index)	103.3	107.6	107.9	109.1	109.6	108.5

1/ According to quarterly statistical records.
2/ Of the disposable number of unemployed, average for the period (NBS estimate).

Chart B11

son in the previous year, when wages increased significantly in public services in accordance with the new Acts on civil and public services.

Wages levels in the individual sectors continued to show relatively marked differences. The highest average monthly nominal wage (Sk 29,088 recorded in financial intermediating) was 2.66 times higher than the lowest wage (Sk 10,942 in agriculture), compared with 2.65 times a year earlier. As in the previous year, wages remained below the average wage in the Slovak economy in five sectors.

Labour productivity maintained relatively strong dynamics in 2003, in both nominal and real terms. At current prices, labour productivity grew by 8.2% and exceeded the dynamics of nominal wages by 1.9 percentage points. The dynamics of real productivity reached 3.4%, which represented an excess of 5.4 percentage points over real wages, which fell during the year.

1.4. Financial results of corporations

According to preliminary data from the Statistical Office of the SR, financial and non-financial corporations reached different financial results in 2003.

Financial corporations (banks, including the NBS, insurance companies, other financial intermediaries) recorded, as in the previous year, a negative financial result. The total loss amounted to Sk 15.1 billion and was affected primarily by the financial performance of the NBS, which resulted in a loss of Sk 31.4 billion in 2003. The deepening negative financial result can be ascribed to the loss of financial institutions (which grew by 59.7% compared with 2002), offset partly by an increase in the earnings of insurance companies (by 104%) and the profits of other financial intermediaries.

According to preliminary data, non-financial corporations generated a gross profit of Sk 153.1 billion, which was 9.9% more than a year earlier. In terms of volume, the largest profits were achieved in industrial production; electricity, gas, and water supply; and in trade. The only loss-making sector was agriculture, fishing, and forestry.

The relatively steep year-on-year increase in profits took place predominantly in transport; post and telecommunications; electricity, gas, and water supply; and in industrial production, where the largest increases in profits were achieved in the production of machines and equipment, metals and metal articles, rubber and plastic goods, and electrical and optical equipment.

Table B13 **Financial results of corporations** **(current prices)**

	Sk millions		Index
	2002	**2003**	**2003/02**
Financial result (before taxation)			
Non-financial and financial corporations in total	133,685	138,023	103.1
Non-financial corporations	139,138	153,145	109.9
Financial corporations	-5,453	-15,122	277.3
Number of non-financial corporations (with 20 or more employees)			
Non-financial corporations in total	6,127	5,849	-278
Non-loss-making corporations	4,426	3,919	-507
Loss-making corporations	1,701	1,930	229

Source: Statistical report on the basic trends of development in the economy of the SR in 2003.

Within the structure of non-financial corporations, a substantial part of the profit (52.9%) was generated by large companies, while medium-sized companies accounted for 15.9% and small companies 31.2% of the total profit. The year-on-year growth in earnings in the non-financial sector was affected by a marked increase in the profits of large companies (with 1,000 and more employees), while the profits of small and medium-sized enterprises remained below the level of the previous year.

2. BALANCE OF PAYMENTS

2.1. Current account

In 2003, the balance of payments on current account resulted in a deficit of Sk 10.2 billion, which was Sk 77.1 billion less than in the previous year. This development was mainly due to a year-on-year improvement in the trade balance. The upturn in export activity, mainly in relation to EU countries, led to a year-on-year growth of Sk 151.0 billion in exports.

The marked improvement in the trade balance caused the ratio of the current account deficit to

Chart B12

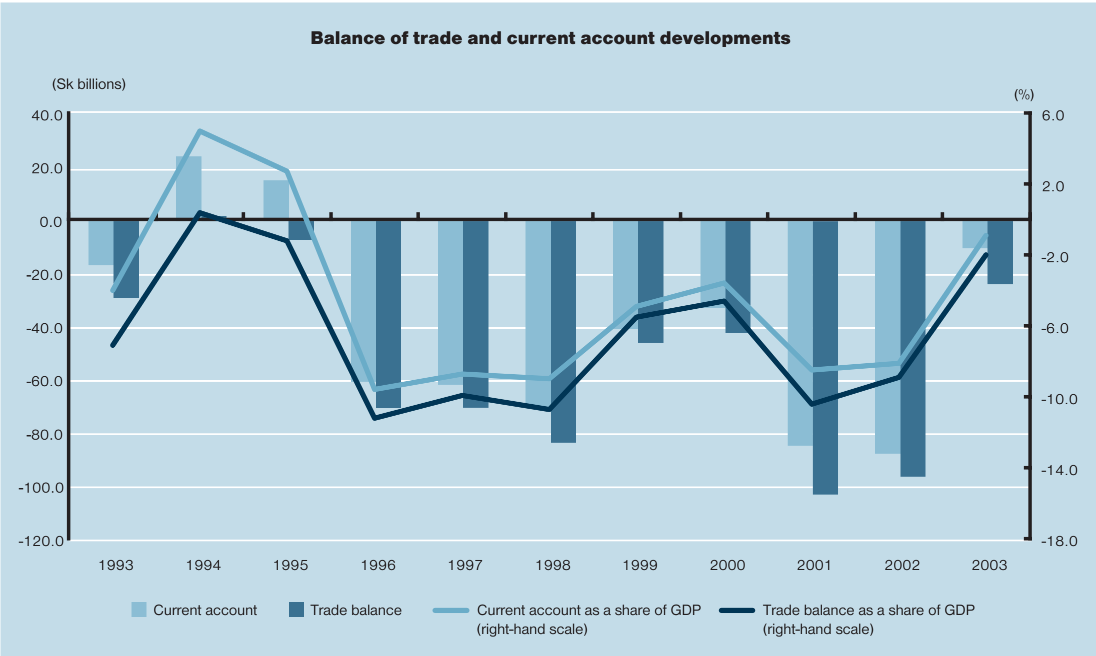


Table B14 **Balance of payments on current account** **(Sk billions)**

	2003		2002
Balance of trade	-23.6	(-23.6)	-96.0
Services balance [1/]	8.6	(14.4)	20.7
Income balance [1/]	-4.4	(-18.8)	-20.7
Current transfers	9.2	(11.8)	8.8
Current account in total	**-10.2**	**(-16.2)**	**-87.2**
Current account as a share of GDP in %	**-0.9**	**(-1.4)**	**-8.1**

1/ The methodology applied for determining the compensation of employees was changed with effect from 2003. In contrast with the original methodology (which was based exclusively on banking statistics), the new methodology also applies data estimated or calculated by of the Statistical Office of the SR (number of employees abroad, average wage, expenses of employees abroad, etc.). Since the change in methodology affects not only the income balance (the compensation of employees is part of the income balance) but tourism (the expenses of Slovak workers abroad are included in payments within the scope of tourism) and in part the balance of current transfers as well (part of the compensation of employees received is delivered through the transfers of natural persons), the information value of the comparison of 2003 with the previous year decreases (the said change caused the current account deficit to improve by Sk 6.0 billion). Figures according to the original methodology are presented in brackets.

GDP to drop to 0.9% (the best value since 1995, when the current account generated a surplus). The trade deficit as a share of GDP diminished to 2.2%.

Balance of trade

The trade balance resulted in a deficit of Sk 23.6 billion, representing a year-on-year improvement of Sk 72.4 billion. The improvement was mainly a result of faster growth in the physical volume of exports than in the volume of imports, despite the persistence of low demand on the world markets. The result of foreign trade in 2003 was also supported by the exchange relations affected by a fall in the overall import price index, a rise in the export price index, and a year-on-year appreciation in the nominal exchange rate of the koruna against the major currencies.

From a geographical point of view, the balance of trade improved substantially with EU countries, especially with Germany and partly with Austria and Great Britain. The share of EU member states, including the accession countries, reached 86% of total exports and 75% of total imports. In relation to other advanced market economies (except the European Union and CEFTA countries), the deficit changed into a surplus as a result of improvement in the trade balance with the USA in 2003, when the export of automobiles to that region significantly increased.

According to preliminary data from the Statistical Office of the SR, goods were exported over the course of 2003 in the total amount of Sk 803.0 billion, which was 23.2% more than in the same period of the previous year (51.8% in USD and 26.8% in EUR).

Table B15
Year-on-year changes in Slovak exports and the contributions of individual components

	Exports in billions of Sk		Contribution in %	
	2003	2002	2003	2002
Raw materials	2.5	-1.0	*0.4*	*-0.2*
Chemical goods and semi-products	14.8	8.6	*2.3*	*1.5*
Machines and transport equipment	124.0	21.5	*19.0*	*3.5*
of which: Machines	28.7	3.3	*4.4*	*0.5*
Transport equipment	95.3	18.2	*14.6*	*3.0*
Finished products	9.7	11.6	*1.5*	*1.9*
Exports in total	151.0	40.7	*23.2*	*6.7*

Table B16

Year-on-year changes in Slovak imports and the contributions of individual components

	Imports in billions of Sk		Contribution in %	
	2003	2002	2003	2002
Raw materials	-1.5	-11.1	-0.2	-1.6
Chemicals and semi-finished goods	20.2	19.7	2.7	2.8
Machines and transport equipment	49.1	15.4	6.5	2.2
Finished products	10.9	9.9	1.5	1.3
of which:				
Agricultural and industrial products	2.4	7.9	0.4	1.1
Automobiles	1.4	-0.4	0.2	-0.1
Machines and electrical-engineering consumables	7.1	2.4	0.9	0.3
Imports in total	78.7	33.9	10.5	4.7

In the structure of exports by commodity, the share of machines and transport equipment increased in 2003. This category was the only one to achieve an above-average growth on a year-on-year basis (46.4%). Slovak exports were completely dominated by the automobile industry. Of the total year-on-year increase in exports, the exports of automobiles and automobile components accounted for 66.3%.

Automobile components include automobile seats, the exports of which increased by 60% in 2003. Automobile seats were the main source of growth in furniture exports, which are included in the category 'finished products'. In addition, increased export activity was recorded in footwear, while the exports of clothes and other industrial products declined.

Foreign direct investment was one of the main stimuli to growth in the exports of machines and electrical instruments. The year-on-year growth in exports in this category took place in automatic data processing machines, white technology, videophones, bearings, mechanical instruments, electrical transformers, integrated circuits, neon tubes, and cables, etc.

Year-on-year increases were also recorded in the exports of certain semi-finished goods, such as iron and steel, iron and steel products, rubber, metal articles, and selected wood products. Year-on-year decline in exports was recorded in chemical products, mainly organic chemicals, pharmaceuticals, and cleaning agents (the exports of these products declined mainly as a result of a fall in prices, and developments in the exchange rate of the koruna against the US dollar).

The volume of goods imported in 2003 totalled Sk 826.6 billion, representing a year-on-year increase of 10.5% (corresponding to 36.3% in USD and 13.7% in EUR).

In imports, as in exports, the share of machines and transport equipment increased slightly in 2003. Imports in this category grew by 20.7%, exceeding the rate of overall year-on-year growth. Imports were concentrated in the automobile industry, which led to growth in the imports of vehicle components and selected machine engineering products (e.g. engines, etc.). On the other hand, a slight decline was recorded in the imports of machines and equipment for industry, mainly printing, metallurgy, and the textile industry, and in the imports of office machines, machines used in construction, agriculture, etc. The decline in the import of machines and equipment, which may be classified as import of technological equipment for the national economy, was connected with the fall in investment demand.

The import of finished products, which grew at a faster rate than in 2002, was driven mostly by the growing imports of consumer electronics. In addition to household goods, a modest increase in imports was also recorded in footwear, clothes, toys, sporting goods, and automobiles, while the imports of most foodstuffs and beverages declined.

Year-on-year decline in imports was also recorded in the category 'mineral fuels'. The fall in the Sk price of oil, resulting from the favourable trend in the exchange rate of the Slovak koruna against the US dollar, is responsible for the fact that oil imports declined, despite a certain increase in both volume and price (in USD), by 5.8%. Of other raw materials, a certain decline was recorded in gas imports, where the fall in volume exceeded the increase in price not only in dollars but in koruna as well. Within the category 'raw materials', the decline in gas and oil imports in koruna terms was offset partly by a growth in the import of electrical energy.

In 2003, trade in services generated a surplus of Sk 8.6 billion, which was Sk 12.1 billion less than a year earlier (without the change in methodology, Sk 6.3 billion would be achieved). Receipts from the exports of services fell by Sk 5.7 billion, while payments for imported services increased by Sk 6.4 billion. The decrease in the services balance surplus took place in all components. While receipts from the exports of services fell most significantly in 'other services in total', payments for imports increased mostly in 'transport services'.

Table B17 **Balance of services (Sk billions)**

	2003	2002
Balance of services	8.6	20.7
Transport	18.7	25.5
Tourism	10.7	12.8
Other services in total	-20.8	-17.6

Receipts from the international transport of goods and persons amounted to Sk 51.6 billion (a year-on-year fall of Sk 0.9 billion) and expenses totalled Sk 32.9 billion (an increase of Sk 5.8 billion). In terms of volume, the largest item in transport services was still income from the transport of gas and oil, which reached Sk 27.8 billion (54% of the total receipts from transport). Transit charges paid in the form of gas supply from Russia fell by Sk 3.5 billion, in connection with the depreciation of the US dollar.

In international road, railway, and water-borne transport services, as well as in other services directly related to transport, the deficit increased by almost Sk 3.0 billion. The increase in the deficit was generated by increased payments to foreign transporters for the transport of goods, mainly by road and to a lesser extent by rail, as a result of accelerated growth in foreign trade.

The positive balance of foreign tourism diminished year-on-year by Sk 2.1 billion. Foreign exchange receipts from foreign tourism reached Sk 31.7 billion (96.7% of the figure for 2002). The lower receipts from active tourism can be explained partly by the smaller number of foreign visitors and partly by the smaller number of days they spent in Slovakia. While the number of foreign visitors and the number of nights spent in Slovakia increased slightly in the first half of the year, the annual values of these indicators for 2003 remained below the level of 2002. The second reason was the appreciation of the Slovak koruna against the three basic currencies (the Czech koruna, the euro, and the US dollar). If we assume that the dollar accounted for 40% of the total receipts from tourism, the appreciation of the koruna caused a more than Sk 3.5 billion fall in receipts (according to quarterly statements of foreign exchange receipts and payments by region, more than 50% of the receipts from tourism came from visitors from European countries).

The expenses of Slovak citizens on foreign travel reached Sk 21.0 billion, which was Sk 1.0 billion more than in 2002. With effect from 2003, these expenses are to be increased, in accordance with the methodology of national accounts and the balance of payments manual of the IMF (5th edition), by the expenses of citizens on goods and services in the countries where they work (for this reason, expenses on foreign travel were increased by Sk 5.8 billion in 2003). Excluding this amount, the amount of foreign exchange drawn by Slovak citizens for travel abroad would fall by more than 25%.

The balance of ‘other services in total’ (telecommunications, construction, insurance, financial, leasing, computer engineering, advertising, business, and technical services, etc.) produced a massive deficit as in previous years. The deficit in ‘other services in total’ amounted to Sk 20.8 billion (a year-on-year increase of Sk 3.2 billion).

Compared with 2002, the sharpest fall in receipts was recorded in legal, accounting, and consulting services. The pronounced fall in receipts from the exports of these services was, however, accompanied by a higher fall in payments for their import, which led to a year-on-year decrease in the deficit by Sk 1.0 billion. The fall in receipts from financial services exported and growth in payments for the import of such services resulted in an increase of Sk 1.2 billion in the deficit in this category. In addition to financial services, an increase in payments was also recorded in insurance and computer engineering services, with the deficit increasing in both cases by more than Sk 1.0 billion.

A positive balance was also recorded, as in the previous year, in construction and telecommunications services, due to the excess of receipts from exports over payments for imports. While the faster growth in exports than in imports resulted in an increased surplus in construction services, the faster growth in imports in telecommunications services caused a moderate decrease in the positive balance in comparison with 2002.

The income balance resulted in a deficit of Sk 4.4 billion, representing a year-on-year improvement of Sk 16.3 billion. The improvement was caused mainly by a change in the methodology applied for determining the compensation of employees, which takes into account not only data from bank statements but also the incomes of Slovak citizens working abroad, as estimated by the Statistical Office of the SR (Sk 14.5 billion was added for 2003).

The balance of income from investment resulted in a deficit of Sk 19.5 billion, representing an improvement of Sk 1.8 billion compared with the figure for 2002. In 2003, the steepest increase took place in income from the reserve assets of the NBS, mainly in the form of interest on portfolio investments. As opposed to the NBS, the banking sector recorded a drop in receipts from deposits abroad, which fell in volume by more than Sk 13 billion.

The year-on-year growth on the income side was accompanied by a moderate increase on the expenditure side. The structure of interest and yield payments abroad was dominated by interest paid to non-residents within the scope of investment in domestic securities. Compared with 2002, interest payments abroad increased by Sk 5.5 billion, while 75% of the increase took place in government bonds in Slovak koruna.

In 2003, the balance of current transfers resulted in a surplus of Sk 9.2 billion, representing a year-on-year improvement of Sk 0.4 billion. The increase in the positive balance of current transfers was affected by a decline in transfers abroad, in the form of gifts and transfers by legal entities.

2.2. Capital and financial account

The capital and financial account resulted in a surplus of Sk 64.6 billion, which was Sk 169.7 billion less than in the same period a year earlier. The surplus in the capital and financial account as a share of GDP dropped from 20% to 5.4%. The structure of financial inflows also changed: the share of foreign direct investment decreased, mainly in the official sector, and that of short-term capital increased substantially, due to strong demand in the banking sector for short-term funds.

The capital account, which comprises foreign assistance of investment nature granted by foreign governments and non-governmental entities and the purchases / sales of patents, licences, and copyrights, resulted in a surplus of Sk 3.7 billion, representing a moderate fall in comparison

Table B18 Capital and financial account of the balance of payments (Sk billions)

	2003	2002
Capital account	3.7	4.9
Direct investment	21.3	181.7
SR abroad	-0.5	-0.2
In the SR	21.8	181.9
Portfolio investment and financial derivatives	-22.2	25.1
SR abroad	-30.5	12.4
In the SR	8.3	12.7
Other long-term investment	-13.0	-5.0
Assets	7.0	12.5
Liabilities	-20.0	-17.5
Short-term investment	74.8	27.6
Assets	-11.2	19.8
Liabilities	86.0	7.8
Capital and financial account in total	**64.6**	**234.3**

with 2002. A substantial part of this amount (85%) was made up of funds that came to Slovakia (to the accounts of the Ministry of Finance at the NBS) via the PHARE, ISPA, SAPARD, and similar programmes.

The marked decline in foreign direct investment (FDI) in comparison with 2002 was connected mainly with the different activities of the Government in the area of privatisation. After the Government had privatised property via the National Property Fund in the amount of more than Sk 150 billion in 2002, the process of privatisation slowed down in 2003, with privatisation proceeds totalling Sk 10.4 billion (Sk 5.4 billion for the privatisation of the Eastern Slovakia Power Company, Sk 0.3 billion for Banka Slovakia, and additional payments for the privatisation of the Slovak Gas Industry accounted for Sk 2.6 billion, the Western Slovakia Power Company Sk 1.4 billion, and the Central Slovakia Power Company Sk 0.7 billion).

The inflow of FDI into the Slovak economy, destined for increases in equity capital of foreign investors in companies and banks based in the SR (which belongs to the second category of FDI) reached Sk 20.5 billion, representing a year-on-year decline of Sk 8.4 billion. This decline was caused mainly by a downturn in FDI in the banking sector and retail trade. In 2003, however, more capital was invested in industrial production than in 2002. In 2003, almost 56% of the non-privatisation funds was invested in industry, mostly in the production of coke, refined oil products, and nuclear fuels; the production of metal structures, and in food processing (in 2002, 37% of the non-privatisation FDI took place in industry).

In the area of portfolio investment, there was increased demand among domestic portfolio investors for foreign securities throughout the year. Among the major investors in 2003 were domestic banks, which invested mostly in long-term bonds. Non-bank entities also took an active part in trading in foreign securities. Apart from investing in bonds, the corporate sector also made use of the possibility of purchasing shares in foreign companies, up to 10%. In 2003, the outflow of funds for the purchase of foreign securities reached almost Sk 29 billion, which represented a change in trend in comparison with 2002, when foreign securities were sold mostly by commercial banks.

Foreign investors increased their holdings of domestic debt securities by Sk 6.1 billion. Their structure was dominated by government bonds. Koruna-denominated government securities, which were purchased by foreign investors via securities dealers in Slovakia, showed considerable volatility over the course of the year. In 2003, trading in Sk-denominated government securities ended with an excess of purchases over sales on the part of non-residents in the amount Sk 4.0 billion, which was slightly less than in 2002.

In 2003, the Government issued eurobonds on foreign markets in the amount of Sk 30.8 billion, while its liabilities arising from the maturity of eurobonds issued in 1998 amounted to Sk 31.5 billion.

Other investments resulted in an inflow of funds from abroad in the amount of Sk 61.8 billion. The increased inflow in comparison with 2002 took place in the banking sector and official sector (NBS), while the corporate sector recorded an increased outflow of capital.

Other long-term investments recorded an outflow of funds in the amount of Sk 13.0 billion. The outflow of long-term capital was caused mainly by the excess of repayments over drawings of financial credits, which took place in the government (including the NBS) and corporate sectors, in roughly equal measure.

Government loans were drawn in the amount of Sk 3.7 billion, which was somewhat more than in 2002 as a result of a loan drawn from the World Bank in the last quarter of 2003. Long-term transactions in the government sector, including government agencies and the NBS, were connected mostly with the repayment of loans drawn in previous years, which reached almost Sk 15.0 billion. The increased loan repayments in this sector were also affected by the early repayment by the NBS of a loan received from the Japan Bank for International Cooperation.

The drawings of corporate loans reached Sk 23.7 billion, which was 20% more than in 2002. The increased borrowing was connected with the renewal of interest in using foreign funds in the production and distribution of electricity, gas, and water. This sector absorbed 27% of the total volume of foreign funds and became second to 'trade and business services' (30%), where increased borrowing had been recorded since 2001. The inflow of credit resources into the individual industries (20%) took place in smaller amounts, while significant borrowing activity was recorded only in the production of machines and equipment. In comparison with the previous year, the repayment of financial credits in the corporate sector increased by 17%, to Sk 34.9 billion.

Short-term capital, which showed increased volatility during the year (on both sides of the balance sheet), recorded an inflow of Sk 74.8 billion.

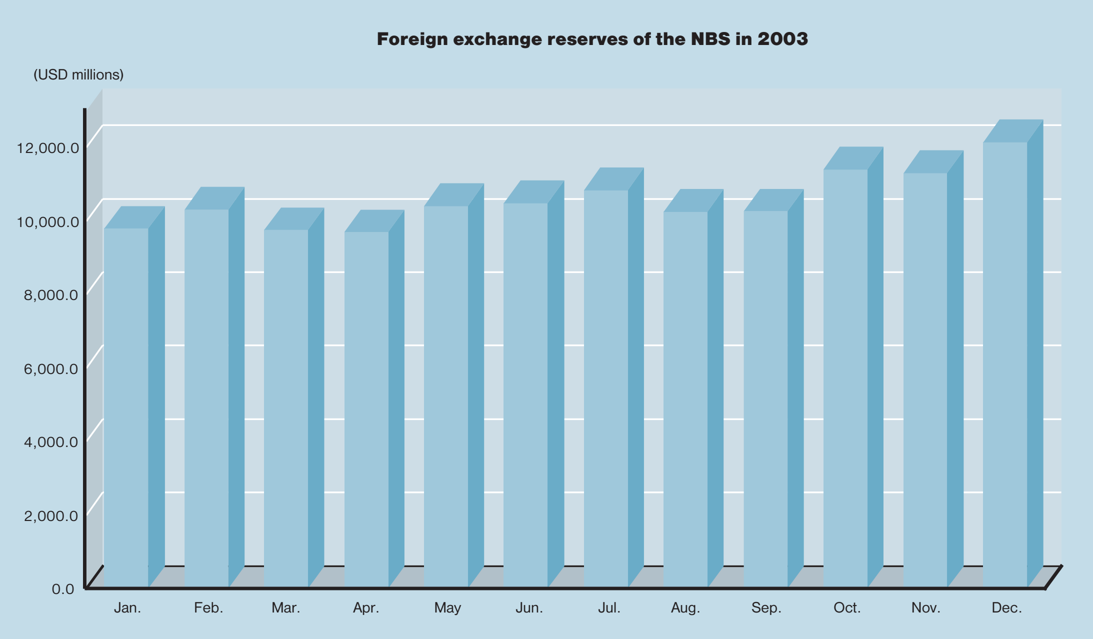
The volume of short-term liabilities was affected substantially (an increase of Sk 86.0 billion) by commercial banks (Sk 50.0 billion), which recorded increased capital inflows from parent banks based abroad. The inflow of short-term capital into the government sector, including the NBS (Sk 31.0 billion), was affected by repo operations conducted within the scope of foreign exchange reserve control by the NBS. The activities of the corporate sector in the area of short-term capital (Sk 5.0 billion) were connected mainly with the drawing of short-term trade credits.

A major role on the short-term assets side (an increase of Sk 11.2 billion) was played by the corporate sector. The outflow of short-term corporate capital took place in large part via increased lending abroad in connection with the export of goods. As the corporate sector, commercial banks also increased their lending activity in relation to non-residents in 2003. On the other hand, commercial bank deposits abroad declined in 2003, when banks converted these funds into more profitable assets, especially bonds.

2.3. Foreign exchange reserves

At the end of 2003, the foreign exchange reserves of the NBS reached USD 12.1 billion (EUR 9.7 billion), representing an increase of USD 3.0 billion (EUR 0.9 billion) since the beginning of the year. The key factors positively affecting revenues were the lending activities of the

Chart B13



Government, proceeds from the privatisation activities of the Government, and central bank interventions. Expenditures were determined mainly by debt service payments effected on behalf of the Government. The Bank's foreign exchange reserves were also affected during the year by the exchange rates of fully convertible currencies on international financial markets. The surplus in the balance of revenues and expenditures in 2003 (USD 1.4 billion) was accompanied by positive exchange rate differentials (USD 1.6 billion), which resulted from the strengthening of fully convertible currencies (especially the euro) in relation to the US dollar on international financial markets.

The expenditure side of foreign exchange reserves was affected in 2003 by:
- proceeds from the privatisation activities of the Government in the amount of USD 0.3 billion;
- yields from deposits and securities held in the portfolio of the NBS in the amount of USD 0.3 billion;
- the drawing of government loans from foreign financial institutions in the amount of USD 1.0 billion, of which the issue of eurobonds accounted for USD 0.9 billion;
- receipts from interventions and direct transactions on the interbank foreign exchange market in the amount of USD 0.7 billion;
- net receipts of the Central Bank from repo operations in the amount of USD 0.8 billion;
- other revenues of the NBS in the amount of USD 0.2 billion.

The expenditure side of foreign exchange reserves was affected in 2003 by:
- debt service payments by the Government in the amount of USD 1.3 billion, of which the payment of principal and interest on government eurobonds issued in previous years accounted for USD 1.1 billion;
- debt service payments by the NBS in the amount of USD 0.3 billion;
- other expenditures of the NBS in the amount of USD 0.3 billion, incurred mostly in connection with the realisation of cross-border payments for NBS clients (USD 0.2 billion).

At the end of 2003, the foreign exchange reserves of the NBS were 5.7 times greater than the volume of average monthly imports of goods and services to Slovakia in 2003.

2.4. External debt of the SR

On 31 December 2003, the total external debt of the SR stood at USD 18.3 billion (EUR 14.7

Table B19 **External debt of the SR**

	USD millions		EUR millions	
	1 Jan. 2003	31 Dec. 2003	1 Jan. 2003	31 Dec. 2003
Total external debt of the SR	13,107.3	18,322.3	12,577.5	14,654.0
Long-term external debt	8,870.7	10,287.9	8,512.1	8,228.1
Government and the NBS 1/	3,740.2	4,347.7	3,589.1	3,477.2
Commercial banks	164.8	322.2	158.1	257.7
. **Entrepreneurial entities**	4,965.6	5,618.0	4,764.9	4,493.2
Short-term external debt	4,236.6	8,034.4	4,065.4	6,425.9
Government and the NBS	0.0	915.5	0.0	732.2
Commercial banks	1,289.5	2,951.2	1,237.4	2,360.4
Entrepreneurial entities	2,947.1	4,167.7	2,828.0	3,333.3
Foreign assets	14,127.4	18,907.5	13,556.5	15,122.0
Net external debt	-1,020.2	-585.2	-979.0	-468.0
SKK/USD and SKK/EUR exchange rates:	40.036	30.920	41.722	41.161
EUR/USD cross exchange rate:	1.042	1.250	x	x

1/ Including government agencies and municipalities.

billion), representing an increase of USD 5.2 billion (EUR 2.0 billion) compared with the end of 2002. The increase in the level of debt was caused in large part by developments in the cross rate of the euro against the US dollar.

The debt arising from long-term foreign liabilities increased by USD 1.4 billion. The increase in the long-term external debt of the Government and the NBS was generated exclusively by the exchange rate of the dollar, while repayments exceeded drawings by Sk 0.4 billion in 2003. The year-on-year depreciation of the dollar also generated an increase in the long-term liabilities of the commercial sector, mainly the corporate sector.

Total short-term debt increased year-on-year by USD 3.8 billion. The increase in short-term debt took place in part in the government sector (almost 24%) as a result of NBS repo operations, which had an upward effect on the level of NBS foreign exchange reserves. The level of short-term debt in the commercial sector was determined by commercial banks, whose liabilities increased, mainly in relation to parent banks based abroad. The share of short-term debt in the country's total gross external debt increased to 43.9%.

At the end of 2003, Slovakia's per-capita gross external debt reached USD 3,406 and total gross external debt as a share of GDP 47.4% (compared with 48.2% in 2002).

Net external debt – expressed as the difference between gross foreign debt, i.e. USD 18.3 billion (liabilities of the Government, the NBS, commercial banks, and the corporate sector – except for capital participation), and foreign assets, i.e. USD 18.9 billion (foreign exchange reserves of the NBS, foreign assets of commercial banks and the corporate sector – except for capital participation), reached USD 0.6 billion (creditor position) at the end of 2003.

Table B20
Structure of investment by country

Country	Number of permits	Investment (in thousands of Sk)
Ukraine	6	29,828
Croatia	6	4,563
Russia	1	168
Total	**13**	**34,559**

2.5. Licensing activity of the NBS

In 2003, the licensing activity of the NBS took place in accordance with the country's foreign exchange regulations, which included provisions liberalising certain operations in financial derivatives as opposed to the previous year.

By 31 December 2003, foreign exchange permits and licences had been issued as follows:
- foreign exchange permits: 108 permits and 13 extensions;
- foreign exchange licences: 37 licences and 39 extensions.

Foreign exchange permits

Investment abroad

In 2003, the NBS issued 13 foreign exchange permits for direct investment in countries that are not members of the OECD or the European Economic Area (EEA), in the amount of Sk 34,559 thousand. Direct investment in OECD and EEA countries has been liberalised.

Opening of foreign-currency accounts at foreign banks

The NBS issued:
- 47 foreign exchange permits and 8 extensions for the opening of accounts at foreign banks, for the purpose of covering necessary expenses incurred in connection with construction, assembly, and repair work abroad, in the total amount of Sk 1,829.6 million (estimated on the basis of contracts);
- 21 foreign exchange permits and 1 extension for the opening of accounts for residents at foreign banks and for exemption from the transfer requirement in connection with the acceptance of financial credits from non-residents, in the amount of Sk 10,139.1 million, for payments for goods and services abroad, the construction of shopping centres in the SR, and in connection with the repayment of these credits from receipts abroad (1 foreign exchange permit and 1 extension were issued for the purpose of obtaining a bank guarantee in connection with a public tender abroad);
- 1 permit for the receipt of compensation for damage to health abroad, 1 permit for the receipt of charges from Czech customers; 3 foreign exchange permits for the opening of an account abroad in connection with the provision of services abroad; 3 permits and 1 extension for participation in the system of financing through cash pooling; 1 permit for the assumption of a foreign company's debt; and 6 foreign exchange permits for participation in an employee programme launched by a foreign investor;
- 4 foreign exchange permits and 1 extension for the placement of funds in accounts abroad due to involvement in the system of financing applied within a specific group of companies, 6 foreign exchange permits for the placement of funds in an account abroad in connection with the purchase of employee shares, and 1 permit and 1 extension for trade in financial derivatives.

Foreign exchange licences

The NBS issued:
- 34 foreign exchange licences and 36 extensions for trading in foreign currencies and traveller's cheques (non-bank exchange offices);
- 1 foreign exchange licence for transactions in financial derivatives (for dealers in securities), plus 2 licences and 3 extensions for the provision of financial services to and from abroad.

3. PUBLIC SECTOR

Budgetary performance

Budgetary performance in 2003 was regulated by Act No. 750/2002 on the State Budget, with total revenue projected in the amount of Sk

235.4 billion and total expenditure estimated at Sk 291.4 billion. In accordance with this law, the budget deficit was set at Sk 56 billion for 2003.

In the State Budget for 2003, the cost of bank restructuring was not specified separately (as it was in 2002) within the scope of the programme to increase the transparency of budgetary relations. This means that this cost, budgeted in the amount of Sk 10.7 billion for 2003, was a direct component of the budget expenditure.

At the end of 2003, the State Budget resulted in a deficit of Sk 56.0 billion, which corresponded to the budgeted figure.

Budget revenue reached Sk 233.1 billion (99% of the figure budgeted for 2003), representing an increase of Sk 12.7 billion in comparison with 2002.

Tax revenues totalled Sk 200.1 billion in 2003 (fulfilling the budget to 92.8%), which was Sk 11.3 billion more than a year earlier. The shortfall in tax revenues amounted to more than Sk 15 billion, which took place predominantly in value added tax. This was due mainly to an amendment to the VAT law, which modified the VAT rate. Despite exceeding the level of 2002 by Sk 1.5 billion, VAT revenue (Sk 83.8 billion) reached only about 84% of the figure budgeted for 2003. In addition to the aforementioned one-off effect, this development was affected by the lower level of consumption and the overestimation of the impact of change in VAT rates. Revenue from excise duties (Sk 38 billion) exceeded the budgeted level by 5%, and was Sk 6 billion higher than a year earlier. This was a result of the August increase in excise duties on mineral oils, tobacco products, and beer, which was effected by the Government in the interest of maintaining the deficit within the planned limits. Corporate income tax revenue reached Sk 29.1 billion at the end of 2003, fulfilling the budget to 99.2% and exceeding the previous year's level by Sk 1.2 billion. Personal income tax revenue reached Sk 31.9 billion (a year-on-year increase of Sk 2.1 billion) and fulfilled the budget to 95.5%.

Non-tax revenues recorded a decline in comparison with the previous year. They reached Sk 19.2 billion in 2003, exceeding the figure budgeted for the year by Sk 7.1 billion. Other revenues totalled Sk 13.8 billion (an increase of Sk 3.5 billion in comparison with 2002).

In terms of dynamics, the drawing of budget expenditures corresponded roughly to the drawing of revenues. By the end of the year, expenditures had reached Sk 289.1 billion (a year-on-year increase of approximately Sk 17 billion) and fulfilled the annual budget to 99.2%.

In general terms, the budget deficit was maintained at the projected level in 2003. The shortfall in tax revenues was high, mainly in VAT and personal income tax. The shortfall in tax revenues was offset partly by increased non-tax revenues, including other revenues from grants and transfers. The increase in these revenues took place in State financial assets, National Property Fund (NPF) funds obtained from privatisation, funds from the unblocking of government loans, and funds from the payment of excise duty on mineral oil supplies stored by the Administration of State Material Reserves of the SR.

Government guarantees

The provision of government guarantees in 2003 was governed strictly by Act No. 386/2002 on government debt and government guarantees, according to which government guarantees may be granted in a given year up to the limit of Sk 6.7 billion, for the purposes specified by law. This limit was utilised only up to the amount of Sk 0.6 billion. Of this amount, the Government of the SR granted guarantees for loans to Slovenská záručná a rozvojová banka, a. s. (Slovak Guarantee and Development Bank, plc.) and Slovenské lodenice Komárno, a. s. (Slovak Shipyards Komárno, plc.). The estimated amount of guarantee payment from NPF in 2003 was Sk 7.0 billion, of which only Sk 2.8 billion had to be used for the repayment of a loan on behalf of Železnice SR (Slovak Railways).

Relationship between the NBS and the State Budget of the SR

On the basis of an agreement signed between the Ministry of Finance of the SR and the National Bank of Slovakia, interest on the credit balance of the summary memorandum account of the Slovak Republic was paid on a quarterly basis, at a rate corresponding to the overnight sterilisation rate of the NBS.

Interest accrued on the balance of the summary memorandum account of the Slovak Republic held by the NBS, reached Sk 459.1 million during the year, and the Ministry of Finance earned Sk 287.6 million in interest on time deposits.

During 2003, funds obtained form the privatisation of SPP (Slovak Gas Industry) were deposited in a special one-year account at the NBS, maintained for the pension reform. With the interest accrued being capitalised, the interest costs of the NBS reached Sk 4.6 billion.

In the State Budget for 2003, no income was budgeted from the transfer of the remaining profit of the NBS, and with regard to the loss sustained, no transfer was made.

State financial assets and liabilities

State financial assets in the form of deposits with the NBS amounted to Sk 7.4 billion at the end of 2003, representing a fall of Sk 1.4 billion in comparison with the beginning of the year.

In the course of the year, marked changes were recorded mainly as a result of the receipt of funds from repayment of a revolving loan provided to ČSOB. At the end of January, Sk 4 billion (the second loan instalment) was deposited in the account of State financial accounts at the NBS, thus the loan was repaid in full (Sk 10 billion). In February, the funds were transferred to a short-term time deposit account of the Ministry of Finance of the SR (MF SR) with the proviso that they may be used on an ad hoc basis, according to the actual financial needs of the MF SR. The following months saw mutual accounting transfers of these funds between the time deposit account of the MF SR and the account of State financial assets.

During December, the MF SR gradually transferred all the funds held on the short-term time deposit account of the MF SR at the NBS to the account of State financial assets (Sk 10 billion). On 23 December, part of these funds was released (Sk 2.2 billion) in accordance with relevant decision of the Government to strengthen the revenue side of the State Budget. A total of Sk 400 million was used for the remission of the Slovak Television's debts (discharge of liabilities from previous years).

State financial liabilities (liabilities of the State vis-à-vis the NBS) reached a zero value at the end of 2003.

State funds

In 2003, there were two State funds operating in the Slovak Republic: the State Housing Development Fund and the State Fund for the Liquidation of Nuclear Power Engineering Facilities and the Handling of Spent Fuels and Radioactive Waste.

In developing and improving the housing fund, the State rendered assistance via the State Housing Development Fund. The State Fund for the Liquidation of Nuclear Power Engineering Facilities accumulated funds for the putting of nuclear engineering facilities out of operation and for the handling of spent fuels and radioactive waste.

On 31 December 2003, the balance on the accounts of State funds totalled Sk 12.3 billion, including funds which had been allocated to specific entities but remained unused. Interest accrued on the accounts of State funds held at the NBS reached Sk 631.1 million during the year, while State funds earned Sk 562.4 million in interest on time deposits.

The budgetary performance of State funds, with the overall balance being adjusted for funds remaining from the previous year and total expenditure for loan repayments, resulted in a surplus of Sk 2.9 billion in 2003.

The National Property Fund

In 2003, the budgetary performance of the National Property Fund (FNM) resulted in a surplus of Sk 3.1 billion (according to the so-called cash principle), but according to the ESA 95 methodology, a deficit of Sk 9.8 billion was recorded. Of the total income (Sk 20.4 billion), privatisation proceeds accounted for Sk 11.7 billion (domestic and foreign proceeds in total) and funds from previous years for Sk 3.6 billion (according to ESA 95, these funds are to be excluded from the income). Receipts from dividends amounted to Sk 4.0 billion. Expenses totalled Sk 17.3 billion and were mostly in the form of transfers to State financial assets (Sk 7.3 billion); transfer to Veriteľ, a. s., (Sk 3.4 billion); and transfer to the State Budget for the repayment of a realised government guarantee (Sk 2.8 billion).

Budgetary performance in public finances according to the ESA 95 methodology[1]

In 2003, budgetary performance in the government sector resulted in a net borrowings of Sk 41.5 billion (3.5% of GDP according to the notification of March 2004). This result was negatively affected mainly by the deficits in the State Budget (Sk 49.9 billion) and the budget of the NPF SR (Sk 9.8 billion). The local government sector recorded a deficit in budgetary performance, amounting to Sk 2.1 billion. The shortfall in public finances was positively affected by the budgetary performance of State funds (Sk 5.4 billion); the company Veriteľ, a. s. (Sk 3.4 billion); Slovak Consolidaton Agency (Sk 2.1 billion); and State financial assets (Sk 1.0 billion). The marked surplus in the budgetary performance of social security funds (Sk 10.3 billion) contributed to the reduction in the overall deficit in the government sector. In comparison with the public budget for 2003, which had expected a net deficit of Sk 57.5 billion (4.9% of GDP), the actual situation was far more favourable, due mainly to improved budgetary performance in the individual components of the State Budget, State funds, and social security funds.

4. MONETARY POLICY AND MONETARY DEVELOPMENTS

In 2003, the NBS implemented its monetary policy in an environment marked by rising inflation, favourable developments in the balance of trade, persistent economic growth, falling unemployment rate, and appreciation of the exchange rate of the Slovak koruna against the euro, especially in the second half of the year.

The course of inflation in 2003 corresponded to the assumptions of the NBS and its year-end value was within the range projected in the revised monetary programme. Price level was determined by administrative price adjustments, mainly by the increase in regulated prices and by the changes in indirect taxes. Administrative measures accounted for approximately three quarters of the overall price increase. Whereas price levels increased as a result of growth in the cost factors, the NBS did not react by adjusting its interest rates.

In 2003, the current account deficit reached a 0.9% share in GDP, representing a marked improvement in comparison with the projected figure. The improvement in the current account

[1] *The ESA 95 methodology uses data on the accrual principle, according to which a transaction is recorded at the moment the contract is signed and not at the time when it is actually concluded. In addition, financial transactions are excluded from the balance of income and expenditure. These two things are the principal differences against the recording of the budget deficit in general government on the cash principle. According to the ESA 95 methodology, the deficit in public finances provides a basis for the assessment whether the convergence criterion is fulfilled or not.*

was caused for the most part by the trade balance, the favourable development of which was a result of dynamic growth in exports. Differences between the expected and actual rates of growth in exports (11.2% projected in the revised monetary programme and 23.1% in reality) were recorded mainly in the category 'machines and transport equipment'. In connection with the increased production and export of higher-priced types of vehicles and other components, including car-bodies, the category 'transport vehicles' recorded increased exports in comparison with the figure projected in the revised monetary programme (by more than 40%).

Despite the favourable trend in the trade balance, the NBS actively intervened in the interbank foreign exchange market with the aim to moderate the nominal appreciation of the Slovak koruna to a level corresponding with the stance of the economy. The prevailing pressure for appreciation of the Slovak koruna resulted to a certain extent from the existing positive interest rate differential, which has been attractive to short-term foreign investors. During the year, the NBS absorbed EUR 658 million from the foreign exchange market via interventions, and thus influenced the average annual appreciation of the Slovak koruna (2.8%). Based on the industrial producer price index, the koruna appreciated in real terms on average by 13.2%, and on the basis of the industrial products price index (excluding the price of energy and mineral raw materials) by 7.2%.

Over the course of the year, the Bank Board of the NBS changed its key interest rates twice.

At its meeting on 25 September 2003, the Bank Board stated that neither price developments nor the level of final consumption, domestic demand, or imports indicated the presence of demand-based pressures or a potential risk of such pressures arising in future. The adjustments to regulated prices and increases in excise duties led to a marked rise in the 12-month overall inflation rate, but on the other hand, their impact on effective demand in the household sector and the favourable relationship between the growth in labour productivity and real wages had a dampening effect on the formation of demand-based pressures. To maintain the positive trends of development in the economy and to eliminate the potential risks, the Bank Board of the NBS decided to lower its key interest rates by 0.25 percentage point, to 6.25% for two-week repo tenders, 4.75% for overnight sterilisation operations, and 7.75% for overnight refinancing transactions.

At its meeting on 19 December 2003, the Bank Board of the NBS acknowledged that, despite a relatively dynamic growth in labour productivity and decline in investment demand, price developments and imports confirmed the absence of demand-based pressures in the economy and the fact that there were no signs of such pressures being formed in future. The 12-month inflation rate in 2004 will be again determined by administrative measures, which will have a dampening effect on the level of effective demand. The year 2004 is also expected to see a further reduction in the fiscal deficit, thus developments in public finances and real wages are not expected to stimulate significant growth in domestic demand. The dynamic growth in exports is not expected to continue in 2004; this may lead to a slowdown in the rate of economic growth if the current trend in domestic demand continues. Thus the persistence of these trends in future may cause a downturn in economic activity and exert excessive pressure for a fall in prices, as a result of which the Bank Board of the NBS again moved to lower the key interest rates by 0.25 percentage point.

In 2003, the level of interbank rates fell more significantly than in the previous year, which was caused in large part by a sharp drop in interest rates at the end of 2002, rather than by changes in interest rates in 2003 (which took place in the last quarter of 2003 and represented a reduction of 0.5 percentage point in cumulative terms).

To bring its monetary policy instruments into harmony with those applied by the ECB, the NBS reduced the ratio of required reserves from

4% to 3% (with effect from 1 January 2003), which corresponded to the reserve ratio set for home savings banks. The base for the calculation of the amount of reserves, the system of interest payment, and the period of reserve requirement fulfilment remained unchanged.

The monetary policy of the NBS maintained its sterilisation nature in 2003. Compared with 2002, when the sterilisation position was increased significantly by the use of funds obtained from the privatisation of the State's property holdings (mainly in the second half of the year), however, sterilisation followed a relatively balanced course in 2003. During the year, there were no marked fluctuations in the volume of sterilisation resources and the annual volume of sterilisation reached Sk 162.7 billion in average.

A major factor of liquidity inflow in 2003 represented NBS interventions in the foreign exchange market against the excessive appreciation of the Slovak koruna. The liquidity of the banking sector was most significantly affected by foreign exchange interventions in January (Sk 8.2 billion) and May (Sk 16.8 billion), while their annual volume reached approximately Sk 27 billion in cumulative terms.

The liquid assets of commercial banks recorded a one-off increase, caused by the January reduction in the ratio of required reserves for the banking sector (by 1 percentage point). The volume of excess liquidity resulting from this reduction amounted to Sk 6.5 billion.

The reserves of the banking sector were also increased during the year by the release of funds obtained from privatisation and held on a special account of the NPF at the NBS. However, with regard to the fact that the privatisation process slowed down in 2003, the use of privatisation proceeds had only a modest effect on the level of liquidity in comparison with 2002. Proceeds from privatisation (including additional payments for assets privatised last year) amounted to ca. Sk 10.4 billion. Of this amount, approximately Sk 6 billion flow to the banking sector, while most payments were intended for the needs of the Ministry of Health, Ministry of Transport, and for the realization of government guarantees on behalf of Slovak Railways.

The increase in liquidity was also influenced by the deficit in the State Budget and the standard release of funds from selected balance sheet accounts held at the NBS, on a more or less regular basis.

Chart B14

Survey of reserve requirement fulfilment in the banking sector in 2003

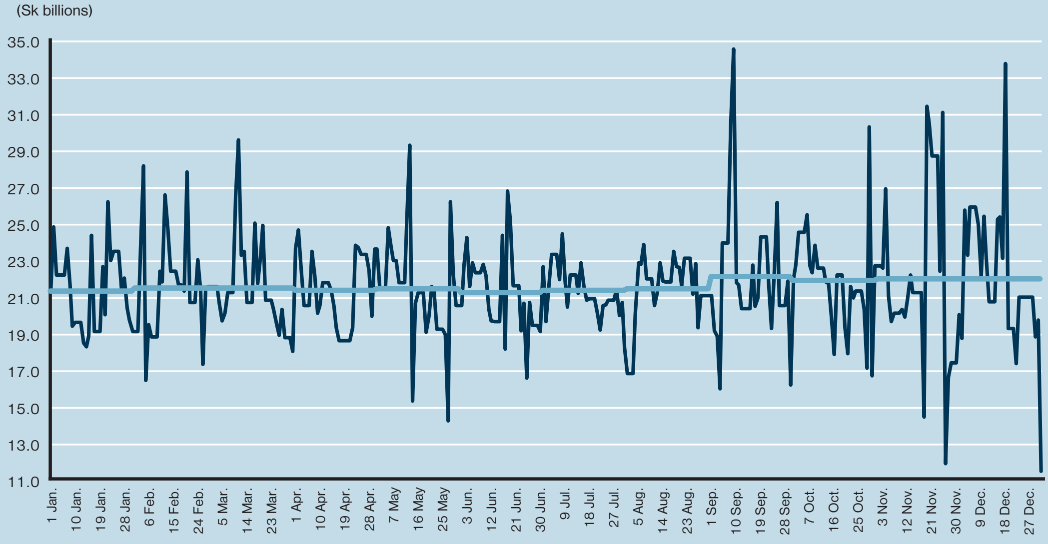


Table B21 **Fulfilment of reserve requirements in 2003** **(Sk billions, %)**

	Required reserves	Actual reserve requirement fulfilment		
		Average	Fulfilment in %	Standard deviation
January	21.28	21.32	100.19	2.24
February	21.44	21.60	100.76	2.98
March	21.41	21.44	100.12	2.78
April	21.32	21.37	100.23	1.77
May	21.40	21.43	100.15	3.39
June	21.20	21.22	100.10	2.43
July	21.31	21.34	100.11	1.35
August	21.40	21.46	100.31	1.60
September	22.06	22.09	100.14	4.24
October	21.86	21.91	100.20	2.89
November	21.93	22.03	100.44	5.34
December	21.95	22.00	100.26	4.38

A counterbalance to the inflow of liquidity from the above-mentioned sources was the securities sector, which withdrew liquidity from the banking sector (through issues of government securities in excess of repayments) in the amount of ca Sk 50 billion. The excess was also influenced, to some extent, by the increased issuing activity of the Ministry of Finance in connection with the acquisition of funds for the repayment of part of a Government foreign debt in the amount of USD 300 million in the domestic market and/or its conversion into an internal debt. Part of the liquidity was absorbed by a growth in the volume of currency in circulation (Sk 8.7 billion in cumulative terms).

Under these conditions, the sterilisation position of the NBS vis-à-vis the banking sector increased during the year, from Sk 144 billion (on 1 January 2003) to Sk 176 billion (on 31 December 2003), i.e. by Sk 32 billion. The average annual sterilisation position increased, from Sk 91.5 billion in 2002 to Sk 162.7 billion in 2003, i.e. by Sk 71.2 billion.

As a result of the cut in the reserve ratio, the average level of required minimum reserves fell by Sk 5.7 billion. The reserve requirements were fulfilled throughout the banking sector in 2003. In the conditions of a marked surplus of liquidity and continued NBS interventions for sterilisation purposes, the prescribed amount of required reserves was achieved in each month and was not exceeded to a significant extent. After NBS interventions, the average excess reserves ranged from Sk 0.02 billion to Sk 0.16 billion.

On average, the maximum changes in the daily reserve holdings ranged from a surplus of Sk 7.0 billion to a shortage of Sk 5.4 billion.

4.1. Monetary aggregates

The M2 money supply (at fixed 1993 exchange rates) increased in comparison with the beginning of the year by Sk 43.6 billion, to Sk 730.0 billion at the end of 2003. The rate of growth in M2 accelerated to 6.4% (comparing to 4.7% in 2002), but its annual average (7.3%) was 1.2 percentage points lower than in 2002.

As far as the sources of the money supply are concerned, the growth in M2 was affected, in contrast with the previous year, largely by domestic factors, mainly the continued growth in loans to enterprises and households and the indebtedness of the public sector. With regard to the downturn in the privatisation activity of the Government, the effect of large inflow of funds from abroad, which resulted in an increase net foreign assets in 2002, did not appear again.

Domestic loans grew in comparison with the beginning of the year by a total of Sk 95.2 billion, due to an increase in net credit to general government and loans to enterprises and households in virtually equal measure. The faster growth in domestic loans was not fully reflected in the money supply growth, due to the extensive use of alternative forms of collective investment, which are not part of the M2 aggregate.

The volume of loans to enterprises and households (at fixed 1993 exchange rates) grew in comparison with the beginning of the year by Sk 46.8 billion (14.1%), to Sk 378.0 billion at the end of 2003. The growth took place predominantly in koruna loans, which increased by Sk 30.8 billion, of which loans to households accounted for Sk 23.6 billion. Households showed increased interest in mortgage loans in particular, in an effort to make use of the attractive government support before its reduction in July 2003. The increased government support contributed, in all probability, to the premature and cumulative conclusion of mortgage contracts, which is not expected to continue with the same intensity in future, after the government contribution is reduced. The increase in loans in foreign currency (Sk 16.0 billion), allocated mostly to the corporate sector, was almost four times greater than in the previous year. Koruna loans to enterprises recorded an upturn in the last two months of the year, while they grew in volume by a total of Sk 7.2 billion during the year.

Net credit to the Government and the NPF (at fixed 1993 exchange rates) increased over the course of the year by Sk 48.4 billion, mainly within the internal debt position.

In the foreign area, the Government converted part of its foreign into domestic debt by using part of the funds obtained from domestic issues of government bonds for the redemption of foreign eurobonds in the amount of USD 0.3 billion (approximately Sk 10.4 billion at the current rate). In addition, the Government issued 2-year eurobonds in the amount of EUR 500 million to replace eurobonds due in the same amount, originally denominated in German marks. Since the Government had increased the May issue by EUR 250 million in November (an equivalent of approximately Sk 10.2 billion) with regard to the

Table B22 **Developments in household and corporate deposits**

	Year-on-year change in %			Year-on-year change in Sk billions		
	2001	2002	2003	2001	2002	2003
At fixed 1993 exchange rates:						
Household deposits	7.8	1.4	-2.8	26.7	5.1	-10.7
Koruna deposits in total	6.3	0.0	-0.6	19.1	0.1	-1.9
- demand deposits	24.3	8.9	12.0	13.1	6.0	8.9
- time deposits	2.4	-2.3	-4.3	6.0	-5.9	-10.8
In foreign currency	19.0	10.2	-15.8	7.6	5.0	-8.8
Corporate deposits	16.8	11.1	21.1	28.4	22.0	46.7
Koruna deposits	19.7	10.6	22.4	28.1	18.1	43.1
- demand deposits	21.5	10.4	14.6	14.2	8.4	13.0
- time deposits	18.3	10.8	29.2	13.9	9.7	30.1
of which: insurance cos.	9.1	-22.4	-3.0	1.9	-5.1	-0.5
In foreign currency	1.1	14.2	12.4	0.3	3.9	3.6
At current exchange rates:						
Household deposits	8.2	0.1	-4.5	29.6	0.2	-17.8
of which: in foreign currency	18.5	0.2	-22.8	10.5	0.1	-16.0
Corporate deposits	15.8	9.4	19.3	28.4	19.6	44.3
of which: in foreign currency	0.8	4.0	3.3	0.3	1.5	1.2

favourable conditions, the foreign position approached its initial level by the end of 2003.

4.2. Structure of the money supply

In 2003, the M2 money supply (at fixed 1993 exchange rates) increased by Sk 43.6 billion, to Sk 730.0 billion at the end of December. The increase was concentrated in the third and fourth quarters, when the money supply grew in volume by Sk 47.7 billion. The year-on-year dynamics of M2 increased from 4.7% in December 2002 to 6.4% in December 2003.

During the year, the volume of currency in circulation outside banks grew by Sk 7.6 billion, while the year-on-year rate of growth accelerated, from 4.0% in December 2002 to 9.0% in December 2003. The year-on-year dynamics of currency in circulation increased until May, then stabilised at the level of approximately 10%. The increase in dynamics was affected partly by an increase in the average amount of transactions concluded via payment cards in 2003, resulting from the policy of commercial banks in the area of fees and charges.

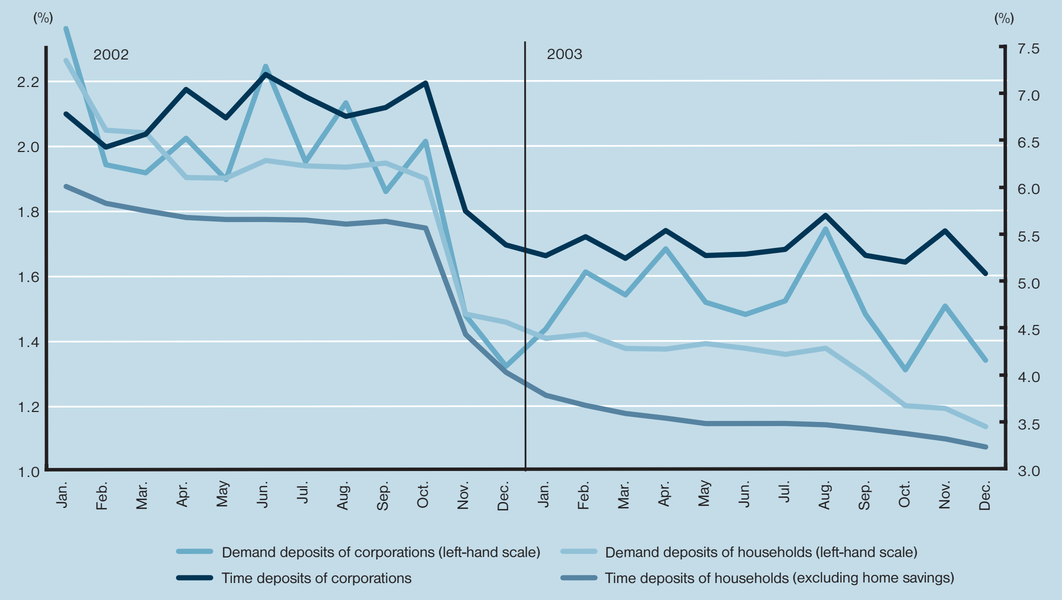
Slovak-koruna deposits (demand and time deposits in total) grew by Sk 41.2 billion from the beginning of the year, and their year-on-year growth dynamics increased from 3.7% in December 2002 to 8.0% in December 2003. The increase in Sk deposits took place in both demand (Sk 21.9 billion) and time deposits (Sk 19.3 billion). The rate of year-on-year growth in demand deposits accelerated by 3.7 points (to 13.4%) and the dynamics of time deposits by 4.3 points (to 5.4%). The year-on-year increase in koruna deposits took place mostly in corporate deposits, while the Sk deposits of households declined.

The development of koruna deposits in 2003 continued to be characterised by a trend of preference for short-term and demand deposits in the individual sectors of the economy. This trend was apparent mainly in the deposits of corporate entities, of which demand and short-term deposits in total accounted for roughly 99% (their share increased by 1.1 percentage points on a year-on-year basis). Within the structure of corporate deposits, the most significant increases were recorded in time deposits with a maturity of up to one month (Sk 32.0 billion), demand deposits (Sk 13.5 billion), and time deposits with a maturity of up to seven days (Sk 7.4 billion), while three-month deposits fell in volume by Sk 5.6 billion. Deposits with other maturities recorded no marked changes. The interest rate differential between the demand and time deposits (including savings deposits) of corporations diminished by 0.3 percentage point to 3.7 percentage points, with the average rate for time deposits falling by 0.3 percentage point and the rate for demand deposits remaining unchanged.

Household deposits were also characterised by a trend of preference for highly liquid resources, when the share of demand and short-term deposits in total household deposits in Sk increased year-on-year by 0.5 percentage point (to 79.3%), due to an increase in demand deposits. Time deposits fell in volume by Sk 2.6 billion and savings deposits by Sk 8.2 billion in 2003. At the same time, marked changes were recorded in the structure of time and savings deposits (six-month deposits declined by Sk 4.6 billion, seven-day deposits by Sk 3.9 billion, and one-year deposits by Sk 3.8 billion, while one-month deposits increased by Sk 6.2 billion and three-month deposits by Sk 2.5 billion). Within the structure of savings deposits, one-year deposits fell in volume by Sk 7.8 billion and medium-term deposits by Sk 5.2 billion, while three-month deposits grew by Sk 2.7 billion and long-term savings deposits by Sk 2.0 billion (of which home savings deposits increased by Sk 2.5 billion). The interest rate differential, i.e. the difference between interest rates on demand and time deposits for households, diminished by 0.4 percentage point to 2 percentage points as a result of a greater fall in interest rates on time deposits (0.7 percentage point) than on demand deposits (0.3 percentage point).

Chart B15

Developments in interest rates on household and corporate deposits



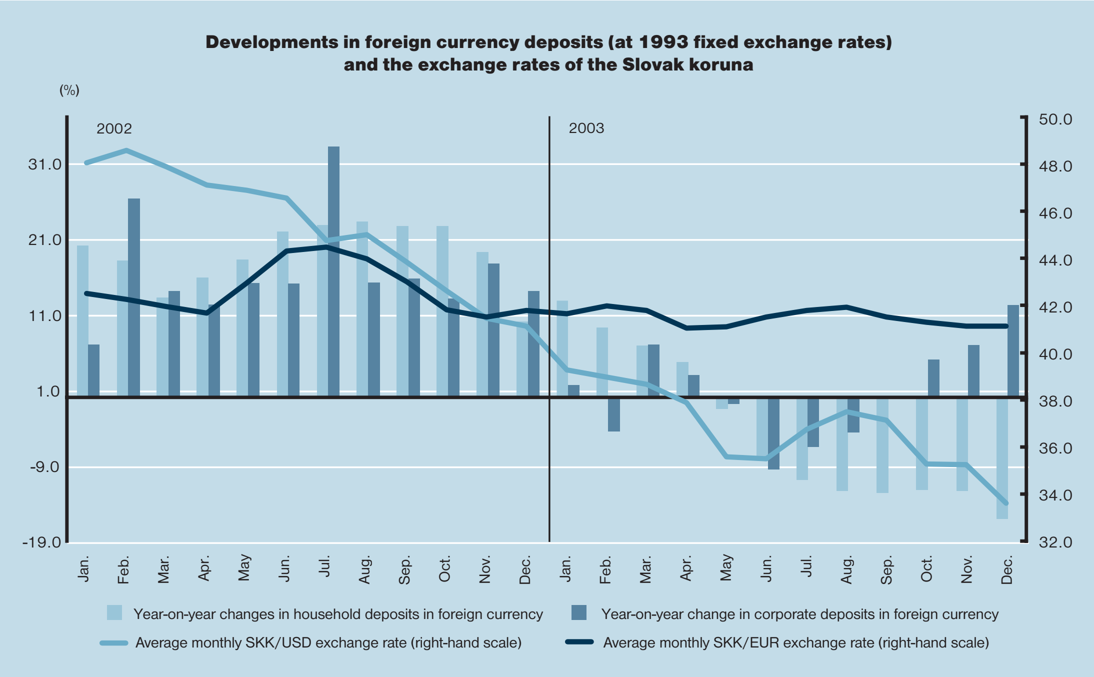
The development of koruna deposits in the household sector has reflected the changes in the allocation of financial resources. The changes in preferences are connected primarily with the level of yields offered for individual bank products, which, coupled with the effect of falling interest rates, stimulated households to allocate their funds more effectively. This is documented by the growing popularity of investment funds in 2003, when the net value of assets allocated to mutual funds operating on the Slovak financial market increased year-on-year by Sk 22.2 billion, with most funds being invested in open-end funds specialising in Sk-denominated securities (their net assets increased year-on-year by Sk 18.7 billion). At the same time, the diminishing interest rate differential tended to reduce the attractiveness of time deposits in comparison with demand deposits.

If we compare the rates of interest on household and corporate deposits in Sk, both demand and time deposits showed increased differences in interest levels in 2003. In the case of demand deposits, the interest rate differential gradually increased during the year, while corporate deposits in 2003 attracted an interest rate 0.2 percentage point higher (in 2002, the average rate for corporate deposits was at virtually the same level). In the case of time deposits (excluding home savings deposits), the differential increased still further, when corporate deposits attracted an interest rate 1.9 percentage points higher than household deposits (the rate in 2002 was 1.2 percentage points higher). The higher interest paid on corporate deposits is probably connected with the larger volume of these deposits.

In 2003, deposits in foreign currency (at fixed 1993 exchange rates) fell in volume by Sk 5.2 billion (6.1%), after growing in 2002 by Sk 8.9 billion (11.6%). The decline took place in household deposits (Sk 8.8 billion), while corporate deposits increased by Sk 3.6 billion. The year-on-year rate of decline in household deposits in foreign currency reached 15.8% (compared with a growth of 10.2% in 2002). The year-on-year growth dynamics of corporate deposits in foreign currency weakened, from 14.2% in December 2002 to 12.4% in December 2003.

With the changes in exchange rates in 2003 (an appreciation of 1.3% against the euro and 17.8% against the US dollar) taken into account, deposits in foreign currency (at current exchange rates) fell in volume by Sk 14.8 billion (13.9%), with house-

Chart B16



hold deposits declining by Sk 16.0 billion (22.8%). At the same time, corporate deposits increased slightly, by Sk 1.2 billion (3.3%).

If we compare the trends in foreign-currency deposits, it is apparent that the strongest reaction to the appreciation of the Slovak koruna in the form of a reduction in deposits held in foreign currency was produced in the household sector. This is probably connected with the fact that enterprises maintain foreign-currency deposits mainly for financing their trading activities, while households make such deposits as savings. Hence, in the case of currency appreciation and/or expectations of a persistent trend of appreciation, households try to minimise their exchange rate losses by converting these deposits into domestic currency.

Table B23 **Absolute changes in the volumes of loans (December 2003)**

	Koruna loans		Loans in foreign currency		Total	
	Year-on-year change in Sk billions	Share of loans in %	Year-on-year change in Sk billions	Share of loans in %	Year-on-year change in Sk billions	Share of loans in %
Short-term loans	8.2	31.2	9.0	37.2	17.2	32.5
Medium-term loans	2.3	27.9	6.9	31.6	9.2	28.6
Long-term loans	18.4	40.9	5.8	31.2	24.2	38.9
Total	28.9	100.0	21.7	100.0	50.6	100.0

Table B24 **New loans in 2003** **(cumulative figures)**

	Entrepreneurial sector		Households	
	Volume in Sk billions	Share in %	Volume in Sk billions	Share in %
Short-term loans	847.3	91.8	31.6	44.4
Medium-term loans	60.3	6.5	17.6	24.8
Long-term loans	15.7	1.7	21.8	30.8
Total	923.3	100.0	71.0	100.0

4.3. Lending activities

Loans in total (in Slovak koruna and foreign currency, at current exchange rates), provided to the entrepreneurial sector, households, central and local authorities for extra-budgetary purposes, are loans reported by the banking sector according to the rules of statistical reporting. From a procedural point of view, they are not to be confused with loans to enterprises and households according to the methodology of the monetary survey, which does not include the government sector.

The volume of loans in total grew year-on-year by Sk 50.6 billion, with koruna loans increasing by Sk 28.9 billion and loans in foreign currency by Sk 21.7 billion. At the end of the year, the total volume of loans reached Sk 402.1 billion, of which koruna loans accounted for Sk 320.4 billion and loans in foreign currency Sk 81.7 billion.

Within the structure of loans by sector, the most significant increase in comparison with the end of 2002 was recorded in koruna loans in other sectors (Sk 24.8 billion), accounting for 40.6% of the loans in total. In transport, storage, post and telecommunications, loans increased by a total of Sk 8.0 billion (9.3% of the total volume of loans); in banking and finance by Sk 6.2 billion (7.2%); and in trade, repair of consumer goods and motor vehicles, hotels and restaurants by Sk 1.9 billion (12.7%). The sharpest decline in koruna loans (Sk 8.6 billion) took place in the production and distribution of electricity, gas, and water (accounting for 10.5% of the loans in total) and in industrial production, i.e. Sk 4.4 billion (15.3% of the total), of which Sk 4.0 billion took place in metallurgy and machine engineering.

Within the structure of loans by term, the steepest increase was recorded in long-term koruna loans, due largely to a growth in mortgage loans. The volume of short-term and medium-term loans also increased, due mainly to a growth in other loans and investment loans. The increase in koruna loans was accompanied by a growth in loans in foreign currency, which was probably connected with the expectations of an appreciation in the exchange rate of the Slovak koruna.

Of the total volume of new loans provided in 2003 (Sk 1,005.3 billion in cumulative terms), loans to the entrepreneurial sector accounted for 91.9% and were predominantly under foreign control. New loans in the household sector accounted for 7.1%. Short-term loans had a dominant share in the volume of new loans (88.0%).

4.4. Interest rate developments

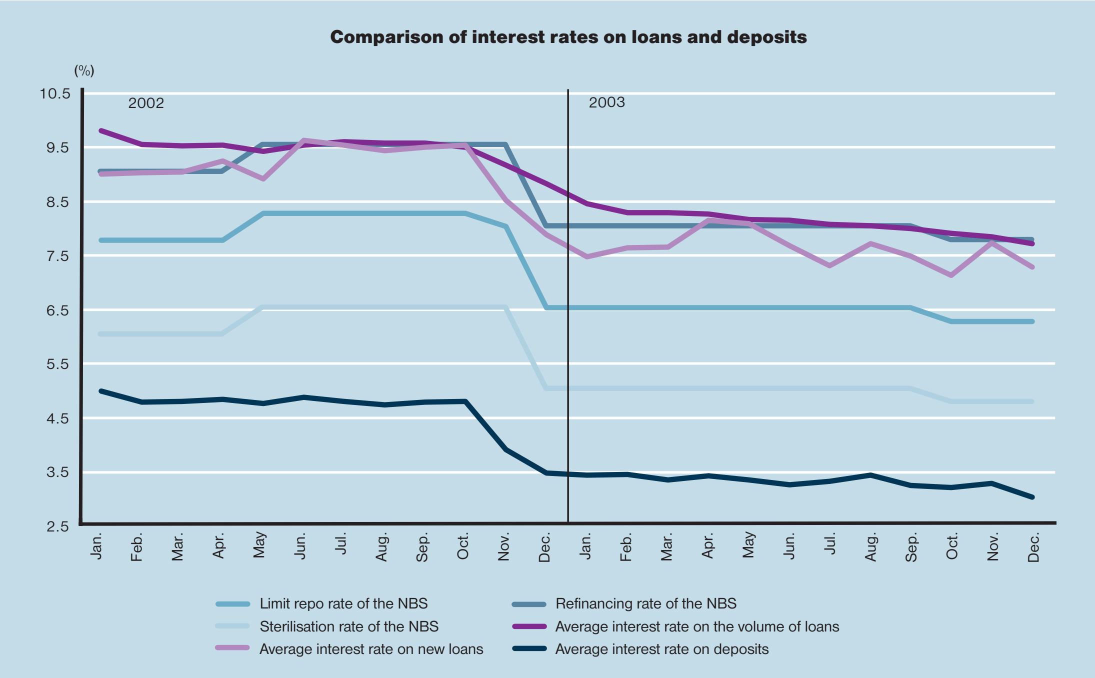
The level of customer interest rates in 2003 was affected significantly by the cut in key NBS interest rates in November 2002. Since this change was reflected in interest rates as early as the end of 2002, the year 2003 saw no significant fall in customer interest rates on a year-on-year basis (in December 2003 compared with December 2002). The downward trend in customer interest rates is evident from the comparison of annual averages for 2003.

In 2003, the Bank Board of the NBS decided to lower its key interest rates in September and December, equally by 0.25 percentage point. The September cut in key NBS rates had no significant impact on the level of customer interest rates. During the year, the average interest rate on new loans hovered around the level of the

Table B25 **Developments in selected interest rates**

	Average interest rate (%)		Difference
	2002	2003	(percentage points)
BRIBOR 1M	7.6	6.2	-1.4
Volume of loans	8.7	7.6	-1.1
New loans	9.1	7.6	-1.5
Deposits	4.6	3.3	-1.3

Chart B17



refinancing rate, while the average deposit rate maintained a virtually constant difference from the sterilisation rate.

Compared with the end of 2002, the average interest rate on new loans (excluding loans with zero interest rate) fell by 0.6 percentage point, to 7.2% in December 2003. Its course was relatively volatile during the year, especially in April and May, when the average rate for new loans exceeded the level of the refinancing rate. In other months, the price of new loans fell and hovered below the level of the refinancing rate, with some minor deviations in the individual months.

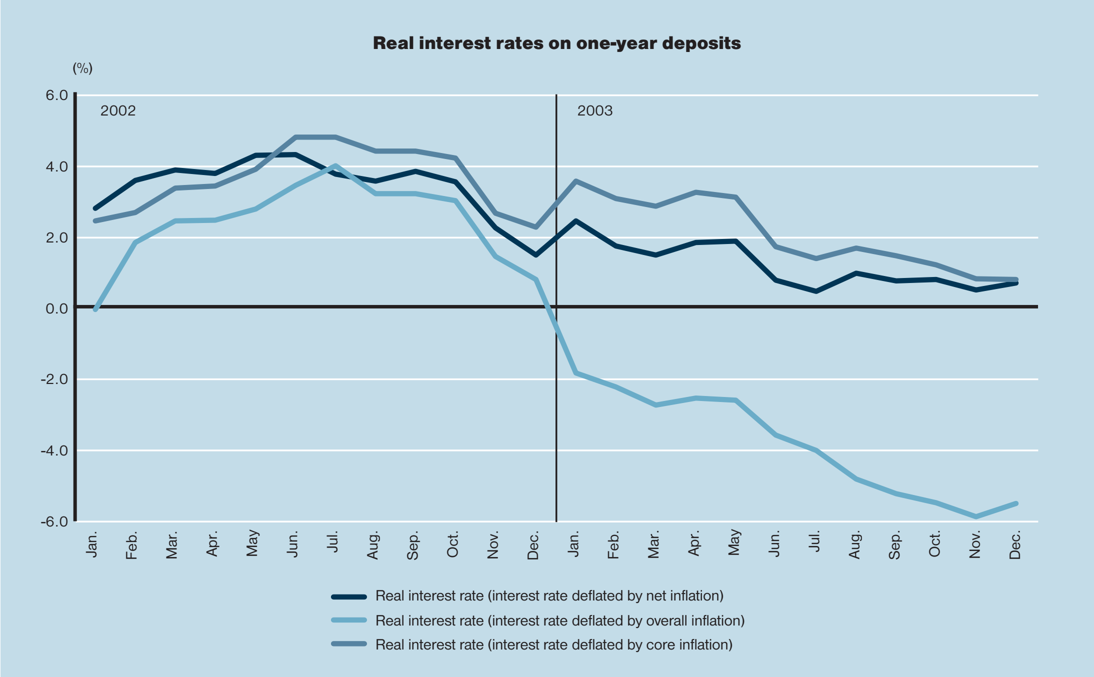
On a year-on-year basis, the average interest rate on new short-term loans fell by 0.3 percentage point (to 7.2%) and substantially affected, through its dominant share in new loans in total (88.0%), the average rate for the total volume of new loans.

New medium-term loans recorded a fall in the average rate of interest (0.9 percentage point, to 8.6%), while their cumulative share in total new loans was 8.1%. The average interest rate on long-term loans fell by 1.4 percentage points, to 7.0% (due primarily to the increased provision of mortgage loans [2]), while the proportion of these loans was only 4.0%.

From the point of view of purpose, bank lending in 2003 was affected by a fall in interest rates, mainly on other loans, which include operating loans, overdraft facilities, development loans, bills-of-exchange loans, housing loans, and mortgage loans (they accounted for 75.9% of the total volume of new loans, in cumulative terms). The average interest rate on other new loans dropped year-on-year by 2.8 percentage points, to 6.5%. In this category, a marked drop was recorded in average interest rates on mortgage loans with government contribution (by 2.8 percentage points, to 5.2%) and mortgage loans without government contribution (by 2.3 percentage points, to 7.7%), while long-term mortgage loans accounted for 32.0% of the total volume of long-term loans at the end of 2003). Another important loan category, which affected the average interest rate on new loans in total was that of current account overdrafts (with a share of 17.7% at the end of the year), where interest rates fell year-on-year by 2.6 percentage points.

[2] With effect from 1 July 2003, the system of providing government subsidies for mortgage loans was modified (the level of government contribution is not guaranteed for the whole period of loan repayment).

Chart B18



Interest rates on the volume of loans showed a tendency to fall. The average interest rate on the total volume of loans (excluding loans with zero interest rate) fell during the year by 1.1 percentage points, to 7.7%. The average rate for short-term loans fell by 1.2 percentage points (to 7.8%) and that for medium-term loans by 0.7 percentage point (to 8.8%). The price of long-term loans dropped by 1.3 percentage points, to 6.8%.

Average interest rates on deposits fluctuated below the level of the sterilisation rate throughout the year, and were relatively stable with a slight tendency to fall. Compared with December 2002, the average interest rate on deposits fell by 0.4 percentage point, to 3.0% in December 2003. The average rate for demand deposits fell by 0.1 percentage point (to 1.5%) and that for time and savings deposits in total by 0.5 percentage point (to 3.9%).[3]

Within the structure of time and savings deposits by term, average interest rates on short-term and medium-term deposits dropped, while the rates for long-term deposits increased. Interest rates on short-term time and savings deposits fell by 0.5 percentage point (to 4.1%), and the price of medium-term deposits dropped by 0.7 percentage point (to 3.1%). Interest rates on long-term deposits rose by 0.1 percentage point, to 3.1%.

By the end of December 2003, the real interest rate on one-year deposits had fallen by 6.3 percentage points in comparison with the end of 2002. As a result of a rise in the 12-month inflation rate (from 3.4% to 9.3%) and a fall in the average rate for one-year deposits (from 4.1% to 3.8%), the real interest rate reached a negative value (-5.5%).

If the rate of interest on one-year deposits is deflated by core and/or net inflation, the value of the real interest rate for December 2003 becomes positive (0.8% and/or 0.7% respectively). In comparison with the end of 2002, the real interest rate fell by 1.5 percentage points (and/or by 0.8 percentage point), due to a fall in the average rate for one-year deposits (0.4 percentage point) and a rise in core and net inflation rates (1.1 and 0.4 percentage points respectively).

[3] According to the original methodology (applied until the end of 2002), deposits were divided into demand and time deposits. With effect from 2003, an important change was made in the methodology: savings deposits were excluded from time deposits as a separate group. The structure of time deposits also changed: one-day deposits were excluded from deposits at up to seven days, nine-month deposits were included in deposits with a maturity of up to twelve months, and three- and four-year deposits were included in deposits with a maturity of up to five years.

4.5. Monetary policy instruments

Interest rate policy

a) Basic interest rate of the NBS [4] (rate for two-week repo tenders):

from 18 November 2002	6.50%
from 26 September 2003	6.25%
from 22 December 2003	6.00%

b) Interest rate for overnight refinancing operations:

from 18 November 2002	8.00%
from 26 September 2003	7.75%
from 22 December 2003	7.50%

c) Interest rate for overnight sterilisation operations:

from 18 November 2002	5.00%
from 26 September 2003	4.75%
from 22 December 2003	4.50%

Monetary policy instruments of the NBS

Open market operations

a) Main instrument:
Standard repo tender with a maturity of two weeks – conducted by the NBS with commercial banks regularly on a weekly basis. The NBS sets an interest rate for such operations (basic interest rate).

b) Instrument for longer-term liquidity control:
Issue of NBS bills for the portfolios of commercial banks – an instrument of the NBS for longer-term liquidity control in the banking sector. Auctions in NBS bills are conducted at least once a month, by using the Dutch auction technique.

c) Fine-tuning instrument:
Quick tender – an instrument used by the NBS for fine-tuning of liquidity of commercial banks on an ad hoc basis.

d) Structural operations:
Individual transactions – an instrument of the NBS enabling a direct purchase or sale of government securities for or from the NBS portfolio.

e) Foreign exchange swaps:
An instrument for liquidity fine-tuning in the koruna area on a temporary basis, through forward foreign exchange transactions.

Automatic operations (standing facilities)

a) Overnight refinancing operations:
Commercial banks have automatic access to sources of finance (provided they have a sufficiency of acceptable securities) at the announced interest rate.

b) Overnight sterilisation operations:
Commercial banks are allowed to deposit excess funds in the form of non-collateralised deposits, at the announced interest rate.

Other instruments

a) Redistribution loans:
- Traditional: interest rate = rate for two-week repo tenders + 0.5%;
- Soft loans: interest rate = rate for two-week repo tenders - 2% + 0.5%.

b) To maintain a bank's liquidity, the NBS may provide, in exceptional cases, a short-term loan to the bank for a period of up to three months.
Such a loan was not provided in 2003.

Reserve requirements

With effect from 1 January 2003, commercial banks were required to maintain minimum reserves in the amount of 3% of primary koruna and foreign-currency deposits (from residents and non-residents); of koruna and foreign-currency deposits from non-resident banks; of securities

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

issued and other liabilities to non-bank clients. The ratio of required reserves for home savings banks was 3%. Maintained reserves were evaluated in 2003 on a monthly basis. Required minimum reserves attracted an interest rate of 1.5 %, up to the amount set for the given month.

Exchange-rate and foreign-exchange policies

a) Exchange rate system:

The National Bank of Slovakia applied a floating exchange rate regime in 2003 The exchange rate of the Slovak koruna was determined in relation to a reference currency (the euro), and its value depended on the level of supply of, and demand for, the koruna on the foreign exchange market. The National Bank of Slovakia intervened in the foreign exchange market in the event of excessive volatility in the exchange rate of the Slovak koruna and/or if the exchange rate did not correspond to the indicators of macro-economic development.

b) Nominal exchange rate of the SKK:

The nominal exchange rate of the Slovak koruna appreciated against euro during the year by 1.3%, to SKK 41.161/EUR on 31 December 2003. The exchange rate of the koruna against USD appreciated by 17.8%, to SKK 32.920/USD.

c) Nominal and real effective exchange rates of the SKK[5]:

In 2003, the nominal effective exchange rate of the Slovak koruna (NEER) was affected mostly by the marked appreciation of the koruna vis-à-vis the US dollar (18.9%), well exceeding the rate of appreciation in 2002 (6.2%) In that period, the koruna achieved a somewhat higher rate of appreciation in relation to the dollar than the currencies of Slovakia's main trading partners. During 2003, the NEER index appreciated year-on-year most dynamically than a year earlier, with the average rate of appreciation reaching 7.0% (compared with 0.1% in 2002).

The real effective exchange rate of the koruna (REER), calculated on the basis of the producer price index, appreciated year-on-year by an average of 13.2% in 2003 (in 2002 by 1.8%). On the basis of industrial products prices (excluding mineral raw materials and energy prices), the REER index appreciated last year by an average of 7.2% year-on-year, compared with 0.5% in 2002.

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

In 2003, the turnover of receipts and payments in convertible currencies in the payment categories 1 to 6 reached Sk 1,536.8 billion (the average monthly turnover

Table B26 Currency structure of foreign exchange receipts and payments

	1999	2000	2001	2002	2003
Total turnover (in billions of Sk)	**812.8**	**1,094.3**	**1,277.9**	**1,385.6**	**1,536.8**
of which:					
Euro and former currencies of EMU countries	58.3%	58.5%	61.3%	63.7%	69.8%
Czech koruna	9.3%	7.5%	8.7%	9.3%	7.8%
American dollar	28.4%	30.0%	26.4%	23.2%	19.0%
Other currencies	3.9%	4.0%	3.6%	3.8%	3.3%
Turnover as a share of GDP (at current prices)	96.3%	117.1%	126.5%	126.4%	128.5%

[5] *The IMF calculation methodology of indices of the nominal and real effective exchange rates of the Slovak koruna (NEER and REER) is used. It is established on average monthly exchange rates of the Slovak koruna and the currencies of trade partners against the US dollar, and is based on the producer price index PPI (the prices of industrial manufacturing products PPI) in the initial year 1999 and for the sixteen major trade partners of the Slovak Republic, representing roughly 86 to 89% of the volume of Slovakia's foreign trade in 1993 – 2002: Germany, Czech Republic, Italy, Austria, France, Netherlands, the USA, Great Britain, Switzerland, Poland, Hungary, Ukraine, Russia, Japan, China, and Turkey*

was Sk 128.1 billion), representing an increase of 10.9% compared with the previous year. Foreign exchange receipts and payments resulted in a positive balance of Sk 15.8 billion, compared with a negative balance in 2002 (Sk 24.1 billion).

The strengthening trade relations between Slovakia and euro area countries led to growth in the importance of the euro, which was directly reflected in the currency structure of foreign exchange receipts and payments. The turnover took place predominantly in EUR and USD, while the share of the EUR increased during the year by 6.1 percentage points to the detriment of other currencies. The most significant drop occurred in the proportion of the dollar (4.2 percentage points), while the share of the Czech koruna decreased by 1.5 percentage points and that of other currencies by 0.5 percentage point.

4.6. Chronology of monetary developments

January

- Japan's R&I (Rating and Investment Information) agency increased the long-term liability rating of the SR for koruna liabilities, from BBB- to BBB.

March

- Fitch Ratings, the international rating agency, improved its ratings for Slovakia: the rating for long-term foreign exchange debt was raised from BBB- to BBB and that for long-term liabilities in domestic currency from BBB+ to A-.

April

- The NBS granted permission to BASL Beteiligungverwaltungs GmbH of Austria, member of the Meinl Bank Aktiengesellschaft Group, to acquire a 60.1% share in the registered capital of Banka Slovakia, a.s.
- The Government of the SR approved an amendment to the Deposit Protection Act, made in accordance with the relevant laws of the European Communities, with effect from 1 July 2003.

May

- The Bank Board of the NBS approved the Updated Monetary Programme for 2003, in which the year-end inflation rate of 8.4% to 9.7% had been projected. The NBS reduced its predictions for the average and core inflation rates. The original range (2.7 to 5.0%) was lowered and narrowed, to 2.1 to 3.6%. The risks in this forecast were the world price of oil, the exchange rate of the koruna, and the range of administrative measures and their impacts on price developments. The current account deficit was expected to reach 4.5% of GDP, compared with the originally projected 6.2%. The positive change was connected with the increased dynamics of exports, decelerated growth of imports, and the strengthening of the Slovak koruna against the US dollar. Due to the favourable trend in foreign trade, the expected rate of economic growth was increased, from 3.9% to 4.1%.

July

- The Government discussed the Strategy for the Adoption of the Euro in the Slovak Republic, worked out by the Ministry of Finance and the NBS, and ordered that the document be revised by the middle of 2004. At the July session, the Government and the NBS approved a Joint Statement concerning the procedure to be followed in connection with the entry of the SR into the euro area.

August

- The IMF published a Final Report on Economic Developments in Slovakia in 2002, classifying Slovakia as the most reform oriented country among the four Central European states joining the EU with effect from 1 May 2004. In this report, the monetary policy of the NBS received positive evaluation (especially the Bank's foreign exchange market operations against speculative capital and the reductions in key interest rates). The IMF report also stated that Slovakia's banking sector had strengthened and stabilised, and drew attention to the need for progress in the area of institutional development towards integrated financial market supervision, which is to be constituted within the NBS in 2006.

September

- The Bank Board of the NBS discussed and approved an amendment to the Banking Act and proposed amendments to numerous other laws. The approved amendment to the Banking Act was to enter into force and effect on 1 January 2004.

October

- The National Council of the SR passed a law introducing a flat 19% tax on personal and corporate income, with effect from 1 January 2004.

November

- The international rating agency Fitch Ratings improved the long-term rating outlook of banks in Slovakia, Poland, Lithuania, and Slovenia. This was followed by an increase in the long-term foreign exchange liability ratings of candidate countries for EU membership. As for Slovakia, the long-term rating outlook of banks was changed from stable to positive, and the BBB ratings were confirmed.

December

- The National Council of the SR approved the State Budget for 2004, with a deficit of Sk 78.5 billion. Revenues were budgeted in the amount of Sk 232.2 billion, expenditures in the amount of Sk 310.5 billion. According to the ESA 95 methodology, the deficit in public finances should reach 3.9% of GDP.
- The Bank Board of the NBS approved the Monetary Programme for 2004, with a medium-term outlook for the years 2005-2007. In the 2004 Monetary Programme, the 12-month overall inflation rate is predicted to reach 5.5 to 7.3% at the end of the year, which corresponds to an average inflation rate of 7.2 to 8.2%.

5. FINANCIAL MARKETS

5.1. Money market

Operations of the NBS on the money market

The monetary policy of the NBS maintained its sterilisation nature over the course of 2003. Commercial banks used standard types of transactions on the open market for liquidity sterilisation, i.e. overnight deposits, two-week repo tenders, and issues of three-month NBS bills. For refinancing purposes, overnight repo transactions were applied. Although the same monetary-policy instruments were applied, the possibility of initiating overnight transactions was optimised through the extension of the time available for the conclusion of overnight transactions with the NBS. On the initiative of banks, a third time zone was opened within the scope of SIPS (Slovak Interbank Payment System), from 13.00 to 13.30, for the transfer of priority payments between the central bank and banks with a system for automatic sterilisation operations (overnight deposits). Thus the NBS made it possible for banks to control the daily level of liquidity more effectively even in the case of unexpected payments from customers. The third time zone for the transfer of priority payments between the central bank and commercial banks, was opened with a view to ensuring compliance with the EU standards. The second change was the extension of the time for the conclusion of overnight refinancing transactions, by 15 minutes (from 12.00 to 12.15). This made the actual situation on bank clearing accounts more transparent in the case of delays in the processing of standard payments.

Table B27

Average monthly effects of NBS transactions on the level of banking sector liquidity **(Sk millions)**

	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
O/N repos	710	368	240	916	4,945	1,685	100	288	258	453	284	26
O/N deposits	-6,633	-3,724	-3,838	-779	-5,421	-5,208	-3,769	-1,496	-4,494	-2,232	-2,542	-8,419
NBS bills	-44,480	-47,746	-51,402	-52,420	-52,197	-57,698	-55,378	-56,007	-39,925	-44,500	-31,700	-38,258
SRT	-102,267	-106,516	-111,966	-115,382	-107,082	-101,312	-103,783	-112,184	-123,563	-119,146	-124,292	-114,584
Total	-152,670	-157,618	-166,966	-167,665	-159,755	-162,533	-162,830	-169,399	-167,724	-165,425	-158,250	-161,235

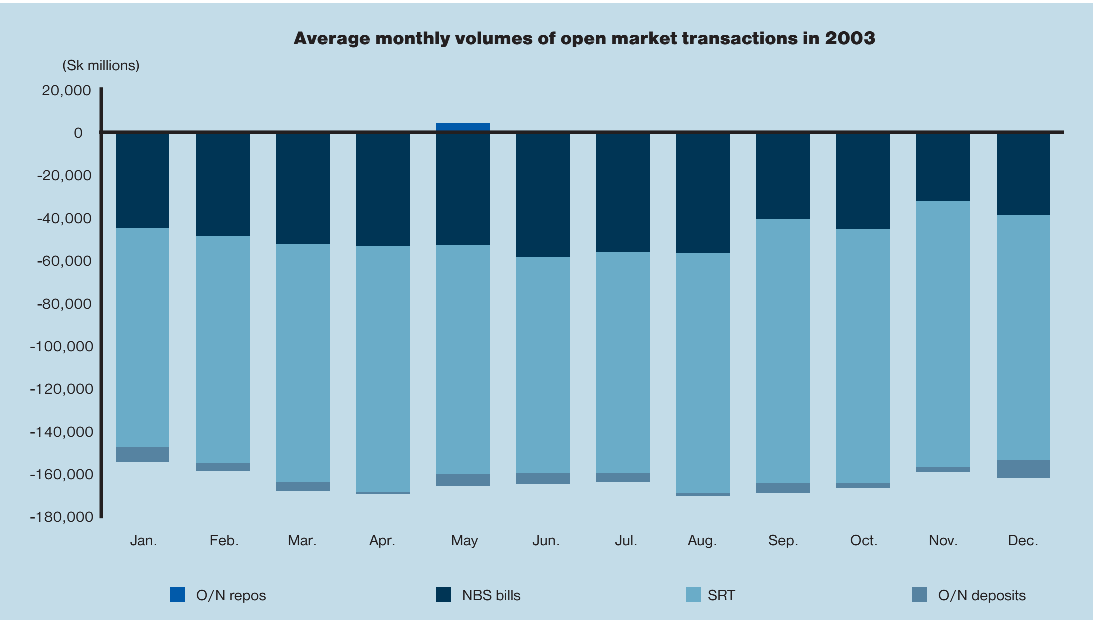
+ inflow of liquidity
- outflow of liquidity

On a daily basis, the average volume of sterilisation funds in the NBS reached Sk 162.7 billion in 2003 (a year-on-year increase of 77.4%). Most NBS transactions on the money market took place in the form of sterilisation repo tenders; another frequently applied instrument was the issue of three-month NBS bills. For the elimination of deviations in the level of daily liquidity, banks continued to use overnight deposits and, to a lesser extent, overnight refinancing repo operations.

The sterilisation of excess liquidity was dominated by two-week repo tenders, with an average share of 68.7% in 2003. This was 10.7 percentage points less then in 2002. In 2003, the NBS announced 53 repo tenders, which were conducted in American style with a set limit rate. Demand was reduced only in four cases. The amounts accepted ranged from Sk 36.0 billion to Sk 78.6 billion. The minimum interest rate accepted deviated from the maximum rate by 1 to 20 basis points and, in one case, reached 32 basis points (after the volume accepted had been significantly reduced).

The second most effective instrument was the NBS bill, with a share of 29.3% (a year-on-year increase of 11.1%). Fourteen NBS bill issues were issued for the portfolios of banks (all the auctions were conducted in the Dutch style) in the total amount of Sk 230.6 billion, with a maturity of three months. The NBS reduced the volume of bids only in three cases. Demand was first reduced at the September auction, where banks required an inadequately high yield. In December, the excessive demand at the auction was corrected with regard to the predicted level of interbank liquidity. The reason behind the change in maturity in October (60 days) was the preparation of a change in the taxation of yields on securities. The December

Chart B19



change (73 days) was a result of persistent uncertainty in connection with the approval of the tax reform. The gradual increase in interest in NBS bill auctions in the first half of the year diminished in the second half, mainly as a result of a decrease in the interest rate differential between the expected yield on bills (at the level of the limit yield for repo tenders) and the price of three-month deposits on the interbank market.

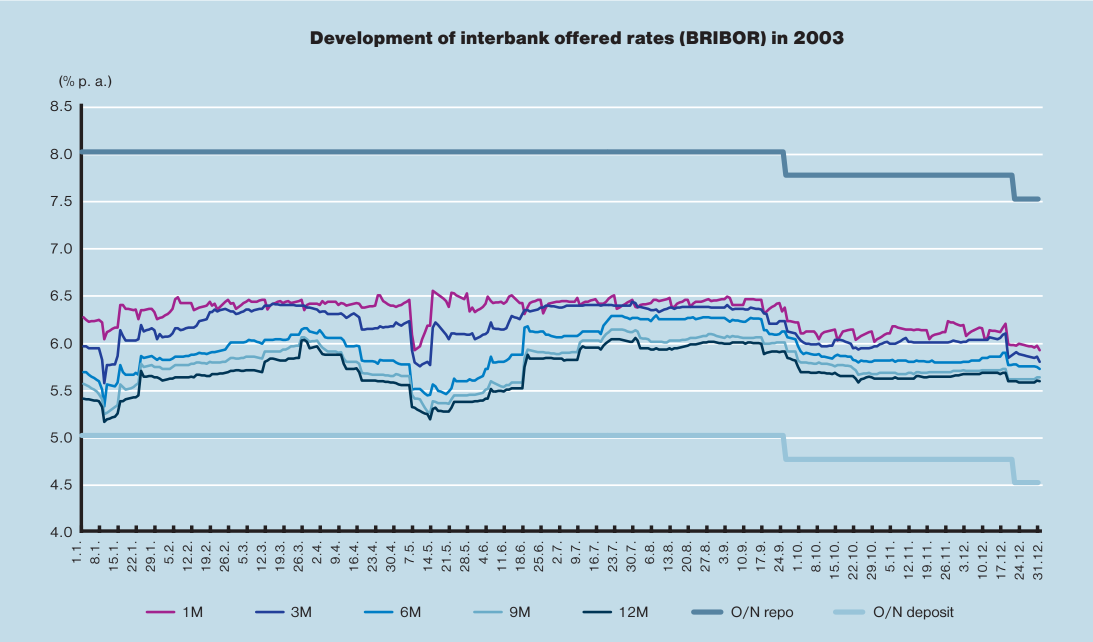
Overnight transactions were applied by banks more frequently than in 2002. Overnight refinancing transactions were used during 67 days (compared with 48 days in 2002) and deposits during 270 days (246 days in 2002), including banking holidays. In the use of overnight refinancing transactions, the most intensive activity was recorded in May and June. In May, this was due to an outflow of liquidity from the banking sector (Sk 40.4 billion) after the acceptance of excessive demand at the repo tender, accompanied by the investment of funds in a new issue of government bonds. In June, banks gave preference to investment in NBS bills (investment exceeded the due amount by Sk 9.3 billion) over a short-term liquidity shortage. In deposits, the largest volume achieved was Sk 23.2 billion (compared with Sk 18.6 billion in 2002) and in the case of refinancing repo operations Sk 19.2 billion (Sk 10.8 billion in 2002).

Developments in money market rates

In 2003, money market rates (except overnight rate) fluctuated within the corridor delimited by the rates for overnight deposits and refinancing repo operations. The overnight rate exceeded the level of the refinancing rate four times during the year. By raising the price of short-term deposits, banks attempted to defend themselves against increased interest in these deposits at a time when there was a marked shortage of daily liquidity, due to the transfer of liquidity to accounts held at the NBS. Repeated shortages of daily liquidity were produced by the preference of banks for the conversion of liquid assets into NBS bills, repo tenders, and new issues of government securities. The rates for maturities over two months fluctuated in the lower part of the corridor and the yield curve maintained an inverse shape throughout the year. Changes were recorded only in the slope of the curve as an indication of changes in expectations concerning the future course of NBS interest rates and/or as a direct reaction to changes in demand for longer-term deposits. One- and two-week rates followed a course with weekly cycles and approached, on auction days, the level of the limit rate for repo tenders from above or from below, depending on the actual level of liquidity in the banking sector. Rates for longer-term maturities were affected by irregular purchases and sales of deposits, but mainly by currency swaps conducted in large part by foreign banks. The restricted possibilities for trading in swaps (owing to the limited foreign exchange holdings of domestic banks at the time speculation against the exchange rate of the Slovak koruna) significantly affected the prices of interbank deposits. Hedging against risks arising from the open positions of foreign banks through interest rates derivatives did not always correspond to the trend in deposit rates, in spite of the fact that derivatives are derived from money market rates.

The marked downward changes in the quotations of short-term rates were affected as early as the beginning of the year by the opening of the koruna positions of foreign banks in connection with the strengthening of the koruna, as a result of which the volume of interbank deposits was increased through currency swaps as well. The fall in the price of deposits was also supported by the fiscal measures adopted in connection with the reform of the pension system, with the aim of reducing the budget deficit. The fall in interest rates was stopped by NBS interventions in the foreign exchange market in January. After the Hungarian central bank repeatedly reduced its key interest rates, foreign banks started to close their positions and left the foreign exchange markets, which had negative consequences for the neighbouring countries as well (including Slovakia). This situation led to a relatively marked increase in BRIBOR rates for three to twelve months. A change occurred at the end of January, when the news

Chart B20



about the selection of Slovakia for the construction of a new plant for PSA Peugeot Citroën was published.

In response to an unsuccessful auction in seven-year government bonds in March (due to the low level of the coupon), nine-month and twelve-month BRIBOR rates increased. The announcement of the plan of the Ministry of Finance to issue eurobonds in the amount of EUR 500 million and twenty-year eurobonds denominated in Slovak koruna for the European Investment Bank in April, led to the placement of deposits through currency swaps and forward rate agreements (FRA), which caused a fall in interest rates for maturities over three months.

Another marked change took place in May, when the NBS reacted to the strengthening of the koruna vis-à-vis the euro by making repeated interventions in the foreign exchange market. The interventions gave rise to increased concern among banks that the NBS may also lower its key interest rates, to which the money market reacted with a fall in the price of interest rates for longer maturities. The fall was stopped at the end of May, when the country's favourable trade results were announced.

The repeated currency depreciation in the neighbouring countries in June made foreign banks to close their positions, which led to increased demand for deposits with longer maturities, followed by a significant rise in their price. An even more pronounced depreciation of the koruna in July motivated domestic and foreign banks to purchase deposits and futures contracts, which led to an immediate rise in the price of deposits with a maturity of over six months. The situation changed in September, when the gradual appreciation of the domestic currency increased the sales of interest rate derivatives and deposits through currency swaps with longer maturities.

The September cut in key NBS interest rates did not meet a strong reaction from money market rates, for the reduction had been expected and was therefore already included in the interbank market rates.

The second cut in key NBS rates in December (by 25 basis points) gave rise to an adequate fall in the yield curve of BRIBOR as a whole. The attempt of banks towards the end of the year to deposit the excess of liquidity in connection with the planned reduction in required reserves with effect from 2004, led to a fall in the price of deposits with a maturity of one to three months.

Table B28

Monthly volumes of purchases and sales on the interbank market **(Sk billions)**

	Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
Deposits	529	482	454	522	410	502	558	495	496	625	454	579
Repos	0	0	0	0	0	0	0	0	0	0	0	0
Swaps	649	594	617	758	696	721	1,157	653	728	764	619	611

Interbank transactions on the money market

The total volume of interbank money market transactions, consisting of deposits, repo operations, and swaps, showed a tendency to grow in 2003 and was 35.0% higher than in the previous year. Although several repo transactions were concluded, their share in the total turnover was very small and, for reporting purposes, negligible. Reference banks accounted for 90.4% of the total turnover. Of the total volume of interbank transactions, trading between domestic banks accounted for 36.0% and transactions between domestic and foreign banks 64.0%. Foreign banks showed increased interest in swaps, which reached a share of 72.4%.

In terms of volume, trading was concentrated in the shortest maturities. Transactions with a maturity of one day to one week accounted for more than 90% of the total volume of transactions. A similar result was recorded in 2002, while 2003 saw a modest increase in the share of transactions with a maturity of up to one week.

The largest share in the volume of interbank transactions in 2003 was reached by swaps: an average of 58.4% (compared with 48.9% in 2002). The stable level of interest rates on the money market created conditions for continued growth in trading with derivatives that are connected to the money market rates, i.e. forward rate agreements (FRA) and interest rate swaps (IRS).

Treasury bills

Primary market

Owing to a sufficiency of other funds in the clearing registration account of the Ministry of Finance, the current deficit in the State Budget in the 1st half of 2003 was not financed by issues of Treasury bills. In view of the growth in the state budget deficit in the middle of the year and the fact that 18 Treasury-bill issues of 2002 fell due at weekly intervals between July and November (in the amount of Sk 39.5 billion), the Ministry of Finance conducted the first sale of Treasury bills in July 2003.

During 2003, twenty one issues were placed on the market via American-style auction, with unlimited amount of issue rate and price, with maturity in 2004. The maturity was set at 6, 9, and 12 months. One of the auctions was closed with zero acceptance, due to unacceptable interest requirements on the part of investors.

Total sales of SR Treasury bills reached Sk 54.6 billion, representing 38.6% of total demand (Sk 141.6 billion). The average amount per issue was Sk 2.6 billion, and average demand per auction reached Sk 6.4 billion. The high level of demand for Treasury bills was mainly due to a surplus of liquidity and a shortage of other low-risk assets. Of the primary purchase of Treasury bills, foreign investors accounted for 94.5% and domestic banks 5.0%. The share of other domestic investors was negligible.

The average interest yield on primary sales of Treasury bills reached 5.6% in 2003. The yields were below the level of domestic money market rates for comparable maturities throughout the year. On average, SR Treasury bills were placed on the market in 2003 at a rate 33 basis points below the level of the BRIBOR rate.

The yields of Treasury bills followed a trend, alternating between growth and decline. A marked increase was recorded mainly in August and at the beginning of September, when yields grew by as much as 56 basis points. They were affected mainly by the issuer's increased issuance in connection with the accumulation of large repayments of government securities in that period. In the following period, the situation consolidated and, at the beginning of October, the yields achieved began to show a tendency to fall. This was caused primarily by a change in the key interest rates of the NBS (by 25 basis points). In November and December, the yields began to rise again at a moderate rate. This fact was caused by the shortening of the maturity of these issues to 6 months, which corresponded to the course of the yield curve of the interbank deposit market.

Secondary market

The total amount of transactions on the secondary market for Treasury bills reached Sk 133.9 billion in 2003. Of this amount, transactions with the participation of the NBS accounted for only 2%, because the NBS conducted intervention operations through the NBS bills. Trading activity was concentrated mostly in the second half of the year (95.4% of all transactions), when the issuer placed new issues on the market. The significant increase in the secondary trading in Treasury bills was caused by the exchange of portfolios between investors at the end of the year.

Secondary transactions between banks, and between banks and their clients, were conducted almost exclusively (97.5%) in the form of direct transactions to maturity. The predominant part of these transactions (66.0%) consisted of sales of Treasury bills held by foreign entities to residents on the first or second day following the issue of securities, which was connected with the utilisation of the difference between the tax burdens of domestic and foreign investors.

5.2. Capital market

Primary market

Government bonds

In 2003, the market for government bonds was of historical importance for the issuer in formulating the issuing policy, mainly in setting the level of interest yields. For the first time, the issuer decided to make 6 issues with a zero coupon and unlimited price, and hence set only the total issue-amount. The maturities of the issues were set at 1 to 1.5 years. The second important element on the government-bond market was the setting of maturities. The individual issues were placed more evenly, according to maturity, and this was connected with the requirement of investors that government bonds should make up a complete yield curve.

In total, 13 government bond issues were offered in the total amount of Sk 98.5 billion, representing an increase of 31.2% compared with the same period a year earlier. The issuer cancelled three auctions: two in connection with the low demand (each amounted to Sk 3.0 million) and one at the end of the year due to excessive requirements for yields on the part of investors (up to 5.94% p.a.). At the auctions, yields were accepted between 3.67% and 5.75%. The maximum and minimum yields were recorded at auctions with a zero coupon. Of the total number of issues, five were re-openings through which the issuer created conditions for the extension of tradable issues on the secondary market, even where the expected increase in tradability was met only in part. Four reopening issues had a maximum amount set at Sk 15.0 billion and one issue at Sk 20.0 billion. Demand for these issues oscillated between 38.46% (Issue No. 199) to 173.4% (Issue No. 189).

In terms of maturity, there were three issues of 1-year bonds (14.2%); three 1.5-year bonds (16.8%); two 2-year bonds (15.3%); one 5-year and 7-year bonds (15.2% equally); and three 10-year bonds (23.2%). In 2002, 1-year issues accounted for 45.8%; 2-year issues 18.4%; 3-year issues 2.1%, 5-year issues 19.5%; and 10-year issues 14.2% of the total issue-amount.

Aggregate demand for government bonds reached Sk 186.3 billion in 2003, representing an increase of 136.4% compared with the figure for 2002 (Sk 78.8 billion). The average issue-amount was Sk 5.5 billion, compared with Sk 2.4 billion in 2002. The increase was influenced by the reopening of government bond issues with the total amount of Sk 68.9 billion, and by zero-coupon issues in the amount of Sk 30.5 billion, and an average issue-amount of Sk 5.3 billion. The strongest demand for government bonds was recorded in the first half of the year, i.e. Sk 168.6 billion (90.5% of total demand), which was connected with the issuer's strategy to concentrate his issuing activity in the first six months.

There was much demand for issues of zero-coupon government bonds and room was created for investors to formulate and enforce their price demands. Demand for these issues fluctuated between Sk 5.6 billion and Sk 18.7 billion (140.0% and 347.3%). The rate of satisfaction was between 26.7% to 71.4%. The increased interest of investors in these issues was connected with the fact that, in the given period, no Treasury bills were issued and there was a significant surplus of liquidity in the banking sector.

At 31 December 2003, there were 24 foreign investors (representing 18.5% of the total number of investors) registered on the primary market for government bonds.

In 2003, twenty-four government-bond issues were repaid in the total amount of Sk 60.5 billion. The biggest share of this amount (46.2%) was repaid for one-year government bonds. The yield on government bonds reached Sk 19.2 billion in 2003 (in 2002 Sk 23.9 billion), of which foreign investors accounted for 66.7% (46.3% in 2002). The share of foreign investors in the total amount of yield paid in 2003 increased by 20.0%.

Non-government bonds

In total, 72 issues were floated in 2003 (4 more than in 2002). The total volume of non-government bonds issued reached Sk 32.6 billion, representing a year-on-year increase of Sk 27.9 billion. In foreign currency, 14 issues were made in the amount of EUR 15.2 million, compared with 7 issues in 2002 (EUR 19.9 million).

Secondary market

As far as the capital market is concerned, Act No. 566/2001 on securities and investment services was amended in 2003 by Act No. 162/2003, which postponed the deadline for the establishment of an over-the-counter (OTC) market until the expiration of 60 days of the grant of membership to the first member of the First Central Depository. The amendment became effective on 1 June 2003.

The new Stock Exchange Rules, which had been brought into harmony with Act No. 429/2002 on the Stock Exchange, came into force on 13 April 2003.

In 2003, during 243 trading days, 62,890 transactions were concluded on the Bratislava Stock Exchange (BCPB), in the total trading amount of Sk 1,097 billion. The highest volume was traded in bonds (Sk 1,072.4 billion) in 3,167 transactions. Compared with 2002, the volume of transactions increased by a total of 70.5%. The number of transactions was almost four times higher than in 2002, which represented an increase of 286.7%.

Foreign investors accounted for 48.1% of the total turnover of the BCPB, of which 51.7% took place in purchases and 44.4% in sales.

Bonds

In 2003, trading in bonds reached an all-time high (Sk 1,072.4 billion) in 3,167 transactions. The volume of transactions increased by 76.3% in comparison with 2002. Electronic order book transactions recorded a year-on-year increase of 123.0% (to Sk 119.3 billion), while negotiated trade rose by 71.8% (to Sk 953.1 billion). Transactions in public sector bonds (government bonds and bonds of state-owned companies) accounted for 98.3% of the total volume of trading in 2003. The highest volumes were achieved in government bonds, i.e. Issue No. 142 (Sk 253.9 billion), Issue No. 143 (Sk 97.2 billion), and Issue No. 152 (Sk 77.3 billion). Among non-government bonds, the best performers were Poľnobanka III (Sk 3.8 billion) and SE 03 bonds (Sk 3.2 billion). Most transactions (262) were concluded in government bonds, Issue No. 191.

In the market-makers module, the following issues were traded over the course of the year: 8 government-bond issues (No. 131, 133, 147, 166, 174, 187, 188, 189); 3 corporate-bond issues (B.O.F. 04, SHS II, and Železiarne Podbrezová II); and 3 issues of mortgage bonds (HZL VÚB VI, HZL Tatrabanka 01, and HZL Istrobanka I). The volume of transactions in the market-makers module amounted to Sk 654.1 million (in 51 transactions), representing a negligible share (0.6%) of the total volume of electronic order book with bonds.

On the last trading day of the year, the market capitalisation of bonds amounted to Sk 331.9 billion (a year-on-year increase of 14.1%), of which Sk 286.0 billion was in listed issues (an increase of 17.3% in comparison with 2002).

The Slovak Bond Index (SDX) for bank and corporate bonds closed the last trading day of the year with an increase of 7.2%, at 238.9% of the nominal value of its portfolio, with an average yield to maturity of 7.3% and a duration of 1.5 years. The index reached a minimum on 7 January (223.0%) and a maximum on 23 December (238.9%).

Aa of the end of the year, the average price of the government-bond portfolio in the SDX's base stood at 217.2% (a year-on-year increase of 4.2%), with an average yield amounted to 5.3% and duration 3.5 years. This component recorded a minimum on 7 January (208.2%) and a maximum on 23 December (217.3%).

Shares

In terms of financial volume, trading on the stock market continued to decline in 2003. The total volume of transactions reached Sk 24.3 billion (in 59,723 transactions) and thus remained below the level of the bond market. In a year-on-year comparison, the volume of transactions dropped by 30.2%.

In the market-makers module, two share issues were available for trading during the year (Slovnaft and Slovakofarma). The volume of trading in the market-makers system amounted to Sk 1.3 million (in 11 transactions), representing a negligible share (0.1%) of the total volume of electronic order book transactions in shares.

Year 2003 was one of the most successful years in the history of the Slovak Share Index (SAX): the value of SAX appreciated during the year by 26.9%, from 140.0 to 177.6 points. This development was affected first and foremost by the shares of Slovnaft, the price of which reacted flexibly to the acquisition of Slovnaft by the Hungarian oil refinery MOL Rt. Further factors determining the course of the index in the first quarter were the shares of Slovnaft (an increase of 41.0%) and Nafta (an increase of 38.8%). The SAX index followed a downward trend over the first quarter, then stabilised in the second and third quarters. This development took place in virtually all the basic shares that are included in the index. The last quarter saw an increase in the value of SAX, due mainly to the publication of news about the continued privatisation of Slovnaft. On 26 November, the SAX index reached a yearly and almost five-year maximum, at 149.60 points. In 2003, as opposed to other years, the value of SAX did not fall below its initial level (100 points).

5.3. Foreign exchange market

Operations on the foreign exchange market

During the year, the exchange rate of the Slovak koruna against the euro appreciated by 1.3% (from SKK 41.722/EUR to SKK 41.161/EUR). The average exchange rate was SKK 41.491/EUR.

The total volume of foreign exchange purchases in direct interventions for the weakening of the Slovak koruna reached EUR 250.0 million in 2003 (May 2003). In addition, the National Bank of Slovakia accepted the offers of commercial banks throughout the year and purchased EUR 408.0 million in direct transactions. Thus the NBS purchased a total of EUR 658 million on the interbank foreign exchange market.

Table B29

Changes in the exchange rate of the koruna (%)

	Year-on-year change	Average 2003 / Average 2002
Exchange rate of the SKK:		
against the euro	-1.3	-2.8
against the dollar	-17.8	-18.9

The minus sign means an appreciation in the value of the SKK.

Interbank foreign exchange market

The total volume traded on the interbank exchange market (in foreign currency conversion, swap, and forward transactions, excluding foreign exchange interventions by the NBS) reached USD 400.0 billion, representing an increase of 85.9% in comparison with the figure for 2002 (of which transactions in USD accounted for 78.8%, in EUR 13.8%, and in other currencies 7.4%). Within the structure of transactions, currency swaps accounted for 91.0% (compared with 86.7% in 2002), spot operations 8.9% (13.2% in 2002), and forward transactions 0.1% (the same figure as in 2002).

The average daily turnover on the spot market amounted to USD 143.9 million. The market was dominated by trading in EUR, which accounted for 99.1% of the total volume, due to the euro being the reference currency. Trading between domestic banks and between domestic and foreign banks on the spot market confirmed the trend of increased activity on the part of foreign banks on the Slovak foreign exchange market (29.6% of the total turnover was in favour of domestic banks and 70.4% in favour of foreign banks). In 2003, the overall balance of transactions between foreign and domestic banks was positive (USD 192.6 million), i.e. foreign banks purchased mostly foreign currency and sold Slovak koruna. Of this figure, however, it is difficult to draw unambiguous conclusions about the interest of foreign banks in the purchase or sale of Slovak koruna. The customers of foreign banks are not only foreign entities, but domestic banks and companies as well. The market for Slovak koruna is a global one, hence numerous domestic entities use the services of foreign banks, mainly in cases, when they need to convert a larger amount. Therefore, the final balance of transactions between foreign and domestic banks does not reflect the actual inflow or outflow of foreign currency from the domestic exchange market.

The volume of transactions between domestic commercial banks increased by 36.0%, to USD 75.2 billion. Trading took place mostly in US dollars (79.4%; compared with 70.5% in 2002), followed by the euro with a share of 20.0% (28.9% in 2002), and other currencies accounting for 0.5%. Trading between domestic banks accounted for 18.8% (24.9% in 2002) of the total interbank foreign exchange market.

In the structure of transactions, 85.9% of the total volume of trading between domestic banks took place in the form of swap operations (79.9% in 2002) and spot transactions accounted for 14.1 % (20.1% in 2002).

Trading with foreign banks also recorded a marked year-on-year increase (100.3%), to USD 324.9 billion. Most trading took place in US dollars

(78.8%, compared with 80.4% in 2002), followed by the euro with a share of 12.1% (17.5% in 2002) and other currencies accounting for 9.0%. The volume of transactions with foreign banks represented a substantial part of the foreign exchange market (i.e. 81.2%).

In the last few years, the interest of foreign investors (banks and their customers) in the Slovak koruna has been on the increase. In the past, Slovakia was perceived as a country using non-standard procedures in the area of domestic policy. At present, Slovakia is considered to be standard functioning economy, the development of which can no longer be changed by current political issues in the long term. Powerful stimuli to growth in the interest of foreign investors in Slovakia was provided by the country's recent achievements in the area of foreign policy (entry into the EU, NATO, OECD), improved credit rating (Slovakia received an investment rating from the leading rating agencies), foreign investments (PGA Peugeot Citroën), and by the adoption of principal structural changes (pension reform, flat tax).

The major factor that discouraged investors from making even larger exposures in Slovak koruna in 2003 was the emergence of problems on the market as a result of unexpected steps taken by the Hungarian central bank, which attempted to resolve problems in the exchange rate area and to achieve its inflation target through radical changes in the key interest rates. Due to interventions and significant interest rate changes in Hungary, foreign banks took a more careful attitude towards the entire region. After a certain time, however, the developments on the Hungarian financial market ceased to have a substantial impact on the volatility of the neighbouring currencies (Czech koruna, Polish zloty, Slovak koruna).

From the point of view of the exchange rate of the koruna against the euro, the growth in liquidity on the foreign exchange market is of substantial importance. The increased daily turnover helps dampen the exchange rate volatility in the event of an increased outflow or inflow of foreign exchange into the sector. The fall in volatility has been apparent since 2000.