



MONETARY PROGRAMME OF THE NATIONAL BANK OF SLOVAKIA UNTIL THE YEAR 2008

On 21 December 2004 the Bank Board of the National Bank of Slovakia (the “NBS”) approved the Monetary Programme of the NBS until the year 2008, reflecting the integration ambitions of Slovakia. The Programme was presented on the same day at a press conference by Ivan Šramko, Deputy Governor of the NBS, and as of 1 January 2005 Governor of the NBS.

In May 2004, Slovakia became a member of the European Union and the NBS joined the European System of Central Banks. With the signing of the Accession Treaty, Slovakia became a member of the Economic and Monetary Union as a Member State with



derogation. This means that Slovakia accepted a commitment to join the monetary union in the future. The Convergence Programme of Slovakia until 2010, as well as its update, maintain that the economy of Slovakia is heading toward sustainable fulfilment of the Maastricht criteria in 2007. In September 2004, the government adopted common material of the Ministry of Finance of the Slovak Republic and the NBS called “Specification of the Strategy for Adopting the Euro in the Slovak Republic” which states, based on an evaluation of results of analyses and the situation with realization of reforms, that introduction of the euro is realistic in 2009.

This clear and unambiguous timing of integration ambitions of the Slovak Republic represents a challenge for the central bank as well as for the whole society. For the monetary policy and the NBS as such, a time frame has been outlined within which the NBS will be responsible for the fulfilment of Maastricht inflation and exchange rate criteria. Therefore, the NBS has undertaken to define an unambiguous framework for its monetary policy in the medium term, not in the form of an outlook but in the form of a binding target. Simultaneously, the NBS defines

the conduct of its monetary policy as inflation targeting in the conditions of ERM II.

The main anchor of the monetary policy in this time horizon is setting the target figure for the development of inflation. In the medium term, consistent with obligations

resulting from membership of the EU and the goal of establishing conditions for adopting the common currency the euro, as well as consistent with commitments of the government in the area of reducing the fiscal deficit, the NBS has established a target for the year-on-year rate of inflation measured by the harmonized index of consumer prices (HICP) below 2.5 percent for December 2006 and below 2 percent for December 2007 and for December 2008, in order to fulfil the Maastricht criterion on the basis of average twelve-month inflation. The NBS assumes the value of the Maastricht criterion at the level of approximately 2 percent at the beginning of 2008, when the preparedness of Slovakia for entry into the euro area will be assessed.

With regard to the fact that the Maastricht inflation criterion is not fixed but variable, the inflation target for 2007 and 2008 has been set to ensure the fulfilment of this demanding criterion, which results from possible low inflation in the EU Member States.

The value of year-end inflation for December 2005 at the level of 3.5 percent à 0.5 percentage points also has the character of a target, and at the same time this level reflects the extent of administrative



adjustments to regulated prices and simultaneously is in line with the medium-term inflation target.

The inflation target set in this way is based on the meeting of the Maastricht criterion and represents an unambiguous commitment to which the NBS will subordinate the conduct of monetary policy. The ability of the NBS to meet this inflation target will however be conditioned by the development in the fiscal and wage areas and can be influenced by unexpected development, for example in prices of mineral raw materials and food, and by natural disasters. Measures of the central bank in the form of changes to interest rates as its main instrument can only influence the development of some inflationary effects, in particular of demand character. For this reason, the NBS finds it necessary to set out exceptions from achieving the inflation target, that have the character of unexpected events and influences beyond the scope of monetary policy.

Development of inflation will further to a great extent be influenced by an increase of the excise tax on tobacco and tobacco products. Therefore, in order to meet the Maastricht criterion in the area of inflation, the NBS considers it appropriate to adjust the timetable for increasing excise taxes in order to minimize their negative impact on price dynamics in the period important for meeting the set inflation target.

Apart from using interest rates as a monetary policy instrument of the central bank, the NBS will to a greater extent focus on formation of inflationary expectations of the public as another indirect but powerful tool influencing the development of inflation. The NBS expects that determining of a medium-term inflation target will provide individual economic entities with a more transparent and clearer framework for the formulation of their longer-term business and investment plans, for decisions concerning savings, and for the area of wage policy and wage bargaining.

A necessary condition for achieving inflation within the target range is coordination of fiscal and monetary policies. A deviation from the declared trajectory of consolidation of public finances and an introduction of additional administrative measures and changes of indirect taxes, apart from those assumed at this time, represent factors beyond the influence of the monetary policy and belong among substantial risks influencing the achievement of the inflation target within the set range.

Until the time of entry into the ERM II, the managed floating exchange rate regime will be used, which is in line with meeting the target in the area of inflation. The NBS will be evaluating the development of the exchange rate in relation to the set inflation

target over the entire period before the euro is adopted.

Membership of Slovakia of ERM II should not represent an obstacle to meeting the inflation target. On the contrary, this exchange rate regime should create an appropriate framework for nominal and real convergence. On the one hand, ERM II will represent a certain degree of exchange rate stability and a discipline framework for the macroeconomic policy, and on the other hand, it leaves sufficient room for adjustments to shocks and the economic development.

The change in monetary policy strategy has been reflected also in Monetary Surveys, which will involve, on a quarterly basis, results of a medium-term model simulation. This situation will consistently include the current and anticipated development of individual indicators of economic development, such as the development of GDP, wages, exchange rate, and the fiscal sector, in order to create a framework for the identification of factors and their effect on the development of inflation in the medium term with the aim of adjusting the monetary policy accordingly to achieve the set target.

The presented monetary policy strategy, aimed at culminating in fulfilling Slovakia's integration ambitions, forms the core of the National Bank of Slovakia Monetary Programme until the year 2008. Information on forecast medium-term macroeconomic development also forms a part of the approved monetary programme.

In conclusion Ivan Šramko emphasised that the meeting of the Maastricht criteria is not an isolated matter of only monetary or just fiscal policy, but it concerns the entire society. The primary role of the NBS will be to make such steps and decisions which will meet the Maastricht inflation and exchange rate criteria, however, in coordination and cooperation with fiscal policy, as well as, particularly in the wage area, general income policy. Any deviation from the programme of declared fiscal consolidation can cause contradictory reactions of the market and increase costs of potential stabilization.

The detailed version of the Monetary Programme of the National Bank of Slovakia until the year 2008, is available on the NBS home page (<http://www.nbs.sk>) in the section 'Monetary Policy'.

Photo: Pavel Kochan