NÁRODNÁ BANKA SLOVENSKA

Annual Report 2006

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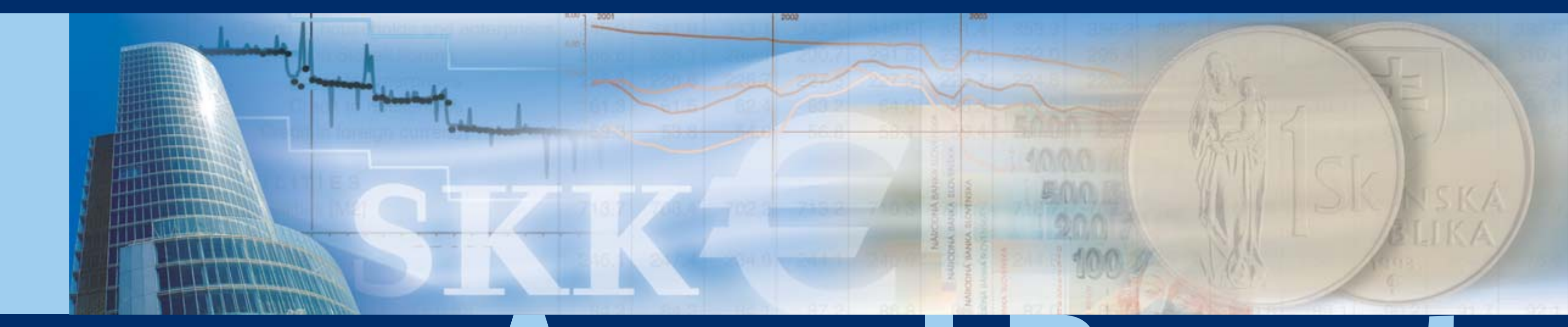

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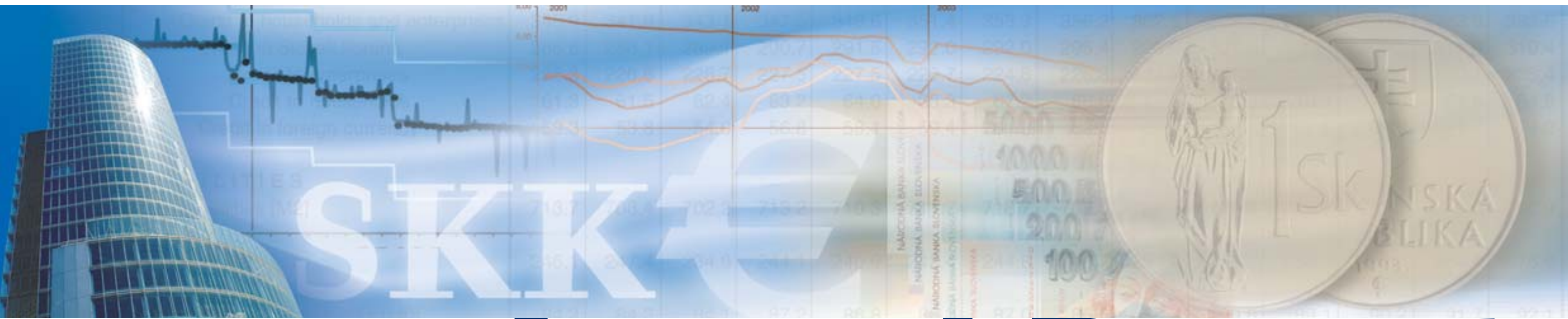

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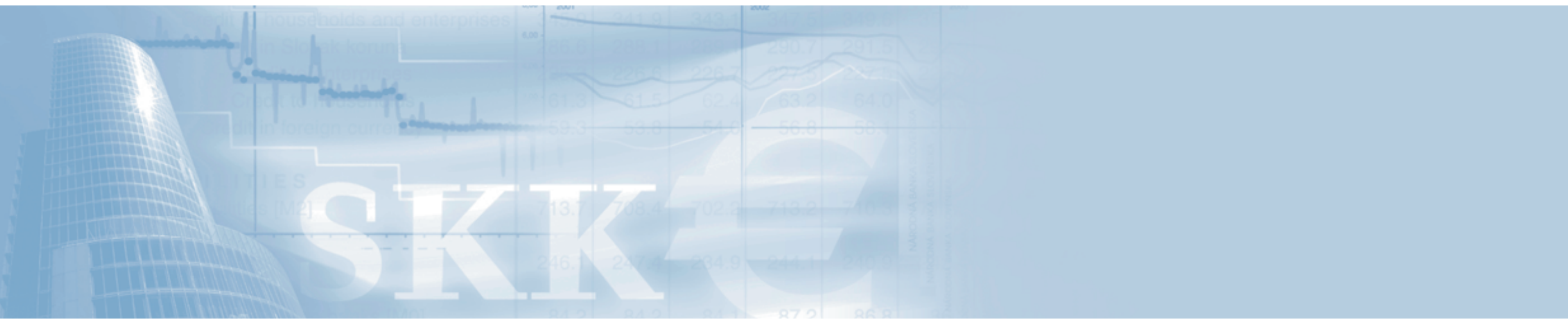


Foreword

Year 2006 was characteristic above all by strong economic growth and by the general elections. The annual economic growth recorded an all-time high of 8.3%, but that figure is likely to be surpassed in 2007. The favourable economic development was also reflected in the labour market, as employment rose and unemployment declined. The commitment to adopt the euro in 2009 was confirmed by the new government, which was formed after the June general elections.

2006 was the second year of implementation of the inflation targeting strategy under ERM II. Consumer price growth increased in comparison with the previous year. The increase in inflation was given by faster price growth in most of the core groups of the consumer basket. However, the dominant influence was exerted by domestic factors, notably the effect of adjustments to regulated prices. Inflation in 2006 exceeded the NBS target of 2.5%, largely owing to developments in energy prices, i.e. to a factor lying beyond the scope of monetary policy and representing exemptions from meeting the inflation target.

In order to mitigate the secondary effects of higher energy prices and regulated prices, the Národná banka Slovenska gradually raised the base rate by a total of 1.75 percentage points in 2006. The implementation of monetary policy was restrictive in the key interest rate. The nominal exchange rate appreciated during 2006, except for a short period around the time of the general elections. The NBS intervened several times in the foreign exchange market in order to mitigate excessive volatility in the Slovak koruna's exchange rate and to react to developments inconsistent with macroeconomic fundamentals.

Since 1 January 2006, the Národná banka Slovenska has been performing supervision of the entire financial market in the Slovak Republic. The integrated supervision of the financial market was established in reaction to the cross-connections of activities performed by different financial market entities operating in the fields of banking, capital market, insurance, and pension saving. The main purpose of integrated supervision is to support both the stability of the financial market as a whole and its security and sound operation.

To meet the needs of cash in circulation in 2006, the NBS provided for the printing of banknotes in the denominations of 20, 50, 200 and 500 koruna, and the minting of coins in the denominations of 50 halier and 1 koruna. The NBS issued three commemorative coins during the year with motifs of the Muránska planina National Park and anniversaries of Karol Kuzmány and Mojmír II. In addition, four issues of annual collector sets of coins in circulation were produced.

The Národná banka Slovenska continued to perform its tasks under the National Euro Changeover Plan and the NBS internal plan for euro adoption, and thereby contributed to fulfilling the euro introduction strategy. It revised the valid legal regulations issued by the NBS or related to the NBS, which will have to be amended in relation to the euro introduction. A number of analyses were performed in regard to information system modifications. As for the payment system in Slovakia, a new concept was drawn up for its development until 2009. The core features of this concept are the integration to the European payment system TARGET2 and the construction of a new domestic payment system. Detailed analyses were elaborated on the effect of the euro introduction on enterprises, banking and financial institutions and households.

Since entry into ERM II, the Slovak economy has undergone significant structural changes. The gradual acceleration of economic growth and the large differential between productivity growth in Slovakia and in the euro area resulted in substantial appreciation of the equilibrium exchange rate. The conditions were thereby created for a revaluation of the central parity, which serves as a basis for assessing the fulfilment of the Maastricht exchange rate criterion for the euro introduction. At the request of Slovakia, and with the agreement of the members of the ERM II Committee, the central parity of the Slovak koruna was revalued with effect of 19 March 2007. The new central parity was set at 35.4424 koruna per euro.

In 2006 the Národná banka Slovenska conducted an audit of management processes and activities. The main purpose of the audit was to establish a new procedural and organizational model for the bank, comprehensively supported by effective information systems, and to create an improved structure of qualified staff and a competitive system of remuneration. The audit outputs laid the basis for implementing gradual changes aimed at streamlining the operation of NBS's internal processes in future years.

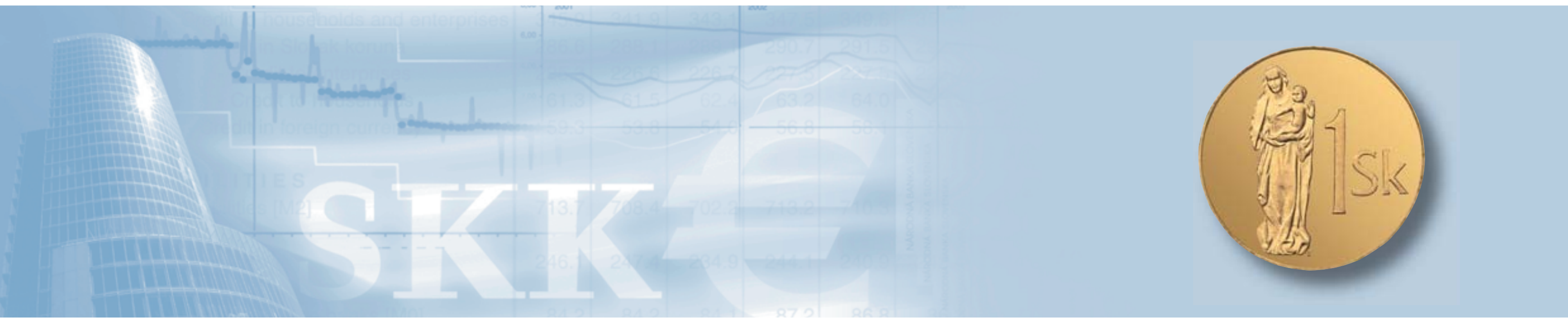
The past year also saw the NBS cooperate more intensively with the European Union and its Member States, but also with non-Member States and international institutions. The nature of the cooperation has changed. Slovakia became a donor member of the International Monetary Fund and the International Development Association. The NBS represents Slovakia in foreign exchange transactions related to foreign aid. In 2006 the NBS organized several meetings and educational events in relation to the ESCB, foreign technical cooperation and foreign technical assistance.

Many interesting challenges lie ahead. The most pressing one for the Národná banka Slovenska is the introduction of the euro and adoption of the ECB common monetary policy. The progress already made in meeting the tasks related to the successful completion of technical preparations for the euro introduction, as well as the current forecast for developments regarding the Maastricht criteria suggest that Slovakia will soon join the group of countries implementing the common monetary policy of the ECB.

Ivan Šramko
Governor

May 2007

External Economic Environment



1 External Economic Environment

1.1 Global trends in output and prices

The relatively strong growth of the world economy continued in 2006. In comparison with 2005, growth accelerated slightly, reaching roughly the level of 2004. The increased economic activity benefited from favourable financing conditions, strong corporate profits and an overall strengthening of the corporate sector. The dynamic growth recorded in emerging Asian economies played a key role in the global economy. The euro area saw a renewed upturn in economic growth, even if at lower levels than in emerging markets. Economic growth likewise rose slightly in the United States, despite fears of a slowdown. These fears were mainly related to the uncertainty regarding housing market, with a possible impact on final household consumption, to interest rate growth and global imbalances. Following a long period of stagnation, Japan saw some signs of a recovery, primarily in the form of a growth in exports. These were accompanied by the end of a period of deflation and a slight price growth, pointing to a gradual recovery taking place in the economy. High oil and industrial commodity prices in 2006 contributed to faster growth in Russia, the Middle East and Latin America.

World prices saw a stable development in 2006, and inflation remained relatively low. Despite the fact that prices for oil and industrial commodities on world markets remained at a high level, they did not significantly influence global price growth nor threaten global economic growth. Global tensions partially weakened over 2006 and the hurricane season in the Gulf of Mexico was milder than expected. This contributed to a decrease in the risk premium on the oil market. After reaching a peak of 78 USD per barrel in mid 2006, world oil prices fell partially over the last quarter to 60 USD per barrel, which was in line with its level at the end of 2005. Thus, oil prices had a favourable effect on global inflation in the second half of 2006. Besides economic factors, oil prices were also influenced by activities of speculative investors and hedge funds, betting on changes in oil prices and thus contributing to the growth in their volatility.

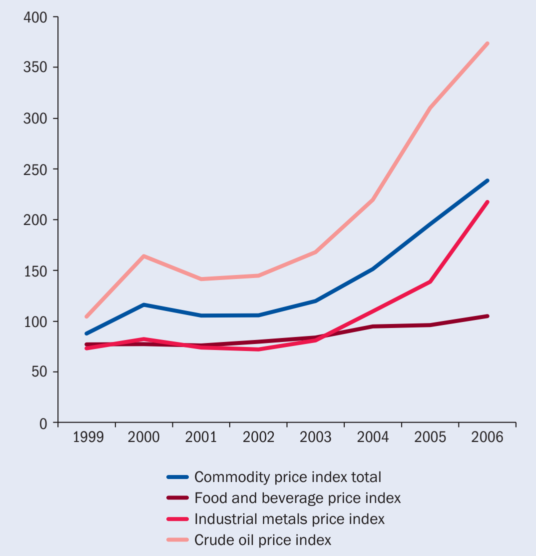
Fast economic growth in China and India was reflected in the strong demand for ferrous and non-ferrous metals. This together with the low level of inventories of non-ferrous metals and low processing capacities for industrial metals led to a growth in prices of these commodities. In an attempt to diversify their portfolios and reduce risks, investment funds also had a certain

Table 1 **Global output** **(year-on-year growth in %)**

	2004	2005	2006
Global output	5.3	4.9	5.4
Developed economies	3.3	2.5	3.1
The United States	3.9	3.2	3.3
Japan	2.7	1.9	2.2
The euro area	2.0	1.4	2.7
Emerging Asian economies	8.7	9.2	9.4
China	10.1	10.4	10.7
India	7.8	9.2	9.2
Russia	7.2	6.4	6.7
Central and Latin America	6.0	4.6	5.5
Brazil	5.7	2.9	3.7
Middle East	5.6	5.4	5.7

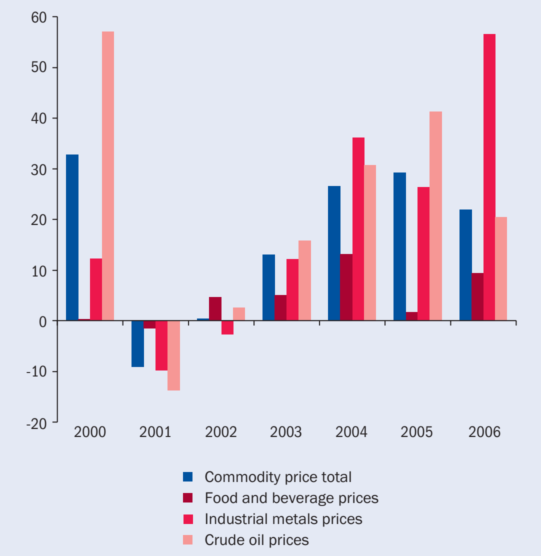
Source: World Economic Outlook, IMF, April 2007, Eurostat.

Chart 1 **Price development (index, year 1995 = 100)**



Source: World Economic Outlook, IMF, April 2007.

Chart 2 **Year-on-year change in commodity prices (%)**



Source: World Economic Outlook, IMF, April 2007.

effect on commodity prices. Nevertheless, their activities affected mostly gold and silver prices.

Prices of agricultural and food commodities and goods recorded a more pronounced growth, primarily in the second quarter of 2006. Despite that, their overall rise was relatively moderate.

Exchange rates around the world were affected by the euro continuing appreciation against the US dollar, the Japanese yen and the Swiss franc. However, the euro lost ground against the British pound. Exchange rates in 2006 were primarily influenced by expectations regarding interest rate changes in the United States and the euro area. Monetary policy in China and Japan was of significant influence as well, primarily as regards the slight loosening of the exchange rate regime in China.

The US dollar depreciation against the euro, particularly at the beginning of the year, was influenced by the growing US double deficit (current account and fiscal deficit) and the negative outlook for economic growth. Conversely, the economic recovery in the euro area was reflected in the strengthening of the euro against the major world currencies.

The developed economies in 2006 again recorded a deepening of their balance of payments current account deficits. However, this growth in the deficits was only moderate, having slowed against the previous year. Risks flowing from global imbalances decreased, primarily due to the slower growth of the US current account deficit.

1.2 Economic development in the United States

Economic growth in the United States increased slightly in 2006 to 3.3%, compared to 3.2% a year earlier. The economy's continued acceleration from 2005 was seen particularly at the beginning of 2006, while in later periods the rate of economic growth slowed. Economic growth was supported by private consumption and increased federal and state spending. Favourable financing conditions and profit growth stimulated corporate investment. The gradual slowdown in the rate of economic growth over the course of 2006 was connected with a fall in investments in the real estate sector and a slowdown in housing construction. The rate of growth in private consumption by households, representing the largest contribution to GDP creation, fell from 3.5% in 2005 to 3.2% in 2006. The largest fall was recorded in household spending on non-durables. Household spending was suppressed by high energy prices and increased housing costs. On the other hand, household consumption benefited from wage and employment growth.

The average twelve-month inflation in 2006 fell slightly from 3.4% in 2005 to 3.2%. Price growth accelerated as a result of the rise in energy prices and also higher utilisation of production capacities in the first half of the year. From the summer though, the year-on-year rate of inflation slowed to 2.5% at the year-end.

The current account deficit, in comparison with the 6.4% of GDP recorded in 2005, rose only slightly in 2006 to 6.5% of GDP. Influenced by global economic growth and the depreciation of the USD real effective exchange rate, a positive trend was recorded in export dynamics, particularly in the export of goods. On the other hand, imports were influenced by relatively strong consumer demand.

A positive development was seen in the fiscal area, when the public finance deficit ended the year at USD 248 billion, representing a decrease on 2005 from 2.6% of GDP to 1.9% of GDP. This improvement was due to increased tax revenues from legal and natural persons.

Over the course of the first half of 2006, the Federal Open Market Committee (FOMC) of the Federal Reserve System raised its target rate for federal funds four times, each time by a quarter of a percentage point. By the end of June, the rate had thus risen by 100 basis points to 5.25%. Interest rates then remained unchanged over the course of the year, despite the FOMC repeatedly stating that inflationary risks persisted.

1.3 Economic development in Japan

In 2006 the Japanese economy continued recovering from the long lasting crisis, with GDP growth reaching 2.2%. Similarly as in other industrialised countries, however, the rate of economic growth slowed over the year. Economic activity was stimulated in particular by faster growth in private investment, reflecting the favourable financial conditions and corporate profitability. Increased export activity, supported by the JPY weaker exchange rate and strong demand for mechanical equipment, contributed to the growth. A substantial upturn in industrial output, rising from 1.6% in 2005 to 4.6% in 2006 was also connected with this.

Over the course of 2006, deflationary fears weakened in Japan, with consumer prices growing year-on-year by 0.2%, compared with their decline in 2005 by 0.3%. Price development remained subdued, primarily due to downward pressures on wages.

The banking sector's gradual recovery led to a credit growth for the first time since 1996. Corporate investment rose to 7.7%, compared to 6.6% in 2005. The TANKAN index, an indicator of manufacturers' sentiment published by the Bank of Japan, again recorded a rise on the preceding year and reflected the growing confidence of the business sector in Japan. The current account again recorded a surplus growth, supported in particular by exports, and reached USD 170.4 billion, representing 3.9% of GDP compared to 3.6% of GDP in 2005.

In 2006 the Bank of Japan stopped its "quantitative easing policy", which it had been applying since 2001, and increased the key interest rate from 0% to 0.25%. Likewise it also withdrew excess liquidity from the banking sector.

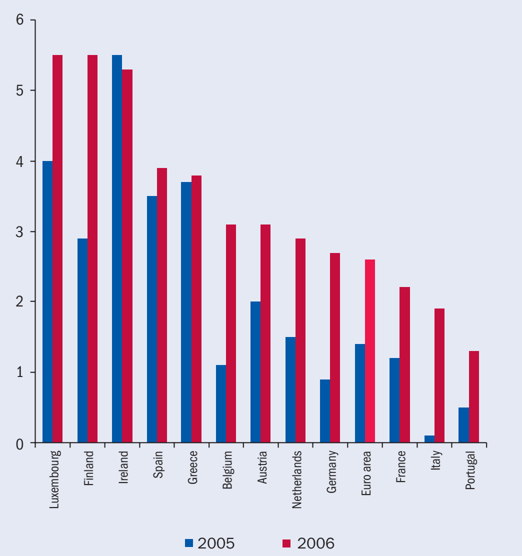
1.4 Economic development in the euro area

In 2006 economic growth in the euro area almost doubled from its level in 2005 (1.4%) to reach 2.7%. Following a gradual and slight recovery in growth in the second half of 2005, the first half of 2006 saw a more substantial upswing. This development was reflected in an improvement in consumer and business confidence, as well as in labour market conditions. The rate of growth was the highest seen since 2000.

The sluggish economic growth since 2001 had been connected with the fall in prices of financial assets followed by subsequent restructuring of corporations' balance sheets, though at the cost of a decline in investment and job creation. It was this successful process of restructuring corporations' balance sheets in the preceding period that in 2006 led to an upturn in investment demand and in the demand for labour. The main driver of this growth was domestic demand, primarily fixed investments. Although exports accelerated substantially in 2006 as a consequence of the world economy's continued expansion, the external sector's contribution to GDP growth was neutral, since the faster domestic demand was also reflected in higher imports.

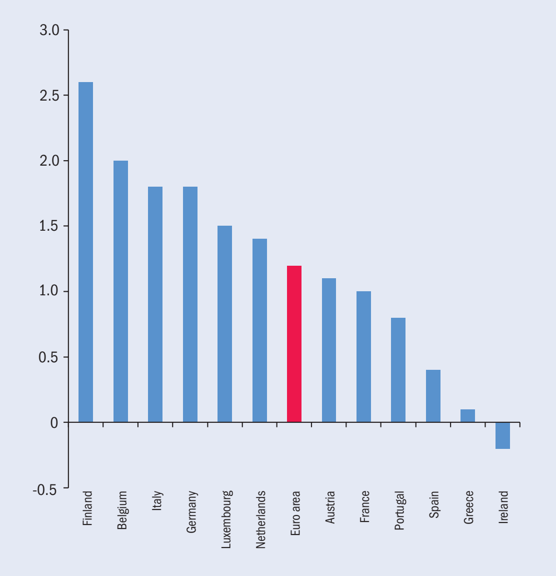
Investment growth in 2006 reached its highest rate since 2000 (4.3%), being connected in particular with

Chart 3 **GDP growth in the euro area countries** **(%)**



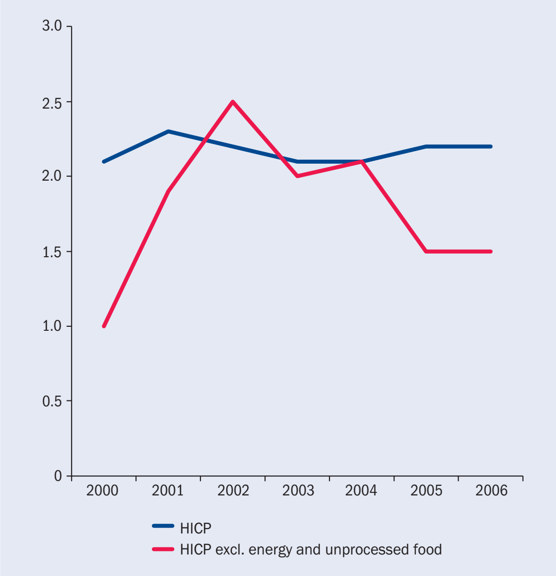
Source: Eurostat.

Chart 4 **Changes in the economic growth rate in 2006 compared to 2005 (% points)**



Source: Eurostat.

Chart 5 **Inflation in the euro area (%)**



Source: Eurostat.

rising corporate profitability and low external financing costs. In comparison with the previous year, in 2006 an increase in the rate of growth also in private consumption was recorded (from 1.5% to 1.8%), the main source of which was higher growth in real disposable income. Despite the negative effects of energy prices on household purchasing power, real income growth was higher as a consequence of strong growth in employment and non-wage income. The moderation of consumer spending had a positive influence on household savings.

The divergence between rates of GDP growth among the individual countries of the euro area lessened in 2006, and most of the countries recorded an increase in the rate of growth on 2005.

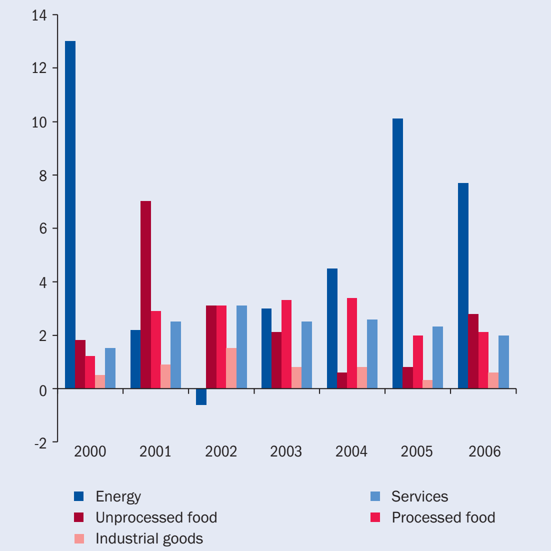
Labour market conditions improved substantially in 2006. Employment grew primarily in the service sector, while its decline in construction and industry abated. The rate of unemployment continued to fall in 2006 to 7.5% in the fourth quarter. Although these figures suggest a cyclical response of the labour market, part of the fall in unemployment was also due to structural reforms in several euro area countries.

Labour productivity growth continued to accelerate over 2006. This acceleration was most pronounced in industry, while labour productivity growth in services remained stable, though at a considerably lower level than in industry. An increase in labour productivity was connected with the cyclical development of the economy; nevertheless the achieved level still remains below expectations. On the one hand, this reflects the impact of structural reforms undertaken in the labour market aimed at increasing the engagement of low-qualified workers, and on the other hand, an insufficient utilisation of productivity-increasing technologies, as well as a lack of competition and a strict regulatory framework of markets in goods.

In 2006, overall average HICP inflation remained unchanged from 2005 at 2.2%. The year-on-year rate of inflation, however, recorded a relatively significant volatility during the year, caused mainly by the development in energy prices. Inflationary pressures were also related to the rise in world non-energy commodity prices, which was reflected in substantial price growth in intermediate goods. The slight increase in producer prices of consumer goods may signal secondary effects of the earlier growth in commodity prices, though as yet these remain suppressed. The slight growth in wage costs and the euro's appreciation also had a dampening effect on prices. The average price of Brent crude oil (in euro) grew in 2006 by 20%, following a 45% rise in 2005.

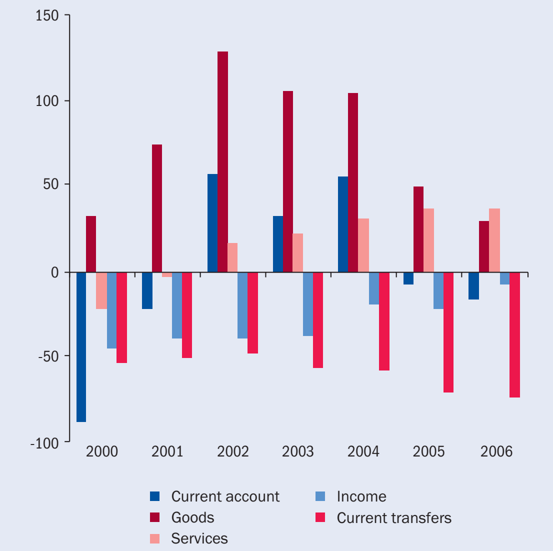
In comparison with 2005 the contribution of unprocessed food prices to the growth in consumer prices was more pronounced, particularly as a result of adverse weather conditions in the second half of the year. In 2006, the average HICP inflation excluding energy and unprocessed food remained unchanged at the level of 2005 (1.5%). Over the course of the year, however, the year-on-year rate of inflation accelerated slightly. This was connected with the rise in non-energy industrial goods prices. The rate of growth of prices in services remained stable at 2.0%. Overall it may be said that

Chart 6 **Year-on-year change in individual components of HICP inflation in the euro area (%)**



Source: Eurostat.

Chart 7 **Balance of payments current account (EUR billion)**



Source: Eurostat.

in 2006 inflationary pressures in the euro area were contained and the impact of the growth in oil and non--oil commodity prices on consumer prices was limited. Long-term inflation expectations remained anchored at levels consistent with price stability.

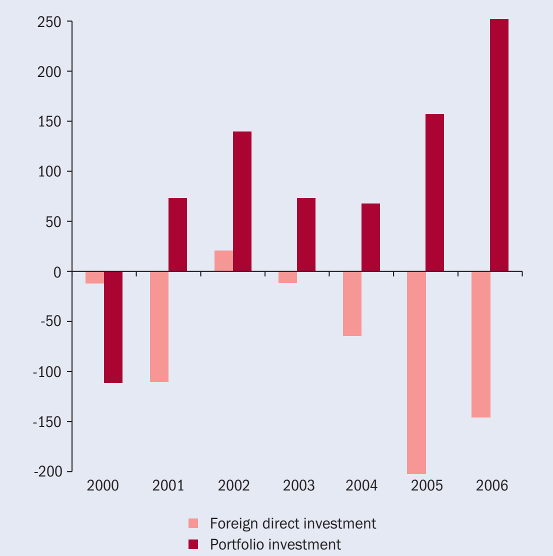
The year-on-year rate of growth in industrial producer prices grew from 4.1% in 2005 to 5.1% in 2006. This growth was primarily caused by energy prices, though an upward trend was also recorded in producer prices excluding energy. This may be particularly ascribed to the rising prices of non-energy commodities and the indirect impacts of higher oil prices. By all plausible measures, labour costs in 2006 remained moderate, as in 2005, though the situation in individual countries differed. Overall, labour costs continued to contribute to domestic inflationary pressures to a lesser extent. The main factor behind this was the pressure of strong global competition. Other contributing factors were the positive influence of monetary policy on inflation expectations, reduced membership of labour unions and an increase in the share of part-time and short-term labour contracts.

In 2006 the euro area recorded a current account deficit of EUR 16.2 billion (0.2% of GDP) in comparison with a deficit of EUR 6.8 billion (0.1% of GDP) in 2005. The higher deficit resulted mainly from a lower trade surplus in goods, where imports of goods grew faster (16.1%) than exports (13.8%). The slightly higher deficit in current transfers was only partially compensated for by a lower deficit in the income balance, whereas the balance of services remained unchanged.

The financial account in 2006 was marked by a significant net inflow of direct and portfolio investment, in contrast to the net outflow of capital in 2005. These developments were primarily the result of a significantly lower net outflow of foreign direct investments from the euro area and a higher net inflow of portfolio investments.

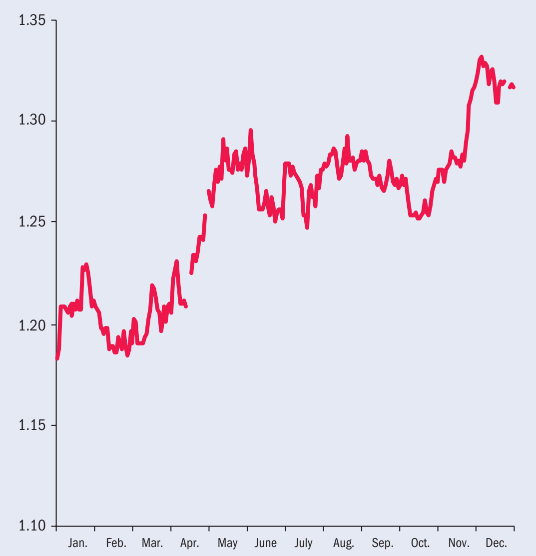
Over the course of 2006 the euro exchange rate appreciated against the US dollar by 11.4%. This trend

Chart 8 **Direct and portfolio investment in the euro area (EUR billion)**



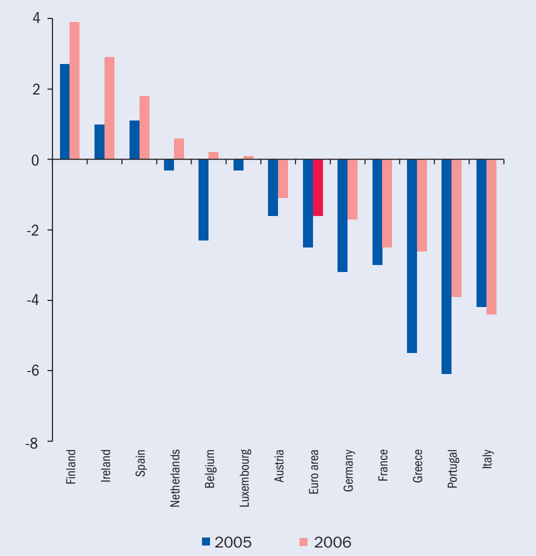
Source: Eurostat.

Chart 9 **USD/EUR exchange rate in 2006**



Source: ECB.

Chart 10 **Public finance positions of the euro area countries (% of GDP)**



Source: Eurostat.

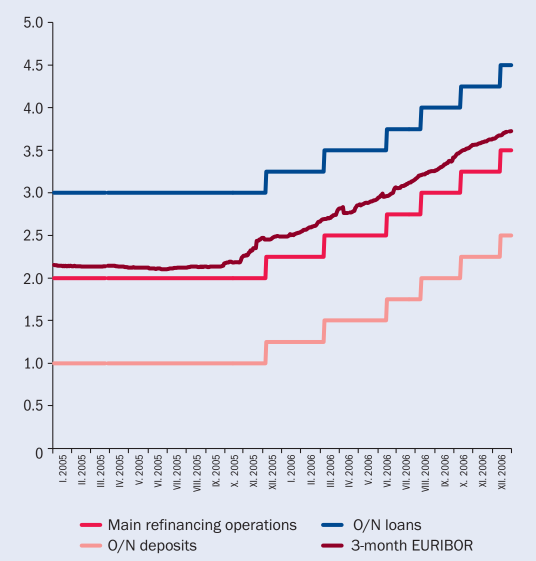
primarily reflected the markets' more favourable expectations regarding the euro area's economic development. At the beginning of the year, one of the main reasons of appreciation of the euro was the deepening US double deficit, though gradually the main reason for this trend became the differing position of the economic cycle in the United States and the euro area, as well as the future settings of monetary policy in these two economic areas.

With regard to relatively strong economic growth and higher revenues, fiscal performance in the euro area in 2006 may be considered to be positive, even if greater efforts in the field of budgetary consolidation were still lacking. The public finance deficit in the euro area in 2006 was 1.6% of GDP, compared to 2.5% of GDP in 2005. Of the five countries against which the excessive deficit procedure was initiated in 2006, three (Germany, Greece, France) managed to bring their deficits below the reference value of 3%. Italy and Portugal remained with a deficit exceeding the reference value. In comparison with 2005, all countries except Italy succeeded in lowering their public finance deficits in 2006.

In line with these developments in public finances, the public debt fell slightly below 70% of GDP in the euro area (in 2005 public debt was 70.5% of GDP, in 2006 69.0%). This reflected the reduction in public debt achieved in all countries, except Italy (the country with the highest public debt ratio to GDP among the euro area countries) and Portugal.

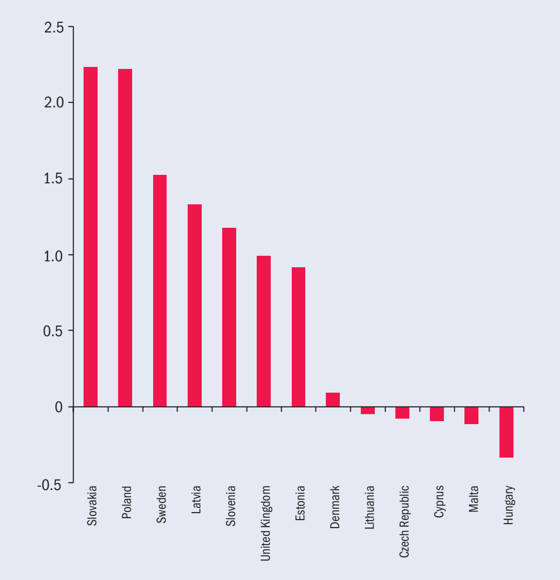
Over the course of 2006, the ECB raised its key interest rate in total by 1.25 percentage points from 2.25% in January 2006 to 3.50% at the year-end. The main reason was the increase in inflationary risks to price stability. These risks included a stronger than expected pass-through of the past growth in oil prices, a possible further increase in regulated prices and indirect taxes, and the possibility of renewed growth in oil prices, as well as stronger wage growth. The monetary policy was tightened in an environment of robust economic growth, significant monetary and credit expansion and surplus of liquidity in the euro area.

Chart 11 **ECB and EURIBOR interest rates (%)**



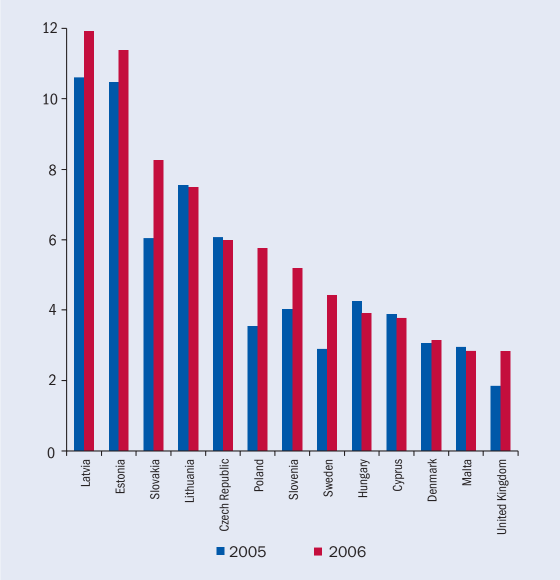
Source: ECB.

Chart 12 **Change in economic growth in 2006 on 2005** **(% points)**



Zdroj: Eurostat.

Chart 13 **Economic growth in 2006 and 2005** **(%)**



Source: Eurostat.

1.5 Economic development in the non-euro area Member States

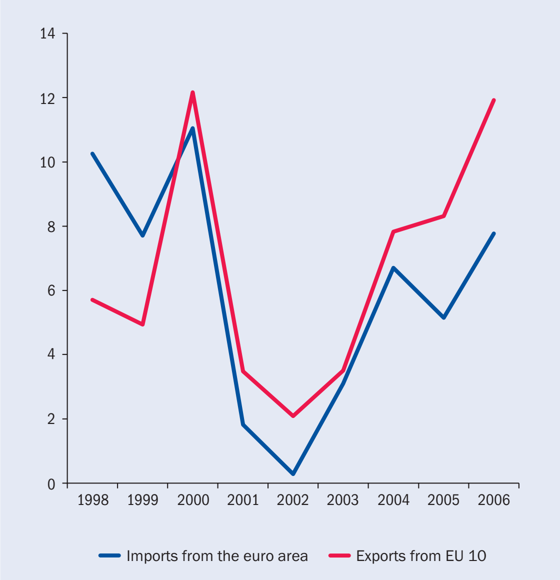
Economic growth in the Member States outside the euro area accelerated in 2006, though the levels of growth differed markedly among individual countries. Economic growth accelerated most in Slovakia, Poland and Sweden, although the highest levels were achieved in the Baltic States, especially in Latvia and Estonia, but also in Slovakia. Economic growth in the other economies of the central Europe region was also relatively robust.

In most of the countries was the dynamic economic growth driven by domestic demand. Private consumption was stimulated by increased disposable income connected with dynamic wage growth, a fall in unemployment and rising real estate prices. Growth in investment demand reflected the relatively favourable financing conditions and an improved business environment, and, in some countries, also by substantial inflows of foreign direct investment.

Besides domestic demand, an upsurge in exports was also recorded in several countries. This was largely connected with the inflow of foreign direct investment in the previous years and the favourable development of foreign demand. Nevertheless, the dynamic development of exports in most countries was also accompanied by fast growth in imports. This was a consequence of the relatively strong domestic demand and high import intensity of exports in certain countries. The contribution of net exports to GDP growth was, then, in general neutral. A positive contribution from the net export to economic growth was recorded by Hungary, the Czech Republic, Malta, Slovakia and Sweden.

Inflation measured by the harmonised index of consumer prices rose in most non-euro area Member

Chart 14 **Imports to the euro area and exports from EU 10** **(year-on-year change in %, constant 2000 prices)**

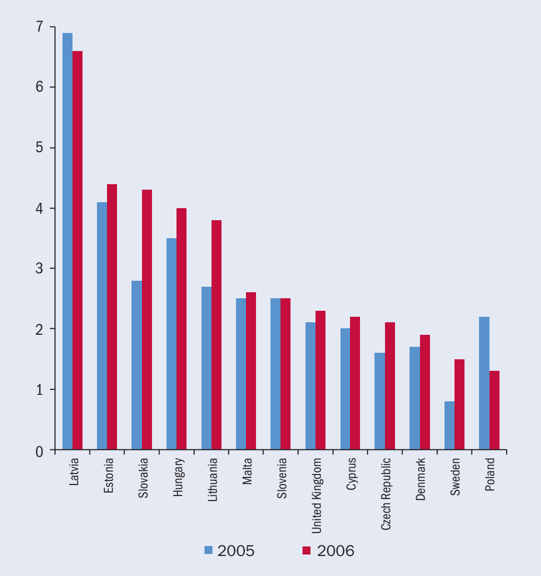


Source: Eurostat, NBS calculations.
Note: EU-10 – countries which entered the EU in 2004.

Chart 15 **Change in the twelve-month average rate of inflation (HICP) in 2006 (% points)**

Source: Eurostat.

Chart 16 **Twelve-month average rate of inflation (HICP) (%)**



Source: Eurostat.

States. The highest level was reached in the Baltic States, Hungary and Slovakia. The lowest rate of inflation, significantly below the euro area average, was reported by Poland and Sweden.

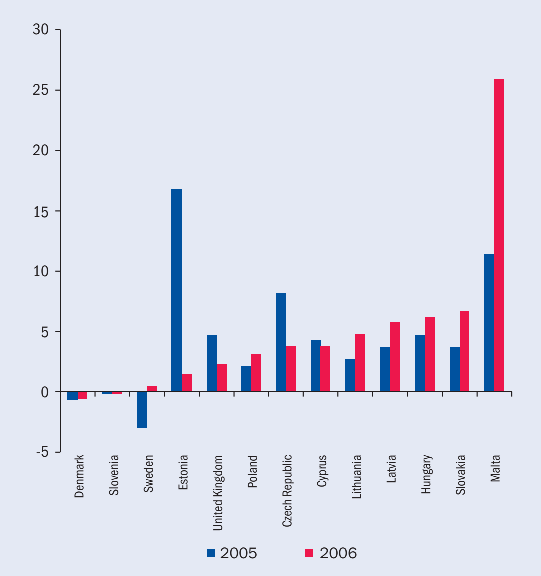
The acceleration of price growth in several countries was a consequence of administrative measures. Price development was also influenced by higher oil prices and the subsequent growth in energy prices. Food prices also contributed to higher price growth in some countries. Fast growing domestic demand in some economies, however, also contributed to a rise in inflationary pressures.

The balances of the combined current and capital account of the balance of payments in individual countries continued to differ significantly. While Sweden and Denmark achieved surpluses, other countries reported

Chart 17 **Combined current and capital account of the balance of payments (% of GDP)**

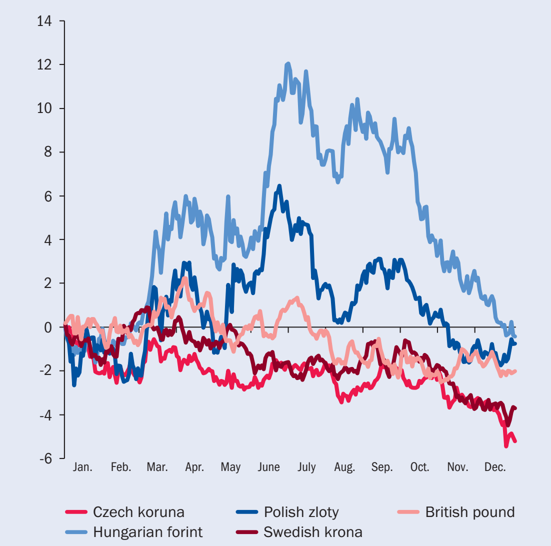
Source: ECB.
Note: Data for Estonia, Malta, Sweden and the United Kingdom are cumulative for the four quarters preceding the third quarter of 2006.

Chart 18 **Net FDI inflow (% of GDP)**



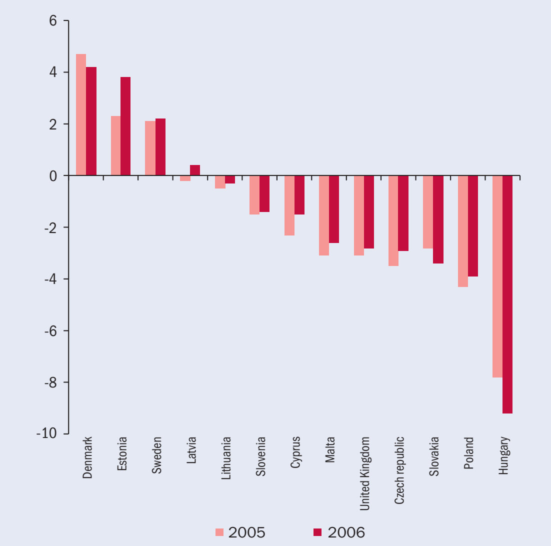
Source: ECB.
Note: Data for Estonia, Malta, Sweden and the United Kingdom are cumulative for the four quarters preceding the third quarter of 2006.

Chart 19 **Changes in daily exchange rates of the currencies of the EU countries outside ERM II against the beginning of 2006** (%)



Source: Eurostat.
Note: Negative values represent appreciation.

Chart 20 **Public finance deficit** **(% of GDP)**



Source: Eurostat.

deficits. Overall, in comparison with 2005, there was a moderate deterioration. An extraordinarily high deficit of almost 20% of GDP was recorded in Latvia, and deficits in Estonia and Lithuania ranged above 10% of GDP. The current and capital account deficits in those countries that entered the EU in May 2004 were in part related to the catching up process. In certain countries, however, these deficits reflected strong consumer demand and credit growth, which may signal a risk to the sustainability of the external position.

The net inflow of foreign direct investment in most non-euro area countries increased in comparison with 2005. In several countries net foreign direct investments represented a significant source of financing of combined current and capital account deficits, though they were insufficient, in particular in the Baltic States.

The developments in the non-euro area Member State exchange rates reflected to a significant extent the individual countries' exchange rate regimes. The national currencies of Denmark, Estonia, Cyprus, Latvia, Lithuania, Malta, Slovenia and Slovakia were participating in ERM II. These countries' exchange rates, with the exception of Slovakia's, hovered closely around their central parities.

The exchange rate developments of the currencies that did not participate in ERM II differed across individual countries. From the first months of the year, the Czech koruna and Swedish krona shifted to an appreciation trend and in comparison with the beginning of the year strengthened by 5.2% and 3.7% respectively. The British pound also began to gradually appreciate from July 2006 (having strengthened as at the year-end by 2.0%). The Polish zloty and Hungarian forint recorded increased volatility and a trend of significant depreciation over the course of the first half of 2007, reflecting the global risk aversion to emerging markets. In the case of Hungary, the pressure on the currency was also the result of the fiscal situation and fears of external imbalances. In the second half of the year the trend in the exchange rate developments reversed and both currencies recorded gradual appreciation. This reflected the renewed global appetite for risks, and in the case of Hungary, also the increased level of interest rates. At the end of the year both countries' exchange rates had returned close to their initial levels at the beginning of the year.

In the field of public finances, relatively large differences persisted among individual countries in 2006. While Denmark, Sweden and Estonia recorded fiscal surpluses, other countries reported deficits. With the exception of Hungary, the budgetary outcomes were in line with the 2005 convergence programmes. The fiscal position in several countries was positively influenced by robust economic growth.

As at the end of 2006, the Czech Republic, Malta, Hungary, Poland, Slovakia and the United Kingdom were subject to excessive deficit procedure. In July 2006, the excessive deficit procedure against Cyprus was abrogated, while in January it was initiated against the United Kingdom. Of the six countries to which the excessive deficit procedure related, the United Kingdom, the Czech Republic and Malta succeeded in bringing their public finance deficits below the 3% reference value.

During 2006 the central banks of most countries whose currencies participated in ERM II adopted measures for tightening their monetary policies. In several cases these reflected interest rate changes by the ECB, which increased the rate for the main refinancing operations in total by 125 basis points in 2006.

In mid-February 2006 the Danmarks Nationalbank raised its key rates by 10 basis points to 2.5% in response to an outflow of capital connected with purchases of foreign securities by Danish investors. Over the further course of the year the Danish central bank adapted its rates to changes in the ECB key rates, gradually raising its key interest rate to 3.75%. With regard to currency board arrangements, the central banks of Estonia and Lithuania do not set key interest rates. Both these countries thus automatically adopted the monetary policy decisions of the ECB. Furthermore, the Eesti Pank implemented several preventive measures in the financial sector. These were aimed at eliminating risks to financial stability, connected primarily with fast credit growth. These measures included an increase in the reserve requirement ratio from 13% to 15%. Also the Latvian central bank tightened its monetary policy, raising interest rates from 4% to 5% in two steps. At the same time, the Latvijas Banka expanded the reserve base to include bank liabilities with a maturity exceeding two years. As a result of the narrowing short-term interest rate differential against the euro, Malta's central bank increased its key rate in three steps by a total of 75 basis points to 4%. Cyprus's central bank likewise increased rates slightly, by 25 basis points to 4.5%. This step was connected with the tightening of ECB monetary policy and growing inflationary pressures. The Banka Slovenije took account of fact that the country's short-term interest rates should converge with those prevailing in the euro area prior to adopting the euro on 1 January 2007. Thus, during the first half of 2006, it gradually lowered its main policy rate and from August onwards kept it stable at 3.5%.

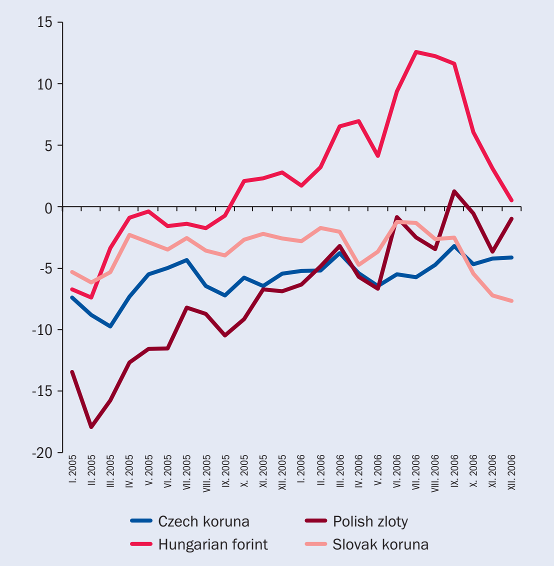
The central banks of most non-euro area Member States not participating in ERM II increased their key rates in consequence of growing fears of upside risks to price stability. The Česká národní banka raised its key rate by 50 basis points to 2.5%, largely on account of its inflation forecast. A deteriorating inflation outlook was the reason for increasing rates also in Hungary, where the Magyar Nemzeti Bank cumulatively in five steps raised its key rates by 200 basis points to 8%. A relatively high level of inflation, moving above the target, was also the reason for raising rates in the case of the Bank of England. Sweden's Sweriges Riksbank raised its key interest rate from 1.5% to 3.0% with an aim to maintain inflation close to target.

The only central bank of the non-euro area Member States not participating in ERM II that lower its key rates was Poland's Narodowy Bank Polski. Rates were lowered in two steps from 4.5% to 4%. The reason was the greater than expected decrease in inflation, as well as a more favourable inflation outlook.

1.6 Developments in V4 countries

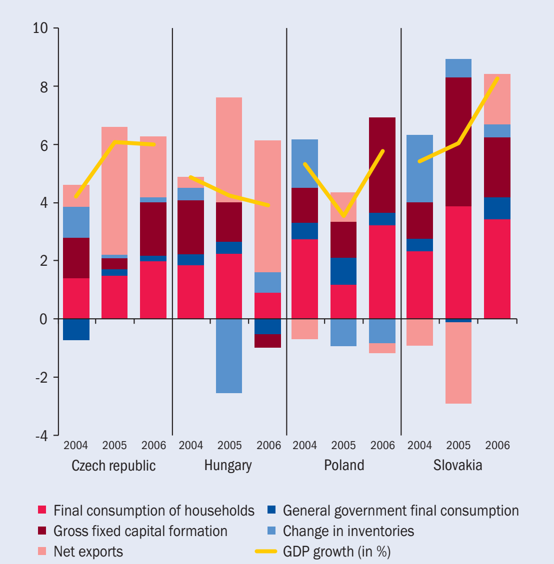
Economic growth in the V4 countries maintained its dynamic rate from 2005, where favourable impulses to the region's economic activity included gross investment including foreign direct investment and net exports. Inflation in the region accelerated in comparison with the previous year (with the exception of Poland), though in the last third of the year it was favourably influenced by falling oil prices. Central banks in the region (except for the Narodowy Bank Polski) raised key interest rates over the course of the year by 50 to 200 basis points. The Czech and Slovak korunas recorded a year-on-year appreciation, which in connection with the renewed attraction of the Central European region strengthened even further in the last third of the year. A change in investors' mood concurrently contributed to a slowdown in the Hungarian forint's depreciation. The relatively strong trend of appreciation recorded by the Polish zloty in 2005 continued in 2006, though this trend lessened over the course of the year. In autumn the governments presented their convergence programme updates, which imply that the euro introduction

Chart 21 **Development in exchange rates of the currencies of V4 countries against euro (year-on-year change in %)**



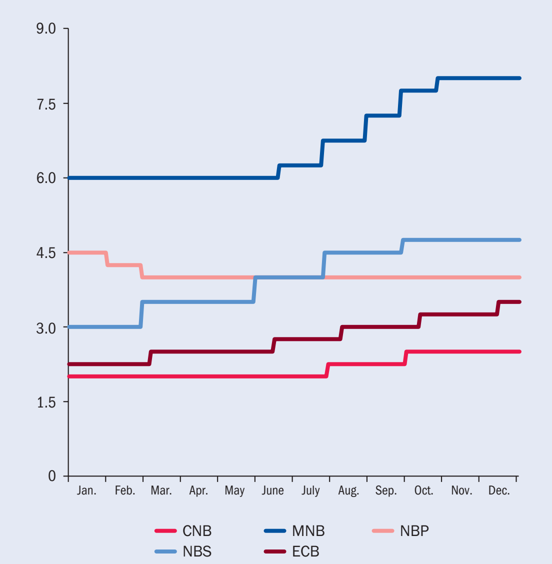
Source: Eurostat, NBS calculations.
Note: Negative values represent appreciation.

Chart 22 **Contributions to GDP growth (% points)**



Source: Eurostat, NBS calculations.

Chart 23 **Key rates of national central banks (%)**



Source: NCB, ECB.

in the three neighbouring countries was postponed beyond 2010.

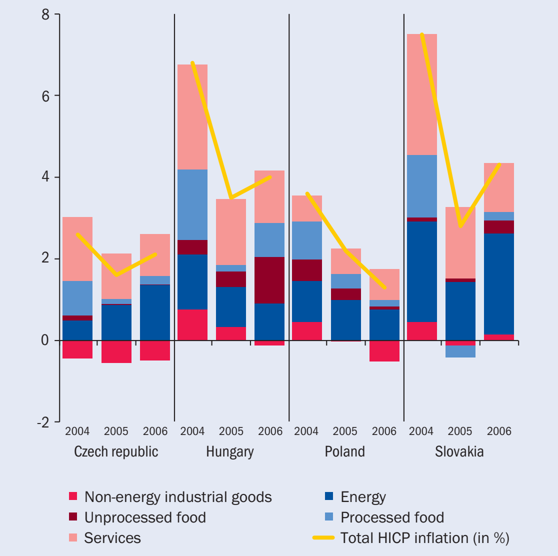
As in the previous year, the **Czech economy** grew in real terms by 6.0%, though the structure of growth changed. The previously dominant impulse from the side of foreign trade decreased, and, on the other hand, gross investment and household consumption contributed significantly to growth. The growth in gross value added was fostered mainly by the manufacturing industry, particularly manufacturing of transport vehicles. A significant increase in the number of jobs was reflected in a fall in the rate of unemployment to 7.1% (compared to 7.9% in 2005). The average rate of HICP inflation reached 2.1%, rising by 0.5 percentage points in comparison with 2005. Non-energy industrial goods continued to have a dampening effect on price development, whereas energy prices rose. Over the course of the year, the development of inflation was influenced by an increased contribution from regulated prices in the first three quarters and its significant decrease in the last quarter (a fall in prices of housing). In the same period the pro-growth influence of food prices also weakened. A decrease in inflation in the last quarter was encouraged by falling prices of energy commodities, as well as by the Czech koruna appreciation. At the close of the year the Czech koruna reached its historically highest level against the euro and the USD.

The deficit in the current and capital account of the balance of payments rose against the preceding year from 1.9% to 4.5% of GDP. This deterioration reflected the outflow of dividends and reinvested earnings in the income balance[1]. The trade deficit as a proportion of GDP improved against 2005. Fiscal development on the revenue side was influenced by the economy's strong growth. On the other hand, the expenditure side reflected higher pension and social security benefits, as well as the early repayment of a guarantee towards the Česká národní banka for claims the bank took over in connection with the stabilising of the banking sector. Thus, the public finance deficit (according to the excessive deficit procedure definition) totalled 2.9% of GDP (compared to 3.5% of GDP in 2005). The Česká národní banka raised its key rate in total by 50 basis points, even though this the negative interest-rate differential towards the ECB rate deepened as at the year-end by 0.75 percentage points to 1 percentage point. The Česká národní banka's decisions were based on the inflation forecast, which predicted an upward shift in the cyclical position of the economy. These decisions also took account of risks identified in fiscal developments and rise of rates in the euro area.

Economic development in **Hungary** in 2006 was substantially influenced by the adoption of a fiscal consolidation plan in the second half of the year. The adopted stabilisation measures put a brake on economic growth and led to an increase in inflation. GDP growth slowed slightly to 3.9%. The dominant contribution of net exports to growth recorded in 2005 became even more pronounced. Exports, concentrated primarily on machinery, chemical and metal products, found support in a recovery in external demand

[1] *The evaluation of the structure of the current account of the balance of payments for the Czech Republic, Hungary and Poland is based on the data for the first to third quarters of 2006.*

Chart 24 **Contributions to HICP inflation (% points)**



Source: Eurostat, NBS calculations.

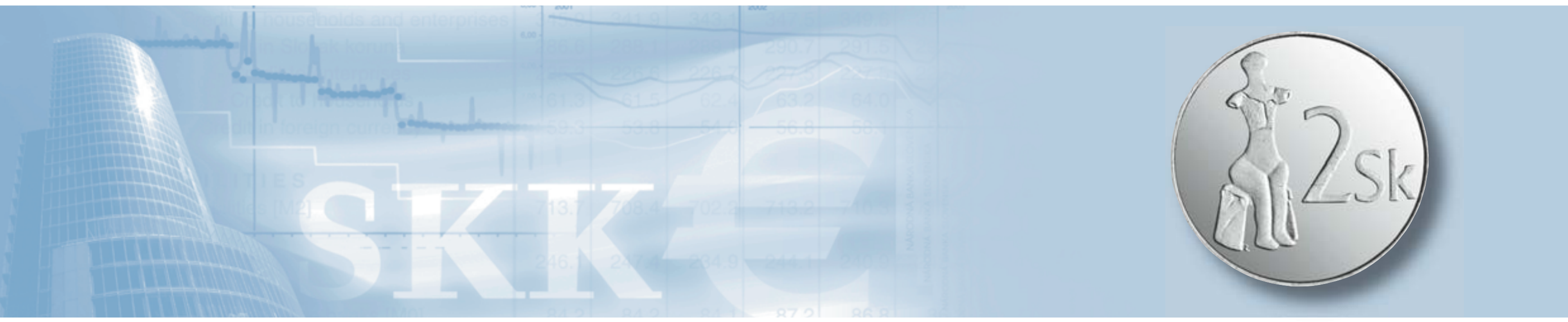
(particularly as a consequence of German economic growth), as well as in the weakening forint. Conversely, the impulse from the side of household consumption and gross investment weakened against the preceding year. A milestone in the economic development was the introduction of a fiscal consolidation plan in June with a restrictive influence on consumer and investment decisions (the introduction of a solidarity tax for legal and natural persons, and a tax on interest income and capital gains from September). The rate of unemployment grew slightly against 2005 to 7.5%. The average HICP inflation reached 4%, increasing by 0.5 percentage points in comparison with 2005. In the first months of the year the year-on-year rate of inflation hovered at relatively low levels, but began to increase gradually as a result of growing inflationary expectations. Price development recorded a further acceleration in August, as a result of energy price increases for households and under the influence of an increase in indirect taxes. With effect from September, VAT was increased for basic foods, along with an excise duty on cigarettes and alcohol. Thus, over the course of the year, the year-on-year rate of inflation rose from 2.5% in January to 6.6% in December.

The current and capital account deficit fell slightly against 2005, by 0.3 of a percentage point to 5.6% of GDP. The financial account achieved a significant surplus, partly due to the high inflow of net foreign direct investment of 6.2% of GDP (e.g. the sale of the Budapest airport). The worsening of the public finance deficit (according to the excessive deficit procedure definition) to 9.2% of GDP in comparison with 7.8% in 2005 was influenced by expenditures on anti-flood measures, the waiving of the Iraqi debt, army purchases, as well as by the inclusion of costs for the construction of motorways and pension reform in the deficit (in contrast to the practice in the previous years). The deficit was partly compensated by an increase in revenues in connection with the fiscal consolidation plan. In fear of an increase in inflationary expectations and of emergence of secondary effects following administrative price adjustments, the Magyar Nemzeti Bank felt the need to tighten monetary policy. In raising the key rate in total by 200 basis points it also took account of the higher risk premium of Hungarian assets and the forint's weakening.

The **Polish economy's** real growth in comparison with 2005 increased by 2.3 percentage points to 5.8%, reflecting the favourable development of gross investment and strong household consumption resulting from a growth in real disposable income and consumer credit. Robust growth in investment demand (a growth in fixed capital by 16.7%) was connected in particular with investments in the aviation and electronic industries, logistics, and other sectors. The favourable effects of this were reflected in job creation and in the fall of the rate of unemployment to 13.8% (from 17.7% in 2005). As a result of the continuing emigration of workers and of structural changes (in health care, mining, construction, and the textile industry) the problem of a shortage of workers deepened in certain market segments. This, despite the fact that for the Central European region Poland has relatively high labour market flexibility, was characterised by the highest share of part-time and fixed-term contracts. However, the resultant growth in total labour costs (strongest in the construction sector) represents an inflationary risk. Price development in 2006 slowed, when the average HICP inflation decreased to 1.3%, in comparison with 2.2% in 2005. The zloty's appreciation coupled with a marked fall in prices of clothing and falling oil prices in the second half of the year all had a dampening effect on inflation. A further factor was the setting of regulatory policy that did not fully internalise the rise in energy prices since 2004.

The current and capital account deficit, as in the preceding year, reached 1.4% of GDP. In the current account, the deficit of the trade balance and income balance worsened slightly. As in the preceding year, the financial account was in surplus, particularly as a result of foreign direct investment inflow. The public finance deficit (according to the excessive deficit procedure definition) fell in comparison with 2005 by 0.4 percentage points to 3.9% of GDP. The fiscal improvement was influenced by the revenue side in connection with faster economic growth and with an increase in indirect taxes. The Narodowy Bank Polski reduced its key rate in total by 0.5 percentage points in the first quarter, and in view of the favourable development of inflation, it left the rate unchanged at 4% till the end of the year.

Monetary Developments



2 Monetary Developments

2.1 Introduction

In 2006 the Slovak economy developed in an environment of relatively robust growth of the global economy. Its growth accelerated somewhat in comparison with 2005, to approximately the level of 2004. Global prices followed a relatively stable course in 2006 and inflation remained comparatively low. Despite the elevated levels of oil and industrial commodity prices on the world markets, this factor had no profound upward effect on price levels in the world and posed no threat to global economic growth. From the perspective of the global economy, an important role was played by the robust growth in emerging Asian economies and other emerging countries. A revival in economic growth, though at lower growth levels than in the emerging regions, was recorded in the euro area. Economic growth also accelerated somewhat in the United States, despite market concerns about a possible slowdown in the economy. They were mainly related to the uncertainty about real estate market developments with a possible impact on final consumption in the household sector, interest rate growth, and global imbalances. After a long period of stagnancy, the Japanese economy also showed signs of revival, mainly in the form of export growth. This was connected with the end of the deflation period and the modest price increase, which points to a gradual economic recovery. The high oil and industrial commodity prices in 2006 contributed to the accelerating economic growth in Russia, the Middle East, and Latin America. After the price culmination in the middle of 2006, the last quarter saw a certain fall in global oil prices, to the level of the end of 2005. Thus, oil prices had a favourable effect on global inflation in the second half of 2006.

The favourable macroeconomic developments created good conditions for the progress of the Slovak economy, whose growth was supported by strong foreign direct investments. Rising oil prices in the first half of 2006 posed an increased risk to inflation development in the SR. This affected the implementation of NBS monetary policy in 2006, whose primary task was to continue taking necessary measures to meet the country's inflation targets and for creating conditions for fulfilling the Maastricht inflation and exchange rate criteria. The basic anchor of monetary policy was, in line with the inflation-targeting strategy under the conditions of ERM II, the setting of target figures for future inflation as measured by the Harmonised Index of Consumer Prices (HICP). In line with the obligations arising from EU membership and the goal to create conditions for entry into the euro area, consistently with the government's commitment to reduce the fiscal deficit, the Národná banka Slovenska set the year-on-year inflation target below 2.5% for December 2006 and below 2% at end-2007 and end-2008 in its Monetary Programme for the period 2006-08, in order to meet the Maastricht criteria for the average 12-month inflation rate.

Inflation as measured by the Harmonised Index of Consumer Prices (HICP) recorded higher values than in 2005 throughout 2006. The acceleration of inflation and consequent exceeding of the inflation target in 2006 were mainly caused by higher-than--expected increases in energy and food prices. Energy prices were largely determined by commodity price developments on the world markets, which subsequently passed through into regulated prices and fuel prices. In addition to the poor harvest, food prices were influenced by an increase in the excise duty on cigarettes. These factors belong to the exemptions from the inflation target, which are defined in the Monetary Programme of the NBS for the Period until 2008 and as such are outside the domain of the central bank. Hence, the NBS focused first and foremost on the dampening of the effects of secondary factors, especially regulated price increases, on other components of the consumer basket.

The development of the real economy in 2006 was characterised by strong year-on-year dynamics. Looking at the two halves of the year, real growth accelerated gradually in the second half. The structure of economic growth in 2006 confirms that the accelerated GDP creation was mainly caused by an increase in the production capacity of the economy, particularly in sectors with foreign direct investment inflows. The expansion of production capacities and production activities, especially in the automotive and electronics industries, was reflected in the growing export performance of the economy, when, unlike in 2005, net exports also contributed to the dynamic economic growth. On the supply side of the economy, the accelerated GDP growth was influenced by the development of the value added creation in all economic sectors, mainly in manufacturing, trade, and electricity, gas, and water supply. In terms of use, the structure of economic growth was influenced by both foreign and domestic demand, while foreign demand showed three times stronger dynamics than domestic demand. Domestic demand growth was mainly stimulated by faster growth in investment demand, which was mainly produced by non-financial corporations through the purchase of new technological equipment. In 2006 final consumption was only slightly higher than in 2005, due to growth in general government final consumption in the first half of 2006. Household final consumption was stable during 2006 and its growth was largely stimulated by wage developments, employment growth, and the utilisation of credit resources.

The relatively dynamic economic growth in 2006 was also reflected in an increase in employment, a decrease in the number of unemployed persons, labour productivity growth, and an improvement in the financial results (profits) of corporations. The average monthly nominal wage continued to grow in 2006, but its dynamics weakened in comparison with the same period a year earlier. Such development occurred in spite of acceleration in labour productivity growth in the economy, which is mainly indicated by an increase in the gross operating surplus, which should be realised in the form of dividends paid to shareholders and/or reinvested. The slower nominal wage growth, coupled with a higher average inflation rate than a year earlier, was also reflected in the slower pace of real wage growth. In 2006 the dynamics of real labour productivity exceeded the dynamics of real wage growth, representing an upturn compared to 2005.

A deficit trend of the balance of payments on current account continued in 2006, when all its basic components, except for the balance of services, recorded certain deterioration in comparison with 2005. The faster growth in the exports of goods and services in comparison with their imports was reflected in the improved ratio between export performance and import intensity, and owing to the dynamic export and import growth, the openness of the Slovak economy widened. Exports showed strong dynamics throughout 2006 and recorded increases in a wide spectrum of commodities in all basic categories of goods, while the acceleration was mainly caused by exports of the automotive and electronics industries (the exports of automobiles and television sets). The deepening of the balance of trade deficit in 2006 was also influenced by machine imports, represented by investments into the expansion of production capacities, mainly in the automotive industry.

The exchange rate policy was conducted under the exchange rate mechanism II (ERM II). The exchange rate of the Slovak koruna followed an appreciating trend until the end of March, then stagnated until May, when it started to depreciate back to the central parity level. This development was not a result of change in the economic fundamentals, but was caused by developments in the neighbouring currencies and the uncertainty resulting from domestic political developments. To moderate the volatility of the exchange rate, the NBS conducted foreign exchange interventions at the end of June and during July. In connection with the stable macroeconomic environment, the continuing fiscal consolidation, and the improving results of the real economy, the Slovak koruna showed a gradually appreciating tendency from August 2006.

Monetary policy operations focused on the achievement of medium-term inflation targets and the fulfilment of the Maastricht inflation criteria throughout 2006. The accelerating dynamics of GDP growth and the associated increase in output, receipts, and labour productivity pointed to a possibility of faster wage growth and the occurrence of inflationary pressures. Inflationary effects were also exerted by the rising oil prices, regulated prices, and goods prices. As a consequence of the identified upside risks to price stability, the NBS tightened its monetary policy through interest rate adjustments in May, July, and September 2006. In total, the NBS increased its key interest rates by 1.75 percentage points. The key interest rate increases passed through into money market rates, (both short-term and long-term) and their developments reflected the increases in the key interest rates throughout the year.

Despite the rise in interest rates, bank lending activities strengthened in 2006, mainly in relation to the private sector. The dynamics of lending to households slowed somewhat as a consequence of strong credit growth in the previous year. In 2006, as in the previous year, households used credit resources for long-term investment in particular. In terms of structure, loans to households were still dominated by loans for house purchases. The growth in household loans was also reflected in their growing indebtedness. This development was connected with the process of real convergence and was also observed in the other new EU Member States. In comparison with the euro area and V4 countries, the lowest level of household indebtedness was recorded in Slovakia. The non-financial corporations sector witnessed less dynamic bank lending. In terms of purpose, the credit expansion was mostly concentrated in investment loans and real estate loans.

Macroeconomic developments in 2006 can be considered to be favourable; they were determined with the actual trends in the domestic economy and the external environment. By pursuing a cautious monetary policy aimed at eliminating the potential risk of overheating of economy, the NBS in 2006 focused its efforts on fulfilment of the convergence criteria and its inflation targets in particular. The NBS will continue in these efforts and thus contribute to the creation of conditions for the adoption of the single European currency in 2009.

2.2 Economic developments

2.2.1 Price developments

Inflation as measured by the Harmonised Index of Consumer Prices

Consumer prices, expressed in terms of the Harmonised Index of Consumer Prices (HICP), had increased by 3.7% by the end of December 2006, representing an expected slowdown in dynamics in comparison with the end of 2005 (of 0.2 of a percentage point). The average inflation rate reached 4.3% in 2006 (2.8% in 2005), with the prices of goods and services rising by 4.6% and 3.5% respectively. The year-on-year rate of core inflation (overall inflation, excluding energy and unprocessed food prices) averaged 2.1% in 2006 and was 0.4 of a percentage points higher than in the previous year.

In its Monetary Programme for 2005–2008 of December 2004, the Národná banka Slovenska defined its monetary policy as inflation targeting under the conditions of ERM II. The main anchor of monetary policy became the setting of an inflation target. For December 2005, the year-on-year inflation rate was set at 3.5% (±0.5 of a percentage point). The targeted inflation for the period 2006-08 was set below 2.5% for the end of 2006 and below 2% for end-2007 and end-2008. The NBS also defined exemptions from achieving the inflation target. In December 2005, the actual year-on-year inflation rate stood at 3.9%, which was within the limits defined in the monetary programme. In December 2006, however, the actual inflation rate reached 3.7%, which was 1.2 percentage points more than the target figure.

The acceleration of inflation and the exceeding of the inflation target were mainly caused by higher--than-expected increases in energy and food prices. Energy prices were affected by a marked increase in regulated prices, resulting from commodity price developments on the world markets, when the price of oil in Slovak koruna reached a year-on-year growth rate of 40% in 2006, compared with the estimated 5% in the Monetary Programme for the Period until 2008, where the inflation target was set. Food prices were affected in 2006 by the poorer-than-expected harvest, accompanied by an increase in the excise duty on cigarettes, though the monetary programme predicted such tax increases for 2007-2008. The year-on-year rate of increase in non-energy industrial goods prices was somewhat faster and was caused by steeper regulated price increases in health services (pharmaceuticals) during 2006.

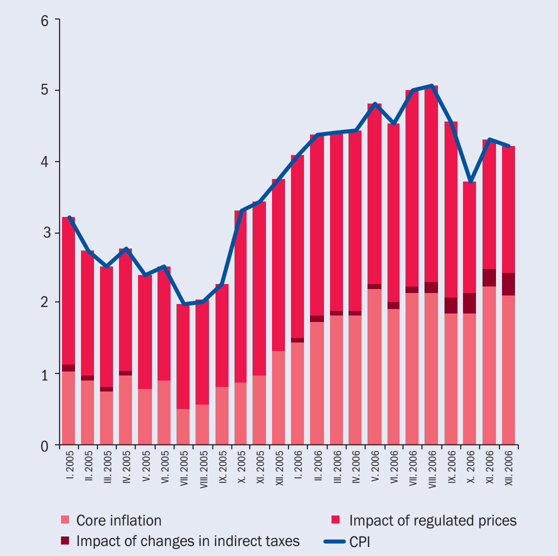
The above stated factors resulted from commodity price developments on the world markets in the form of increased regulated energy prices and increased regulated prices in health services, as well as from increased excise duties on cigarettes and the climatic conditions (bad harvest). These factors belong to the exemptions from the inflation target, which are exactly defined in the Monetary Programme of the NBS for the Period until 2008 and as such are out of influence of NBS monetary policy. Hence, the NBS focused first

Table 2 **Consumer price developments in terms of the HICP (average for the period)**
(year-on-year changes in %)

	2005	2006				
		Q1	Q2	Q3	4Q	Year
Total	2.8	4.2	4.6	4.8	3.5	4.3
Goods	1.6	4.5	5.1	5.3	3.7	4.6
Industrial goods	3.0	6.9	7.0	6.7	3.6	6.0
Non-energy industrial goods	-0.7	-0.3	0.4	1.1	1.1	0.6
Energy	8.2	16.5	15.7	14.1	6.7	13.1
Foodstuffs	-0.7	0.5	2.1	2.7	3.8	2.3
Processed food (including alcohol and tobacco)	-1.7	-0.2	0.7	1.9	3.2	1.4
Unprocessed food	1.1	2.1	4.7	4.3	5.1	4.0
Services	5.5	3.7	3.5	3.9	3.1	3.5
Core inflation (excluding energy and unprocessed food prices)	1.7	1.5	1.9	2.6	2.4	2.1
Total, excluding energy	1.6	1.6	2.1	2.7	2.7	2.3

Source: NBS calculations based on data from the Statistical Office of the SR.

Chart 25 **Structure of CPI inflation (percentage points)**



Source: Statistical Office of the SR and NBS calculations.

and foremost on the mitigation and/or elimination of the impact of second-round factors, especially regulated price increases, in order to prevent price contagion from spreading to other components of the consumer basket.

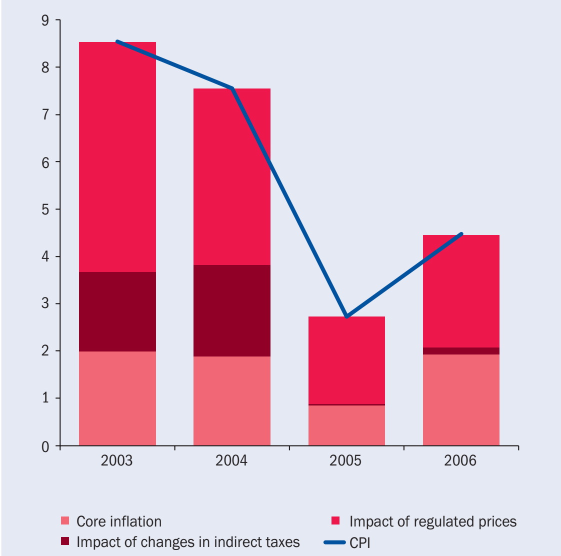
Goods

As in previous years, the increase in goods prices in 2006 was stimulated by energy prices. The most significant increases took place in regulated prices (electricity, gas, and other energy prices, which rose by an average of 14.9%) and fuel prices, which were on average 5.5% higher than in 2005. The prices of non-energy industrial goods increased during the year by an average of 0.6%, while the year-on-year rate of increase gradually accelerated over this period. Within the structure of this sub-aggregate, the steepest increases occurred in the prices of non-durable industrial goods (an average of 4.5%), while the prices of durable industrial goods dropped by 5.5%. Food prices rose by an average of 2.3%, due to increases in both processed and unprocessed food prices (1.4% and 4.0% respectively).

Services

In services, the most rapid increases were recorded in prices for services related to housing (an average of 5.8%) and prices for other services (6.3%). The only category of services to record a price fall was post and telecommunications, where prices dropped during the year by an average of 1.1%.

Chart 26 **Changes in the structure of CPI inflation (percentage points)**

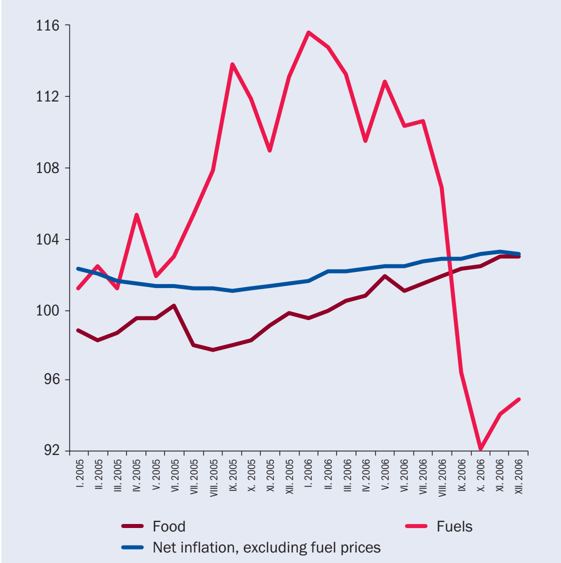


Source: Statistical Office of the SR and NBS calculations.

Inflation as measured by the national Consumer Price Index

In 2006 consumer prices increased more dynamically than in 2005, with the year-on-year inflation rate expressed in terms of the Consumer Price Index (CPI) reaching 4.5% on average (compared with 2.7% in 2005). In December 2006, consumer prices recorded a year-on-year rise of 4.2% (compared with 3.7% in December 2005).

Chart 27 **Year-on-year changes in the prices of core inflation components (year-on-year growth in %)**



Source: Statistical Office of the SR.

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Table 3 **Consumer price developments** **(year-on-year change)**

	2005		2006				
	Dec.	Year	Mar.	June	Sep.	Dec.	Year
Total in %	3.7	2.7	4.5	4.6	4.6	4.2	4.5
Regulated prices in %	11.1	8.2	11.2	11.3	11.0	7.5	10.5
Share of total in percentage points[1)]	2.44	1.84	2.55	2.53	2.48	1.76	2.37
Impact of changes in indirect taxes on non-regulated prices – *Share of total in percentage points*	0.00	0.03	0.08	0.08	0.26	0.31	0.15
Core inflation in %	1.7	1.1	2.4	2.5	2.4	2.7	2.5
Share of total in percentage points[1)]	1.29	0.86	1.82	1.93	1.83	2.12	1.93
of which:							
Food prices in %	-0.2	-1.2	0.5	1.0	2.4	3.0	1.5
Share of total in percentage points[1)]	-0.03	-0.22	0.07	0.14	0.38	0.46	0.22
Tradable goods in %[1)]	-0.2	-2.0	0.3	0.4	-1.0	-1.0	-0.2
Share of total in percentage points[1)]	-0.06	-0.36	0.09	0.14	-0.33	-0.32	-0.05
Tradable goods, excluding fuels in %[1)]	-1.7	-2.0	-1.3	-0.7	-0.5	-0.5	-0.8
Share of total in percentage points[1)]	-0.53	-0.61	-0.38	-0.22	-0.16	-0.15	-0.25
Fuels in %	13.2	6.3	13.3	10.4	-3.5	-5.1	6.0
Share of total in percentage points[1)]	0.47	0.25	0.47	0.36	-0.16	-0.17	0.20
Market services in %[1)]	5.1	6.0	6.2	6.1	6.6	7.3	6.5
Share of total in percentage points[1)]	1.37	1.43	1.66	1.64	1.78	1.98	1.75
Net inflation (excluding the impact of changes in indirect taxes)	2.1	1.8	2.9	2.9	2.4	2.7	2.8
Share of total in percentage points[1)]	1.32	0.95	1.75	1.79	1.46	1.65	1.71
Net inflation, excluding fuels (excluding the impact of changes in indirect taxes) in %	1.5	1.5	2.2	2.5	2.8	3.2	2.6
Share of total in percentage points[1)]	0.84	0.74	1.28	1.42	1.62	1.83	1.50

Source: Statistical Office of the SR.
1) NBS calculations based on data from the Statistical Office of the SR.

The acceleration in the year-on-year rate of consumer price increase in 2006 was caused by an increase in price dynamics in most of the basic consumer basket categories.

Price levels in 2006 were, as in previous years, mainly affected by adjustments to regulated prices. On average, administrative measures (changes in regulated prices) accounted for approximately more than 50% of the overall price increase in 2006. The accelerating increases in regulated prices were probably also reflected in the second-round effects of prices for market services, whose year-on-year dynamics gradually accelerated during the year. The prices of tradable goods recorded a slowdown in the year-on-year rate of decline.

Regulated prices

One of the determining factors in consumer price developments was, as in previous years, the implementation of administrative measures in the area of regulated prices. The year-on-year dynamics of regulated prices reached an average of 10.5% in 2006 (compared with 8.2% in 2005). January 2006 saw increases in regulated prices for electricity, gas, heat, water, sewage disposal, and health services. Price levels also increased during the year for transport and education. The price of heat was raised with effect from October and that of gas from November.

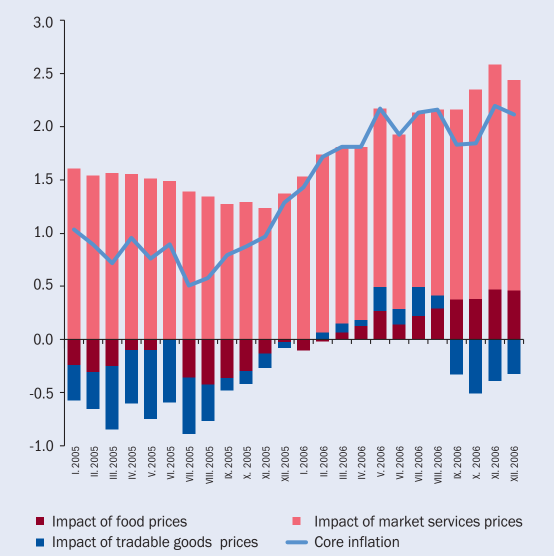
Changes in indirect taxes

Indirect tax rates were modified in 2006. In the first few months, year-on-year price dynamics were affected by an increase in the excise duty on alcohol, followed by an increase in the excise duty on cigarettes in August.

Core inflation

In 2006 core inflation reached an average of 2.5%, representing a rise of 0.8 of a percentage point in

Chart 28 **Structure of the 12-month core inflation rate (percentage points)**



Source: Statistical Office of the SR and NBS calculations.

Chart 29 **Changes in the structure of the 12-month core inflation rate (percentage points)**

Source: Statistical Office of the SR and NBS calculations.

comparison with the previous year. In December 2006, the year-on-year rate of core inflation stood at 2.7% (compared with 1.7% in December 2005).

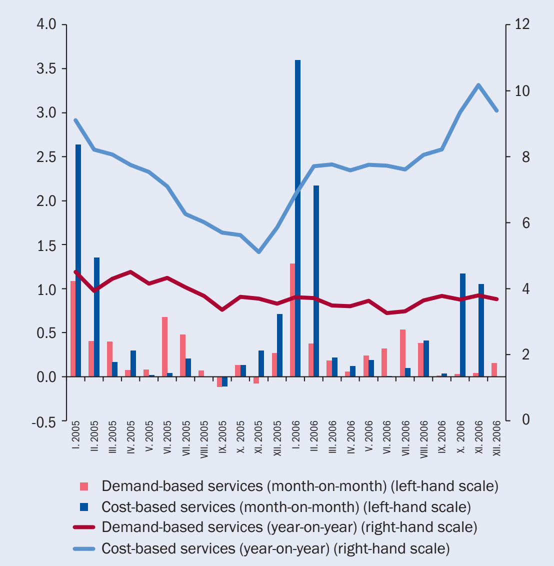
Within the basic structure of core inflation, prices for market services were the determining factor in the price increase (making the most significant contribution to core inflation), for they probably reflected the second-round effects of regulated price increases (growth in prices for services related to housing).

Food prices, as a component of core inflation, recorded a gradual acceleration in year-on-year dynamics throughout the year. This development was a reflection of the gradual increase in the dynamics of bread and pastry prices, vegetable prices (mainly potatoes), and a slowdown in the year-on-year decline in meat prices.

Core inflation was dampened by the prices of tradable goods, which dropped year-on-year by an average of 0.2% in 2006. The prices of tradable goods excluding fuels fell by an average of 0.8% during 2006. Thus, the pace of price fall slowed in comparison with the previous year. An upward effect on tradable goods prices in the first half of the year was exerted by fuel prices, which, however, acted as a disinflationary factor in the second half. They reacted to changes in oil prices and the exchange rate of the koruna against the dollar. Fuel prices recorded an average year-on-year rate of increase of 6.0%.

The year-on-year dynamics of prices for market services accelerated during the year, due primarily to domestic cost factors. The acceleration was probably a reflection of regulated price increases, mainly in heat and gas prices at the beginning and end of 2006. Prices for market services recorded an average year-on-year increase of 6.5%, compared with 6.0% in 2005. The developments in services prices showed no signs of excessive demand-based pressures, when the steepest year-on-year increase occurred during the year in prices for services related to housing. The year-on-year dynamics of prices for demand-based services fluctuated at roughly the same level throughout 2006.

Chart 30 **Prices for cost-based and demand-based market services (year-on-year growth in %)**



Source: Statistical Office of the SR and NBS calculations.

Table 4 **Year-on-year developments in producer prices (average for the period)** (%)

	2005	2006				
		Q1	Q2	Q3	Q4	Year
Industrial producer prices	4.7	9.5	9.6	8.4	6.1	8.4
Raw materials prices	6.0	43.0	47.2	48.6	19.2	38.4
Manufacturing products prices	2.1	2.1	2.5	2.6	1.2	2.1
Prices of electricity, gas, steam, and hot water	8.3	17.2	16.4	13.6	11.2	14.5
Construction prices	4.3	3.8	3.8	4.0	4.0	3.9
Building materials prices	4.4	0.9	1.8	3.9	5.3	3.0
Agricultural products prices	-2.4	-1.7	-1.3	1.3	-0.3	-0.2
Prices of plant products	-10.8	-11.6	-6.8	6.5	0.3	1.1
Prices of animal products	1.4	0.3	-0.8	-1.8	-0.5	-0.7

Source: Statistical Office of the SR.

Producer prices

Producer price developments in 2006 were affected by several factors, the most important being a marked increase in the prices of refined oil products in the first eight months and the related rise in energy prices. In May, producer prices started to reflect the dampening effect of the Slovak koruna's gradual appreciation vis-à-vis the US dollar. The downward effect on food prices of competition among retail chains weakened in the course of 2006. As a result of these factors, the dynamics of industrial producer prices increased, while agricultural prices recorded smaller decreases than in the previous year. Prices for construction work and building materials increased at a slower rate than a year earlier.

Industrial producer prices

The faster year-on-year rate of increase in industrial producer prices in 2006 was mainly a result of external cost factors. The oil-price factor, which culminated in August, caused steeper year-on-year increases in electricity, gas, steam, and hot water prices than a year earlier (an average of 14.5% in 2006, compared with 8.3% in 2005). The prices of manufacturing products rose in 2006 to the same extent as in the past year. Raw materials prices continued to increase strongly until October 2006, but had no substantial impact on the level of industrial producer prices, due to their small weight.

Energy price developments in 2006 were mostly influenced by increases in prices for gas production and the distribution of gaseous fuels by pipeline (an average of 22.7%, compared with 21.6% in 2005), prices for the production and distribution of steam and hot water (an average of 18.4%, compared with 7.8% in 2005), and prices for the generation and supply of electricity (an average rise of 9.1%, compared with 1% in 2005). Prices for water treatment and supply increased in 2006 at a slower rate (by 2 percentage points, to 9.6%).

The same year-on-year rise in manufacturing products prices as a year earlier (an average of 2.1%) was a result of accelerated increases in the prices of electrical and optical equipment (by 2.3 percentage points, to 1.7%) and paper products (by 1.9%, after stagnating a year earlier). On the other hand, slower increases than a year earlier were recorded in the prices of refined oil products (by 11.7 percentage points, to 13.1%), base metals and finished metal products (by 4.2 percentage points, to 3%), and chemical products (by 2.6 percentage points, to 1.3%). On a year-on-year basis, food prices had a weaker influence on manufacturing products prices than a year earlier, despite their considerable weight, close to one third (an average fall of 0.4% in 2006, compared with 4% in 2005).

Construction prices

The rate of increase in construction prices slowed somewhat in 2006, by 0.4 of a percentage point in comparison with the previous year, to an average of 3.9%. Prices for construction repair and maintenance work rose by an average of 4.1%; those for work on new construction, modernisation, and reconstruction projects in residential and civil engineering construction increased by an average of 3.9%.

The rise in the prices of materials and products used in construction (material and products of domestic industrial producers) also slowed in comparison with the previous year (by 1.4 percentage points, to 3%). The average year-on-year increase in the prices of materials used in construction repair and maintenance work slowed by 0.9 of a percentage point (to 3%) and the prices of materials used in new construction, modernisation, and reconstruction projects slowed by 1.5 percentage points to 3% as well.

Agricultural prices

The prices of agricultural products dropped in 2006 by 0.2% year-on-year and had a weaker influence than a year earlier, mainly due to a rise in the price of plant products (an average of 1.1%, compared with a fall of 11% in 2005). The prices of animal products dropped year-on-year by an average of 0.7%.

Price developments in plant production were mainly connected with rises in the prices of potatoes (23.5%), oilseeds (12.2%), vegetables (2.9%), and cereals (2.6%).

Developments in animal products prices were affected by drops in the prices (for live animals) of fish (16.7%), poultry (7.1%), and unpasteurised cow milk (0.7%) on the one hand, and by increases in the prices of eggs (3.2%), beef including veal (2.5%), and pork (0.3%) on the other hand.

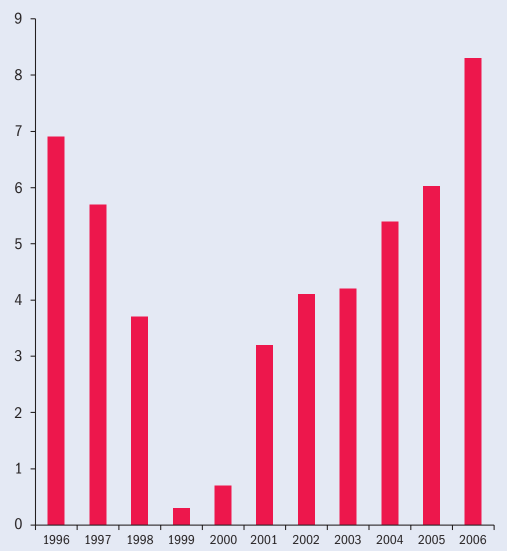
2.2.2 Gross domestic product

GDP deflator

The general price increase, expressed as an increase in the GDP deflator, reached 2.7% in 2006, which was 0.3 of a percentage point more than in 2005. Developments in the GDP deflator were primarily influenced by the faster year-on-year increase in consumer prices.

An upward effect on the GDP deflator was exerted by the domestic demand deflator and a dampening effect was produced by the relationship between the export and import deflators (the prices of exported goods and services rose at a slower pace than the prices of imported goods and services from foreign supply). The growth in the domestic demand deflator was influenced by the prices of final consumption components.

Chart 31 **Annual real GDP growth (year-on-year growth in %)**



Source: Statistical Office of the SR.

The growth in the GDP deflator was dampened by price developments in foreign trade. Developments in the exchange rate of the Slovak koruna and other price factors on foreign markets led to smaller increases in the export and import deflators (2.2% and 3.6% respectively) in comparison with the domestic price level.

Gross domestic product

According to a revised estimate of the Statistical Office of the SR, gross domestic product (GDP) increased year-on-year by 8.3% at constant prices. Compared with 2005, the pace of economic growth accelerated by 2.3 percentage points.

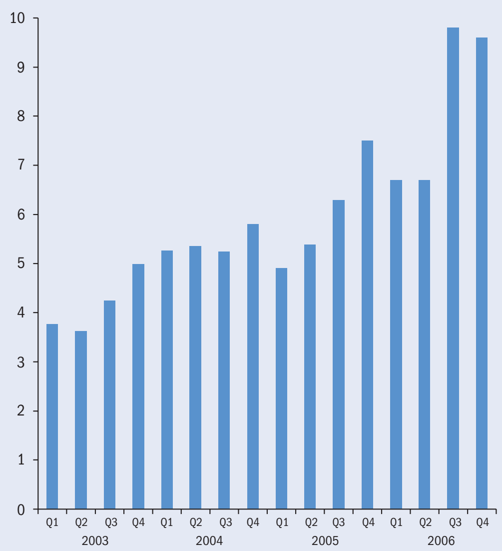
In terms of use, economic growth in 2006 was influenced by both domestic and foreign demand. The growth in foreign demand was 1.5 times faster than in 2005. In terms of production, development of the real economy was mostly influenced by economic activity

Table 5 **Developments in the GDP deflator (index, same period a year earlier = 100, average for the period)**

	2005	2006				
		Q1	Q2	Q3	Q4	Year
Consumer prices	102.7	104.3	104.6	104.9	104.1	104.5
Industrial producer prices	104.7	109.4	109.6	108.4	106.0	108.4
GDP deflator	102.4	101.8	103.6	103.7	101.7	102.7
Export deflator	98.1	103.8	103.3	102.3	99.8	102.2
Import deflator	98.4	106.3	104.4	103.3	101.2	103.6

Source: Statistical Office of the SR.

Chart 32 **Quarterly real GDP growth (year-on-year change in %)**



Source: Statistical Office of the SR.

in manufacturing, where the strong growth continued in the manufacture of machines, electrical equipment, and transport vehicles, as well as in trade, real estate, renting, and business activities. The nominal volume of GDP created in the period under review amounted to SKK 1,636.3 billion, which was 11.2% more than a year earlier.

Broken down by quarter, real economic growth accelerated during 2006 from 6.7% in the first and second quarters to 9.8% in the third quarter, and to 9.6% in the fourth quarter.

The development of domestic and foreign demand led to growth in aggregate demand (12.9% at constant prices, compared with 10.9% in 2005). Within the structure of aggregate demand, the share of foreign demand increased year-on-year by 3.1 percentage points (to 49.1%), to the detriment of domestic demand.

Regarding aggregate demand formation, economic growth in 2006 was promoted by both domestic demand and net exports. Aggregate supply also reacted to the increased foreign demand, which led to accelerated growth in GDP as well as imports. The openness of the Slovak economy, expressed in terms of the ratio of exports and imports of goods and services to nominal GDP, reached 176% in 2006, representing a year-on-year increase of 16.4 percentage points.

Supply side of GDP

GDP generation in 2006 was mostly influenced by gross value added creation, which grew year-on-year

Table 6 **Aggregate demand and its coverage** **(constant 2000 prices)**

	Volume in billions of SKK		Structure in %	
	2005	**2006**	**2005**	**2006**
Aggregate demand	2,288.4	2,583.4	100.0	100.0
Domestic demand	1,235.9	1,312.9	54.0	50.9
Foreign demand	1,052.5	1,270.5	46.0	49.1
Coverage of aggregate demand				
Domestic supply	1,177.9	1,275.3	51.5	49.4
Foreign supply	1,110.5	1,308.2	48.5	50.6

Source: Statistical Office of the SR.
Note: Domestic demand includes statistical discrepancies. Foreign demand includes the exports of goods and services. Domestic supply represents GDP and foreign supply is formed by imports of goods and services.

Table 7 **Breakdown of GDP creation by component (index, same period a year earlier = 100, const. 2000 prices)**

	2005	2006				
	Year	**Q1**	**Q2**	**Q3**	**Q4**	**Year**
Gross output	101.9	110.1	110.7	114.0	119.4	113.7
Intermediate consumption	99.8	110.9	112.2	118.3	121.6	115.8
Gross value added	104.9	109.0	108.6	108.6	116.3	110.6
Net taxes on products[1)]	115.2	91.2	93.6	121.0	69.2	91.4
GDP	106.0	106.7	106.7	109.8	109.6	108.3

Source: Statistical Office of the SR.
Note: The growth indices are calculated from figures expressed in millions of SKK.
1) VAT, excise taxes and import taxes minus subventions.

Table 8 **Sectoral breakdown of gross domestic product (index, same period a year earlier = 100, constant 2000 prices)**

	2005 / 2004	Q1 06 / Q1 05	Q2 06 / Q2 05	Q3 06 / Q3 05	4.Q 06 / 4.Q 05	2006 / 2005
Gross domestic product	106.0	106.7	106.7	109.8	109.6	108.3
of which:						
Agriculture, hunting, forestry, and fishing	115.7	98.7	99.6	103.4	107.4	102.6
Industry in total	116.0	104.0	108.4	114.6	115.2	110.6
Mining and quarrying	110.0	71.8	76.1	72.7	81.0	75.4
Manufacturing	122.3	104.7	107.7	113.4	116.6	110.7
Electricity, gas, and water supply	81.8	103.5	121.1	135.8	108.0	114.7
Construction	104.4	103.5	105.5	106.5	122.1	109.8
Services in total	96.6	115.4	110.2	105.4	117.3	111.8
Trade	103.5	134.0	124.5	106.8	136.1	122.8
Hotels and restaurants	118.1	112.9	105.8	112.9	111.0	110.5
Transport, storage, post and telecommunications	99.4	107.8	102.4	109.3	115.7	109.2
Financial intermediation	81.9	103.4	103.9	123.0	114.2	110.3
Real estate, renting, and business activities	88.2	114.7	110.6	96.0	114.3	108.8
Public administration, defence, compulsory social security	102.4	108.9	96.9	106.3	106.8	104.7
Education	96.3	106.5	101.5	105.8	103.7	104.2
Health and social care	98.5	107.0	101.0	95.2	121.1	105.2
Other community, social, and personal services	98.8	123.2	118.3	109.1	124.6	118.9
Other[1)]	115.2	91.2	93.6	121.0	69.2	91.4

Source: Statistical Office of the SR.
1) Value added tax, excise duty, import tax, minus subsidies and imputed production of banking services (FISIM).

by 10.6% at constant prices (compared with 4.9% in the same period a year earlier). Its growth in the fourth quarter almost twofold exceeded the rates of growth in the first three quarters of 2006. Net taxes on products, including value added tax, excise duty, and import tax, minus subsidies, decreased by a total of 8.6% (in 2005 increased by 15.2%). GDP growth was thus connected with the increased gross output, coupled with intermediate consumption growth.

In 2006 value added growth was recorded in all sectors; two-digit real growth rates were achieved in trade (22.8%); other community, social, and personal services (18.9%); industry (10.6%); hotels and restaurants (10.5%); and financial intermediation (10.3%).

In industry, value added growth was a result of year-on-year increases in value added in electricity, gas, and water supply (14.7%), and in manufacturing production (10.7%). The growth in value added in manufacturing was mainly stimulated by the production of machines, electrical equipment, and transport vehicles.

Demand side of GDP

In terms of use, the structure of economic growth in 2006 was influenced by both domestic and foreign demand. Foreign demand grew in real terms by 20.7%, and thus increased the export performance of the economy. Economic growth was also stimulated by domestic demand, but its pace lagged behind the figure recorded a year earlier.

Within the scope of domestic demand, the year 2006 saw the most rapid growth in investment demand (8.2% in real terms), which was, however, more than 50% slower than in the previous year. The growth in the "consumption" component of demand was 0.6 of a percentage point faster than a year earlier, which was mainly a result of growth in general government final consumption (4.1% in real terms). The dynamics of household final consumption weakened year-on-year by 0.9 of a percentage point.

Domestic investment demand

Gross capital formation increased by 8.2% (at constant prices), due to growth in fixed investments (7.3% year-on-year) and growth in inventories, whose annual increase (SKK 33.1 billion at constant prices) exceeded the figure for 2005 by approximately SKK 5.2 billion. Within the structure of inventories, all components increased in 2006, with the most rapid

2

Table 9 **Development of gross domestic product by use (index, same period a year earlier = 100, constant 2000 prices)**

	2005	2006				
		Q1	Q2	Q3	Q4	Year
Gross domestic product	106.0	106.7	106.7	109.8	109.6	108.3
Domestic demand	108.6	108.1	104.5	109.2	104.1	106.4
Final consumption	105.0	106.8	105.9	105.0	104.9	105.6
– households	107.2	106.6	105.9	106.5	106.1	106.3
– general government	99.4	107.8	106.6	101.2	102.3	104.1
– non-profit institutions serving households	96.9	100.5	95.6	96.3	95.0	96.8
Gross capital formation	118.6	111.7	101.4	119.3	101.9	108.2
Gross fixed capital formation	117.5	113.8	103.6	106.7	107.0	107.3
Exports of goods and services	113.8	117.7	118.1	123.8	122.6	120.7
Imports of goods and services	116.6	119.6	114.0	122.9	115.3	117.8

Source: Statistical Office of the SR.

increases recorded in work-in-progress and materials inventory.

Gross fixed capital formation was mostly affected by the purchase of new fixed assets (a growth of 9.9% at constant prices). Looking at the breakdown of fixed assets by the sector of national accounts, their increases were most significantly influenced by the investment activities of non-financial corporations, which comprised both foreign and domestic investments. They were also supported by the financial results of non-financial corporations, whose profits increased year-on-year by 25.8% in 2006 (compared with 16.4% in 2005). The largest amount of funds (75.5% of the total volume) was invested by non-financial corporations through the acquisition of new fixed assets. Most investments were made by entrepreneurial entities in manufacturing, the power industry, real estate and business activities, hotels and restaurants, and in transport, post and telecommunications. The growth in gross fixed capital formation in real terms was also supported by the investment activities of households (a growth of 7.8% at constant prices) and the general government sector (a growth of 1.1% at constant prices).

According to revised data from the Statistical Office of the SR, investment in machines grew in real terms by

Table 10 **Structure of gross fixed capital formation in 2006**

	Gross fixed capital formation (SKK millions)	Proportion (%)	Index 2006/05	Index 2005/04
Economy of the SR in total:	432,084	100.0	107.3	117.5
of which (by sector):				
Non-financial corporations	302,598	70.0	108.1	121.4
Financial corporations	7,524	1.7	104.1	109.3
General government	32,054	7.4	101.1	91.6
Households	88,837	20.6	107.8	118.2
Non-profit institutions	1,071	0.2	88.6	115.0
of which (by production):				
Machinery	230,277	53.3	115.2	96.0
of which: metal products and machines	180,592	41.8	110.9	105.3
transport equipment	49,685	11.5	133.9	69.1
Buildings and structures	172,606	39.9	98.3	155.2
of which: residential buildings	43,277	10.0	96.5	221.4
other structures	129,329	29.9	98.9	140.9

Source: NBS calculations based on data from the Statistical Office of the SR.
Note: Amounts and proportions are at current prices, indices at constant 2000 prices.

Table 11 **Investments and savings** (%, current prices)

	2005	2006
Savings ratio[1)]	24.1	24.3
Gross investment ratio[2)]	29.2	29.0
Fixed investment ratio[3)]	26.8	26.4
Coverage of investments by savings[4)]	82.6	83.6

Source: NBS calculations based on data from the Statistical Office of the SR.
1) Ratio of gross domestic savings (GDP less final consumption in total) to GDP.
2) Ratio of gross capital formation to GDP.
3) Ratio of gross fixed capital formation to GDP.
4) Ratio of gross domestic savings to gross investment.

15.2%, while investment in construction declined in real terms by 1.7%. Investment in transport equipment grew more than threefold faster than investment in metal products and machines. Investment in construction was mainly affected by a decline in investment in residential buildings (by 3.5% in real terms), and thus its share in fixed investments decreased by 3.8% percentage points, to 39.9%.

The share of domestic savings in the financing of investment demand increased in 2006. There were almost 83 haliers worth of gross savings in the national economy for one koruna worth of gross investments in 2005; this ratio increased in 2006 to 84 haliers. This increase was a consequence of accelerated year-on-year growth in savings compared with the change in gross investments.

Domestic consumer demand

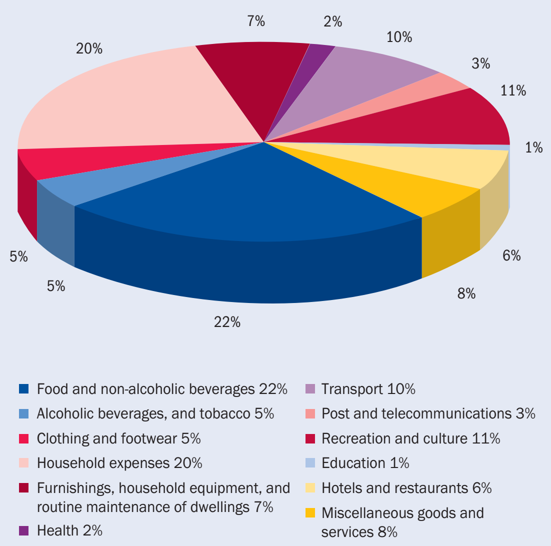
Final consumption expenditure in 2006 increased year-on-year by 5.6%, mainly in the household and general government sectors, while its growth was dampened by the consumption expenditure of non-profit institutions. The growth in general government final consumption was connected with the growth in wages, employment, and purchases of goods and services in the public sector (mainly in the first half of 2006), and welfare benefits in kind. Within the structure of final consumption, the dynamics of general government final consumption increased in 2006 (compared with the previous year) and the dynamics of household final consumption diminished.

Final consumption by households increased year-on-year by 6.3% in 2006, and its share of total GDP reached 54.0% (compared with 55% in 2005). Private household consumption followed a relatively smooth course in the individual quarters, which was connected with the growth in wages, employment, gross mixed income (remuneration for work and profits earned by small entrepreneurs), and the utilisation of credit facilities. The total receivables of monetary financial institutions from households as a share of their final consumption followed an increasing trend during 2006 and reached 25.3% (compared with 21.4% at the end of 2005).

An analysis of household final consumption in 2006 shows that the most significant year-on-year increases occurred in the expenditures of households on hotels and restaurants (13.4% at constant prices) and on furnishings, household equipment, and the routine maintenance of dwellings (13.0% at constant prices). In percentage terms, the largest consumption component (22%, as in 2005) was spending on food and non-alcoholic beverages. The second largest component was expenditure related to housing (20%), whose share in household consumption decreased by 1 percentage point in comparison with 2005.

The year-on-year growth in household final consumption was based primarily on consumer expenditures on food and non-alcoholic beverages; hotels

Chart 33 **Structure of household final consumption in 2006**



Source: Statistical Office of the SR.

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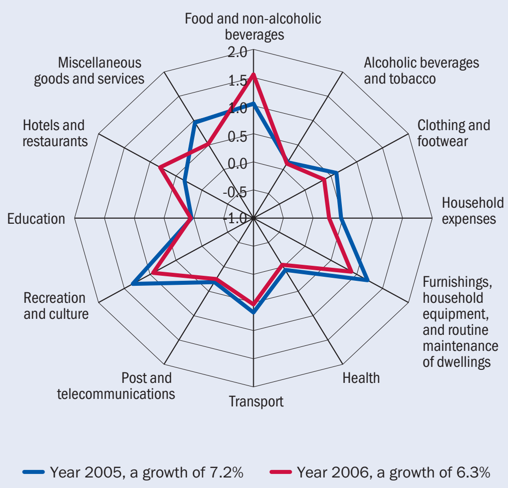
Table 12 **Generation and use of income in the household sector** **(current prices)**

	Volume in SKK billion		Index		Share in %	
	2005	2006	2005/2004	2006/2005	2005	2006
Compensation of employees (all sectors)	590.5	644.9	108.1	109.2	50.6	50.0
of which: gross wages and salaries	460.3	510.0	110.2	110.8	39.4	39.5
Gross mixed income	345.4	391.9	113.4	113.4	29.6	30.4
Property income – received	29.7	32.7	77.9	109.9	2.5	2.5
Social benefits	165.2	180.2	114.1	109.1	14.2	14.0
Other current transfers – received	36.0	40.1	97.1	111.4	3.1	3.1
Current income in total	1,166.9	1,289.8	109.0	110.5	100.0	100.0
Property income – paid	8.4	9.8	105.0	117.0	3.1	3.4
Current tax on income, property, etc.	46.9	48.8	112.6	104.1	17.1	16.8
Social contributions	189.4	197.0	105.9	104.0	69.0	68.0
Other current transfers – paid	29.8	34.4	93.3	115.2	10.9	11.9
Current expenditure in total	274.5	289.9	105.4	105.6	100.0	100.0
Gross disposable income	892.4	999.9	110.1	112.0	-	-
Adjustment for changes in the net equity of households in pension funds	12.1	29.9	406.7	246.7	-	-
Final consumption of households	829.8	927.2	110.0	111.7	-	-
Gross savings of households	74.7	102.7	126.7	-	-	-
Household savings ratio	8.4	10.3	-	-	-	-

Source: Statistical Office of the SR.

and restaurants; furnishings, household equipment, and the routine maintenance of dwellings; and recreation and culture. These four categories of consumption stimulated two-thirds of the growth in consumer demand in 2006 and recorded a slight rise in prices (up to 1%), which indicates that the current trend in household final consumption should not accelerate the rate of consumer price increase in the coming period.

Chart 34 **Contributions of individual consumer expenses to growth in household final consumption** **(percentage points)**



Source: NBS calculations based on data from the Statistical Office of the SR.

***Income and expenditure of households*[2]**

According to preliminary data from the Statistical Office of the SR, the current income of households reached SKK 1,289.8 billion in 2006, representing a year-on-year increase of 10.5% in nominal terms (5.7% in real terms). Compared with 2005, the rate of growth accelerated in nominal terms by 1.5 percentage points.

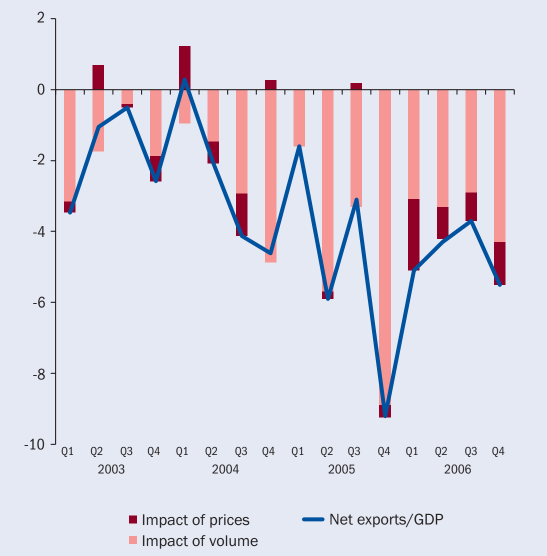
Within the scope of current income, the most rapid growth occurred in gross mixed income, other current transfers, and property income. The current expenditure of households (paid to other sectors and not used for direct consumption) totalled SKK 289.9 billion, representing a year-on-year increase of 5.6% in

[2] *Income from property received (interest, dividends, income from rented land, and other), other current transfers received (insurance compensation paid to households, lottery winnings, etc.), income from property paid (interest paid to households for loans and other payments of this type), other current transfers paid (payments for various types of non-life insurance, life and health insurance), social contributions (direct taxes and fees paid to the State budget, contributions paid to health insurance companies, the social security corporation, and the employment fund, etc.).*

Chart 35 **Propensity of households to consume and save** (%)

Source: Statistical Office of the SR, NBS calculations.

Chart 36 **Net exports as a share of GDP at current prices** (%)



Source: Statistical Office of the SR, NBS calculations.

nominal terms (1.1% in real terms). The year-on-year growth in current expenditure was mainly connected with increases in expenses related to property income and other current transfers paid. The smallest increase was recorded in social contributions.

With current expenditure being deducted from current income, the gross disposable income of households amounted to SKK 999.9 billion, representing a year-on-year increase of 12.0% (compared with 10.1% a year earlier). Of the disposable income, 92.7% was used for final consumption, the remainder went to gross savings, which increased year-on-year by 37.4%. The total increase in the dynamics of gross savings, which exceeded the dynamics of gross disposable income, was reflected in the ratio of gross household savings (10.3%), which was 1.9 percentage points higher than a year earlier (8.4%).

The exports and imports of goods and services achieved two-digit growth rates in 2006 (exports: 23.3%; imports: 22.0% at current prices). In nominal terms, net exports resulted in a deficit of SKK 76 billion (SKK 74.8 billion in 2005). Developments in import prices in foreign trade, as measured by the deflator of imports of goods and services, were mainly connected with the rising prices of energy-producing raw materials in the first three quarters of 2006. The prices of exported goods and services also increased, but to a lesser extent than import prices, since they were dampened by a fall in the export prices of transport vehicles. Data from preliminary quarterly national accounts indicate that nearly one quarter of the trade deficit (at current prices) was caused by unfavourable developments in the terms of trade.

The export performance of the Slovak economy improved year-on-year in 2006, when the exports of goods and services as a share of GDP at current prices reached 85.7%. Import intensity increased in comparison with export performance at a slightly slower rate, reaching 90.3%. The openness of the Slovak economy, expressed in terms of the ratio of exports and imports of goods and services to nominal GDP, stood at 176% last year.

Chart 37 **Export performance and import intensity** (%)

Source: Statistical Office of the SR.

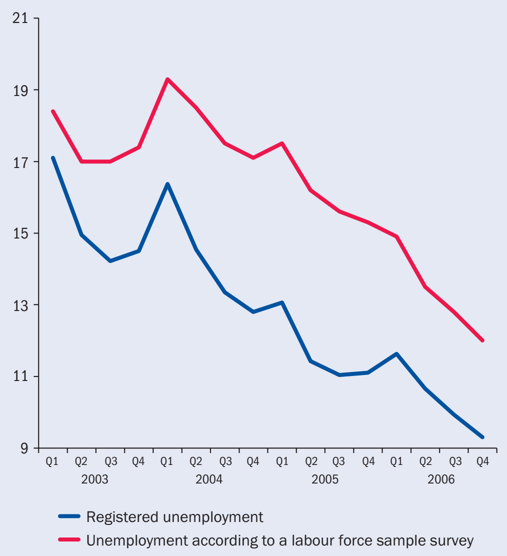
2.2.3 Labour market

Employment and unemployment

The favourable economic development in 2006 was also reflected in the level of employment. According to the results of a Labour Force Sample Survey (LFSS), the number of workers increased year-on-year by 3.8%, which represented an acceleration of 1.7 percentage points in comparison with 2005. Employment according to an LFSS was influenced by labour demand in the domestic part of the economy, when the number of persons working in the Slovak economy increased by 2.5%, as well as by the growing number of persons working abroad (by 26.1%). In terms of structure, overall employment in 2006 was substantially influenced by the favourable trend in the number of employees, which increased by 3.8%. The number of entrepreneurs increased year-on-year by 3.7%, due mainly to an increase in the number of entrepreneurs without employees (by 5%), while the number of entrepreneurs with employees dropped year-on-year by 0.3% (as in the previous year). According to the ESA 95 methodology, employment grew year-on-year by 2.3%, which represented an acceleration of 0.9 of a percentage point compared with the previous year. Looking at the breakdown of employment by sector, the year 2006 saw growing demand for labour in services, which led to dynamic employment growth in hotels and restaurants; real state, renting, and business activities; and trade (according to ESA 95). On the other hand, employment remained below the level of the previous year in financial intermediation and health care. In production sectors, employment grew rapidly in average terms in 2006 in construction, while employment in agriculture declined.

Chart 38 **Unemployment rate**

(%)



Source: Centre for Labour, Social, and Family Matters and the Statistical Office of the SR.

The strong demand for labour was also reflected in the favourable trend in unemployment. On the basis

Table 13 **Labour market indicators**

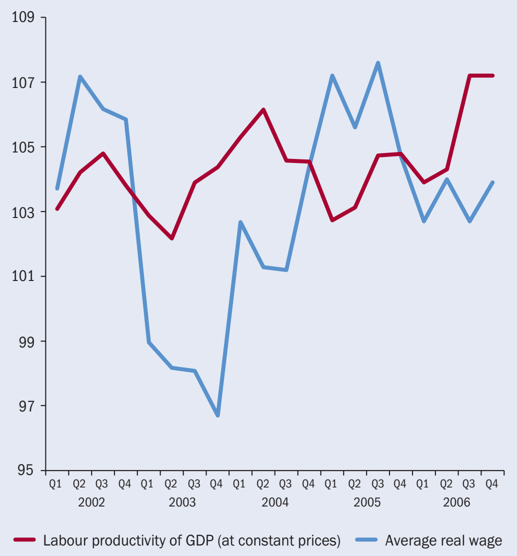
	2005	2006				
		Q1	Q2	Q3	Q4	Year
Nominal wage (SKK)	17,274	17,315	18,324	18,212	21,131	18,761
Nominal wage (index)	109.2	107.1	108.8	107.7	108.2	108.0
Real wage (index)	106.3	102.7	104.0	102.7	103.9	103.3
Compensation per employee in nominal terms, ESA 95 (index)	105.1	106.5	108.2	107.6	108.3	107.6
Compensation per employee in real terms, ESA 95 (index)	102.3	102.2	103.5	102.7	104.6	103.2
Labour productivity of GDP (index, current prices)	106.2	106.6	108.1	111.2	109.1	108.8
Labour productivity of GDP (index, constant prices)	103.8	104.6	104.3	107.2	107.2	106.0
Labour productivity of GDP, ESA 95 (index, current prices)	107.0	106.5	108.1	111.1	109.1	108.7
Labour productivity of GDP, ESA 95 (index, constant prices)	104.5	104.5	104.3	107.1	107.2	105.9
Employment according to statistical records (index)	102.2	102.0	102.3	102.4	102.2	102.2
Employment according to LFSS[1)] (index)	102.1	103.7	104.5	103.8	103.5	103.8
Employment according to ESA 95 (index)	101.4	102.1	102.3	102.5	102.2	102.3
Registered unemployment rate (%)	11.6	11.6	10.7	9.9	9.3	10.4
Unemployment rate according to LFSS (%)	16.2	14.9	13.5	12.8	12.0	13.3
Unit labour costs in nominal terms (ULC)	100.6	101.9	103.7	100.5	101.0	101.7
Consumer prices (average index)	102.7	104.3	104.6	104.9	104.1	104.5

Source: Statistical Office of the SR and NBS calculations based on data from the Statistical Office.
1) Labour force sample survey (LFSS).

of a labour force sample survey, the number of people out of work decreased year-on-year by 17.3% in 2006. This decrease was also reflected in the annual rate of unemployment, which reached 13.3% in 2006, representing a drop of 2.9 percentage points compared with 2005. The falling trend in unemployment was also confirmed by data on registered unemployment. According to the registers of Offices for Labour, Social Affairs, and Family, the average unemployment rate in 2006 stood at 10.4%.

The continuing year-on-year growth in labour supply (i.e. persons in productive and post-productive age) was mostly reflected in the increased number of economically inactive persons (i.e. persons outside the labour market) in 2006. As a result of this development, the rate of economic activity reached 59.1%, representing a year-on-year fall of 0.4 of a percentage point. Among the economically active population, the increasing share of persons in employment led to a rise in the employment rate, by 1.7 percentage points year-on-year in 2006 (to 59.4%).

Chart 39 **Developments in real wages and real labour productivity (index, same period a year earlier = 100)**



Source: Statistical Office of the SR, NBS calculations.

Wages and labour productivity

In 2006 the average monthly nominal wage in the Slovak economy increased year-on-year by 8.0%, to SKK 18,761. The rate of growth was 1.2 percentage points slower than in the same period a year earlier. The strongest nominal wage growth in 2006 took place in real estate, renting, and business activities (10.3%); public administration, defence, and compulsory social security (10.3%); financial intermediation (9.6%); agriculture and fishing (8.6%); education and health care (8.5% equally). Nominal wages in the entrepreneurial sector (broken down by the form of ownership) increased as follows: in enterprises with 20 and more employees by 8.8%, in small enterprises with up to 19 employees by 6.5%, in budgetary organisations by 14.8%, and in subsidised organisations by 7.7%. The average real wage increased year-on-year by 3.3% in 2006. Compared with the previous year, real wage dynamics weakened by 3.0 percentage points, which was due to a slowdown in nominal wage growth and higher average inflation than a year earlier. Real wages increased in all sectors of the economy.

Labour productivity increased in nominal terms by 8.8% and in real terms by 6.0% in 2006. Labour productivity followed a positive trend in relation to wages, when the dynamics of real labour productivity exceeded the rate of real wage growth by 2.7 percentage points.

Unit labour costs according to the ECB's methodology (ULC_{ECB}, defined as the ratio of growth in nominal compensation per employee to growth in real labour productivity based on ESA 95) increased year-on-year by 1.7% in 2006. Real unit labour costs ($RULC_{ECB}$, defined as the ratio of real compensation per employee to real labour productivity based on ESA 95) decreased year-on-year by 2.5%. The acceleration of ULC_{ECB} was caused by faster growth in compensation per employee, which was dampened by a slight increase in the dynamics of labour productivity.

2.2.4 Financial results of corporations

From the beginning of 2006, financial and non-financial corporations earned a cumulative profit of SKK 268.4 billion, representing a year-on-year increase of 6.7%. The profit earned by non-financial corporations grew year-on-year by 25.8%, to SKK 280.4 billion (according to preliminary data). Financial corporations recorded a loss of SKK 12.0 billion.

Among non-financial corporations, most profits in 2006 were generated by entrepreneurial entities in manufacturing (SKK 91.4 billion), trade (SKK 55.2 billion), and electricity, gas, and water supply (SKK 52.5 billion). Profits in transport, post and telecommunications reached SKK 31.8 billion, in real estate and renting activities SKK 21.8 billion, in construction SKK 14.4 billion, in mining and quarrying SKK 3.7 billion, in other community services SKK 3.3 billion, in health and social services SKK 2.8 billion, in agriculture and fishing SKK 2.2 billion, in hotels and restaurants SKK 1 billion, and in education SKK 0.1 billion. The profits earned by non-financial corporations increased year-on-year by SKK 57.5 billion. This increase was largely generated in manufacturing (SKK 16.3 billion);

Table 14 **Financial results of corporations**

	2005 SKK billions, current prices	2006 SKK billions, current prices	2005/2004 index	2006/2005 index
Financial results (before taxation)				
Non-financial and financial corporations in total	251.5	268.4	141.3	106.7
Non-financial corporations	222.9	280.4	117.4	125.8
Financial corporations	28.6	-12.0	-	-
Of which: NBS	-0.7	-45.1	-	-
Financial corporations, excluding NBS	29.3	33.1	149.3	113.0
Commercial financial institutions	16.9	19.7	120.3	116.6
Insurance corporations	3.4	4.4	99.9	129.2
Other financial intermediaries	9.0	9.0	127.6	100.3
Monetary financial institutions	16.2	-25.4	-	-
Of whitch: NBS	-0.7	-45.1	-	-
Commercial financial institutions	16.9	19.7	120.3	116.6

Source: Statistical Office of the SR and NBS calculations.

transport, post and telecommunications (SKK 14.5 billion); trade (SKK 13 billion); and in electricity, gas, and water supply (SKK 5.8 billion). Agriculture, including fishing, and education recorded a year-on-year change, from a loss to a profit.

Financial corporations recorded a loss of SKK 12.0 billion. Financial corporations, excluding the NBS, achieved a profit of SKK 33.1 billion, while the NBS recorded a total loss of SKK 45.1 billion. Within the scope of financial corporations excluding the NBS, commercial financial institutions generated a profit of SKK 19.7 billion. This was SKK 2.8 billion more than in the previous year. The profits of insurance corporations and pension funds increased year-on-year by SKK 1 billion, to SKK 4.4 billion. Other financial intermediaries earned a profit of SKK 9 billion and thus achieved the same financial result as in the previous year.

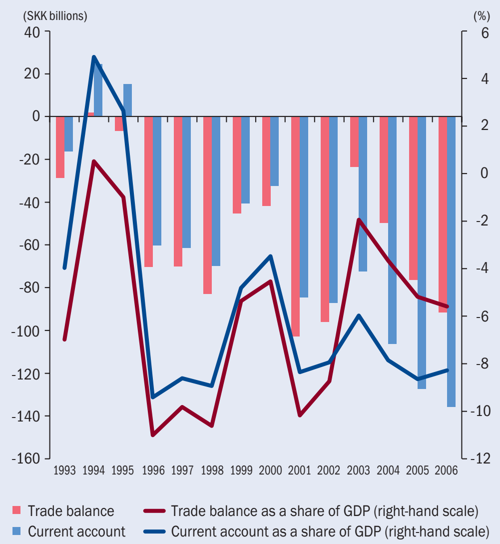
The negative financial result of the NBS was responsible for the losses of monetary financial institutions in 2006 totalling SKK 25.4 billion (in 2005 they achieved a profit of SKK 16.2 billion), while commercial financial institutions generated a total profit of SKK 19.7 billion.

2.3 Balance of payments

2.3.1 Current account

In 2006 the balance of payments on current account resulted in a deficit of SKK 135.6 billion, which was SKK 8.4 billion more than in 2005. This increase was largely due to a year-on-year deterioration in the trade balance, which was to a considerable extent offset by the growing surplus in the balance of services. The

Chart 40 **Balance of trade and current account developments**



Source: NBS and the Statistical Office of the SR.

Table 15 **Balance of payments on current account** **(SKK billions)**

	2006	2005
Balance of trade	-91.6	-76.3
Balance of services	19.7	9.9
Balance of income	-62.1	-61.3
Current transfers	-1.6	0.5
Current account in total	-135.6	-127.2
Current account as a share of GDP in %	-8.3	-8.6

Source: NBS and the Statistical Office of the SR.

Table 16 **Exports from January to December**

	Year-on-year change in billions of SKK		Contribution to the year-on-year change in % points	
	2006	2005	2006	2005
Raw materials	12.3	14.8	1.2	1.7
Chemicals and semi-finished goods	59.0	38.5	5.9	4.5
of which: Chemical products	16.4	12.2	1.6	1.4
Semi-finished goods	42.6	26.3	4.3	3.1
Machinery and transport equipment	166.6	36.0	16.8	4.2
of which: Machines	98.7	62.5	9.9	7.3
Transport equipment	67.9	-26.5	6.8	-3.1
Finished products	6.9	10.1	0.7	1.2
Exports in total	244.8	99.4	24.6	11.6

Source: NBS calculations based on data from the Statistical Office of the SR.

Table 17 **Imports during January to December**

	Year-on-year change in billions of SKK		Contribution to the year-on-year change in % points	
	2006	2005	2006	2005
Raw materials	44.0	32.8	4.1	3.5
Chemicals and semi-finished goods	54.8	21.7	5.1	2.3
of which: Chemical products	21.1	8.0	2.0	0.9
Semi-finished goods	33.7	13.7	3.1	1.5
Machinery and transport equipment	106.8	33.2	10.0	3.6
of which: Machines	77.6	37.9	7.2	4.1
Transport equipment	29.2	-4.7	2.7	-0.5
Finished products	54.5	41.0	5.1	4.4
of which: Agricultural and industrial products	19.9	22.1	1.9	2.4
Automobiles	5.6	1.7	0.5	0.2
Machines and electrical consumer goods	29.0	17.2	2.7	1.9
Imports in total	260.1	128.7	24.3	13.9

Source: NBS calculations based on data from the Statistical Office of the SR.

b.o.p. current account deficit reached 8.3% of GDP at current prices, i.e. 0.3 percentage points less than in 2005. The trade deficit as a share of GDP increased, from 5.2% to 5.6%.

The trade balance resulted in a deficit of SKK 91.6 billion. Despite a year-on-year increase in the deficit (by SKK 15.3 billion), the rate of export growth slightly exceeded the dynamics of imports.

According to preliminary data from the Statistical Office of the SR, goods were exported during 2006 in the total amount of SKK 1,239.4 billion, which was 24.6% more than in the previous year (30.1% in USD and 29.1% in EUR).

In goods exports, the growth rate from the previous year accelerated by 13 percentage points in 2006. Exports showed strong dynamics throughout the year and accelerated still further in the second half of 2006. Increased exports were recorded in a wide spectrum of goods in all basic commodity categories; steeper year-on-year increases mainly occurred in the exports of machines and transport equipment, and in a smaller degree in chemical products and semi-finished products.

The increased exports in the "machinery and transport equipment" category was the main factor in the year-on-year growth in exports. The growth in the category as a whole resulted from the growing exports of machines and growing exports in the automotive industry. Increased machine exports in comparison with 2005 were recorded from the first months of 2006; the rate of growth accelerated still further during the year. The acceleration took place mostly in the electronics industry, due to increased exports of television sets in particular. After a marked decline in automobile exports, which was partly a result of preparations (installation of production lines) for the manufacture of a new automobile model, there was an increase in output and exports in the automotive industry in 2006. The year-on-year increase was mainly attributable to the extension of production and the start of production by new automobile manufacturers.

The main factor in the dynamic year-on-year growth in the exports of chemical products and semi-finished goods was the continuation of positive trends from 2005. Strong growth was mainly recorded in the exports of iron and steel, iron and steel products, plastics, copper, aluminium, and related products.

The accelerated growth in raw material exports was promoted to a significant extent by the rising oil prices, which caused an increase in the export value of oil products. Oil prices rose at a slower rate than in 2005, which, coupled with the appreciation of the koruna against the US dollar, was the main reason behind the slowdown in the year-on-year growth in the entire “raw materials” category.

The weakest year-on-year growth occurred in the exports of finished products. The overall growth in exports in the “finished products” category was mostly supported by year-on-year increases in the exports of furniture, pharmaceuticals, and agricultural products, especially sugar, beverages, milk and dairy products.

The volume of goods imported in 2006 amounted to SKK 1,331.0 billion, representing a year-on-year increase of 24.3% (29.7% in USD and 28.8% in EUR).

In 2006 import dynamics lagged somewhat behind the rate of export growth, due to developments in the second half of the year, when imports, unlike exports, followed a decelerating trend. The total year-on-year increase in imports took place predominantly in machinery and transport equipment and chemical products and semi-finished goods. The year-on-year growth accelerated in all categories of goods under review.

In comparison with 2005, the strongest growth was recorded in the imports of machinery and transport equipment. The accelerating growth was supported by increased imports of machinery as well as transport equipment. The increased imports of transport equipment (compared with the previous year) were mainly connected with the increased production and exports of automobiles. Within the overall group this was supported by higher imports of electronic components and automatic data processing machines.

The imports of finished products recorded a larger increase than in 2005 as a result of steadily growing imports of machine engineering products and electrical consumer goods in particular, coupled with increased imports of industrial products (pharmaceuticals, clothes, and footwear) and, in a smaller degree, passenger cars. On the other hand, the imports of agricultural products grew at a slower rate than a year earlier (mainly as a result of lower tobacco and meat imports).

The main factor in the increased raw material imports was the rise in oil prices, which was reflected in the increased imports of oil and oil products. The strong correlation between oil prices and the price of natural gas also caused a rise in price levels and a consequent increase in the imports of this commodity. The growth in raw materials imports was also supported by increased electricity imports.

Trade in services resulted in a surplus of SKK 19.7 billion in 2006, when receipts from exported services increased by 17.5%, while payments for imported services grew by only 11.1%.

The increased services balance surplus was mainly caused by an increase in the positive balance of transport services and, in a smaller degree, the balance of tourism, accompanied by a decrease in the negative balance of “other services in total”.

Receipts from the international transport of goods and passengers amounted to SKK 56.5 billion (a year-on-year increase of 14.1%) and expenses totalled SKK 38.0 billion (an increase of 1.6%). In terms of volume, the largest item in transport services was still income from the transport of natural gas and oil (SKK 29.6 billion), which increased year-on-year by SKK 3.6 billion. The growth in transit receipts was significantly affected by a non-standard payment of withheld payments from 2004-2006, which took place in December 2006. Despite increased receipts from transit, the share of this group of services in total

Table 18 **Balance of services** (SKK billions)

	2006	2005
Transportation	18.5	12.1
Travel	13.6	11.3
Other services in total	-12.4	-13.5
Balance of services	19.7	9.9

Source: NBS.

income from transport slightly decreased on a year-on-year basis, to 52.4% in 2006.

In international transport services (railway, road, air, and waterborne transport, excluding transit), including services related to transport, a deficit of SKK 1.0 billion was recorded, 80.9% of which took place in payments for freight services, including trade costs, and 19.1% in expenses on passenger transport. Receipts had a similar structure: 84.9% came from freight transport services and 15.1% from passenger transport services provided. The year-on-year improvement in the balance of transport services excluding transit (by SKK 5.0 billion) was mainly caused by an improvement in air passenger transport (growth in receipts from air transport services and particularly a fall in the expenses of Slovak residents on services rendered by non-residents are connected with the development of air traffic in the SR). Within the scope of freight transport, the growth in receipts from road haulage services provided was offset by falling receipts from railway freight transport services provided, which caused a year-on-year decrease in the modest surplus in the balance of freight transport services.

The positive balance of foreign tourism increased year-on-year by SKK 2.3 billion. The increase in the balance surplus was caused by increased receipts, whose growth exceeded the growth in the expenses of Slovak residents on services related to tourism.

Foreign exchange receipts from foreign tourism reached SKK 45.0 billion, representing an increase of 20.0% compared with the level of 2005). The increase in foreign exchange receipts from tourism was supported by the increased total number of overnight stays by visitors from abroad. The main factor behind the growth in the number of overnight stays was the increased number of foreign tourists (accommodated visitors) compared with last year (by 6.4%), while the average number of overnight stays remained unchanged on a year-on-year basis (at 3.2). The strong growth in foreign exchange receipts was achieved despite the appreciation of the Slovak koruna against the euro, which was offset by its depreciation vis-à-vis the Czech koruna.

In 2006 the expenses of Slovak citizens on travel abroad reached SKK 31.4 billion, which was 19.2% more than in 2005. The number of Slovak citizens who travelled abroad increased year-on-year by 1.3%. The expenses of Slovak citizens on foreign travel were determined by the growth of real wages, the offer of reasonably priced trips, and partly by the appreciation of the koruna against the euro.

The balance of "other services in total" (telecommunications, construction, insurance, financial, renting, computer engineering, advertising, business, and technical services, etc.) remained in deficit as in previous years, but the deficit decreased by SKK 1.1 billion. The exports of these services grew by 18.9% and imports by 13.3% on a year-on-year basis. The decreasing deficit in the balance of "other services in total" was mainly supported by an increase in the surplus achieved in telecommunications services and partly by smaller shortfalls in computer engineering, legal, accounting, and consulting services. The total year-on-year decrease in the deficit in "other services in total" was, on the other hand, negatively affected by a deterioration in receipts from construction services provided and a marked increase in payments for financial services.

Table 19 **Balance of income** **(SKK billions)**

	2006	**2005**
Compensation of employees	30.8	28.0
Direct investment	-90.9	-82.8
of which: reinvested earnings	-23.8	-37.8
Portfolio and other investments	-2.0	-6.5
Balance of income	-62.1	-61.3

Source: NBS.

In 2006 the income balance resulted in a shortfall of SKK 62.1 billion, representing a slight deterioration in comparison with last year (by SKK 0.8 billion). The year-on-year deterioration was caused by an increase in the negative balance of income from investment, which exceeded the increase in the positive balance of compensation of employees.

Investment in Slovak equity securities paid foreign direct investors dividends in the amount of SKK 64.3 billion, representing a year-on-year increase of SKK 18.6 billion. The yields of foreign investors from capital invested in the territory of Slovakia (yield from foreign direct investment is calculated as yield from property including interest as a share of the volume of foreign direct investment) reached approximately 14.5%, which represented an increase in comparison with 2005, when the same ratio reached 11.0%. Investment in foreign equity securities paid Slovak investors SKK 1.1 billion in dividends (somewhat more than in the previous year). In contrast with dividends, the estimate of the part of earnings reinvested by foreign investors decreased year-on-year, to SKK 25.0 billion (a year earlier, reinvested earnings were estimated at SKK 39.0 billion) and caused a marked slowdown in the growth of deficit in the balance of income from direct investment.

The balance of income from portfolio investment resulted in a surplus of SKK 7.6 billion, representing an improvement of SKK 5.4 billion in comparison with 2005. The year-on-year increase in the surplus was most significantly influenced by the growth of receipts from commercial bank assets.

The deficit in the balance of other investments deepened year-on-year by SKK 0.7 billion. The year-on-year change was mainly caused by a year-on-year increase in payments (by SKK 0.4 billion), with a substantial part formed by an increase in interest payments (on both loans and deposits received). The year-on-year decline in receipts (by SKK 0.3 billion) was caused by an interest rate cut for short-term financial loans.

Within the overall income balance, the deterioration in the balance of income from investment was partially alleviated by an increased surplus in compensation of employees. During short-term stays abroad, Slovak workers earned a total of SKK 32.2 billion (according to NBS calculations). The increase in the incomes of Slovak citizens abroad exceeded the increase in the incomes of foreign citizens in Slovakia, which led to a year-on-year increase in the positive balance of compensation of employees (by SKK 2.8 billion).

In 2006 the balance of current transfers resulted in a deficit of SKK 1.6 billion. The year-on-year change (by SKK 2.1 billion) from a modest surplus last year to a deficit was a result of the fact that the deepening of the deficit in private transfers (caused by increased payments of benefits, distraint fees, and bails) surpassed the increase in the surplus in government transfers resulting from an increase in receipts from the EU budget.

2.3.2 Capital and financial account

The capital and financial account resulted in a surplus of SKK 32.4 billion, which was SKK 144.3 billion less than in the previous year. The surplus in the capital and financial account as a share of GDP decreased from 12.0% to 2.0%. The structure of financial flows also changed during the year: there was an outflow of short-term capital and an increased inflow in foreign direct investment.

The capital account, which comprises foreign assistance of investment nature granted by foreign governments or non-governmental entities and the purchase / sale of patents, licences, and copyrights, resulted in a deficit of SKK 1.2 billion, representing a modest increase in comparison with 2005. The year-on-year change was basically caused by the lower drawing of funds in the form of grants (in net terms).

In 2006 the total inflow in foreign direct investment (FDI) reached SKK 112.9 billion, representing an increase of SKK 52.4 billion compared with 2005.

The inflow of equity capital into the SR reached SKK 56.0 billion, which was SKK 32.8 billion (141.4%) more than in the same period a year earlier. The increased inflow of equity capital in comparison with the previous year was caused almost exclusively by privatisation proceeds (the privatisation by Enel of Slovenské elektrárne in April), while the inflow of equity capital in 2005 came exclusively from sources other than privatisation. With this fact taken into account, the inflow of equity capital into Slovakia (excluding

Table 20 **Balance of payments capital and financial account** **(SKK billions)**

	2006	2005
Capital account	-1.2	-0.6
Direct investment	112.9	60.5
SR abroad	-10.9	-4.9
of which: reinvested earnings	-1.2	-1.2
In the SR	123.8	65.4
of which: reinvested earnings	25.0	39.0
Portfolio investment and financial derivatives	43.4	-31.3
SR abroad	-18.1	-23.1
In the SR	61.5	-8.2
Other long-term investment	18.6	-15.0
Assets	5.3	-9.8
Liabilities	13.3	-5.2
Short-term investment	-141.3	163.1
Assets	-38.4	-4.6
Liabilities	-102.9	167.7
Capital and financial account in total	32.4	176.7

Source: NBS.

income from privatisation) increased by 7.8% (SKK 1.8 billion), due to a modest increase in demand among foreign investors.

In comparison with 2005, Slovak companies showed increased interest in investment abroad. The increase in the asset exposures of Slovak investors abroad in the form of foreign direct investment amounted to SKK 6.9 billion, when SKK 9.5 billion was achieved during 2006.

Estimated reinvested earnings (in net terms) reached SKK 23.8 billion and thus their weight in the balance of direct investments diminished to a significant extent. The share of reinvested earnings in the total FDI inflow reached 21.1% (or, after being adjusted for privatisation proceeds, 29.1%), compared with 62.5% in 2005.

The inflow of other capital (within FDI), which expresses the financial and trade relations between direct investors and direct investment companies, totalled SKK 42.6 billion. The marked year-on-year increase (SKK 40.5 billion) was connected with FDI inflows in previous years and made the most significant contribution to the higher total FDI inflow in 2006. The year-on-year increase in other capital inflows was caused by an increase in payables and a decrease in the receivables of domestic entities from direct investors.

In 2006 the largest FDI inflows (except privatisation) were allocated especially to the manufacturing industry and, in a smaller degree, to financial intermediation, wholesale and retail trade. Broken down by territory, most investments went to the Bratislava (mainly in connection with privatisation) and Žilina regions. In the case of the Žilina region, the inflow of funds was connected with the construction of an automobile assembly plant for KIA, which confirms the fact that, after Italy and Austria, the Korean Republic was the third most significant investor in 2006. The inflow of funds from this country in the form of foreign direct investment reached SKK 7.9 billion.

Portfolio investment resulted in a net inflow of SKK 43.4 billion in 2006, compared with a net outflow of SKK 31.3 billion in the previous year.

Demand for foreign securities among domestic portfolio investors declined in comparison with 2005. While in 2005, companies tended to invest in long-term bonds (insurance companies also belong to this category), the year 2006 saw the opposite trend, which led to a net inflow of SKK 0.7 billion from abroad. Banks also showed lower interest in investment in long-term securities. The decline in investment in debt securities within the corporate sector was offset by an increase in investment in equity securities of foreign companies with a share smaller than 10%. The total outflow of funds for the purchase of foreign securities reached SKK 18.1 billion, representing a year-on-year decline of SKK 5.0 billion.

While foreign investors reduced their holdings of debt securities from Slovak entities by SKK 8.2 billion in 2005, a different trend was recorded in 2006: an inflow of funds totalling SKK 61.5 billion. The year-on-year change was mainly a result of government activities. The most significant factor was the issuance of new eurobonds (SKK 37.6 billion), which, in contrast with 2005, was not accompanied by the repayment of eurobonds issued in previous years. Similar developments were recorded in the case of government securities sold to non-residents, where the interest of non-residents grew year-on-year by SKK 5.7 billion. The increased interest among investors in securities issued by domestic entities was, in a lesser degree, offset by a fall in interest in the purchase of equity securities (with a share smaller than 10%) on the part of foreign entities.

In “other investments”, an outflow of SKK 122.7 billion was recorded in 2006, compared with an inflow of SKK 148.1 billion in 2005. Most of the year-on-year change of SKK 270.8 billion was caused by the development in the banking sector.

Other long-term investment resulted in a capital inflow of SKK 18.6 billion. The year-on-year change from an outflow of long-term capital to an inflow of SKK 33.6 billion was significantly influenced by the payment of SKK 25.0 billion to ČSOB in 2005 (in the government sector) due to an arbitration court ruling and to a downturn in bank lending to non-residents.

The corporate sector drew long-term loans in the amount of SKK 46.3 billion in 2006, which was 30.4% more than in 2005. Loan repayments by enterprises increased to an even greater extent, when the year-on-year growth reached 59.7%, which represented loans repaid in the amount of SKK 42.0 billion. The excess of drawings over repayments of long-term financial credits by enterprises led to a net inflow of funds from loans received, in the amount of SKK 4.3 billion. Compared with 2005, however, with regard to the fast rate of repayment, the net inflow diminished by SKK 4.9 billion and thus negatively affected the year-on-year increase in the net inflow of long-term capital within the scope of other investments.

Within the scope of short-term capital, a net outflow of SKK 141.3 billion was recorded, compared with an inflow of SKK 163.1 billion in 2005. The main factor in the year-on-year change was an outflow of short-term non-resident deposits from Slovak banks, reaching SKK 147.3 billion in 2006, compared with an inflow of SKK 124.9 billion in 2005. The total year-on-year decline in other short-term investments in the

Table 21 **Capital inflows in other investment by sector** **(SKK billions)**

	2006	2005	year-on-year change
Banks	-150.6	148.3	-298.9
Enterprises	26.5	26.7	-0.2
Government and the NBS	1.4	-26.9	28.3
Total	-122.7	148.1	-270.8

Source: NBS.

government sector (by SKK 302.1 billion) was affected by interbank foreign exchange market developments in June and July, when a temporary depreciation in the exchange rate of the Slovak koruna (as a result of exchange rate volatility, which was regarded by the central bank as a temporary phenomenon caused by uncertainty among foreign investors due to developments on other emerging markets and domestic political developments) led to NBS interventions. On the other hand, the increase in non-resident deposits at Slovak commercial banks in 2005 was induced by expectations concerning the appreciation of the Slovak koruna. On the assets side, the outflow of funds in 2006 mainly took place in the form of an increase in financial credits provided and growth in the short-term deposits of Slovak banks held on accounts abroad. In comparison with last year, part of the inflow into the corporate sector in the form of financial credits was replaced by import credits drawn from abroad (import credits increased as a result of growing imports).

2.3.3 Foreign reserves

At the end of December 2006, the foreign reserves of the NBS reached USD 13,363.8 million (EUR 10,145.1 million), representing a fall of USD 2,115.7 million (EUR 2,921.5 million) since the beginning of the year. The total foreign reserves of the NBS were affected by numerous factors during the year. The key factor positively affecting revenues was income arising from the March issue of eurobonds. Expenditures were mainly determined by central bank interventions in the foreign exchange market. The Bank's foreign reserves were also affected during the year by the exchange rates of fully convertible currencies on global financial markets. The deficit in the balance of revenues and expenditures in the period under review (USD-2,567.2 million) was partly offset by positive exchange rate differentials (USD 451.5 million), which resulted from the appreciation of the euro against the US dollar on global financial markets.

The revenue side of foreign reserves was determined in 2006 by the following factors:

- yields from deposits and securities held in the portfolio of the NBS, amounting to USD 390.8 million;
- revenue from eurobond issues in the amount of USD 1,202.5 million;
- revenues of the NBS from repo operations (a positive balance of USD 2.7 million);
- revenues in the amount of USD 127 million from repo operations in gold;
- other net revenues of the NBS in the amount of USD 172.3 million (positive balance), incurred mostly in connection with cross-border payments made for NBS clients.

The expenditure side of foreign reserves was determined in 2006 by:

- debt service payments by the Government in the amount of USD 248.9 million, of which the payment of interest on government eurobonds issued in previous years accounted for USD 102.1 million;
- outflow of funds through interventions and direct transactions on the interbank foreign exchange market, amounting to USD 3,899.3 billion;
- debt service payments by the NBS in the amount of USD 1.4 million;
- the sale of EUR 247 million (USD 312.9 million) according to the Bank Board's decision of 25 April 2006 on the optimisation of the level of the NBS foreign reserves.

At the end of 2006, the foreign reserves of the NBS were 3.2 times greater than the volume of average monthly imports of goods and services to Slovakia during 2006. The coverage of average monthly imports by the official foreign reserves is one of the key indicators of currency stability and is monitored as a rule, despite the fact that foreign reserves are no longer required to fulfil this role (coverage of imports by foreign reserves) under the conditions of liberalised b.o.p. current and financial accounts. With regard to the essence and purpose of this indicator, it appears to be more reasonable to include in the coverage of foreign reserves only that part of imports which is not financed from loans or foreign sources. Hence, starting from July 2006, the NBS also publishes the ratio of foreign reserves to the volume of payments for goods and services, according to banking statistics. Unlike the volume obtained from usual data sources, this volume provides an alternative (more realistic) picture of the coverage of goods and services imports

Table 22 **External debt of the SR**

	In millions of USD		In millions of EUR	
	31.12.2005	**31.12.2006**	**31.12.2005**	**31.12.2006**
Total external debt of the SR	27,052.5	32,205.9	22,835.3	24,448.9
Long-term external debt	11,850.7	16,649.7	10,003.3	12,639.5
Government and NBS[1)]	5,578.3	7,702.1	4,708.7	5,847.0
Commercial banks	866.7	1,559.2	731.6	1,183.6
Entrepreneurial entities	5,405.7	7,338.4	4,563.0	5,608.9
Short-term external debt	15,201.8	15,556.2	12,832.0	11,809.4
Government and NBS	4.4	0.0	3.7	0.0
Commercial banks	9,360.4	6,148.8	7,901.2	4,667.8
Entrepreneurial entities	5,837.0	9,407.4	4,927.1	7,141.6
Foreign assets	25,455.3	26,718.4	21,487.2	20,283.2
Net external debt	1,597.2	5,487.5	1,348.1	4,165.7
SKK/USD and SKK/EUR rates	31.948	26.246	37.848	34.573
EUR/USD cross exchange rate	-	-	1.185	1.317

Source: NBS.
1) Including government agencies and municipalities.

by reserves, since it only includes imports that are to be paid for. In this case, the ratio of foreign reserves to the amount of payments for goods and services recorded in banking statistics reached 4.1 times the volume of average monthly imports of goods and services to the SR in 2006.

The foreign reserves of commercial banks reached USD 2,149.1 million at the end of 2006. The volume of foreign reserves in the banking sector, including the NBS, stood at USD 15,512.9 million at the end of the year.

2.3.4 External debt of the SR

At the end of December 2006, Slovakia's total gross external debt stood at USD 32.2 billion (EUR 24.4 billion), representing an increase of USD 5.2 billion (EUR 1.6 billion) since the beginning of the year. Total long-term foreign debt grew year-on-year by USD 4.8 billion, while total short-term foreign debt increased by USD 0.4 billion.

Within the scope of short-term external debt, conflicting developments were recorded in 2006, when the foreign liabilities of commercial banks decreased by USD 3.2 billion, while the foreign liabilities of entrepreneurial entities increased by USD 3.6 billion.

Long-term external debt witnessed increases in the foreign liabilities of the Government and the NBS (by USD 2.1 billion), the foreign liabilities of entrepreneurial entities (by USD 2.0 billion), and the foreign liabilities of commercial banks (by USD 0.7 billion).

At the end of December, Slovakia's total per-capita gross foreign debt stood at USD 5,987, compared with USD 5,029 at the end of December 2005. The share of short-term foreign debt in the country's total gross external debt decreased year-on-year by 7.9 percentage points, from 56.2% at the end of December 2005 to 48.3% at the end of December 2006.

The net external debt of Slovakia, expressed as the difference between gross foreign debt, i.e. USD 32.2 billion (liabilities of the NBS and the Government, commercial banks, and the corporate sector – except for equity participation), and foreign assets, i.e. USD 26.7 billion (foreign reserves of the NBS, foreign assets of commercial banks and the corporate sector – except for equity participation), reached USD 5.5 billion (debtor position) at the end of December 2006. The net external debt of the SR increased year-on-year by USD 3.9 billion.

2.4 General government sector

Budgetary performance in the general government sector according to ESA 95

Budgetary performance in the general government sector in 2006 according to the European System of Accounts (ESA 95), governing the evaluation of compliance with the Maastricht criteria, resulted in a deficit of SKK 55.4 billion (including the costs of the pension reform), representing 3.4% of GDP. The most significant contribution (92.5%) to the general government deficit came from the central government deficit amounting to SKK 52.5 billion. A negative balance was also recorded in the local government sector, in the total amount of SKK 5 billion. The budgetary performance of social security funds resulted in a surplus of SKK 2.1 billion. Compared with the budgeted general government deficit (SKK 64.6 billion, i.e. 4.2% of GDP), the actual deficit decreased by 0.8% of GDP. In nominal terms, the deficit shrank by SKK 9.2 billion. The deficit ratio was positively influenced by the stronger-than-expected GDP growth, which caused this ratio to decrease by 0.2% of GDP. Apart from this, the smaller general government budget deficit was positively affected first and foremost by an improvement in the state budget in comparison with the budgetary objective (by SKK 17.7 billion, including the balance on extra-budgetary accounts) and in the performance of the Social Insurance Agency, which recorded a positive change (by SKK 3.4 billion) against the budget. State funds in total enhanced their balance by SKK 0.2 billion and achieved a surplus of SKK 5.7 billion. Slovak Consolidation Agency improved its budgetary performance by SKK 5.9 billion, due to a capital transfer received from the state budget in the amount of SKK 5.7 billion. Within the general government, deteriorations in comparison with the budget were recorded by municipalities (a deterioration of SKK 5.4 billion) and health insurance companies (a deterioration of SKK 1.25 billion). In the central government sector, a worse result was achieved by the National Property Fund (NPF), whose budgetary performance deteriorated by SKK 8.6 billion against the budget, as a result of a capital transfer to the state budget in the amount of SKK 7.7 billion for the repayment of loans covered by government guarantees and the debt assumption of NPF´s risky liabilities arising from purchase agreements, in the amount of SKK 3.4 billion. Deficits were also recorded by public universities in the total amount of SKK 1.0 billion, while the budget assumed a balanced performance. Subsidised state-owned organisations produced a deficit of SKK 0.7 billion (a deterioration of SKK 0.9 billion compared with the budget).

The positive results of budgetary performance in the general government sector in comparison with the budget were caused by increased tax revenues, which exceeded the budget by SKK 14.0 billion, and by an excess of non-tax revenues (SKK 8 billion). Insurance revenues remained below the budgeted level by SKK 7.5 billion. The favourable developments in tax and non-tax revenues were offset by the non-fulfilment of the budgeted income from grants and transfers, which remained below the budget by SKK 15.5 billion. This was partly due to the non-fulfilment of the budgeted income from EU funds (a shortfall of SKK 7.5 billion), which simultaneously contributed to the fall in expenditures financed from EU funds and co-financed from the state budget. Total expenditure lagged behind the budgeted amount (by SKK 9.5 billion), owing to the lower drawing of current expenditures (by SKK 13.9 billion). This was mainly reflected in the state budget, where the actual amount of current expenditures was by SKK 34.4 billion lower than the budgeted figure, which was partly compensated for by amounts in excess of the budgets of municipalities (SKK 4.8 billion), health insurance companies (SKK 5.1 billion), the Social Insurance Agency (SKK 7.3 billion), and public universities (SKK 2.5 billion). Capital expenditures exceeded the budget by SKK 4.4 billion, due mainly to the increased expenses of municipalities on the acquisition of capital assets, which were exceeded by SKK 6.3 billion.

Apart from the reclassification of the National Property Fund's guarantees, negative effects on the general government budget were also exerted by the remission of receivables towards foreign countries (SKK 0.53 billion); repayment of foreign receivables in goods (SKK 1.3 billion); a liability to Slovnaft arising from uncertainty about the result of a legal dispute (SKK 1.3 billion); capital transfer from the state budget to the Slovak Water Resource Management Company (SKK 1.1 billion); the Slovak Railways (SKK 0.97 billion), and the Žilina Airport Company (SKK 0.08 billion).

At 31 December 2006, the public debt as defined in the Maastricht criteria stood at SKK 503.1 billion, representing 30.7% of GDP. It decreased somewhat in comparison with 2005, by SKK 4.2 billion. The level of debt was positively influenced by the utilisation of funds obtained from the refinancing system of the SR State Treasury for financing the state budget deficit on a continuous basis and reducing the assumed debt from risky guarantees by SKK 6.3 billion from the resources of the National Property Fund. The debt was also affected positively by the appreciation of the Slovak koruna, which caused a reduction in the debt denominated in foreign currency (by SKK 12.4 billion).

State budget

The State budget of the Slovak Republic was approved by Act No. 655/2005 of 13 December 2005, in which total revenue was budgeted at SKK 272.7 billion and total expenditure at SKK 330.2 billion. The budget deficit was set at SKK 57.5 billion. The actual results were much better than the budgeted figures. The State budget recorded a deficit of SKK 31.7 billion, with budget revenues totalling SKK 292.0 billion and expenditures SKK 323.7 billion.

The positive results can be ascribed to increased budget revenues, combined with savings in budget expenditures. Positive developments were also recorded in tax revenues, which exceeded the budget by SKK 20.6 billion, mainly in value added tax (an excess of SKK 8.5 billion) and corporate income tax (an

Table 23 **State budget fulfilment in 2006** **(SKK billions)**

	Budgeted volume	Actual figure	Difference
Value added tax	120.0	128.5	+8.5
Value added tax	51.9	52.1	+0.2
Corporate income tax	36.2	47.3	+11.1
Individual income tax	2.5	2.6	+0.1
Other taxes	5.1	5.8	+0.7
Tax revenues	215.7	236.3	+20.6
Non-tax revenues	57.0	55.7	-1.3
Total revenue	272.7	292.0	+19.3
Current expenditures	283.4	282.9	-0.5
Capital expenditures	46.8	40.8	-6.0
Total expenditure	330.2	323.7	-6.5
Difference	-57.5	-31.7	+25.8

Source: Ministry of Finance of the SR.

excess of SKK 11.1 billion). Savings in expenditures were mainly achieved in the area of capital expenditures (approximately SKK 6 billion), while current expenditures were drawn to almost 100% (savings: SKK 0.5 billion).

Funds from the EU budget were drawn in the amount of SKK 20.4 billion, which means that approximately SKK 7.5 billion remained unused from the budgeted amount (SKK 27.9 billion).

2.5 Monetary policy and monetary developments

In 2006 the NBS conducted its monetary policy in an environment characterised by dynamic economic growth, which was mainly promoted by an increase in the production capacity of the economy and, unlike in 2005, by a positive contribution from net exports. Labour productivity growth in 2006 exceeded the rate of wage growth, while employment grew at a pace comparable with the 2005 figure. The moderation of the rise in oil and energy prices on the world markets and the decision of the Regulatory Office for Network Industries to make adjustments to regulated prices, created conditions for a downward trend in inflation.

To prevent the excessive exchange rate volatility, the NBS intervened in the foreign exchange markets on several occasions. In June and July, the excessive volatility was connected with the developments in the Central-European currencies and the uncertainty stemming from domestic political developments. The foreign exchange intervention in December was necessitated by the extraordinary degree of exchange rate volatility, which was connected with the liquidity shortage during the Christmas holidays.

During 2006 the risk of a rise in inflation over the next year increased. Hence, the NBS tightened its monetary policy. Over the first three quarters, the NBS gradually raised its key interest rates in four steps: in March, May, and July by 0.50 of a percentage point, and in September by 0.25 of a percentage point (by a total of 1.75 percentage points). The lower than estimated cost effects contributed to the completion of the cycle of key NBS interest rate increases at the end of last year.

The falling inflation, accompanied by sound GDP growth, stimulated by in increase in the economy's potential output and representing no risk of possible demand-based inflationary pressures, provided a framework for a change in monetary policy settings over the medium-term horizon and a reduction in the key NBS interest rates in 2007.

2.5.1 Monetary aggregates and M3 counterparts

The M3 monetary aggregate (according to ECB methodology) increased by SKK 127.1 billion in comparison with 31 December 2005, to SKK 958.5 billion at the end of 2006. The year-on-year rate of M3 growth[3] reached 15.3% in December. In 2006 the M3 monetary aggregate recorded a more than twofold total increase, at a rate almost twice as fast as in the previous year.

[3] The year-on-year growth dynamics of monetary aggregates and their counterparts are calculated from end-of-month data, including non-transaction operations, which comprise all movements in the balance-sheet items, resulting from changes in the valuation of marketable instruments, the depreciation/write-off of loans, exchange rate differentials, reclassification, and other changes.

Table 24 **Developments in the M3 monetary aggregate and the main counterparts of M3**

	Volume as at 31 December	Change since the beginning of the year[1)]	
	SKK billions	SKK billions	%
Year 2006			
M3 monetary aggregate	958.5	+127.1	+15.3
Main counterparts of M3			
Long-term financial liabilities (excl. capital and reserves)	122.6	+19.7	+19.1
MFI loans and securities	895.7	+100.5	+12.6
of which: General government	254.8	-18.7	-6.8
Other residents	640.9	+119.2	+22.8
Year 2005			
M3 monetary aggregate	831.4	+60.2	+7.8
Main counterparts of M3			
Long-term financial liabilities (excl. capital and reserves)	102.9	+4.6	+4.6
MFI loans and securities	795.2	+86.1	+12.1
of which: General government	273.5	-21.7	-7.4
Other residents	521.7	+107.8	+26.0

Source: NBS.
1) Since monetary aggregates and the counterparts of the M3 aggregate (according to ECB methodology) are not evaluated as at 1 January of the given year, the values recorded as at 31 December of the previous year are used in the table and the further text as initial values for the year.

During 2006 the dynamics of M3 gradually increased, except for standard seasonal deviations caused in certain months (in April, September, and December), mainly by the dates of income tax payments and/or dividend payments in the corporate sector. The main pro-growth effect on the M3 aggregate was, however, exerted by the dynamic growth in commercial bank lending. At the same time, deposits increased as a result of a rise in interest rates; this led to a liquidity outflow from investment funds into M3. The accelerated growth of currency in circulation was consistent with the environment of intense economic growth at a higher inflation rate.

The increases in key NBS interest rates started to be reflected in the structure of short-term deposits (shift of demand deposits from the M1 aggregate to higher-interest-bearing time deposits in the M2 sub-aggregate) and the increase in the volume of loans began to moderate from the second half of 2006, which indicates that monetary policy tightening affects developments in the banking sector with a delay of several months.

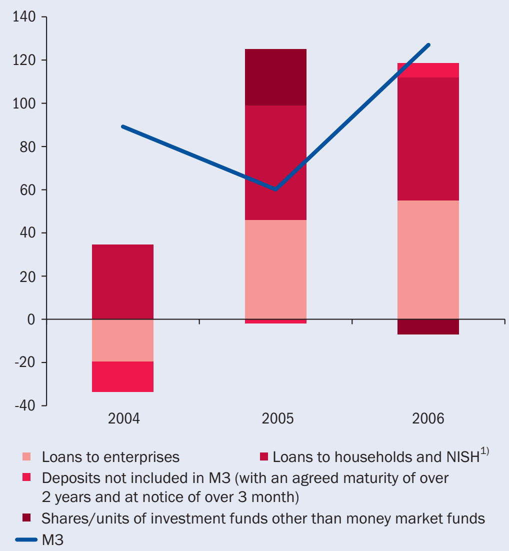
Among the main components of the M3 aggregate, the biggest change occurred in the structure of short-term deposits. This was due to the fact that non-financial corporations often shifted part of their free funds from the shortest-term deposits (deposits repayable on demand) to deposits with agreed maturity and back, which significantly affected the volatility of M1. The annual increase in deposits and received loans repayable on demand reached SKK 48.9 billion and the increase in deposits and received loans with an agreed maturity of up to 2 years was SKK 66.1 billion. While the increase in demand deposits was SKK 12.8 billion smaller than in 2005, the increase in deposits with agreed maturity was SKK 92.7 billion larger, which confirms the assumption that the structure of deposits is influenced by interest rate increases.

Table 25 **Net sales of open-end investment funds (OIF)** **(billions of SKK)**

	OIF shares/units in SKK and foreign currency in total	Shares/units of OIFs other than money market funds	Shares/units of money market OIFs
Year 2006			
Cumulative net sales	+4.1	+2.9	-0.9
Year 2005			
Cumulative net sales	+37.9	+25.8	+13.1

Source: NBS calculations based on data from the Slovak Association of Asset Management Companies (SASS).

Chart 41 **Selected counterparts of M3 (year-on-year increases in billions of SKK)**



Source: NBS.
Note: Quarterly data on shares/units of investment funds other than money market funds have only been available since 2004.
1) Non-profit institutions serving households.

In 2006 the total increase in the less liquid components of M3 (marketable instruments) was smaller than in 2005 (an increase of SKK 3.9 billion, compared with SKK 6.9 billion in 2005). The determining factor was the markedly subdued investment in money market funds shares/units (a decline of SKK 0.9 billion, compared with an increase of SKK 13.1 billion in 2005). On the other hand, this decline partly offset a steeper increase in the volume of debt securities issued with a maturity of up to 2 years (an increase of SKK 4.8 billion, compared with SKK 3.6 billion in 2005).

Among the main counterparts of M3, the accelerating trend in the growth of long-term financial liabilities (excluding capital, reserves, and provisions) from 2005 culminated in the second half of 2006. The annual increase in the main long-term financial liability items in 2006 was markedly higher than the figure for 2005, when the volume of debt securities issued with a maturity of over 2 years increased by SKK 13.0 billion and the volume of deposits and received loans with an agreed maturity of over 2 years by SKK 10.2 billion (they grew in 2005 by SKK 6.4 billion and SKK 4.7 billion respectively). The volume of deposits redeemable at a period of notice of over 3 months declined in comparison with 2005 by SKK 3.5 billion, which was SKK 6.6 billion less than in 2005.

The increase in the total receivables of monetary financial institutions (MFI) from residents (including securities issued by clients and held by MFIs) grew year-on-year by SKK 14.4 billion, while the decrease in the receivables of MFIs from the public sector was fully offset by an increase in MFI receivables from the private sector. The decrease in receivables from the public sector in 2006 was smaller than in the previous year (by SKK 3.0 billion) and the increase in receivables from other residents was SKK 11.4 billion larger.

2.5.2 Structure of the money supply

The year-on-year dynamics in the money supply accelerated throughout 2006 (its dynamics culminated in November 2006, at 16.1%) and the volume of the M3 aggregate reached SKK 958.5 billion at the end of 2006. Among the money supply components, the contributions to M3 growth from the most liquid components increased in the first half of 2006 (currency, deposits and received loans repayable on demand), but then diminished in the second half of the year in favour of the growth of contributions from the less liquid M3 components. Among the counterparts of M3, the growing trend continued in the area of MFI receivables from the private sector. This trend, however, slowed somewhat at the end of the year, owing to the rise in interest rates.

The substantial components of the M1 aggregate are deposits and received loans repayable on demand. The contributions of the most liquid types of deposits to M3 growth reflected the developments in household deposits and received loans repayable on demand, which recorded a slowdown in the year-on-year growth rate in the second half of 2006. The deposits and received loans of non-financial corporations repayable on demand made a positive contribution to money supply growth throughout the period. The second M1 component is currency in circulation, which recorded a gradual slowdown in the year-on-year growth rate throughout 2006 (a year-on-year growth of 9.5% in December 2006, compared with 19.3% in December 2005), which was also reflected in its reduced contribution to money supply growth.

The less liquid money supply components (M2 – M1) are deposits and received loans with an agreed maturity of up to 2 years and deposits redeemable at notice of up to 3 months. Their volume began to increase at the beginning of this year and thus they made a positive contribution to M3 growth. This growth took place mainly in the second half of the year, when their contributions to money supply growth accounted for almost a half of the total growth. Developments in the less liquid fixed-term deposits were determined by an increase in the volume of deposits and received loans with an agreed maturity of up to 2 years, while deposits redeemable at notice of up to 3 months

Table 26 **Developments in monetary aggregates in 2006**

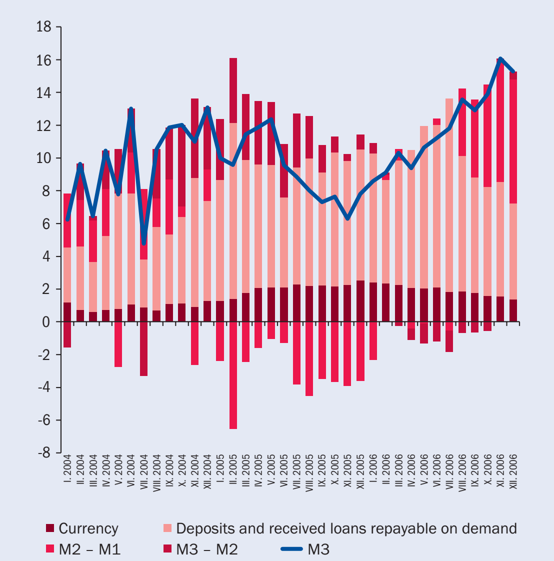
	Volume as at 31.12.2006 (SKK billions)	Year-on-year change (SKK billions)	Contribution to M3 growth (% points)
Currency in circulation	131.2	11.3	1.4
Deposits and received loans repayable on demand	414.9	48.9	5.9
M1	546.1	60.2	7.3
Deposits and loans taken with an agreed maturity of up to 2 years	350.5	66.1	8.0
Deposits redeemable at a period of notice of up to 3 months	11.6	-3.2	-0.4
M2 – M1	362.1	62.9	7.6
M2	908.1	123.2	14.8
Money market fund shares/units	45.0	-0.9	-0.1
Repo operations	0.0	0.0	0.0
Debt securities issued with a maturity of up to 2 years	5.4	4.8	0.6
M3 – M2	50.3	3.9	0.5
M3	958.5	127.1	15.3

Source: NBS.

contributed to the money supply growth negatively throughout the year. The growth in fixed-term deposits was mainly connected with the rise in customer interest rates and, in part, with the fall in interest in investment in money market funds shares/units in the first half of 2006.

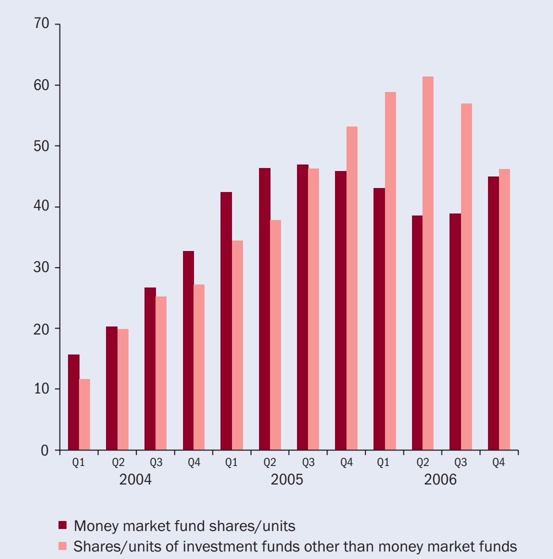
The smallest share of the money supply was in marketable instruments (M3 – M2). They represent the least liquid component, which is mostly formed by money market fund shares/units. In 2006 money market fund shares/units continued to follow the falling trend from 2005. This fall came to a halt in the last quarter of 2006 and their volume began to grow again. Their development was influenced by the shift of household funds into more lucrative products, such as time deposits and, in the first half of the year, the shares/units of investment funds other than money market funds. The rest of marketable instruments is formed by repo operations and debt securities issued with a maturity of up to 2 years, whose share in the money supply began to increase slightly in the second half of 2006, as well as their contribution to the year-on-year rate of M3 growth.

Chart 42 **Contributions of individual M3 components to its year-on-year dynamics (% points)**



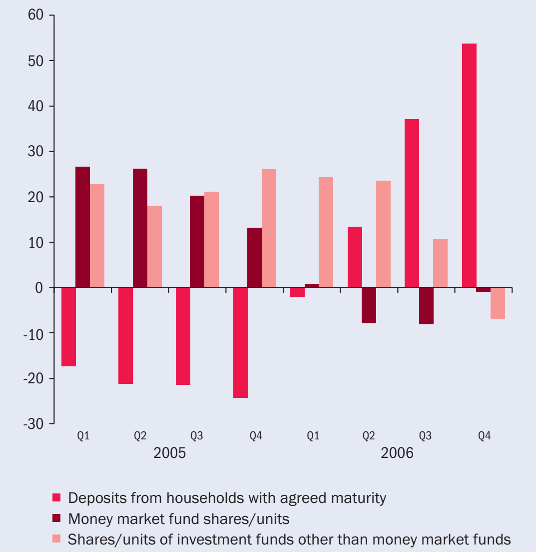
Source: NBS.

Chart 43 **Investment fund shares/units – amounts (SKK billions)**



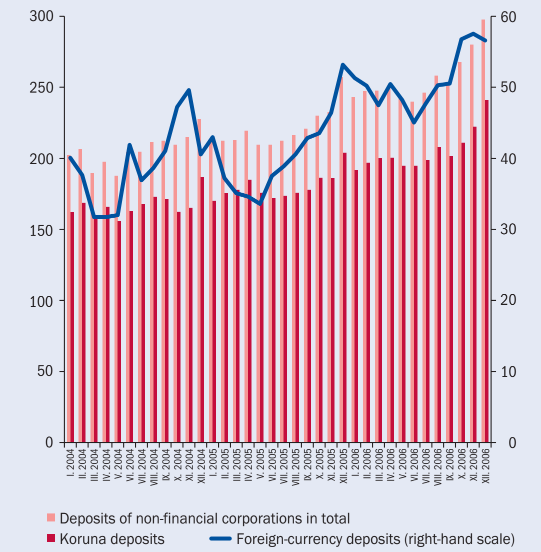
Source: NBS.

Chart 44 **Year-on-year growth in household deposits and shares/units (SKK billions)**



Source: NBS.

Chart 45 **Deposits of non-financial corporations (SKK billions)**



Source: NBS.

Deposits from non-financial corporations

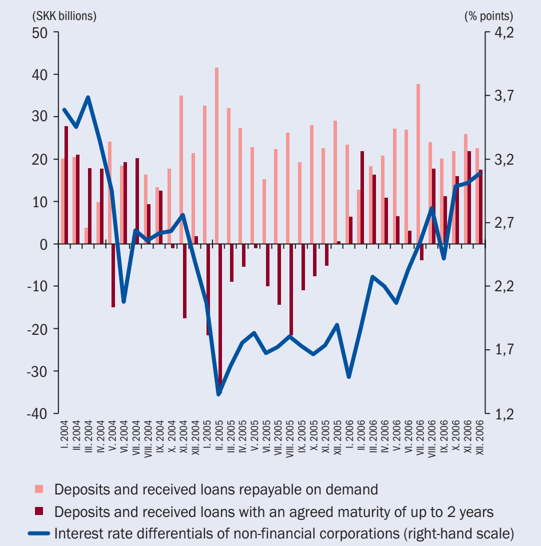
Deposits from non-financial corporations grew in volume by SKK 40.2 billion in comparison with December 2005, to SKK 297.3 billion at the end of 2006. The year-on-year growth in corporate deposits took place in both koruna deposits (representing approximately 80% of the total volume of corporate deposits) and foreign-currency deposits. Developments in corporate deposits in the individual months were mostly influenced by koruna deposits. Thus, the total volume of corporate deposits increased despite a fall in foreign-currency deposits. A marked increase in deposits occurred in the last quarter, mainly due to an increase in the volume of koruna deposits from non-financial corporations.

Corporations tend to use their deposits primarily for transactions, so they give preference to the most liquid types of deposits in the long term. The deposits and received loans of non-financial corporations repayable on demand account for up to 60% of the total volume of corporate deposits; their volume reached SKK 176.9 billion in December 2006. Besides deposits repayable on demand, time deposits also made a positive contribution to the growth in deposits from non-financial corporations. After declining in 2005, corporate deposits and received loans with an agreed maturity of up to 2 years followed a growing trend. One of the factors stimulating interest in this deposit product was the rise in its interest rate, which corresponded to the increase in the key interest rate of the NBS. Deposits redeemable at notice of up to 3 months recorded a modest increase, but these deposits represent only a negligible part of the deposits of non-financial corporations.

Household deposits

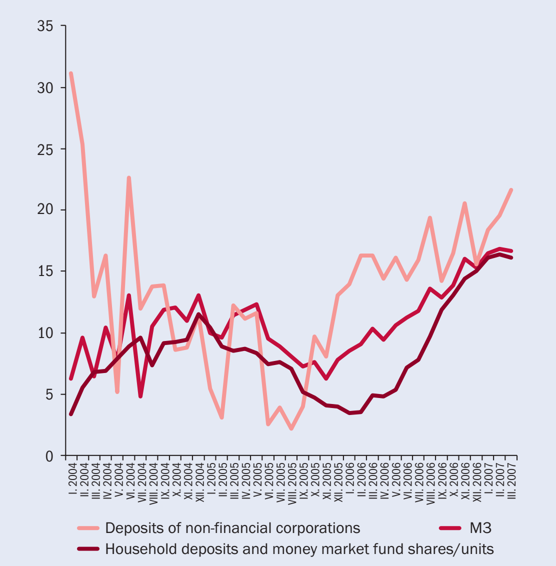
Household deposits recorded an increase in their year-on-year growth dynamics since the beginning of the year, to 17.5% in December 2006 (the average year-on-year growth rate in 2005 stood at 0.5%).

Chart 46 **Year-on-year growth in deposits from non-financial corporations**



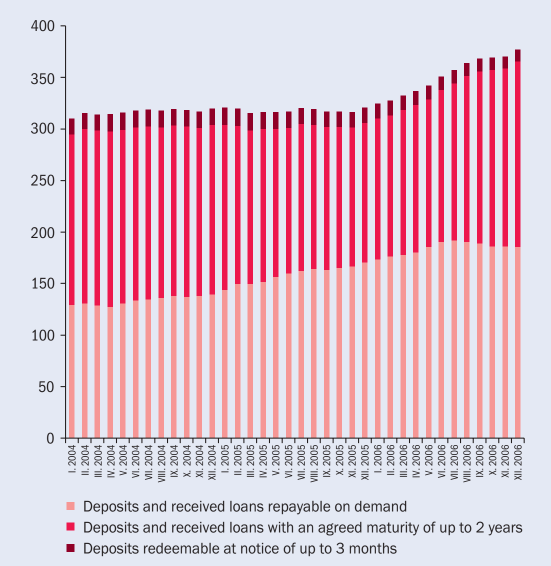
Source: NBS.
Note: Interest rate differential is difference between the interest rates on less liquid M2 components (deposits and received loans with an agreed maturity of up to 2 years and deposits redeemable at notice of up to 3 months) and the interest rate on deposits and received loans repayable on demand.

Chart 47 **Year-on-year dynamics of M3 and of deposits of households and non-financial corporations (%)**



Source: NBS.

Chart 48 **Developments in household deposits (SKK billions)**



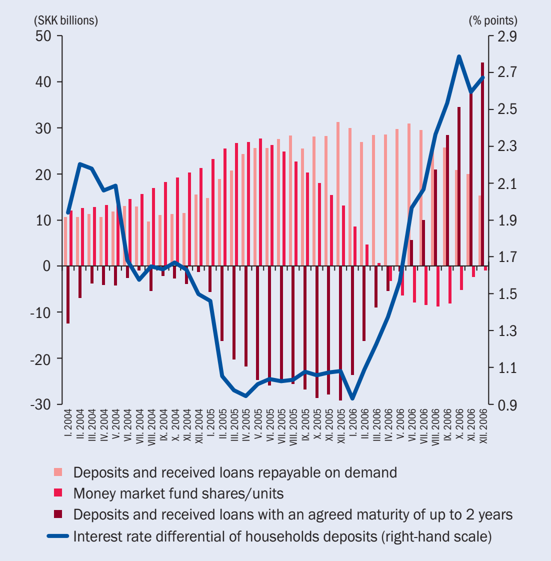
Source: NBS.

The total year-on-year increase (SKK 56.1 billion) mainly took place in deposits and received loans with an agreed maturity of up to 2 years, which grew year-on-year by SKK 44.1 billion in December 2006. The contributions of deposits and received loans repayable on demand decelerated somewhat, mainly in the second half of 2006, but they remained positive.

As in the case of non-financial corporations, small differences were recorded in 2005 between interest rates on fixed-term household deposits and deposits repayable on demand, which increased from the beginning of 2006. Owing to this development, the year-on-year decline in deposits and received loans with an agreed maturity of up to 2 years slowed, and gradually changed to a marked increase (SKK 44.1 billion year-on-year). The growth in deposits was probably also influenced by the weakening interest in investment in money market fund shares/units. This form of investment in the first half of the year was also replaced by investment in the shares/units of investment funds other than money market funds. In the second half of 2006, however, a backward transfer of funds was observed between investment funds, when the growing interest in time deposits and money market fund shares/units was accompanied by a decline in investment in the shares/units of investment funds other than money market funds. Household deposits redeemable at notice of up to 3 months made a negative contribution to the overall growth of deposits during the year.

Broken down by currency, developments in household deposits were mostly determined by koruna deposits, which accounted for almost 90% (SKK 334.8 billion) of all household deposits. As in the case of total household deposits, the rate of growth gradually accelerated over the course of 2006. Deposits in foreign currency also made a positive contribution to the year-on-year growth in total household deposits. Their volume decreased somewhat in the last quarter,

Chart 49 **Year-on-year growth in household deposits**



Source: NBS.
Note: Interest rate differential is the difference between the interest rates on less liquid M3 components (deposits and received loans with an agreed maturity of up to 2 years and deposits redeemable at notice of up to 3 months) and interest rate on deposits and received loans repayable on demand.

which was probably connected with koruna exchange rate development in this period.

Deposits not included in M3

Of deposits not included in the M3 monetary aggregate, household deposits with an agreed maturity of over 2 years slightly increased, while household deposits redeemable at notice of over 3 months continued to decrease. The deposits of non-financial corporations not included in the M3 aggregate recorded a modest increase, but they had a negligible share in the total volume of corporate deposits.

2.5.3 Monetary financial institutions loans to the private sector

MFI loans to the private sector (excluding securities) reached SKK 627.3 billion at the end of December 2006, representing an increase of SKK 119.8 billion compared with the end of 2005. This development took place partly in loans denominated in Slovak koruna (an increase of SKK 108.4 billion) and partly in euro-denominated loans (an increase of SKK 11.8 billion). Loans in other foreign currencies recorded a slight decrease (SKK 0.3 billion). The structure of loans by currency remained virtually unchanged at the end of 2006. The share of koruna loans in the total volume slightly increased, to 80.0%, while the share of euro loans decreased to 18.8% and loans in other currencies accounted for 1.2%. At the end of 2005, loans in Slovak koruna accounted for 77.5%, euro loans 20.9%, and loans in other foreign currencies 1.6%.

The year-on-year dynamics of loans to the private sector recorded lower values in the second half of 2006 (compared with the first half), and reached an average of 26.0% during the year. The most significant contribution to the year-on-year growth in loans

Table 27 **Deposits of households and non-financial corporations in 2006**

	Volume as % of M3	Year-on-year change in %				Volume in SKK billions			
	Dec.	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Household deposits	39.3	2.5	10.7	16.2	17.5	327.5	336.8	368.3	376.9
Deposits and received loans repayable on demand	19.4	18.0	19.4	15.7	8.9	176.6	180.1	189.0	185.9
of which: in Slovak koruna	17.7	20.6	21.3	17.5	11.0	159.0	162.2	171.1	169.4
Deposits and received loans with an agreed maturity of up to 2 years	18.7	-10.6	3.9	20.5	32.5	136.9	143.2	167.1	179.6
of which: in Slovak koruna	16.1	-12.2	2.6	21.9	37.2	113.4	118.9	141.3	154.4
Deposits redeemable at notice of up to 3 months	1.2	-15.5	-16.9	-17.7	-22.0	14.0	13.5	12.2	11.4
of which: in Slovak koruna	1.1	-14.8	-16.5	-17.7	-21.0	13.4	13.0	11.7	10.9
Household deposits in Slovak koruna	34.9	3.2	11.2	17.5	19.9	285.8	294.0	324.1	334.8
Household deposits in foreign currency	4.4	-2.0	7.4	7.5	1.0	41.7	42.8	44.2	42.1
Deposits of non-financial corporations	31.0	16.3	14.3	14.2	15.6	247.0	251.0	252.2	297.3
Deposits and received loans repayable on demand	18.5	9.3	20.9	15.3	14.7	150.9	136.3	151.3	176.9
of which: in Slovak koruna	14.2	5.0	21.3	15.0	11.6	114.7	102.2	112.4	136.6
Deposits and received loans with an agreed maturity of up to 2 years	12.5	29.4	3.9	12.6	17.1	96.0	114.6	100.6	120.2
of which: in Slovak koruna	10.8	24.5	2.1	11.3	27.7	81.9	98.2	89.0	103.9
Deposits redeemable at notice of up to 3 months	0.0	-13.8	3.7	6.1	28.2	0.2	0.2	0.2	0.2
of which: in Slovak koruna	0.0	-13.8	3.7	6.1	28.2	0.2	0.2	0.2	0.2
Slovak-koruna deposits of non-financial corporations	25.1	12.3	13.1	13.3	18.0	196.8	200.6	201.6	240.7
Foreign-currency deposits of non-financial corporations	5.9	34.9	20.0	18.0	6.5	50.2	50.4	50.5	56.6

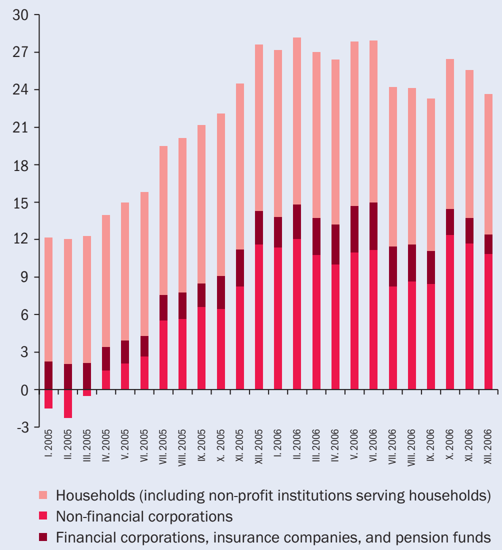
Source: NBS.
Note: The differences in the sum totals are due to rounding.

was made by loans to households[4] (a contribution of 11.2 percentage points, causing an increase of SKK 56.9 billion). Loans to non-financial corporations contributed 10.8 percentage points (an increase of SKK 55.0 billion). Compared with December 2005, the contribution of loans to non-financial corporations decreased by 1 percentage point, to 1.6 percentage points (year-on-year increase of SKK 7.9 billion).

In 2006 MFI loans to households followed the growing trend from the previous year, and reached at the end of 2006 an year-on-year increase of SKK 56.9 billion; the year-on-year dynamics stood at 31.4%. The dynamics of bank lending to households decelerated somewhat, due to the strong credit expansion in the previous year (a decrease of 9.8 percentage points in comparison with December 2005). The year-on-year contributions of loans in absolute terms began to decrease as late as the second half of the year, but still reached high values. The interest in loans was probably also reflected in the consumer confidence indicator, which began to rise (after a fall in the second half of 2005, caused by an announced increase in regulated prices) and recorded, for the first time, a positive value at the end of 2006.

Of the total volume of loans to households, loans in Slovak koruna accounted for an average of 98.7%. In 2006 as in the previous year, households used credit resources especially for long-term investment.

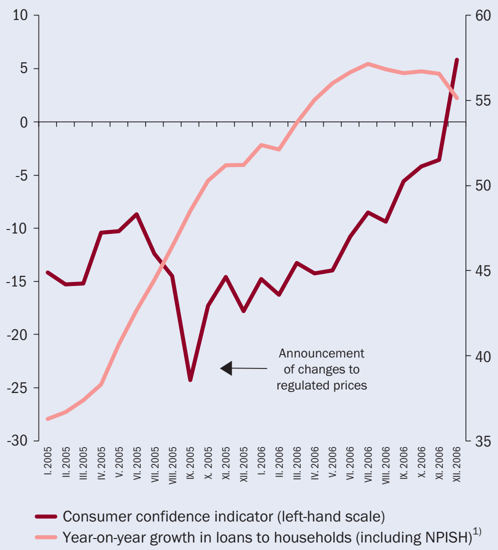
Chart 50 **Contributions to the year-on-year growth in MFI loans to the private sector (% points)**



Source: NBS.

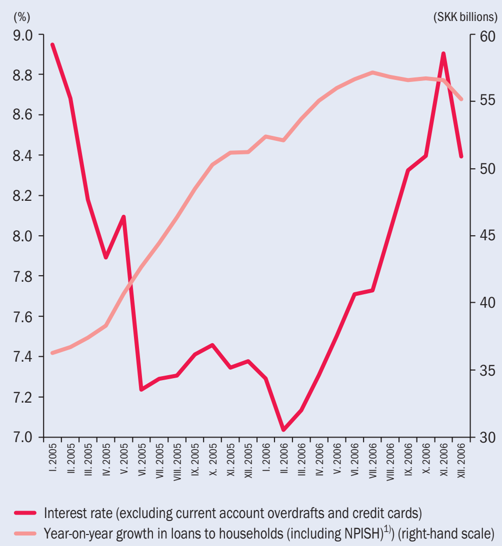
Regarding the structure of loans by purpose, the steepest year-on-year increase was recorded in loans for house purchases[5] (SKK 38.0 billion, compared with SKK 31.0 billion in 2005), which contributed 21.0 percentage points to the year-on-year growth in loans to households. With effect from January 2006, a sta-

Chart 51 **Consumer confidence indicator and absolute growth in loans to households (SKK billions)**



Source: NBS, Statistical Office of the SR.
1) Non-profit institutions serving households (NPISH).

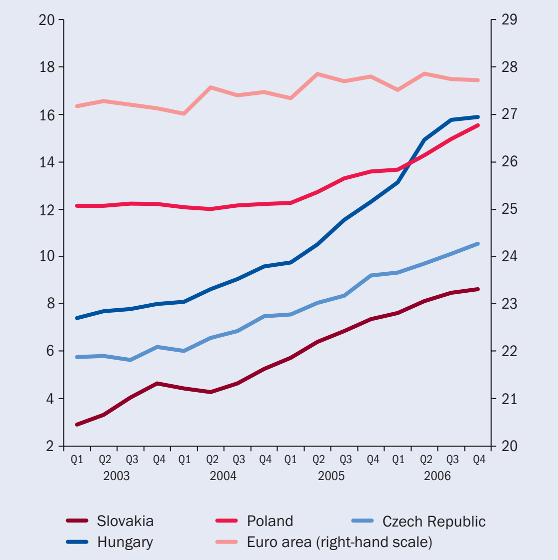
Chart 52 **Interest rate on loans to households and absolute year-on-year growth in loans to households**



Source: NBS.
1) Non-profit institutions serving households (NPISH).

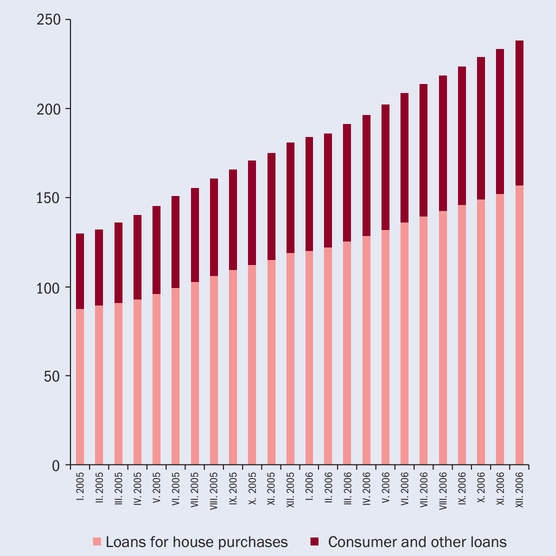
[4] *Including non-profit institutions serving households (NPISH).*
[5] *Loans to households (including non-profit institutions serving households) broken down by purpose comprise loans for house purchases, consumer loans, and other loans.*

Chart 53 **Consumer and other loans to households as a share of final consumption (%)**



Source: NBS, Eurostat and the national central banks.

Chart 54 **MFI loans to households (SKK billions)**



Source: NBS.

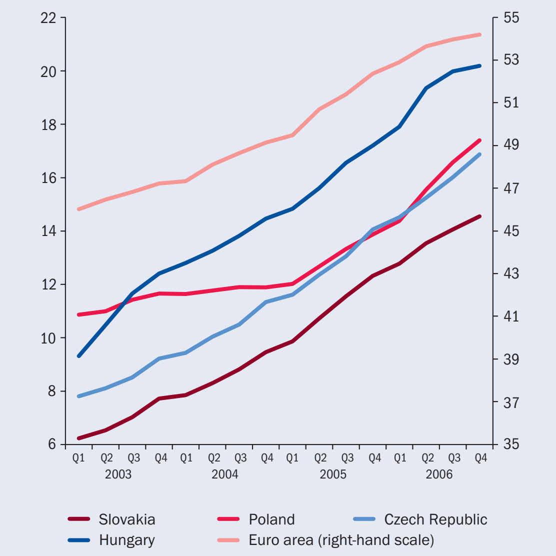
tistical change was introduced concerning "American mortgages", which are recorded within the individual loan categories according to the purpose of use[6]. The absolute year-on-year increases in consumer and other loans were stable, with moderate decreases in the last months of the year (reaching SKK 18.9 billion in December 2006). Consumer and other loans thus represented one of the sources of growth in household final consumption. Their share in final consumption of households increased more moderately in 2006, by 1.2 percentage points compared with the previous year, to 8.6% (the year 2005 saw an increase of 2.1 percentage points, to 7.4%). It was, however, still lower than in the euro area and other V4 countries.

The growth in the monetary financial institutions loans to households was accompanied by a rise in their indebtedness (expressed in terms of the ratio of loans to households to GDP), which increased year-on-year by 2.2 percentage points and reached 14.5% at the end of 2006. Similar developments in connection with the process of real convergence are also recorded in other new Member States, while household indebtedness in these countries is much lower than in the euro area (54.2% in 2006).

Loans in the non-financial corporations sector showed less dynamic development than those in the household sector. After moderating in the third quarter of 2006, their year-on-year growth again accelerated and reached an average rate of 19.0% in 2006.

As from January 2006, loans at zero interest rates are recorded in the respective loan categories according to purpose, while before December 2005 they had been recorded as an individual category. Owing to this methodological change, the dynamics of individual types of loans by purpose are partially distorted. The impact of this methodological change

Chart 55 **MFI loans to households as a share in GDP (%)**



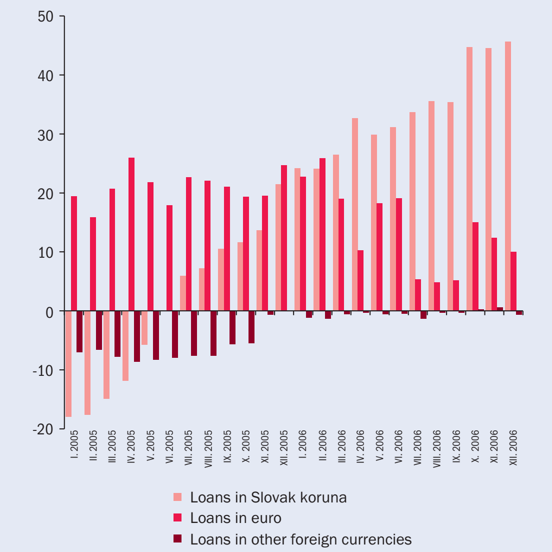
Source: NBS, Eurostat and the national central banks.

[6] *In 2005, all "American mortgages" were recorded in the "other loans" category. As a result of this change, the "consumer and other loans" aggregate provides a more consistent view of the structure of loans by purpose.*

Chart 56 **Loans to non-financial corporations (year-on-year increases in SKK billions)**

Source: NBS.

Chart 57 **Year-on-year growth in MFI loans to non-financial corporations (SKK billions)**



Source: NBS.

was most apparently reflected in other loans (a year-on-year increase of SKK 13.6 billion in December 2006), which form the largest part of zero interest loans. In terms of purpose, the steepest year-on-year increases were recorded in investment loans and loans for house purchases (SKK 28.0 billion in December 2006). In recording loans to non-financial corporations by purpose, part of the investment loans was shifted to the "house purchase loans" category in December 2006. Therefore, since loans of these two types are similar in character, they are assessed as an aggregate.

Regarding the time structure of MFI loans to non-financial corporations, a gradual slowdown was recorded in the growth rate of long-term loans with a maturity of over 5 years. However, they still recorded steep year-on-year increases (SKK 25.3 billion in December 2006). On the other hand, long-term loans with 1-year to 5-year maturities showed increased year-on-year dynamics and grew year-on-year by SKK 12.0 billion by the end of the year (compared with a year-on-year decline of SKK 5.9 billion in December 2005). The growth in short-term loans, representing the largest part of loans to corporations, stagnated (after accelerating in the previous year) and reached an average of SKK 19.9 billion in 2006.

Broken down by currency, loans to corporations were dominated by koruna loans (reaching SKK 217.0 billion at the end of 2006), euro loans (SKK 102.2 billion) and loans in other foreign currencies (SKK 7.1 billion). They followed the trend from the previous year, when the increase in koruna loans continued to grow. The increase in euro-denominated loans to corporations diminished, largely in the second half of 2006, and the growth in loans in other foreign currencies slowed slightly practically throughout the year.

2.5.4 Interest rate developments

Customer interest rates

Customer interest rates were influenced in 2006 by increases in the key NBS rates of March, May, July, and September (by 1.75 percentage points in cumulative terms). Banks reacted to increases in the basic NBS rate more flexibly in the case of non-financial corporations than in the case of households. In lending to non-financial corporations, the increases in the basic NBS rate were not fully reflected in customer interest rates. In lending to households, the lending rate was raised to a greater extent than the basic NBS rate (this was, however, due largely to an increase in rates for current account overdrafts). As far as deposits rates are concerned, the reaction of banks was more flexible in the case of non-financial corporations, which react to interbank market developments relatively sensitively. In the case of households, the increases in the basic rate of the NBS were reflected in the deposits rates only for some of the deposit products (deposits with agreed maturity), the reaction in the case of other deposit products was inflexible.

Interest rates on loans to non-financial corporations

Developments in interest rates on loans to non-financial corporations were dominated by a rising trend from the end of 2005 to the third quarter of 2006, which was followed by a moderate fall. This development mirrored the increases in key NBS interest rates, which was also reflected in money market rates. The slight fall in lending rates in the last quarter of 2006 was connected with the situation on the interbank market, which reflected a change in expectations regarding the future developments in key NBS rates. The changes in interbank market rates were mirrored in the values of both short-term and long-term interest rates. An exception in the last quarter was formed by loans of over EUR 1 million with a short fixation period, when their interest rates remained at roughly the level of the third quarter. This was probably due to a slower pass-through of changes in market rates to interest rates on loans of over EUR 1 million. This is mainly connected with the possibilities of external financing for large companies and the improved credit conditions in the form of lower interest rates.

Although lending rates for non-financial corporations increased, approximately 13% more loans were provided to non-financial corporations in 2006, compared with 2005 (excluding current account overdrafts and credit cards).

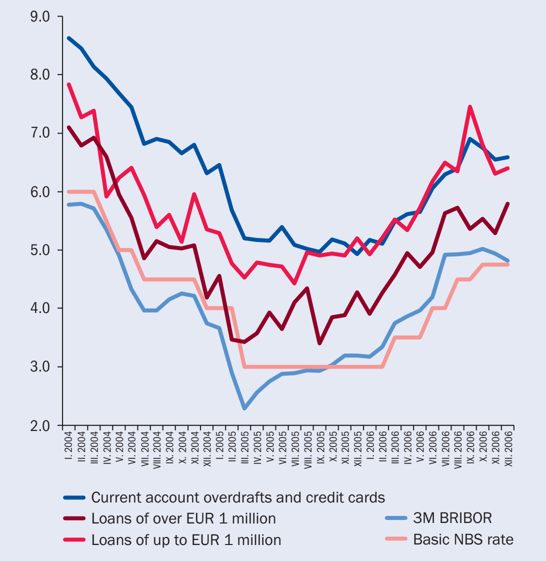
During 2006 interest rates on loans to non-financial corporations (excluding current account overdrafts and credit cards) rose by 1.4 percentage points and rates for current account overdrafts and credit cards increased by 1.7 percentage points. Looking at the breakdown of loans by purpose, the steepest increases occurred in rates for operating loans (1.7 percentage points) and investment loans (1.4 of percentage points).

Interest rates on loans to households

Developments in interest rates on loans to households were characterised, as in the case of non-financial corporations, by a rising trend during 2006, which reflected the increases in key NBS rates. Despite the rising interest rates on loans to households, the relatively high demand for loans continued, especially for loans for house purchases.

The marked rise in rates for current account overdrafts and credit cards in the first few months of 2006 was connected with the expected increases in key NBS rates and the methodological change in the reporting of loans based on the new NBS decree on the classification of assets and liabilities[7]. In the following period, interest rates on current account overdrafts and credit cards continued to rise slowly, in reaction to the increases in key NBS rates. The rise

Chart 58 **Interest rates on loans to non-financial corporations, 3-M BRIBOR, and the basic rate of the NBS** **(%)**



Source: NBS.

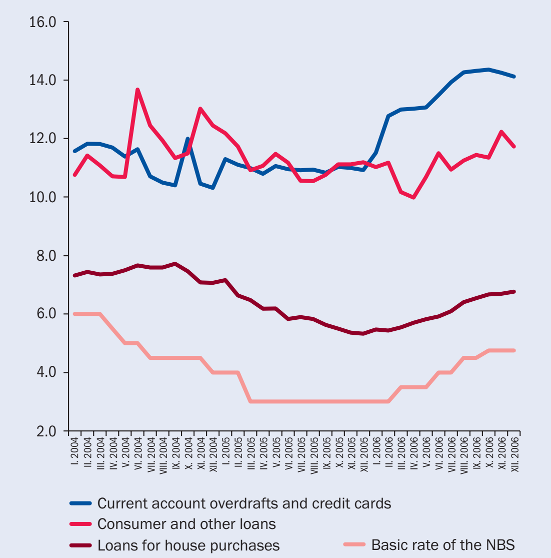
in lending rates for these types of loans reached 3.2 percentage points year-on-year in December 2006.

Interest rates on loans for house purchases also rose somewhat in each month of 2006. This development was mainly connected with the increases in key NBS rates. The average price of house purchase loans rose by 1.4 percentage points during 2006. Within the scope of loans for house purchases, however, interest rates on bank loans and home savings bank loans followed different trends. While interest rates on other loans for house purchases and mortgage loans significantly increased, the rate for intermediate loans rose only slightly and that for building loans dropped somewhat. Home savings bank loans (mainly building loans granted after the saving period) are less dependent on the setting of the key central bank rate than bank loans. On a year-on-year basis, lending rates increased for other loans for house purchases (by 1.7 percentage points), mortgage loans (by 1.5 percentage points), and intermediate loans (by 0.6 of a percentage point), while the price of building loans fell by 0.3 of a percentage point.

After a slight fall at the beginning of 2006, interest rates on loans for consumption (consumer and other loans) showed a moderately rising tendency, reflecting the increase in the key NBS rates. This was mainly reflected in the price of consumer loans granted for specific purposes, which rose by approximately 1.2 percentage points, and in the price of American

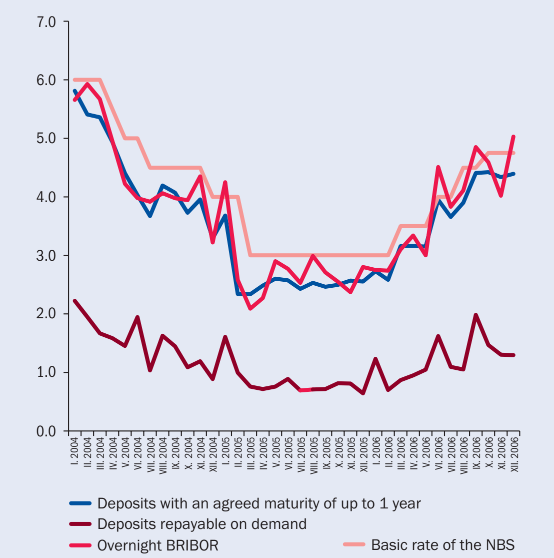
[7] *Decree No. 7/2005 of the NBS on the classification of assets and liabilities of banks and branches of foreign banks, adjustment of their valuation, formation and dissolution of reserves, and related reporting.*

Chart 59 **Interest rates on loans to households** (%)



Source: NBS.

Chart 60 **Interest rates on deposits from non-financial corporations** (%)



Source: NBS.

mortgages (non-specific loans secured by real estate), which increased by 1 percentage point. The rate for non-specific consumer loans remained unchanged in December 2006 (compared with January), though its fluctuations observed during this period reached up to 1.5 percentage points.

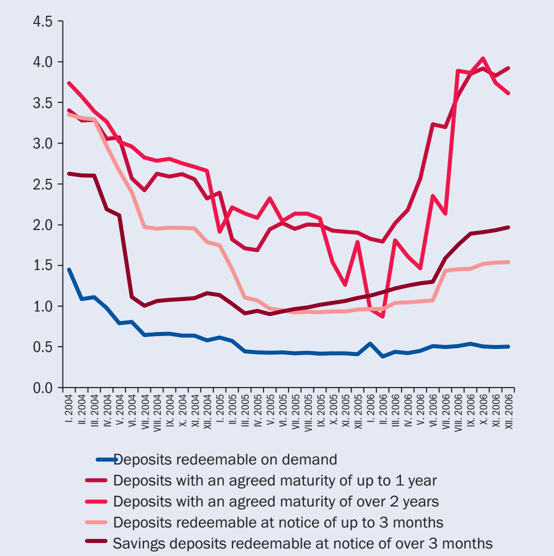
Interest rates on deposits from non-financial corporations

Interest rates on deposits from non-financial corporations followed a rising trend in 2006, which reflected the increases in key NBS rates and the situation on the interbank market. Customer interest rates reacted to the increases in the key NBS rates relatively flexibly. This was mainly indicated by developments in the prices of deposits with an agreed maturity of up to 1 month and up to 1 year, when interest rates on these types of deposits rose by an average of 2 percentage points, to 4% (up to 1 year) and 4.6% (up to 1 month) respectively. Interest rates on deposits repayable on demand were relatively volatile, with fluctuations copying the levels of interbank market rates (except in December 2006). Deposits with an agreed maturity of over 1 year and deposits redeemable at notice form a negligible part of the deposits from non-financial corporations, hence their interest rates are rather volatile.

Interest rates on household deposits

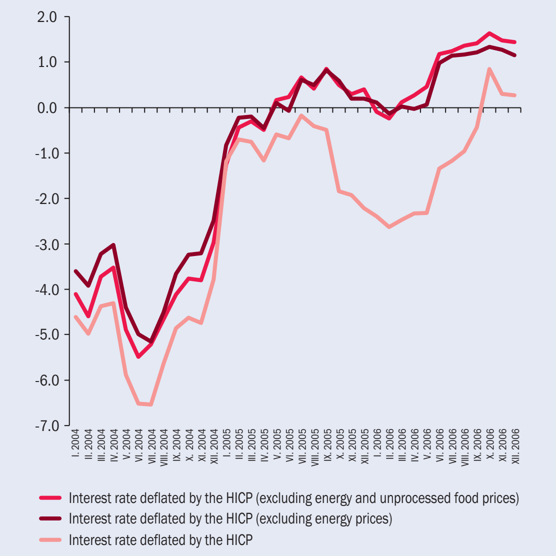
Interest rates on household deposits were characterised by a rising tendency in 2006. This was mainly a consequence of increases in the key NBS interest rates. The strongest reaction was recorded in interest rates on long-term deposits (deposits with agreed maturity). Within the scope of deposits with agreed maturity, the steepest increases took place in rates for deposits with an agreed maturity of over 2 and up to 5 years (3 percentage points) and deposits maturing in up to 1 year (2.4 points). Despite the marked increase, however, interest rates on household deposits with agreed maturity remained below the level of deposit rates for non-financial corporations. Interest rates on

Chart 61 **Interest rates on household deposits** (%)



Source: NBS.

Chart 62 **Real interest rates on household deposits** **(%)**



Source: NBS, Statistical Office of the SR.

deposits redeemable at notice rose during 2006 only slightly and those on demand deposits were stagnant throughout the year.

Real interest rates, calculated by deflating the rates of interest on the amounts of one-year household deposits by HICP inflation, showed a rising tendency during 2006. This was mainly connected with the increases in deposit rates and the gradual fall in inflation at the end of the year. As a result of this development, the real interest rates recorded their first positive values in the final quarter of 2006.

2.6 Monetary policy instruments

Interest rate policy

Basic interest rate of the NBS[8] *(the rate for two-week repo tenders):*

from	1 March 2005	3.00%
from	1 March 2006	3.50%
from	31 May 2006	4.00%
from	26 July 2006	4.50%
from	27 September 2006	4.75%

Interest rate for overnight refinancing operations:

from	1 March 2005	4.00%
from	1 March 2006	4.50%
from	31 May 2006	5.00%
from	26 July 2006	6.00%
from	27 September 2006	6.25%

Interest rate for overnight sterilisation operations:

from	1 March 2005	2.00%
from	1 March 2006	2.50%
from	31 May 2006	3.00%
from	26 July 2006	3.00%
from	27 September 2006	3.25%

Monetary policy instruments of the NBS

Open market operations

a) *Main instrument – standard repo tender with a maturity of two weeks:*
The NBS conducts standard repo tenders with commercial banks on a weekly basis, usually on Tuesdays. The NBS also sets an interest rate for such operations (the basic interest rate).
b) *Instrument for longer-term liquidity management – 3-month central bank bills issued for the portfolios of commercial banks:*
The NBS generally conducts auctions in NBS bills once a month, by using the American auction technique.
c) *Fine-tuning instruments:*
An instrument of the NBS for fine-tuning the liquidity of banks and interest levels on the market (on an ad hoc basis) in the case of unexpected liquidity fluctuations. This instrument was not used in 2006.
d) *Structural operations – individual transactions:*
An instrument of the NBS for optimising the level of liquidity with respect to the structural position of the central bank vis-à-vis the financial sector. This instrument was not used in 2006.

Standing facilities

a) *Overnight refinancing operations:*
Commercial banks have automatic access to sources of finance (provided they have a sufficient amount of eligible securities), at the rate of interest announced.
b) *Overnight sterilisation operations:*
Commercial banks are allowed to deposit excess funds in the form of non-collateralised deposits, at the rate of interest announced.

[8] *On 12 December 2002, the Bank Board of the NBS decided to introduce a basic NBS interest rate 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, refers to the basic interest rate of the National Bank of Slovakia.*

Other instruments

Short-term loans for a period of up to three months: To maintain a bank's liquidity, the NBS may, in exceptional cases, provide a short-term loan to the bank concerned. This instrument was not used in 2006.

Reserve requirements

With effect from 1 January 2005, banks, branches of foreign banks, and electronic money institutions are required to maintain minimum reserves in the amount of 2%:
- of demand deposits, time deposits, and loans received in Slovak koruna or foreign currency;
- of deposits redeemable at notice and loans received in Slovak koruna or foreign currency;
- of debt securities issued in Slovak koruna or foreign currency, except for mortgage bonds.

Maintained reserves are evaluated on a monthly basis. Required minimum reserves held at the NBS on money reserve accounts pay interest at a rate of 1.5% p.a., up to the amount set for the given month.

Exchange-rate and foreign-exchange policies

a) *Exchange rate regime:*
During 2006, the Slovak koruna participated in the Exchange Rate Mechanism II (ERM II). The central parity of the koruna vis-à-vis the euro was set at EUR 1 = SKK 38.4550. In accordance with the standard fluctuation band in ERM II (±15% around the central rate), the compulsory intervention rates were SKK/EUR 32.6868 (lower limit) and SKK/EUR 44.2233 (upper limit). The Národná banka Slovenska intervened in the foreign exchange market. These interventions were made in order to correct cases of excessive volatility in the exchange rate of the Slovak koruna, or to respond to the exchange rate development inconsistent with the macroeconomic fundamentals.

b) *Nominal exchange rate of the Slovak koruna:*
In relation to the euro, the nominal exchange rate of the koruna appreciated during the year by 8.65%, to SKK/EUR 34.573 on 29 December 2006 (the average annual rate of appreciation was 3.53%). This rate was 10.09% stronger than the central rate fixed under ERM II. Owing to the depreciation of the US dollar against the euro on the world markets, the exchange rate of the Slovak koruna appreciated vis-à-vis the US dollar by 17.85%, to SKK/USD 26.246 at the end of 2006 (representing an average appreciation of 3.97% during the year).

c) *Nominal and real effective exchange rates of the Slovak koruna:*
The average year-on-year appreciation of the nominal effective exchange rate (NEER) of the Slovak koruna accelerated to 2.4% in 2006, from 1.7% in the previous year. The accelerated appreciation of the NEER index was mostly caused by the strengthening of the koruna against the euro (by 1.9 percentage points), followed by an appreciation in relation to the Hungarian forint (0.4 of a percentage point). The appreciation of the nominal effective exchange rate was mostly dampened by a negative contribution (-0.3 of a percentage point) coming from the weakening of the domestic currency vis-à-vis the Czech koruna.
The faster appreciation of the Slovak koruna in 2006 (in nominal terms) was also accompanied by an accelerated appreciation in the real effective exchange rate (REER). The average year-on-year appreciation of the REER index, defined on the basis of consumer prices, accelerated in comparison with the previous month by 2.8 percentage points, to 4.2%. This development was also supported by an increase in the inflation differential vis-à-vis foreign trading partners, caused by an increase in regulated prices. In the case of the REER index, defined on the basis of industrial producer prices, the rate of appreciation accelerated by 4.7 percentage points, to 6.6%, due partly to a rise in domestic price levels as a result of increases in raw materials and energy prices. The appreciation

Table 28 **Developments in the currency structure of foreign exchange receipts and payments**

	2003	2004	2005	2006
Total turnover (in billions of SKK)	1,536.8	1,657.5	1,892.5	2,225.4
of which: euro (including former EMU currencies)	69.8 %	70.2 %	69.0 %	69.7 %
Czech koruna	7.8 %	7.5 %	7.3 %	6.6 %
American dollar	19.0 %	18.8 %	19.6 %	18.8 %
other currencies[1)]	3.3 %	3.6 %	4.1 %	4.8 %
Turnover as a share of GDP (at current prices)	126.7 %	122.3 %	128.6 %	136.0 %

Source: NBS.
1) Hungarian forint, Danish krone, Norwegian krone, Swedish krona, Swiss franc, British pound, Australian dollar, Japanese yen, Canadian dollar, and other currencies.

of the REER index, defined on the basis of manufacturing products prices, accelerated during 2006 by an average of 1 percentage point, to 0.4%.

d) *Evaluation of the currency structure of foreign exchange receipts and payments in the Slovak Republic:*
The total turnover of receipts and payments in convertible currencies in the payment categories 1 to 6 reached SKK 2,225.4 billion in 2006. The average monthly turnover stood at SKK 185.4 billion, which was 17.6% more than in 2005. The negative balance considerably deepened on a year-on-year basis, to SKK 136.1 billion, which was SKK 105.2 billion more than in 2005. In the long term, the currency structure of the total turnover is dominated by EUR and USD, with a total share of 88.5% in 2006. The share of the euro slightly increased in comparison with 2005 (by 0.7 of a percentage point), while that of the US dollar decreased (by 0.8 of a percentage point). The share of the Czech koruna followed a long-term downward trend and decreased by 0.7 of a percentage point, while that of other currencies increased by 0.7 of a percentage point.

2.7 Chronology of monetary developments

January

• The functions of the Financial Market Office – its supervisory and regulatory powers, tasks and responsibilities, including its employees – are passed over to the Národná banka Slovenska with effect from 1 January 2006.

February

• The Bank Board of the NBS decides to increase its key interest rates by 0.5 of a percentage point with effect from 1 March 2006. The limit rate for two-week repo tenders is raised to 3.5%, the rate for overnight refinancing transactions to 4.5%, and that for overnight sterilisation operations to 2.5%.

March

• Fitch Ratings and Standard & Poor's Ratings Services assign an A rating with a stable outlook to Slovak eurobonds issued under the Euro Medium-Term Note programme.

May

• The Bank Board of the NBS decides to increase its key interest rates by 0.5 of a percentage point with effect from 31 May 2006. The limit rate for two-week repo tenders is raised to 4.0%, the rate for overnight refinancing transactions to 5.0%, and that for sterilisation operations to 3.0%.

June

• After the parliamentary elections, the NBS conducts two foreign exchange interventions during the month, in which EUR 1,335 million is sold in total.

July

• The NBS accepts a new strategy for managing its branch offices and sub-branches, aimed at ensuring a more optimal and economical management in the individual organisational units – some of the NBS branches and sub-branches are cancelled with effect from 1 July 2006. The sub-branches in Bratislava, Trenčín, Nové Zámky, Žilina, Lučenec, Banská Bystrica, Poprad, Košice, and Humenné are maintained as offices charged with the exclusive task of ensuring money circulation and money supply management.

• The Bank Board of the NBS decides to change its key interest rates with effect from 26 July 2006. The rate for overnight refinancing transactions is increased to 6.0%, the limit rate for two-week repo tenders is raised to 4.5%, while the rate for overnight sterilisation operations is kept unchanged, at the level of 3.0%.

• The Národná banka Slovenska intervenes in July and sells a total of EUR 1,750 million in direct foreign exchange interventions.

September

• The Bank Board of the NBS decides to increase its key interest rates by 0.25 of a percentage point with effect from 27 September 2006. The rate for overnight refinancing transactions is raised to 6.25%, the limit rate for two-week repo tenders to 4.75%, and the rate for overnight sterilisation operations to 3.25%.

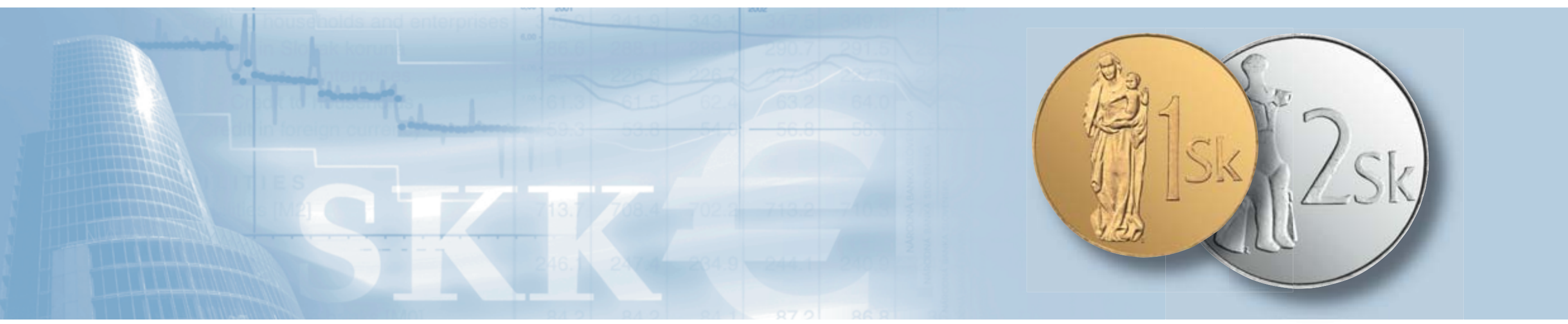
October

• Moody's Investors Service increases its rating for Slovak government bonds in both domestic and foreign currency, from A2 to A1. According to the agency, this step can be ascribed to the good results achieved in the area of structural reforms and the continuing strong economic growth. Moody's Rating Agency also increases the ceiling for foreign-currency bank deposit ratings, from A2 to A1, with a stable outlook.

December

• The Národná banka Slovenska intervenes in December and purchases a total of EUR 495 million in direct foreign exchange interventions.

NBS Monetary Operations



3 NBS Monetary Operations, Foreign Exchange Operations and Investment Activities in Foreign Reserve Management

3.1 Monetary policy operations

The implementation of NBS monetary policy in 2006 was related to decisions taken by the NBS Bank Board in the previous year. The essential framework of NBS instruments comprised operations with banking institutions, namely operations on the open market (including the issuance of short-term securities) and standing facilities, the size and structure of which were subject to current developments in the liquidity of the Slovak banking sector. An anti-inflationary approach was accentuated, and had the most important effect on the NBS monetary policy decisions. Concerning foreign exchange operations, the NBS was looking to correct incidents of emerging and inappropriate volatility in the exchange rate of the Slovak koruna against the euro. It also sought to correct speculation-driven exchange rate movements, representing a deviation from the expected equilibrium level.

Liquidity management in the banking sector

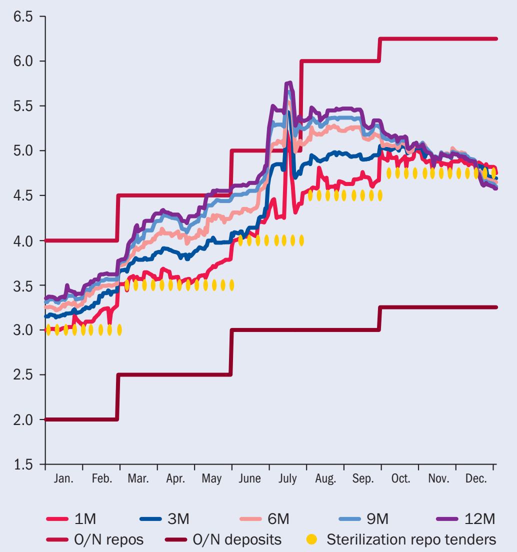
As in previous years, the banking sector's liquidity was quite ample during 2006. The average daily amount sterilized through monetary policy operations fell by SKK 53.1 billion in comparison with 2005, to stand at SKK 346.1 billion, and the conduct of monetary policy continued to have the same sterilization character. The overall liquidity surplus fluctuated during the year, largely due to foreign exchange interventions performed. Sales of euros in June and July, made against Slovak currency weakening, had the effect of reducing the average monthly sterilization position – from SKK 390.1 billion in January, the figure was down to SKK 288.2 billion in August and shrank further by the end of the year to stand at SKK 279.7 billion in December.

Main monetary policy operations

In 2006, standard sterilization repo tenders continued to be the main monetary policy operations. This instrument's share of total sterilization positions fluctuated above 90% for most of the year. As in the previous period, sterilization repo tenders were held on a regular weekly basis and their 14-day maturity period likewise remained unchanged. A total of 52 sterilization repo tenders were held during the year, and in each of them the NBS accepted the full demand. In all cases, the average interest rate matched the NBS current interest rate limit for repo tenders. Amid monetary policy tightening, this key rate was raised by the NBS Bank Board several times during the course of the year. After starting out at 3%, it underwent four adjustments to stand at 4.75%. The banking sector automatically passed on the key rate increments to money market rates. Under the effect of interest rate movements, as well as persisting expectations for further rate hikes, the money market curve was steadily moving up, except at the year-end. The appearance of an inversion curve at the end of

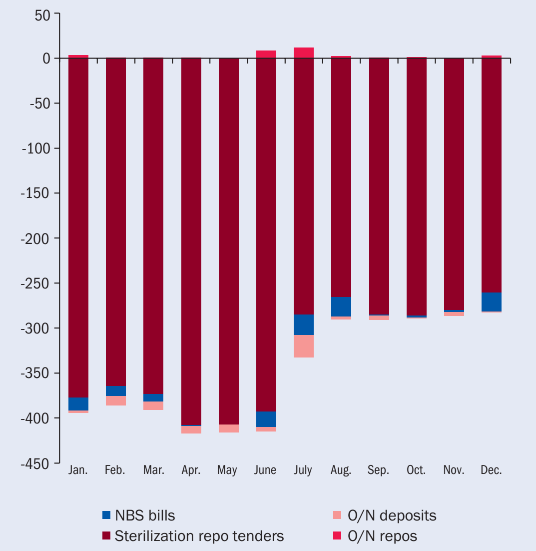
Chart 63 **BRIBOR in 2006**

(% p. a.)



Source: NBS.

Chart 64 **Open market operations in 2006 by type (monthly average) (SKK billion)**



Source: NBS.

the year reflected shifting anticipation of the further development of interest rate expectations.

Longer-term operations

Regular auctions of NBS bills were a supplementary monetary instrument that NBS also used during the course of 2006. There were a total of 13 auctions with a standard 84-day maturity. Demand in the auctions was affected by expectations for a gradual rise in NBS key rates. The application of the same limit rate to this three-month monetary instrument as to two-week sterilization repo tenders was reflected in the relatively low interest as well as in the demand accepted. That was why this type of longer-term sterilization of funds declined as a proportion over the year, to below one per cent. By the end of the year, the banking sector had reviewed and adjusted its expectations for the NBS key rates to reflect current macroeconomic developments as well as the continuing appreciation trend of the Slovak koruna. While it was expected to see the NBS key rates unchanged in the near term, the banking sector counted on rate cuts in the long run. As a result, the last auction of 2006 attracted higher interest, but although the accepted demand exceeded SKK 36 billion, it did not materially affect the share of NBS bills in the overall sterilization position in 2006.

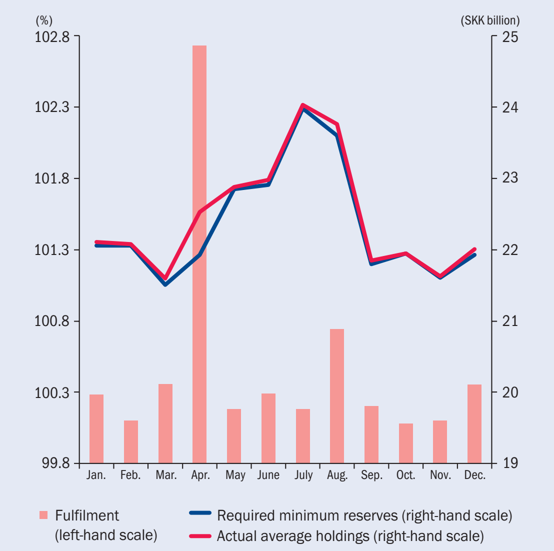
Standing facilities

Standing facilities, which take the form of deposits with the NBS, if there is excess liquidity, or repo transactions, if liquidity is insufficient, were used by banks in 2006 to adjust their current liquidity position. Both forms were applied in a standard way with a one-day maturity. Standing facilities were typically used at times when the banking sector, participating in main monetary operations, incorrectly estimated its total available funds. Towards the end of months, especially on the last days, banks's recourse to these facilities accelerated, in the effort to adjust their positions so as to meet the minimum reserve requirements. Since sterilization was a principal feature of monetary policy, it was also predominant within standing facilities. Nevertheless, the banking sector found itself at several times making more intensive use of overnight credit. Banks were also drawing intra-day credit during the course of the year. In comparison with standing facilities, this method was used only to ensure smooth operation of the payment system and did not have any monetary effects.

Minimum reserve system

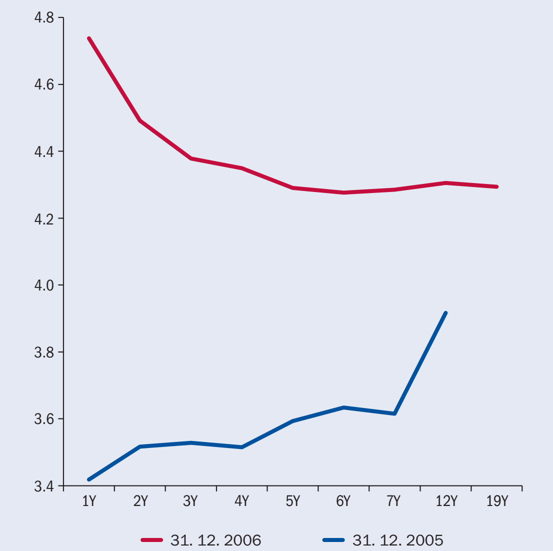
In Slovakia, the requirement to create and maintain minimum reserves applies to banks, branches of foreign banks and electronic money institutions. Besides influencing interest rates on the domestic money market, required minimum reserves also provide for the short-term liquidity of banking entities. A total of 17 banks and 7 branches of foreign banks held minimum reserves in 2006. Among the branches of foreign banks, one conducted banking activities under a licence issued by the NBS and six did so under a single banking licence applicable throughout the European Union and issued in the home Member State of the parent company. The conditions for minimum reserve system remained unchanged in 2006: a minimum reserve ratio of 2% of specific liability items, a period of one calendar month, and interest at a fixed rate of 1.5%. Ahead of euro area entry, the NBS is required to bring the national minimum reserve system into line with that applied in the euro area. Changes will concern, for example, the monitoring period for minimum reserve maintenance, with the length to be determined according to the meetings schedule of the ECB General Council. Moreover, the fixed interest on minimum reserves (remuneration) will be replaced with a variable rate derived from the ECB's interest rate. The value of required minimum reserves showed a rising trend during the first half of 2006 and increased by an average of SKK 1.9 billion. The trend reversed in the second half of the year and the value of required reserves decreased on average by SKK 2 billion. The actual fulfilment of the minimum reserve requirement for the banking sector as a whole was balanced in 2006, with the exception of April. Amid a marked excess of liquidity in the banking sector and continuing absorption of liquidity by NBS interventions, the total minimum reserve requirement was met in each month of the year.

Chart 65 **Required minimum reserves in 2006**



Source: NBS.

Chart 66 **Benchmark yield curve of government bonds** **(in % p. a.)**



Source: NBS.

Risk management

In 2006 NBS continued to apply the risk management system which it had introduced in 2005. It is still in the process of harmonizing this system with the principles applied in the euro area, prior to entry into the same. That is why the conditions for selecting counterparties, and for selecting financial assets, which the NBS accepts in monetary policy operations are set out in NBS decisions. These eligible financial assets are valued at market or theoretical prices on a daily basis. The system of financial asset valuation also includes haircuts, monitored and adjusted by the NBS on the basis of developments in financial asset prices in domestic financial markets. Since the conditions for using the "Single List" (of assets eligible for Eurosystem monetary policy operations) in its entirety require not only the mentioned selection of assets but also supplementation of the legal framework related to financial assets, as well as intensive communication between the NBS and ECB or other central banks, the NBS at the end of 2006 began to work on targeted preparations for these needs, including the automation of the respective procedures. Banks and other financial institutions are to be informed about these conditions by the NBS in the run up to euro area entry.

Benchmark bond yield curve

In 2006 the NBS continued to coordinate the quotation of prices for benchmark government bond portfolios traded by banks and to create the related yield curve. The NBS monitored the benchmark portfolio structure on a continuous basis and updated it in cooperation with the banks. The benchmark portfolio of securities was last updated in November 2006, the aim being to broaden the term structure of the quoted government bonds. One of the criteria for the inclusion of a bond in the benchmark portfolio is a minimum issue amount of SKK 5.0 billion. At present, the portfolio includes bonds with a maturity of 1 to 7 years as well as 12-year and 19-year bonds. The prices are set by the daily processing of quotations given by eight banks active in the market, and they are published on the Reuters system. Like banks, the NBS uses indicative benchmark curve prices for the theoretical valuation of financial assets.

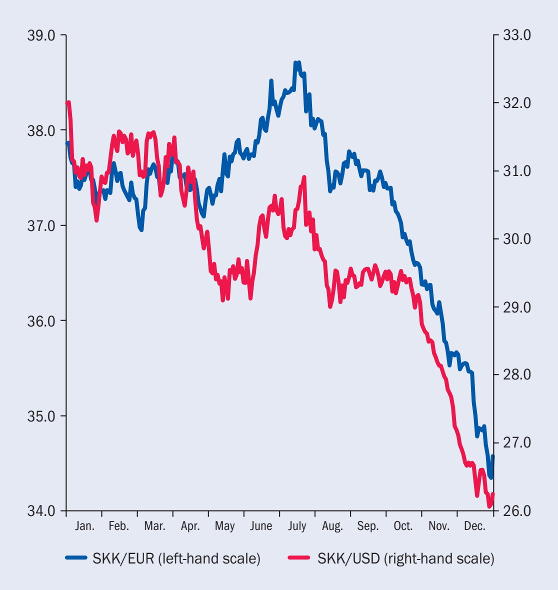
Government bond yields in 2006 were affected mainly by changes in the NBS key interest rate, expectations for these changes, and the exchange rate of the Slovak koruna. After the parliamentary elections, however, these yields were briefly, but markedly, influenced by the domestic political situation. It was mainly the yields on shorter maturities that were affected when the NBS raised key rates four times, as a result of which the yield curve's standard slope flattened out or evened. Following the last of the key rate increases, the yield curve acquired a distinct inversion.

3.2 Foreign exchange operations

Foreign exchange market operations

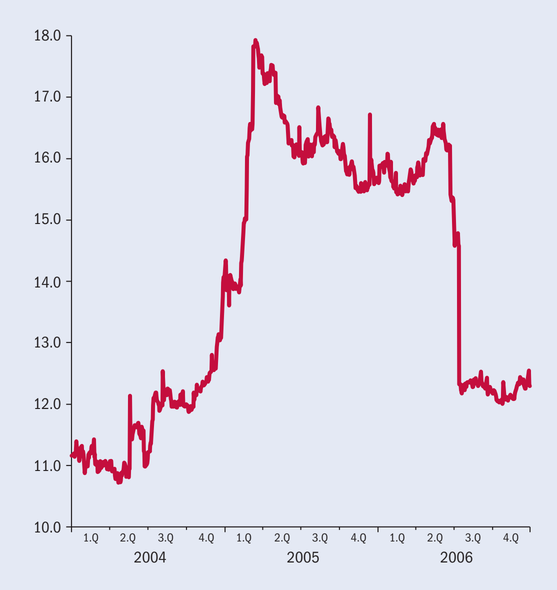
During 2006, the exchange rate of the Slovak koruna against the euro appreciated by 8.65% (from SKK/EUR 37.848 at 31 December 2005, to SKK/EUR 34.573

Chart 67 **Exchange rates of the Slovak koruna against the euro and dollar in 2006**



Source: NBS.

Chart 68 **Foreign reserve assets managed by the NBS (USD billion)**



Source: NBS.

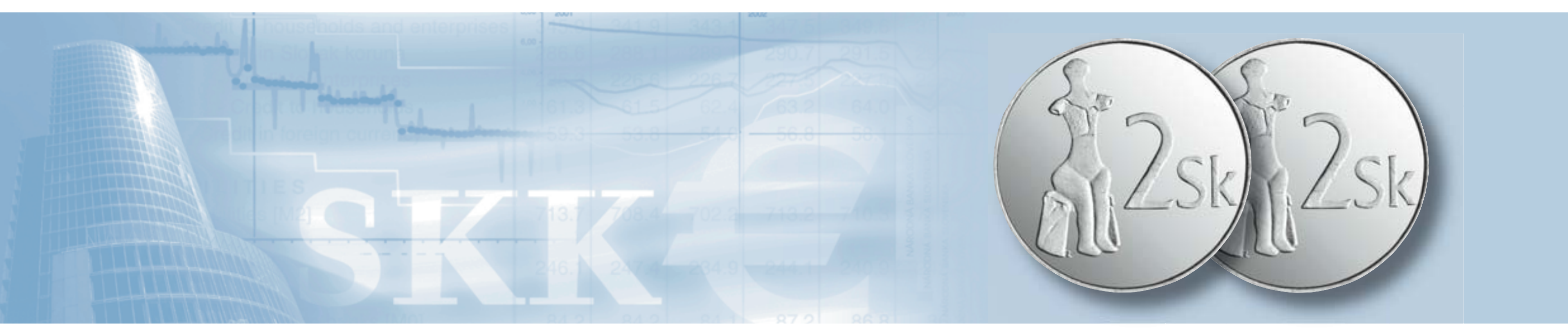
at 31 December 2006). The average exchange rate was SKK/EUR 37.248, representing an appreciation of 3.5% in comparison with 2005. Against the US dollar in 2006, the koruna's exchange rate strengthened by 17.85% (from SKK/USD 31.948 at 31 December 2005, to SKK/USD 26.246 at 31 December 2006). The average exchange rate was SKK/USD 29.724, representing an appreciation of 4.2% year-on-year. The exchange rate of the Slovak koruna against the Czech koruna strengthened by 4%.

In regard to the Slovak koruna's strong volatility, the NBS made several foreign exchange interventions in 2006. As a result of the premature demise of the coalition-led government, and especially the pre-election uncertainty which this gave rise to, as well as the increased aversion of investors to the currencies of emerging markets, the Slovak koruna lost value and the NBS reacted with foreign exchange interventions aimed against its weakening. During the interventions on 21 June, 29 June and 12 July, the NBS sold EUR 3,085 million. The last of these was the largest single-day intervention in Slovakia's history, with the NBS selling EUR 1,750 million. In view of the relatively high amount of foreign exchange funds sold from the NBS foreign reserve assets, there was speculation about whether the central bank had the ability to defend the koruna against any further depreciation. In the second half of the year, however, investors returned to emerging market currencies and the koruna began to show stable appreciation, gaining an average of 2 percentage points per month and finishing the year at its strongest ever level. The koruna appreciated most sharply during December, when it deviated by 11.43% from its central parity. In order to dampen the koruna's volatility, the NBS made another intervention on 29 December, entering the market when the currency was at its strongest level of the year: SKK/EUR 34.060. The NBS purchased EUR 495 million to curb the koruna's appreciation, and so in the net balance of foreign exchange interventions in 2006 it sold EUR 2.59 billion.

Investment activities in foreign reserve management

In 2006, as in the previous two years, the NBS conducted investment policy for foreign reserve management in accordance with the rules set out in the long-term investment strategy that it approved in 2004. Last year, as part of an active approach to foreign reserve management, the NBS began trading in futures contracts, both for the dollar investment portfolio and for the euro investment portfolio. In regard to the Slovak koruna's considerable exchange rate volatility against the euro during 2006, the corrective interventions made in response affected both the total value of foreign reserve assets and the values of individual portfolios. The value of foreign reserve assets at the respective exchange rates and market prices fell from USD 15.5 billion at the end of 2005 to USD 13.4 billion at the end of 2006. The return on foreign reserves represented 1.8% for the euro investment portfolio and 4.4% for the dollar investment portfolio. The total interest income from foreign reserve management in 2006 was approximately SKK 9.6 billion.

Financial
Market Supervision



4 Financial Market Supervision

4.1 Regulation of the financial market in Slovakia

In exercising supervision of the financial market – in banking, the capital market, the insurance industry and pension saving – the Národná banka Slovenska follows general procedural rules laid down in Act No. 747/2004 Coll. on financial market supervision, as amended. This statute entered into force on 1 January 2006, the date that the Národná banka Slovenska assumed the competences of an integrated financial market supervisory authority, including the powers exercised by the Financial Market Authority until 31 December 2005.

The aim of financial market supervision (responsibility for which lies with a deputy governor of the Národná banka Slovenska) is to support both the stability of the financial market as a whole and its secure and sound operation. The financial market supervision department conducts financial market regulation, involving mainly:

– rulemaking activities – it produces draft generally binding legal regulations of the Národná banka Slovenska in the financial market field, in particular, draft prudential regulation, operational security rules and other requirements for the conduct of business by supervised entities;

Table 29 **Number of financial institutions**

	Number of institutions as at 31 December 2006	Number of institutions as at 31 December2005	Change
Number of banks in Slovakia	17	18	-1
Home savings banks	3	3	0
Mortgage-lending banks	9	9	0
Other banks	5	6	-1
Number of branches of foreign banks in Slovakia	7	5	+2
of which: authorized by the NBS	1	1	0
on the single European passport principle	6	4	+2
of which: branches of foreign mortgage-lending banks	1	1	0
Number of foreign banks branches‘ contributing to the Deposit Protection Fund	2	2	0
Number of foreign banks‘ representative offices in Slovakia	10	9	+1
Number of branches (organizational units) of banks in Slovakia	715	692	+23
Number of lower organizational units in Slovakia	460	457	+3
Number of branches of Slovak banks in other countries	1	1	0
Number of representative offices of Slovak banks in other countries	1	1	0
Number of foreign entities freely providing cross-border banking services	131	104	+27
Banks	123	99	+24
Electronic money institutions	3	2	+1
Foreign financial institutions	3	3	0
Credit cooperatives	2	0	+2
Slovak banks providing free cross-border banking services abroad	1	1	0
of which: electronic money institutions	0	0	0

Continued on page 74

Table 29 **Number of financial institutions (continued)**

	Number of institutions as at 31 December 2006	Number of institutions as at 31 December 2005	Change
Number of staff of banks and branches of foreign banks	19,525	19,850	-325
Number of insurance companies in Slovakia	24	25	-1
of which: insurance companies providing only life insurance	5	5	0
insurance companies providing only non-life insurance	5	4	+1
insurance companies providing life or non-life insurance	14	16	-2
Insurance companies providing services on a freedom to provide services basis	296	200	+96
of which: without establishing a branch	289	196	+93
of which: through branches	7	4	+3
Number of insurance companies in Slovakia providing compulsory contractual third-party liability insurance for motor vehicles	9	8	+1
Number of pension fund management companies	6	8	-2
Number of supplementary pension companies	3	0	+3
Number of supplementary pension insurance companies	1	5	-4
Number of domestic asset management companies in Slovakia	10	10	0
of which: asset management companies with an extended licence under Article 3(3) of the Collective Investment Act	7	7	0
Number of domestic mutual funds	109	100	+9
Open-end mutual funds	62	51	+11
Closed-end mutual funds	44	49	-5
Special mutual funds	3	0	+3
Number of foreign asset management companies and foreign collective investment undertakings operating in Slovakia on the basis of an authorisation issued under Article 75 of the Collective Investment Act	3	3	0
Through a branch in Slovakia	2	2	0
Without establishing a branch	1	1	0
Number of foreign asset management companies and foreign collective investment undertakings operating in Slovakia on the basis of a single European passport	21	14	+7
Foreign asset management companies	7	4	+ 3
Foreign investment companies	14	10	+ 4
within which: number of mutual funds and sub-funds of foreign investment companies	360	294	+66
Number of foreign asset management companies performing activities under Article 3(3) of the Collective Investment Act	6	3	+ 3
Number of securities dealers	33	36	-3
of which: banks and branches of foreign banks	18	18	0
Number of foreign entities operating in Slovakia as securities dealers	304	204	+100
Through a branch in Slovakia	2	2	0
Without establishing a branch	302	202	+100
Number of Slovak securities dealers providing services abroad	7[1)]	5[2)]	+2
Number of investment services intermediaries in Slovakia	888	756	132
Legal persons	55	37	18
Natural persons	833	719	114

Source: NBS.
1) In sixteen countries.
2) In nine countries.

- licensing activities – it conducts proceedings, takes first-instance decisions, issues authorisations, approvals and prior approvals, and imposes sanctions and corrective measures;
- supervision activities – it supervises financial market entities through on-site and off-site supervision;
- analytical activities – it produces analyses of the financial market as a whole, as well as of individual financial entities.

The financial market comprises four sectors – the banking sector (principally represented by banks and branches of foreign banks), the capital market (mainly securities dealers, asset management companies, the stock exchange and the central securities depository), insurance sector (mainly insurance companies and branches of foreign insurance companies) and the pension savings market (mainly pension fund management companies and supplementary pension companies/pension insurance companies).

Slovakia's membership of the European Union means that foreign banks, foreign financial institutions and electronic money institutions may operate in the country without an authorization from the Národná banka Slovenska, provided that they are authorized in another EU Member State (the single European passport principle). It is a similar situation with securities, which may be offered to the public or admitted to trading on a regulated market in Slovakia on the basis of a prospectus, and supplements thereto, approved by the competent supervisory authority of the issuer's home Member State. In the case that the NBS has been notified of this fact in the relevant manner the approval of the prospectus is not required.

4.2 Rulemaking activities of the supervisor

In the field of financial market regulation, several statutes, statutory instruments, methodological instructions and recommendations governing the legal environment of regulated institutions were adopted in 2006. The purpose of this part is not to enumerate these measures but rather to draw attention to those which have had the greatest effect on the activities of regulated entities in individual financial market sectors in Slovakia.[9]

Statutes and statutory instruments in the banking sector and capital market sector were adopted mainly in order to improve prudential regulation for banks and securities dealers operating on the single financial market of the European Union. As far as the banking and capital market sectors are concerned, the most important of these pieces of legislation is Act No. 644/2006 Coll. amending the Banking Act and the Securities Act, which fully transposes the appertaining provisions of Directive 2006/48/EC of the European Parliament and of the Council relating to the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC of the European Parliament and of the Council on the capital adequacy of investment firms and credit institutions. These directives, implementing the New Basel Capital Accord (Basel II), are aimed mainly at ensuring that the capital requirements of banks and securities dealers correspond to the actual risks to which banks and securities dealers are exposed and that groups providing financial services in more than one country are not unduly burdened by multiple levels of legal regulation and supervision. The amended prudential regulation are also focused on strengthening risk sensitivity, take into account the mitigation of risks related to the context in which individual exposures arise, and reflect the substantial progress in risk management and measurement procedures. For the same reasons, provisions regulating trading book keeping were bolstered and provisions on the treatment of credit derivatives and other financial instruments were introduced.

As regards the capital market, Act No. 213/2006 Coll. amending Act No. 594/2003 Coll. on collective investment and on amendments to certain laws, as amended, entered into force on 1 May 2006. This amendment allows for records of book-entry fund shares/units to be kept separately by an asset management company and depository and, in regard to market requirements, it provides for the creation of a new type of mutual fund – a real-estate special fund. This statute at the same time amended the Securities Act by, inter alia, introducing the holder's account. During 2006 a wide-ranging bill amending the Securities Act was being drafted with the aim of transposing several directives of the European Parliament and of the Council into Slovak law, e.g. Directive 2004/39/EC on markets in financial instruments (MiFID), as well as Commission implementing Directive 2006/73/EC and Directive 2004/109/EC on the harmonisation of transparency requirements. A bill amending Act No. 429/2002 Coll. on the stock exchange was also drafted for the purpose of implementing these directives. The amendment bill on the Securities Act includes an amendment to the Collective Investment Act which is designed to remove certain legislative barriers in the part concerning the real-estate special fund, in particular stipulations referring to real estate companies. On 20 December 2006, the NBS Bank Board approved NBS Decree No. 14/2006 on the submission of reports by asset management companies for the company and the mutual funds it manages, deposi-

[9] *A summary of the legal norms which concern the remit of the NBS and were adopted in 2006 is given in Chapter 10.*

tories of mutual funds, stock exchange and central depository of securities for the purpose of supervision of the financial market and for statistical purposes. The decree on the submission of reports is the first legal regulation concerning the capital market that provides for the collection of data required for off-site supervision and statistical purposes by means of the application software system STATUS DFT.

In the insurance sector, legislative activity included the adoption of Act No. 188/2006 Coll. amending Act No. 381/2001 Coll. on compulsory contractual motor vehicle third-party liability insurance and on amendments to certain laws, under which the policyholder is required to conclude an insurance contract with his existing insurer for the remainder of the insurance period where his original contract has been terminated owing to premium payment default. This law also changed the way members of the Slovak insurers' bureau pay their annual contributions. A number of adopted statutes included amendments to Act No. 95/2002 Coll. on the insurance industry and amending and supplementing certain acts, concerning, for example, reporting by supervised entities and the assessment of the credibility of entities for the purposes of that Act. In 2006 fundamental changes were made in regard to insurance intermediaries and reinsurance intermediaries, related to the entry into force on 1 September 2005 of Act No. 340/2005 on insurance mediation and reinsurance mediation and on amendments to certain laws, as amended, which required insurance intermediaries to be in compliance with this law by not later than 31 December 2006. The Register of Insurance Intermediaries and Reinsurance Intermediaries was also established. At the level of secondary legislation, there was the adoption of NBS Decree No. 8/2006 on the submission of reports by insurance companies and branches of foreign insurance companies, which provides for the collection of data required for off-site supervision and statistical purposes by means of the application software system STATUS DFT and which takes account of the need to adjust to the trend of risk-oriented supervision.

In the field of pension savings, there were alternations to primary legislation with the adoption of two acts that amended the law on retirement pension saving and the law on supplementary pension saving. The more comprehensive amendment, effective as of 1 August 2006, was Act No. 310/2006 Coll., amending Act No. 461/2003 Coll. on social insurance and on amendments to certain laws, as amended. This piece of legislation changed certain provisions on personal scope in retirement pension saving in relation to amendments contained in Act No. 461/2003 Coll. on social insurance, as amended; it elaborated the provision on the protection of savers' personal data and on retirement pension saving contracts, introduced the return of retirement pension saving contributions from the pension fund to the Social Insurance Agency, and changed the rules under which certain activities of a pension fund management company may be delegated to another entity. This law also abolished the position of the intermediary of retirement pension saving with effect from 1 January 2007. In the area of supplementary pension saving, this law transposed Directive 2003/41/EC of the European Parliament and of the Council on the activities and supervision of institutions for occupational retirement provision. Within secondary legislation concerning retirement pension saving, a decree was issued in regard to the implementation of STATUS DFT, a system that will provide for the collection, processing and storing of statistical data reported by financial market entities.

4.3 Licensing activities of the supervisor

Table 30 shows the number and breakdown of licensing-related decisions taken by the NBS in 2006 which concern financial market entities.

Table 30 **Number of decisions issued by the NBS in 2006**

Financial sector	
Banking sector and securities dealers	151
Capital market	299
Insurance sector	370
Pension saving	7,209

Source: NBS.

In 2006 the principal licensing-related decisions taken by the Národná banka Slovenska in respect of entities in the Slovak financial market included the following:

- On 1 March 2006, J & T BANKA, a.s., a branch of a foreign bank, commenced operation on the basis of a single European passport. Deposits of the branch are insured in the Deposit Protection Fund, Prague, the Czech Republic.
- Under an NBS Decision of 17 March 2006, Slovenská sporiteľňa, a.s. received prior approval to use an internal model for the calculation of market risk.
- By its Decision of 15 May 2006, the Národná banka Slovenska issued prior approval for the winding up of CALYON BANK SLOVAKIA, a.s. as a result of a bank enterprise's sale, it having been purchased by the foreign bank CALYON S. A., France. The said company had decided to change the operation of CALYON BANK SLOVAKIA, a.s., controlled by it, in the SR, and transfer all its activities to the newly established branch of CALYON S. A. At the same

time the NBS granted prior approval for the sale of the bank enterprise and the sale of the securities dealer enterprise to the seller, CALYON BANK SLOVAKIA, a.s., and the purchaser, CALYON S. A. France.

- On 22 August 2006, Slovenská sporiteľňa, a.s. received an NBS Decision under which the prior approval for the use of an internal model for the calculation of market risk is expanded.
- Under an NBS Decision of 19 October 2006, UniBanka, a.s. was granted prior approval to become a subsidiary of Bank Austria Creditanstalt AG (Vienna). Another NBS Decision, of 24 October 2006, gave Bank Austria Creditanstalt AG (Vienna) prior approval for the acquisition of a share of 97.11% in the share capital of UniBanka, a.s. and the attached voting rates.
- A licence for the provision of investment services was issued to Money Market Brokers, o. c. p., a. s., Bratislava under an NBS Decision of 31 May 2006.
- In 2006 the NBS issued decisions under which the following companies received prior approval to return their licences for the provision of investment services: Stredoeurópsky maklérsky dom, o.c.p., a.s. (decision dated 29 June 2006), EURÓPSKA KAPITÁLOVÁ o.c.p., a.s. (16 August 2006) and Capital Partners, o.c.p., a.s. (16 October 2006).
- On 14 August 2006, the NBS issued decisions allowing the following securities dealers to change their business names: Across Investment Services, o.c.p., a.s. became Across Wealth Management, o.c.p., a.s., and AFS, o.c.p., a.s. became SALVE INVESTMENTS, o.c.p., a.s.
- A licence for the provision of investment services was issued to ACTIVE FINANCE o.c.p., a.s. Košice under an NBS Decision of 12 October 2006.
- In connection with the possibility to create a new type of mutual fund, the NBS issued four licences for the creation of a real-estate special fund to the following asset management companies:
  - Investičná a dôchodková, správ. spol., a. s.,
  - Asset Management Slovenskej sporiteľne, správ. spol., a. s.,
  - Tatra Asset Management, správ. spol., a. s.,
  - PRVÁ PENZIJNÁ správ. spol., a. s.
- Also in 2006, the Národná banka Slovenska issued:
  - one licence for the creation of a higher-risk special fund to Asset Management Slovenskej sporiteľne, správ. spol., a.s.
  - sixteen licences for the creation of an open-end mutual fund to ČSOB Asset Management, správ. spol., a.s., Tatra Asset Management, správ. spol., a.s., ISTRO Asset Management, správ. spol., a.s., VÚB Asset Management, správ. spol., a.s., AIG Funds Central Europe správ. spol., a.s., Asset Management Slovenskej sporiteľne, správ. spol., a.s.,
  - one prior approval for the merger of closed-end mutual funds, and, subsequently, prior approval for the conversion of a closed-end fund into an open-end fund, to PRVÁ PENZIJNÁ správ. spol., a.s. (this concerns the only asset management company operating closed-end funds; it intends to convert these funds, at the end of their period of appreciation, into open-end funds, and then to merge these funds so that the net value of the assets therein does not decline after the funds are made open-end);
  - two prior approvals for the merger of open-end mutual funds to VÚB Asset Management, správ. spol., a.s. (of the original ten open-end funds managed by this asset management company, six remained);
  - one prior approval for the delegation of an activity mentioned in Article 3(2)(a) of the Collective Investment Act to Tatra Asset Management, správ. spol., a.s. (this concerned prior approval for the delegation of an activity to Raiffeisen Kapitalanlage-Gesellschaft m.b.H. in regard to five mutual funds).
- As part of its licensing activities in 2006, the Národná banka Slovenska issued three decisions that approved changes in the Operating Rules of the Central Securities Depository, based largely on the need to harmonize the Operating Rules with the amended text of the Securities Act.
- In 2006 the NBS also approved a change to the licence for the establishment and operation of the Central Securities Depository. This was related to an extension of the scope of the CSD's activities to include the setting up and maintenance of holders accounts for members.
- In 2006 the NBS issued prior approval for the acquisition of 100% of the share capital of the Central Securities Depository of the Slovak Republic held by the National Property Fund of the Slovak Republic. The NBS subsequently issued prior approval for the acquisition by the Bratislava Stock Exchange of 100% of the CSD’s share capital. The acquisition by BSSE of 100% of the CSD’s share capital was made in order to implement the Government’s decision on the privatization of state-owned stocks and their sale to the BSSE. The purpose of this acquisition was to standardize relations in the Slovak capital market by means of changing the shareholder structure of the CSD in favour of capital market entities using its services. This decision was preceded by the prior approval to increase its 66% share in the BSSE’s capital granted by the NBS for the National Property Fund of the Slovak Republic.
- In 2006 the Národná banka Slovenska examined 29 mandatory takeover bids. These bids were made either because the statutory percentage of the voting rights attached to the shares of a single issuer had been reached or exceeded (nine such

bids were approved), or because the issuer's general meeting of shareholders had decided to delist the company's shares from the BSSE or to suspend trading in its shares on this stock exchange (18 such bids were approved and two were rejected).

- In 2006 the NBS issued 34 decisions in connection with the approval of prospectuses for 24 issues of securities (16 mortgage bond issues, 7 bond issues and 1 share issue).
- On 30 January 2006, an NBS Decision on the return of the authorisation to perform insurance business issued to Vzájomná životná poisťovňa Sympatia, a.s. entered into force.
- On 8 February 2006, AEGON Životná poisťovňa, a.s. was issued an authorisation to perform life insurance business in the insurance classes A1, A4 and A6.
- On 26 May 2006, an NBS Decision on the return of the authorisation to perform insurance business issued to Winterthur poisťovňa, a.s. entered into force.
- On 20 October 2006, on the basis of an application by OTP Garancia poisťovňa, a.s., the NBS extended company's authorisation to perform non-life insurance business to cover class B10a.
- On 20 December 2006, on the basis of an application by KOOPERATIVA poisťovňa, a.s., the NBS extended company's authorisation to perform non-life insurance business to cover class B17.
- On 10 May 2006, on the basis of an application by QBE poisťovňa, a.s., the NBS restricted the coverage of company's authorisation to perform life insurance business.
- Under an NBS Decision of 13 January 2006, Buffalo Springfield Holding SA (Luxembourg) and natural persons Peter Struhár and Ladislav Rehák jointly acquired a share of 10.23% in the capital of Winterthur d.s.s., a.s.
- Prvá dôchodková sporiteľňa, d.s.s., a.s. was dissolved on 1 March 2006 after the NBS had approved its merger with Allianz–Slovenská dôchodková správcovská spoločnosť, a.s.
- In 2006 the NBS issued each of the following companies with a licence for the incorporation and operation of a supplementary pension company:
  - ING Tatry–Sympatia, d.d.s., a.s.,
  - Winterthur d.d.s., a.s.,
  - Doplnková dôchodková spoločnosť Tatra banky, a.s.,
  - Stabilita, d.d.s., a.s. (the company had not been incorporated by the end of 2006 and was not entered in the Companies Register of the Slovak Republic).

The Národná banka Slovenska fulfil the tasks of a foreign exchange authority ensuing from Act of the National Council of the Slovak Republic No. 202/1995 Coll., the Foreign Exchange Act, as well as the tasks ensuing from Act of the National Council of the Slovak Republic No. 566/1992 Coll. on the National Bank of Slovakia.

Following the completion of the foreign exchange regime liberalisation process and abolishing of the regulation of individual transactions on the current and capital accounts of the balance of payments by means of foreign exchange authorisations, certain entrepreneurial activities conducted on cash or cashless basis and related to funds in the Slovak currency and in other currencies (trade in foreign exchange assets and foreign currency services) remained subject to foreign exchange regulations.

In relation to these entrepreneurial activities, the Národná banka Slovenska, on the basis of factual assessment of the filed requests and annexed documents, granted foreign exchange licences as follows:

- 46 licences to provide currency exchange activities – to purchase and sell foreign currencies for Slovak koruna in cash (27 of which were granted to legal persons and 19 to natural persons),
- 18 licences to provide currency exchange activities – to sell foreign currencies for Slovak koruna in cash (8 of which were granted to legal persons and 10 to natural persons),
- 1 licence to trade in currencies on a cashless basis.

4.4 Supervision activities of the supervisor

In total during 2006, 15 on-site supervisions, comprising 11 thematic supervisions and 4 follow-up supervisions, were conducted in banks, branches of foreign banks, and securities dealers. The follow-ups to on-site supervision were made in order to review the measures that the Národná banka Slovenska had imposed on the banks concerned. The thematic on-site supervision centred on the management of credit risk, market risk, operational risk and liquidity risk, on banks' preparedness for using internal models to calculate market and credit risk capital requirements, on reviewing selected reports, and on the operation of securities dealers. Selected securities dealers were subjected not only to on-site supervision, but also to visits focusing on their organization and management activities, how they closed transactions, and their processes for accounting and reporting. In addition to the standard activities carried out within the scope of off-site supervision – i.e. verifying that reporting to the NBS is complete and correct and evaluating the fulfilment of plans adopted following on-site supervision – other tasks were performed: e.g. an analysis of reports on the estimated maturity of assets and liabilities was carried out, and, as part of the evaluation of auditor's reports, the conclusions of the supervisor's internal evaluation of the auditor's reports were discussed with

Table 31 **Number of on-site supervisions conducted in banks, branches of foreign banks, and securities dealers in 2006**

	Quarter I		Quarter II		Quarter III		Quarter IV		Quarters I-IV	
	Started	Completed	Started	Completed	Started	Completed	Started	Completed	Planned	Actually
On-site supervision:										
– comprehensive	–	–	–	–	–	–	–	–	–	–
– follow-up	3	3	–	–	–	–	1	1	4	4
– thematic	1	1	5	2	-	3	5	5	10	11
Total	4	4	5	2	0	3	6	6	14	15

Source: NBS.

the auditing companies (with the responsible auditors and partners) in the presence of the representatives of the respective commercial banks.

In the capital market, the on-site supervision of collective investment focused on compliance with the provisions of generally binding legal regulations governing collective investment by asset management companies, in particular, the management of mutual fund assets. In 2006 on-site supervision was conducted in two asset management companies and in one legal entity that procures the issuance and redemption of securities of foreign collective investment undertakings. Also in 2006, off-site supervision was carried out on 10 asset management companies (altogether managing 110 mutual funds) and 7 banking entities performing the role of depository as defined in the Collective Investment Act. The main aim of the off-site supervision was to monitor compliance with disclosure and reporting obligations as set out in the Collective Investment Act and the Securities Act, and to validate statements and reports concerning risk diversification. Among foreign collective investment undertakings, off-site supervision was exercised over 2 foreign asset management companies authorized by the NBS to perform activities in the territory of Slovakia. The supervision exercised over the BSSE's activities during 2006 consisted mainly of the ongoing monitoring of executed transactions in securities admitted to trading on its markets within its business system modules. The monitoring of trading was aimed especially at possible violation of insider dealing prohibition and market manipulation, particularly in regard to trading with issuers' shares which were subject to a mandatory takeover bid, and at whether BSSE members conducted their activities in accordance with the honest business relationship principle and with professional care. The exercise of supervision over the CSD in 2006 was focused on the reliability of the securities registration modules and the clearing and settlement modules operated by the CSD. In 2006 the Národná banka Slovenska also exercised off-site supervision in regard to the fulfilment of the disclosure obligation by securities issuers. As for investment services intermediaries, two on-site supervisions and 37 off-site supervisions were carried out at legal entities in 2006. The main aim of the supervision was to comprehensively review the state of compliance with provisions of Act No. 566/2001 Coll. on securities and investment services, in regard to the performance of licensed activities in the Slovak financial market.

In the insurance sector, five thematic supervisions had been launched in insurance companies by the end of 2005, the focus of which included the level and method of setting technical reserves for claims outstanding provided under compulsory contractual motor vehicle third-party liability insurance, and the claims settlement within this type of insurance. Four on-site supervisions were conducted in the first quarter of 2006 and one in the third quarter. The off-site supervision included review of the insurance companies' standard statements and reports prepared as at the end of 2005 (audited) and for each quarter of 2006 (interim), as well as reports forwarded on an ad hoc basis, and the handling of 145 complaints on the insurance companies activities. The off-site supervision of insurance intermediaries and reinsurance intermediaries included review of the statements and reports submitted by these intermediaries for the end of 2005, as well as review of notifications of any changes in the facts presented by these intermediaries when they applied for the licence to perform intermediary activities, and the handling of 15 complaints on the insurance intermediaries activities. As part of the review of entities' reporting obligations, 80 insurance intermediaries were examined. Under the off-site supervision of insurance brokers of legal and natural persons, the NBS reviewed the validity of indemnity insurance contracts for insurance mediation that were concluded for an indefinite period.

As regards pension savings, the on-site supervision carried in the sector of retirement pension saving and supplementary pension saving focused on compliance with the provisions of generally binding legal regulations, in particular, with the provisions of Act No. 43/2004 Coll. on retirement pensions saving, as amended, and Act No. 650/2004 Coll. on supplementary pension saving, as amended. During 2006 a total of nine on-site supervisions were made. The Národná banka Slovenska carried out continuous daily monitoring and evaluation of all transactions in pension fund assets and the total amount of pension fund assets, on the basis of information which pension fund management companies and their depositories provided on a daily basis in accordance with Article 110(3) of the Act on retirement pension saving. There was also review of the fulfilment of disclosure obligation of asset management companies as laid down by Decree of the Ministry of Labour, Social Affairs and Family of the Slovak Republic No. 75/2005 Coll. Under Article 114(1)(h) of the Act on retirement pension saving, the activities of the Social Insurance Agency are subject to NBS supervision in regard to the transfer of retirement pension saving contributions to pension fund management companies under a separate regulation. Within that remit, the NBS examined over the course of the year 2006 112 submissions from savers and seven initiatives from pension fund management companies.

4.5 Analytical activities of the supervisor

One of the purposes of financial market supervision is to contribute both to the stability of the financial market as a whole, and to the secure and sound functioning of the financial market. In addition to rule-making, licensing and supervision activities, analytical activities are also performed in this regard.

In 2006 the Financial Market Supervision Division produced the Report on the Results of the Slovak Financial Sector Analysis for the first half of 2006 and for the whole of 2006. This report is submitted to the NBS Bank Board and published in an abridged version.[10] The other regular analysis carried out on a semi-annual basis is the Report on the Status and Development of the Slovak Financial Market, which in accordance with the Financial Market Supervision Act is submitted to the Government and the National Council of the Slovak Republic. This report consists mainly of a description of key trends and an evaluation of the risks inherent in them. The analysis covers each type of financial institution separately, as well as the financial market as a whole.

In the context of improving how the effects of various risks are monitored, especially in the banking sector, the supervision division has been working on the further development of economic-mathematical models, mainly in the following areas:

- the incorporation of correlations in the stress-testing of market risks;
- a panel regression model for evaluating the credit risk of particular economic sectors;
- a model that simulates the impact of changes in unemployment and interest rates and of a decline in real estate prices on retail loans portfolio, by using data on a sample of households;
- a model of the impact of interest rate shocks on banks' financial results, taking account of how changes in the NBS base rate are gradually translated into other interest rates (modelled using a so-called error correction model). This model complements the existing model based on an assessment of changes in net economic value;
- a model for estimating probability of default by means of learning systems that utilize fuzzy logic. A learning systems-based model for the evaluation of banks has been used by the supervisor for a relatively long period of time.

In regard to pension saving and collective investment undertakings, new statistical reports have been drafted which will allow for risk measurement and stress testing to be extended to these institutions in 2007.

Besides regular analyses for the NBS Bank Board, the analytical activities of supervision in 2006 was largely devoted to evaluating the increase in household lending and the related risk, both at the macrolevel and at the level of individual households.

On the subject of entry into the euro area, an analysis was conducted on the possible effects of the euro changeover on the performance and activities of the banking sector in Slovakia.

The analytical activities of supervision include the validation of banks' internal risk measurement models in accordance with the Banking Act. In 2006, two market risk models were assessed, and several unfinished credit risk models were the subject of pre-validation consultations.

4.6 Financial market developments in 2006[11]

The financial market entities analysed in 2006 comprised banks, branches of foreign banks, insurance companies, branches of foreign insurance companies, asset management companies, pension fund management companies, supplementary pension (insurance) companies, and securities dealers.

[10] *http://www.nbs.sk/DFT/BD/ANALYZY/INDEXA.HTM*
[11] *Based on preliminary data, with the exemption of the banking sector and the insurance sector.*

As at 31 December 2006, the assets managed by these institutions amounted to almost SKK 1 759 billion, representing just under 107% of GDP in current prices. Year-on-year, the volume of assets and managed assets increased by SKK 62.5 billion, or 3.7%. That represented a slowdown in comparison with the 12 months of 2005, when the financial market grew by SKK 318 billion, or 23%. The slowdown in the growth rate reflects mainly banks' balance sheet total, which increased by only SKK 4 billion (representing minimal growth in the context of a total amount of SKK 1 409 billion).

The financial market experienced another year of positive trends in 2006. The environment of strong economic growth and the improving financial position of the main sectors of the real economy was reflected in the growth of almost all financial market sectors.

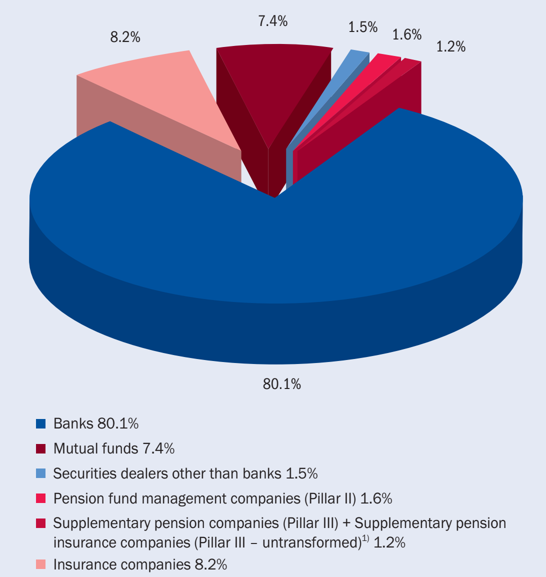
The positive economic development was most substantial in the banking sector. This was largely due to customer lending, which increased by 20% year-on-year and accounted for 46% of total assets in December 2006. Most of the lending growth was driven by household and enterprises loans. The main pillar of funds continues to be household deposits, which in 2006 increased both in amount and as a share of the balance sheet total.

Almost one third of banks' balance sheet total comprises funds deposited with the NBS or invested in NBS bills. These funds are largely financed with short-term funds from foreign banks. However, their volume fell after the NBS intervened in the foreign exchange market in June and July 2006 in favour of the Slovak koruna. An important fact in regard to the financing of banks' activities is that, for the time being, most domestic banks and the Slovak banking sector as a whole have a sufficient amount of stable domestic funds at their disposal.

As lending continued to rise sharply and the amount of own funds remained more or less stable, the capital adequacy ratio declined. This was observable in most banks, and the average capital adequacy ratio, weighted by the amount of own funds, fell year-on-year from 14.8% to 13%. All banks, however, maintained the ratio above the minimum threshold of 8%.

The banking sector reported a net profit of SKK 17.8 billion for 2006 and a return on equity (ROE) of 21.2%. Net interest income, in particular, rose substantially in comparison with 2005, which was related to continuing growth in lending and in banks' interest margins. Income from trading declined year-on-year. Operational efficiency in banking sector increased, with a decline in the ratio of operating costs to gross income from banking activities.

Chart 69 **Financial institutions by share of assets and managed assets of the financial market in December 2006**



Source: NBS.
Note: For banks and insurance companies, the share is evaluated by net assets, and for other sectors, by value of managed assets.
1) The figures for SPICs are estimates.

The risk profile of the banking sector did not change significantly in 2006 – it was largely related to the previously mentioned higher increase in banks' credit exposure to households and enterprises. Although, at present, non-performing loans account for a relatively small percentage of banks' credit portfolios, there is a potential risk in the close dependence of banks on the domestic business cycle. As regards the structure of customer lending, real estate prices have an increasingly significant position. The risk relates in particular to the financing of commercial real estate, where the returns on property developments are closely connected with real estate price movements. On the other hand, the economy's positive development has improved the financial position of borrowers. Household income has risen and unemployment has fallen. The financial condition of enterprises has also improved, especially the profitability of small and medium-sized enterprises.

The structural changes in banks' balance sheets can be expected to impact liquidity risk in terms of banks' ability to repay their liabilities in the event of a run on deposits, notwithstanding the maturity mismatch between the actual contractual maturity of assets and liabilities. In this regard, it is important that a sufficient holdings of customer deposits are covered by relatively liquid assets, for example, NBS bills, government bonds or other assets, which banks may sell, where necessary, without suffering a substantial loss because of the quick sell. Largely due to the increase in customer deposits, the ratio of liquid assets to customer deposits and other volatile funds declined in 2006. It should be noted, however, that time deposits, which are relatively less volatile, recorded the largest growth.

The banking sector's exposure to market risk in 2006 involved mainly the interest rate risk of instruments held to maturity, meaning the risk of a gradual decrease in net interest income in the event of a rise in interest rates. The interest rate risk of instruments measured at fair value, foreign exchange risk, and equity risk did not have a particularly significant effect on banks (except for foreign exchange risk among branches of foreign banks). Banks are, however, exposed indirectly to interest rate risk in view of the fact that a significant portion of customer loans is provided at short-term fixed interest rates. A relatively significant increase in rates could raise repayments, and therefore increase the credit risk on these loans as borrowers find themselves in a worse financial position.

Gross written premium according to IAS/IFRS international standards was in total SKK 51.3 billion as at 31 December 2006, which represented 3.1% of GDP (insurance penetration). Gross written premium in life insurance was SKK 23 billion and in non-life insurance SKK 28.3 billion. Because written premium had been reported in accordance with Slovak accounting standards until the end of 2005, the NBS adopted an analysis of technical premium, which may be defined as the price agreed in individual insurance contracts without regard to the method of their financial reporting. The same approach was taken to the analysis of claim expenses. In 2006 technical premium amounted to SKK 53.6 billion, including SKK 25.3 billion in life insurance and SKK 28.3 billion in non-life insurance.

Technical premium in life insurance rose by 15.6% in 2006, confirming the trend of higher growth in technical premium in this field. In non-life insurance, technical premium fell by 5%. The gradual trend decline in market concentration continued. Technical expenses for claims increased by 25% year-on-year, to stand at SKK 21.2 billion. The earnings recorded by insurance companies in 2006 increased to SKK 4.5 billion. That increase occurred despite a sharp rise in operating costs (20% in life insurance and fully 41% in non-life) which was largely due to the creation of fewer technical provisions in life insurance. The allocation of technical provisions saw no changes, and they continued to be invested in low-risk assets.

Within the services provided by securities dealers, the amount of customer transactions totalled SKK 1 810 billion in 2006, representing a year-on-year increase of 10%. Fully 95% of these transactions were made through banks. Transactions concluded on the account of customers increased significantly in comparison with 2005. The most traded instruments were bonds and forward contracts.

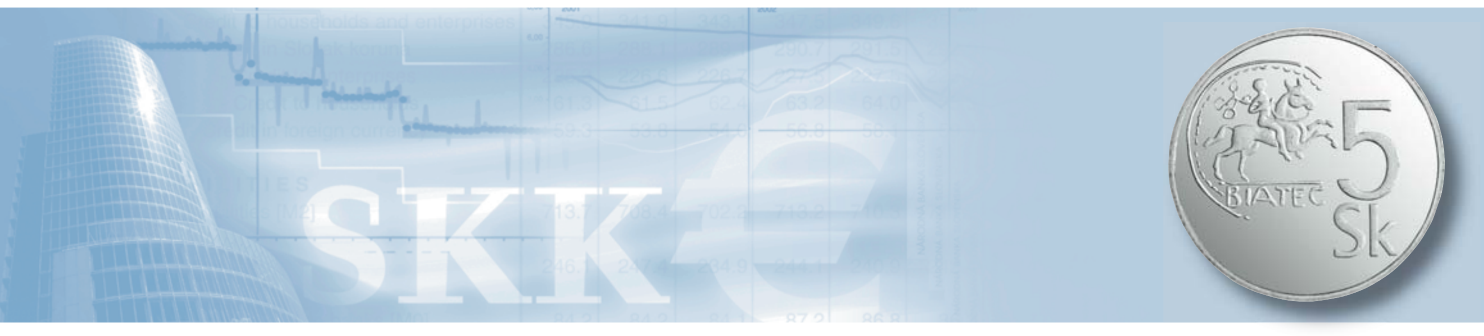
The amount of funds invested through mutual funds in 2006 increased far more slowly in comparison with the previous few years. This reflected the level of interest rates which, after a long downward trend, began to move up in 2005, and this rise continued in 2006. This change adversely affected the performance of, in particular, bond funds and mixed funds. Besides that, the performance of funds was influenced by the substantial appreciation of the Slovak currency, as instruments denominated in foreign currencies fell in value. As a result, the net asset value of open-end mutual funds increased during 2006 by only 4%. In 2005, the total net sales of funds represented SKK 38.7 billion, but in 2006 the figure was negative – sales by investors exceeded purchases by SKK 2.6 billion. The redemptions were highest among bond funds and money market funds. The funds acquired in this way were transferred mainly into funds of funds, equity funds, and time deposits in banks. The riskier groups of funds, especially, equity funds, profited from European stock markets, which rose in 2006, albeit less quickly as in 2005.

The new pension system had its first year of practical operation in 2006, as the last deadline for voluntary entry into the second pillar of pension insurance passed on 30 June 2006. As at the end of December 2006, the number of savers registered with pension fund management companies stood at 1.54 million, and the assets in their pension accounts amounted to SKK 28 billion. Nevertheless, individual pension fund management companies reported little change in their market share. The three largest of these companies were managing 73% of total pension fund assets.

Pension fund assets are mostly concentrated in growth funds, where the risk is significantly greater and the predicted returns over the long run are highest. They are followed by balanced funds and then conservative funds. Although most assets are managed in growth funds, the structure of investments is still fairly conservative. Fully 86% of the assets are invested in bank accounts and bonds. The annual yield on pension funds as at 31 December 2006 carried spreads of 2.8% to 3.7% for conservative funds, 3.2% to 4.8% for balanced funds, and 3.1% to 5.2% for growth funds. At the same time, simulations using historical data of interest rates, share prices and exchange rates show that in the event of market difficulties, conservative funds should not decline by more than 0.5%, and balanced and growth funds by not more than 1.5%, over a period of 10 days with a probability of 99%. Equity risk and foreign exchange risk should be the most significant, while the foreign exchange risk should be negligible.

The number of Slovak citizens participating in three supplementary pension companies and one untransformed supplementary pension insurance company involved in the third pension pillar came to 856,000 and their savings in this pillar amounted to SKK 21.3 billion. These assets are invested in a similar way as pension fund assets, mostly in bank accounts and bonds.

Issuing Activity and Currency in Circulation



5 Issuing Activity and Currency in Circulation

5.1 Slovak currency issuance

In 2006, in accordance with the needs of currency circulation, the Národná banka Slovenska ensured the printing of 31.44 million 20 Sk banknotes, 13 million 200 Sk banknotes and 11 million 500 Sk banknotes. Based on a contract from 2005, 20.2 million 50 Sk banknotes were supplied by the Canadian printer Canadian Banknote Company, Ottawa. 20 Sk banknotes were printed by the Polish printer Polska Wytwornia Papierow Wartosciowych S. A., Warsaw, 200 Sk banknotes were produced by the French printer Francois-Charles Fiduciaire, Rennes and 500 Sk banknotes were made by the British printer De La Rue, Gateshead.

Besides banknotes, for the needs of cash circulation, 22.05 million 50 halier coins and 9.61 million 1 Sk coins were produced. For collector purposes, 17 500 coins were produced in the denominations 10 Sk, 5 Sk, 2 Sk, 1 Sk and 50 halier, which were used in four types of annual collector sets of circulation coinage of the Slovak Republic.

In 2006 the Národná banka Slovenska issued three types of commemorative coins in precious metals, commemorating important events and anniversaries and intended for collector purposes. The commemorative coins in the denominations 200 Sk and 500 Sk were struck from silver and a commemorative coin in the denomination 5000 Sk was made of gold. A 200 Sk commemorative coin to mark the 200th anniversary of the birth of Karol Kuzmany was included in the project "Common Issues for Europe". Of the total number of commemorative coins issued to mark this occasion 9,600 proof coins were bought by a foreign collector. The production of all coins and sale of annual collector sets of circulation coinage was ensured by the state mint, Mincovňa Kremnica, š. p.

5

5.1.1 Currency in circulation and net annual issuance[12] in the SR

The value of currency in circulation in the Slovak Republic as at the close of 2006 represented SKK 143.5 billion (including Slovak and federal commemorative coins). Compared with 31 December 2005, the value of currency in circulation rose by SKK 13.4 billion in 2006, representing a year-on-year growth of 10.3%.

Over the course of 2006 the balance of currency in circulation continued to develop in a typically seasonal pattern: falling in the first quarter of 2006 and rising in the pre-Christmas period. This is documented also by data on the development of the net monthly issuance, which ranged from SKK -0.97 billion in January 2006 to SKK 5.24 billion in December 2006.

The daily value of currency in circulation in 2006 ranged from SKK 128.6 billion to SKK 148.6 billion. The minimum value was reached on 2 February 2006

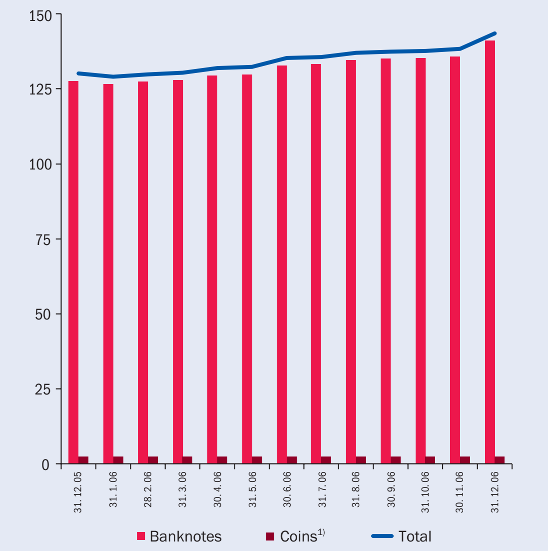
Table 32 **Commemorative coins issued by the NBS in 2006**

Face value	Event commemorated	Number of coins issued		NBS Decree
		total	proof	
500 Sk[1)]	Protection of the environment and countryside – Muran Plain national park	7,100	2,800	88/2006 Coll.
200 Sk[1)]	200th anniversary of the birth of Karol Kuzmany	17,350	12,450	448/2006 Coll.
5000 Sk[2)]	Last monarch of the Great Moravian Empire Mojmir II.	4,000	4,000	556/2006 Coll.

Source: NBS
1) Commemorative silver coin.
2) Commemorative gold coin.

[12] *The net issuance is the difference between the amount of money put into and taken out of circulation in a specified period of time. The term is consistent with that used by the European Central Bank.*

Chart 70 **Monthly development of currency in circulation in 2006 (SKK billion)**



Source: NBS.
1) Including commemorative coins.

and the maximum in the pre-Christmas period on 22 December 2006.

5.1.2 Structure of the currency in circulation and net issuance

On 31 December 2006, 175.6 million banknotes with a value of SKK 141.1 billion, 1,113.8 million circulation coins with a value of SKK 1.8 billion, and 867,000 commemorative coins issued by the NBS with a value of SKK 643.4 million were in circulation. Of the total value of currency in circulation, banknotes accounted for 98.3%, circulation coins 1.2% and commemorative coins, including federal commemorative coins, 0.5%. Of the total number of coins and banknotes in circulation, banknotes accounted for 13.6%, circulation coins 86.3% and commemorative coins 0.1%.

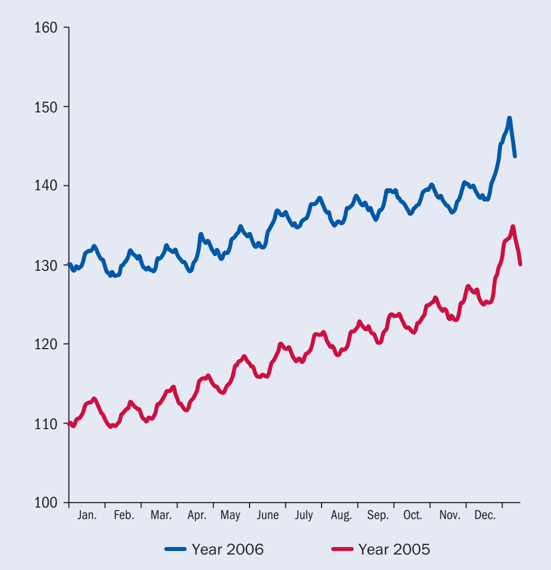
The net annual issuance for 2006 totalled SKK 13.4 billion and, in comparison with 2005, was SKK 6.8 billion lower. The net annual issuance for 2006 com-

Table 33 **Currency in circulation in SKK**

	Value in SKK		Share in %	
	31.12.2006	**31.12.2005**	**31.12.2006**	**31.12.2005**
Banknotes				
5000 Sk	68,029,362,500	60,530,677,500	47.40	46.52
1000 Sk	61,320,830,500	56,298,082,500	42.73	43.27
500 Sk	5,361,164,875	4,864,545,875	3.74	3.74
200 Sk	2,292,431,250	2,055,817,650	1.60	1.58
100 Sk	2,512,164,150	2,386,890,550	1.75	1.83
50 Sk	867,629,800	803,035,150	0.60	0.62
20 Sk	720,110,265	668,318,405	0.50	0.51
Total	141,103,693,340	127,607,367,630	98.32	98.08
Circulation coins				
10 Sk	881,149,330	881,097,520	0.61	0.68
5 Sk	333,777,320	307,494,745	0.23	0.24
2 Sk	232,742,040	213,482,432	0.16	0.16
1 Sk	152,756,209	140,241,785	0.11	0.11
50 hal.	25,042,036	25,211,472	0.02	0.02
50 hal. II	74,212,418	63,057,108	0.05	0.05
20 hal.	44,304,304	44,346,033	0.03	0.03
10 hal.	26,980,004	26,998,155	0.02	0.02
Total	1,770,963,661	1,701,929,248	1.23	1.31
Commemorative coins1)	643,389,180	801,298,680	0.45	0.62
Total currency	143,518,046,181	130,110,595,558	100.00	100.00

Source: NBS.
1) Including federal commemorative coins.

Chart 71 **Daily development of currency in circulation (SKK billion)**



Source: NBS.

prised banknotes in the value of SKK 13.5 billion and circulation coins in the value of SKK 69.0 million. The issuance of commemorative coins was negative, and stood at SKK -157.9 million (including federal commemorative coins, the validity of which ended on 30. September 2000, and which had been exchanged by the Národná banka Slovenska for legal tender up to 30 June 2006).

In 2006 the denominations which represented the largest net issuance (SKK 7.5 billion, 1.5 million pieces) were 5000 Sk banknotes, followed by 1000 Sk banknotes (SKK 5.0 billion, 5.0 million pieces). These two denominations together represented 93,4% of the net issuance in 2006.

The structure of banknotes in circulation remained unchanged against 2005. The largest share of banknotes in circulation comprised the denominations 1000 Sk (61.3 million pieces), 20 Sk (36.0 million pieces) and 100 Sk (25.1 million pieces). 5000 Sk and 1000 Sk banknotes (totalling SKK 68.0 billion and SKK 61.3 billion respectively) together formed

Table 34 **Currency in circulation in pieces**

	Number of pieces		Share in %	
	31.12.2006	**31.12.2005**	**31.12.2006**	**31.12.2005**
Banknotes				
5000 Sk	13,605,873	12,106,136	1.05	0.99
1000 Sk	61,320,831	56,298,083	4.75	4.59
500 Sk	10,722,330	9,729,092	0.83	0.79
200 Sk	11,462,156,	10,279,088	0.89	0.84
100 Sk	25,121,642	23,868,906	1.95	1.94
50 Sk	17,352,596	16,060,703	1.34	1.31
20 Sk	36,005,513	33,415,920	2.79	2.72
Total	175,590,940	161,757,927	13.61	13.18
Circulation coins				
10 Sk	88,114,933	88,109,752	6.83	7.18
5 Sk	66,755,464	61,498,949	5.17	5.01
2 Sk	116,371,020	106,741,216	9.02	8.70
1 Sk	152,756,209	140,241,785	11.84	11.43
50 hal.	50,084,071	50,422,943	3.88	4.11
50 hal. II	148,484,836	126,114,215	11.50	10.27
20 hal.	221,521,521	221,730,163	17.17	18.06
10 hal.	269,800,042	269,981,546	20.91	22.00
Total	1,113,828,096	1,064,840,569	86.32	86.75
Commemorative coins[1)]	866,959	830,945	0.07	0.07
Total currency	1,290,285,995	1,227,429,441	100.00	100.00

Source: NBS.
1) Including federal commemorative coins.

90.1% of the total value of currency in circulation, which was a slightly higher share than in the preceding year (89.8%).

In 2006 the net issuance of circulation coins represented a value of SKK 69.0 million (almost 49 million pieces). The net issuance was positive in almost all valid circulation coin denominations, with the exception of 50-halier coins (1993 design), the issue of which fell by SKK 169,400. The highest net issuance was recorded for 5 Sk coins (SKK 26.3 million) and the highest increase in number was recorded for 50-halier coins (increasing by 22 million pieces). In connection with the end of validity of the lowest denomination coins (20-halier and 10-halier coins) only a minimal number (208,600 pieces) of 20--halier coins were returned from circulation in 2006 (in 2005 the figure was 3.3 million pieces), while 181 500 pieces of 10-halier coins were returned (3.1 million pieces in 2005). More than 491 million pieces of these coins remain in circulation, which as at 31 December 2006 represented more than 44% of the total number of coins issued between 1993 and the end of 2006.

The total number of commemorative coins in circulation grew in 2006 by 36,000 pieces, representing an SKK 31.2 million increase in value (only Slovak commemorative coins). In 2006 federal commemorative coins in a total value of SKK 74,100 were returned from circulation.

5.1.3 Average value of currency in circulation

The value of currency in circulation as at 31 December 2006 totalled SKK 26,631 per capita[13]. This consisted of SKK 26,183 in banknotes, SKK 329 in circulation coins and SKK 119 in commemorative coins. In comparison with 2005, the total value of currency in circulation per capita grew by SKK 2,447, of which banknotes accounted for SKK 2,464 and circulation coins SKK 13. The value of commemorative coins per capita declined by SKK 30.

Concerning citizens' holdings of currency, there were almost 33 banknotes per capita, which was three more than in 2005. The most numerous were 1000 Sk banknotes, with 11 per capita, and 20 Sk numbering almost 7. The number of circulation coins per capita in 2006 increased against 2005 from 198 to 207. Halier coins (10, 20 and 50 halier), as in 2005, still have the largest share, with 128 pieces per capita (compared to 124 pieces in 2005). Of the valid coins, the most numerous is the 50-halier denomination, with 37 pieces per capita (compared to 33 pieces in 2005).

The average value of the currency mark[14] reached SKK 111.2 in 2006, an increase of SKK 5.2 over the year. Its development corresponds to that of the quantity and value of currency in circulation. A comparison of the development of the average value of the currency

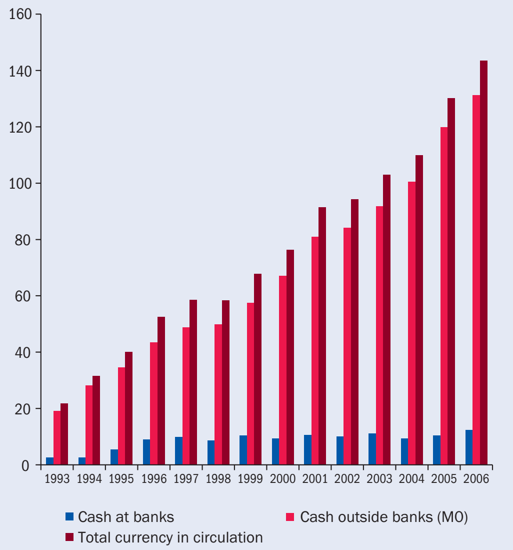
Table 35 **Development of the average value of the currency mark** **(in SKK)**

Year	Banknotes	Circulation coins	Currency including commemorative coins
1993	289.3	3.2	90.2
1994	384.1	2.0	76.4
1995	455.6	1.8	76.7
1996	537.3	1.7	81.8
1997	566.3	1.6	80.5
1998	552.3	1.5	72.2
1999	594.1	1.5	76.1
2000	631.4	1.4	77.1
2001	693.6	1.4	84.4
2002	697.8	1.4	80.3
2003	729.2	1.4	85.0
2004	738.8	1.6	94.0
2005	788.9	1.6	106.0
2006	803.6	1.6	111.2

Source: NBS.

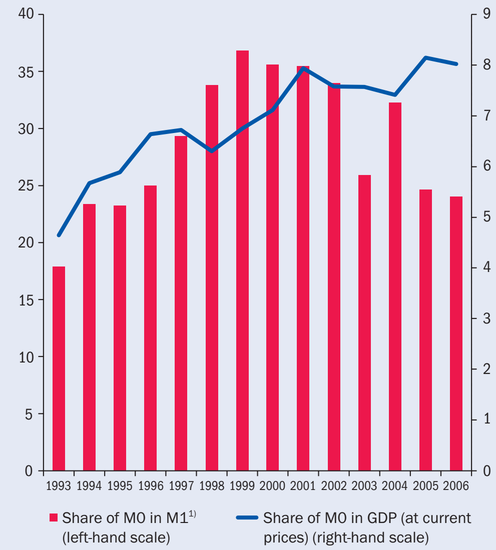
[13] *As at 31 December 2005 the population numbered 5,389,180; source: Statistical Office of the SR.*
[14] *The average value of the currency mark = the total value of currency in circulation / total number of coins and banknotes in circulation.*

Chart 72 **Currency in circulation held by the public and by banks** **(SKK billion)**



Source: NBS.

Chart 73 **Proportion of M0 aggregate to M1 and GDP** **(current prices, %)**



Source: NBS.
1) Since 2003 according to ECB methodology.

mark since 1993, broken down by the individual types of currency in circulation, is given in Table 35.

The development of the average value of the currency mark over the past years has been influenced by the faster growth in the value of currency in circulation compared to its quantity.

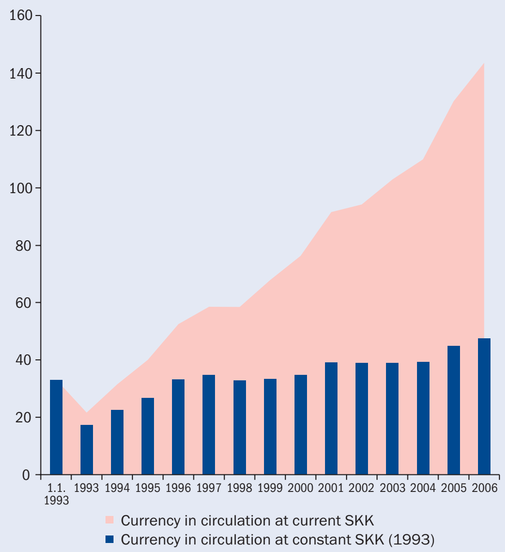
5.1.4 Currency in circulation and selected macroeconomic variables

In a year-on-year comparison as at 31 December 2006, the total value of currency in circulation had increased from SKK 130.1 billion to SKK 143.5 billion (10.3%). Of this, the amount held by the public grew from SKK 119.8 billion to SKK 131.2 billion (9.5%) and the amount held by banks increased from SKK 10.3 billion to SKK 12.3 billion (19.5%).

The share of the M0 money aggregate in M1[15] declined in 2006 against the previous year by 0.6 percentage points to 24.0%. This indicator since 2004 had shown a declining trend, indicating that the level of cashless payments in Slovakia is gradually increasing, albeit moderately.

The share of M0 in GDP[16] in Slovakia decreased in 2006 by 0.1 percentage points to 8.0%, which is comparable with values in the euro area countries (ranging from 3% to 10%).

Chart 74 **Effect of inflation on currency in circulation** **(SKK billion)**

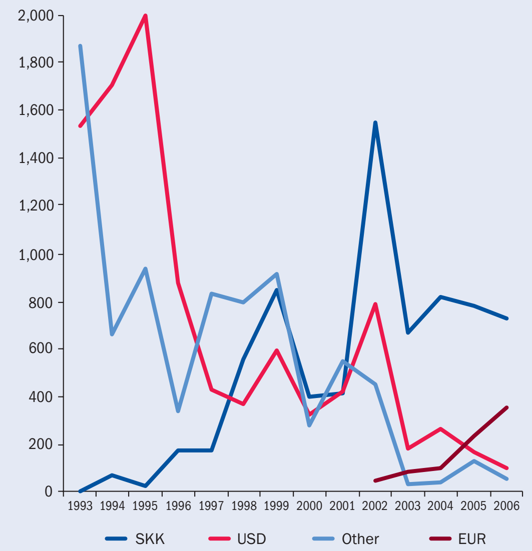


Source: Statistical Office of the SR, NBS.

The value of currency in circulation at constant prices[17] stood at SKK 47.46 billion as at 31 December

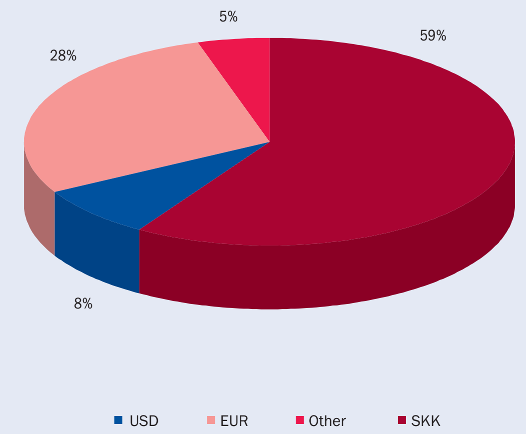
15 The aggregates M0 and M1 are calculated according to the NBS methodology in the years to 2002 and from 2003 according to ECB methodology (monthly bulletin NBS Monetary Survey, January 2006).
16 GDP at current prices; source: Statistical Office of the SR.
17 The price level as measured by the consumer price index (CPI) had increased by 202.4% since 1993; source: Statistical Office of the SR.

Chart 75 **Number of seized counterfeits (in pieces)**



Source: NBS.

Chart 76 **Breakdown of counterfeits in 2006 (%)**



Source: NBS.

2006, and in comparison with 2005 had grown by SKK 2.63 billion. The year-on-year growth in currency in circulation at constant prices was, as in the previous year, influenced to a significant degree by the faster growth in currency in circulation (10.3%) than the growth in the annual rate of inflation (4.2%).

5.2 Counterfeit money seized in the Slovak Republic

In 2006 a total of 1,233 items of counterfeit Slovak and foreign currency were seized in the Slovak Republic. In comparison with 2005, this represents a decrease of 83 items in the total number of seized counterfeits, i.e. a fall of more than 6%. Of this number, 70% of counterfeits were seized directly from circulation by banks, branches of foreign banks, non--banking entities and security services.

Slovak koruna and euro recorded the largest share in the breakdown of counterfeits (59% and 28% respectively). US dollars formed a share of 8%, with other currencies representing 5%.

5.2.1 Counterfeits of Slovak koruna

In 2006 a total of 726 counterfeit Slovak koruna banknotes were seized, including two composed banknotes, 27 forgeries, 8 adapted banknotes and coins and one coin plate. The highest incidence of counterfeits was recorded in the Košice region (256 items) and the Bratislava region (99 items). 1000 Sk and 500 Sk banknotes were the most frequently counterfeited, making up two thirds of Slovak koruna counterfeits.

Table 36 **Number of seized Slovak koruna counterfeits** **(in pieces)**

Year	Denomination									Total
	5000	1000	500	200	100	50	20	10	P1)	
2002	14	1,307	105	17	49	38	17	2	0	1,549
2003	14	396	131	58	31	27	8	0	1	666
2004	45	419	203	36	68	36	11	1	1	820
2005	23	337	151	103	87	48	28	0	7	784
2006	28	344	138	95	55	22	6	0	38	726

Source: NBS.
1) Forgeries, adapted and composed banknotes and coins, coin plate.

Table 37 **Number of seized US dollar counterfeits** **(in pieces)**

Year	Denomination								Total
	1	5	10	20	50	100	1000	P 1)	
2002	4	1	1	1	11	768	0	4	790
2003	0	0	0	3	3	176	0	5	187
2004	3	0	1	1	5	252	0	2	264
2005	0	0	1	1	3	163	0	3	171
2006	2	1	0	0	3	94	1	0	101

Source: NBS.
1) Manipulated banknotes, forgeries and adapted banknotes.

Table 38 **Number of seized euro counterfeits** **(in pieces)**

Year	Denomination									Total
	2	5	10	20	50	100	200	500	P 1)	
2002	0	0	0	2	31	14	0	1	0	48
2003	0	0	2	18	41	9	13	4	1	88
2004	3	1	0	1	48	26	17	2	5	103
2005	8	0	0	13	114	26	37	34	2	234
2006	3	1	4	6	69	217	38	10	0	348

Source: NBS.
1) Manipulated banknotes, forgeries and composed banknotes.

Table 39 **Number of counterfeits of other foreign currencies** **(in pieces)**

Year	Currency							Total
	GBP	CZK	CAD	PLN	CHF	HUF	Others 1)	
2002	9	369	1	6	1	0	69	455
2003	20	3	6	2	1	0	0	32
2004	14	12	4	2	1	3	0	36
2005	82	21	3	1	1	18	1	127
2006	39	9	0	2	0	7	1	58

Source: NBS.
1) Currencies replaced by the euro, Norwegian krone and Australian dollars.

5.2.2 Counterfeits of foreign currency

In 2006 a total of 101 US dollar counterfeits, 348 euro counterfeits and 58 counterfeits of other foreign currencies were seized in the Slovak Republic. The largest incidence was recorded in the Košice region.

Counterfeit US dollars

Since 2005 there has been a declining trend in the number of counterfeit US dollars and concurrently in this currency's share in the total number of seized counterfeits. While in 2005 a 35% decline was recorded in comparison with the preceding year, in 2006 the decline was as high as 41%. The highest occurrence was recorded in Bratislava region, in which 54 counterfeit items were seized in 45 cases. The most frequently counterfeited denomination was the 100 USD banknote, which formed as much as 93% of the total number of US dollar counterfeits.

Counterfeit euro

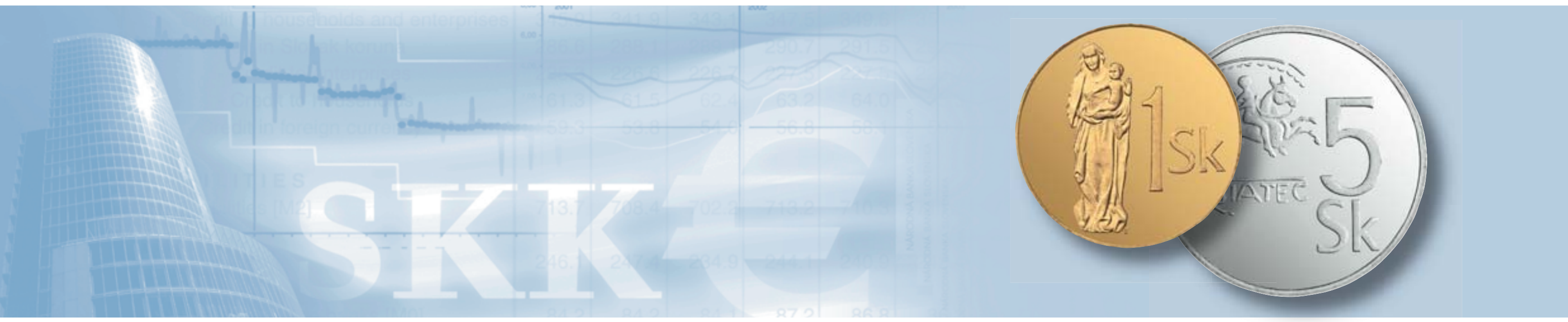
The rising trend in the number of seized counterfeit euro continued in 2006, when in comparison with 2005 the number of seized counterfeit euro rose by approximately half. Counterfeit euro with 348 items accounted for 28% of the total number of seized counterfeits. In the Economic and Monetary Union countries low denomination banknotes (€20 and

€50) were the most frequently counterfeited, while in Slovakia the most numerous counterfeits seized were €100 banknotes, forming almost 63% of the total number of euro counterfeits.

Counterfeits of other foreign currencies

In 2006, the number of counterfeits of other foreign currencies fell by more than half, numbering 58 items and representing 5% of the total number of seized counterfeits. As in 2005, British pounds formed the highest share of counterfeits.

Payment System



6 Payment System

6.1 Legal and institutional aspects

The payment system in the Slovak Republic is governed primarily by Act No. 510/2002 Coll. on the payment system and on amendments to certain laws, as amended. This act regulates primarily domestic and cross-border funds transfers, the issue and use of electronic payment instruments, the establishment and operation of payment systems, oversight of payment systems, as well as complaints and redress procedures, and out-of-court settlements of disputes related to payments.

Other generally binding legal provisions that govern payment services include the following decrees:
- NBS Decree No. 9/2002 on the method of creating constant symbols used in the payment system and on the structure and list of these symbols,
- NBS Decree No. 10/2002 on the report submitted by an issuer of an electronic money payment instrument to the Národná banka Slovenska,
- NBS Decree No. 11/2002 on the report submitted by the operator of a payment system to the Národná banka Slovenska,
- NBS Decree No. 7/2003 laying down the structure of a bank identification code for the purposes of domestic transfers, the structure of an international bank account number for the purposes of cross-border transfers and details on the issue of the identification codes conversion table.

The Slovak legal code also includes the following regulations of the European Parliament and of the Council (European Communities):
- Regulation No. 2560/2001 of 19 December 2001 on cross-border payments in euro, implementing the principle of equal fees – i.e. fees for cross-border payments up to EUR 50,000 within the European Union are equal to fees for analogous payments in euro made within a Member State,
- Regulation No. 1781/2006 of 15 November 2006 on information on the payer accompanying transfers of funds (effective as of 1. 1. 2007), the aim of which is the unified transposition of Special Recommendation VII within the European Union for transfers made within the European Union single market – i.e. for domestic transfers and transfers between Member States, as well as for transfers between Member States of the European Union and third countries.

The Permanent of Court Arbitration of the Slovak Banking Association was established with effect from 1 July 2003 and has its registered office in Bratislava; at present it has two chambers:
a) the chamber for deciding disputes on payments,
b) the chamber for deciding disputes arising from other commercial or civil relations, which commenced operation on 1 January 2004.

In 2006 the Národná banka Slovenska approved the Slovak Banking Association's proposal not to pay any subscription fee in 2006 for the activity of the Permanent Court of Arbitration of the Slovak Banking Association with regard to the economic results of this court and the sufficient funds for the activity of the chamber for deciding disputes on payments for 2006. The Národná banka Slovenska at the same time approved Addendum 2 to the Statute and Rules of Procedure of the Permanent Court of Arbitration.

6.2 The payment system of the Slovak Republic

As at the end of 2006, the Národná banka Slovenska operated the SIPS interbank payment system for 30 participants, of which 28 were direct participants and 2 third parties. Over the course of 2006 the number of direct participants increased through the addition of two branches of foreign banks operating in Slovakia on the basis of a single European passport.

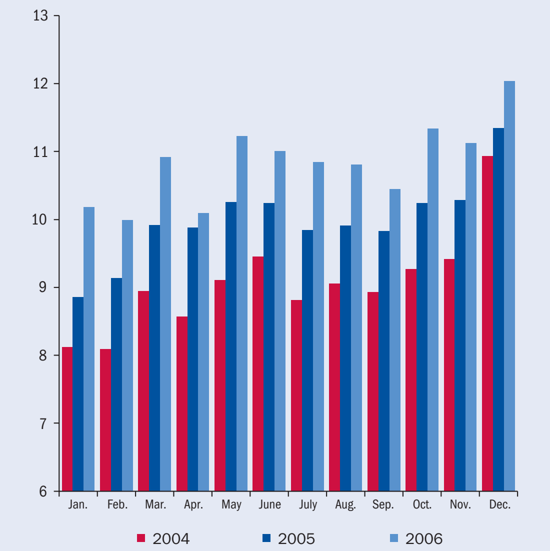
In 2006 the SIPS interbank payment system did not undergo any changes to its basic functions.

6.2.1 Payment system in the SR and introduction of the euro

In connection with the introduction of the euro the Národná banka Slovenska in 2006 began preparing a new concept of the payment system solution in the SR.

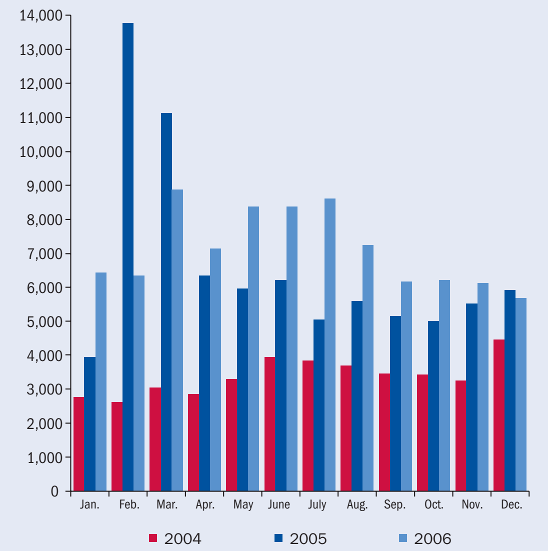
The basic elements of this concept are the implementation of the TARGET2 system for all real-time

Chart 77 **Number of transactions processed in SIPS** **(million)**



Source: NBS.

Chart 78 **Value of transactions processed in SIPS** **(SKK billion)**



Source: NBS.

payments (i.e. priority payments) and for holding banks' minimum reserves, and at the same time establishing a new SIPS interbank payment system (with the working title SIPS RETAIL) for processing payments for which immediate finality is not required (as a rule customer payments of a low value and with low priority). The system will work on the basis of net multilateral processing of payments and their settlement in the TARGET2 system. TARGET2 is a real-time gross settlement system provided by the central banks of the Eurosystem.

By the end of 2006 the new conception of the payment system in the SR had been presented several times to SIPS interbank payment system participants, being the result of consensus reached between the Národná banka Slovenska and banks represented by the Slovak Banking Association as well as other participants of the SIPS interbank payment system.

6.2.2 Payments realised via SIPS

In 2006 a total of more than 130 million transactions were processed in the SIPS payment system. Against 2005 the number of transactions rose by 8.59%, confirming the stable growing trend of previous years.

Chart 77 and Table 40 show data on transactions made in the individual months of 2004 to 2006.

The value of transactions processed, too, recorded a growing trend in 2006. In total SIPS processed transactions in the value of more than SKK 85.6 trillion, which against 2005 represents a growth of 7.5%.

Chart 78 and Table 41 show the development of transactions processed in the individual months of 2006 in comparison with 2005 and 2004.

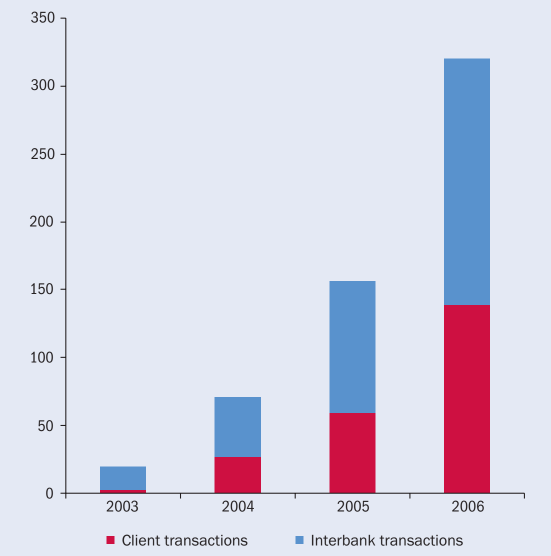
Since the beginning of 2003, when the NBS commenced operation of SIPS system, the fastest growth from among all types of transactions was recorded in customer and interbank priority payment orders. Whereas the total number of priority payments processed in 2005 stood at 156,000, the figure for 2006 was more than 320,000 payments, representing once again, as in the preceding year, a growth of more than 100%. The development of the number of priority payments processed in SIPS is shown in Chart 79.

Table 40 **Number of transactions processed in SIPS** **(million)**

	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.
2004	8.12	8.09	8.94	8.57	9.11	9.46	8.81	9.06	8.94	9.27	9.42	10.93
2005	8.86	9.14	9.91	9.88	10.25	10.24	9.84	9.91	9.83	10.24	10.28	11.34
2006	10.18	9.99	10.92	10.09	11.23	11.01	10.85	10.80	10.45	11.34	11.13	12.04

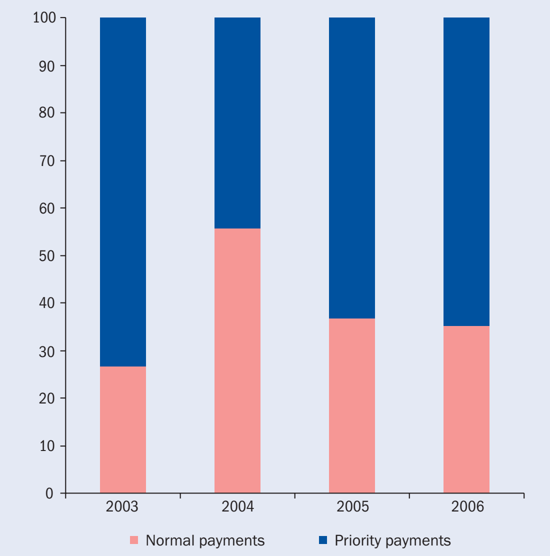
Source: NBS.

Chart 79 **Number of priority payments processed** **(thous.)**



Source: NBS.

Chart 80 **Payment types by share in the value of processed transactions** **(%)**



Source: NBS.

Priority payments as a share of the total number of executed transactions, though, remained at only 0.25%, with normal payments forming the remaining 99.75% share. Whilst priority payments were low in number, their settlement value was in excess of SKK 55,491 billion, accounting for almost 65% of the value of all processed transactions. The shares of normal and priority payments in the total value of processed transactions over the years 2003 to 2006 are shown in Chart 80.

Information on the number and volume of transactions processed in the SIPS is published on the Národná banka Slovenska website and is updated daily at 15:50 hours.[18]

On bank holidays and weekends the payment system is closed and system maintenance is carried out. In 2006 there were 247 working days. On a daily basis, SIPS processed and settled an average of 501,000 payments in a total amount of almost SKK 346.66 billion, with an average value per transaction of approximately SKK 658,000.

To better understand this data, it can be said that over the course of roughly 4.5 working days, SIPS processed and settled payments with a cumulative value equivalent to Slovakia's gross domestic product for 2006.[19]

The Národná banka Slovenska provides intraday credit to those participants of the interbank payment system who are required to hold minimum reserves. Intraday credit is offered as an overdraft facility on financial reserve accounts, with a maximum overdraft limit. The intraday credit is payable within one operating day and must be fully collateralized, i.e. by the relevant amount of securities listed in the central register of short-term securities maintained by the NBS.

In 2006 SIPS participants who applied for intraday credit were provided with this credit in the total amo-

Table 41 **Value of transactions processed in SIPS** **(SKK billion)**

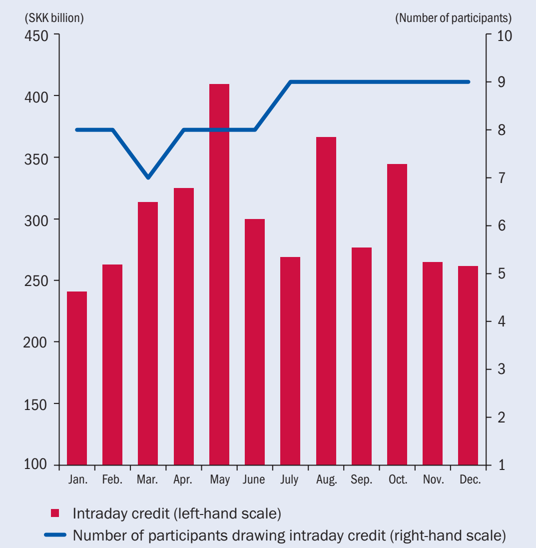
	Jan.	Feb.	Mar.	Apr.	May	June	July	Aug.	Sep.	Oct.	Nov.	Dec.
2004	2.77	2.62	3.05	2.86	3.30	3.95	3.84	3.70	3.46	3.43	3.25	4.46
2005	3.95	13.78	11.12	6.35	5.98	6.22	5.04	5.60	5.14	5.00	5.53	5.93
2006	6.43	6.36	8.88	7.15	8.37	8.38	8.61	7.25	6.17	6.21	6.13	5.69

Source: NBS.

[18] *www.nbs.sk – Payment systems / Statistical data.*

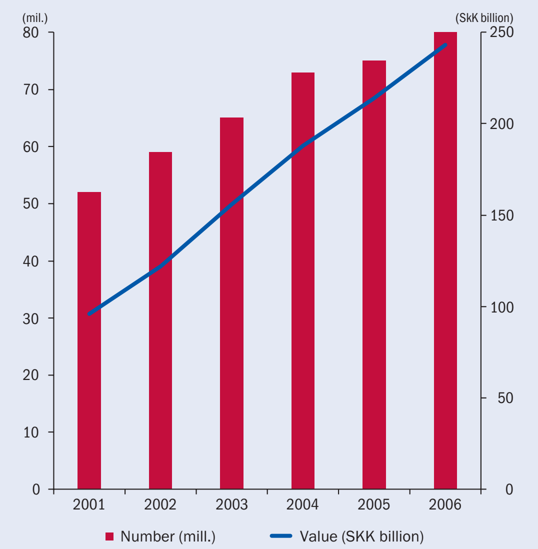
[19] *GDP for 2006 amounted to SKK 1,636.3 billion. (Source: Statistical Office of the SR).*

Chart 81 **Intraday credit in 2006 (SKK billion)**



Source: NBS.

Chart 82 **Number and value of ATM cash withdrawals**



Source: Slovak Bank Card Association.

unt of more than SKK 3,646 billion. The amount of intraday credit provided to participants is monitored on a weekly basis. Per week, the Národná banka Slovenska provided intraday credit in an average amount of SKK 69.887 billion.[20]

Chart 81 shows the amount of intraday credit provided in the individual months of 2006 and the number of SIPS participants who applied for this credit.

6.3 Payment instruments

Among the most used instruments for non-cash payments are transfers and electronic payments. The most used electronic payment instruments are remote access payment instruments – especially bank payment cards as well as electronic banking payment applications, which enable customers to draw funds from a bank account by means of electronic communication media (for example, internet banking, home banking or telephone applications).

As at 31 December 2006, the number of active bank payment cards in circulation stood at 4,475,861, which represents an 11% increase in comparison with 2005. Of the total number, debit cards form 75% and credit cards 25%.

Banks are issuers of the following bank payment cards: VISA (VISA and VISA Electron) and MasterCard Europe (MasterCard and Maestro), American Express and Diners Club.

Bank customers in Slovakia may use a network of 2,009 ATMs and 22,665 EFT POS payment terminals.

In 2006 bank payment card holders made more than 120 million transactions in a total amount of almost SKK 290 billion, which in comparison with 2005 represents an 11% increase in the number of transactions and a 17% increase in the value of transactions. Of all card transactions, debit-card transactions formed 94% of the number and 96% of the value, while credit-card transactions formed 6% of the number and 4% of the value.

Payment cards may be used not only for traditional transactions, such as cash withdrawal or payment, but also for other payment transactions (e.g. making a transfer order).

The number of ATM cash withdrawals made in 2006 stood at 79.58 million and the total value was SKK 242.84 billion, representing a 10% rise in the number of withdrawals and a 13.5% increase in their value.

Chart 82 shows how the number and value of ATM cash withdrawals developed between 2001 and 2006.

In 2006, EFT POS terminals were used to make a total of 41.2 million payments with an overall value of SKK

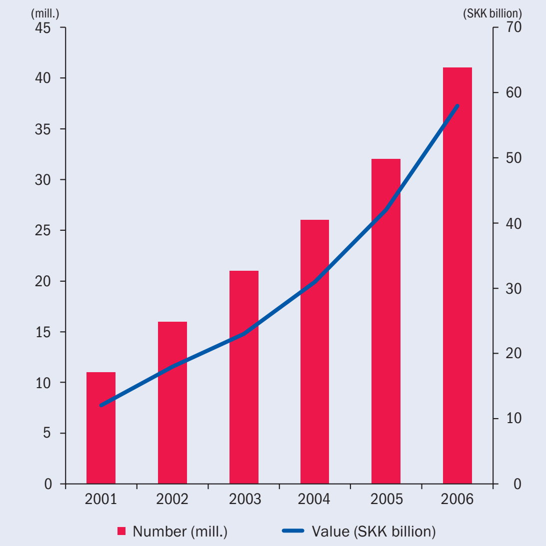
[20] *The amount of provided intraday credit is deemed to be the value of the securities (decreased by the haircut) that the NBS accepted from participants as collateral for the loan. This is the maximum limit up to which participants may draw down intraday credit. At present, actual drawing of credit is not subject to statistical tracking.*

58.02 billion, which in comparison with 2005 represents an increase of 29% in the number of payments and 38% in their value.

Chart 83 shows how the number and value of payments made via EFT POS terminals developed between 2001 and 2006.

A trend within bank payment card acceptance is the marked growth in the number of EFT POS terminals in comparison with the increase in the number of ATMs. Over 2006 the number of EFT POS terminals rose by 19%, while the number of ATMs rose by 8%. Although ATM cash withdrawals still dominate, the trend is one of continuing and dynamic growth in card payment. Charts 84 and 85 give a percentage comparison of the number and value of withdrawals and payments.

Chart 83 **Number and value of EFT POS payments**



Source: Slovak Bank Card Association.

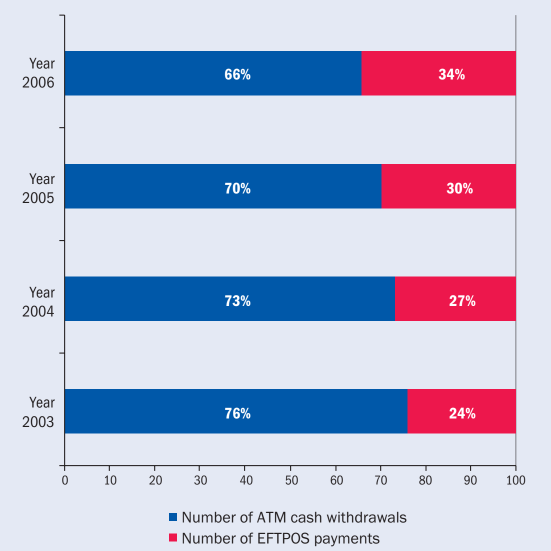
6.4 Cooperation with the international financial institutions in the field of payment systems

European Central Bank

Each year the Národná banka Slovenska is involved in the European Central Bank project for the collection of statistical payment system data for the purposes of preparing the so-called Blue Book. The data is published in an addendum to the table annex to the Blue Book, which contains statistical data from the EU Member and Accession States for the period of the past five years concerning payment systems and securities settlement systems.

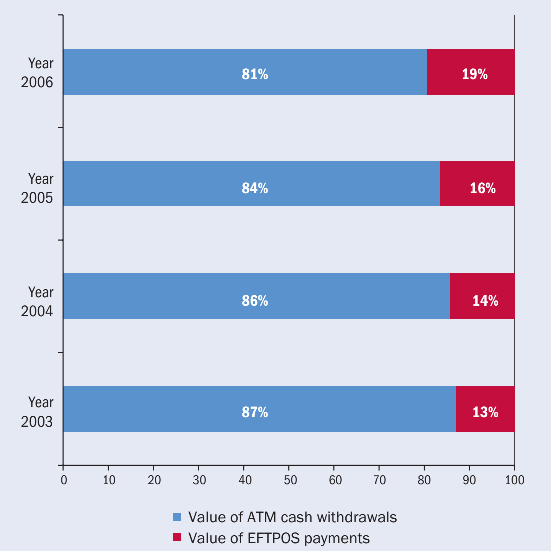
Over the course of 2006 statistical data collection for the field of payment systems was conducted in a new manner, by means of the application program system STATUS (APS STATUS). Under NBS Decree No. 10/2005 of 13 December 2005 on the submission of statements for statistical purposes by banks and branches of foreign banks, the obligation is imposed on banks to send such data through APS STATUS.

Chart 84 **Number of ATM and EFT POS transactions** (%)



Source: Slovak Bank Card Association.

Chart 85 **Value of ATM and EFT POS transactions** (%)



Source: Slovak Bank Card Association.

In 2006 the European Central Bank updated the text of the Blue Book describing payment systems and securities settlement systems of the EU Member and Accession States. The Národná banka Slovenska captured the changes made since the last update in 2001, concerning primarily the payment system operated by the Národná banka Slovenska.

European Commission and Council of the European Union: legislative field

In 2006 work continued on the wording of the Draft Directive of the European Parliament and of the Council on payment services in the internal market and amending Directives 97/7/EC, 2000/12/EC and 2002/65/EC (hereinafter "the Draft Directive on Payment Services in the Internal Market").

The Slovak Republic's position on the Draft Directive on Payment Services in the Internal Market was prepared by the Ministry of Finance in cooperation with the Národná banka Slovenska. This position in the form of an opinion and comments to the text of the Directive was sent in February 2006 as a basis for further negotiations at the Council of the European Union.

The aim of the Draft Directive on Payment Services in the Internal Market is to harmonise the legal framework for payment systems insofar as it concerns entities providing payment systems, the transparency of the conditions under which these services are provided, and the rights and obligations of providers and users of payment services.

European Payments Council: SEPA

Introduction of the euro currency in 1999 and the completion of the cash changeover in 2002 laid the foundations for the road to the Single Euro Payments Area – SEPA. SEPA is considered a priority for the euro area. The aim is to create an area where it will be as simple and cheap to make payments as in the individual Member States. The reason behind the drive for changing over to SEPA was to facilitate free movement of goods and services, representing one of the basic pillars of the European Union. The creation of SEPA means primarily a changeover from national payment instruments – credit transfers, direct debits and payment cards – to European payment instruments. The basic requirement is that all payments made within the euro area are equal to domestic payments as regards their speed, security and cost. An efficient single market in the field of payment system services should increase competition, bring new business opportunities and strengthen specialisation and innovation.

The governing body for the field of creating SEPA is the European Payments Council (EPC). The basic mission of the EPC is to fulfil the strategy of achieving SEPA. In December 2004 the EPC plenary approved the "EPC Roadmap 2004-2010". The roadmap defined SEPA in more detail and set milestones for the development and procedure of implementing European payment instruments. The roadmap gives priority on creating SEPA payments schemes for credit transfers, direct debits and debit cards. In December 2006 the European Payments Council approved and subsequently published the rules for SEPA credit transfers and direct debits – version 2.2. These rules represent the basic business standards intended for implementing the SEPA payment instruments.

New legislation in the field of payment services should support the creation of SEPA, remove legal barriers preventing the creation of pan-European payment services and infrastructure, improve conditions for competition between payment service providers and support customers' confidence and their protection.

The Slovak banking sector is likewise preparing for compatibility with SEPA. Since implementing SEPA in Slovakia requires active preparation, a Subcommittee for SEPA was established in 2006, composed of representatives from the NBS, the Ministry of Finance of the SR and commercial banks. Over the year the Subcommittee drew up and in December approved the plan for putting SEPA in place entitled Implementation Plan of SEPA in the SR. The Implementation Plan will be revised on an ongoing basis and supplemented on the basis of new requirements and information. In practice this means that banks and branches of foreign banks in the SR will have to introduce new standards in current payment instruments (i.e. credit transfers, direct debits, payment cards) and adapt their information systems and software to SEPA requirements.

The Eurosystem and the creation of the next generation of the TARGET2 payment system

In 2006 cooperation continued and deepened between representatives of central banks, the Eurosystem, the European System of Central Banks and also of future users in the development of the next generation of the TARGET2 payment system. TARGET2 will be legally structured as a multiplicity of RTGS systems, based on the Single Shared Platform (SSP). Each Eurosystem central bank will operate its own payment system, which will be part of the TARGET2 payment system.

In 2006 the ECB continued in publishing materials on the development of the TARGET2 system on its protected website intended for future system users. This concerned primarily the publication of the document

Communication on TARGET2 in July 2006, in which the Eurosystem confirmed the awaited launch of the TARGET2 system in November 2007, as well as all migration phases during which all Eurosystem central banks are to migrate over to the TARGET2 system. The document also published the new amended harmonised fee schedule for basic services and also all forms of future participation in the TARGET2 system so that future users can decide on the form of their participation in this system.

November 2006 saw the publication of the third report on the development of the TARGET2 system, which contained primarily the fee schedule for ancillary systems, liquidity transfers and home accounts, the definition of account groups, and information concerning testing and migration.

The current development indicates that the development of the TARGET2 system is proceeding according to plan and that the planned go-live of the TARGET2 system on 19 November 2007 will be achieved.

6.5 Preparations for the introduction of the euro

The highest directing and coordinating authority for the preparation of the euro changeover in Slovakia is the National Coordination Committee. Expert opinions on individual issues concerning the Slovak economy's transition to the euro are being prepared in working committees for the euro changeover. The banking sector falls within the remit of the Working Committee for Banks and the Financial Sector, the activity of which is coordinated by a representative of the Národná banka Slovenska, and its members are representatives of the Národná banka Slovenska, the Slovak Banking Association and individual associations of the financial sector. The Working Committee officially began its activity at the end of 2005.

In 2006 negotiations of the Working Committee for Banks and the Financial Sector focused primarily on solving tasks resulting from the National Euro Changeover Plan for the field of payment systems. The Committee drew up comprehensive rules for the dual display of prices for the whole financial sector. The final wording of the rules was agreed at the December meeting of the Working Committee and published on the NBS website. The rules set the minimum scope of requirements which entities must fulfil.

In the field of cashless payments this concerns in particular the approval of the overall concept of the future development of the payment system in the Slovak Republic.

In the field of cash payments this concerned in particular determining the need for euro cash and defining the process of its acquisition from the NBS. The results will be detailed further in 2007.

At the meeting of the Working Committee for Banks and the Financial Sector a paper for the banking sector concerning Regulation No. 1781/2006 on information on the payer accompanying transfers of funds was presented. The aim of the paper was to provide information on the application of this Regulation in practice, primarily with regard to the regime of minimum data on a payer in domestic transfers and transfers between Member States, on the regime of complete data on a payer that is applied to transfers between Member States of the European Union and third countries, as well as information on other obligations and exceptions in executing transfers.

Within the Working Committee for Banks and the Financial Sector a Subcommittee for SEPA was established with the remit of preparing a master implementation plan for SEPA in the Slovak Republic.

Statistics

7 Statistics

The Národná banka Slovenska collects, compiles and publishes various types of statistics in order to support the implementation of the monetary policy and financial stability. In 2006, the process of harmonising individual fields of statistics in accordance with the requirements of the ECB, other Community institutions as well as other international institutions continued. The scope of activities performed has expanded to include statistics of financial accounts, insurance companies, the capital market and pension saving. The main aim of the medium-term strategy in the field of statistics is to ensure tasks connected with the introduction of the single European currency.

Monetary and banking statistics

In terms of activities performed in the field of monetary and banking statistics, the year 2006 saw a stabilisation in reporting harmonised statistics in accordance with ECB methodology and requirements. Primarily in the field of compiling balance sheet and interest rate statistics, data was provided smoothly, on the basis of changes made to the structure and methodology of source statements in previous years (the transition from national to harmonised ECB methodology began in 2002).

In order to ensure the implementation of monetary policy, the monetary aggregates and counterparts to the M3 monetary aggregate were compiled on the basis of balance sheet statistics for the institutional sector of monetary financial institutions in line with ECB methodology. Thus, balance sheets statistics were compiled and reported for the central bank, banks and branches of foreign banks, money market mutual funds as well as the State Treasury representing the central government. Besides stock data, the compilation of balance sheet flow statistics continued while year-on-year growth rates of selected items from the monetary statistics were published in compliance with ECB methodology. Work also continued in compiling historical time series in accordance with the ECB strategy for the transmission of underlying data from all Member States of the euro area in the event of its expansion.

Concerning harmonised interest rate statistics, over the course of 2006 interest rates on deposits provided and loans taken were compiled for the banking sector in terms of stocks as well as the volume of new businesses. Statistics of long-term interest rates for representative government bonds were provided for the purposes of monitoring the fulfilment of one of the convergence criteria.

Preparations of the methodology and legal framework for expanding statistics to include the sector of other financial intermediaries were completed in 2006. In addition to the existing reporting of assets and liabilities of individual mutual funds for statistical purposes (equity funds, bond funds, mixed funds and funds of funds), the compilation of these statistics is to be extended to include the companies involved in financial leasing, hire purchase and factoring. Thus, these new provisions by the NBS as well as those of the ECB take into account the growing importance of the mentioned entities in the economy.

The interrelation between monetary and banking statistics and other types of statistics and the utilisation of these statistics in other activities ensured by the NBS is most clearly demonstrated by the fact that the data provided are employed not only for monitoring the development of a part of the financial market, but also as underlying data for compiling quarterly financial account statistics, for the calculation of credit institutions' required reserves, the compilation of balance of payments statistics and bank development statistics, for financial stability (prudential) analyses, for structural statistical indicators as well as for payment system statistics within the ESCB.

In 2006 the presentation and accessibility of the harmonised national data was expanded on both the NBS and ECB websites.

Quarterly financial account statistics in 2006

In terms of ECB requirements, the Národná banka Slovenska also contributes to the compilation of quarterly financial account statistics of the monetary union. These activities, which began in 2006, are aimed in the first phase at building up a matrix of quarterly financial accounts (QFAs), and, afterwards, on the regular collection and processing of data for QFAs.

The main purpose for compiling QFAs is to create a supporting analytical tool for the purpose of monitoring the monetary policy transmission mechanism and for financial stability analyses.

The matrix of QFAs contains data on the structure of financial flows for individual financial instruments (currency in circulation, deposits, loans, debt and equity securities, financial derivatives, mutual funds and insurance technical reserves) between individual institutional sectors in the economy, classified according to the European System of Accounts (ESA 95). In compiling QFAs, the Národná banka Slovenska cooperated closely with the Statistical Office of the SR, which is responsible for the general government sector in QFAs.

In 2006 the main emphasis was placed on methodological aspects and technical provisions for the compilation of QFAs. In the methodological field, consultations were held between the NBS and the Statistical Office of the SR regarding the acquisition of data for the sector of the NBS and other financial institutions, since, besides QFA compilation, consistency with annual financial accounts is also important, for which the Statistical Office of the SR is responsible. At the same time, methodological instructions were drawn up for the collection of data for the sector of insurance companies, pension fund management companies and supplementary pension fund management companies.

In connection with the technical provisions for the compilation of QFAs, regular meetings aimed at specifying a common database for QFA compilation were held between representatives of the NBS, the Statistical Office of the SR and an external consultancy firm. This database has been created for the servers of the Statistical Office of the SR.

Statistics on insurance companies and the capital market

At the beginning of 2006 a significant change was made to the financial market regulations in Slovakia, when the Financial Market Authority (the supervisory authority for insurance companies, the capital market and pension saving) was incorporated into the organisational structure of the Národná banka Slovenska, with the aim of integrating the supervision of the entire financial market.

In connection with this organisational change, for statistical purposes, as of 1 January 2006, the NBS was charged with the task of ensuring the collection, processing and archiving of data on financial market entities other than banks and branches of foreign banks that are required for the performance of integrated supervision by national as well as international institutions.

An integral part of the preparations for the new approach to the collection of data was the process of drafting legislative amendments to specific legal regulations governing the submission of statements and notifications by reporting entities.

Statistics of non-banking entities

The field of statistics of non-banking entities involves the acquisition and processing of statistical reports from entities other than banks and branches of foreign banks, for the purposes of balance of payments compilation.

Concerning activities performed in the statistical area of non-banking entities, the year 2006 saw a harmonisation of statistics in accordance with the recommendations of international institutions, primarily the ECB, concerning the methodology for the compilation of balance of payments and international investment position statistics.

Upon Slovakia’s entry into the euro area, the scope of reported data will also undergo changes, so as to allow the compilation of the balance of payments and international investment position statistics for the entire euro area. In addition to data on transactions with the rest of the world, it will be necessary to send monthly balance of payments statistics and data on transactions with non-residents of the euro area to the ECB. Quarterly balance of payments statistics and a geographical breakdown of data in a predetermined structure must also be sent to the ECB. For this reason, statistics of non-banking entities and/or the corporate statistical report DEV1-12 were expanded. With regard to the fact that after entering the euro area historical data for the period of the previous three years must be transmitted, it was necessary to make certain changes to that corporate statistical report as of 2006.

In 2006 information on foreign direct investment continued to be published on the NBS website, within its Monetary Survey monthly bulletin.

International cooperation

In the field of statistics, the Národná banka Slovenska is represented on the ECB and ESCB Statistics Committee and working groups, and on the Eurostat working groups. The NBS also cooperates with the BIS and IMF.

Foreign Activities

8 Foreign Activities

8.1 European Union

Cooperation with the European Union (EU) and its Member States, as well as with the acceding countries Romania and Bulgaria, continued to be a priority of the NBS in 2006. This was carried out through the NBS delegates in bodies of the Council of the European Union (the Council) and the European Commission (EC).

In 2006 the NBS Governor attended the informal ECOFIN meetings (in Vienna and Helsinki), which are held semi-annually in the country holding the Presidency of the Council. The main focus of these meetings was global competition, innovation and productivity, the economic situation and financial stability.

The NBS representation at meetings of the Economic and Financial Committee (EFC), which contributes to the preparations of the ECOFIN, was also important. Moreover, the NBS was involved in the activities of the EFC Sub-Committee on IMF and related issues and its Euro Coin Sub-Committee.

At the level of EC committees, NBS experts attended meetings of the Committee of European Banking Supervisors and its expert groups, the Committee of European Securities Regulators, and the Committee of European Insurance and Occupational Pensions Supervisors. The NBS was also involved in the committees' activities focusing on statistics, as well as on banknotes and coins.

The NBS also participates in the submission of comments on EU legal acts where these are being discussed by working committees and groups of the Council which do not include NBS representatives. During 2006, the NBS expressed its opinion on, inter alia, the Convergence Report of the EC and ECB on Lithuania and Slovenia and on the other Member States concerned, and on draft proposal for a directive on consumer loan contracts and a directive on acquisitions, etc.

In connection with the preparation of December's EC Convergence Report, the European Commission carried out a mission in Bratislava in September 2006. The discussions at the NBS focused mainly on monetary policy and the exchange rate, and the current development of, and projections for, inflation.

Regarding the coordination of decision-making on EU matters, a key role is played by the Commission for EU Affairs established at the Ministry of Foreign Affairs of the Slovak Republic. Throughout 2006 its meetings were regularly attended by a representative from the NBS.

The European System of Central Banks (ESCB) and the European Central Bank (ECB)

The Národná banka Slovenska cooperates with the ECB at several levels. The NBS Governor is a member of the General Council of the ECB, which convened four times in 2006. These meetings are attended by the governors of all national central banks of the ESCB and the highest representatives of the ECB. The governors of the Romanian and Bulgarian central banks had observer status at the 2006 meetings, ahead of their countries' accession to the EU on 1 January 2007 and the simultaneous inclusion of their central banks in the ESCB. A further two General Council teleconference meetings were held in regard to the approval of the ECB Convergence Reports on Lithuania and Slovenia (May 2006) and on the other Member States with a derogation (November 2006). During the year NBS representatives contributed to the activities of the committees and working groups of the ESCB by performing specific tasks, including the preparation of documents for discussions of the ECB General Council and Governing Council.

Many of the NBS activities within the ESCB involve the consultation of draft proposals for general legal regulations, i.e. draft laws, announcements and decrees that fall within the competences of the ECB. For the purposes of legislative transparency across the EU, government bodies of the Member States are required to submit for comments to the ECB their draft legislation falling within the ECB remit, and these are then made available to the other Member States. In 2006 the Národná banka Slovenska submitted the draft law on the NBS for comments and also made its own comments on the ECB opinions regarding the draft legislation of other Member States.

The Phare Programme

In October 2006 the implementation of the Phare Programme under the last pre-accession memorandum (2003) was completed. The contracted projects, “Support for Risk-Oriented Supervision” and “Software Development for Capital Market Supervision”, represented the logical continuation of the programme successfully completed under the Financial Memorandum 2002, “Strengthening Financial Sector Supervision”, which was implemented between June 2004 and October 2005 by the consortium Wiener Burse A.G. Both programmes supported the expansion and streamlining of supervisory authorities in their capacity to regulate the financial market effectively and efficiently, and they helped to create the technical bases for the incorporation of the Financial Market Authority (FMA) into the NBS.

The project “Support for Risk-Oriented Supervision”, budgeted at EUR 1.15 million and launched in June 2005 as a form of technical assistance for the FMA and NBS, was implemented by the Belgian Bankers Academy (BBA).

This programme was tied in with outputs from previous projects in the field of integrated supervision and, in addition, brought quality improvements to the system of risk-oriented supervision of the capital market, insurance industry, pension funds and financial conglomerates. As regards the supervision of credit institutions, it addressed how to deepen consolidated supervision and to implement the New Basel Capital Accord (Basel II). Under the banking module, BBA experts held a series of special seminars on risks in the context of Basel II and on consolidated supervision; they produced two summary manuals for the conduct of on-site supervision in accordance with the requirements of Basel II, and they trained NBS staff to work with the specialist software “CADcalc” and “CADmarkt”. Under the insurance module, specialist seminars were held on how to conduct off-site supervision in accordance with the Solvency II accord, and the supervision framework plan, including provision for software support, was prepared. Moreover, specialized secondments abroad were organized for staff responsible for the supervision of insurance mediation. Under the capital market module, specialist seminars were held and consultations provided on how to address current issues of supervision, in particular, the supervision of brokerage companies and the implementation of the “UCITS” and “MiFID” directives. Under the pension funds module, BBA experts organized a series of specialist seminars on current issues of supervision, and they provided consultations and assistance in regard to the drafting of an amendment to the law on pension funds.

The project involved 18 foreign experts, and the 36 seminars organized by them were attended by a total of 600 staff from the FMA and NBS.

The final project, “Software Development for Financial Market Supervision”, budgeted at EUR 100 000, was launched in December 2005 and was implemented by AXON PRO, s.r.o., for the FMA. The aim of the project was to supply software applications, developed in accordance with the functional specification and technical-operational requirements of the NBS, in order to meet the needs of the current supervision system for the capital market. The software can be used on a daily basis for the electronic collection, evaluation and archiving of data submitted by capital market entities subject to NBS supervision. The supply included the software installation and testing, delivery of the respective documentation, and the training of supervision staff in its use and servicing.

The completion of these projects marked the culmination of the technical assistance which the European Commission had been providing to the Slovak banking sector through the Phare Programme since 1993. Using EU grants of over EUR 17 million, the NBS prepared more than 60 development projects during a period of over 13 years for employees of both commercial banks and the NBS.

8.2 NBS cooperation with international institutions

International Monetary Fund (IMF)

In 2006 Slovakia joined the IMF donor members. In February, the IMF notified the Národná banka Slovenska, which represents the Slovak Republic in operations of the Financial Transactions Plan (FTP), that Slovakia was for the first time included on the list of 48 countries participating in the FTP, through which economically strong IMF members lend foreign exchange funds to member countries experiencing balance of payments difficulties. In accordance with the approved plan, Slovakia undertakes to meet IMF requests to provide the required funds from its foreign exchange reserves. During 2006 Slovakia did not make any such transfers to the IMF.

The mutual cooperation in 2006 was developed mainly through the IMF mission that visited Slovakia between September and October 2006. The IMF conducts regular consultations with each member country on an annual basis, under Article IV of the Articles of Agreement of the IMF, and this mission represented its consultations with Slovakia. The discussions at the NBS concerned mainly monetary policy, entry into ERM II, adoption of the euro, and macroeconomic and inflation forecasts.

In accordance with Article VIII of the Articles of Agreement of the IMF, the NBS updated for the IMF its Annual Report on Exchange Arrangements and Exchange Restrictions, and forwarded to the IMF Executive Board, the list of foreign exchange restrictions that Slovakia applies in order to preserve national and international security, and to protect the financial system against financial terrorism.

In April 2006 the highest representatives of the Národná banka Slovenska attended the Spring Meetings of the International Monetary Fund and World Bank, held in Washington, and their Annual Meetings, held in Singapore in September. The meetings focused on outlooks for the world economy and financial markets, the IMF medium-term strategy, IMF supervision, and the assistance provided to low-income countries within the fulfilment of the Millennium Development Goals. Most attention, however, was directed at the reform of member countries' quotas and the ad hoc quota increases for China, Korea, Mexico and Turkey, the countries most under-represented.

The Belgian Constituency of the IMF and World Bank held a meeting of central banks and finance ministers at the Deputies level in Prague in June 2006. The discussion focused on official development assistance and the accumulation and management of foreign reserve assets.

The World Bank

The cooperation between Slovakia and the World Bank institutions is gradually changing in correlation with the transformation process in the Slovak economy.

Within the International Bank for Reconstruction and Development (IBRD), Slovakia is one of the EU-8, a group of countries that may still receive financial or technical assistance. During 2006 the technical assistance was provided through the relevant Slovak ministries: the Ministry of Health, which is drawing a loan for health sector modernization, and the Ministry of Labour, Social Affairs and Family, which is drawing down for a project to reform the administration of social benefits. The Ministry of Labour, Social Affairs and Family is working with the Ministry of Education on a project to support human capital. The aim of the project is to cooperate in modernizing employment and education support systems and to provide assistance in the field of social policy.

In the International Development Association (IDA), Slovakia has the position of a donor country, providing financial assistance to developing countries. In January 2006 Slovakia paid EUR 2.07 million as the first instalment of its contribution under the 14th replenishment of IDA funds. The next instalments will be made in 2007 and 2008.

In November and December 2006 the World Bank conducted a mission to Slovakia, the aim of which was to reassess the Financial Sector Assessment Program (FSAP). The mission's work at the Národná banka Slovenska involved assessing the standards applied in the banking sector and insurance sector.

Bank for International Settlements (BIS)

In 2006 the NBS Governor attended the 76th Annual General Meeting of the BIS member central banks, as well as the regular BIS Meeting of Governors. The meetings addressed ERM II and its entry criteria, inflation measurement, developments in the field of payment and settlement systems, cross-border integration of financial markets, and core principles of effective banking supervision.

In 2006 the Národná banka Slovenska hosted the 5th meeting of the BIS Monetary Policy Working Group for Central and Eastern Europe. The meeting in Bratislava was attended by representatives of the BIS, ECB and 21 European national central banks, and the discussions covered macroeconomic development, the external sector and financial sector, financial and monetary policy and exchange rate policy.

Also in 2006 the NBS joined the 45 central banks that are members of the Network on Central Bank Governance supporting the exchange of information on central bank management between central banks and BIS.

World Trade Organization

The first half of the year saw intensive discussions at both the WTO and at the Article 133 Committee of the Council of the EU, which is responsible for the EU multilateral trade policy. The NBS expressed its opinions on financial services, in particular on proposed changes to the Schedule of Specific Commitments of the EU and within the "compensatory negotiations" under Article XXI of the General Agreement on Trade in Services, which stemmed from the enlargement of the EU to include 10 new Member States in May 2004.

Organisation for Economic Cooperation and Development (OECD)

In 2006 NBS representatives contributed to the activities of relevant committees and working groups of the OECD, namely the Economic Policy Committee (EPC), the Economic and Development Review Committee (EDRC), the Committee on Financial Markets (CFM), and the Insurance and Private Pensions Committee.

In addition, an OECD structural mission to Slovakia was conducted in September 2006, and this was followed up in December by an OECD political mission led by the OECD chief economist, J. P. Cotis. The purpose of the missions was to prepare documents for the Economic Survey of the Slovak Republic, due to be published in April 2007. The discussions at the NBS focused on the fulfilment of the convergence criteria for entry into the euro area, financial market regulation and pension reform issues.

European Bank for Reconstruction and Development (EBRD)

In 2006 the attention was focused on the EBRD strategy for the period 2006-2010, namely, the Capital Resource Review 3. This document was officially approved in May 2006 at the Annual Meeting of the EBRD Board of Governors in London. One of the strategic objectives is to shift the EBRD activities further towards East and South-East of Europe, alongside the gradual termination of assistance provided to the countries which joined the EU in May 2004 (including Slovakia) and have up to now been recipients of EBRD assistance. A number of discussions with representatives of the Constituency Slovakia forms a part of were held in this regard.

International Investment Bank (IIB) and International Bank for Economic Cooperation (IBEC)

The IIB and IBEC, headquartered in Moscow, are banks founded by member countries of the former Council for Mutual Economic Cooperation. Slovakia, as an independent republic, became their member in 1993. Its share in the paid-up capital of the IIB represents 4.85% or EUR 10.4 million, and in the IBEC, 6% or EUR 8.6 million.

The supreme governing bodies of both banks are the Bank Boards, which convene twice a year. In 2006, their spring and autumn meetings were held in Moscow and Vietnam, respectively.

International Investment Bank

At its spring meeting, the IIB Bank Board took under consideration the “Report on activities for 2005”; it approved a profit of EUR 10.5 million, the budget of EUR 8.7 million for general operating expenses in 2007, and the appointment of KPMG company to audit the 2006 financial statements. The Board also approved a new reallocation of official posts among the Member States for the term 2006–2011. Slovakia will be filling the positions of deputy chairman of the board of directors and assistant director of the investment lending department.

The autumn meeting of the IIB Bank Board saw the approval of the “Report on activities for the first nine months of 2006”, the “Report on the progress of negotiations regarding the settlement of claims against Cuba”, the “Report on the fulfilment of the 2006 budget for general operating expenses”, and the composition of the revision commission for the period 2006-2011. With effect from 1 January 2007, the Bank Board appointed representatives of Slovakia, Bulgaria and Romania deputy chairmen of the board of directors.

International Bank for Economic Cooperation

At its spring meeting, the IBEC Bank Board took under consideration the “Report on the bank’s activities for 2005” and approved the “Report on the revision committee’s activities for 2005”, and the work plan for the period May 2006 to May 2007. A budget of EUR 8.0 million for general operating expenses was also approved.

The autumn meeting of the IBEC Bank Board took under consideration the bank’s balance sheet as at 31 December 2005 and its retained earnings; it approved the “Report on the bank’s activities for the first half of 2006”, the “Report on fulfilment of the budget for general operating expenses for the first nine months of 2006”, and appointed new members of the revision committee. The Bank Board also addressed the Russian Federation’s delegation with a request to nominate a chairman of the board of directors.

8.3 The NBS foreign activities with regard to training and development

In the field of training and development, the NBS foreign activities centre on cooperation within the European System of Central Banks (ESCB). The NBS participates in the creation and implementation of a common strategy through its representative in the Task Force on Training and Development. The purpose is to develop a common basis for the training and development of employees throughout the ESCB, as well as to create a common culture across the ESCB and Eurosystem.

In 2006 the NBS Institute of Banking Education (IBE) took part for the first time in the organization of joint training events of the ESCB, and hosted one part of the training programme Heading for Leadership. Held from 24 to 28 April 2006 at the premises of the NBS in Bratislava, the event focused on the development of management skills, especially of leadership, and was attended by 16 representatives from ten national central banks of the ESCB, the European Central Bank and supervisory authorities of EU Member States.

The IBE also offered staff from ESCB central banks the chance to participate in three Open Seminars, two of which were focused on the development of language skills – Banking and Financial English (9 to 12 May 2006) and Financial English for Corporate Lawyers and Non-Financial Managers (16 to 19 October 2006) – and one of which was on the specialized issues of International Accounting Standards and International Standards of Financial Reporting (12 to 14 June 2006). The open seminars attracted a total of 28 foreign participants from 18 national central banks of the ESCB.

As part of foreign technical cooperation, the NBS organized a further two training events free-of-charge for experts from neighbouring countries' central banks or supervisory authorities. In May 2006 four experts from the Banka Slovenije attended a two-day consultation on risk management issues at the NBS Risk Management Methodology Department. In December 2006 the IBE, in cooperation with experts from the Risk Management Methodology Department, organized a two-day workshop on the topical issue of credit risk management of households and non-financial institutions, which was attended by ten banking supervisors from Austria, the Czech Republic, Hungary, Poland, and Slovenia. The programme included presentations by acknowledged experts from the Oesterreichische Nationalbank, and active contributions from other foreign participants.

The Národná banka Slovenska is an active provider of training-related foreign technical assistance. In line with Slovakia's foreign policy and the EU common foreign policy (the European Neighbourhood Policy), the NBS has targeted its foreign technical assistance mainly at the National Bank of Ukraine (NBU).

In February 2006, the IBE director and the director of the NBU personnel department signed an agreement under which the NBS prepared and carried out eight training events in accordance with the specific requirements of the NBU. Of those events, four were held at the NBS in Bratislava and four in Kiev. They were led by 38 experts from 11 NBS departments, and altogether 93 staff of the NBU participated in them.

The first seminar in Kiev focused on internal audit issues and the second one addressed the implementation of monetary policy. The other six events were consultative in nature – study visits centred on technical issues, including cash management, the legal regulation of the NBS activities, the harmonization of legislation regulating banking supervision with the EU requirements, foreign reserve management, the liberalization of capital transactions, the preparation of an inflation report, and the monetary transmission mechanism.

The NBS experts concentrated on sharing their practical experience from the transformation process related to Slovakia's accession to the EU, the inclusion of the NBS in the ESCB and the planned introduction of the euro in Slovakia and the NBS entry into the Eurosystem, as well as presenting NBS approaches in the respective areas.

The preparation and implementation of training events, either in the context of the ESCB, foreign technical cooperation or the provision of foreign technical assistance provided positive experiences in 2006 which the NBS is planning to follow up on in the years ahead. The most important recipient of foreign technical assistance will continue to be the National Bank of Ukraine, which has already expressed interest in pursuing this form of cooperation.

Preparations for the Euro Introduction

9 Preparations for the Euro Introduction

Preparations for the euro introduction progressed in 2006 both from the economic-political perspective and on the technical and organizational side. These preparations will allow Slovakia to adopt the euro as of 1 January 2009, and favourable economic developments are increasing the chances of meeting this deadline. The Národná banka Slovenska continued to perform its tasks under the National Euro Changeover Plan and its internal euro adoption plan, and thereby contributed to the accomplishment of the euro adoption strategy.

9.1 National Euro Changeover Plan and organizational preparations

Preparations for introducing the euro and the completion of tasks under the National Euro Changeover Plan for the Slovak Republic proceeded on schedule, and the euro is on track to be introduced on 1 January 2009. The National Plan tasks with a deadline in 2006 were for the most part fulfilled. The tasks were not, however, brought to completion at an even pace across different areas. Nevertheless, important tasks were fulfilled at the beginning of 2007, and the completion of following activities was not put at risk. An important milestone for the continuation in the preparations was the approval of the Government Programme Declaration, in which the new Slovak Government confirmed the commitment to adopt the euro in 2009. The tasks for 2006 that were not performed included mainly the nomination of a new national coordinator for the euro changeover and the update of the National Euro Changeover Plan. The coordinator was appointed in January 2007 and the National Plan was updated in March 2007.[21]

The regular semi-annual report on the completion of tasks under the National Plan as at the end of 2006 confirmed that the state of preparations for the euro changeover in Slovakia was good. However, some working committees did not work intensively enough and time reserves have been largely spent.

Most of the tasks for 2006 that the Národná banka Slovenska was assigned under the National Plan were completed. The NBS internal euro adoption plan was supplemented and updated, and a majority of the tasks stipulated for 2006 were met. Where tasks were not completed on schedule, the cause lay either with third parties or excessively ambitious deadlines. Extending these deadlines will not prevent the euro from being introduced on the planned date.

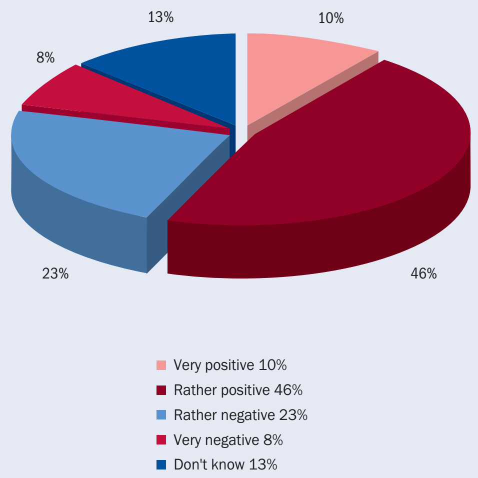
The NBS conducted a review of the legal regulations either issued by the NBS or concerning the NBS which will need to be amended in connection with the euro changeover. A plan to modify the domestic payment

Table 42 **Procedures before and after euro adoption**

Fulfilment of the Maastricht Criteria	2007 to March 2008
EC and ECB convergence reports	April/May 2008
EC proposal to the Council of the EU for abrogation of the derogation	May 2008
Consultations with the European Parliament	May/June 2008
Council of the EU abrogates the derogation and sets the conversion rate	June/July 2008
Start of mandatory dual pricing	July 2008
Euro area entry – “€ Day”	1 January 2009
Dual circulation of koruna and euro banknotes and coins	1–16 January 2009
End of mandatory dual pricing	31 December 2009
Recommended end of voluntary dual pricing	30 June 2010

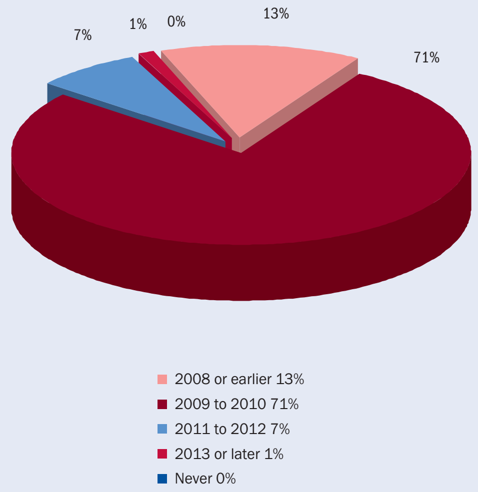
[21] *The document is published at www.nbs.sk/Euro/Documents.*

Chart 86 **Expectations of Slovak citizens for the effect of the euro changeover in Slovakia**



Source: Eurobarometer, 2006.

Chart 87 **Expectations of Slovak citizens for the date of the euro changeover in Slovakia**



Source: Eurobarometer, 2006.

system was drawn up and preparations were made for connecting to the European payment system. Preparatory analyses were carried out in regard to producing a concept for linking the NBS to the ECB's information systems. There were also several detailed analyses of the effect of euro changeover on enterprises, banking and financial institutions, and households made in 2006. In addition, a large number of information and communication activities were carried out (exhibitions, lectures, seminars, presentations in the media).

Slovakia's preparations for introducing the euro have been positively assessed abroad. The European Commission's regular reports on practical preparations for the euro make clear that Slovakia is making sufficient progress in its preparations for introducing the currency. The schedule for euro adoption remains largely unchanged. The experience of Slovenia indicates that the dates set for certain key decisions by European institutions may be put back slightly from the dates originally expected, but this will not prevent the euro from being introduced, as planned, on 1 January 2009.

Confidence that Slovakia will introduce the euro from 2009 is rising not only in professional circles, but also among the public. According to an opinion poll on the euro changeover which the European Commission conducted in the new EU Member States in September 2006, 71% of Slovak citizens expect Slovakia to introduce the euro in 2009 or 2010. The same survey shows that 56% of Slovak citizens expect the introduction of the euro in Slovakia to have a positive effect, compared to 31% who forecast a negative effect.

9.2 Economic policies and the Maastricht Criteria for euro adoption

Meeting the Maastricht Criteria is a key precondition to introducing the euro. The significance of economic policies to their fulfilment was confirmed by the negative development recorded by Slovakia in the summer months soon after the parliamentary elections. The regional effects and uncertainty in regard to the direction of economic policy was reflected in the weakening exchange rate of the Slovak koruna.

Sound economic policies are required not only for the euro changeover itself, but also to ensure that the Slovak economy is able to function successfully within the euro area and to make maximum use of the potential benefits offered by the single European currency.

The Národná banka Slovenska is co-responsible for, in particular, the criteria of inflation and exchange rate stability. The priority is to meet the Maastricht inflation target.

The year-end inflation target for 2006 was set at 2.5% and it was not met. The main cause of the faster inflation growth and overshooting of the inflation target was the higher than expected dynamics of prices of energy and foodstuffs. In regard to such effects, exemptions from the fulfilment of the inflation target were precisely defined in the NBS Monetary Programme until 2008, since they are out of influence of NBS monetary policy.

The average rate of inflation for 2006 stood at 4.3%, which was substantially higher than the reference value of the inflation criterion. The most critical year for euro adoption will be 2007, for which the NBS has set an HICP inflation target of up to 2%. The forecast for inflation development indicates that the target, and therefore the inflation criterion, will be met at the end of 2007.

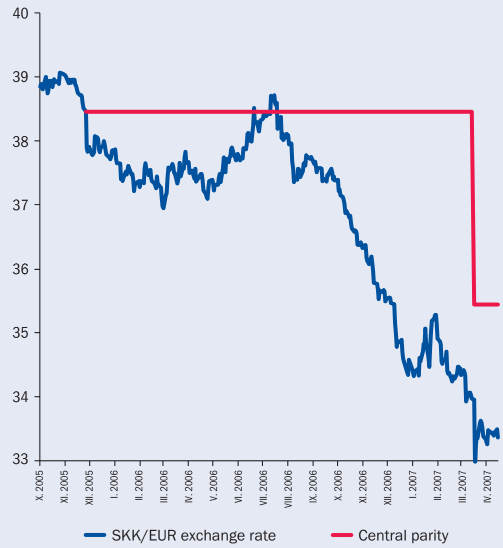
The second target for which the NBS is co-responsible is exchange rate stability within ERM II. The stability of the exchange rate is at present a joint responsibility of the Government and the NBS. The central bank is responsible for preventing short-term fluctuations of the exchange rate, and, together with the Government, should seek to keep the medium-term development of the exchange rate close to the equilibrium level and prevent creation of imbalances that could affect exchange rate developments.

The Slovak koruna exchange rate followed a stable course in 2006, but since the condition of two-year membership in ERM II was not met, the fulfilment of the exchange rate criterion cannot be assessed as yet.

The koruna joined ERM II on 28 November 2005. At the same time as the decision on entry was made, the central parity was set at SKK 38.4550 per euro. Within ERM II, the koruna observes the standard fluctuation band of ±15% around a central parity. The lower compulsory intervention rate was set at SKK/EUR 32.6868 and the upper rate at SKK/EUR 44.2233. Should either of these rates be reached, the currency must be defended by the central banks of all euro area countries and of countries participating in ERM II, including the NBS. Of course, the NBS may intervene to stabilize the exchange rate at any time, not only at the compulsory intervention rates, and in 2006 it exercised this option on more than one occasion. In the period after the parliamentary election, in June and July 2006, the NBS intervened on the foreign exchange market since its exchange rate was not corresponding to the economy's development and had weakened excessively. In this period, the koruna remained for several days on the depreciation side of the fluctuation band. The rate then appreciated steadily and reached historical peaks. By the end of the year, the koruna's exchange rate was not in line with the equilibrium value, and, therefore, the NBS intervened again. For most of its time in ERM II, the koruna has been stronger than the central parity and at the end of 2006 it was fluctuating at around 10% above the parity.

Since entry into ERM II, the Slovak economy has gone through significant structural changes. The differential in productivity growth in comparison with the euro area led to substantial strengthening of the real equilibrium exchange rate, and, in an environment of relatively low inflation, these developments were reflected in the level of the nominal exchange rate. As a consequence, the central parity ceased to be in line with the current state of the economy. At the request of Slovakia, and with the agreement of members of the ERM II Committee, the koruna's central parity in ERM II was revalued with effect from 19 March 2007, to SKK 35.4424 per euro. The lower compulsory intervention rate was reduced to SKK/EUR 30.1260 and the upper compulsory intervention rate to SKK/EUR 40.7588.

Chart 88 **The koruna's exchange rate following entry into ERM II**



Source: NBS.

While the Slovak koruna has been in ERM II, its exchange rate against the euro has been sufficiently stable. Despite several interventions, the exchange rate's stability was maintained naturally, and exchange rate stabilization did not have to be sought at the expense of the stability of the rest of the economy.

The fiscal criterion was not met in 2006. The general government deficit excluding the effect of introducing the second pension pillar declined year-on-year to 2.3% of GDP. However since April 2007 costs of pension reform have to be included in the deficit, which raises the deficit to 3.4% of GDP, i.e. above the limit of 3% GDP. It will be important in 2007 to reduce the deficit to the required level.

A lower general government deficit will enable to ensure the long-term sustainability of government debt, which represents the second part of the fiscal criterion. The level of government debt is substantially lower than the reference value limit. The fulfilment of this part of the fiscal criterion has not as yet been in danger. Reducing the deficit and meeting the fiscal

Table 43 **Fulfilment of the Maastricht Criteria in 2006**

Criterion	Figure for 2006	Reference value
Inflation (average HICP, in %)	4.3	2.8
Long-term interest rates (%)	4.4	6.2
Government debt (% of GDP)	30.7	60.0
General government deficit (% of GDP)	3.4	3.0
Exchange rate stability	ERM II since November 2005	

Source: Eurostat, NBS, MF of the SR.

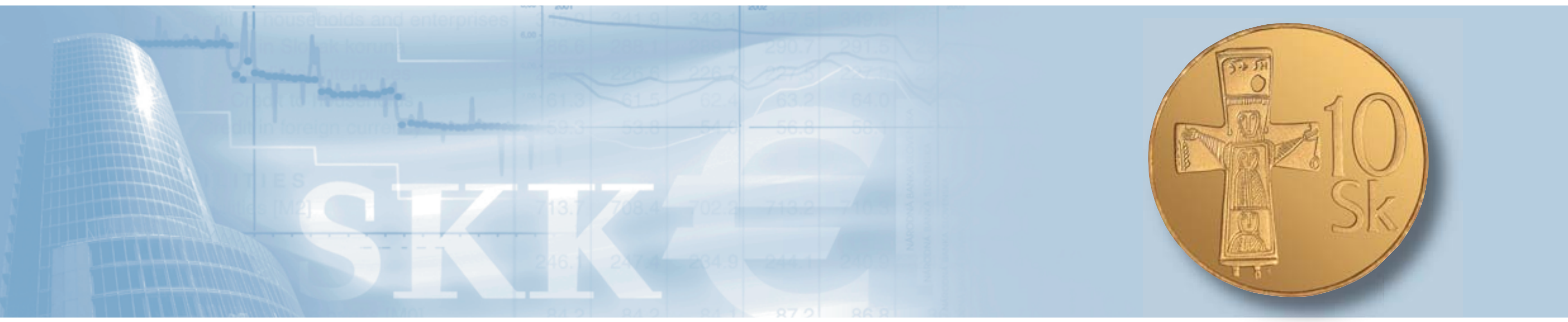
criterion helps to curb demand-side pressures and is therefore essential to fulfilling the inflation criterion. A responsible and credible fiscal policy also supports stabilization of the exchange rate.

Fiscal consolidation is essential not only for meeting the Maastricht Criteria, but also for ensuring that the government has the discretion, during economic downturns, to raise public spending in order to stabilize the economy without fear of breaking the rules of the Stability and Growth Pact.

The fulfilment of the last Maastricht criterion – the level of long-term interest rates – is closely related to meeting the other criteria. Given the decline in inflation and the high credibility of economic policies, Slovak long-term interest rates are substantially lower than the reference value. If all the other Maastricht Criteria are met, the fulfilment of the interest rate criterion should not be at risk.

Meeting the Maastricht Criteria and introducing the euro in Slovakia represent short-term objectives that support the fulfilment of the more significant and longer-term objectives of real convergence. These objectives include mainly achieving economic growth and higher living standards through increasing the economy's flexibility. On the other hand, nominal convergence – the fulfilment of the Maastricht Criteria – is already taking place with the robust support of real convergence. An example of this is the record economic growth which Slovakia reported in 2006.

Legislation



10 Legislation

In 2006 the Národná banka Slovenska continued to exercise its legislative and approximation competences in the monetary area and in areas of currency in circulation, foreign exchange management and banking. From 1 January of 2006 these competences also covered the capital market, insurance industry and pension saving, by virtue of the Národná banka Slovenska assuming the powers of the abolished Financial Market Authority (FMA).

Legislative amendments prepared and implemented in 2006 to laws on matters within the competence of the Národná banka Slovenska

Act No. 483/2001 Coll. on banks and on amendments to certain acts, as amended, was amended in 2006 by Act No. 214/2006 Coll. and Act No. 644/2006 Coll. The most important changes were made under Act No. 644/2006 Coll., which brought the prudential business rules of banks and branches of foreign banks into line with the requirements of the European Union's single financial market, so that the capital requirements for financial institutions correspond to the actual risks and that groups providing financial services in more than one country are not unduly burdened by multiple levels of legal regulations and supervision.

Act No. 566/2001 Coll. on securities and investment services and on amendments to certain acts – the Securities Act – as amended, was amended in 2006 by Act No. 213/2006 Coll. and Act No. 644/2006 Coll. As with the Banking Act, the most significant changes were contained in Act No. 644/2006 Coll., under which the new regulation of prudential business rules in line with the requirements of EU single financial market applies to all financial market entities, and therefore also to securities dealers and branches of foreign securities dealers. Act No. 644/2006 Coll. also governs provisions on takeover bids in accordance with the requirements laid down by EU law.

Act No. 510/2002 Coll. on the payment system and on amendments to certain acts, as amended, was amended in 2006 by Act No. 214/2006 Coll. This statute harmonized the Payment System Act with the new Act on Bankruptcy and Restructuring and also made it obligatory for the Národná banka Slovenska to notify the Commercial Bulletin of every NBS decision to revoke a payment system operating licence.

Act No. 747/2004 Coll. on financial market supervision and on amendments to certain acts, as amended, was amended in 2006 by Act No. 214/2006 Coll. and Act No. 644/2006 Coll. Under Act No. 214/2006 Coll. modifications were made to provisions on the method of collecting fees for acts and proceedings of the Národná banka Slovenska; Act No. 644/2006 Coll. changed the annual contribution rates for supervised entities.

Act No. 202/1995 Coll., the Foreign Exchange Act, amending Act of the Slovak National Council No. 372/1990 Coll. on misdemeanours, as amended, was amended in 2006 by Act No. 214/2006 Coll. This statute provided for the implementation of a single licence under which foreign banks may operate in Slovakia in the foreign exchange field.

Act No. 95/2002 Coll. on the insurance industry and on amendments to certain acts, as amended, was amended in 2006 by Act No. 10/2006 Coll., Act No. 262/2006 Coll. and Act No. 644/2006 Coll. The most important changes were made under Act No. 262/2006 Coll. which, for example, defines a "credible person" more precisely and regulates provisions concerning the technical provisions of insurance and reinsurance companies.

Act No. 594/2003 Coll. on collective investment and on amendments to certain acts, as amended, was amended in 2006 by Act No. 213/2006 Coll. This statute changed mainly the provisions on the separate records of book-entry shares/units of an open-end mutual fund and the rules under which an asset management company may acquire a participation in a real estate company.

Act No. 43/2004 Coll. on retirement pension saving and on amendments to certain acts, as amended, was amended in 2006 by Act No. 310/2006 Coll., Act No. 644/2006 Coll. and Act No. 677/2006. Notable changes implemented by Act No. 677/2006 Coll. including, for example, a reduction in the pension fund management fee charged by a pension fund management company (PFMC) and modification of a

PFMC's expenditure limit for concluding a retirement pension saving contract and for promotional activities and advertising, including sanctions for exceeding that limit.

Act No. 650/2004 Coll. on supplementary pension saving and on amendments to certain acts, as amended, was amended in 2006 by Act No. 310/2006 Coll. The function of this statute was largely to incorporate into the Act the EU Directive on the activities and supervision of institutions for occupational retirement provision.

Act No. 340/2005 Coll. on insurance mediation and reinsurance mediation and on amendments to certain acts was amended in 2006 by Act No. 644/2006 Coll. Under this statute, the competences of the abolished Financial Market Authority were replaced by the competences of the Národná banka Slovenska.

Act No. 381/2001 Coll. on compulsory contractual third-party liability insurance for motor vehicles and on amendments to certain acts, as amended, was amended in 2006 by Act No. 188/2006 Coll. This statute requires a policyholder whose insurance is to be terminated during the insurance period because of premium payment default to conclude an insurance contract with his existing insurer for the remainder of the insurance period.

Decrees issued by the Národná banka Slovenska in 2006 under its legislative powers to issue implementing, generally binding legal regulations

Decree No. 88/2006 Coll. on the minting of SKK 500 commemorative silver coins marking the Protection of Nature and Landscape – National Park Muránska planina.

Decree No. 172/2006 Coll. stipulating the maximum level of the technical interest rate in life insurance.

Decree No. 448/2006 Coll. on the minting of SKK 200 commemorative silver coins marking the 200th anniversary of the birth of Karol Kuzmány.

Decree No. 461/2006 Coll. amending Decree of the Ministry of Finance of the Slovak Republic No. 448/2005 Coll. on a qualification test of an actuary.

Decree No. 476/2006 Coll. amending Decree of the Ministry of Finance of the Slovak Republic No. 417/2005 Coll., which implements certain provisions of Act No. 340/2005 Coll. on insurance mediation and reinsurance mediation and on amendments to certain acts.

Decree No. 547/2006 Coll. on putting the third reprint of the SKK 20 banknote (1995 series) into circulation.

Decree No. 556/2006 Coll. on the minting of SKK 5,000 commemorative gold coins marking Mojmir II, the last Great Moravian Ruler.

Decree No. 567/2006 Coll. laying down the content of reports on the management of a pension fund's assets, reports on the management of the own assets of a pension fund management company, the method and scope of their publication, and the content of the daily information on each transaction in a pension fund's assets.

Decree No. 568/2006 Coll. laying down the content of annual and semi-annual reports on the management of assets in a supplementary pension fund and the content of annual and semi-annual reports on the management of own assets of a supplementary pension company.

Decree No. 604/2006 Coll. amending Decree of the Ministry of Finance of the Slovak Republic No. 595/2004 Coll. on the own funds of a pension fund management company, as amended by Decree No. 158/2005 Coll.

Decree No. 605/2006 Coll. amending Decree of the Ministry of Finance of the Slovak Republic No. 217/2005 Coll. on the own funds of supplementary pension companies and on methods and procedures for fixing the value of assets in supplementary pension funds.

Decree No. 606/2006 Coll. amending Decree of the Ministry of Labour, Social Affairs and Family of the Slovak Republic No. 440/2004 Coll., which lays down what is meant by "false or misleading information" and "service or performance not related to retirement pension saving", as amended by Decree No. 774/2004 Coll.

Decree No. 617/2006 Coll. on the minting of SKK 200 commemorative silver coins marking the 200th anniversary of the birth of Jozef Maximilián Petzval.

Decree No. 640/2006 Coll. amending Decree of the Ministry of Finance of the Slovak Republic No. 228/2005 Coll. on the own funds of a financial conglomerate and on how to calculate the adequacy of the own funds of a financial conglomerate in accordance with Act No. 95/2002 Coll. on the insurance industry and on amendments to certain acts as amended.

Decree No. 665/2006 Coll. amending Decree of the Ministry of Finance of the Slovak Republic No.

567/2004 Coll., which lays down the minimum amount in the guarantee fund of an insurance company or branch of a foreign insurance company.

Decree No. 685/2006 Coll. amending NBS Decree No. 441/2004 Coll. on how to calculate and demonstrate the actual rate of solvency of an insurance company or branch of a foreign insurance company, how to calculate the required rate of solvency of an insurance company or branch of a foreign insurance company and on risk capital.

NBS Provision No. 1/2006 on information provided in relation to customer payments of a bank or branch of a foreign bank (notification No. 416/2006 Coll.).

NBS Provision No. 2/2006 amending NBS Provision No. 2/2003 on the Register of Credits and Guarantees as amended (notification No. 462/2006 Coll.).

NBS Provision No. 3/2006 amending NBS Provision No. 11/2005, which lays down the amount of the fees for particular operations of the Národná banka Slovenska (notification No. 503/2006 Coll.).

NBS Provision No. 4/2006 on reporting in respect of mutual funds by asset management companies for statistical purposes (notification No. 552/2006 Coll.).

NBS Provision No. 5/2006 on reporting by pension fund management companies and supplementary pension companies for statistical purposes (notification No. 553/2006 Coll.).

NBS Provision No. 6/2006 on reporting by factoring companies, instalment credit companies and leasing companies for statistical purposes (notification No. 561/2006 Coll.).

NBS Provision No. 7/2006 on reporting by banks and branches of foreign banks for statistical purposes (notification No. 577/2006 Coll.).

NBS Provision No. 8/2006 on reporting by insurance companies and branches of foreign insurance companies (notification No. 607/2006 Coll.).

NBS Provision No. 9/2006 on the submission of statements, reports and other disclosures of an insurance consolidated group or insurance sub-consolidated group, a financial consolidated group or financial sub-consolidated group, and a mixed consolidated group or mixed sub-consolidated group (notification No. 610/2006 Coll.).

NBS Provision No. 10/2006 on reporting by banks and branches of foreign banks, securities dealers and foreign securities dealers for supervision purposes (notification No. 627/2006 Coll.).

NBS Provision No. 11/2006 on reporting the adequacy of own funds of financial conglomerates in accordance with Act No. 95/2002 Coll. on the insurance industry and on amendments to certain acts, as amended (notification No. 643/2006 Coll.).

NBS Provision No. 12/2006 on reporting the adequacy of own funds of financial conglomerates in accordance with the Securities Act (notification No. 659/2006 Coll.).

NBS Provision No. 13/2006 amending NBS Provision No. 15/2004 on the own funds of financial conglomerates and large exposures of financial conglomerates (notification No. 660/2006 Coll.).

NBS Provision No. 14/2006 on reporting by asset management companies in respect of each company and the mutual funds under its management, by depositories of mutual funds, by the stock exchange and by the central securities depository, for financial market supervision and statistical purposes (notification No. 687/2006 Coll.).

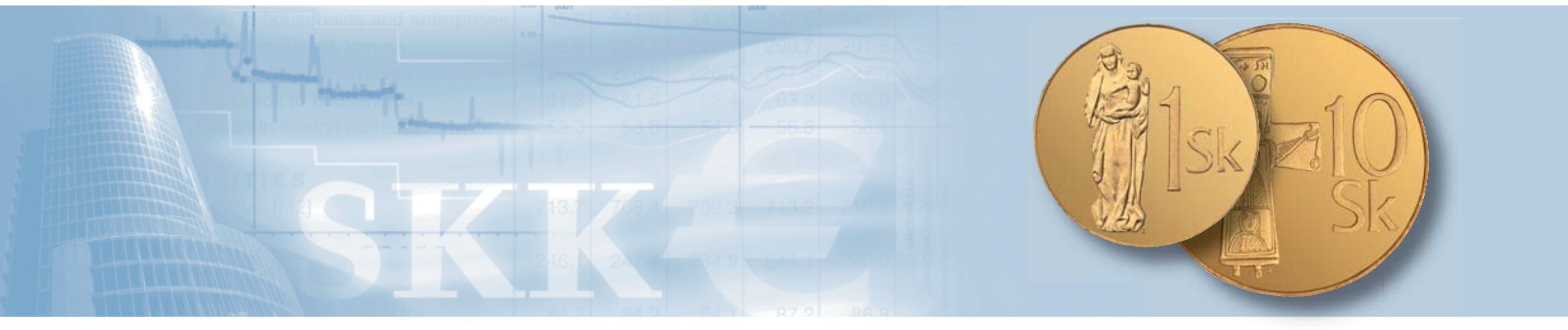
NBS Provision No. 15/2006 amending NBS Provision No. 12/2004 on risk and the risk management system (notification No. 682/2006 Coll.).

NBS Provision No. 16/2006 amending NBS Provision No. 3/2004 on the liquidity of banks and branches of foreign banks and the liquidity risk management process of banks and branches of foreign banks (notification No. 683/2006 Coll.).

NBS Provision No. 412/2006 Coll. amending NBS Provision No. 614/2003 Coll. which stipulates the requisites of an application for a foreign exchange licence and how to demonstrate fulfilment of the conditions for the issuance of a foreign exchange licence, and concerning the requirements set out in Article 13(8) of the Foreign Exchange Act.

NBS Provision No. 691/2006 Coll. on reporting pursuant to the Foreign Exchange Act.

Institutional Development



11 Institutional Development

A high-quality and operationally efficient internal process management system is a basic precondition for the top-level performance of tasks arising under the Národná banka Slovenska Act. The principal conditions for this include an optimal organizational structure, a high-level of management processes, and the professional management of human resources.

11.1 Organization and management

In accordance with the declared bases for the institutional development of the Národná banka Slovenska, two important organizational changes were made during the course of 2006.

Effective from 1 January 2006, the Financial Market Authority (FMA) was incorporated into the Národná banka Slovenska, thereby establishing the NBS as the sole institution responsible for licensing and supervisory processes and activities across the domestic financial market.

An organizational change that brought the transformation process of the branch management system to an end was approved by the NBS Bank Board with effect from 1 July 2006. As a result, the branches in Bratislava, Banská Bystrica and Košice were cancelled and subsequently transformed into internally unstructured sub-branches. Activities in the areas of foreign exchange supervision, economic administration, personnel and wages, which had been carried out by the branches, were assigned to organizational units at the NBS headquarters.

During 2006, in accordance with the NBS need to prepare for entry into the euro area and the related increase in demands on the quality and effectiveness of internal processes and activities, and in line with its officially declared aim to be a modern European central bank, an audit of management processes and activities was conducted at the NBS. The audit was carried out on the basis of a contract concluded between the Národná banka Slovenska and Deloitte Advisory s.r.o., the winner of a public tender.

The main aim of the audit was to assess the effectiveness of the organizational management, as well as the efficiency of the harmonization of management processes and the optimization of organizational and capacity requirements. In the follow-up to the audit's conclusions, a new version of the NBS Organizational Rules was approved on 20 December 2006 to take effect from 1 February 2007, the result being a new organizational structure of the Národná banka Slovenska. Under this organizational change, the management level of chief executive directors was abolished and the number of departments was reduced, related to which was an improvement in NBS management performance and unification of supervision over the domestic financial market.

Bank Board of the Národná banka Slovenska

The Bank Board is highest governing body of the Národná banka Slovenska. The scope of its powers is laid down by the NBS Act, separate laws, other generally binding regulations, and the NBS Organizational Rules.

The NBS Bank Board underwent a number of personnel changes during the course of 2006. In January, the following were newly appointed to the NBS Bank Board: Doc. Ing. Jozef Makúch, PhD., Ing. Slavomír Šťastný, PhD., MBA and Mgr. Ľudovít Ódor. Two members of the Bank Board came to the end of their term of office in 2006: NBS Deputy Governor Ing. Elena Kohútiková, CSc., on 27 March, and RNDr. Karol Mrva, executive director of the Banking Transactions and Foreign Exchange Division, on 30 November; the membership of Mr Mrva was renewed on 10 January 2007. Also in 2006, Doc. JUDr. Ladislav Balko, PhD. stepped down from the NBS Bank Board.

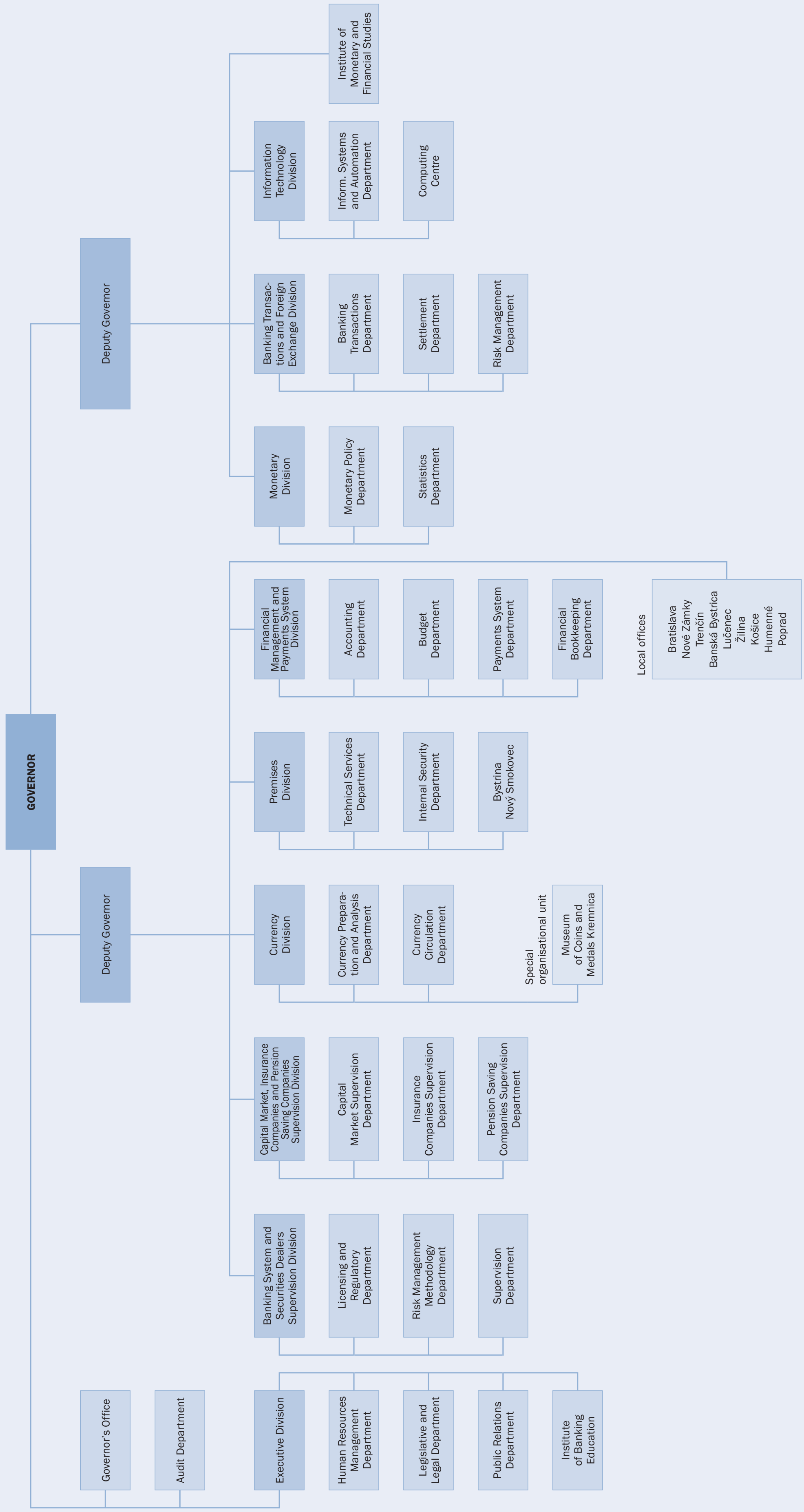
11.2 Human resources

11.2.1 Personnel provision

As at 31 December 2006, the NBS had 1,221 established positions, representing an increase of 0.4% year-on-year, and its number of registered employees at that date came to 1,174, also up by 0.4%.

The NBS took on 74 staff during the course of 2006. Where the internal selection procedure proved unsu-

NBS organizational structure as at 31 December 2006



NBS Bank Board[22]

Front row (left to right):	Milena Koreňová – Chief Executive Director, Financial Management and Payments System Division
	Ivan Šramko – Governor
	Martin Barto – Deputy Governor
Back row (left to right):	Ľudovít Ódor – Member of the NBS Bank Board
	Slavomír Šťastný – Member of the NBS Bank Board
	Jozef Makúch – Member of the NBS Bank Board
	Peter Ševčovic – Chief Executive Director, Monetary Division
	Karol Mrva – Chief Executive Director, Trade and Foreign Exchange Division

ccessful, new employees were recruited through an external selection procedure announced in accordance with internal regulations.

Altogether during the year, 167 staff ceased to be employed by the NBS. Of these 79 employees (the largest group) were made redundant in consequence of organizational changes.

In the context of cooperation between national central banks of the ESCB and the ECB in the field of human resources, the seconding of banking experts from these central banks has been taking place for several years. In 2006 two members of the NBS staff took up positions at the ECB after passing the selection procedure.

11.2.2 Personnel developments

Personnel developments in 2006 may be seen in the staff structure.

The number of employees aged 30 or below increased by almost 15%, and the number aged 31 to 40 remained stable. By contrast, employees aged 41 to 60 fell in number as a result of increased staff movements related to the comprehensive organizational changes made during the year.

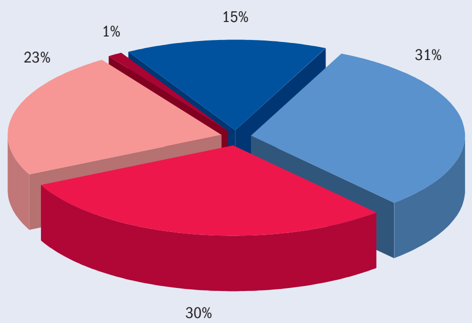
The change in the age structure of staff was also reflected in the structure of staff by years worked at the NBS. The number of people employed at the NBS for less than 5 years increased by more than 8% in comparison with 2005, whereas a sharp decline was recorded in the number employed for between 21 and 30 years (by 34.3%) and over 30 years (by 17%).

The decline in the number of people employed at the NBS for between 5 and 10 years (by 27%) was also linked to the relatively high number who voluntarily ceased their employment with the NBS in 2006.

A positive aspect of personnel developments in the NBS is the trend rise in the number of graduate em-

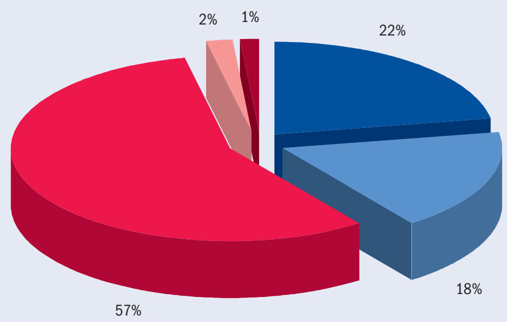
[22] *As at 30 November 2006.*

Chart 89 **NBS staff structure in 2006 by age**



Source: NBS.

Chart 90 **NBS staff structure in 2006 by years worked at the NBS**



Source: NBS.

ployees. They accounted for 55% of the total staff in 2006, representing an increase of almost 9% in comparison with 2005.

As a result of the organizational changes made in 2006, the number of management employees fell by 4.5% year-on-year.

The trend seen in 2004 and 2005 towards an equal balance of male and female employees continued in 2006.

11.2.3 Employee remuneration

The NBS applies an internal system of remuneration in accordance with the Labour Code. Its principles and procedures are regulated by NBS internal regulation No. 20/2002 on the remuneration of NBS employees, as amended.

The average wage at the bank was SKK 40,275 with an index of 104.5 in comparison with 2005. Statutory premium contributions for 2006 amounted to SKK 174,147,000.

11.2.4 Social expenses

Social expenses in 2006 included severance payments (and compensatory provision) related to organizational changes which amounted to SKK 63,602,000. Payments made on the completion of employment contracts (including compensation) and on retirement came to SKK 5,060,000.

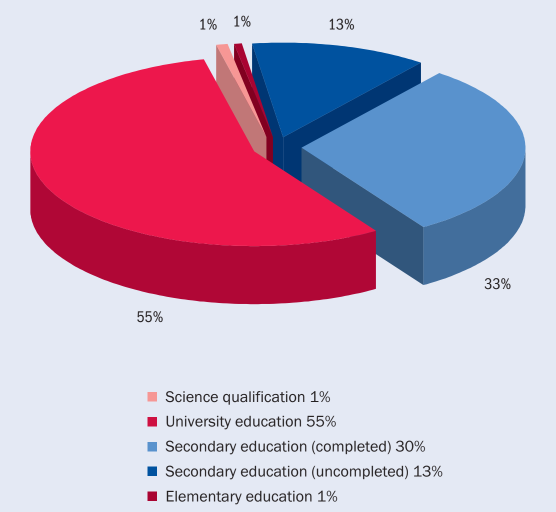
Under the implementation of social policy during 2006, the NBS paid on behalf of employees SKK 10,281,000 in contributions to supplementary pension insurance and additional pension insurance schemes.

11.3 Training and education

By joining the European Union and adopting the Lisbon Strategy, Slovakia has set out on the road towards a competitive knowledge-based society and economy. In accordance with that strategy, the NBS is treating training and education as one of the most important aspects of the professional and personal development of its employees, and thus of improving the quality of their work. The NBS training and educational activities are organized by the Institute of Banking Education (IBE), and are provided not only for NBS staff, but also for employees in the banking sector and other financial institutions. The IBE has in place a quality management system that complies with ISO 9001:2000 and it is certified in accordance with this international standard.

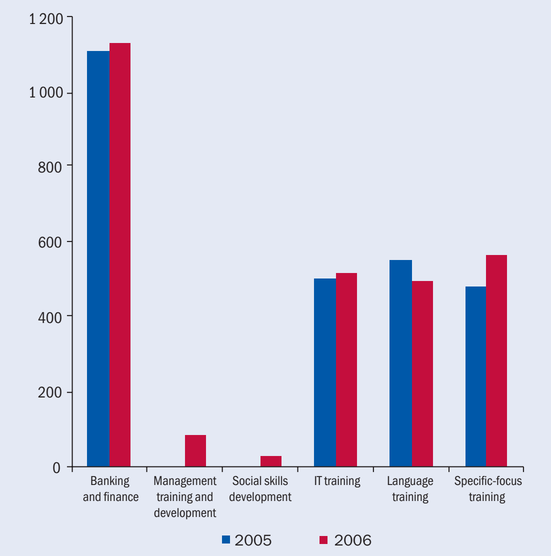
Training and education are conducted predominantly in a classroom form and to a lesser extent through distance learning. One of the most interesting distance learning projects is the Preparatory Course for the European Foundation Certificate in Banking (EFCB); the IBE has been running this course since 2005 as the only educational provider in Slovakia which is accredited by the European Bank Training Network (EBTN). The IBE is thus authorized to hold the exams and to award the EFCB, a certificate recognized throughout Europe.

Chart 91 **NBS staff structure in 2006 by educational attainment**



Source: NBS.

Chart 92 **Training and education of NBS staff (number of participants)**



Source: NBS.

11.3.1 Training and education of NBS employees

A total of 2,803 NBS employees attended 576 training and educational events in 2006. In comparison with 2005, the number of participants increased, while the number of teaching hours declined owing to the focus on less time-demanding training events. The ratio of training and education-related expenses to wage costs rose slightly year-on-year, to 3.42%. Altogether, NBS staff spent 2.7% of their total usable working time in training and education.

The main focus of the training and education of NBS staff in 2006 was on technical issues of professional training in banking and finance. Other important areas included specific-focus training, language training, and IT training. The participation of NBS staff in each category of training for 2006 and 2005 is shown in the Chart 92.

In the banking and finance category, the training and education were centred on issues directly related to the performance of tasks emerging from the NBS membership in the European System of Central Banks (ESCB), from the planned entry into the Eurosystem and introduction of the euro in Slovakia, as well as on strengthening of the European dimension of the NBS activities. The NBS has for a long time been utilizing professional specialized training and educational events provided free-of-charge within a framework of foreign technical cooperation by institutions such as the IMF, the BIS Financial Stability Institute in Basel, and the national central banks of the EU countries and other countries (the United States, Switzerland).

In 2006, a total of 183 NBS employees attended 155 such training and educational events abroad.

NBS staff also took part in Open Seminars organized by individual central banks of the ESCB. Among the most subscribed was a series of seminars jointly organized by the German and Austrian central banks on issues related to the New Basel Capital Accord, in particular on risk management.

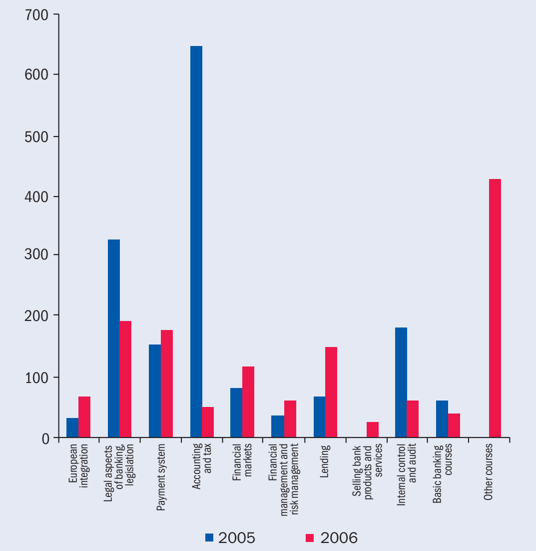
For the training of new NBS employees, the IBE continued in 2006 to run the course „Minimum of the NBS Employee“. It also prepared a new series of seminars entitled „Crosscut of NBS Activities“, and pursued with the so-called European integration training (especially half-day or one-day seminars on current issues). In comparison with 2005, the extent of management training increased and language training registered a slight decline.

The NBS also supports employees in raising or enhancing their qualifications through external study at universities and certified educational programmes. Besides training and education of its own staff, the NBS provided pre-graduation work experience to 13 university students and work experience to 32 students of economics secondary schools during the previous year.

11.3.2 Training and education of commercial banks and other financial institutions employees

In 2006 the Institute of Banking Education prepared and held 121 training events attended by a total

Chart 93 **Training and education for employees of banks and other financial institutions** **(number of participants)**



Source: NBS.

of 1,589 employees of banks and other financial institutions. The structure and contents of these events were tailored to the needs of target groups, in particular banks.

The core part of the IBE programme comprised training events devoted to topical professional issues related to banking and finance. The participation within individual training categories in 2006 and 2005 is shown in the Chart 93. The numbers reflect the relevance of the issues for practical needs.

The category of training events which attracted the most interest in 2006 was "other courses". This included mainly the free-of-charge training of financial market entities in a software application system for the collection, processing and reporting of statistical data, in regard to the expansion of the group of entities subject to NBS supervision as of 1 January 2006. The interest in the other categories of training and education remained relatively stable.

The training events were usually seminars of an interactive and practical type. At the seminars, trainers used primarily participatory methods of teaching that facilitated the active involvement of participants in the training process and the acquisition or development of practical knowledge and skills. The average duration of an event was 1.5 days, which reflected a global trend to make such events shorter.

11.3.3 Internal trainers

Internal trainers – members of the NBS staff – are actively involved in the preparation and implementation of training and educational events. In addition to their demanding work duties, they willingly make the time to share their expertise and experience with colleagues from the NBS and employees of commercial banks and other financial institutions.

NBS experts also take part in teaching activities within the context of providing foreign technical cooperation and assistance, which are provided at a highly professional level.

Altogether in 2006 there were 153 training presentations, which included the involvement of 83 NBS staff.

Communication

12 Communication

In ensuring its principal aims and statutory tasks, the Národná banka Slovenska is an independent institution. Through open communication and transparency in information provision, it demonstrates an effort to be accountable for its activities, not only to parliament but also to the general public.

The Národná banka Slovenska is required by law to publish information on monetary developments at least once every calendar quarter. In providing an assessment of monetary developments on a monthly basis, as well as (since 2005) a quarterly forecast of economic and monetary developments, the Národná banka Slovenska does more than is required. As appropriate, NBS representatives present and explain current issues to parliamentary committees, at meetings with the professional community, at regular press conferences, and through articles and presentations in the media.

The Národná banka Slovenska considers communication to be an integral part of its work and one of the implementation tools of monetary policy. The rules and principles applicable to the communication of monetary policy are elaborated in the "Communication Strategy of the Národná banka Slovenska until 2009".

By continuing to provide information on meetings of the NBS Bank Board in 2006, the Národná banka Slovenska observed the principle of openness and transparency. This included publishing the schedule of meetings, holding telephone and press conferences immediately after the Bank Board met to discuss the situation report on monetary developments and to assess the level of key interest rates, and the convening of press conferences by the Governor for announcements on monetary developments and on the breakdown of votes on any interest rate changes.

One of the NBS's most important communication channels is its website. Over the years it has developed into a comprehensive information base for professionals, but more recently it has become a means of communicating with all target groups without exception. The NBS website recorded an increased number of hits in 2006: the average number of visits per month was more than 376,000, representing a rise of 30% in comparison with the previous year. This development is to a large extent related to the incorporation of the Financial Market Authority into the Národná banka Slovenska and the integration of its website into that of the NBS, but also to increasing public interest in information on preparations for the euro introduction.

Again in 2006, the Národná banka Slovenska produced a full range of expert publications and information materials in print and electronic form. The main sources of core analytical and evaluative information were the Annual Report, Financial Stability Report and Monetary Survey monthly bulletin. Additional analyses and research works concerning monetary developments, the financial market, the convergence of the Slovak economy and the effect of the euro introduction were published in electronic form.

The Národná banka Slovenska is a member of the European System of Central Banks (ESCB) and its communication strategy is linked to the communication activities of the European Central Bank (ECB). NBS representatives participate in meetings and activities of the EUROSYSTEM/ESCB Communications Committee (ECCO), or its working groups, established for the preparation of national language versions of official ECB publications, as well as for the euro changeover information campaign and for communications concerning issues related to the new euro banknotes. In the context of communication about the euro introduction, the Národná banka Slovenska also cooperates with partner units of the European Commission and, as part of a twinning programme, with the Oesterreichische Nationalbank (OeNB).

In line with the principles of ESCB's multilingual communication, the Národná banka Slovenska ensures the translation of official ECB publications. In 2006 this applied to the quarterly issues of the ECB monthly bulletin, the ECB Annual Report, the Convergence Report and the updated edition of the publication "The Implementation of Monetary Policy in the Euro Area". Slovak translations of selected ECB press releases are also published on the NBS website.

The BIATEC journal also plays an important role in the area of public communication, being a respected platform for the presentation of specialist knowledge in banking, finance and economics. Its authors and readers represent a balanced link between the Národná banka Slovenska, the banking and financial sector, and the academic and educational sphere. The journal has become not only a communication tool of the central bank, but also its contribution to the fulfilment of the Lisbon Strategy objectives and the creation of a knowledge-based economy.

NBS's communication activities in 2006 were in large part focused on preparations for the euro introduction in Slovakia. The Národná banka Slovenska is the coordinator of two of the six working committees which, under the National Euro Changeover Plan for the Slovak Republic, will be coordinating the entire process of euro adoption in Slovakia. One of these two committees is the Working Committee for Communication.

During the course of the year, the Governor and other members of the Bank Board had several meetings with representatives of the economic sphere at which they presented the results of analyses of the Slovak economy's convergence and issues concerning the effect of the euro introduction on the corporate sector.

In 2006 the Národná banka Slovenska presented the designs chosen for the national sides of Slovakia's euro coins at an exhibition called “Slovak Euro Coins”. Held in Bratislava, Kremnica, Banská Bystrica and Košice, it attracted a total of almost 25,000 visitors. The exhibition, which is due to be taken to more Slovak cities and towns in 2007, includes some of the other designs entered in the competition. Children were also invited to send in their ideas of what should be on the Slovak sides of the euro coins and a selection of their designs are shown too.

The Národná banka Slovenska last year contributed to preparations for the exhibition “Contemporary Slovak Art”, held by the European Central Bank at its Frankfurt headquarters. Showcasing works by 26 Slovak artists, the exhibition ran from 22 June to 8 September. The opening ceremony was attended by ECB President Jean-Claude Trichet and NBS Governor Ivan Šramko.

One of the aims of NBS's communication policy is to provide the general public with appropriate information on NBS's activities. To this end, the NBS also organizes visits for students which include topical lectures given by NBS experts. For those interested, technical information on the NBS headquarters building is provided and a video of its construction is available to watch. In 2006 the Národná banka Slovenska was visited by more than 700 secondary schoolchildren and university students, including students from foreign universities.

The NBS building houses a permanent exhibition of the Slovak currency past and present, which is open every working day from 10:00 to 15:00.

On 13 May 2006, the Národná banka Slovenska held an Open Day for the general public, giving visitors the opportunity to see the meeting rooms of the Bank Board, the office and conference room of the Governor, the dealing desk and the library. To those interested, experts explained the procedures used to authenticate banknotes. There was also a unique chance to see a gold bar on display. A forum on the euro introduction in Slovakia attracted particular interest, with visitors spending almost two hours in discussion with NBS Governor Ivan Šramko and former deputy governor Elena Kohútiková.

The Národná banka Slovenska also offers library and information services to the public. At the end of 2006, the online library catalogue contained around 40,000 documents and 416 periodical titles in the field of economics, central banking and commercial banking. The library includes a full range of specialized databases and electronic resources, used mostly by NBS staff. Members of the public may access any of the reference, bibliographical and search services by writing to centralna.kniznica@nbs.sk.

During 2006 the Národná banka Slovenska met, within the legally stipulated period, 1,143 requests for information made under Act No. 211/2000 on freedom of access to information.

The Museum of Coins and Medals at Kremnica is a part of the Národná banka Slovenska. Its activities in 2006 centred mostly on the organization of cultural and educational events designed for secondary schoolchildren and university students. In addition to the permanent exhibitions, members of the public could visit a temporary international exhibition of the V4 countries and ten domestic exhibitions. For the first time, the museum took part in the international event “Museums' Night” held on International Museum Day. In 2006 the permanent and temporary exhibitions of the Museum of Coins and Medals at Kremnica attracted more than 40,000 visitors from Slovakia and abroad.

Independent Auditors' Report and Financial Statements of the NBS for the Year Ended 31 December 2006

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Independent Auditors' Report

To the Bank Board of Národná banka Slovenska:

We have audited the accompanying financial statements of Národná banka Slovenska ('the NBS'), which comprise the balance sheet as at 31 December 2006, the income statement and notes.

NBS Bank Board's Responsibility for the Financial Statements

The Bank Board of the NBS is responsible for the preparation and fair presentation of these financial statements in accordance with the Slovak Act on Accounting and with the European Central Bank accounting rules ('the ECB rules'). This responsibility includes: designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with the International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate for the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Bank Board of the NBS, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of Národná banka Slovenska as of 31 December 2006, and its financial performance for the year then ended in accordance with the Slovak Act on Accounting and the ECB rules.

5 March 2007
Bratislava, Slovak Republic

Ernst & Young

Ernst & Young Slovakia, spol. s r.o
SKAU Licence No. 257

Ing. Dalimil Draganovský
SKAU Licence No. 893

Ernst & Young Slovakia, spol. s r.o., IČO: 35 840 463, zapísaná v Obchodnom registri Okresného súdu Bratislava I, oddiel: Sro, vložka číslo: 27004/B a v zozname audítorov vedenom Slovenskou komorou audítorov pod č. 257.

The Ministry of Finance of the Slovak Republic
Decree No. MF/8338/2005-74

BALANCE SHEET
of Národná banka Slovenska
in millions of SKK

A s s e t s

		Notes	As at 31.12.2006	As at 31.12.2005
1.	Gold	4	18,788	18,450
2.	Debt securities denominated in foreign currency	5	312,364	447,776
3.	Derivatives	6	226	52
4.	Receivables from banks and central banks	7	25,154	191,864
4.1.	current accounts, deposits, and loans denominated in foreign currency		21,872	188,028
4.2.	loans related to monetary policy operations in SKK			
4.3.	receivables not related to monetary policy operations in SKK		3,282	3,836
5.	Receivables from the International Monetary Fund	8	15,870	3,934
6.	Receivables from clients	9	245	210
7.	Equity shares in subsidiary and affiliated accounting units and other shares and participating interests	10	437	483
8.	Non-current assets	11	6,053	6,422
8.1.	depreciable		5,711	6,082
8.2.	non-depreciable		342	340
9.	Other assets	12	260	119
	TOTAL ASSETS		**379,397**	**669,310**

NÁRODNÁ BANKA SLOVENSKA
Financial statements as at 31 December 2006 - Balance sheet
(in SKK millions)

Liabilities

		Notes	As at 31.12.2006	As at 31.12.2005
1.	Currency in circulation	13	143,518	130,110
2.	Liabilities to banks and central banks	14	272,238	559,138
2.1.	current accounts denominated in SKK		2,560	1,998
2.2.	overnight deposits, loans and deposits denominated in SKK and minimum reserves		261,603	392,577
2.3.	current accounts, deposits, and loans denominated in foreign currency		8,075	164,563
3.	Liabilities from debt securities	15	37,435	20,004
3.1.	denominated in SKK		37,435	20,004
3.2.	denominated in foreign currency			
4.	Derivatives	6	1,382	1,545
5.	Liabilities to the International Monetary Fund	8	15,833	3,893
6.	Liabilities to other international financial institutions	16	2,462	670
7.	Liabilities to clients	17	863	3,953
8.	Reserves and other liabilities	18	305	362
9.	Statutory fund	19	483	467
10.	Funds from profit appropriations and capital fund	19	10,312	10,208
11.	Valuation differences from revaluation of	19	16,931	16,260
11.1.	gold		16,456	16,260
11.2.	derivatives		418	
11.3.	securities		57	
11.4.	foreign currencies			
12.	Retained profit / (outstanding loss) from previous years	19	(77,237)	(76,637)
13.	Profit / (loss) for the current accounting period	19	(45,128)	(663)
	TOTAL LIABILITIES		**379,397**	**669,310**

3

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The Ministry of Finance of the Slovak Republic
Decree No. MF/8338/2005-74

INCOME STATEMENT
of Národná banka Slovenska
in millions of SKK

		Notes	As at 31.12.2006	As at 31.12.2005
1.	Interest income and similar revenues		14,453	12,733
1.1.	on SKK - denominated loans related to monetary policy operation		144	32
1.2.	on SKK - denominated receivables not related to monetary policy operations		93	165
1.3.	on receivables and securities denominated in foreign currency		14,216	12,536
a.	Interest expense and similar expenses		(14,219)	(13,045)
a.1.	on SKK - denominated liabilities related to monetary policy operations and from securities		(13,797)	(12,344)
a.2.	on SKK - denominated liabilities not related to monetary policy operations		(49)	(556)
a.3.	on liabilities and securities denominated in foreign currency		(373)	(145)
I.	**Net interest (loss)**	20	**234**	**(312)**
2.	Revenues from fees and commissions		169	158
b.	Expenses on fees and commissions		(23)	(31)
II.	**Net profit from fees and commissions**	21	**146**	**127**
3./c.	**Net (loss) / profit from operations in, and derivatives involving, securities denominated in foreign currency**	22	(3,984)	(1,592)
4./d.	**Net profit / (loss) from operations in, and derivatives involving, foreign exchange and gold**	23	(39,832)	2,939
5.	Revenues from dividends and other profit distributions		31	29
6.	Revenues from currency in circulation		208	7
e.	Expenses on currency in circulation		(156)	(169)
III.	**Net profit / (loss) from currency in circulation**	13	**52**	**(162)**
7.	Revenues from dissolution of provisions and written-off receivables and securities			
f.	Expenses on provisioning and the write-off of receivables and securities			
8.	Other operating revenues		118	182
g.	Other operating expenses	24	(1,893)	(1,874)
g.1.	Staff expenses		(907)	(767)
g.2.	Depreciation of tangible & intangible assets		(519)	(500)
g.3.	Other operating costs		(467)	(607)
A.	**Profit / (loss) before appropriations**		**(45,128)**	**(663)**
h.	Profit appropriations			
B.	**Profit / (loss) after appropriations**		**(45,128)**	**(663)**

NÁRODNÁ BANKA SLOVENSKA
Financial statements as at 31 December 2006 - Statement of changes in equity
(in SKK millions)

The Ministry of Finance of the Slovak Republic
Decree No. MF/8338/2005-74

STATEMENT OF CHANGES IN EQUITY

of Národná banka Slovenska

in millions of SKK

	Statutory fund	Capital fund	Reserve fund	Revaluation funds	Retained profit / outstanding (loss)	Equity
1. Balance as at 31 December 2005	**467**	**43**	**10,165**	**16,260**	**(77,300)**	**(50,365)**
2. Integration of ÚFT to NBS as at 1 January 2006	16		104		63	183
3. Adjusted balance as at 1 January 2006	483	43	10,269	16,260	(77,237)	(50,182)
4. Settlement of loss from previous periods						
5. Appropriation to statutory fund						
6. Appropriation to outstanding loss						
7. Appropriation to reserve funds						
8. Revaluation of securities						
losses						
gains				57		57
9. Revaluation of derivatives						
losses						
gains				418		418
10. Change in gold revaluation fund						
losses						
gains				196		196
11. Revaluation of foreign currencies						
losses						
gains						
12. (Loss) / profit for the current accounting period					(45,128)	(45,128)
13. Profit appropriations						
14. Appropriation to social fund						
15. Change over the accounting period						
16. Balance as at 31 December 2006	**483**	**43**	**10,269**	**16,931**	**(122,365)**	**(94,639)**

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NÁRODNÁ BANKA SLOVENSKA
Financial statements as at 31 December 2006 - Statement of changes in equity
(in SKK millions)

The Ministry of Finance of the Slovak Republic
Decree No. MF/8338/2005-74

STATEMENT OF CHANGES IN EQUITY
of Národná banka Slovenska
in millions of SKK

	Statutory fund	Capital fund	Reserve fund	Revaluation funds	Retained profit / outstanding (loss)	Equity
1. Balance as at 31 December 2004	**467**	**77**	**10,165**	**11,874**	**(76,659)**	**(54,076)**
2. Changes in accounting methods						
3. Adjusted balance as at 31December 2004	467	77	10,165	11,874	(76,659)	(54,076)
4. Settlement of loss from previous periods						
5. Appropriation to statutory fund						
6. Appropriation to outstanding loss		(22)			22	
7. Appropriation to reserve funds						
8. Revaluation of securities						
9. Revaluation of derivatives						
10. Change in gold revaluation fund				4,386		4,386
11. Revaluation of foreign currencies						
12. (Loss) / profit for the current accounting period					(663)	(663)
13. Profit appropriations						
14. Appropriation to social fund						
15. Change over the accounting period		(12)				(12)
16. Balance as at 31 December 2005	**467**	**43**	**10,165**	**16,260**	**(77,300)**	**(50,365)**

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NOTES

to the financial statements as at 31 December 2006

Bratislava, 5 March 2007

1. General information on Národná banka Slovenska

Národná banka Slovenska (The National Bank of Slovakia – 'the NBS' or 'the Bank') is the independent central bank of the Slovak Republic. The NBS was established in accordance with Act Nº 566/1992 Coll. on the National Bank of Slovakia as amended ('the NBS Act'). It commenced its activities on 1 January 1993 as the bank of issue of the Slovak Republic. The NBS is a legal entity (Corporate ID: 30 844 789) seated at Imricha Karvaša 1, Bratislava. In respect of its own assets, the NBS acts as a business entity. The NBS has its head office in Bratislava, nine branches in the Slovak Republic and special-purpose organizational units.

The Bank's primary objective is to maintain price stability. Therefore, the NBS:

- determines the monetary policy;
- issues banknotes and coins;
- manages, co-ordinates and ensures money circulation, payment transactions, the clearing of payment transaction data and ensures their fluency and efficiency;
- effects the activities, tasks, rights and obligations resulting from the participation of Národná banka Slovenska in the European System of Central Banks;
- contributes to the stability of the financial system as a whole and to the safe and sound functioning of the financial market in the interest of maintaining credibility of the financial market, protection of clients and respecting of the rules of economic competition; the Bank also supervises the financial market and other financial market activities;
- represents the Slovak Republic in international financial institutions and ensures the fulfillment of tasks resulting from such representations; and
- represents the Slovak Republic in international financial market operations related to the implementation of the monetary policy.

In accordance with the NBS Act, the Bank Board determines the monetary policy, the instruments for its implementation and decides on NBS's monetary policy measures. The Bank ensures the implementation of the monetary policy mainly by using the following instruments – base interest rate, open market operations (repo tenders, issues of treasury bills, direct purchase or direct sale of state securities and NBS treasury bills, foreign exchange swaps), overnight refinancing and overnight money withdrawing operations, minimum reserves requirements, exchange rate regime (floating rate or fixed exchange rate for the SKK after the entry of the Slovak Republic into the Exchange Rate Mechanism ERM II from 28 November 2005).

The Bank ensures the administration of foreign exchange reserves especially by means of financial operations related to securities denominated in foreign currencies, acceptance of loans from foreign entities, purchase of foreign currency from banks and branches of foreign banks, and financial transactions with foreign currencies and gold with the purpose of their appreciation.

(in SKK millions)

The NBS's supreme executive body is the NBS Bank Board ('the Bank Board'). Until 15 December 2005, the Bank Board had eight members (in accordance with the NBS Act): the Governor, Deputy Governors, NBS Chief Executive Directors and other members. The term of the office of Bank Board members was five years. The Governor and Deputy Governors are appointed and dismissed by the President of the Slovak Republic. Chief Executive Directors and other Bank Board members are appointed and dismissed by the Government of the Slovak Republic. According to Act N^{o} 519/2005 Coll. of 27 October 2005, amending the NBS Act with effect from 15 December 2005, the Bank Board has eleven members: the Governor, two Deputy Governors, and eight other members, three of whom may be persons not employed by the NBS. Membership in the Bank Board is limited to a maximum of two consecutive terms of office. The NBS is represented by the Governor.

In 2006, the Bank Board consisted of the following members:

Name	Term of office		Position	Date of appointment
	Form	to		
Ing. Ivan Šramko	11 Jan. 2002	31 Dec. 2009	Governor	1 Jan. 2005
Ing. Elena Kohútiková, CSc.	6 Apr. 1994	27 Mar. 2006	Deputy Governor	28 Mar. 2000
Ing. Martin Barto, CSc.	1 Dec. 2004	30 Jan. 2010	Deputy Governor	31 Jan. 2005
RNDr. Karol Mrva	1 Dec. 2000	30 Nov. 2006	Member	1 Dec. 2000
Ing. Peter Ševčovic	1 Oct. 2004	30 Sep. 2009	Member	1 Oct. 2004
Ing. Milena Koreňová	1. Jan. 2005	31 Dec. 2009	Member	1 Jan. 2005
Doc. JUDr. Ladislav Balko, PhD.	1 Oct. 2004	28 Feb. 2006	Member	1 Oct. 2004
Doc. Ing. Jozef Makúch, PhD.	1 Jan. 2006	31 Dec. 2010	Member	1 Jan. 2006
Mgr. Ľudovít Ódor	1 Jan. 2006	31 Dec. 2010	Member	1 Jan. 2006
Ing. Slavomír Šťastný, PhD., MBA	1 Jan. 2006	31 Dec. 2010	Member	1 Jan. 2006

The Government of the Slovak Republic re-appointed RNDr. Karol Mrva as the member of the Bank Board of the NBS from 10 January 2007.

All the costs necessary for the Bank's activities are covered from its revenues. According to Article 38 of the NBS Act, over the accounting period the Bank generates either a profit or a loss. Profit generated by the Bank is allocated to the reserve fund and to other profit reserves, or used to settle losses from previous years. The remaining profit is transferred to the State budget or, based on the Slovak Government's decision, to state financial assets under a separate regulation. The NBS may settle the loss for the current period from the reserve fund or from other reserves; alternatively, the Bank Board may decide to transfer the outstanding loss to the next accounting period (see Note 19).

As at 1 January 2006 the NBS integrated the Financial Market Authority (*Úrad pre finančný trh*) pursuant to Act N^{o} 747/2004 Coll. on financial market supervision. The integration increased the Bank's equity by SKK 183 million (of which the Statutory fund constitutes SKK 16 million, the Reserve fund SKK 104 million and retained profits from previous years SKK 63 million).

The Bank submits an annual report on its financial results to the National Council of the Slovak Republic, within three months of the end of the calendar year; in addition to the NBS financial statements data and the auditor's opinion on these financial statements, the report specifically states information about the NBS operating costs. Should the National Council of the Slovak Republic request so, the NBS is obliged to amend the report within six weeks to bring it into compliance with the request or, as appropriate, provide explanations to the data stated in the report.

2. Basis for preparation of the financial statements

2.1. Basic principles of preparation of the financial statements

The NBS financial statements have been prepared in accordance with Act Nº 431/2002 Coll. on Accounting as amended ('Accounting Act'). Pursuant to Section 17b of the above Act, the NBS maintains its accounting in accordance with the Guideline of the European Central Bank of 5 December 2002 on the legal framework for accounting and financial reporting in the European System of Central Banks Nº ECB/2002/10 ('ECB Guideline').

When accounting for transactions not regulated by the ECB Guideline, the Bank proceeds in line with the International Financial Reporting Standards ('IFRS') issued by the International Accounting Standards Board ('IASB') and in line with the interpretations issued by the International Financial Reporting Interpretations Committee ('IFRIC') as adopted by the European Commission pursuant to the Directive of the European Parliament and the Council of the European Union. Other cases are subject to the Accounting Act.

When disclosing items of its financial statements, the Banks proceeds in line with the Decree of the Ministry of Finance of the Slovak Republic Nº MF/8338/2005-74 of 14 December 2005 setting out details on the arrangement, description of items in individual financial statements, contents of these items, and the extent of data from financial statements designated for publishing for the National Bank of Slovakia ('Decree of MF SR').

2.2. Changes in accounting method

The financial statements for the year ended 31 December 2005 were prepared in line with the Accounting Act and the Decree of the Ministry of Finance of the Slovak Republic Nº 20 359/2002-92 of 13 November 2002 setting out details on accounting procedures and the general chart of accounts for the National Bank of Slovakia.

Since the Bank applied the ECB Guideline prospectively from 1 January 2006, comparative data as at 31 December 2005 in the financial statements are not comparable with the data as at 31 December 2006. The major differences between the accounting principles and methods used in 2006 and 2005, respectively, and their impact on the balances recognized in the balance sheet and the income statement are as follows:

- Receivables and payables under the automated Securities Lending program in the volume of SKK 157,168 million were recognized as Assets under item 4.1 and Liabilities under item 2.3 as at 31 December 2005. As at 31 December 2006, the bank recognized these receivables and payables only on off-balance sheet accounts.
- Unrealized foreign exchange gains of SKK 3,179 million from revaluation of foreign currency as at 31 December 2005 were recognized in the income statement. In line

(in SKK millions)

with the ECB Guideline, foreign exchange differences from revaluation are recognized at the year end in equity and have no impact on the Bank's income statement.

- Unrealized gains from revaluation of securities to fair value in the amount of SKK 101 million as at 31 December 2005 had an effect on the Bank's financial results. In line with the ECB Guideline, unrealized gains from revaluation of securities are recognized in equity and have no impact on the Bank's income statement.
- Unrealized gains from revaluation of derivatives to fair value in the amount of SKK 0.2 million as at 31 December 2005 had an effect on the Bank's financial results as at 31 December 2005. In line with the ECB Guideline, unrealized gains from revaluation of derivatives are recognized in equity and have no impact on the Bank's income statement.

The application of accounting principles and methods valid from 1 January 2006 would have had the following effect on the financial results and equity of previous periods:

	Net loss for 2004	Net loss for 2005
Recognized in the SAS* statutory financial statements	(36,289)	(663)
Unrealized gains from revaluation of foreign currency	(480)	(3,179)
Unrealized gains from the revaluation of securities	(770)	(101)
Net loss upon application of ECB rules	(37,539)	(3,943)

	Equity as at 1 January 2005
Recognized in the SAS* statutory financial statements	(54,076)
Revaluation differences	1,250
Outstanding losses from previous years	(1,250)
Equity upon application of ECB rules	(54,076)

	Equity as at 31 December 2005
Recognized in the SAS* statutory financial statements	(50,365)
Revaluation differences	3,280
Loss for the current accounting period	(3,280)
Equity upon application of ECB rules	(50,365)

* Slovak accounting standards

In 2006, the Bank also changed the method of posting receivables from and liabilities to the International Monetary Fund (see Note 8).

3. Accounting principles and accounting methods applied

3.1. Recognition rules

The Bank records an accounting entry on the day the respective accounting event occurred, i.e. on the day when cash was paid or received; in the case of a direct debit, on the payment day (when withdrawing money from a third party account); in the case of securities and gold, on the transaction day; in the case of derivatives, on the day the derivative agreement was concluded; in the case of cash in foreign currency, on the day it was credited according to the deal message received; in the case of property relations, on the day when the property title was acquired or terminated; and in the case of a shortage, deficit or surplus, on the day the difference was identified.

(in SKK millions)

3.2. Methods of foreign currency valuation and settlement of valuation differences

From 1 January 2006, during the year assets (including gold) and liabilities denominated in foreign currencies are valued using the average currency exchange rate. Differences between the exchange rate announced by the NBS and the average currency exchange rate represent unrealized foreign currency gains or losses. As at the financial statements date, unrealized foreign exchange gains exceeding unrealized foreign exchange losses are recognized in the Bank's equity on revaluation accounts. Unrealized foreign exchange losses are recognized in the income statement. Foreign exchange losses of one currency cannot be offset by foreign exchange gains of other currencies or gold.

Realized foreign exchange gains and losses from the sale of assets and settlement of liabilities are recognized in the income statement.

The exchange rates of principal foreign currencies used for the valuation of assets and liabilities as at 31 December 2006 were as follows:

Currency	Amount	31 December 2006	31 December 2005
EUR	1	34.573	37.848
USD	1	26.246	31.948
JPY	100	22.081	27.103
XDR	1	39.484	45.659

3.3. Gold

Gold is stated at the market price of London's commodity market morning fix of gold in USD/oz. (troy ounce) as at the financial statements date. Gains from gold revaluation to fair value are included in equity, while losses from gold revaluation to fair value have impact on the Bank's financial results. The sale of gold is reflected in the income statement.

Swap transactions with gold are recorded as repurchase transactions with gold, i.e. gold used in these transactions as collateral is part of the balance sheet amount under the caption 'Gold'.

3.4. Debt securities

Debt securities are initially recognised at acquisition cost. On the day after the purchase up to and including the security's sale or maturity date the Bank amortises the premium or the discount on a daily basis (the difference between the security's cost and nominal value). The amortization of the premium/discount is recognized under Interest income and similar revenues in the income statement.

In the financial statements, the Bank recognizes debt securities at fair value. The difference between the security's fair value and the average acquisition cost adjusted for the accrued discount or premium represents a valuation difference. Valuation differences constituting gains are recognized in the Bank's equity. Valuation differences constituting losses are included in the Bank's income statement.

The fair value of debt securities, for which there is an active market and whose market value can be reliably measured, is determined on the basis of the market value on such a market. If the market value is not available, fair value is determined as the sum of future cash flows discounted using market interest rates of the relevant currency, maturity rates and the risk rating of the security's issuer.

Upon the sale of a security, the difference between the average acquisition cost adjusted for the accrued discount or premium and the sales price represents a realized gain or loss that has an effect on the Bank's income statement.

The Bank reports sales and purchases of securities as at the settlement date.

3.5. Derivatives

In the normal course of business, the Bank is a party to contracts with derivative financial instruments, which represent a very low initial investment compared to the notional value of the contract. The derivative financial instruments used include options and interest futures.

Derivative financial instruments are initially recognized and subsequently re-measured in the balance sheet at fair value. All derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. Losses from revaluation of derivatives have an impact on the Bank's income statement; gains from revaluation of derivatives remain on the revaluation accounts in the Bank's equity.

As at 31 December 2006, options are stated at fair value based on market prices, discounted cash flows and the Merton option pricing formula. In the course of 2006, the Bank re-assessed the impact of the Black-Scholes model formerly used for valuation of options. With the aim of more closely approximating the fair value of options, the Bank applied the Merton pricing model as at 31 December 2006.

Derivatives embedded in other financial instruments are disclosed as separate derivatives, when the risks involved are not closely connected with the risks and characteristics of the underlying instrument.

Major risks influencing derivatives include the price volatility of gold and changes in interest rates and foreign currency rates.

3.6. Receivables

Receivables are recognized on the balance sheet in their nominal value increased by accumulated interest ("amortized cost"). Receivables are decreased by impairment losses. Creation and release of impairment losses has an impact on the income statement.

Following the prudence principle, the Bank evaluates the risk rate of receivables, categorizes them and creates impairment losses for them.

Bad debts are written off to costs based on a court decision and upon the Bank Board's decision and the release of the related impairment losses is debited to costs.

3.7. Repurchase and reverse repurchase transactions

Transactions in which the Bank accepted securities in exchange for cash, along with the commitment to return these securities at a certain date in exchange for the transferred cash amount plus interest (reverse repurchase transaction), are recorded as loans provided. The collateral accepted in a reverse repurchase transaction is recognized in the amount of the loan on off-balance sheet accounts.

Transactions in which the Bank provided securities or gold in exchange for cash, along with the commitment to accept back these securities or gold at a certain date in exchange for the original cash amount plus interest (repurchase transaction), are recorded as received loans with a transfer of collateral. The collateral provided in a repurchase transaction remains in the balance sheet and in the financial statements it is fair valued with the exception of NBS treasury bills.

The Bank's market and credit risks in these transactions are minimised through the specification of products in which the cash received can be invested, as well as the counterparties with whom deals may be performed.

3.8. Receivables from and liabilities to the International Monetary Fund

Receivables from and liabilities to the International Monetary Fund ('IMF') as at 31 December 2006 are stated using the gross method. As at 31 December 2005 the membership quota in SKK and the respective liability were netted off in the balance sheet.

3.9. Ownership interests in subsidiary and affiliated accounting units and other shares and equities

The Bank has an ownership interest with a majority control over RVS, a.s. Bratislava. The equity shares of RVS, a.s. Bratislava are stated at cost.

The Bank has an equity stake in the Bank for International Settlements, Basel, Switzerland ('BIS'). Shares in the BIS are stated at acquisition cost. The equity interest in the BIS is disclosed in the amount of the paid-up share (25%). The unpaid part (75%) is due upon request. Dividends are paid out from NBS's total share in the BIS in Swiss francs.

As part of other ownership interests, the Bank accounts for a contribution in the European Central Bank ('ECB'). On 1 May 2004, the NBS became a member of the European System of Central Banks ('ESCB'). In accordance with the Statute of the ECB, the NBS has paid the initial minimum contribution to the ECB's capital. The amount of the total capital share of individual national central banks depends on the capital key determined on the basis of the following statistical categories: GDP and population. In accordance with the Protocol on the Statute of the ESCB and the ECB, the capital key is adjusted every five years or when new members enter the ESCB.

3.10. Non-current assets

Non-current assets include tangible assets, the acquisition cost of which is higher than SKK 30,000 and whose term of operational and technical capabilities exceeds one year, and intangible assets, the acquisition cost of which is higher than SKK 50,000 and whose term of operational and technical capabilities exceeds one year. On the balance sheet, they are stated at acquisition cost, including the costs related to their acquisition. The carrying value of depreciated non-current assets is shown net of accumulated depreciation. Land, art collections, long-term investments and tangible fixed assets in progress are not subject to depreciation.

(in SKK millions)

The NBS's non-current assets were classified into individual depreciation groups and depreciated on a straight-line basis in accordance with the depreciation plan.

	2006	
Depreciation group	**Depreciation period in years**	**Annual depreciation rate in %**
1. Office equipment, data processing machines, passenger cars and vans	4	25.0
2. Devices and personal technical equipment	6	16.7
3. Security equipment	12	8.4
4. Energy equipment	20	5.0
5. Buildings and structures	30	3.4
6. Objects depreciated using a special rate	separately specified	separately specified

3.11. Non-current assets held for sale

Non-current assets held for sale are assets where the carrying amount will be recovered principally through a sale transaction rather than through continuing use.

Non-current assets held for sale comprise buildings and land, which are classified for sale in their present condition and their sale is considered to be highly probable.

Assets classified as non-current assets held for sale are included in Other assets at the lower of acquisition cost less accumulated depreciation and impairment losses and fair value less costs to sell.

3.12. Currency in circulation

NBS administers the issue of bank notes and coins and their withdrawal from circulation. Currency in circulation represents the Bank's liability arising from issued bank notes and coins. The liability is decreased by the bank notes and coins in the NBS's cash desk. The liability due to currency in circulation is stated at the nominal value.

3.13. Liabilities arising from debt securities

The Bank issues short-term securities falling due within one year (NBS bills). In 2006, they were issued to create a sufficient stock of securities for the performance of money withdrawing repurchase transactions. Money withdrawing repurchase transactions were related to the implementation of monetary policy in transactions on open market operations.

From the settlement date of the issue to the due date, the value of issued and sold NBS bills is gradually increased by the accrued interest (the so-called amortized cost). On the balance sheet, issued NBS bills are shown netted off by any bills repurchased to the NBS portfolio, including the accrued interest.

(in SKK millions)

3.14. Provisions

The Bank recognizes provisions if it has a present obligation as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

3.15. Interest income and interest expense

Interest income and interest expense are recognized in the income statement based on the accrued amount using the straight-line method. Interest income and interest expense include amortized discounts or premiums from purchased and issued securities.

3.16. Cost of employee benefits

The NBS pays regular contributions on behalf of its employees to health insurance agencies for health insurance and to the Social Insurance Agency for sickness, retirement, accident, guarantee, and unemployment insurance, and a contribution to the Guarantee Fund. Contributions are paid in the amounts required by law in the respective year. The Bank also pays a contribution for not employing the obligatory percentage of persons with disability, as set out in the Employment Act.

In co-operation with agencies offering supplementary retirement insurance, the NBS has created an additional pension scheme for its employees.

3.17. Taxation

The NBS is liable to corporate income tax arising from the application of withholding tax in accordance with Section 12 of Act N^{o} 595/2003 Coll. on Income Taxes as amended (‘Income Taxes Act‘).

Since 1 July 2004, the NBS is registered as a VAT payer.

4. Gold

Gold consists of the following items:

	2006	2005
Bullion in standard form	18,760	18,289
Gold in other form	28	161
	18,788	**18,450**

At 31 December 2006, ‘Gold’ comprised a total of 1,126 thousand ounces of gold (1,126 thousand ounces of gold as at 31 December 2005), of which 324 thousand ounces were deposited in correspondent banks, 800 thousand ounces were used in repurchase transactions, and 2 thousand ounces were held by the Bank.

The value of gold provided as collateral in repurchase transactions as at 31 December 2006 (see Note 14.3) amounted to SKK 13,354 million (SKK 9,840 million as at 31 December 2005).

(in SKK millions)

The market value of gold as at 31 December 2006 was USD 635.70 /oz. (USD 513 /oz. at 31 December 2005). Despite the strengthening of the SKK/USD exchange rate (see Note 25), the growth in the market price of gold positively affected the amount reported under 'Gold' at fair value and under 'Valuation differences from revaluation of gold'. As at 31 December 2006, the balance on the Valuation differences from revaluation of gold was SKK 16,456 million (SKK 16,260 million as at 31 December 2005).

From the beginning of the year through to 31 December 2006, the Bank sold 8,160 ounces of gold in the form of golden coins.

5. Debt securities

As at 31 December 2006 the Bank's portfolio of securities comprised the following items (at fair value):

	2006	**2005**
State zero-coupon bonds	66,863	111,379
State coupon bonds	76,650	132,011
Coupons	1,681	2,233
Securities of state bodies - total	**145,194**	**245,623**
Other zero-coupon bonds	21,398	27,941
Other coupon bonds	143,230	170,965
Coupons	2,542	3,247
Securities of other entities - total	**167,170**	**202,153**
Total securities	**312,364**	**447,776**

According to the issuer of securities the sector breakdown of the Bank's portfolio of securities is as follows:

	2006	**2005**
Public sector	195,543	268,549
Financial institutions	84,867	129,232
Financial auxiliaries	31,954	49,995
Total securities	**312,364**	**447,776**

According to the issuer of securities, as at 31 December 2006 the Bank registered securities from EMU countries in the amount of SKK 197,160 million (SKK 342,964 million as at 31 December 2005) and securities from other countries, including international institutions, in the amount of SKK 115,204 million (SKK 104,812 million as at 31 December 2005). The Bank trades with securities on foreign financial markets, mainly in New York, London, Basel, and in the Euro zone countries. These trades mostly involve transactions outside the stock exchanges.

Due to the weakening of the Slovak koruna in 2006, the Bank intervened in order to strengthen the value of the currency. The volume of debt securities denominated in EUR used in these interventions totalled SKK 118,493 million. These transactions resulted in a reduction of NBS assets as at 31 December 2006 compared to 2005.

(in SKK millions)

6. Derivatives

The fair value of derivatives is as follows:

	2006		2005	
	Assets	**Liabilities**	**Assets**	**Liabilities**
Currency swap				731
Put options purchased	217		52	
Call options sold		1,382		814
Interest rate futures	9			
	226	**1,382**	**52**	**1,545**

The currency swap maturing in February 2006 was extended and terminated on 28 March 2006. Upon the termination of the deal, losses of SKK 320 million were posted for 2006.

With the aim of eliminating the risk of a decline in the market price of gold, the NBS purchased two European put options for 400 thousand ounces of gold with the strike price of 259.00 USD/oz. and 295.30 USD/oz. and with the maturity in January and March 2007, respectively (see Note 4).

The Bank concluded two repurchase transactions in gold (‘gold repos’) in 2005. At the beginning of the gold repo transaction, the Bank sold gold and obtained a long-term loan in the amount of USD 89 million. At the end of the gold repo transaction in August 2015, the Bank will repurchase gold at a price agreed in advance and will thus repay the long-term loan received. As at 31 December 2006 the amortized value of this loan was SKK 80 million (see Note 14.3). To eliminate the risk of a decrease in the market price of gold, the NBS purchased two European put options for 200,000 ounces of gold within the scope of the gold repos (see Note 4), with the strike price of USD 443.50 /oz., and in order to increase its income from the gold reserves, the Bank sold two European call options for the same amount of gold with the strike price of USD 750 /oz. and USD 700 /oz. The options may be realized at the end of the gold repo transaction in August 2015. Option premiums for the purchased and sold options were not paid, but were incorporated in the rate of interest (lower than the market rate) for the long-term loan accepted by the Bank. The options are embedded derivatives and were, therefore, separated from the accepted loan and are recorded separately.

The Bank concluded two repurchase transactions in gold (‘gold repos’) in September 2006. At the beginning of the gold repo transaction, the Bank sold gold and obtained a long-term loan in the amount of USD 127 million. At the end of the gold repo transaction in September 2016, the Bank will repurchase gold at a price agreed in advance and will thus repay the long-term loan received. As at 31 December 2006 the amortized value of this loan was SKK 109 million (see Note 14.3). Within the scope of the gold repos, the NBS purchased two European put options for 200,000 ounces of gold (see Note 4), with the strike price of USD 635 /oz., and sold two European call options for the same amount of gold with the strike prices of USD 1,000 /oz. and USD 1,200 /oz. Option premiums for the purchased and sold options were incorporated in the rate of interest based on which interest from used gold is calculated. The options are embedded derivatives and were, therefore, separated from the accepted loan and are recorded separately.

In 2006, as part of the administration of foreign currency reserves, The Bank realized interest rate futures in foreign currency.

(in SKK millions)

7. Receivables from banks and central banks

7.1. Current accounts, deposits, and loans in foreign currency

	2006	2005
Loans granted in repurchase transactions in foreign currency	16,252	19,481
Deposits	4,910	13,392
Receivables from banks in the European System of Central Banks	384	75
Loans granted to commercial banks for the support of business in foreign currency	33	61
Securities lending		154,905
Other	293	114
	21,872	**188,028**

Loans provided in repurchase transactions with foreign entities total SKK 16,252 million (SKK 19,481 million as at 31 December 2005); all loans were granted in EUR. The value of securities accepted as collateral in a Tri-party Reverse Repo transaction as at 31 December 2006 was SKK 16,249 million (SKK 19,478 million as at 31 December 2005). The collateral accepted was composed of securities denominated in EUR.

At 31 December 2006, the Bank had receivables from repurchase transactions based on Securities Lending Agreements, recognized only on off-balance sheet accounts (see Note 2.2). The value of securities accepted as collateral under the Securities Lending Agreements as at 31 December 2006 totalled SKK 141,931 million (SKK 168,247 million as at 31 December 2005), of which SKK 107,126 million in EUR (SKK 126,410 million as at 31 December 2005) and SKK 34,805 million in USD (SKK 41,837 million as at 31 December 2005).

The item ‘Other’ covers the Bank’s current accounts abroad, in countries outside the European System of Central Banks.

7.2. Receivables in SKK not related to monetary policy operations

	2006	2005
Loans granted to domestic banks for the support of business activities by JBIC (Japan Bank for International Cooperation) and EIB in SKK	378	528
Redistribution loans	2,882	3,282
Other	22	26
	3,282	**3,836**

The aim of loans accepted from foreign banks (JBIC and EIB) is to support small and medium-sized enterprises and specific industries of the Slovak economy.

The redistribution loan was provided to a commercial bank for a complex construction of apartment buildings. By virtue of decisions of the NBS Bank Board, the redistribution loan interest rate was adjusted in the course of 2006 to 3.25% (1.5% as at 31 December 2005).

As at 31 December 2006, the NBS recorded a state guarantee accepted for the redistribution loan provided in the amount of SKK 3,821 million (SKK 3,815 million as at

(in SKK millions)

31 December 2005). The state guarantee is provided for the amount of principal, plus interest to maturity.

8. Receivables from and liabilities to the International Monetary Fund

	2006 XDR equivalent	2006 SKK	2005 XDR equivalent	2005 SKK
Membership quota in the IMF	357	15,833	357	16,629
SDR holdings	1	37	1	41
Investments and receivables in foreign currency	**358**	**15,870**	**358**	**16,670**
Account no. 1, 2	15	668	15	668
Securities	343	15,165	343	15,961
Liabilities to non-residents in domestic currency	**358**	**15,833**	**358**	**16,629**

The membership quota of the Slovak Republic in the IMF is denominated in special drawing rights (XDR). It is converted to SKK using the representative XDR exchange rate set by the IMF. The Bank thus records a receivable of XDR 358 million which as at 31 December 2006 translated into SKK 15,870 million (SKK 16,670 million as at 31 December 2005).

The Bank records a liability of the Government of the Slovak Republic to the IMF of SKK 15,833 million (SKK 16,629 million as at 31 December 2005), representing mainly a non-transferable and non-interest-bearing promissory note payable on demand in the amount of SKK 15,165 million (15,961 million as at 31 December 2005).

The membership quota in SKK and the related liability as at 31 December 2006 are stated on the balance sheet using the gross method. As at 31 December 2005 the membership quota in SKK and the respective liability were netted off on the balance sheet; the membership quota in SKK was SKK 3,934 million and the liability to IMF was SKK 3,893 million.

9. Receivables from clients

As at 31 December 2006, Národná banka Slovenska records receivables from clients of SKK 245 million (SKK 210 million as at 31 December 2005). The major part of the receivables from clients consists of consumer and investment loans provided to employees totalling SKK 231 million (SKK 206 million as at 31 December 2005) and debit balances on current accounts of employees totalling SKK 8 million (SKK 4 million as at 31 December 2005).

10. Ownership interests in subsidiary and affiliated accounting units and other shares and equities

10.1. Ownership interests in subsidiary accounting units

At 31 December 2006, the Bank held 1,080 certified shares of RVS, a.s. in the amount of SKK 108 million (SKK 108 million as at 31 December 2005), which represented a 51.58% share in the company's share capital (41.13% as at 31 December 2005). RVS, a.s. does business in the area of relaxation and educational activities. The company's share capital at 31 December 2006 was SKK 209 million (SKK 263 million at 31 December 2005). Based on the resolution of the general meeting from July 2005, the share capital of the company is being gradually reduced by the purchase of own shares. Since the NBS did not offer shares to RVS, a.s. for sale, its capital stake in this company increased.

Even though the Bank is the majority shareholder in RVS, a.s. Bratislava, the NBS does not prepare consolidated financial statements according to Section 22 of the Accounting Act.

10.2. Other investments

The Bank holds ownership interests in the Bank for International Settlements, Basel, Switzerland ('BIS'). As at 31 December 2006, the Bank held 2,858 shares of BIS valued at SKK 656 million (SKK 759 million as at 31 December 2005), which represented a 0.52% share in the BIS share capital. The share in BIS is disclosed on the balance sheet in the amount of the 25% paid-up share, i.e. at SKK 233 million (SKK 270 million as at 31 December 2005). The liability from the unpaid share at 75% of the nominal value of each share amounts to SKK 423 million (SKK 489 million as at 31 December 2005). The unpaid part of the share is due upon request. In July 2006, the NBS received dividends from BIS in the amount of SKK 31 million.

Based on calculations, the capital key of 0.7147% of the total ECB capital was determined for the Slovak Republic from 1 May 2004. In May 2004 the Bank paid the initial contribution in the amount of EUR 2,784 thousand, representing 7% of the total NBS contribution to ECB's subscribed capital. The remaining 93% share is due upon the adoption of the Euro as the national currency.

As at 31 December 2006, the amount of paid-up initial contribution of the Bank to ECB's subscribed capital was SKK 96 million.

11. Non-current assets

Non-current tangible and intangible assets as at 31 December 2006 were as follows:

(in SKK millions)

	Land	Other non-depreciable tangible assets	Buildings and construct-ions	Techno-logical equipment and machines	Other depreciable tangible assets	Software and other intangible assets	Advances and tangible and intangible assets in progress	Total
Acquisition cost as at 31 December 2005	**285**	**56**	**5,930**	**1,919**	**537**	**183**	**295**	**9,205**
Integration of ÚFT				26	1	4		31
Acquisition cost as at 1 January 2006	**285**	**56**	**5,930**	**1,945**	**538**	**187**	**295**	**9,236**
Additions			65	133	2	337	506	1,043
Disposals	50		177	104	183	2	709	1,225
Transfers	(3)		632	(517)	(106)	(6)		0
Acquisition cost as at 31 December 2006	**232**	**56**	**6,450**	**1,457**	**251**	**516**	**92**	**9,054**
Acc. depreciation as at 31 December 2005			**811**	**1,391**	**411**	**132**	**38**	**2,783**
Integration of ÚFT				23		3		26
Acc. depreciation as at 1 January 2006			**811**	**1,414**	**411**	**135**	**38**	**2,809**
Additions			241	192	27	67		527
Disposals			51	103	179	2		335
Transfers			383	(320)	(57)	(6)		0
Acc. depreciation and provisions as at 31 December 2006			**1,384**	**1,183**	**202**	**194**	**38**	**3,001**
Book value of tangible and intangible assets as at 1 January 2006	**285**	**56**	**5,119**	**531**	**127**	**52**	**257**	**6,427**
Book value of tangible and intangible assets as at 31 December 2006	**232**	**56**	**5,066**	**274**	**49**	**322**	**54**	**6,053**

As at 31 December 2006, the Bank recognized a provision for advances paid in the amount of SKK 38 million.

In 2006, the Bank reclassified non-current assets held for sale with the net book value of SKK 180 million from non-current assets to non-current assets held for sale recognized on the balance sheet under Other assets (as at 31 December 2005 the Bank did not recognize any non-current assets held for sale). Non-current assets held for sale were revalued to fair value, with the revaluation loss being SKK 21 million.

(in SKK millions)

In 2006, the Bank transferred certain assets from the categories 'Technological equipment and machines' and 'Other tangible assets' to the category 'Buildings' as these assets are significantly related to buildings. The depreciation period of these assets did not change.

12. Other assets

A significant portion of 'Other assets' consists of non-current assets held for sale, receivables from supplier-consumer relations, from supervision over financial market entities, cash in foreign currency, accruals and inventories. Inventories are stated at cost, i.e. inclusive of costs to sell.

As at 31 December 2006, the Bank posted provisions for debtors of SKK 47 million, provisions for receivables from fines of financial market entities of SKK 20 million and provisions for receivables from contributions of financial market entities of SKK 1 million.

13. Currency in circulation

The issue of banknotes and coins represents the valid national bank notes and coins in circulation:

	2006	2005
Issued coins	2,414	2,503
Issued bank notes	141,104	127,607
	143,518	**130,110**

In 2006, the Bank generated a profit from non-exchanged federal coins in the amount of SKK 189 million, which had a positive impact on the net profit from currency in circulation whose value as at 31 December 2006 represented SKK 52 million (a net loss of SKK 162 million as at 31 December 2005).

The NBS will continue to exchange the 10 and 20 haler coins for free until 31 December 2008. The validity of these coins was terminated in 2003.

14. Liabilities to banks and central banks

14.1. Current accounts in SKK

	2006	2005
Curent accounts of banks for transfers and replenishments	2,544	1,990
LORO accounts of central banks	16	8
	2,560	**1,998**

As at 31 December 2006, the NBS had liabilities to banks and central banks in SKK worth SKK 2,560 million (SKK 1,998 million as at 31 December 2005), a major portion of which consisted of current accounts of banks used for transfers and replenishments.

(in SKK millions)

14.2. Overnight deposits, deposits and loans in SKK, and required reserves

	2006	2005
Loans received in repurchase transactions in SKK	225,898	363,788
Required reserve in the NBS	26,199	14,264
Overnight deposits from banks	8,738	14,126
Interbank settlement in SKK	768	399
	261,603	**392,577**

Within the money withdrawing repurchase transactions in the Slovak inter-bank market, the NBS had liabilities from repurchase transactions in the total amount of SKK 225,898 million as at 31 December 2006 (SKK 363,788 million as at 31 December 2005 – see Note 15).

14.3. Current accounts, deposits and loans in foreign currency

	Loan maturity in year	FC code	2006 FC	2006 SKK	2005 FC	2005 SKK
Current accounts of banks	x	x			x	1,081
Gold repo	2007	USD	116	3,046	115	3,691
Gold repo	2015	USD	80	2,108	85	2,507
Gold repo	2016	USD	109	2,854		
AGL II	2009	EUR	2	67	3	116
Securities Lending		EUR			3,077	116,471
Securities Lending		USD			1,273	40,697
			x	**8,075**	**x**	**164,563**

In September 2006, the Bank entered into two new gold repurchase transactions in the amount of USD 109 million with the maturity in September 2016 (see Note 6).

As at 31 December 2006, the Bank had liabilities from gold repurchase transactions in the amount of SKK 8,008 million (SKK 6,198 million as at 31 December 2005).

15. Liabilities from debt securities

As at 31 December 2006, the NBS issued bills of SKK 537,435 million (SKK 520,004 million as at 31 December 2005) and repurchased bills in the amount of SKK 500,000 million (SKK 500,000 million as at 31 December 2005).

As at 31 December 2006, NBS bills of SKK 264,095 million were used for money withdrawing operations (SKK 385,385 million as at 31 December 2005), of which SKK 226,660 million (SKK 365,381 million as at 31 December 2005) were in the form of money withdrawing repurchase transactions and SKK 37,435 million (SKK 20,004 million at 31 December 2005) in the form of direct issues in the portfolios of domestic banks.

(in SKK millions)

16. Liabilities to other international financial institutions

	2006	2005
Current accounts - Euro Account European Commission	1,769	
Loro accounts - World Bank, Bank for International Settlements	693	669
Deposits - PHARE		1
	2,462	**670**

As at 31 December 2006, the Banks recorded liabilities to other international financial institutions in the amount of SKK 2,462 million (SKK 670 million at 31 December 2005).

17. Liabilities to clients

	2006	2005
Accounts of government	17	2,952
Public sector		206
Current accounts of employees	207	191
Term deposits of employees	497	507
Other	142	97
	863	**3,953**

The decrease of funds on government accounts is related mainly to the transfer of state authority accounts to the State Treasury. ‘Other’ consists mainly of current accounts and term deposits of other clients as well as received but not yet settled payments from clients.

18. Provisions and other liabilities

	2006	2005
Provisions	169	176
Liabilities to suppliers	70	108
Other	66	78
	305	**362**

At 31 December 2006, the Bank recorded provisions for liabilities to employees of SKK 150 million (SKK 157 million at 31 December 2005), provisions for outstanding lawsuits, the annual report, audit of the financial statements and uninvoiced supplies of SKK 19 million (SKK 19 million at 31 December 2005).

‘Other’ includes settlements with employees, with entities entitled to the salaries settlement and other liabilities.

(in SKK millions)

19. Equity

With an effective date from 1 January 2006, new legislation dissolved the Financial Market Authority (*Úrad pre finančný trh – ÚFT*) and its competences were comprehensively assumed by the NBS. The integration of ÚFT into the NBS increased the Bank's assets as at 1 January 2006 by a total of SKK 195 million.

By a resolution of the Bank Board, the ÚFT equity of SKK 16 million was transferred to the NBS statutory fund. The ÚFT reserve fund of SKK 104 million was transferred to the NBS reserve fund. The ÚFT profit for 2005 in the amount of SKK 52 million and retained profits from previous years in the amount of SKK 11 million were transferred to the NBS retained profits from previous years (see the Statement of Changes in Equity).

As at 31 December 2006, the NBS generated a loss of SKK 45,128 million (SKK 663 million as at 31 December 2005) and posted a negative equity of SKK 94,639 million (SKK 50,365 million as at 31 December 2005). Funds generated from the revaluation differences of securities, derivatives, gold and foreign currency represented SKK 16,931 million. The outstanding loss from previous years was SKK 77,237 million.

The losses of the NBS will be covered from the Bank's own resources.

20. Net interest expense

	2006	2005
Interest received on loans related to monetary policy operations, in SKK	144	32
Interest received on receivables not related to monetary policy operations, in SKK	93	165
Interest received on receivables and securities in foreign currency	14,216	12,536
Interest income and similar revenues	**14,453**	**12,733**
Interest paid on liabilites related to monetary policy operations and securities, in SKK	(13,797)	(12,344)
Interest paid on liabilities not related to monetary policy operations, in SKK	(49)	(556)
Interest paid on liabilities and securities in foreign currency	(373)	(145)
Interest expense and similar costs	**(14,219)**	**(13,045)**
Net interest (loss)	**234**	**(312)**

21. Net income from fees and commissions

	2006	2005
Income from fees and commissions	169	158
Expenses on fees and commissions	(23)	(31)
Net profit from fees and commissions	**146**	**127**

The result of Securities Lending transactions as at 31 December 2006 was fee income of SKK 107 million (SKK 106 million at 31 December 2005).

(in SKK millions)

22. Net (loss) / profit from transactions in securities denominated in foreign currency and derivatives

	2006	2005
Revenues from debt securities and revaluations	148	2,978
Losses from debt securities and revaluations	(4,132)	(4,570)
Net (loss) / profit from transactions in securities and derivatives	**(3,984)**	**(1,592)**

23. Net profit / (loss) from transactions in foreign exchange, gold, and derivatives

	2006	2005
Revenues from operations with foreign currency, gold and derivatives	11,532	35,999
Losses from operations with foreign currency, gold and derivatives	(51,364)	(33,060)
Net profit / (loss) from transactions in FX, gold, and derivatives	**(39,832)**	**2,939**

The total net loss from transactions in foreign exchange, gold and derivatives was most significantly affected by exchange rate losses in the amount of SKK 39,825 million as a result of a significant strengthening of the Slovak koruna against EUR and USD during 2006.

24. Other operating expenses

	2006	2005
Salaries and bonuses	(584)	(547)
Social costs	(168)	(165)
Other personnel costs	(155)	(55)
Staff expenses	**(907)**	**(767)**
Depreciation of tangible and intangible assets	**(519)**	**(500)**
Other operating costs	**(467)**	**(607)**
Other operating expenses	**(1,893)**	**(1,874)**

In 2006 the average number of staff employed was 1,204 (1,178 in 2005), of whom 136 held managerial positions (135 in 2005). In 2006 the average number of staff in banking supervision over the financial market, insurance market, pension savings, banks and securities brokers was 162 (80 in 2005).

The total revenues from contributions and fees of financial market entities were SKK 84 million as at 31 December 2006.

(in SKK millions)

25. Foreign exchange structure of assets and liabilities

Currency risk results from the open foreign exchange position of the NBS. The impact of exchange rate changes on NBS's performance is significant. This primarily results from the size of the open foreign exchange position and the volatility of the SKK/EUR and EUR/USD exchange rates.

	Line No.	SKK	Foreign currencies converted to SKK - total	of which: EUR	USD	Other
1. Gold			18,788		18,788	
2. Debt securities denominated in foreign currency			312,364	225,718	86,646	
3. Derivatives		216	10	10		
4. Receivables from banks and central banks		3,283	21,871	16,913	4,920	38
5. Receivables from the International Monetary Fund		15,833	37			37
6. Receivables from clients		245				
7. Equity shares in subsidiary and affiliated accounting units and other shares and participating interests		108	329	96		233
8. Non-current assets		6,053				
9. Other assets		236	24	12	7	5
Assets	**1**	**25,974**	**353,423**	**242,749**	**110,361**	**313**
1. Currency in circulation		143,518				
2. Liabilities to banks and central banks		264,163	8,075	67	8,008	
3. Liabilities from debt securities		37,435				
4. Derivatives		1,382				
5. Liabilities to the International Monetary Fund		15,833				
6. Liabilities to other international financial institutions		692	1,770	1,770		
7. Liabilities to clients		825	38	15	23	
8. Reserves and other liabilities		299	6	6		
9. Equity		(94,696)	57	1	56	
Liabilities	**2**	**369,451**	**9,946**	**1,859**	**8,087**	
Open foreign exchange position at 31 Dec. 2006	**3=1-2**	**(343,477)**	**343,477**	**240,890**	**102,274**	**313**
Assets	**4**	**10,720**	**658,590**	**489,746**	**164,585**	**4,259**
Liabilities	**5**	**497,909**	**171,401**	**120,606**	**46,901**	**3,894**
Open foreign exchange position at 31 Dec. 2005	**6=4-5**	**(487,189)**	**487,189**	**369,140**	**117,684**	**365**
Year-on-year difference	**7=3-6**		**(143,712)**	**(128,250)**	**(15,410)**	**(52)**

As at 31 December 2006, the exchange rate of SKK to EUR strengthened by 8.65% (from EUR 1 = SKK 37.848 to EUR 1 = SKK 34.573) and the exchange rate of SKK to USD strengthened by 17.85% (from USD 1 = SKK 31.948 to USD 1 = SKK 26.246).

The open foreign exchange position as at 31 December 2006 decreased by 29.50% compared to 31 December 2005, from SKK 487,189 million to SKK 343,477 million.

(in SKK millions)

26. Interest rates on assets and liabilities

The following table summarizes the interval (in percentages) of the average interest rates on assets and liabilities for 2006 and 2005, by the main currencies:

2006	EUR	USD	XDR	JPY	SKK
Assets					
Gold		0.02			
Debt securities in foreign currency	2.30 – 3.60	3.40 – 5.20			
Derivatives					
Receivables from banks and central banks	2.00 – 4.21				1.50 – 6.25
Receivables from the IMF			3.06 – 4.07		
Receivables from clients					1.00 – 5.75
Liabilities					
Liabilities to banks and central banks	1.60 – 3.71	4.25 – 4.50			0.50 – 4.75
Liabilities from debt securities					2.99 – 4.75
Derivatives					
Liabilities to the IMF					
Liabilities to government and other clients					0.50 – 7.75

2005	EUR	USD	XDR	JPY	SKK
Assets					
Gold		0.01 – 0.05			
Debt securities in foreign currency	2.33	2.45			
Derivatives					
Receivables from banks and central banks	1.52 – 5.21	1.57 – 4.09	0.00 – 3.03		0.07 – 5.50
Receivables from the IMF					
Receivables from clients					1.00
Liabilities					
Liabilities to banks and central banks	1.00 – 4.71				1.50 – 5.95
Liabilities from debt securities					2.42 – 3.68
Derivatives					
Liabilities to the IMF					
Liabilities to government and other clients	0.50 – 0.75	1.75 – 3.75			0.50 – 3.65

27. Maturity of assets and liabilities

The structure of NBS's assets and liabilities by the remaining time to maturity as at 31 December 2006 is as follows:

(in SKK millions)

		Due within 1 month incl.	Due within 1-3 months incl.	Due within 1 year incl.	Due within 1-5 years incl.	Due in 5+ years	Not defined	Total
1.	Gold	5,828	5,005	1,250		6,677	28	18,788
2.	Debt securities in foreign currency	7,637	65,129	99,718	123,735	16,145		312,364
3.	Derivatives	2	7			217		226
4.	Receivables from banks and central banks	21,987	88	241	240	757	1,841	25,154
4.1	Current accounts, deposits and loans in foreign currency	21,839	10	10	13			21,872
4.2	Loans related monetary policy operations in SKK							
4.3	Receivables not related to monetary policy operations in SKK	148	78	231	227	757	1,841	3,282
5.	Receivables from the International Monetary Fund						15,870	15,870
6.	Receivables from clients	14		2	44	185		245
7.	Equity shares in subsidiary and affiliated accounting units and other shares and participating interests						437	437
8.	Non-current assets						6,053	6,053
9.	Other assets	31	15	7	26	34	147	260
	TOTAL ASSETS	**35,499**	**70,244**	**101,218**	**124,045**	**24,015**	**24,376**	**379,397**
1.	Currency in circulation						143,518	143,518
2.	Liabilities to banks and central banks	264,163	18	18	31	8,008		272,238
2.1	Current accounts denominated in SKK	2,560						2,560
2.2	Overnight deposits, loans in SKK and required reserves	261,603						261,603
2.3	Deposits and loans in foreign currency		18	18	31	8,008		8,075
3.	Liabilities from debt securities	500	36,935					37,435
3.1	denominated in SKK	500	36,935					37,435
3.2	denominated in foreign currency							0
4.	Derivatives					1,382		1,382
5.	Liabilities to the IMF						15,833	15,833
6.	international financial institutions						2,462	2,462
7.	Liabilities to clients	303	13	205	342			863
8.	Reserves and other liabilities	190	47	15	51	12	(10)	305
9.	Equity						(94,639)	(94,639)
	TOTAL LIABILITIES	**265,156**	**37,013**	**238**	**424**	**9,402**	**67,164**	**379,397**

Overnight bank deposits (item 2.2. under Liabilities) amounted to SKK 8,738 million.

(in SKK millions)

The structure of NBS assets and liabilities by the remaining time to maturity as at 31 December 2005 is as follows:

		Due within 1 month incl.	Due within 1-3 months incl.	Due within 1 year incl.	Due within 1-5 years incl.	Due in 5+ years	Not defined	Total
1.	Gold		2,377	2,783	6,558	3,281	3,451	18,450
2.	Debt securities in foreign currency	34,049	73,670	136,525	198,415	5,117		447,776
3.	Derivatives					52		52
4.	Receivables from banks and central banks	187,992	98	260	1,262	2,138	114	191,864
4.1	Current accounts, deposits and loans in foreign currency	187,853	15	12	34		114	188,028
4.2	Loans related monetary policy operations in SKK							
4.3	Receivables not related to monetary policy operations in SKK	139	83	248	1,228	2,138		3,836
5.	Receivables from the International Monetary Fund						3,934	3,934
6.	Receivables from clients	2	1	2	46	158	1	210
7.	Equity shares in subsidiary and affiliated accounting units and other shares and participating interests						483	483
8.	Non-current assets						6,422	6,422
9.	Other assets	26	121	1			(29)	119
	TOTAL ASSETS	**222,069**	**76,267**	**139,571**	**206,281**	**10,746**	**14,376**	**669,310**
1.	Currency in circulation						130,110	130,110
2.	Liabilities to banks and central banks	552,832	58		3,774	2,474		559,138
2.1	Current accounts denominated in SKK	1,998						1,998
2.2	Overnight deposits, loans in SKK and required reserves	392,577						392,577
2.3	Deposits and loans in foreign currency	158,257	58		3,774	2,474		164,563
3.	Liabilities from debt securities	14,253	5,751					20,004
3.1	denominated in SKK	14,253	5,751					20,004
3.2	denominated in foreign currency							0
4.	Derivatives		731			814		1,545
5.	Liabilities to the IMF						3,893	3,893
6.	Liabilities to other international financial institutions						670	670
7.	Liabilities to clients	3,675	112	51	109		6	3,953
8.	Reserves and other liabilities	351					11	362
9.	Equity						(50,365)	(50,365)
	TOTAL LIABILITIES	**571,111**	**6,652**	**51**	**3,883**	**3,288**	**84,325**	**669,310**

Overnight bank deposits (item 2.2. under Liabilities) amounted to SKK 14,126 million.

(in SKK millions)

28. Related party transactions

Parties related to Národná banka Slovenska are defined in the Decree of MF SR. In 2006, the Bank Board members received remuneration and other benefits in the total amount of SKK 31 million (SKK 27 million in 2005).

The Bank recognizes receivables from the Bank Board members for loans provided in the total amount of SKK 9 million as at 31 December 2006 (SKK 11 million as at 31 December 2005).

29. Post-balance-sheet events

After 31 December 2006, there were no significant events that would require adjustments in the 2006 financial statements.

Due to the accession of new members into the European Monetary Union, the Slovak Republic was assigned a new percentage share in the ECB capital at 0.6765% from 1 January 2007, which represents a reduction of the total share by 0.038%. In financial terms this means that the NBS's initial paid contribution to the ECB capital was reduced by EUR 56 thousand. This amount was credited to the NBS account in January 2007.

Ing. Ivan Šramko	Ing. Slavomír Šťastný, PhD., MBA Bank Board member	Ing. Katarína Taragelová
Governor	Executive Director Financial Management and Information Technologies Division	Director Financial Management Department

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Abbreviations

ARDAL	Debt and Liquidity Management Agency
ATM	Automated Teller Machine
BCPB	Bratislava Stock Exchange
BRIBOR	Bratislava Interbank Offered Rates
CPI	Consumer Price Index
EBOR	European Bank for Reconstruction and Development
ECB	European Central Bank
ECOFIN	Economic and Financial Affairs Council of the EU
EFT POS	Electronic Funds Transfer at Point of Sale
EMU	Economic and Monetary Union
ERM	Exchange Rate Mechanism
ESCB	European System of Central Banks
EU	European Union
EUR	euro/€
Fed	Federal Reserve System
FNM	Fond národného majetku – National Property Fund
GDP	Gross Domestic Product
HICP	Harmonised Index of Consumer Prices
IBRD	International Bank for Reconstruction and Development
IMF	International Monetary Fund
NBS	Národná banka Slovenska – National Bank of Slovakia
NEER	Nominal Effective Exchange Rate
OECD	Organisation for Economic Co-operation and Development
p. a.	per annum
p. p.	percentage points
PPI	Producer Price Index
REER	Real Effective Exchange Rate
SAX	Slovak Share Index
WB	World Bank
SEPA	Single Euro Payments Area
SIPS	Slovak Interbank Payment System
SKONIA	SlovaK OverNight Index Average
SSP	Single Shared Platform
TARGET	Trans-European Automated Real-time Gross Settlement Express Transfer
ULC	Unit Labour Costs
USD	US dollar
WTO	World Trade Organization

Glossary

Autonomous liquidity factors – factors other than monetary policy operations influencing banking sector liquidity. Such factors are, in particular, net foreign assets held by the central bank, central government deposits with the central bank and currency in circulation.

Average value of currency mark – the total value of currency in circulation divided by the total number of currency instruments.

Basel II – the New Basel Capital Accord approved in 2004, setting out new rules for the regulation and calculation of capital for financial institutions. The Accord consists of three pillars: Pillar I – minimum capital requirements, Pillar II – supervision process, Pillar III – market discipline.

Basic NBS rate – the interest rate limit applied to the marginal deposit facility of the NBS – its main monetary policy operations. The NBS has published the basic rate since 1 January 2003; whenever the term "discount interest rate of the National Bank of Slovakia" or "discount rate of the Czecho-Slovak State Bank" appears in older legislation, it means the basic NBS rate.

BRIBOR (Bratislava Interbank Offered Rate) – interest rate fixing in the interbank deposit market calculated from prices offered by reference banks for deposits with maturities ranging from 1 day to 12 months.

Central parity – the exchange rate vis-à-vis the euro of currencies of ERM II member countries, around which the ERM II fluctuation margins are defined. The central parity for the Slovak koruna was set on 28 November 2005 at 38.4550 SKK per euro, with a fluctuation band of ±15%.

Classified claims – claims receivable from customers and banks (loans) non-performing for 90 or more days.

Collateral – an asset used to secure a loan. In case of the debtor's default the asset can be sold and the proceeds used to settle the outstanding loan.

Common ECSB Training – a common training program of the European Central Bank (ECB) and national central banks of the European System of Central Banks (ESCB). The program covers manager training designed to learn new knowledge and work procedures, as well as the development of management skills focusing on the effectiveness and efficiency of decision-making in the ESCB and the Eurosystem, to foster a common ESCB culture through sharing of best practices.

Core inflation – measures the rate of growth of the price level on the basis of an incomplete consumer basket. The consumer basket excludes items with regulated prices and items with prices subject to other administrative measures (e.g. change of VAT, consumer taxes, subsidies). It is part of the national index of consumer prices.

Deflation – a decrease in the general price level, the opposite of inflation.

EFCB certificate (European Foundation Certificate in Banking) – an internationally accepted banking certificate awarded in an examination assessing the level of skills required as qualification for a bank employee, comparable within the EU banking sector; the only institution in Slovakia accredited to conduct EFCB training and examinations is the Institute of Banking Education of the National Bank of Slovakia.

Effective exchange rates (nominal: NEER, real: REER) – weighted averages of bilateral SKK exchange rates against the currencies of the main trading partners. The weights used reflect the share of each partner country in Slovakia's foreign trade. Real effective exchange rates are nominal effective exchange rates deflated by a weighted average of foreign, relative to domestic, prices or costs. They are measures of price and cost competitiveness of a country.

Electronic money business – the issue and administration of electronic money and electronic money payment instruments.

Electronic money institution – a legal person other than a bank, foreign bank or the Národná banka Slovenska, holding a license for electronic money business under the Payments Act.

Employee benefits – wage and wage compensations, bonuses, supplementary insurance, severance pay, exit pay, and other non-pecuniary benefits, such as health care.

ERM II (exchange rate mechanism II) – an exchange rate system providing a framework for exchange rate policy cooperation between the euro area countries and the EU Member States not participating in the third stage of the EMU. Membership in ERM II is one of the Maastricht criteria for the adoption of the euro.

ESA 95 – the European System of Accounts adopted in 1995. A common methodology for the compilation and reporting of GDP, employment and employee compensation data for all EU countries.

Euro area – the area encompassing those EU member states in which the euro has been adopted in accordance with the Treaty. The responsibility for monetary policy in the euro area lies with European Central Bank.

European Economic Area – comprises all EU Member States, Norway, Lichtenstein and Iceland.

European Payments Council – an organisation associating European Union banking associations.

Eurosystem – a system of central banks comprising the European Central Bank and the national central banks of those EU member states that have adopted the euro.

Financial market – consists of four sectors: the banking sector (the main representatives are banks and branches of foreign banks), the capital market (the main representatives are securities dealers, asset management companies, the stock exchange and the Central Securities Depository), the insurance sector (the main representatives are insurance companies and branches of foreign insurance companies), and the pension saving market (the main representatives are pension management companies and supplementary pension companies (pension insurance companies)).

Foreign direct investment – a category of international investments reflecting the objective of a resident entity in an economy (direct investor) to acquire a permanent interest in a company residing in an economy other than that of the investor (direct investment company). Direct investments include the initial transaction between these two entities – i.e. the transaction giving rise to the investment relationship - and all subsequent transactions between these two entities and affiliated companies.

Foreign exchange reserves – reserves of the Slovak Republic consisting of gold and other financial assets denominated in foreign currency held and managed by the central bank. They are used to directly finance payment imbalances, to indirectly regulate their size through foreign exchange market interventions in order to influence the exchange rate of the currency, or for other purposes.

Free provision of cross-border services – the conduct of banking activities by foreign entities based in the European Economic Area (foreign banks, foreign financial institutions or electronic money institutions) not present in the Slovak Republic.

GDP deflator – an aggregate price index reflecting developments in the price of products and services in an economy. It is calculated as a ratio of GDP at current prices to GDP at constant prices.

General government – a sector defined in the ESA 95 as comprising resident entities that are engaged primarily in the production of non-market table goods and services intended for individual and collective consumption and in the redistribution of national income and wealth. Included are central, regional and local government authorities as well as social security funds, and any budget-funded or subsidised organisations established by them, whose revenues cover less than 50% of their production costs.

General government debt – gross debt (deposits, loans and other debt securities other than financial derivatives) of the general government at nominal value. A debt-to-GDP ratio of up to 60% is one of the Maastricht convergence criteria for the adoption of the euro.

General government deficit – the difference between total revenues and total expenditures of the general government sector, if expenditures exceed revenues. A deficit-to-GDP ratio of up to 3% is one of the Maastricht convergence criteria for the adoption of the euro.

Gross domestic product (GDP) – the total output of goods and services in an economy in a given period. The main expenditure aggregates that make up GDP are household final consumption, government final consumption, gross fixed capital formation, changes in inventories, and imports and exports of goods and services.

Harmonised Index of Consumer Prices (HICP) – a consumer price index measured on a comparable basis across all EU Member States, which accounts for differences in national definitions. The HICP is one of the indicators used to assess price stability in a country (one of the Maastricht convergence criteria).

IBAN (International Bank Account Number) – an international bank account number format allowing unique customer identification and automated payment processing (mostly cross-border payments at present). In Slovakia, IBAN consists of 24 alpha-numerical characters (ISO country code, control number, account number including bank code).

Implied volatility – expected volatility (i.e. standard deviation) in terms of change in the price of an asset (for example, a bond or share). It can be derived from the price of the asset, maturity date and the exercise price of an option for the asset, as well as from a risk-free rate of return using an option valuation model (e.g. the Black-Scholes model).

Inflation – an increase in the general price level.

Liquidity cushion – defined as the sum of cash in hand, government bonds, Treasury bills and NBS bills, deposits at the NBS and current accounts at other banks after deducting liabilities of banks vis-à-vis foreign banks (except for long-term liabilities) and the ARDAL agency, and assets provided as collateral.

M1 – a narrow monetary aggregate comprising currency in circulation and overnight deposits with MFIs and central government (e.g. post office or the State Treasury).

M2 – an intermediate monetary aggregate that comprises M1 plus deposits redeemable at notice of up to 3 months (short-term saving deposits) and deposits with an agreed maturity of up to 2 years (short-term time deposits) with MFIs and central government.

M3 – a broad monetary aggregate that comprises M2 plus negotiable instruments, i.e. repurchase agreements, money market fund shares and units as well as debt securities issued by MFIs with a maturity of up to two years.

Maastricht criteria – convergence criteria set out in the Maastricht Treaty that must be fulfilled before a country can join the euro area. There are four criteria regarding: public finances (deficit and debt of the general government sector), inflation, long-term interest rates, and exchange rate.

MFI claims on residents – MFI claims receivable from residents other than MFIs (including the general government sector and the private sector) and securities issued by residents other than MFIs (stocks and other equity and debt securities) held by MFIs.

Minimum reserve requirement – financial reserves held by banks, branches of foreign banks, building societies and electronic money institutions on accounts with the central bank. It is a monetary policy tool with the level set individually by the central bank for each minimum reserve holder.

Monetary financial institutions (MFI) – financial institutions which together form the money-issuing/generating sector. These comprise the central bank (NBS), credit institutions (banks and branches of foreign banks) and all other financial institutions whose business is to receive deposits or redeemable funds from entities other than MFIs and, in their own name and for their own account, to grant credit and invest in securities (in particular money market funds).

Net currency issuance – the difference between the amount of currency put into circulation and currency received in a given period.

Overnight refinancing operation of the NBS – a facility which counterparties (banks) may use to make overnight deposits with the central bank. The overnight refinancing rate is one of the key NBS rates.

Overnight sterilisation operation of the NBS – a facility which counterparties (banks) may use to receive overnight credit from the central bank against eligible assets. The overnight sterilisation rate is one of the key NBS rates.

Own funds adequacy – the ratio of own funds to risk-weighted assets (must not fall below 8%). The adequacy of own funds is an indicator of smooth functioning of a financial institution in the future, i.e. an indicator of its financial strength and credibility.

Parent company – a legal person controlling, i.e. holding over 50% of equity or voting rights in another legal person, or the right to appoint or dismiss the majority of the members of its statutory body, supervisory board or another managing, supervisory or controlling body.

Pension Pillar II – old-age pension saving, part of the compulsory state pension system based on a fund system financed trough contributions.

Pension Pillar III – supplementary pension saving. A fund system financed through voluntary contributions and supported by the State through tax relieves.

Persons related to the National Bank of Slovakia – legal or natural persons which are subsidiary accounting units of the NBS, affiliated accounting units, members of the NBS Bank Board, close relatives of a member of the NBS Bank Board, accounting units controlled, co-controlled or subject to the influence or significant voting rights exercised or held by members of the NBS Bank Board or their close relatives.

Portfolio investment – net transactions by residents and their holdings of securities issued by non-residents (assets) and net transactions by non-residents and their holdings of securities issued by residents (liabilities). They comprise equities and debt securities (bonds, bills of exchange and money market instruments). For investments to be considered portfolio investments, the interest in the company concerned must be lower than the equivalent of 10% of ordinary shares or voting rights.

Price stability – a year-on-year increase in consumer prices lower than a limit set by the NBS. As a medium--term target, the NBS seeks to maintain consumer price growth as measured by the HICP below 2% at the end of 2007 and 2008.

Regulated prices – prices and fees set by ministries or regulators (Network Industries Regulation Office, Slovak Post Office, Slovak Telecommunications Office, etc.) or by regional or local governments. They are included in the national consumer price index.

Reinvested earnings – consist of the share of a direct investor (relative to a direct participating interest) in profit not distributed as dividends by subsidiaries or affiliates and in profit of branches not distributed to the direct investor.

Repo operation – the granting or receiving of a loan against collateral in form of securities.

RTGS (Real Time Gross Settlement) – a real-time gross settlement system.

SEPA (Single Euro Payments Area) – a single euro payments area the objective of which is to create a single internal market for cross-border euro payments.

Single banking license (single European passport) – foreign banks, foreign financial institutions or electronic money institutions may conduct banking activities in other European Economic Area member states in accordance with the European Parliament and Council Directive 2000/12/EC relating to the taking up and pursuit of the business of credit institutions, if their license was granted in a European Economic Area member state. These entities may provide their services by opening a branch or under the freedom to provide cross-border services.

Single banking licence principle (single European passport principle) – applies to all banking activities explicitly stated in the Banking Act. In order to provide mortgage loans pursuant to Article 67(1) of the Banking Act and to act as a depositary under the Collective Investment Act, a special license from the National Bank of Slovakia is required.

SIPS – an interbank payment system operated by the National Bank of Slovakia.

Stability and Growth Pact – was designed to ensure sound public finances during the third stage of the Economic and Monetary Union in order to facilitate price stability and a strong sustainable growth contributing to job creation. To that end, the Pact requires Member States to set medium-term fiscal targets. It also defines a specific excessive deficit procedure. The Pact consists of the resolution on the Stability and Growth Pact adopted at the Amsterdam summit of the European Council on 17 June 1997 and two Council regulations, namely (i) Regulation 1466/97/EC of 7 July 1997 on the strengthening of the surveillance of budgetary positions and the surveillance and coordination of economic policies as amended by Regulation 1055/2005/EC of 27 June 2005 and (ii) Regulation 1467/97/EC of 7 July 1997 on speeding up and clarifying the implementation of the excessive deficit procedure as amended by Regulation 1056/2005/EC of 27 June 2005.

STEP2 – a European automated clearing system operated by the Euro Banking Association Clearing, designed to process cross-border euro payments.

Subsidiary – a legal person subject to control (a holding of over 50% of equity or voting rights in the legal person).

TARGET (Trans-European Automated Real-time Gross Settlement Express Transfer) – a real-time gross settlement system for euro payments. It is a decentralised system made up of 15 national RTGS systems, the ECB payment mechanism and the interlinking mechanism.

TARGET2 – a new generation of TARGET in which the current decentralised technical structure will be replaced by a single shared platform.

Two-week repo tender of the NBS – a standard 14-day repo operation of the central bank consisting in lending or borrowing against collateral in form of securities. This repo operation is conducted as a tender. The two-week repo tender rate is the basic NBS rate.

Yield curve – a graphic representation of the relationship between the interest rate/yield and the maturity of an asset with the same credit risk, but different maturities at a specific point in time. The slope of the yield curve can be expressed as the difference between interest rates applied to two selected maturities.