

MONETARY PROGRAMME OF THE NATIONAL BANK OF SLOVAKIA FOR 2003

On 13 December 2002, the Bank Board of the National Bank of Slovakia approved the Monetary Programme for 2003, which includes a medium-term outlook for the years 2004 to 2006. The Monetary Programme was presented by Governor Marián Jusko at a press conference on 17 December 2002.

The implementation of monetary policy in the years 2003 to 2006 will be determined by the integration process. In this connection, the main emphasis should be on the timing of the country's entry into the EMU and the strategy applied in the area of fiscal and monetary policies, with respect to the fulfilment of the Maastricht criteria and participation in ERM II.

The values of the Monetary Programme for 2003 are based on the intention of the Government of the SR to reduce the fiscal deficit in comparison with 2002, and on the decision of the Office for the Regulation of Network Industries in respect of an increase in regulated prices. On the basis of these assumptions, the growth in final consumption in the public and household sectors is expected to slow down. However, the rate of GDP growth is not expected to slow to a significant extent in comparison with 2002, due to the projected favourable effect of foreign and investment demand within the structure of GDP. The fulfilment of these assumptions should ensure real growth in GDP at a level allowing real convergence to continue.

Within the scope of the current account, the expected revival in export will be offset partly by an increase in imports of an investment nature. At the same time, however, the effect of final consumption on imports will diminish in comparison with 2002. With regard to the expected moderate growth in real wages, upturn in lending activity, and the unchanged tendency to consume, the final consumption of households is not expected to fall below the level of 1999 and 2000, nor the imports of consumer goods to decline to a significant extent.



This indicates that consolidation in the public sector, growth in foreign demand, and the slowdown in the dynamics of final consumption in the household and public sectors will create conditions for a reduction in the trade balance and current account deficits.

Developments in monetary aggregates are expected to follow the trend from 2002, without being affected by the restructuring of the banking sector, the increased inflow of privatisation proceeds and their utilisation, or changes in reporting rules for the banking sector. With regard to the lower level of interest rates in 2003, some companies may change their orientation from foreign to domestic resources, which could lead to faster growth in bank lending than foreseen by the National Bank of Slovakia. The upturn in domestic lending activity, coupled with an expected inflow of resources from the structural funds of the EU, and the drawing of loans from abroad roughly in the same amount as in 2002, should create a suitable basis for growth in investment.

The presented rates of growth in the money supply and bank lending are indicative values and their development is to be judged in the context of overall macro-economic development. Therefore, there is no need for immediate action on the part of the National Bank of Slovakia, should individual rates follow a different trend of development than in the monetary programme.

The process of harmonisation of the Bank's monetary policy instruments with those applied by the European Central Bank will continue in 2003, with a further gradual reduction in the ratio of required reserves, to



3.0% for both general banks and home savings banks.

In 2003, the National Bank of Slovakia expects a moderate fall in its sterilisation position vis-à-vis the banking sector in connection with the repayment of a foreign public debt and its revolving on the domestic market. The National Bank of Slovakia recommends that the Government of the SR take measures that enable the surplus of free liquidity at commercial banks to be reduced, together with the exchange rate risk involved in national debt servicing. In the medium term, the values of the monetary programme are based on the assumption that privatisation proceeds will be used for the replenishment of funds set aside for pension reform and for debt servicing, preferably vis-à-vis abroad.

The use of funds obtained from the sale of state property for servicing the national debt and financing the pension reform, should facilitate consolidation in the area of public finances. Improved budgetary performance in public finances, accompanied by the implementation of structural reforms, should create conditions for stable and sustainable economic growth. This is not expected to lead to periods of undue upswing or overheating in the economy, followed by corrections in both monetary and fiscal policies, and a subsequent dampening effect on the rate of GDP growth. The implementation of reforms and the continued process of integration should allow for a minimum of 4% growth in the real economy, while GDP may achieve a balanced structure. With regard to the need for real convergence, a task of vital importance is to create conditions for the fastest possible growth in added value and productivity.

The values of the monetary programme are based on unchanged interest rates and a relatively stable exchange rate vis-à-vis the euro and the US dollar.

Based on the above assumptions, the annual rate of overall inflation is expected to reach 7.7 – 9.7 % in December 2003. The marked increase in comparison with 2002 will be due to developments in regulated prices (a rise of 20%), while the rate of core inflation is expected to reach a level only slightly higher than in 2002. The postponement of the elimination of price anomalies requires that the process be carried out in a relatively short time, which will necessitate an increased one-off price adjustment in 2003. In addition, this cost factor will be coupled with the effect of changes in indirect taxes, leading to an increase in the tax burden. A stable risk factor in price development will be a change in the range of adjustments to regulated prices and the volatility of food prices (having a 21.4 % share in the consumer basket) and fuel prices (reflected over the entire basket).

A rise in inflation in 2003 is regarded by the NBS as unavoidable in the elimination of price anomalies and

the consolidation of public finances. The prices of regulated commodities should adjust to the level of justified costs and adequate earnings sooner or later. Their gradual increase would, however, create an environment of permanent and relatively high inflation. With regard to this possibility, the most rapid growth should be concentrated in a period of one or two years. In the medium term, there will be room for return to the policy of lowering inflation.

The planned entry of the Slovak Republic into the European Union and the recent invitation to join NATO, create conditions for a further improvement in the credit rating of Slovakia. The beginning of reforms in the public sector (pension, social, health care), together with the commitment of Slovakia to meet the Maastricht criteria in the medium term may further increase the attractiveness of investment in the Slovak Republic. This could generate pressure for an appreciation in the exchange rate of the Slovak crown. The first signals of such a development appeared in the post-election period in 2002, when a marked inflow of foreign capital was recorded.

The strategy of the National Bank of Slovakia will have to be adjusted to this situation in the area of monetary instruments, together with the acceptable level of appreciation in the exchange rate, at least in the medium term. The Bank's medium-term monetary policy strategy will have to focus on fulfilment of the Maastricht criteria in respect of both exchange rate and inflation.

In connection with the choice of an optimum strategy in the area of exchange rate policy, it is possible to say that excessive currency appreciation – which is not based on accelerating growth in the economy, particularly in exports – is not beneficial to a small open economy, even if it should cause a temporary fall in inflation. Disproportionate appreciation in the currency could have a negative effect on consumption and import, and could result in a fall in the price-based competitiveness of Slovak producers which could not be offset by an increase in productivity.

In such an environment, the exchange rate automatically becomes a matter of monetary policy, while the achievement of the main objective of the Central Bank remains unaffected. The National Bank of Slovakia will continue in its original monetary policy with emphasis on its primary objective, which is price stability. At the same time, the NBS will monitor the course of the exchange rate. If the rate does not correspond to the state of the economy, the Bank will correct its course with the help of instruments it has at disposal.

The medium-term goal of the National Bank of Slovakia is to reduce inflation to the level of EMU countries in line with the Maastricht criterion for inflation. Based on technical calculations, this could be achieved



ved in 2006. The calculations are based on the estimated development of regulated prices and the consolidation of public finances, which is again based on the medium-term outlook submitted as part of the State Budget Bill. This document predicts that the Maastricht criterion for the fiscal deficit will be met in 2006, which would allow entry into EMU no earlier than 2008. The medium-term outlook for inflation also corresponds to the time schedule for the consolidation of public finances.

Since the Slovak Republic has not yet officially announced the date of expected entry into the EMU, the medium-term outlook should be seen as a possible development rather than a goal, subject to the information derived from the regulation formula and its estimated effect on price developments being processed and used statically. A tighter fiscal policy, enabling the Maastricht criteria to be met as early as 2005, would create room for an acceleration in the process of disinflation and a fall in inflation to a level corresponding to the criterion of nominal convergence in the same year. In that event, the Slovak Republic could become a member of the euro area in 2007.

The medium-term objectives and strategies of Slovakia will be specified according to the official position of the Government and its commitments in respect of the country's planned entry into the EMU. Only on this basis could the National Bank of Slovakia devise a strategy for the control of interest and exchange rate developments so that the Maastricht criteria could be met in the area of inflation and interest rates, and the measures of the Central Bank be adopted gradually, without undue shock to the economy.

Summary of the Monetary Programme of the NBS for 2003

Goal of the monetary programme

The Monetary Programme of the NBS for 2003

expects the year-end rate of overall inflation to reach 7.7 – 9.7%, corresponding to an average annual inflation rate of 8.2 – 9.3%. Core inflation is expected to range from 2.7 to 5.0% and net inflation from 2.9 to 4.5%.

Assumptions of the monetary programme:

- a relatively stable exchange rate of the Slovak crown to the euro, corresponding to the actual performance of the economy;
 - GDP growth at a rate of 3.7 – 4.1% at constant prices;
 - a deficit of 6.2% in the balance of payments on current account (as a share of GDP);
 - a fiscal deficit of Sk 56.9 billion, i.e. 4.92% of GDP.
- On the basis of these assumptions,
- the money supply is expected to grow by 10%;
 - bank lending to households and enterprises is expected to grow by 9.3%.

Risks

- marked pressure for appreciation in the exchange rate of the crown;
- slower than expected growth in the economies of our trading partners;
- change in the range of adjustments to regulated prices and indirect taxes;
- volatile developments in oil prices (outside the reference zone of OPEC: USD 22 – 28 /barrel).

The detailed version of the Monetary Programme of the NBS for 2003, including an evaluation of the year 2002 and a medium-term outlook until 2006, is available on the home page of the National Bank of Slovakia (<http://www.nbs.sk>) in the section 'Monetary Policy'.

Main economic and monetary indicators

	2001	2002	2002	2002	2003	2004	2005	2006
	Reality	Monetary programme	Updated programme	Estimate	Monetary programme	Outlook		
(year on-year change in %)								
Gross domestic product (constant prices)	3.3	3.5 – 3.8	3.5 – 3.8	3.8	3.7 – 4.1	4.2	4.4	4.6
Core inflation (year-end figure)	3.2	3.2 – 4.7	3.2 – 4.7	1.9 – 2.2	2.7 – 5.0	5.3	2.4	2.1
Consumer price index (annual average)	7.3	4.1 – 4.9	3.6 – 4.2	3.3 – 3.4	8.2 – 9.3	7.5	3.9	3.0
Consumer price index (year-end figure)	6.5	3.5 – 4.9	3.5 – 4.9	2.9 – 3.2	7.7 – 9.7	7.4	3.7	2.8
Gross domestic product (nominal, in Sk billion)	989.3	1 032.0	1 032.0	1 063.0	1 170.0	1 290.0	1 405.0	1 525.0
Money supply (M2)	11.9	10.5	11.4	10.4	10.0	10.3	8.7	8.5
Loans to households and enterprises	4.7	7.5	6.9	12.2	9.3	9.4	9.3	9.1
Sterilisation position vis-à-vis the banking sector (Sk billions)	-67.3	-170.8	-159.6	-156.6	-122.6	-118.7	-151.5	-208.5
Coverage of imports (goods and services, monthly av.) by reserves	3.1	4.1	5.6	5.8	4.4	4.2	4.3	4.9
Current account deficit as a share of GDP (%)	-8.6	-7.9	-8.3	-8.4	-6.2	-5.6	-5.1	-4.7
Official reserves (US\$ millions)	4 346.4	6 575.9	8 455.3	8 976.9	8 058.9	8 363.9	9 319.4	11 664.5