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From Independent Slovakian Central Bank Policy to the Monetary Policy of the Euro Area

SUMMARY: The study aims to uncover the factors promoting the introduction of the euro by presenting the unique features of independent Slovakian monetary policy and the Slovakian banking system. It examines Slovakian central bank policy in historical context, distinguishing between the period of independent monetary policy and the central bank policy period preceding the introduction of the euro. After outlining the successes and failures of Slovakian monetary policy, the study focuses on the impact of the European Central Bank's monetary policy on real economy processes in Slovakia. It concludes that due to the abundance of liquidity of Slovakian banks arising from high deposit volume (which was maintained even after the crisis), the quantitative easing programme of the European Central Bank can only have a moderate impact on the Slovakian economy. Using the Slovakian economy as an example, it proves that accession to the currency union has failed to change the relative positions of regions (previously held in the national economy).

KEYWORDS: monetary policy, financial crisis, euro area, European Central Bank, National Bank of Slovakia

JEL CODES: E52, E58, F36, G21

To this day, European real economies are still suffering the ugly aftermath of the economic shock from the financial crisis of eight years ago, getting by with difficulty, hope and amidst doubt. At the end of the first decade of the millennium, we were forced to face a new type of crisis, one which came to be as a result of artificially weakened state apparatus¹ built on a neo-liberal economic philosophy and an unbelievable rate of indebtedness. It was proven that the economic policy consensus applied before the economic shock – policy that was based on neo-liberal principles – failed in developed and emerging economies alike. The shock processes induced by the onset of the financial crisis justified the need for a paradigm shift in economic policy.

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Cohesion Member States of the European Union were harder hit by the global economic crisis, as the growth of the region was built on the involvement of foreign capital to a much greater extent than other emerging regions, which naturally became vulnerable at the time of recession (Farkas, 2012). The rate of decline depended on economic disequilibrium – accumulated prior to the shock – which is why in the region, the economic outlook of Slovakia and the Czech Republic deteriorated the least. Even though the Slovakian economy showed commendable resistance, the countries' developmental and heterogeneity problems (the latter partly attributable to historical reasons) continued to increase even after the introduction of the euro. *Kertész* (2014) argues that the euro area is unable to adapt to the asymmetric economic shock swiftly and

flexibly. *Gál* (2015) also pointed out that in the case of the euro area, it would not be appropriate to speak of an optimal currency area as it is unable to resolve the monetary union's developmental heterogeneity problems which have continued to grow as a result of the economic downturn. From the perspective of the Slovakian economy, the conclusion of *Ramos, Ollero and Suriñach* (2001) still stands, namely that accession to the currency union fails to change the relative positions of regions (previously held in the national economy).² The seven years of euro area membership have proven that at the community level, it is impossible to flexibly manage national and regional level differences in exposure, as monetary policy (given its powers) cannot differentiate on a territorial basis. Due to the shocks caused by crisis, monetary policy at this time must focus on managing the cyclical processes of economic fluctuations.

This study wishes to analyse the impact mechanism of the periods of independent Slovakian and euro area monetary policy. Our goal is to examine two periods that are different in nature yet still highly interdependent. In order to assess the change in the role of the European Central Bank after the onset of the crisis (to assess its impact on real economy processes in Slovakia), it is essential that we outline some of the turnarounds, successes and failures of national central bank policy prior to monetary integration.

THE UNIQUE FEATURES OF THE SLOVAKIAN BANKING SYSTEM IN HISTORICAL CONTEXT

Starting from the beginning of the 1990s, the former federal republic was forced to adapt to a transformed international financial and economic environment, which led to a gradual relaxation of the rigidity of the financial system.

Already in the 1980s, actual steps were taken in Hungary to develop market conditions, and in fact the separation of central bank and commercial bank functions was realised in 1987 (Bozó and Szabó, 2000). These processes only started in the former Czechoslovakia with a few years' delay. The two-tier banking system was set up by legal regulations that entered into force in 1990. The direct instruments of the monetary policy of the State Bank of Czechoslovakia were rather swiftly replaced by indirect instruments, embodied by foreign currency market interventions, open-market operations and the base rate. Following the discontinuation of the gold coverage of the Czechoslovak koruna in 1990³, the federal central bank opted for a nominal anchor of a basket of five world currencies.

The privatisation of commercial banks was implemented in the first wave of voucher privatisation, where a significant portion of securities embodying banks' property rights was passed on to citizens free of charge. However, the conversion of the vouchers into shares required intermediation by investment funds, which concentrated the assets that were initially planned to be dispersed. Voucher privatisation did not represent public finance revenues and capital transfers for financial institutions. Also, it failed to bring about changes in ownership structure that would have established strong owners' interests (Réti, 1998). This privatisation strategy led to delayed banking-related and corporate restructuring, high unemployment and a balance of trade deficit.

At the beginning, the two-tier banking system in Slovakia struggled with severe problems. The acute capital shortage, the uncertainty following the collapse of the socialist economic order, the human resource pool that at times lacked even the most basic market economy know-how, along with rudimentary banking information systems, only served to fuel hopelessness. Until the restructuring

processes at the end of the last decade of the last century, no credit institution was able to fulfil the eight-per-cent capital adequacy ratio set out in the Basel Capital Accord of 1988. The already struggling Slovakian banking system was hit even harder by the dangerously high ratio of so-called bad loans and the never-ending line of defaulting debtors of the real economy. Due to the imbalance between mostly short-term deposits and a growing volume of long-term loans, financial institutions were facing liquidity problems. Despite the disruptions, the lending policy of banks in the 1990s was characterised by a certain degree of carelessness. Banks were rather frivolous in lending to companies of the real economy that needed funds for development and restructuring purposes. At the same time, the non-performing loan portfolio kept growing.⁴ By the turn of the millennium, credit institutions were drowning in sizeable capital shortage, which was subsequently resolved by the central bank, in collaboration with the government, by gradually involving foreign capital. The restructuring of the banking sector that preceded privatisation commenced in the final years of the last century. Firstly, it was necessary to provide the conditions for the achievement of the capital adequacy ratio set out in the Basel Capital Accord; secondly, high-risk loans had to be reallocated to the state financial institution set up for this specific purpose; and thirdly, the Slovakian state injected capital into commercial banks awaiting strategic investors. The banking sector (which became almost entirely foreign-controlled as a result of privatisation processes that took place in the first few years of the new millennium) slowly acquired the unique traits that it continued to hold on to even after the global economic crisis. These traits were expressed as low and stable interbank and loan interests, increasing profitability and typically high liquidity (Nagy, 2015a).⁵

THE MONETARY POLICY OF THE SLOVAKIAN CENTRAL BANK

Analysing Slovakian central bank policy in a historical context, we can distinguish two periods. The first period covers the practice of independent monetary policy between 1993 and 1999. The second period, between 2000 and 2008, focuses on the harmonisation of the instruments of the monetary policies of the National Bank of Slovakia and the European Central Bank.

The first seven years of central bank policy in Slovakia

Before presenting the monetary policy milestones of the first phase, we would like to address separately the real sector refinancing instruments of the Slovakian central bank. In contrast with Hungarian central bank practice,⁶ the Czechoslovak central bank abandoned its role in refinancing real economy the very first year (1990) after the Velvet Revolution, and also broke with the direct refinancing of the budget, however, the National Bank of Slovakia carried on the refinancing operations of the federal central bank that were now only limited to developing the SME sector.

The agreement concluded with the European Investment Bank between 1993–1997 consisted of the disbursement of the Apex Global Loan foreign currency loan package. Small and medium-sized enterprises struggling with capital shortage gained access to foreign currency based development loans disbursed in SKK by way of commercial banks participating in the programme. The exchange risk arising during the term of these loans was assumed by the Slovakian central bank. Interests for these loans were amended depending on either the base rate of the National Bank of Slovakia or the Slovakian interbank koruna

interest rate (formerly BRIBOR). The Slovakian central bank had also concluded similar framework agreements, promoting SME refinancing, with other international financial institutions. One of the most significant among these was the agreement concluded with the Japan Bank for International Cooperation (JBIC) in 1997. The loan package valued at twenty billion JPY⁷ was available exclusively to develop Slovakian small and medium-sized enterprises. The JBIC loans that appeared on the liability side of the central bank balance sheet and then, as a result of refinancing, also on the asset side, were brought to the Slovakian SME sector through the intermediation of commercial banks. The variable interest rate JBIC loans, with interest rates tied to the central bank base rate, were also disbursed in the national currency, and once again exchange risk was assumed by the central bank.

By the turn of the millennium, the Slovakian central bank abandoned its SME-refinancing role. In contrast with the new type of monetary policy of the National Bank of Hungary, which was in part embodied by supporting sustainable economic growth,⁸ the Slovakian central bank was completely forced out of the practice of real sector refinancing. The Slovak Business Agency⁹ (established in 1993 by the Ministry of Economy), its network, the Slovak Guarantee and Development Bank¹⁰ (founded in 1991 by the Ministry of Finance), various ministries and other non-profit organisations supporting the SME sector are responsible for the financing and development of Slovakian small and medium-sized enterprises. The European Investment Bank disburses its loan packages supporting SME financing without any central bank involvement, with intermediation from six Slovakian credit institutions (SBA, 2015).

Pursuant to Act 566 of 1992 on the National Bank of Slovakia, the primary objective of monetary policy was the stability of the

national currency. According to the well-substantiated criticism by *Iša* (2004), the objectives set out in the Act simultaneously included two currency stability elements, namely price level stability and SKK rate stability which, on account of ambiguous wording and definition, led to content-related contradictions in the practices of monetary policy four-five years later.

The National Bank of Slovakia, which enjoyed an independent status in the years following the establishment of the Slovakian state, strived to maintain the price level and the stability of the national currency. Keeping the central bank's main objective in mind, the National Bank did indeed pursue a successful noninflationary monetary policy as in the period between 1993 and 1998, of the economies based on former socialist planned economy principles, the lowest level inflation was indeed observed in the two successor states of the former Czechoslovakia. The National Bank of Slovakia passed on the federal central bank's target zone exchange rate system, and the maintenance of exchange rate stability against the basket (selected as nominal anchor) containing the US dollar and the Deutsche Mark proved to be successful (despite dramatically low foreign currency reserves).¹¹

On the one hand, Slovakian central bank policy adopted the position of the school of monetarism, according to which "*the task of monetary policy cannot be anything else but to shape money supply in a predictable and adaptive manner in line with the needs of the real economy*" (Tatay and Kotosz, 2013, p. 447) and on the other, attempted to meet the requirement of price stability which "*in view of the detrimental effects of inflation (...) was in line with the requirements of the European Union*" (Novák, 2014, p. 923).

The expansive fiscal policy of the 1990s promoting economic growth, and the overly restrictive monetary policy focusing on SKK

rate stability were derailed due to conflicts of interest and contradicting objectives. In 1996, the central bank responded to growing public deficit with austerity measures. It raised minimum reserves and the Lombard rate¹², and turned to the sterilisation instruments of open-market operations with increasing frequency.¹³ Monetary austerity resulted in a substantial rise in interests, the interests of SKK-denominated loans increased sharply and the strictness of underwriting made the access of the real sector to bank funds very difficult. The final years of the 20th century were characterised by lending market recession. Solvent companies that were able to meet the loan disbursement criteria of financial institutions opted to apply for foreign currency loans that promised interest considerably lower than SKK-denominated loans.

The Slovakian central bank's secondary objective concerning money supply did not seem appropriate, which is why by 1997/1998 the exchange rate channel started to dominate the monetary transmission mechanism. From this period onwards, the central bank paid increased attention to exchange rate stability. The target zone exchange rate system became unsustainable on account of the deficits of public finances and the balance of payments. Inflation increased and foreign currency market speculations exerted such pressure on the central bank's foreign currency reserves that in October 1998, it was forced to transition to a more flexible exchange rate system.¹⁴ The central bank opted for the managed floating system, which facilitated the application of inflation targeting monetary policy. A credible inflation targeting regime must be accompanied by a floating exchange rate system, otherwise the inflation target cannot be a primary objective of monetary policy (Matolcsy, 2015).

By the end of the last century, similarly to Czech monetary policy practice, repo tenders became the key instrument of Slovakian mon-

etary policy. Repo tenders are used exclusively for monetary policy purposes, to absorb surplus liquidity or to raise bank liquidity. The Slovakian central bank had two methods at its disposal to rank the bids of financial institutions. According to the most frequently applied American auction method, commercial banks submitting bids with the lowest interest rate are satisfied as having priority. Bids made with higher interest rates were accepted by the central bank until the total expected liquidity surplus was exhausted (Pulay et al., 2013). Bids received above the highest rate determined by the central bank were refused by the national bank. The difference of the Dutch method in Slovakian central bank practice was that the lowest offered interest rate applied to all banks participating in the repo tender.

Implicit inflation targeting

Under the European regulations adopted prior to the global economic crisis, the primary objective of monetary policy is to achieve and maintain price stability; therefore, over the past decade in Europe, monetary policy has been tied to changes in the consumer price index (Kolozi, 2013).

While in May 1997, the Czech central bank transitioned to explicit inflation targeting (along with its managed floating exchange rate policy) without any waiting period,¹⁵ the National Bank of Slovakia applied a rather mixed monetary strategy in the two years following the exchange rate turnaround. It continued to give priority to exchange rate stability. It only transitioned to inflation targeting in 2000.

In the 1990s, the Czech Republic applied a net indicator to determine the inflation target, adjusted for the effects of official prices, indirect taxes, public grants and food prices. This indicator is called net inflation. In the first year after the turn of the millennium, it switched

to targets based on the consumer price index. In order to determine the inflation target, deviating from the practice of the Czech Republic, the Slovakian central bank applied the so-called core inflation, adjusted for official prices, indirect taxes and public grants, which is why Iša (2002) also argues that the monetary policy of the National Bank of Slovakia is closer to the system of implicit inflation targeting. The basic elements of inflation targeting are: the announcement of numerical inflation targets, commitment by the central bank to the inflation target, a monetary strategy based on a broad information base, the transparency of monetary policy, and the accountability of the central bank for attaining its inflation target (Mishkin, 2006).

Inflation targeting was also integrated into the Central Bank Act amended in 2001, which indicated price stability as the primary objective of Slovakian monetary policy. The central bank broke with the outdated indirect instruments of monetary policy, such as the Lombard rate or bill transactions, and it reduced minimum reserves by 1 percentage point year after year.¹⁶ Interest policy is the only efficient instrument to accomplish the inflation target, which is why, true to European monetary policy practice, interest rates became the primary instrument of Slovakian central bank policy. The central bank used two policy interest rates, namely the two-week standard repo tender rate and the overnight sterilisation rate of open-market operations. Repo tenders guaranteed unlimited access for commercial banks to refinancing funds as well as ensuring the placement of the liquidity surplus in the central bank, which ultimately led to money market stabilisation and the reduction of interest rate volatility. Repo tenders, which ensured the accomplishment of the long-term goals of monetary policy, became a strategic indirect instrument of the Slovakian central bank. The National Bank of Slovakia combined the interest rates of overnight steri-

lisation and refinancing operations as stabilisation elements and longer term repo operations with central bank discount bills as instruments serving to accomplish strategic inflation targets (Iša, 2004). This was a significant step forward towards the monetary policy of the European Central Bank.

Through the restructuring and privatisation processes launched at the dawn of the new millennium, the banking sector was stabilised and as such, even before accession to the EU, the abundance of liquidity of banks and loan interest rates dropping year after year became key characteristics. In order to absorb the liquidity surplus arising from privatisation, the central bank responded with sterilisation repo operations¹⁷, later introducing easing measures on account of the 2003 repayment of public debt.

According to *Jusko* (2003), the transition to the managed floating exchange rate system was one of the fundamental conditions of Slovakia's macro-economic stability. The exchange rates of the Slovak koruna and the euro remained relatively stable between 1999 and 2004, as shown in *Figure 1*. The excessive strengthening of the national currency rate only required a foreign currency market intervention by the central bank in 2002.

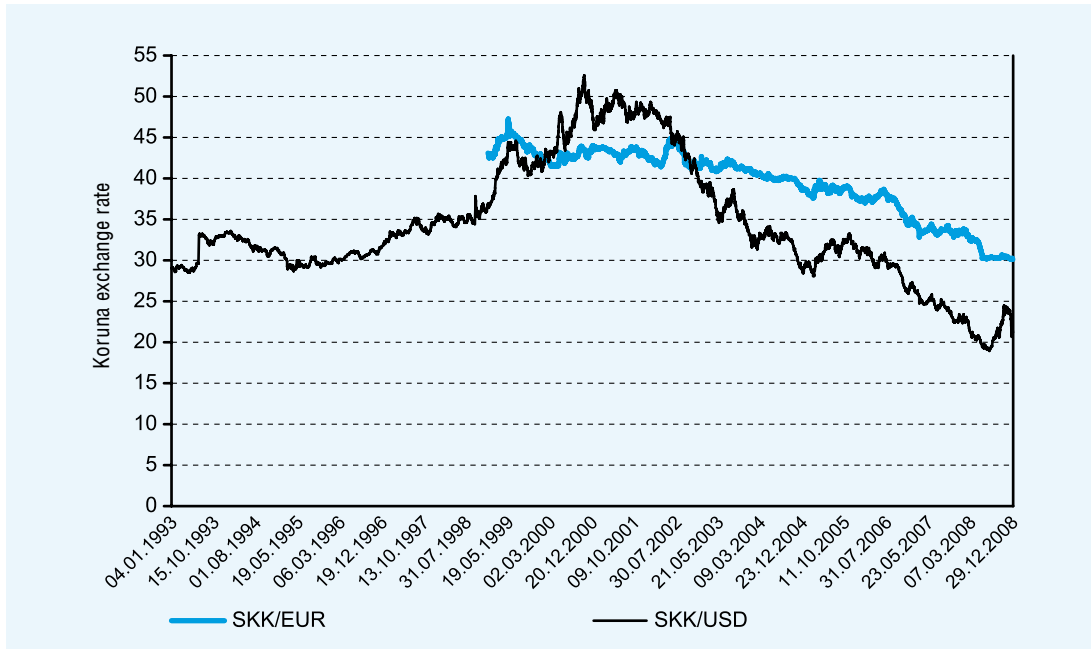
The government discussed its strategy related to the introduction of the euro in 2003, and approved a joint statement with the central bank. Based on the contents of the statement, the government defined its economic policy objectives in a manner that they best serve the country's preparation for euro area membership.

Inflation targeting under ERM II

Following the radical restructuring of the banking sector, the Slovakian government and central bank set the fulfilment of the Maas-

Figure 1

THE EVOLUTION OF THE DAILY EXCHANGE RATES OF THE SLOVAK KORUNA AND THE EURO BETWEEN 1999–2008, AND THE SLOVAK KORUNA AND THE US DOLLAR BETWEEN 1993–2008 (4 JANUARY 1993 – 31 DECEMBER 2008)



Source: own editing, based on the data published on the website of the National Bank of Slovakia

tricht convergence criteria as their objective. The joint statement by the central bank and the government initially planned the accession to the euro area between 2008–2009, then in 2004 clarified the euro introduction strategy and indicated the date of 1 January 2009. As the National Bank of Slovakia was responsible for meeting the exchange rate and inflation criteria of the Maastricht Treaty, in its monetary programme until 2008, the central bank announced the medium-term explicit inflation target under the ERM II. In the inflation targeting system, the central bank indicated interim inflation¹⁸ which was based on the harmonised consumer price index (Šikulová, 2014). The central bank's indirect instruments continued to comprise minimum reserves and interest rates. The primary instruments were the two policy interest rates.

On 28 November 2005, Slovakia joined the European Exchange Rate Mechanism (ERM II), and the Slovak koruna floated in the narrow ± 15 per cent range around the central rate of 38.455 SKK/EUR determined at entry. Starting from this period, the Slovak koruna gradually continued to strengthen (Figure 1), thus the central exchange rate had to be adjusted on two other occasions after joining the ERM II. The first adjustment was carried out in March 2007, and the last in May 2008. It was at the central exchange rate of 30.1260 SKK/EUR determined at the latter time that the official currency of the European Union was introduced on 1 January 2009. The National Bank of Slovakia became a member of the central bank system of the euro area, thus losing its independent monetary policy.

THE IMPACT OF THE MONETARY POLICY OF THE EUROPEAN CENTRAL BANK ON THE SLOVAKIAN ECONOMY

Even though the seven years following accession to the European currency union are insufficient yet to provide a comprehensive assessment, we will still attempt to outline the benefits and disadvantages of euro area membership from Slovakia's perspective. With regard to the great openness of the Slovakian economy, among the greatest benefits we must point out the drop in transaction costs and the elimination of exchange risk¹⁹. However, the Slovakian economy – due to the hopelessness arising from the financial crisis that rocked European economies – has to this day been unable to forge any other advantages. Based on earlier calculations by Šuster (2006), with the introduction of the euro, a 60 per cent increase in Slovakian foreign trade and an economic upturn in excess of 7% seemed relevant. These projections were overwritten by the financial crisis and are today nothing but false hope. In the ten years that have passed since the study published by Šuster, none of the Visegrád countries – which are Slovakia's main trade partners – have introduced the EU's official currency and are not expected to do so in the near future. The economic shock that impacted the countries of the euro area suppressed foreign demand for Slovakian products. The slightly below 4 per cent ratio of net exports to gross domestic product between 2012–2014 is still very low compared to earlier expectations.²⁰ Šuster (2006) also assumed that the general benefits accompanying membership will lead to an increase in the inflow of foreign direct investment but this has not happened yet either, and central bank statistics seem to actually reveal the exact opposite. Morvay (2014), on the other hand, does not dismiss the assumption that without the introduction of the euro, foreign investments would have reached an even lower level.

The greatest disadvantage arising from euro area membership is obviously the loss of independent monetary policy and the monetary policy instruments regulating the development of the domestic economy. Since the European Central Bank did not apply any quantitative easing instruments that can be likened to those used by the US or British central banks until 2015, Šikulová (2015) argues that the disadvantages of membership will grow even stronger in the coming years. The euro area was less able to deal with the shock of the crisis and exhibited less resilience than the United States, which resulted in a prolonged crisis. The Fed managed the crisis not through restrictions, but rather by means of liquidity expansion through its quantitative easing policy (Lentner, 2015b), and signs of improvement were already showing by 2013. While public debt increased each year in the United States, the member states of the currency union implemented strict budgetary restrictions but, at the same time, the necessary monetary policy easing never materialised.

Starting from the onset of the financial crisis Slovakia, along with the majority of European economies, struggled with a substantial budgetary deficit.²¹ In December 2009, the European Council adopted a resolution which initiated the excessive deficit procedure against Slovakia. The budget deficit had to be reduced to 3 per cent by 2013, which was accomplished successfully through fiscal restrictions.²² The government increased the tax burdens on financial institutions, imposed special taxes on water, gas and electricity utility providers, introduced progressive taxation for natural persons and decreased state allowances. The fiscal austerity forced by the EU, however, overshadowed domestic demand weakening as a result of the crisis. Stronger domestic demand would place the Slovakian economy on more stable foundations and would even stimulate the declining labour

market, but this would require a paradigm shift in economic policy. Examining the development of the consumption expenditures of Slovakian households, we can observe a 2–3 per cent increase over the past 4 years, yet the ratio to gross domestic product still shows a slight drop since 2009.²³

The panic caused by the international credit crisis impacted Slovakian credit institutions only to a moderate extent. Even though the profits of the banking sector dropped dramatically in 2009, they were set on the growth path once again the very next year.²⁴ Slovakian banks more or less did well to recover from the shock caused by the financial crisis. This is well illustrated by the fact that they required no foreign bailout or state intervention, and their abundance of liquidity and profitability still exist today.

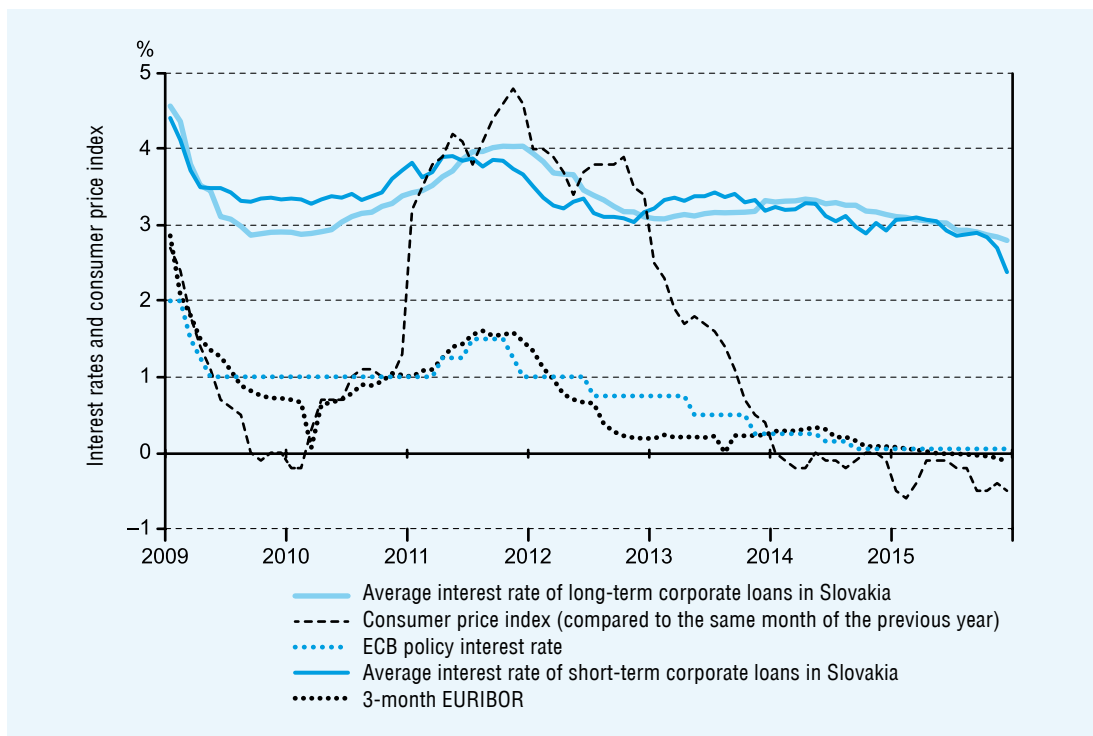
The European Central Bank's efforts preceding last year's quantitative easing to mitigate credit market tension was only a moderate success as loan interest rates within the euro area varied greatly. According to *Beka* (2014), the interest channel of the European Central Bank's monetary transmission mechanism has been impacting the Slovakian lending market favourably since the very first year of currency union membership. This statement is certainly well substantiated given the fact that the European Central Bank's base rate changes do actually spill over flexibly into commercial bank interest rates. This is well illustrated by *Figure 2*. The interest channel of the monetary transmission mechanism, however, has a second phase, where households and companies make their consumption and investment decisions under changing interest conditions. We will elaborate on the second phase later on. If we take an in-depth look at the results concerning the first phase of the interest channel, we do not actually observe any disruptions as the interest rate of loans disbursed by Slovakian banks faithfully follow the development of key reference rates.

The rather high liquidity of Slovakian credit institutions even after the economic shock can be explained by the stable 75–76 per cent loan-to-deposit ratio.²⁵ Given the abundance of liquidity in the banking sector, the quantitative easing programme of the European Central Bank promoting the start of economic upturn, through which it pumps funds into the currency area, can have only moderate success for the Slovakian economy. In contrast with the credit institutions of the euro area, Slovakian banks were not forced to restrain lending supply, as high deposit volume ensures the satisfaction of the borrowing needs of households and the real sector. A gap can also be observed in comparison with other euro area countries in respect of the quality of the loan portfolio. Based on data released by the European Central Bank, more than 16 per cent of Italian loans are non-performing, while this same ratio in Slovakia is at around 6–7 per cent.

Figure 3, presenting the change in the net loan-to-GDP ratio, well illustrates the drop in loan supply at the end of the last century, due to increasingly risky loan transactions and the liquidity shortage of banks. Special mention should be made of the fact that until the turn of the millennium, retail loans represented only approximately 10 per cent of the loan portfolio, which is undeniably due to the interest rate increase caused by the loan disbursement restrictions of the 1990s and the stricter underwriting conditions of banks for households.²⁶ The period, which includes the restructuring and privatisation processes of the banking sector, was characterised by lending market recession, and in this period the loan portfolio of banks hardly changed, while net loan-to-GDP ratio decidedly decreased. The lending market only recovered following involvement of foreign capital and the country's accession to ERM II. Loan interest rates also reacted fairly well to the lowering of cen-

Figure 2

THE FLEXIBILITY OF THE AVERAGE INTEREST RATES OF SLOVAKIAN CORPORATE LOANS TO THE CHANGES OF THE ECB POLICY INTEREST RATE AND THE EURO INTERBANK OFFERED RATE, SUPPLEMENTED BY THE SLOVAKIAN CONSUMER PRICE INDEX (JANUARY 2009 – DECEMBER 2015)



Source: own editing, based on the data published on the websites of the European Central Bank, the National Bank of Slovakia and Eurostat

tral bank policy interest rates. With the spectacularly swift-rate increase in the loan portfolio and loan disbursement, the significant increase in the number of mortgage-backed retail loans also became increasingly apparent.

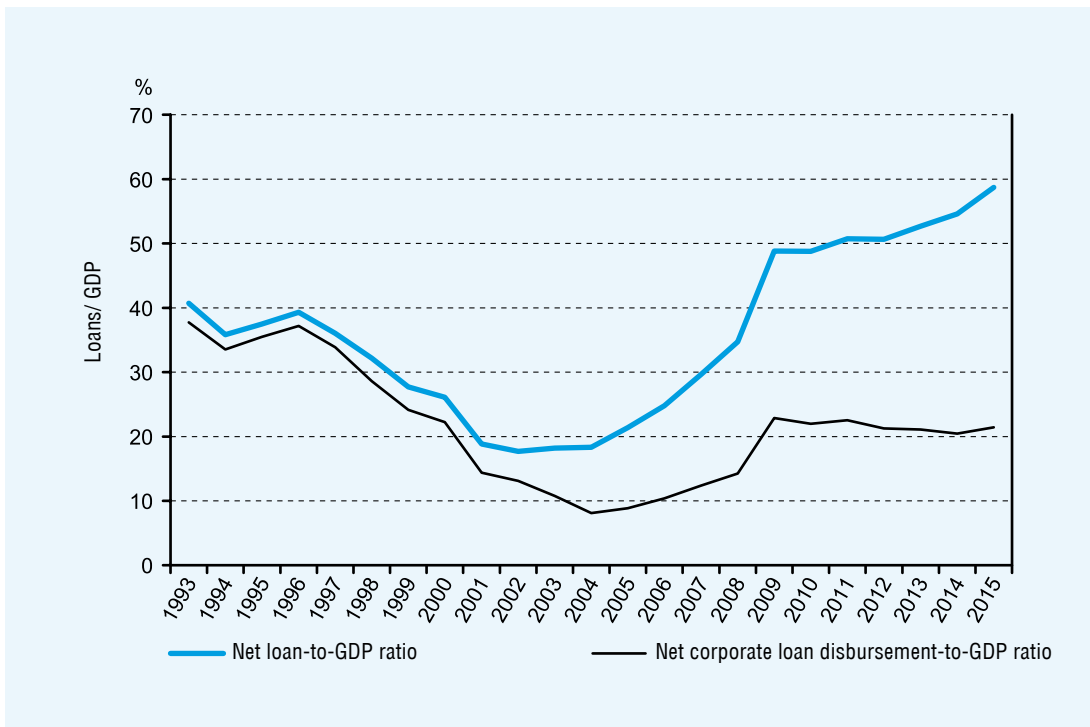
The increasing of the net loan-to-GDP ratio stopped after the crisis (Figure 3). Even though the disbursement of corporate loans increased from EUR 10 billion in 2008 to EUR 14 billion by 2009, only moderate growth can be observed in subsequent years.²⁷ The stagnation of the net corporate loan-to-GDP ratio is driven by the demand side and not the supply side. The lower loan demand of companies can without a doubt be attributed to the hopelessness, uncertainty brought

on by the crisis and diverging expectations. The internal anomalies of the currency union caused by the financial crisis and fear of a new, more significant wave of recession resulted in the real sector being more cautious, and these factors held back investment demand and impacted loan demand as well. As a result of the increasing demand of households for real estate-secured loans, the net loan-to-GDP ratio returned to the growth path in 2013, however, the past 5 years of corporate lending can be characterised with recession.

The second phase of the interest channel of the monetary transmission mechanism impacts the economic decisions of market players made under changing interest condi-

Figure 3

THE CHANGE OF THE NET LOAN-TO-GDP RATIO IN SLOVAKIA BETWEEN 1993–2015



Source: the author's calculations, based on the data published on the websites of the National Bank of Slovakia and the Statistical Office of the SR

tions. Some improvement may be observed in respect of consumer demand but this increase compared to the pre-crisis situation is slower and more sluggish. From 1997 up until 2008, consumption expenditures showed a trend-like increase of 10–12 per cent, which was hindered by the economic recession, and after the stagnation in 2009–2010, only a 2–3 per cent increase was observed in the past five years.

The 20 and 9 per cent increase of investment expenditures in 2010 and 2011 respectively was followed by a 14 per cent drop in 2012, but as of 2013, they are once again on the rise, albeit with a more modest, 2 per cent increase. The drop in 2012 was undoubtedly caused by the second wave of the crisis, something that the real sector reacted very sensitively to. According to the brief report of the

National Bank of Slovakia (2012), the decline in the willingness to invest was primarily apparent in the construction industry, which generated the 14 per cent drop.

SUMMARY

Not even the crisis was able to rock the characteristic features of Slovakian financial institutions, embodied by high liquidity and profitability, therefore the quantitative easing programme of the community-level monetary policy of the euro area, built on monetary dominance, can only have a moderate impact on the Slovakian lending market.

In the aftermath of the crisis, however, we were forced to face the fact that the regional differences in respect of employment and

growth cannot be solved by the monetary policy of the European Central Bank. Accession to the currency union has failed to change the relative positions of counties (previously held in the national economy). The disequilibrium between regions and the geographical anomalies of this disequilibrium increased even further with currency area membership. Industry, production, services and investments continue to focus on the capital and Western counties in its vicinity. Neither the EU, nor the euro area membership was able to bridge the economic gap between counties in Western and Central Slovakia and Eastern Slovakia. Special mention should be made of the lagging behind of Eastern counties and the high unemployment characteristic of the region,²⁸ where domestic and community level, stimulation-promoting economic policy measures have failed one after the other. Unemployment has always been the major social problem of Slovakia. Not only did the country's unemployment rate exceed the EU average, it also showed the highest values among the V4 countries. Based on the research by *Dinga and Ďurana* (2015), the crisis did not hit the Slovakian financial sector or the businesses in the western region of the country, but rather the labour market, or to be more accurate, the East and Central Slovakian segment of the labour market. Among

the causes of this unfavourable situation, in addition to high tax burdens, cultural factors also play a role, which factors cannot be remedied by means of community-level economic policy measures.

The decline of Slovakian real GDP growth was not overly striking even after the economic recession. Per capita GDP in 2009 dropped only by USD 598, in 2011, however, it reached 103 per cent of the 2008 value in 2011 and has been increasing gradually since (Nagy, 2015b). However, the country's steady economic growth was accompanied by a rather contradictory employment rate. In 2009, the unemployment rate increased from 8 per cent in the previous year to 12 per cent, then in 2012 went on to exceed 14 percentage points. Although this was the year when the highest value was recorded since the introduction of the euro, no substantial improvement was observed in subsequent years. Arguably, a substantial decline can be observed in the Slovakian labour market ever since the onset of the crisis. According to Morvay (2014), this phenomenon is due to the slower rate of economic growth in comparison with the pre-crisis period, as well as the related unchanged labour supply elasticity. Effectiveness would require a paradigm shift in economic policy at the national level.

NOTES

¹ The economic policy approach (based on neo-liberal principles) formulated within the framework of the Washington Consensus also appeared within the conditions of loans disbursed by the International Monetary Fund and the World Bank as required content to be featured in national economic policy as well (Lentner, 2010, 2015a). According to Stiglitz (2013), the stabilisation programme created in the spirit of the consensus should not be applied to equal extent in the various economies, given that

there is no standard 'recipe' for crisis management in practice either. The transformation crisis of Central-Eastern European countries bears no resemblance to the Latin American crises of the eighties and neither does the recession of South-East Asian countries at the twilight of the 20th century.

² It is sufficient to support this statement with just a few items of data. While in 1995 the per capita gross domestic product in Prešov County in North-

Eastern Slovakia was only 29.86 per cent of the per capita gross domestic product of Bratislava County, by 2013 this ratio had shrunk to 24.35 per cent (Statistical Office of the SR).

³ The gold coverage of the Hungarian forint had been discontinued eight years before.

⁴ In 1996–1997, non-performing loans made up nearly 16.3 per cent of the loan portfolio (National Bank of Slovakia).

⁵ After the turn of the millennium, deposits amounted to double the value of the loan portfolio (National Bank of Slovakia).

⁶ The National Bank of Hungary cut back its real sector refinancing instruments by 1995, followed by its budget refinancing operations by the turn of the millennium (Kolozsi and Lentner, 2006).

⁷ This was equivalent to nearly USD 154.5 million at the time.

⁸ “The monetary policy turnaround of the Hungarian central bank set the basic goals of government economic policy as objectives: the expansion of employment and long-term economic growth. (...) This enabled the launch of the Funding for Growth Scheme, which stimulates the economy with funds of nearly HUF 3,000 billion” (Matolcsy, 2015, pp. 445–446).

⁹ The SBA manages the Microcredit Programme since the year of its foundation. The programme currently offers Slovakian small and medium-sized enterprises a 4–5 per cent interest loan, with a maximum term of 4 years (SBA, 2015).

¹⁰ Today, it disburses five different state-subsidised, low-interest and long-term loans for the development of small and medium-sized enterprises.

¹¹ THE central bank narrowed down the basket serv-

ing as nominal anchor, which initially contained five world currencies, in July 1994.

¹² The Lombard rate was phased out of the Slovakian monetary policy instruments by 2002.

¹³ This was the first year that the National Bank of Slovakia issued discount bills (Harumová, 2005).

¹⁴ Marcinčin and Beblavý (2002) argue that the Slovakian central bank should have followed the example of the Czech Republic, i.e. it should have abandoned the fixed exchange rate system much sooner.

¹⁵ Of emerging countries and the V4, the Czech Republic was the first to introduce the system of explicit inflation targeting. The monetary policy of the Hungarian central bank switched to inflation targeting in 2001.

¹⁶ In the year of accession to the European Union, the minimum reserve rate shrunk from 5 per cent in 2001 to 2 per cent (National Bank of Slovakia).

¹⁷ As a result of the sterilisation in 2002, the central bank withdrew SKK 85.8 billion from the banking sector (National Bank of Slovakia).

¹⁸ Monthly and/or quarterly inflation.

¹⁹ With the introduction of the euro, foreign currency loans dominating the corporate sector were completely forced out of the Slovakian lending market. By the end of 2011, the ratio of foreign currency debt to total loan volume was under 1 per cent, which is most likely due to the fact that only EUR-denominated loans gained ground in Slovakia from the turn of the millennium onwards. As a member of the ERM II, the slight difference in interest rates between SKK and foreign currency-denominated loans was already perceivable in December 2005 (Nagy, 2015a).

²⁰ Net export had a negative impact on growth up until 2011. The favourable turnaround was due to car production which boosted Slovakian exports.

- ²¹ Based on Eurostat data, -7.9 per cent of gross domestic product in 2009.
- ²² Budget deficit was pushed down to 2.6 per cent of gross domestic product (Eurostat).
- ²³ Based on the author's calculations, the ratio of consumption expenditures to gross domestic product in 2010 shrunk by 4 per cent, but only by 0.12 per cent in 2014, which undoubtedly reveals a favourable outlook.
- ²⁴ According to data by the National Bank of Slovakia, the EUR 15.3 billion profit of the banking sector in 2008 plummeted to EUR 250 million by 2009. In spite of this, the banking sector doubled the previous year's profit already in 2010 and has been gradually growing at a slower rate since then. In 2015, the net profit of the banking sector exceeded EUR 626 million.
- ²⁵ According to the author's calculations, between 2009–2011 the value of bank deposits were 1.5 times that of corporate and retail loans; and as of 2012, with the more dynamic growth of loans, especially retail loans (*Figure 3*), deposit volume amounted to 1.3 times the size of the loan portfolio.
- ²⁶ In Slovakia, underwriting for retail loans was always more prudent and cautious, which means that the reckless lending policy of banks so characteristic of the first half of the 1990s was only characteristic of corporate underwriting.
- ²⁷ According to data by the National Bank of Slovakia, corporate loan disbursement between 2010 and 2015 moved between EUR 14.8–16.3 billion.
- ²⁸ It is true that examining the changes of the regional unemployment rate and the per capita gross domestic product, the differences between Western and Eastern counties of Slovakia are indeed disheartening. While the unemployment rate of Bratislava County in 2014 was 6.13 per cent, those of Prešov County in Eastern Slovakia, Košice County and Banská Bystrica County in Central Slovakia were 17.45, 15.92 and 17.22 per cent respectively.

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