



NÁRODNÁ BANKA SLOVENSKA

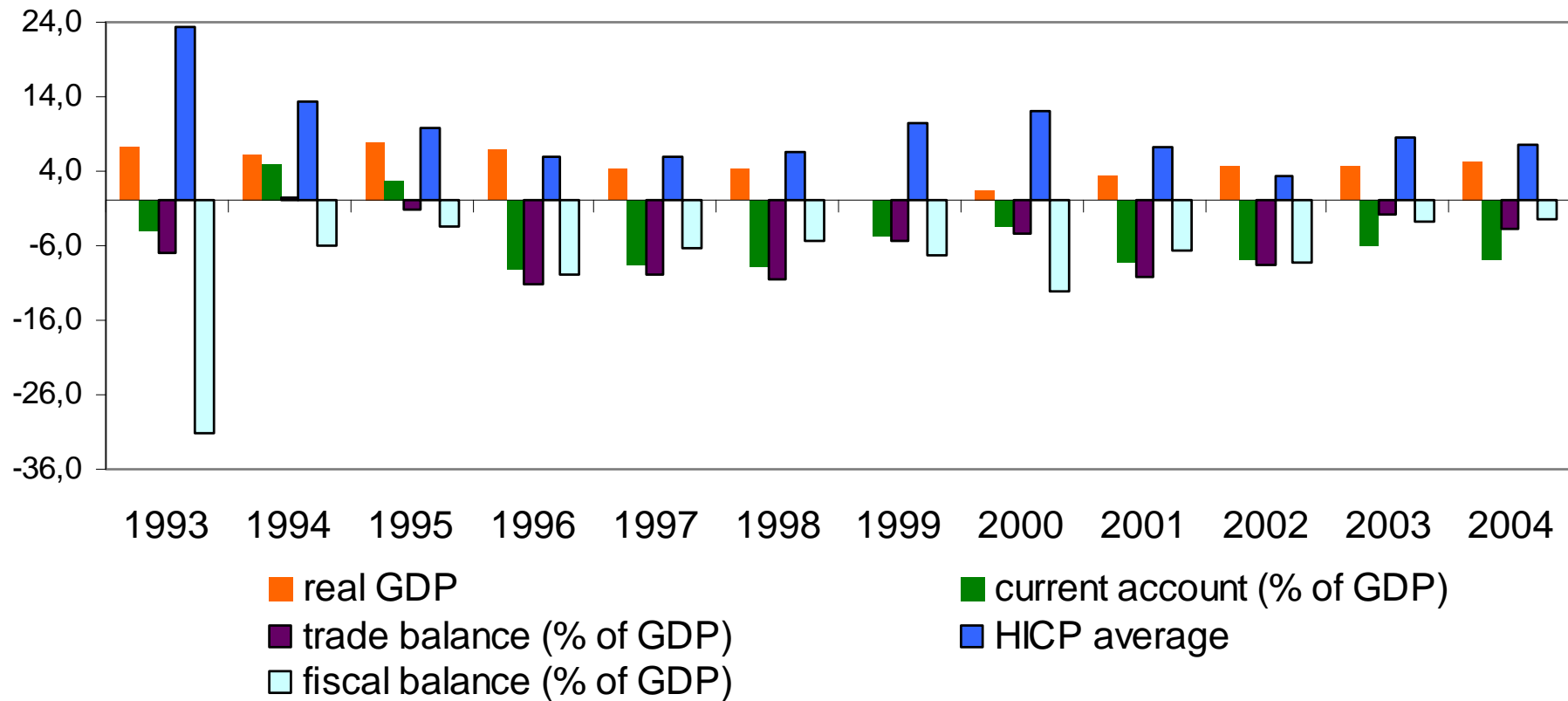
EUROSYSTÉM

Slovakia's monetary policy when approaching the Euro

Bratislava, June 2009

Macroeconomic development

(1993-2004)



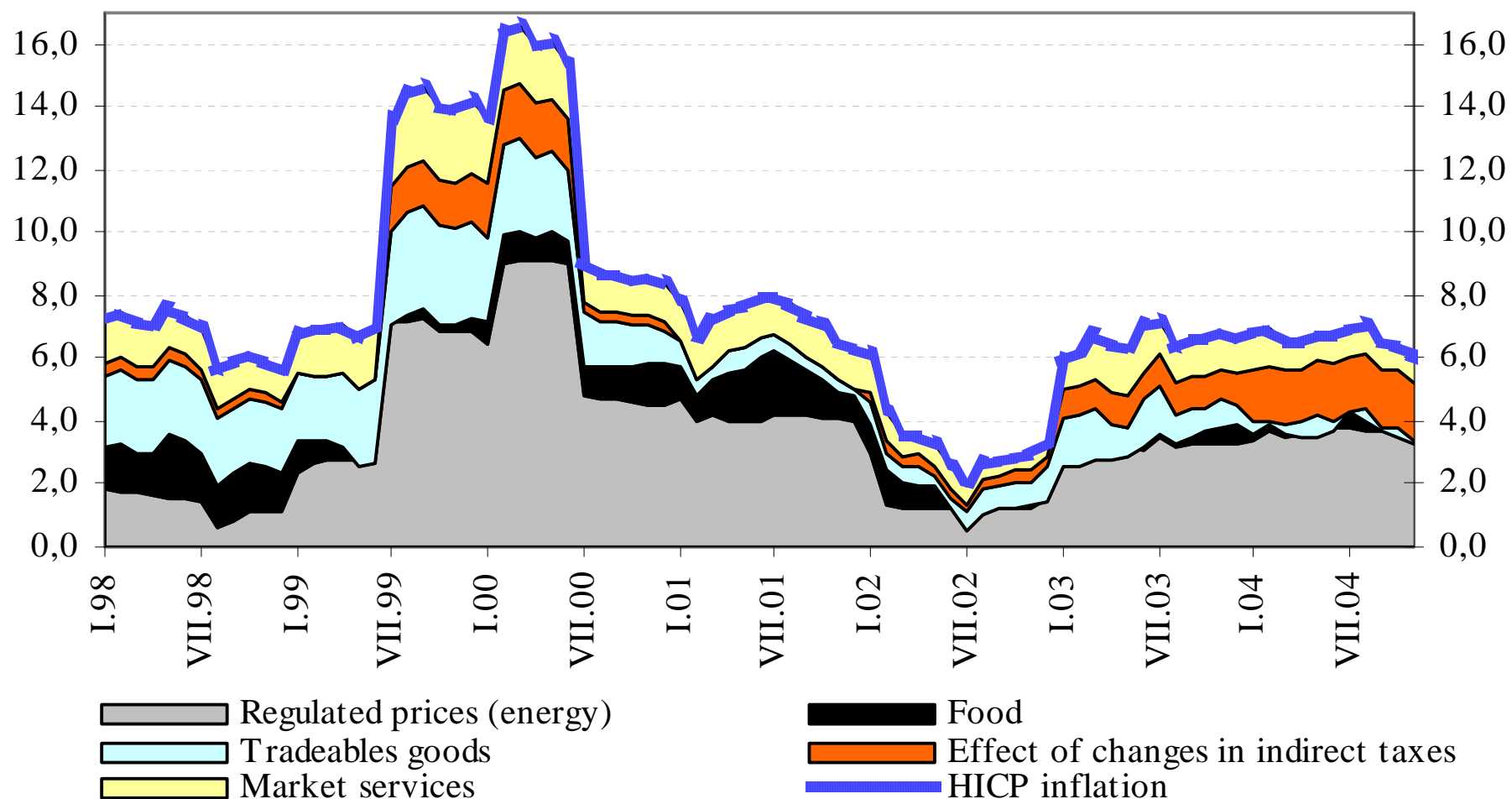
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Development of HICP structure

(1998-2004)



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Introduction of new monetary policy strategy

Decision in December 2004: from implicit towards explicit inflation targeting

Inflation targeting

In the medium term, consistent with obligations resulting from membership of the EU and the goal of establishing conditions for adopting the common currency the euro, as well as being consistent with the commitments of the government in the area of reducing the fiscal deficit, the NBS has established a target for the year-on-year rate of inflation measured by the harmonised index of consumer prices (HICP) **below 2.5 percent for December 2006 and below 2 percent for December 2007 and for December 2008, in order to fulfil the Maastricht criterion on the basis of an average twelve-month inflation.**



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Inflation targeting

Objective: public announcement of a medium-term numerical target for inflation with an institutional commitment by the CB to achieve this target.

Pros:

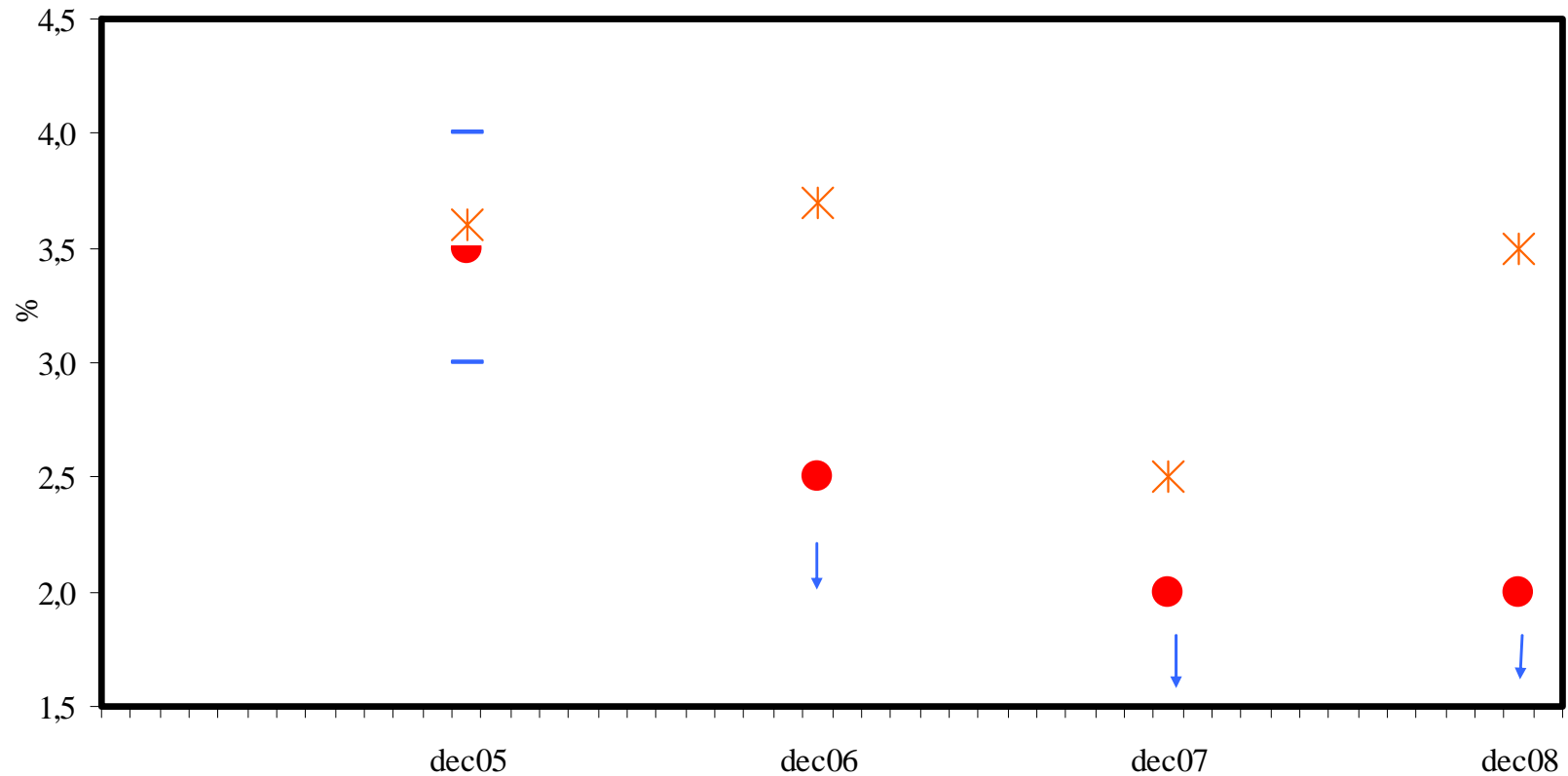
- Transparent monetary policy
- Clear commitment to price stability
- Accountability
- Anchor of inflation expectations

Cons:

- Inflation not easily controlled by central bank (regulated prices, energies, commodities)
- Horizon monetary policy (communication)
- Exchange rate development (communication)



Ambitious inflation target of the NBS for year-on-year HICP inflation and its fulfilment

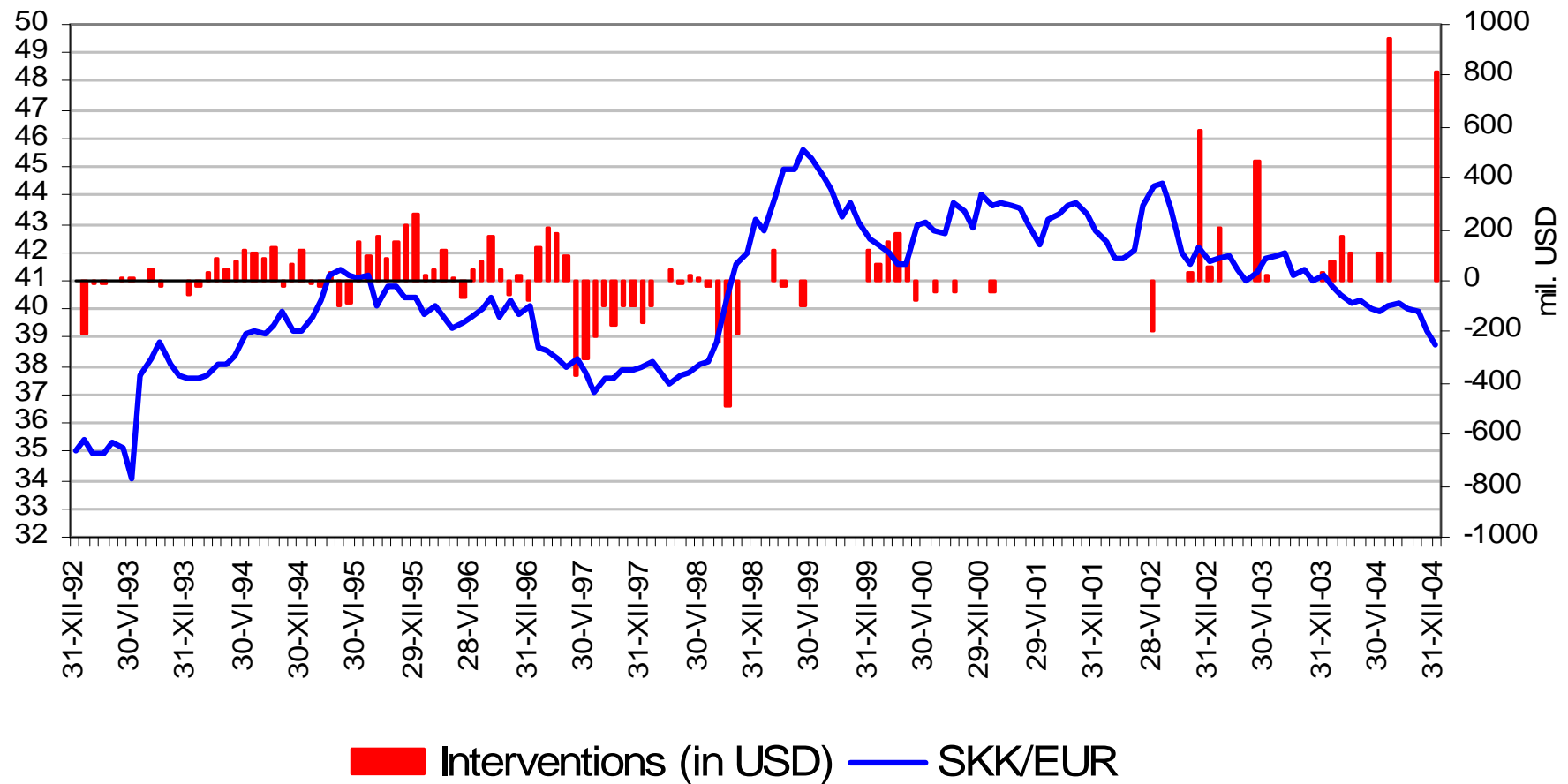


Decision making process in National Bank of Slovakia

- *Monetary programme of the NBS* was replaced by quarterly *Medium term Forecast*
- decision of the Bank Board of the NBS on interest rates were presented by *Rationale behind the decision of the Bank Board of the NBS on the set levels of the NBS interest rates* on www
- Press conference held immediately after the Bank Board of the NBS meeting
- May 2005 –NBS started to publish a voting ratio from the Bank board of the NBS voting from previous month
- End of 2005- NBS started to publish a voting ratio immediately after the Bank Board's meeting
- => more transparency and credibility of CB



Exchange rate development (1993-2004)



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ERM II membership

Change of the Monetary Policy Strategy

28.11.2005

IT =>IT within ERM II

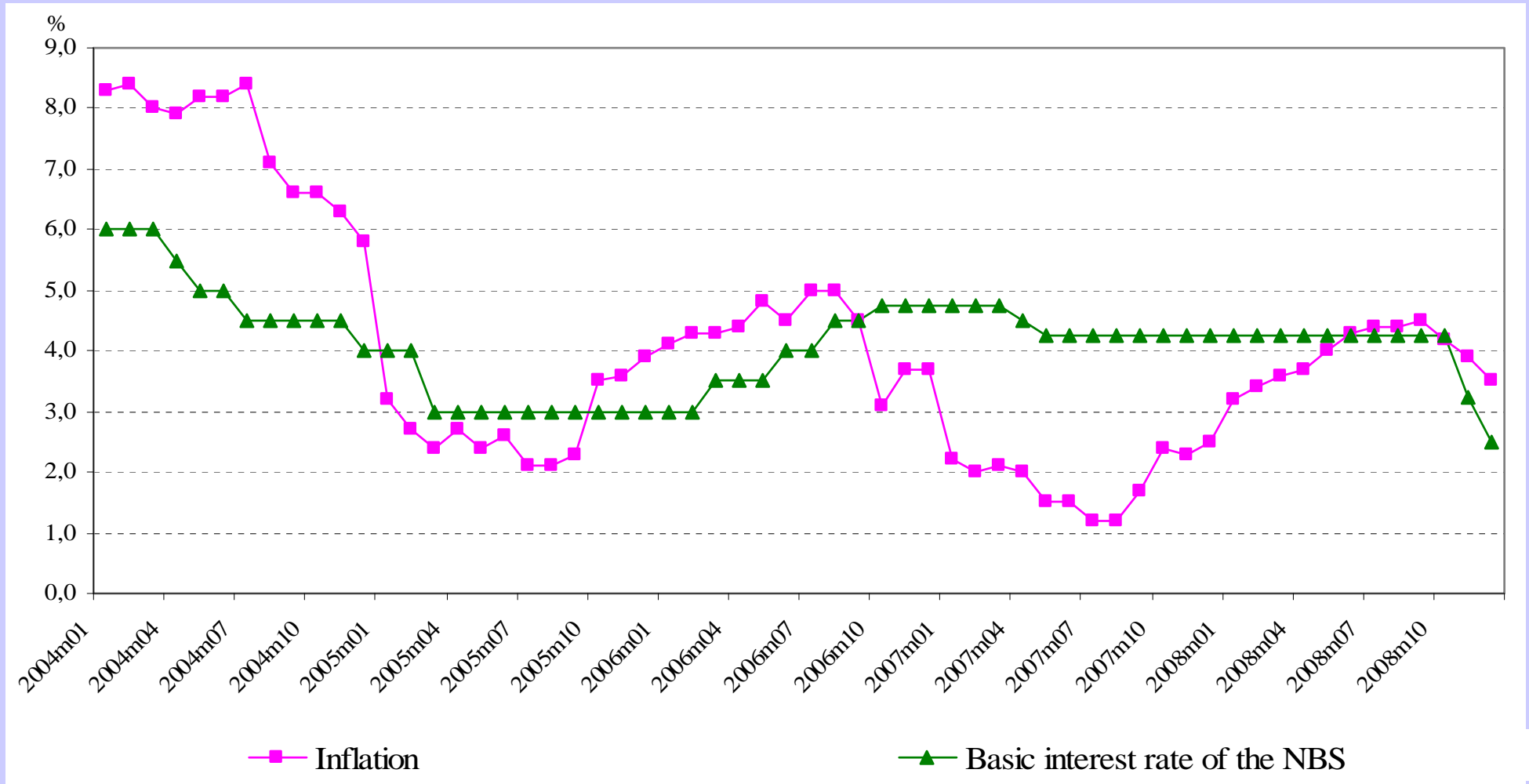
- assessment of exchange rate development with respect to Maastricht criteria fulfilment : what does it exactly mean close to parity?
- how to cope with appreciation trend, when to intervene, how communicate the exchange rate development (in fact how to keep silence) when necessity to take into considerations exchange rate when deciding about interest rates ?



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Development of inflation and interest rate (2004-2008)

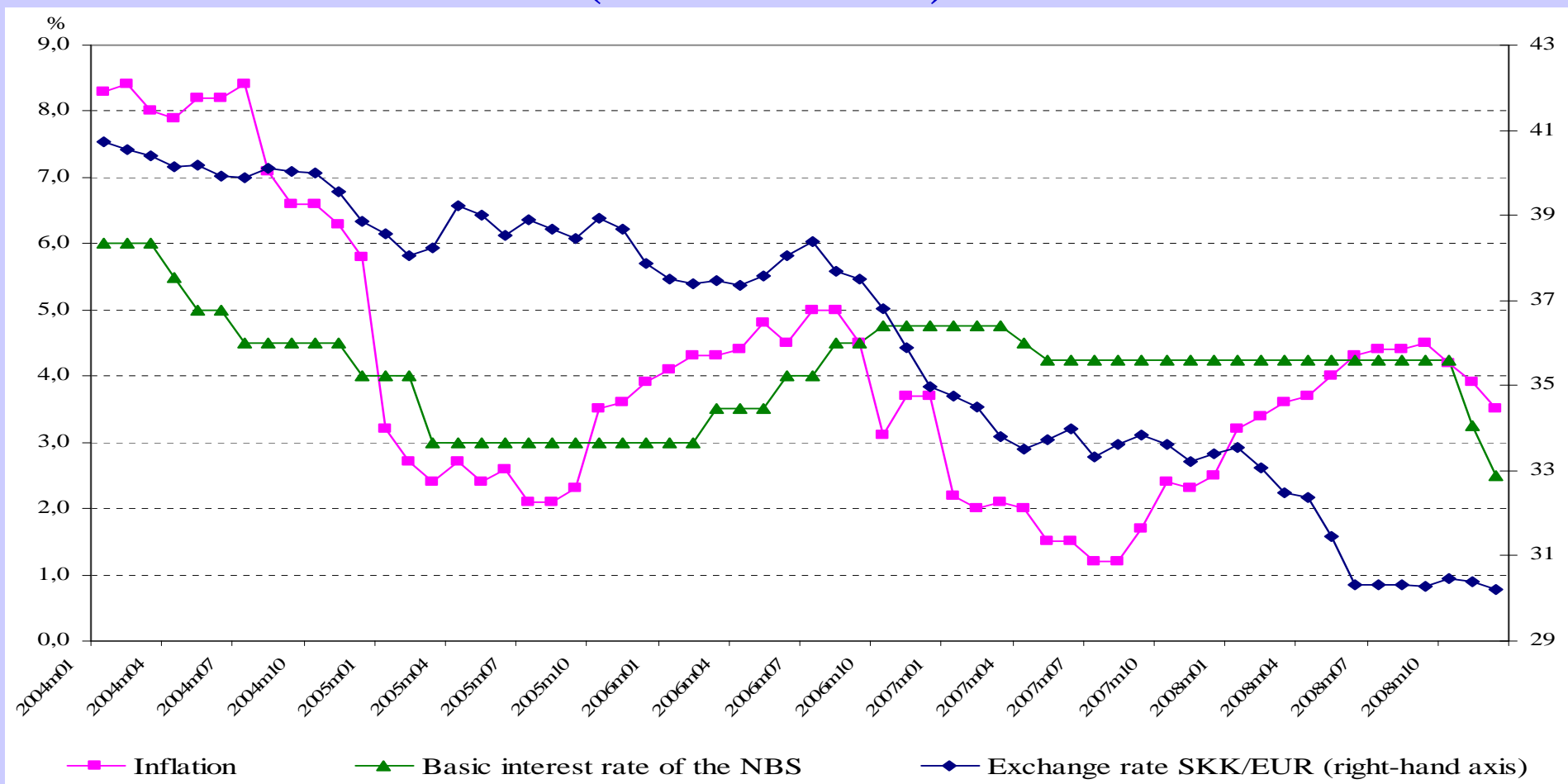


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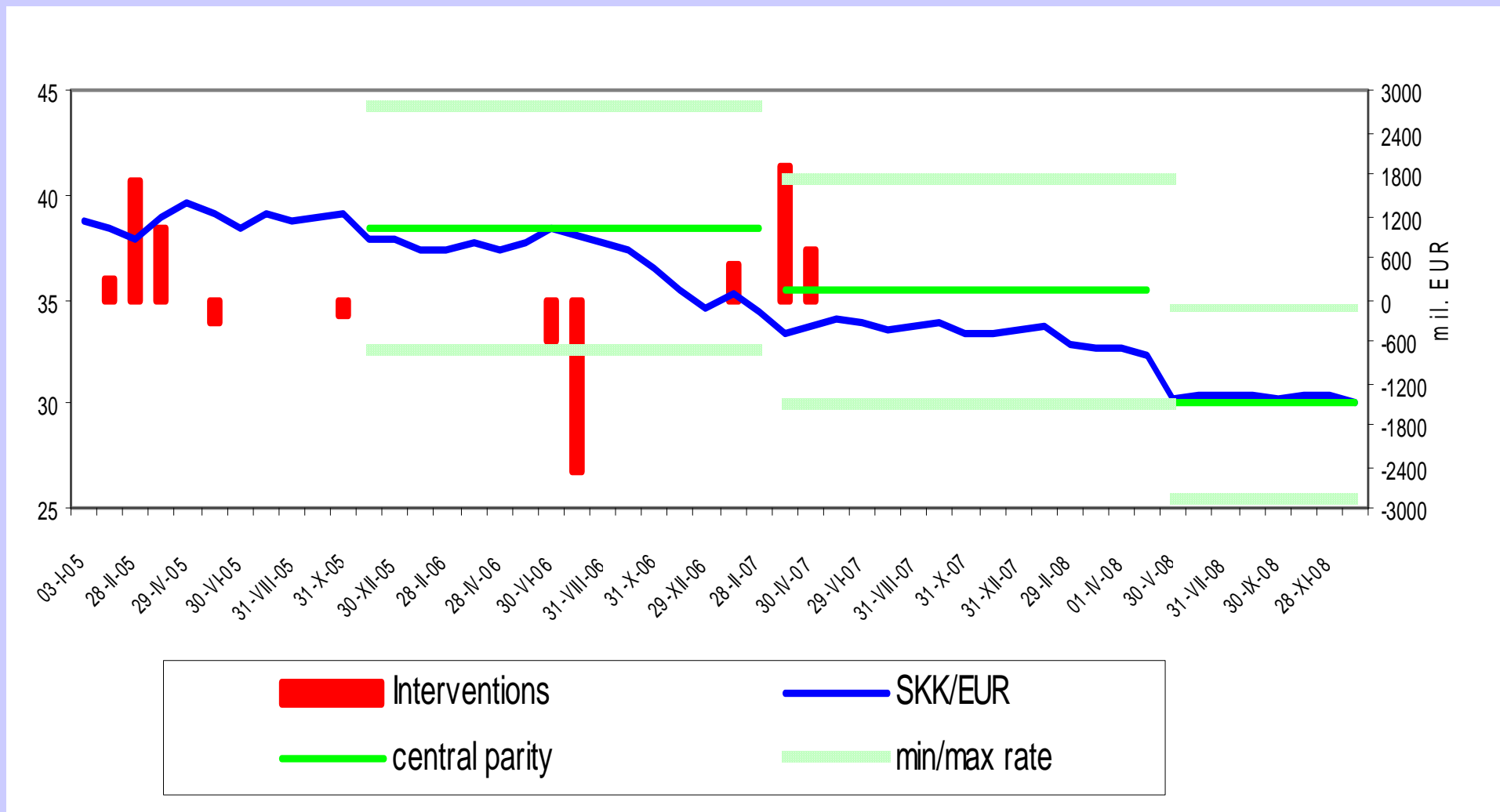
Development of inflation, exchange rate and interest rate (2004-2008)



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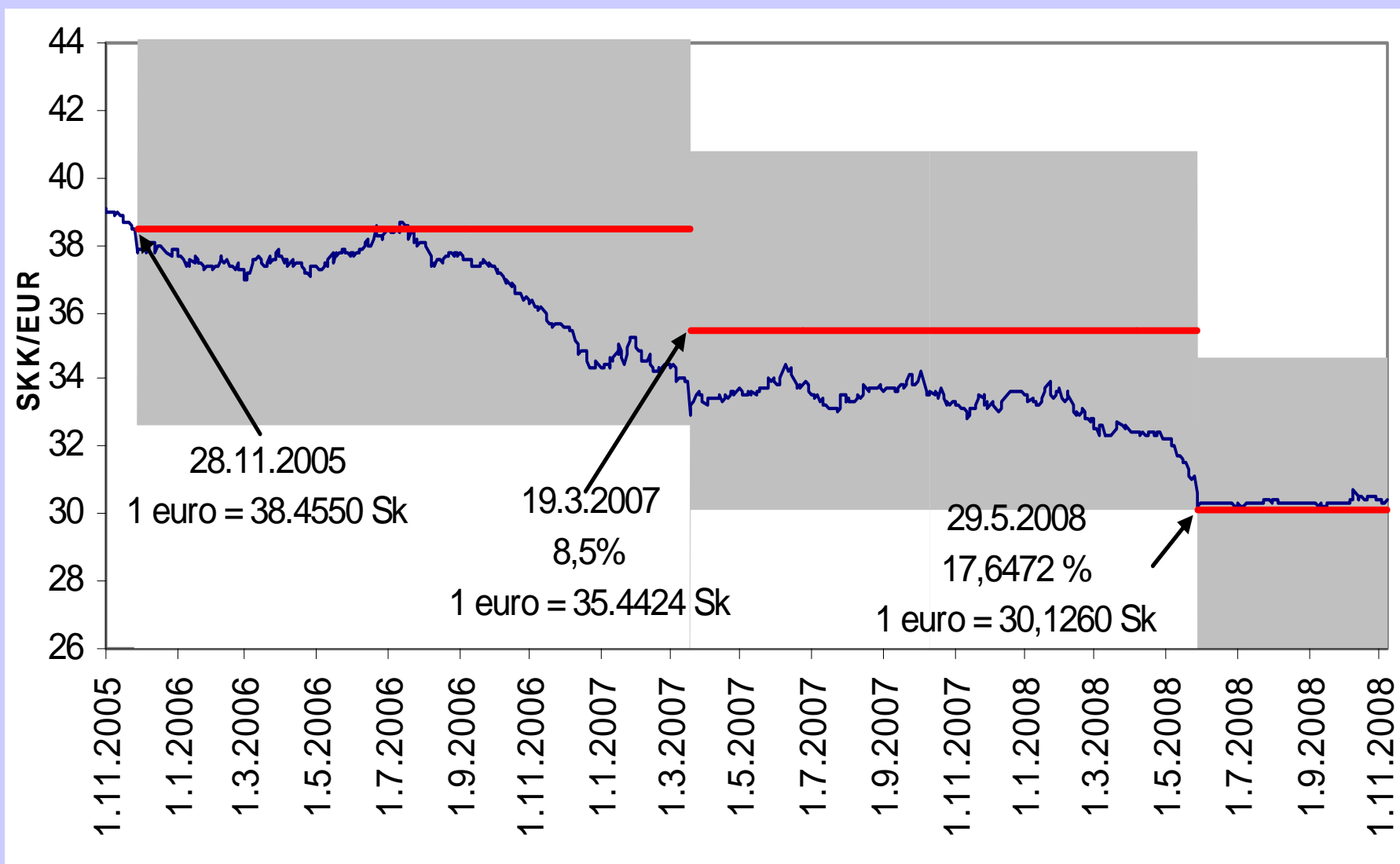
Exchange rate development (2005-2008)



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ERM II membership



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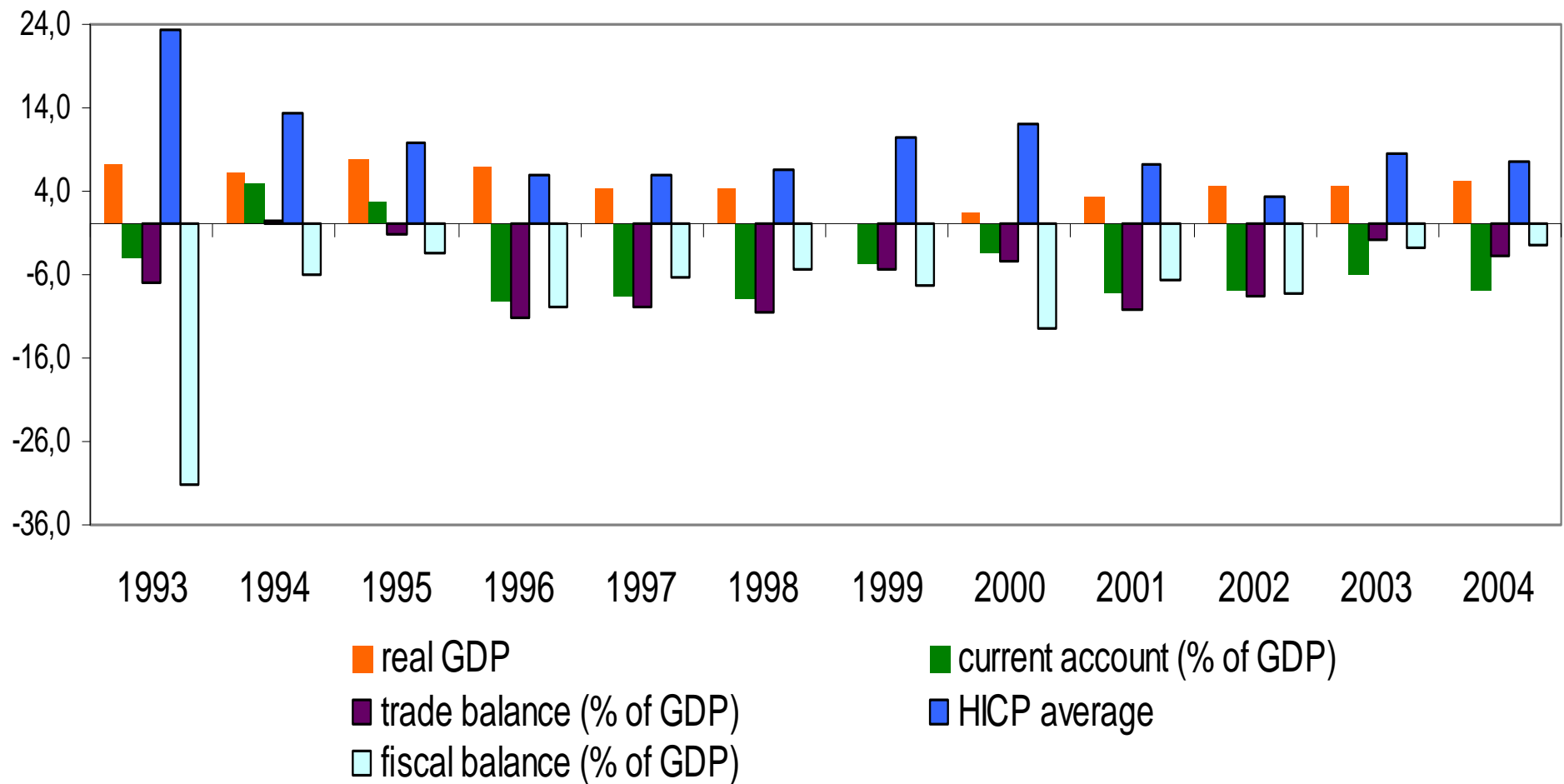
Exchange rate

- NBS directly intervened very seldom (June, July 2006-uncertainty, March 2007- convergence play very strong, net balance of interventions 40 mil. Eur),
- appreciation trend mainly in 2007: due to the improved fundamentals (small impact of convergence play), fit to real equilibrium exchange rate analysis,
- heavy impact of regional sentiment – high volatility (since April 2007 5-8% in appreciation band), no reaction of NBS,
- decision and announcement of NBS BB not to comment anyhow the exchange rate development (highly negative sensitivity of EC and ECB),
- RMCI concept – appreciation no need to increase interest rates, but due to the above mentioned decision quite hard to communicate (very precise formulations needed),
- need to explain there is not overheating when GDP rises and the impact of appreciation on inflation development



Macroeconomic development

(1993-2004)

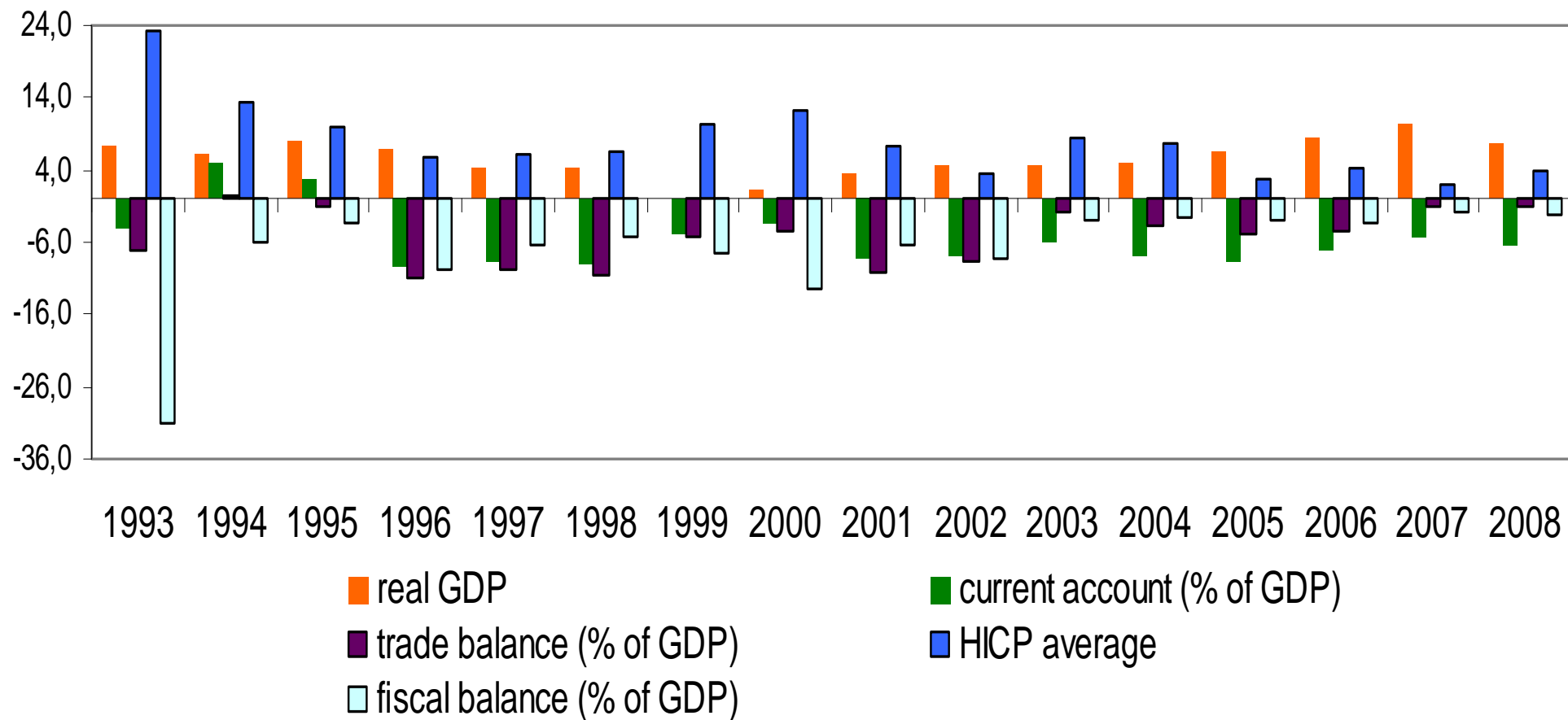


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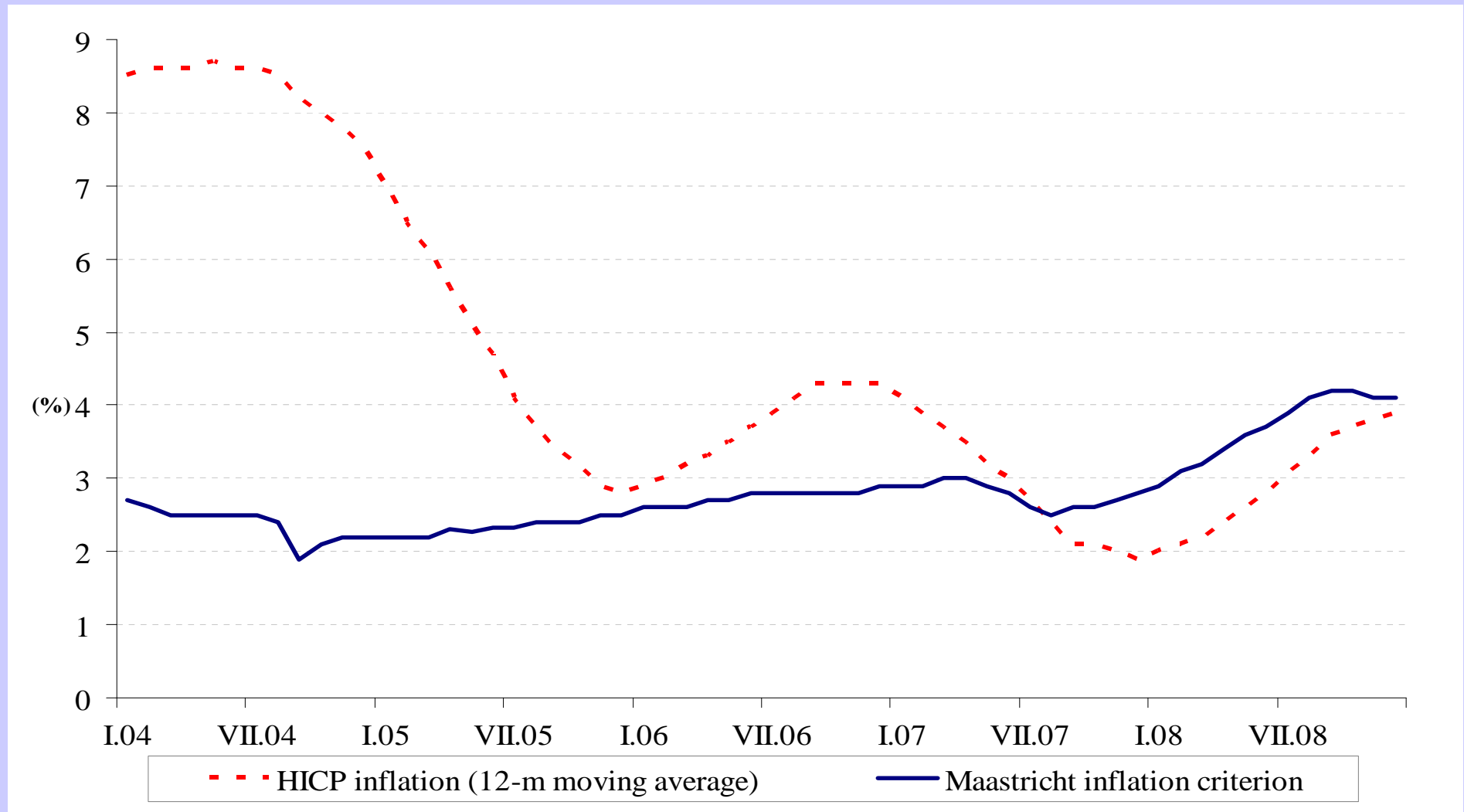
Macroeconomic development (1993-2008)



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Fulfilment of Maastricht inflation criterion (2004-2008)



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Euro changeover yardsticks



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- Euro adoption strategy in 2003 – set target for euro area entry in 2008 or 2009
- Specification of euro adoption strategy in 2004 – € target set for 2009
- National Euro Changeover Plan approved in 2005
- New government in 2006 confirmed plans to adopt euro in 2009
- Updated Changeover Plan in 2007
- Revaluations of the central parity in 2007 and 2008
- Convergence reports of EC a ECB – May 2008

Euro adoption has broad political support in Slovakia



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Benefits of Euro Adoption

Direct (immediate) benefits

- elimination of exchange rate risk against euro
- lower costs of capital
- elimination of some transaction costs
- better resistance to (currency) crises
- lower exchange rate risk against USD
- higher price transparency

Indirect (long-term) benefits

- trade growth
- increase of FDI
- faster growth/increase of living standards/progress in real convergence

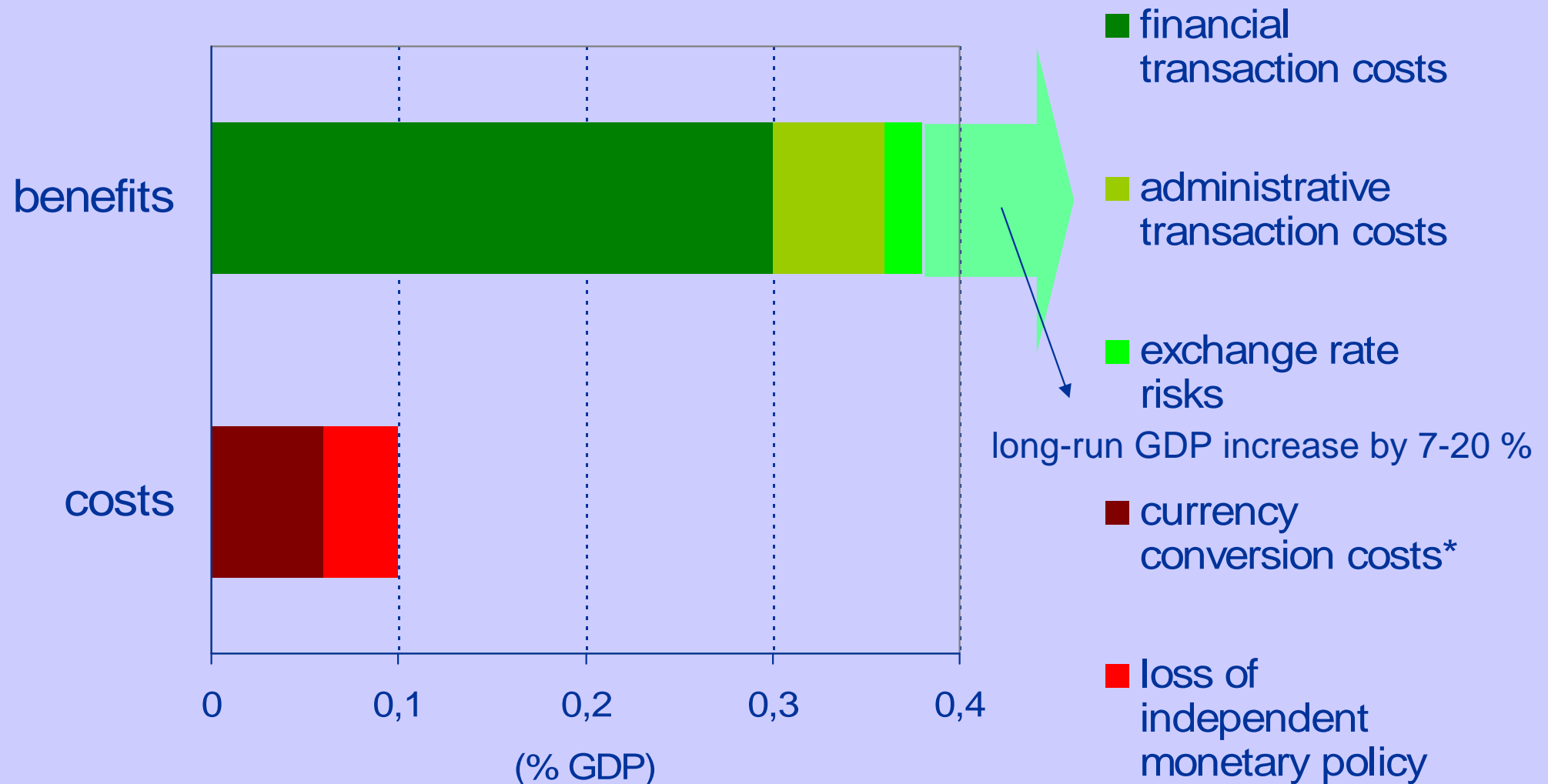


Costs of Euro Adoption

- Technical costs of currency changeover: one-off costs of 0,3% GDP
- Banking sector losses
- Loss of independent monetary policy – loss of an instrument for stabilization of economy
- Likelihood of moderately higher inflation



Euro is Beneficial for Slovakia



* for comparability with permanent effects the one-off conversion costs are split to 5 annual installments

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Internal and external analyses I.

Quarterly transmission mechanism model (QPM) – monetary policy analysis and alternative scenarios - pre and post eurozone entry

Equilibrium exchange rate – Fundamental equilibrium exchange rate model, Behavioral equilibrium exchange rate models

Path-through effect (VAR) – influence of the exchange rate on inflation

BSE – sustainability of inflation

Regulated prices – analysis for EC and ECB



Internal and external analyses II.

- **Inflation targeting under the conditions of ERM II**
- **Preparation for entry into ERM II** – determination of the central parity, economic policy under ERM II, practical steps before and after entry
- **Determination of central parity** – methods, means, approaches
- **Adjustment of central parity**
- **Interpreting and fulfilling the Maastricht criteria** – analysis, experience of other countries
- **Real convergence, monetary union and inflation** – the case of selected eurozone countries
- **Information about announced eurozone and ERM II accession strategies of selected new member states**



Internal and external analyses III.

Analyses of the Research Department:

- **Analyses of convergence of Slovak republic**
- **Effects of euro adoption on the Slovak economy**
- **Estimation of possible impacts of euro adoption on the business sector in Slovak republic**
- **Estimation of possible impacts of euro adoption on the Slovak inhabitants**



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Expected development of main macroeconomic indicators

Slowdown of GDP mainly due to exports, with effects on labour market

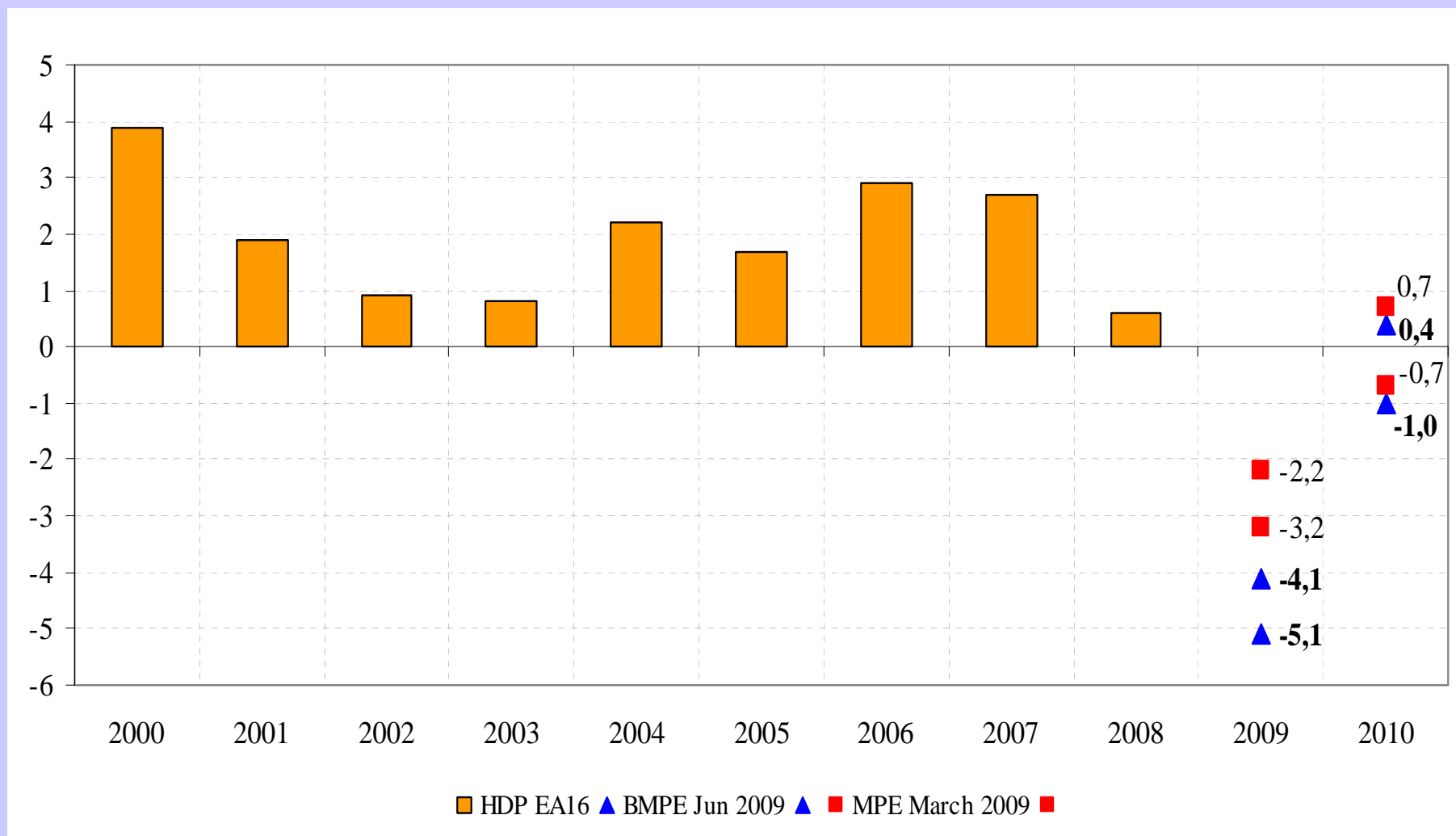
	2009		2010		2011	
	2009- MTFQ1	2009- MTFQ2	2009- MTFQ1	2009- MTFQ2	2009- MTFQ1	2009- MTFQ2
GDP	-2,4	-4,2	2,0	2,4	3,2	4,1
Private consumption	1,0	1,0	1,4	0,3	3,1	3,6
Government consumption	4,4	2,2	1,9	2,1	2,3	2,8
Fixed investment	-0,4	-8,8	2,5	3,2	3,5	2,0
Exports	-8,3	-18,4	0,3	0,8	3,4	6,7
Imports	-4,8	-17,0	-0,1	0,3	3,3	5,2



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GDP forecast - EA

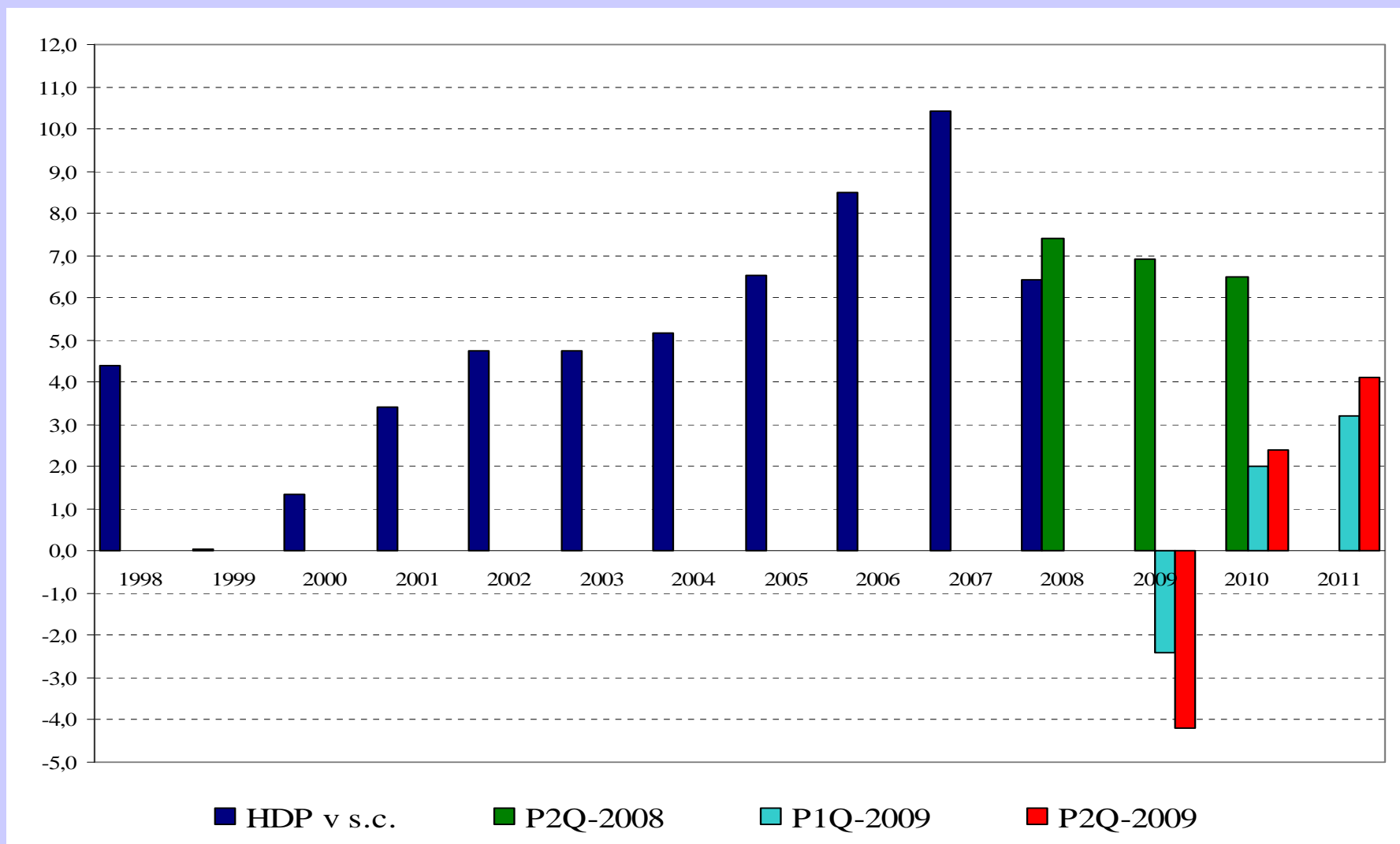


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GDP forecast - SR



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Euro is an instrument,

not a goal!



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Thank you for your attention



2€



1€



50, 20,
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5, 2,
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