INTRODUCTION

The basic tendencies in macroeconomic development recorded in Slovakia in 2002 were in line with the assumptions set out in the 2002 Monetary Program and its update. As the year passed, economic activity and foreign trade picked up. Consumer price growth slowed down due to relatively limited administrative interventions in price level developments. Lower inflation level than projected was largely influenced by inhibiting effect of other cost factors, in particular food prices, coupled with price developments in energy commodities and by U.S. dollar losing ground against the euro. Both in the 2002 Monetary Program and in its update, possible deviations from original assumptions were defined as a possible prediction risk, as monetary policy has no control over the impact or behaviour of these factors. As far as demand factors are concerned, there was no inflationary pressure in 2002.

Real gross domestic product outstripped the NBS estimate[1] as foreign demand and gross investments in particular made a larger contribution to economic growth. In case of gross investments, growth was concentrated in inventories, i.e. an item which is fairly hard to interpret economically and predict because of the quality of available time series.

Economic data on the Slovak economy's development in 2002 draw a different baseline in some aspects when compared to monetary program assumptions. Likewise, developments in selected economic variables in the early months of 2003, along with some latest information (tax reform intentions, more precise privatisation income figures, partial foreign debt rollover) also call for an update in the short-term predictions featured in the NBS Monetary Program for 2003 and its medium-term outlook.

Overall, we can say that virtually all monetary program values had to be revised to reflect the latest macroeconomic development on a national and global scale, as well as the government's tax reform plans.

Based on the development to date, it is obvious that many of the risks identified in the monetary program have already materialised or still persist. This applies primarily to developments in the exchange rate and food prices, affecting inflation in particular (both CPI and PPI), as well as the balance of trade. Meanwhile, the extent of changes in indirect taxes is likely to be revised in July, a move that also figured as a prediction risk in the monetary program. To account for the impact this administrative action is bound to have on consumer prices, the NBS scaled up its inflation estimate in the 2003 Updated Monetary Program.

A lower SKK equivalent of raw material imports in particular, combined with a rebound in iron, steel, car and car body exports, are likely to help the balance of trade do even better than expected in the monetary program. Compared with the 2003 MP assumptions, foreign trade should outperform, leading to a lower current account deficit in the balance of payments. This development is foreshadowed by Slovakia's robust export growth so far, with exports extending their lead over imports in growth terms. For that reason, the NBS expects the ratio of the trade balance deficit to GDP to drop from the originally estimated 7.3% to 5.5%, and the current account deficit from 6.2% to 4.5%.

A more favourable development in foreign trade should also be reflected in a higher contribution of net exports to economic growth, with its mid-range estimate likely to inch up 0.2 percentage points from the monetary program prediction to 4.1%. This coincides with a slightly flagging influence of domestic demand, which should be characterised by a lower gross capital formation compared to the monetary program.

The UMP takes no account of impacts of the fulfilment of the Maastricht criteria, pending approval of an official accession strategy, which may affect the values of macroeconomic indicators, as well as the overall optics of the medium-term outlook.

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[1] Due to methodological changes made in the calculation of gross domestic product in 2002, GDP predictions published in the 2002 MP and UMP cannot be compared to actual performance. That is why actual development is confronted to the estimate stated in the 2003 Monetary Program.

1. World economy development in 2002 and outlook till 2004

Predictions concerning the external economic environment are based primarily on the OECD Outlook published in April 2003.

Compared to the autumn forecast, the current economic growth predictions for selected OECD countries confirm that the recovery awaited in 2003 and 2004 will be slower in coming and less obvious. Based on the data, worse recovery prospects affect euro area countries in particular (especially Germany).

Comparison of autumn and spring GDP growth forecasts for selected countries (OECD) (%)

	2003 forecast			2004 forecast		
	Autumn 2002	Spring 2003	Difference[1]	Autumn 2002	Spring 2003	Difference[1]
USA	2.6	2.5	-0.1	3.6	4.0	0.4
Japan	0.8	1.0	0.2	0.9	1.1	0.2
EU	1.9	1.2	-0.7	2.7	2.4	-0.3
EMU	1.8	1.0	-0.8	2.7	2.4	-0.3
Germany	1.5	0.3	-1.2	2.5	1.7	-0.8
France	1.9	1.2	-0.7	2.9	2.6	-0.3
Italy	1.5	1.0	-0.5	2.5	2.4	-0.1
Czech Republic	3.3	3.0	-0.3	3.6	3.5	-0.1
Hungary	4.1	3.1	-1.0	4.0	3.7	-0.3
Poland	2.5	2.3	-0.2	2.9	3.5	0.6

[1] difference between the autumn and spring forecast

The current OECD forecast for 2003 and 2004 expects just a sluggish return to global economic growth with a largely inconsistent regional pattern. Compared to the November 2002 forecast, economic growth outlooks were scaled down for euro area countries in particular. Economic indicators suggest that economic growth will not really pick up before the second half of 2003. To some extent, this development will be affected by the war in Iraq.

Economic recovery is expected to set in first in the U.S. (driven primarily by fixed corporate investments). In the euro area, recovery is supposed to come later (during 2004) and at a slower pace.

Consumer prices in OECD countries in general show just a moderate growth. Impacts of higher energy price growth on the rate of inflation can be expected in the U.S., in the euro area the effect will be offset by an appreciation of the euro against the U.S. dollar.

Amid a downturn in global economic activity and weaker world markets in information and telecommunication technologies, growth in world trade lost a little speed in late 2002. World trade is expected to pick up from mid-2003 in the wake of a gradual economic rebound in OECD countries.

Macroeconomic indicator forecasts for selected countries (OECD) – April 2003 (%)

	GDP				Inflation[1]				Current account/GDP			
	2001	2002	2003	2004	2001	2002	2003	2004	2001	2002	2003	2004
OECD	0.8	1.8	1.9	3.0	2.8[2]	2.0[2]	2.0[2]	1.3[2]	-1.0	-1.1	-1.2	-1.2
USA	0.3	2.4	2.5	4.0	2.8	1.6	2.4	1.7	-3.9	-4.8	-5.4	-5.5
Japan	0.4	0.3	1.0	1.1	-0.7	-0.9	-0.9	-1.0	2.1	2.8	3.1	3.9
EU	1.6	1.0	1.2	2.4	2.4[2]	2.2[2]	1.7[2]	1.4[2]	0.2	1.1	1.4	1.4
EMU	1.5	0.9	1.0	2.4	2.5	2.4	2.0	1.6	0.1	0.9	1.0	1.0
Germany	0.6	0.2	0.3	1.7	2.1	1.3	0.8	0.4	0.2	2.5	2.9	3.2
France	1.8	1.2	1.2	2.6	1.8	1.9	1.6	1.4	1.6	2.1	2.4	2.2
Italy	1.8	0.4	1.0	2.4	2.3	2.6	2.3	1.9	0.0	-0.5	-0.1	0.0
Czech Republic	3.1	2.0	3.0	3.5	4.8	1.8	2.0	3.1	-5.7	-5.3	-5.3	-5.1
Hungary	3.8	3.3	3.1	3.7	9.2	5.3	5.2	4.6	-3.4	-4.0	-4.5	-3.8
Poland	1.0	1.3	2.3	3.5	5.5	1.9	1.4	2.3	-2.9	-3.5	-4.5	-4.5

[1] measured as consumer price index
[2] measured as private consumption deflator

The **euro area** should see only a slight acceleration of economic growth in 2003 and 2004 (1.2% and 2.4%, respectively), with regional gaps expected to widen. Low household spending is predicted as the main reason for a relatively slim share added by private consumption to GDP growth. That, coupled with an unimpressive export rebound (held back by a strong euro), is likely to curb growth in investment demand. As a result, unemployment is expected to rise up to 8.8% in 2003. In the euro area en bloc, the fiscal position is expected to deteriorate. While Germany and Portugal are supposed to tighten their fiscal policies significantly, other countries, such as Austria, Finland or Italy, are expected to carry on their strongly expansive fiscal policies in 2003 and 2004.

The **German** economy (Slovakia's largest trade partner) was virtually flat in 2002 (0.2% GDP growth), largely due to thin domestic demand. A setback in fixed investments and sluggish growth in private consumption were partly offset by a moderate rise in exports. Economic activity is bound to stay weak in 2003, with exports remaining the main pro-growth factor. In 2004, economic growth should be helped by a gradual rebound in domestic consumption. In the 2003-2004 period, inflation should fall all the way down to 0.4% in 2004 (measured as consumer price index), despite faster wage growth. Due to ongoing inflexibility of the labour market, and despite government efforts to implement stimulating measures, unemployment is set to rise again (to 8.3% in 2003) and employment to decrease. One of the greatest threats looming over the German economy is its downhill fiscal performance. It will take an extensive package of consolidation measures to cut the fiscal deficit below the 3% level.

In the **Czech Republic**, economic growth should pick up (from 2.0% in 2002 to 3.5% in 2004), with consumption and exports (especially by firms part-held by foreigners) likely to stay on as the most important growth stimulants. A major appreciation of the Czech koruna in 2002 sparked a drop in inflation through prices of tradable goods and cheaper energy commodities. Consumer prices were also dampened by lower growth in regulated prices. In the years ahead, a limited growth in the price level should continue. The greatest risk to a balanced mix of macroeconomic policies is currently presented by an expansive fiscal policy, and the OECD forecast does not expect the situation to get much better before 2005.

In spite of a world-wide slump, **Hungary's** economic growth managed to stay relatively strong in 2002 (3.3% of GDP), fuelled by a stimulating fiscal policy. By raising the minimum wage and public sector salaries in 2002, the fiscal policy boosted private and government consumption and, consequently, domestic demand jumped over 7% despite falling private investments. In 2003, GDP is expected to reach the previous year's level and to pick up in 2004 on the back of an economic revival abroad. The current account deficit in the balance of payments expanded, despite slower import growth, and the OECD forecasts the trend to last in 2003. The fiscal deficit, estimated at 8.4% of GDP in 2002, coupled with the effects of wage growth, a policy decision to keep up the level of social transfers, and overly optimistic growth predictions released by domestic institutions for 2003, may cause some serious trouble to meeting Hungary's domestic and foreign economic policy targets (in particular compliance with the Maastricht criteria for admission to the euro area). Likewise, in 2003 there will be an increasing risk of a conflict between the defined inflation goals and a possible decline in key interest rates due to currency appreciation.

GDP growth in **Poland** averaged 1% over the last two years, while unemployment closed in on the 20% mark. Robust export competitiveness, combined with mounting corporate profits during the current period and rising confidence on the eve of Poland's EU entry, are likely to turn up economic growth to the point of 3.5% in 2004. These factors are expected to revive investment demand which, along with a sizeable fiscal deficit (6.2% of GDP in 2003), could put pressure on the current account deficit. In 2003 and 2004, the rate of inflation should go up as a consequence of a depreciating zloty and higher oil prices.

After a major setback in 2001, the **U.S.** economy began to show signs of a slight in 2002, recovery which should gain speed in the second half of 2003. Corporate investments are supposed to pick up, mainly after the end of the war conflict in Iraq and the ensuing drop in energy prices. Subsequently, 2004 is expected to bring much faster growth in foreign demand as well as household and corporate demand. As a result of tax cuts and heavier spending in connection with the Iraq war, public finances are expected to close 2003 with a much larger deficit. A recovery in foreign demand in 2004, combined with a depreciating dollar, should spur export growth.

Public sector balance forecasts for selected OECD countries (% of nominal GDP)

	Public sector balance (+ surplus, - deficit)				
	2000	2001	2002	2003	2004
OECD	0.0	-1.3	-2.9	-3.6	-3.5
USA	1.4	-0.5	-3.4	-4.6	-4.2
Japan	-7.4	-6.1	-7.1	-7.7	-7.8
EU	0.7	-1.1	-2.0	-2.3	-2.2
EMU	0.1	-1.6	-2.3	-2.5	-2.4
Germany	1.1	-2.8	-3.6	-3.7	-3.3
France	-1.4	-1.5	-3.2	-3.6	-3.3
Italy	-0.7	-2.7	-2.5	-2.4	-2.8
Czech Republic	-4.0	-2.8	-4.5	-6.3	-6.2
Hungary	-2.9	-5.2	-8.4	-5.6	-5.0
Poland	-3.0	-5.1	-5.7	-6.2	-5.9

Over the last year until mid-March 2003, the price of Brent oil shot up from USD 20/barrel to USD 35/barrel. This upsurge, however, was fuelled not only by anxiety over the war in Iraq, but also by a failure to perform oil delivery contracts due to strikes in Venezuela and Nigeria, an unusually cold weather in North America and Japan, as well as depleted stocks of Brent oil in OECD countries. The economic development forecast is based on an estimated oil price of USD 25/barrel, i.e. the centre of the range fixed by OPEC.

2. Year 2002

2.1 Inflation

The rate of inflation, measured as consumer price growth, as well as core inflation were lower in December 2002 on a year-on-year basis compared with the original and Updated Monetary Program for 2002. Actual inflation dropped below NBS program targets in particular due to developments in prices of food and market services.

Development in consumer prices in 2002 (%)

		2002 MP	2002 UMP	Updated 2002 estimate[1]	Actual December 2002
Core inflation	**year-on-year**	3.2 - 4.7	3.2 - 4.7	1.9-2.2	1.9
Inflation	**year-on-year**	4.1 - 4.9	3.6 - 4.2	2.9-3.2	3.4
	average year-on-year	3.5 - 4.9	3.5 - 4.9	3.3-3.4	3.3

[1] estimate based on actual development until October 2002

The consumer price forecasts set out in the 2002 Updated Monetary Program assumed a steady development in the exchange rate of the Slovak koruna against the benchmark currency and in prices of energy commodities, with the Brent oil expected to drift inside the OPEC range of USD 22-28/barrel. Domestic competition and a demand satisfied by foreign supply were counted on as the main damping factors. Likewise, price developments in the second half of the year were expected to reflect the impact of a lower comparison base from the same period last year (so-called baseline effect), showing the effect of low food and fuel prices in end-2001. Consequently, inflation was supposed to speed up on a year-on-year basis.

The 2002 UMP formulated risks which, if materialised, could throw actual developments off the programmed range. It fingered food prices as a possible source of volatility, along with expanding retail chains which, besides relieving the price pressure, were liable to one-off price swings triggered by short spells of market imbalance. Other possible risks included the extent of administrative measures, changes in consumer taxes, and developments in the exchange rate of the Slovak koruna.

The actual development in consumer prices in 2002, with growth falling short of NBS expectations in almost all sectors (except regulated prices), was effected by several factors. For the most part, the different-than-expected development was caused by food prices, which actually showed a drop in December on a year-on-year basis. Defying NBS forecasts, 2002 saw a flagging year-on-year price growth in market services, affected by lower cost impacts, in particular in connection with the development of fuel prices, coinciding with a strengthening SKK against the USD and low demand pressure. While the NBS expected domestic demand and real wages to do more to spur price growth in market services, they had no major effect on actual development at the end of the day.

The decline in food prices came largely on the back of prices of "non-processed" foodstuffs (meat, fruits and vegetables). While still rising 4.5% in December 2001, they turned around to fall in June 2002 to finish 0.2% below the year-ago level at the end of 2002. The drop in prices of non-processed food reflected in particular a lasting fall in meat prices (supply outweighing demand due to cheap imports and BSE) and stronger seasonal impacts in fruit and vegetable prices, while the NBS expected a similar behaviour than in the previous years.

Inflation was also influenced by the exchange rate of the Slovak koruna through a lower imported inflation (SKK was expected to gain 2% against USD, but eventually firmed by 6%), with its effect showing across the entire tradable sector, notably in fuel prices which edged up a mere 0.5% from year ago.

Fuel prices are determined primarily by the development of the exchange rate of the Slovak koruna against the dollar and by oil price movements on world markets. Any change in the SKK/USD exchange rate or in oil prices has a virtually instant impact on fuel prices.

The world oil price moved along the lines of the UMP, staying inside the OPEC countries' reference band since March. Even though it rose steadily until the end of the year, the average oil price lied in the middle of the range projected in the 2003 MP, i.e. USD 25/barrel.

Unlike prices of food, tradable goods and market services, which lagged behind NBS expectations, regulated prices outran the targets defined in the 2002 UMP. This was the result of higher prices in telecommunications, health care, education and motor third party insurance premiums. Regulated prices added the largest share to overall consumer price growth at the end of the day, namely 45.2% (as compared to 62.5% in 2001). Faster (than expected) growth in regulated prices thus in part compensated for lower dynamics in other core inflation components (especially food).

As the above implies, from the monetary policy perspective, the price development in 2002 was affected by items influenced by non-monetary policy factors. In particular, we may cite food prices, showing stronger seasonal impacts in 2002, as well as supply (e.g. of meat) exceeding real demand. Another autonomous factor affecting price level in 2002 was the USD exchange rate.

2.2 Producer prices

Industrial producer prices

Industrial producer prices went up an average 2.1% in 2002, in line with the assumptions made in the 2003 Monetary Program. Still, they fell short of the growth targets set in the 2002 MP and UMP, due to prices of industrial products that increased an average 0.7%. Electricity, gas, steam and hot water producer prices moved up 6.7%, while prices of mining and open-cast mining products were the fastest risers (up 7.4%).

The impact of external cost factors (prices of oil, pulp and metals on world markets) was reflected in a year-on-year decline in several domestic product prices. The oil price, assisted by a strengthening Slovak currency against the USD, helped keep the prices of oil refinery products unchanged from last year and prompted a 1.1% decline in prices of chemicals and chemical products.

Industrial producer prices in 2002 (index, the same period previous year = 100)

	2002 MP	2002 UMP	2002 estimate	2002 actual
Average annual index	105.0	103.5	102.1	102.1

Agricultural product prices

Agricultural product prices slipped an average 0.7% in 2002, as plant products, including vegetables and fruits, dropped 1.2% and animal products 0.6%. The drop in plant products was largely due to lower grain prices (down 3.9%), as their market supply constantly exceeded demand in the wake of a rich harvest in 2001.

2.3 Balance of payments

The current account of the balance of payments closed 2002 with a deficit of SKK 87.9 billion (8.2% of GDP), which was above NBS expectations (in the MP). Compared to the 2003 Monetary Program estimate, it was slightly lower.

2002 Balance of payments SKK billion

	2002 MP	2002 UMP	2002 estimate	2002
Balance of trade	-92.0	-98.0	-98.0	-96.6
Balance of services	18.6	20.0	18.0	20.6
Balance of income	-16.8	-16.9	-16.9	-20.7
Current transfers	9.0	9.0	8.0	8.8
Current account	**-81.2**	**-85.9**	**-88.9**	**-87.9**
Capital transfers	1.0	5.0	5.0	4.9
Direct investments	147.1	197.4	190.0	179.7
Portfolio investments	20.1	35.4	32.7	25.1
Other long-term capital	4.8	0.0	3.0	0.9
Capital and financial account	**178.3**	**244.4**	**268.6**	**234.3**
Change in reserves (-, increase)	**-97.1**	**-158.5**	**-179.7**	**-160.6**

Actual development strayed from NBS predictions (MP, UMP, estimate) in particular in the balance of income and trade. A higher deficit in the balance of income can be blamed on increased interest payments on portfolio investments, coinciding with a larger volume of dividends distributed to foreign investors (income on assets was predicted to increase by roughly 50%, but actually jumped almost 100% from 2001).

The foreign trade deficit reached SKK 96.6 billion in 2002, which was roughly in line with UMP expectations and 2003 MP estimates (SKK 98.0 billion). Compared to MP predictions, growth slowed down in both exports and imports, with imports losing less momentum than exports.

The capital and financial account of the balance of payments ended 2002 with a surplus of SKK 234.3 million, stopping short of the estimate from late last year and the UMP, largely due to the inflow of foreign direct investments (FDIs).

Direct investments totalled SKK 179.7 billion, their lower inflow caused by a delayed financial settlement for the privatisation of Východoslovenská energetika and, in part Západoslovenská energetika, from 2002 to 2003. The said lower inflow of direct investments into the official sector was reflected in a lower-than-expected increase in NBS foreign exchange reserves.

With privatisation income deposited with the NBS taken away, the capital and financial account failed to cover the current account deficit. The shortfall was financed by a reduction in foreign exchange assets held by commercial banks, which cut back their foreign exchange positions amid appreciation expectations and to bolster profits.

SKK million

	January – December 2002	
	Actual *	Adjusted **
Current account	-87,900.5	-78,944.6
Capital and financial account	234,308.9	27,118.7
thereof: FDIs in Slovakia – equity	179,746.7	28,680.9
Unassigned items	14,187.6	14,187.6
NBS interventions	-	-18,416.1
Change in net foreign assets held by commercial banks (- increase)	-	56,054.4
Change in NBS reserves (- increase)	-160,596.0	

* original balance of payment design, i.e. including the impact of collections and payments on NBS reserves

** net of the impact of Slovak government and NBS activities not affecting commercial banks' position against non-residents and not representing real current account financing

in the original balance of payments design, interventions are included in NBS foreign exchange reserves

NBS foreign exchange reserves amounted to USD 9.2 billion as at 31 December 2002, covering a 5.9-fold of average monthly imports of goods and services in 2002.

2.4 Gross domestic product[2]

By preliminary estimates, gross domestic product rose 4.4% year-on-year at constant prices in 2002, breaking the upper limit of the target range set in the 2002 MP and UMP (3.5-3.8%). Economic growth accelerated in the last quarter in particular. After increasing by 4.1% year-on-year in the first three quarters, real GDP picked up to 5.4% in the fourth quarter. On the spending side, GDP was influenced primarily by a 4% increase in domestic demand (including statistical discrepancy). Its higher growth, compared with the 3.1% estimate (in the 2003 MP), stemmed from a different development in gross capital formation. Household and government final consumption failed to reach projected growth (December 2002 estimate).

Comparison of 2002 MP, UMP and GDP estimate with actual results

year-on-year change in %

	MP 2002	UMP 2002	2002 estimate	2002 actual
GDP at constant prices of 1995	**3.6**	**3.6**	**3.8**	**4.4**
Domestic demand*	2.7	2.5	3.1	4.0
Thereof				
Final consumption total	3.5	3.4	5.4	4.9
Final consumption of households	4.1	3.8	5.9	5.4
Final consumption of government and non-profit institutions	2.1	2.5	4.3	3.8
Gross capital formation*	1.0	0.7	-2.4	1.7
Gross fixed capital formation	6.6	6.3	0.5	-0.9
Exports of goods and services	7.3	3.3	4.8	5.9
Imports of goods and services	6.1	1.8	3.9	5.3

* statistical discrepancy in respect of the change in inventories included for forecast purposes

The actually higher growth in real GDP and domestic demand in 2002 (as opposed to MP 2003 estimates) was affected by a different development in inventories, which expanded year-on-year in contrast to the NBS's expectations of a fall. This fact was also reflected in gross capital formation, which recorded a year-on-year increase to deny predictions of a decline. Final consumption followed the projected trend, its annual growth just a little slower than expected.

Gross capital formation (including the change in inventories and statistical discrepancy) increased by 1.7% in 2002 at constant prices (contrary to a predicted 2.4% drop). It was driven off the NBS-projected course by a different development in fixed investments and inventories. The volume of fixed investments dropped 0.9% from 2001 (expected to rise 0.5%). Expectations of a moderate recovery in investment demand did not come true in 2002, as statistical data shows. Ultimately, growth in gross capital was fuelled solely by a change in inventories, which returned to positive values after a four-year fall (SKK 7.3 billion, as opposed to a predicted SKK 3.7 billion drop). To some extent, the different development in inventories, as compared with estimates and track record in the previous years, can be related to finished, but not exported, products, as well as the fact that inventories may encompass items of an investment nature (e.g. outstanding machinery and equipment leasing contracts, investments in progress). Given their considerable volatility, inventories are generally regarded as a risk component in GDP forecasts, which is why they may also have an effect on real economic growth in the Slovak Republic in 2003.

[2] 2002 GDP forecasts set out in the 2002 MP and UMP were based on unrevised data on GDP development in earlier years. The GDP estimate for 2002, as well as the forecast for 2003-2006, published in the 2003 MP already referred to revised time series data published by the Slovak Statistical Office in June 2002. As a result of the revision, the GDP structure was modified in particular, making it impossible to compare the development in GDP components predicted in the 2002 MP and UMP with actual development in 2002.

Household final consumption expanded by 5.4% from year ago (5.9% predicted), driven, as expected, primarily by low inflation across the year and rising wages. Its development was also affected by a mounting volume of consumer loans and new products and instalment sale opportunities. After showing fairly rapid growth in the first half of the year, final consumption of government (including the consumption of non-profit institutions serving households) slowed down significantly year-on-year in the second half in the wake of cost-cutting measures. Over the year, it went up 3.8% (4.3% predicted).

Contributions of individual components to GDP growth at constant prices perc. points

	2002 estimate	2002 actual
GDP at constant prices of 1995 in %	**3.8**	**4.4**
Domestic demand*	3.2	4.1
Thereof		
Final consumption total	4.0	3.6
Final consumption of households	3.1	2.8
Final consumption of government and non-profit institutions	0.9	0.8
Gross capital formation*	-0.7	0.5
Gross fixed capital formation	0.2	-0.3
Net exports	0.6	0.3
Exports of goods and services	3.8	4.6
Imports of goods and services	-3.2	-4.3

* statistical discrepancy in respect of the change in inventories included for forecast purposes

2.5 Wages and employment

The wage development in 2002 was characterised by an accelerated year-on-year growth in nominal and real wages alike, which was in line with NBS estimates used as the basis for 2003 wage forecasts. The average monthly nominal wage in the Slovak economy reached SKK 13,511 after gaining 9.3% from year ago (NBS estimated 9.7% in the 2003 MP), outstripping 2001 growth by 1.1 percentage points. Real wage growth was 5.8% (NBS estimated 6.0%), speeding up by 5 percentage points from year ago. Apart from growing nominal wages, real wage growth was also affected by a falling average inflation (7.3% in 2001 as opposed to 3.3% in 2002).

From the sectoral perspective, nominal wage growth slowed down from 2001 in manufacturing industries and in some market services (transportation, post and telecommunications, sales and repair services, real estate, leasing, trade activities and research). Nominal wages recorded a marked rise in sectors providing mostly non-market services (up 15.4% on average by NBS calculations), which was related, for the most part, to the implementation of laws on state and public service and, in the 'other public, social and personal services' sector, to cutbacks in publicly beneficial jobs from 2001. With non-market services disregarded, nominal wages for all industries taken together went up an average 7.2%, while real wages gained 3.8% (by NBS calculations).

Development in nominal and real wages in 2002

	Average monthly wage 2002		
	Nominal		Real
	SKK	Index	Index
Nation-wide average	13,511	109.3	105.8
thereof:			
Agriculture	10,413	104.8	103.4
Industry total	13,354	107.3	103.9
mineral mining	15,595	107.8	104.4
manufacturing industries	13,837	107.2	103.8
electricity, gas and water production and distribution	19,516	108.5	105.0
Construction industry	11,547	104.5	101.2
Market services total*	15,328	107.5	104.1
thereof:			
Wholesale and retail, and repair services	14,117	105.4	102.0
Hotels and restaurants	10,282	108.8	105.3
Transportation, warehousing, post and telecom	14,553	106.8	103.4
Banking and insurance industry	27,094	111.0	107.5
Real estate, leasing and trade services, research	17,102	110.0	106.5
Non-market services total*	12,047	115.4	111.7
thereof:			
Public administration and defence, statutory social security	16,509	112.6	109.0
Education	10,932	115.7	112.0
Health and social care	12,020	115.8	112.1
Other public, social and personal services	10,220	115.1	111.4
Consumer prices – year average	*x*	*103.3*	*x*

Source: Slovak Statistical Office and *NBS calculations

Development in wages and productivity of labour in 2002 year-on-year change in %

	2002 MP (range)	2002 UMP (mid-range)	2002 estimate (mid-range)	2002 actual
Average monthly nominal wage	7.0-8.0	7.5	9.7	9.3
Average monthly real wage	2.4-3.3	3.5	6.0	5.8
Labour productivity in GDP at c.p.	2.6-2.9	3.0	3.6	4.3
Real productivity – wage in perc. points	+0.2 – (-0.4)	-0.5	-2.4	-1.5
NBS-recommended wage development				
nominal	6.0	6.0	-	x
real	1.4	2.0	-	x
Average inflation	*4.5*	*3.9*	*3.5*	*3.3*

The labour productivity (GDP per employee in the Slovak economy) recorded quite substantial increases from year ago in 2002 both at current and constant prices. The nominal labour productivity went up 8.4% (1.1 percentage points faster than year ago), while real productivity improved by 4.3% (2.5 percentage points faster). The more rapid growth in the real labour productivity was owed both to a strong GDP performance as well as a considerable slowdown in employment growth. By NBS calculations, the private sector takes all credit for the gain in the real labour productivity, stepping up its productivity by 7.7% year-on-year (the private sector made up 88.9% of GDP in 2002), while the public sector actually saw a 24.6% setback. This drop, however, could have been related to the privatisation of some high value-added enterprises.

It was mainly due to the wage development in the public sector that the fairly dynamic rise in the productivity of labour failed to cover wage growth. In nominal terms, wages in the national economy outran the productivity of labour by 0.9 percentage points, and by 1.5 percentage points in real terms. In cumulative terms, however, the labour productivity still grew ahead of wages, although some of its advantage from 2001 was lost. Since the narrowing lead was caused solely by wage development (notably in the public sector), it is vital to attune wage growth in the public sector to actual development in the labour productivity in the national economy to maintain a sound economic growth and Slovakia's competitiveness in years to come.

Development in real wages and productivity of labour
year-on-year change in %
Average real wage
Labour productivity in GDP at constant prices

Development in real wages and productivity of labour - cumulative
Change in %
Real wage - cumulative
Real productivity of labour - cumulative

In 2002, the NBS expected employment to increase by 0.1-0.3% from year ago (0.2% mid-range) and registered unemployment to reach 17-18% at year-end.

By statistical reports, employment edged up 0.1% from year ago in 2002, which was the bottom of the range (2003 MP estimate). Its growth was impeded by falling employment in wholesale, hotels and restaurants, post and telecommunications sectors, as well as faint growth in manufacturing industries, real estate, leasing, trade activities and other services.

The development in unemployment was relatively favourable in 2002, as the rate of registered unemployment reached a level within the lower half of the estimated interval at 17.4%.[3]

Development in employment and unemployment in 2002

	2002 MP	2002 UMP (mid-range)	2002 estimate (mid-range)	2002 actual
Employment – year-on-year change in %	0.9	0.7	0.2	0.1
Unemployment rate at year-end	x	x	17.5	17.4

2.6 Public sector

In the 2003 Monetary Program, we expected the budget deficit as at 31 December 2002 to end some SKK 1 billion below the State Budget Act target, at SKK 37 billion (excluding bank restructuring costs). These assumptions turned out to be correct, as the current state budget deficit reached SKK 37.1 billion at the end of 2002. After adding in the bank restructuring costs, i.e. SKK 14.6 billion, the overall state budget deficit amounted to SKK 51.7 billion. This resulted, to a decisive extent, from a SKK 8.1 billion over performance in tax revenues (direct taxes in particular). Non-tax revenues, in contrast, fell some SKK 7 billion short of the mark despite financial recoveries of Russian debt. By ESA 95 methodology, the fiscal deficit of the public sector reached SKK 77.8 billion (7.2% of gross domestic product), while the monetary program forecast was SKK 80.1 billion (7.5% of GDP). Our expectations about the impact of privatisation earnings and debt recoveries on domestic demand were basically met.

[3] Flat employment combined with a decreasing unemployment may be caused by a part of the ~~workforce~~ **labour force** leaving the Slovak labour market or the labour market altogether (e.g. as some of the employed and unemployed retire).

Public sector deficit by national methodology SKK million

Public budget chapter	Approved budget	Actual as at 31/12/2002	Performance %
State budget	-53,479	-51,642	96.6
thereof: excluding bank restructuring costs	-38,000	-37,077	97.6
State funds	1,954	829	42.4
National Property Fund	0	1,440	x
Slovak Land Fund	0	279	x
National Employment Office	509	1,480	290.8
Social Insurance Agency	-379	566	x
Health insurance companies	-692	3,618	x
Higher territorial units	x	166	x
Towns	-200	-1,124	562.0
Public administration total	**-52,316**	**-44,388**	**84.8**
thereof: excluding bank restructuring costs	-36,837	-29,823	81.0
Ratio to GDP, excluding bank restructuring costs	-3,5	-2,8	x

Public sector deficit by ESA 95 methodology SKK million

Public administration total		**-77,805**
thereof:	State budget	-54,042
	State financial assets	-4,473
	State guarantees	-11,635
	Higher territorial units	235
	Towns	197
	Social security funds	7,272
	State funds	5,864
	Privatisation funds (NPF and SPF)	-18,770
	Slovenská konsolidačná, a.s.	-104
	State budget-supported organisations	-2,155

2.7 Monetary development and monetary policy

Monetary development

The development in monetary aggregates in 2002 was different than predicted in the Monetary Program and its update, notably in aggregate money supply and its subaggregates: net foreign assets and credits to enterprises and households.

Net foreign assets fell short of the updated growth forecasts, mainly because the assumptions regarding privatisation income did not take place. The shortfall in privatisation earnings was due to a postponed sale of VSE to 2003 and lower proceeds from the ZSE sell off.

In contrast, banks' lending activities surpassed the NBS' expectations, spurred by a financial sector revitalisation, sharpening competition and the introduction of new products. With respect to the risk a credit expansion may present to price developments, the 2002 growth can be described as neutral, because it was absorbed by a decreasing debt position of the public sector and because money supply growth slowed down in 2002.

A non-standard development was observed in aggregate money supply, which dropped below the projected level at year-end, despite its average year-on-year growth rate of over 8% during the year. A gradual slowdown in M2 dynamics which started the year at 11.8% was caused by several factors. Lower privatisation income and its slow release was the main reason why the UMP estimates were not fulfilled. A more striking setback in M2 growth at year-end was in part due to the baseline effect, as the M2 increment in December 2001 was augmented by the redemption of privatisation bonds by the NPF. Another determinant was a lower amount of accrued deposit interests, due to lower average customer deposit rates.

%	2002 MP	2002 UMP	Actual
Net foreign assets	**80.5**	**115.4**	**113.9**
Net domestic assets	**-4.8**	**-14.9**	**-13.9**
Domestic credits	-3.9	-10.1	-11.8
Net position of public sector	-13.2	-24.1	-26.1
Credits to enterprises and households	7.5	6.9	13.8
M2	**10.5**	**11.4**	**4.7**

Monetary policy

The NBS has applied a qualitative approach to regulation by setting key interest rates. As the EU accession process gains momentum, it puts rising demands on monetary policy, which not only remains responsible for price stability, but also participates in stabilising the entire economic environment, including external relations. Consequently, monetary policy had to respond to factors which, though having no immediate impact on inflation, could destabilize the monetary environment. That is why the NBS adjusted its interest rates to counter signs of macroeconomic imbalance and employed its interest rate policy as a supporting instrument in the exchange rate policy when the Slovak koruna appreciated out of proportion.

Negative tendencies in economic development lingered early in the year, reflected in a hazardous development in public finance and in the current account of the balance of payments. Due to possible repercussions on the exchange rate and inflation, the NBS responded to the absence of other economic measures by lifting its interest rates by 0.5% percentage points effective from 27 April 2002.

In the third quarter, a stable net inflation development and outlook, a decreasing deficit of the balance of trade, and easing risks to the development of public finances allowed the NBS to respond by trimming the two-week REPO limit rate by 0.25 percentage points to 8.0% (taking it to the symmetrical centre of the corridor defined by published rates for automatic overnight operations).

An inflow of short-term foreign capital, sparked mainly by positive expectations related to the gradually fulfilling integration ambitions of the Slovak Republic and an upgrade in Slovakia's rating, not supported by an adequate improvement in economic indicators, put on the pressure on nominal exchange rate appreciation in the last quarter. With effect from 18 November 2002, the NBS Bank Board decided to enhance the effectiveness of foreign exchange market interventions by slashing all NBS interest rates by 1.5% percentage points. The two-week repo limit rate dropped to 6.5%, the overnight sterilising rate fell to 5%, and the overnight refinancing rate to 8%. At the same time, the NBS declared its flexibility in the application of all available instruments in order to prevent further exchange rate overappreciation, which might have an adverse effect on the economy's restructuring and export performance and, consequently, cause a further deepening of the deficit of the current account of the balance of payments.

In 2002 again, the NBS carried out its monetary policy against a backdrop of a high liquidity surplus, which determined its sterilising nature. Due to an inflow of privatisation income, notably in the second half of the year, the NBS' sterilising position against the banking sector deepened markedly (the largest item was a SKK 121 billion payment for SPP, other privatisation proceeds added up to some SKK 30 billion). Out of the total privatisation revenues, about SKK 75 billion impacted banking sector liquidity and called for an increase in the NBS' direct sterilising position. Of that amount, SKK 49.3 billion went into public debt service, SKK 9.1 billion were paid in redemption of government bonds held by VÚB, SKK 5 billion in novation of liabilities under NPF bonds, SKK 4.1 billion in refunds of gas-line installation costs to cities and towns, SKK 3.7 billion were spent to work out debts of health care facilities and health insurance companies, and SKK 2.9 billion to relieve the debt of personal railway transport.

The NBS' indirect sterilisation was increased by a special SKK 61.7 billion deposit of the Social Insurance Agency with the NBS, coming from the SPP privatisation and earmarked for a pension system reform.

NBS interventions in the foreign exchange market against an excessive strengthening of the Slovak koruna were another major source of liquidity, increasing SKK liquidity at commercial banks by SKK 18.4 billion.

The volume of sterilisation was also influenced, although not so heavily, by a 1% cut in required reserves in January, leaving another SKK 5.7 billion in excess liquidity to be drained off the market.

Overall, the amount of funds sterilised by the NBS' open market operations (i.e. through direct sterilisation) in 2002 rose from SKK 58.1 billion to SKK 143.9 (the average annual sterilising position of the NBS increased by SKK 35.8 billion to SKK 91.5 billion in 2002). With the Social Insurance Agency deposit and the NPF's account with the NBS counted in (indirect sterilisation), overall sterilisation reached SKK 209.1 billion as at 31 December 2002.

3. Updated Monetary Program for 2003

The values featured in the Updated Monetary Program reflect actual macroeconomic performance in the first quarter of 2003 and late last year. In addition, the Updated Monetary Program incorporates a likely hike in certain consumption taxes slated for July 2003. If implemented, this measure will materialise one of the risks defined in the 2003 Monetary Program, reflecting in higher consumer price growth.

Compared to the 2003 Monetary Program, in its update the NBS expects to see a more favourable development in the current account of the balance of payments. This is related both to relatively high export dynamics in late 2002 and the first months of 2003 and the impact of a high appreciation of the Slovak koruna against the dollar, which was reflected in a lower value of imports, in particular raw materials and food products. The development of the USD exchange rate was also singled out as a possible prediction risk in the 2003 Monetary Program.

3.1 Inflation

According to the 2003 MP, the year-end values of year-on-year inflation should reach 7.7-9.7%, with average inflation at 8.2-9.3%. The values of core inflation should range between 2.7% and 5.0%. The 2003 MP assumed that a resumed deregulation process, as compared to last year, would turn up cost pressure and, consequently, spur headline inflation. The consumer price forecast was based on an assumption of growing regulated prices following a decision of the Network Industry Regulation Authority and the Slovak government, a change in consumption taxes and VAT rates, stabilising prices of energy and industrial inputs, oil prices travelling within the OPEC reference range (USD 22-28/barrel), and a steady exchange rate. A lingering high unemployment and rising energy prices (curbing demand pressure), and particularly domestic competition and the satisfaction of demand by foreign supply, should play the greatest role in dampening core inflation. As a result of a secondary impact of regulated energy prices, food prices were expected to grow faster.

Latest developments from January to April 2003

The development in consumer prices until April was marked by a rising trend in year-on-year inflation. In April, consumer prices went up 7.7% from year earlier, with regulated prices coming out the fastest riser with 22.3% year-on-year. From the beginning of the year, inflation reached 6.6%. As these figures imply, consumer price growth so far was at the lower limit of the interval predicted in the NBS Monetary Program, with average inflation even dropping below the bottom of the range projected by the NBS.

As regards the external environment, the price dynamics were determined by the stabilisation of the koruna against the reference currency, its appreciation against the U.S. dollar, and an adverse energy price development on world markets, with oil prices keeping above the OPEC reference range in the first three months of 2003 (the average price three months into 2003 just exceeded USD 31/barrel). Since April, after the end of the military operation in Iraq, oil prices have fallen.

Among domestic factors, as expected in the 2003 MP, price development was affected by hikes in regulated prices and indirect taxes. An increase in consumption taxes and a change in VAT rates in January 2003 had a greater impact on inflation than expected in the 2003 MP, which was compensated by a smaller contribution of the regulated prices sector.

The development in core inflation, which was up 1.9% year-on-year in April, hinted at certain variances from the 2003 MP predictions. In particular, food prices, held back by a lasting fall of meat prices, are likely to end the year below the 2003 Monetary Program targets.

In the tradable goods sector, demand is curbed by lower wages and, perhaps, higher household expenditures on services on one hand, and by low imported inflation, a steady exchange rate and, above all, a strong competition on the other hand. Nevertheless, their growth picked up slightly in the first three months, driven by accelerating growth in fuel prices. In April, fuel prices posted a drop year-on-year again, slowing down the growth in tradable goods.

The impact of price deregulation is felt most strongly in prices of market services, which are outpacing expectations.

Assumptions made in the Updated Monetary Program and expected development till the end of the year

In the updated inflation forecast for 2003, we are expecting a change in consumption taxes to come into force in July 2003, namely a raise in excise on tobacco products, beer and mineral oils.

The 2003 UMP inflation forecast, as in the 2003 MP, assumes an average oil price at USD 25/barrel. Even though the average oil price lay well above that level in the first quarter, it did not stimulate inflation through rising fuel prices because the Slovak koruna strengthened against the U.S. dollar.

As regards the exchange rate, the price development prediction is based on the current exchange rate (SKK/EUR and SKK/USD) applicable at the time the 2003 UMP was written.

A moderate year-on-year growth in core inflation is supposed to last throughout 2003. It should peak in the summer months due to a very low level recorded in the summer of 2001 (baseline effect).

The development in food prices is one of the main risk factors in 2003. Their development to date indicates that food prices, in particular in non-processed food, respond to market situation flexibly. In the summer months, prices are expected to take a seasonal drop which, however, should not be as sharp as last year.

In tradable goods and market services, prices are likely to be in line with the 2003 MP to end the year at 1.5-2.1% and 6.2-8.3%, respectively. Price growth in the tradable sector should be flagging as a result of low imported inflation and full-grown competition. In market services, prices should be spurred by cost factors.

Given the likely raise in consumption taxes come July 2003, headline inflation can be expected to reach values in the upper half of the original 2003 MP range. On the other hand, price developments seen since the beginning of the year (especially food prices) should confine core inflation to the lower half of the 2003 MP target range. Therefore, the Updated Monetary Program scales up the headline inflation estimate, while expecting core inflation to record lower values. **Hence, headline inflation should range between 8.4% and 9.7% at year-end, which corresponds to average inflation at 8.3-8.8%. Core inflation could leave December 2003 somewhere in the region of 2.1-3.6%.**

Risks to the 2003 inflation forecast

The inflation forecast for 2003 could be jeopardises by possible swings in the exchange rate of the Slovak koruna. Any major exchange rate movement, upward or downward, could affect price growth in the tradable sector in particular. Given the sector's weight in the consumer basket and a large share of imported goods intended for end consumption, the impact of an exchange rate shift could prompt an over- or undershooting of the target range.

The oil price is perceived as another risk. Now that the war in Iraq is over, an excess of oil on world markets could trigger a price slump, with possible effects on fuel prices. Such a scenario could send year-on-year inflation falling to the bottom of the target range at year-end. Conversely, a higher demand for oil driven by a possible economic recovery could make it grow, with consequent effects on consumer prices.

3.2 Producer prices

According to the 2003 Monetary Program, producer prices were supposed to rise 5.9% from year ago. In its prediction, the NBS assumed oil prices would settle inside the OPEC benchmark band (USD 22-28), a steady exchange rate, and an increase in regulated prices following a decision by the Network Industries Regulation Authority. The NBS also figured that higher regulated prices would have a secondary impact in the shape of stepped-up growth in food prices in 2003.

Latest development since the beginning of the year

In the first three months of 2003, producer prices gained an average 8.5% from year ago, coming primarily on the back of a 16.7% rise in prices of electricity, natural gas, steam and hot water. Energy prices outpaced NBS expectations as a result of more rapid growth in electricity prices (up 12.1% year-on-year in March, average growth since year-start was 9.3%). This was probably due to the fact that many eligible consumers[4] have yet to sign up for power supplies at prices below the regulated price fixed by the Network Industries Regulation Authority (which increased by approximately 18%). The NBS thought eligible consumers would be quicker to react than they were. Although electricity prices could see some adjustment prompted by eligible consumers as the year moves on, its timing is questionable. The later these consumers negotiate cheaper power supplies, the bigger their impact on the overall producer price dynamics. The price of natural gas climbed an average 35.6% (up 30% in March), which was close to NBS expectations.

Higher energy costs sparked a year-on-year increase in mining and open-cast mining (up 6.9%) and, to a lesser extent, in industrial product prices (up 3.6%), as individual producers chose not to pass on the full extra cost into their prices in order to retain market share (or competitive edge).

Industrial product prices have also grown ahead of expectations since the beginning of the year, fuelled, in addition to higher energy prices, in particular by soaring world oil prices (averaging over USD 30/barrel in the first three months). As a result, prices of oil refinery products went up 17.6%, while rubber and plastic products were 4.0% more expensive than a year earlier. A major rise was also registered in other non-metal mineral products (up 5.4%), which make basic inputs into the construction industry. Prices of food, beverages and tobacco picked up 2.7% year-on-year, with milk products and ice cream leading the way with 8.6%.

Assumptions made in the Updated Monetary Program and expected development till the end of the year

The producer price predictions are based on the same assumptions regarding prices of energy commodities and the exchange of the Slovak koruna against the euro and the U.S. dollar as the consumer price forecasts.

With faster growth in producer prices during first three months in 2003 outstripping 2003 MP predictions (by more than 2 percentage points as a result of higher than expected oil and energy prices), the update envisions a more rapid industrial price growth.

Industrial product prices are expected to rise an average 2.6% in 2003 (fuelled by faster-than-expected growth in energy prices and higher oil prices), with their contribution to overall price growth in the industry likely to weigh in at 1.7 percentage points. Prices charged by electricity, natural gas, steam and hot water producers may go up an average 17.8%, representing a 6.3% contribution to growth in industrial producer prices.

Under the above assumptions, industrial producer prices would post an average year-on-year increase by 8.0%. As far as the price dynamics structure is concerned, an entire 80% of the price growth will come from energy producer prices, but their impact on price competitiveness of industrial products should be nowhere near dramatic.

[4] Effective 1 January 2003, the number of eligible consumers (i.e. customers whose annual consumption is over 40 GWh; in 2002 the cut-off was 100 GWh) increased, which means that more firms are no longer bound by prices fixed by the Network Industries Regulation Authority and, as the electricity market opens up, are free to choose their own power suppliers (including foreign suppliers) and, thus, decide what prices they are going to pay. They are estimated to account for two-thirds of total electricity consumption.

Prediction of industrial producer prices for 2003 the same period of previous year = 100

	2002 actual	2003 MP	2003 UMP
Average annual index	102.1	105.9	108.0
thereof:			
- industrial products	100.7	101.7	102.6
contribution	-	*0.6*	*1.7*
- electricity, natural gas, steam, hot water	106.7	114.0	117.8
contribution	-	*5.3*	*6.3*

Risks to the 2003 producer price forecast

During the year, prices of food-processing enterprises could be affected by long spells of dry weather, which may spark increased growth. Another pitfall to producer price predictions lies in possible fluctuation of the SKK/USD exchange rate, in particular due to the U.S. dollar's erratic track record in the first months of 2003. World oil prices are perceived as another hazard.

3.3 Foreign accounts

3.3.1 Balance of payments

The 2003 Monetary Program anticipated a current account deficit of SKK 73.1 billion and a SKK 41.2 billion inflow of funds in the capital and financial account.

The updated balance of payments forecast for 2003 reflects the latest data on its performance in 2002 and early 2003, as well as methodological changes in balance of payments reporting introduced in 2003.

The development in foreign trade in the first months of 2003, coupled with stronger exchange rate appreciation (especially against the USD) than expected in the Monetary Program (5.6%), pave the way for the balance of trade deficit to drop from SKK 85 billion to SKK 65 billion. Changes in other current account items were largely prompted by revised methodology in the balance of services (travel expenditures), balance of income (collected employee compensation and interest payments) and current transfers. If these assumptions come true, the current account deficit could stop some SKK 19.2 billion short of the MP forecast and its ratio to GDP could be lower by 1.7 percentage points.

The capital and financial account is set to surpass the MP forecast by 16%. More funds will funnel in through the long-term capital channel in particular, based on a revised assumption that government debt falling due in 2003 will be part-financed by funds raised on foreign markets.

Current account items in SKK billion	**2003 MP**	**2003 UMP**
Balance of trade	-85.0	-65.0
Exports	720.0	725.0
Imports	805.0	790.0
Balance of services	20.0	14.0
Balance of income	-16.1	-6.9
thereof: balance of interest	-12.9	-19.1
Current transfers	8.0	4.0
Current account	-73.1	-53.9
Ratio of current account to GDP in %	-6.2	-4.5

Balance of trade

If exports keep up the high volume recorded in the first quarter of 2003, with seasonal effects taken into account, annual exports could exceed MP predictions and their speed pick up from 10.3% to 11.3%. The import growth forecast was scaled down from 7.2% to 5.6% to reflect actual development in the first quarter of 2003 and an anticipated higher appreciation of the Slovak koruna, in particular against the USD.

Latest data on foreign trade performance in 2003 shows that exports expanded by 22.1% in the first quarter, as opposed to imports up 11.8%. Different export and import performance in the first and second half of

2003 will call for a reduction of annual growth estimates in 2003. While in the first half of 2002 exports fell short of the same period in 2001, they increased 13.4% year-on-year in the second half. Given a straight-line development in 2003, different half-year export volumes in 2002 (the first-half average was SKK 51.2 billion, as compared to SKK 57.4 billion in the second half) will lead to an opposite trend. In other words, exports and imports should lose speed during the first half-year (imports and exports followed a similar path), while double-digit growth rates are likely to drop to single digits (a 16.8% year-on-year in exports in the first half, with imports up 8.2%, as compared to 6.4% and 3.4%, respectively, in the second half).

Exports in SKK billion	2003 MP	2003 UMP
Finished products	110.0	111.0
Machines and transport equipment	303.0	304.0
Semi-finished goods	251.0	255.0
Raw materials	56.0	55.0
Total	720.0	725.0

The assumption that, for the most part, overall export growth should take place in the machines and conveyances, and semi-finished goods categories still stands, but their estimated volumes were fine-tuned to account for actual development in early 2003 (in particular a dynamic growth in exports of semi-finished goods, notably iron and steel).

Imports in SKK billion	2003 MP	2003 UMP
Finished products	172.4	171.0
Machines and transport equipment	266.0	261.0
Semi-finished goods	244.0	241.0
Raw materials	122.6	117.0
Total	805.0	790.0

The development in domestic demand and inflation in the EU were the key factors underlying the import predictions (stripped of imports of raw materials and reprocessing imports).

Lower imports in the machines and transport equipment item than expected in the MP reflect actual machinery imports in early 2003, suggesting that the MP estimate was probably a little overstated. In imports of finished goods, growth is still likely to come out less dynamic as a result of a year-on-year slowdown in household end consumption from 5.4% to 3.0%.

Raw material imports are supposed to show only a moderate increase from 2002 under unchanged MP assumptions (i.e. oil prices rising from USD 25 to 28 a barrel, and a stable natural gas price). The difference from the MP is due to a sharper drop in the USD exchange rate, which played a role in lower values of semi-finished goods, in particular chemical products.

The SKK 65 billion estimate for the balance of foreign trade in 2003 assumes an uptrend in exports, not only transport equipment, but also other semi-finished type commodities (iron and steel, aluminium, etc.) and finished products (furniture, clothing, footwear), considering actual performance three months into the year. The said estimate can be seen as the bottom deficit limit. If, in the months ahead, the commodities mentioned above lose some of the momentum seen in the first quarter, exports could end up SKK 5-7 billion lower, **possibly leading to a roughly 0.5% increase in the current account deficit.**

The balance of services, income and current transfers will be affected by revised methodology in 2003, preventing comparisons to earlier time series and monetary program predictions. Apart from methodological changes, the Updated Monetary Program foresees no major change of trends in individual items of the balance of services, income and current transfers.

Effective from 2003, the method of calculation of several current account components has changed. In employee compensations, the new methodology, unlike the previous one which relied solely on bank statistics, also makes use of estimates and calculations published by the Slovak Statistical Office (number of expatriate workers, average wage, expenditures of expatriate workers, etc.). This change of methodology has an effect not only on the balance of income (which includes employee compensations), but also on travel (expenditures of Slovak nationals working abroad are included in travel payments) and, to some extent, on the balance of current transfers (a portion of expatriates'

compensation is remitted through personal transfers). This methodological revision will be reflected in part in the current account and in part in the financial account, and will not affect the size of mistakes and errors. A second change in methodology concerns the balance of income – portfolio investments – interest payments, which will include a pro rata portion of interest on SKK-denominated government bonds (so far, these payments were understated, as in bank statistics there were included in domestic payments and assigned a payment title 850, which is not used in the compilation of the balance of payments. This information will be derived from additional data reported by commercial banks or, where appropriate, the Securities Centre). This change should be offset to a large degree by a counteritem in portfolio investments – collections – government bonds (which will include an appropriate portion of interest income).
The size of differences arising from the application of this revised methodology in practice is shown in the table below, obviously indicating that the inclusion of transactions by residents working abroad has a positive effect on the current account, while income paid as part of coupon washing has a negative effect.
Since a sizeable portion of so-called restructuring bonds fell due in February, the effect of the revised methodology was negative. Its impact, however, is not going to build up later in the year and is likely to stay around SKK 1 billion.

SKK million	1-2/2003 new methodology	1-2/2003 original methodology	Difference	UMP new methodology	UMP original methodology	Difference
Travel	1,712.3	3,012.3	-1,300.0	3,000.0	12,000.9	-9,000.0
Current transfers	1,153.0	1,853.0	-700.0	4,000.0	8,000.0	-4,000.0
Employee compensation	3,030.5	30.5	3,000.0	18,750.0	750.0	18,000.0
Investment income	-3,964.0	-1,491.0	-2,473.0	-25,631.0	-19,627.0	-6,004.0
Current account	1,931.8	3,404.8	-1,473.0	119.0	1,123.0	-1,004.0

As a consequence of the said revisions, the current account deficit is expected to reach 4.5% of GDP (which compares to 6.2% of GDP projected in the MP).

The updated forecast for the capital and financial account targets a surplus of SKK 62.1 billion (the MP expected a SKK 41.2 billion surplus).

Capital and financial account items (SKK billion)	**2003 MP**	**2003 UMP**
Capital transfers	8.0	6.0
Direct investments	41.0	43.4
in the Slovak Republic	42.0	44.4
FDIs – commercial sector	30.0	35.0
FDIs – official sector	12.0	9.4
Portfolio investments	16.0	13.0
Other long-term financial account	-31.5	-21.9
Liabilities	-31.5	-21.9
Government + NBS	-38.4	-17.4
Commercial banks	1.0	2.4
Enterprises	5.9	-6.8
Short-term financial account	7.7	21.6
Capital and financial account	41.2	62.1

The capital transfer estimate was scaled down slightly to reflect the fact that, every year, the potential volume of these funds is not drawn in full.

The total net inflow of foreign direct investments increased from the original SKK 41.0 billion to SKK 43.4 billion. The official sector will see its inflow swell by SKK 9.4 billion as a consequence of two major changes in privatisation activities (an additional payment of SKK 2.6 billion related to the SPP sale, and the postponement from 2002 to 2003 of the privatisation of power distribution networks worth SKK 6.8 billion). On the other hand, the delay in the privatisation of Slovenské elektrárne will cause a SKK 12.0 billion drop in FDI inflow into the official sector.

FDI inflow into the commercial sector will depend on the business sector's ability to expand its capacities in tune with the interest showed by foreign investors, on competition from other countries trying to attract FDIs, as well as on the development in foreign demand for Slovak commodities on world markets. FDI estimates for 2003, supported by available information, are based on the assumption that an increased inflow of FDIs into individual manufacturing industries (chemicals, construction materials, food and beverages, etc.) is going to continue, including a part of the investments into a new car assembly plant.

The outflow of other capital is set to decrease by SKK 23.5 billion from the monetary program forecast. In long-term capital on the liabilities side, the largest change occurred in the government and NBS sector which, in contrast to the MP, is expected to tap foreign markets for some of the funds needed to pay off government debt. A lower inflow of long-term debt into the commercial sector, as compared to the MP, was prompted by a declining deficit in the current account of the balance of payments and, consequently, lower financing needs.

A heavier short-term capital inflow than expected in the MP was triggered by a drop in short-term commercial bank assets in the wake of NBS interventions on the interbank foreign exchange market.

Transactions in the government and NBS sector will lead to a SKK 8.2 billion, i.e. USD 210.2 million, increase in NBS reserves. The turnaround from a fall (the MP predicted a fall by USD 795.5 million) to a rise will be fuelled by an inflow of foreign currency from bond issues on foreign markets and by interbank foreign exchange market interventions made in January and May 2003. Foreign exchange reserves are expected to reach USD 9.4 billion at the end of 2003, which will be enough to pay for imports of goods and services for 4.9 months.

SKK billion	**2003 MP**		**2003 UMP**	
	Actual	*Adjusted*	*Actual*	*Adjusted*
Current account	-73.1	-67.6	-53.9	-51.1
Capital and financial account total	41.2	59.9	62.1	52.3
Foreign direct investments in Slovakia	42.0	30.0	44.4	35.0
Unassigned items	0.0	0.0	0.0	0.0
NBS interventions	0.0	0.0	0.0	-22.8
Change in net foreign assets of commercial banks (- increase)		7.7		21.6
Change in NBS foreign reserves (- increase)	31.9		-8.2	
Current account coverage by FDIs in %	57.5	44.4	82.4	68.5

The surplus in the capital and financial account in 2003 will cover the current account deficit to the tune of 115.2%, bringing about an increase in NBS foreign exchange reserves. Disregarding government and NBS operations, the adjusted capital and financial account will cover the full current account deficit. A SKK 21.6 billion fall in net foreign assets held by commercial banks will stem from the interventions carried out in January and May 2003.

3.3.2 Foreign debt

In the government sector, the foreign debt forecast for 2003 was based on more precise debt service data and available information on the Slovak government's borrowing strategy in 2003.

In the foreign debt and foreign debt service forecast, we are expecting gross debt to edge up by USD 0.3 billion to USD 13.5 billion in 2003. The higher foreign debt estimate, as compared to the MP, can be attributed to two factors. First, high exchange rate differences in 2002 were the main reason for an increased 2002 baseline (total foreign debt missed the 2002 forecast by USD 1.8 billion). The second factor has to do with the government's expected borrowing to meet its liabilities payable in 2003 (as compared to the MP assumption). Long- and medium-term foreign debt should add up to USD 8.9 billion in 2003, with short-term debt expected to reach USD 4.6 billion.

Position -end of period in USD billion	2002 estimate	2002 actual	2003 MP	2003 UMP
Total gross foreign debt of the Slovak Republic	11.4	13.2	11.5	13.5
Total long-term foreign debt	8.2	9.0	7.8	8.9
thereof: official government and NBS debt	3.3	3.7	2.5	3.6
foreign debt of the commercial sector	4.5	5.3	5.3	5.3
Total short-term foreign debt	3.2	4.2	3.7	4.6
Net foreign debt of the Slovak Republic	2.0	-0.9	0.1	-0.7

3.4 Gross domestic product

The NBS Monetary Program for 2003 predicted GDP growth between 3.7% and 4.1% at constant prices (mid-range value of 3.9%), counting on foreign demand as the main driving factor. Foreign demand was expected to grow at double the pace of domestic demand.

The 2003 GDP forecast, as well as the estimate until the end of 2002 stated in the 2003 MP, were based on actual performance in the first two quarters of 2002. Economic growth surpassing NBS forecasts in 2002 (4.4% as opposed to 3.8%), combined with better performance in the foreign trade balance, prompted a revision to the GDP forecast for 2003.

As far as domestic demand is concerned, the 2003 Updated Monetary Program expects no major changes in trends in individual domestic demand components from the 2003 MP, except for the change in inventory stocks.

Consumer demand is likely to fare slightly below the MP 2003 level, with private consumption up 2.7% and public consumption (including consumption of non-profit institutions serving households) up 1.1% at constant prices.

Private consumption will be shaped by several factors. Its lower dynamics, as compared to the 2003 MP, will be largely related to a slight decline in real wages (in contrast to mid-range growth by 1.2% expected in the 2003 MP, the UMP predicts a mid-range drop by 0.1%). On the other hand, fairly heavy spending in 2002 is likely to influence the propensity to consume this year again, especially in higher-income households. Presumably, a distinct setback in the purchasing power of the population at the beginning of the year will wear off later on and consumption will stabilise gradually. This is also confirmed by the consumer confidence index which, after posting a sharp slump in November 2002, was on the rise between December and May 2003. With respect to consumer expectations, the most optimistic outlooks are seen in household's financial situation and the overall economic condition. The greatest pessimism, in contrast, prevails in savings expectations.

Development in final consumption of households, inflation and real wages

index, same period last year = 100
Private consumption at constant prices
Average annual rate of inflation
Real wages

Other factors keeping up the growth in private consumption near 3% include strong growth in mortgage loans, consumer loans and various forms of instalment sales, as well as a continuing rise in the number of tradesmen, reflected in a growing share of mixed income in ordinary household income.

The demand for fixed investments will rise on, in accordance with the 2003 MP. As in the monetary program, we are expecting to see business sector investments, focused primarily on environmental projects and expanding production in manufacturing industries, combined with accelerated local government investments into industrial park infrastructure and related land buyouts, rentals and exemptions, as well as continued construction of highways and high-speed motorways. Nevertheless, growth in fixed investments is likely to be somewhat slower than predicted in the 2003 MP due to lower gross fixed capital formation in 2002. In 2003, fixed investments could increase by 4.2% at constant prices (4.9% forecast in the 2003 MP). At this rate, fixed investments would stay at the 2002 level (28.9% at constant prices). Assuming that fixed investments would grow as predicted in the update, and a slight increase in inventories in 2003, gross capital formation should gain 1.9% at constant prices, falling short of the 5.1% forecast in the 2003 MP.

With individual domestic demand components developing as described above, aggregate domestic demand could rise 2.1% (3.2% in the 2003 MP). Effective domestic demand, net of the change in inventories, comprising only final consumption and fixed investments, could post a year-on-year increase by 2.8% at constant prices (3.2% in the 2003 MP).

The Updated Monetary Program expects the net export deficit (including the effect of unrecorded economy) to reach SKK 13 billion at constant prices (SKK 20 billion in the 2003 MP). A lower deficit is due to a revised foreign trade forecast which, unlike the 2003 MP, expects heightened export growth and flagging import growth. With price and exchange rate effects taken into account, reflected in increments in export and import deflators, exports of products and services (including the estimates for unrecorded economy) could gain 7.6% at constant prices, as opposed to a 5.0% rise in imports of goods and services.

As a result of a drop in net export deficit in 2003, we may expect GDP growth to pick up to 3.9-4.4% at constant prices (as compared to 3.7-4.1% in the 2003 MP), moving the mid-range estimate up 0.2% percentage points from the 2003 MP (to 4.1%).

GDP prediction for 2003 at constant prices, year-on-year change in %

	2002 estimate	2002 actual	2003 MP	2003 UMP
GDP at constant prices of 1995 (range) mid-range	**3.8**	**4.4**	**3.7-4.1 (3.9)**	**3.9-4.4 (4.1)**
Domestic demand*	3.1	4.0	3.2	2.1
Thereof:				
Final consumption total	5.4	4.9	2.5	2.2
Final consumption of households	5.9	5.4	3.0	2.7
Final consumption of government and non-profit institutions	4.3	3.8	1.1	1.1
Gross capital formation*	-2.4	1.7	5.1	1.9
Gross fixed capital formation	0.5	-0.9	4.9	4.2
Net exports	x	x	x	x
Exports of goods and services	4.8	5.9	5.9	7.6
Imports of goods and services	3.9	5.3	5.0	5.0

* Statistical discrepancy in respect of the change in inventories included for forecast purposes

According to updated forecast, individual GDP components are expected to contribute to its growth as follows:

Contribution of components to GDP growth at constant prices percentage points

	2002 actual	2003 MP	2003 UMP
GDP at constant prices of 1995 – range	**4.4**	**3.9**	**4.1**
Domestic demand*	4.1	3.3	2.2
Thereof:			
Final consumption total	3.6	1.9	1.6
Final consumption of households	2.8	1.6	1.4
Final consumption of government and non-profit institutions	0.8	0.2	0.2
Gross capital formation*	0.5	1.5	0.6
Gross fixed capital formation	-0.3	1.4	1.2
Net exports	0.3	0.6	1.9
Exports of goods and services	4.6	4.7	6.0
Imports of goods and services	-4.3	-4.1	-4.1

* Statistical discrepancy in respect of the change in inventories included for forecast purposes

Compared with the 2003 MP, its update scales down the contribution of domestic demand to GDP (to 2.2 percentage points from 3.3 percentage points in the 2003 MP). Economic growth should benefit to a larger extent from an improved net export deficit (contributing 1.9 percentage points, rather than 0.6 percentage points predicted in the 2003 MP). The risk to the real GDP forecast lies in actual changes in inventories, which could deflect GDP 0.5% either way.

Assuming real GDP growth at 3.9-4.4%, **GDP could reach SKK 1,185 billion at current prices in 2003.** Because of a higher increment in the GDP deflator in 2002, as compared to the NBS' estimate, the GDP deflator is supposed to reach 6.1% in 2003 according to the updated forecast.

	2002 forecast	2002 actual	2003 MP	2003 UMP
GDP at current prices				
SKK billion	1,063.0	1,073.0	1,170.0	1,185.0
Year-on-year increase in %	7.4	8.5	10.1	10.4
Implicit GDP deflator (year-on-year % increment)	3.5	4.0	5.9	6.1

3.5 Wages and employment

The 2003 Monetary Program envisaged annual growth in nominal wages at 9.0-11.0% and in real wages at 0.3-2.1%, assuming an average annual inflation of 8.7% (mid-range). The NBS considered nominal wage growth of up to 10% as acceptable, leaving enough room for labour productivity to grow ahead of real wages.

Latest development since the beginning of the year

According to statistical surveys of selected industries of the national economy for the first three months of this year, all industries reviewed registered lower growth in average monthly nominal wages than deemed acceptable by the NBS. In most industries, other than the construction industry, wholesale, post and telecommunications, nominal wage growth was lower than in the first three months in 2002.

In most surveyed industries, real wages trailed the levels recorded in the first three months a year earlier. Higher values were found only in real estate, leasing, trade and other services, post and telecommunications, and wholesale. Besides nominal wage development, real wages were also influenced by more rapid consumer price growth.

Development in wages and productivity of labour in January-March 2003 (index, same period last year = 100)

	Industry	Construction	Wholesale	Car sale and repair	Retail	Real estate, leasing, trade and other services	Transport	Post and telecom
Nominal wage	105.6	104.9	108.5	101.9	103.2	109.8	104.1	109.6
Nominal labour productivity*	x	x	121.4	x	x	x	104.8	115.9
Real wage	98.1	97.5	100.8	94.7	95.9	102.0	96.7	101.9
Real labour productivity*	109.4	108.3	x	116.1	98.6	96.5	x	x

Source: Slovak Statistical Office, monthly data on selected industries
*Labour productivity from sales of own products and merchandise

The relationship between wages and the labour productivity was positive from the beginning of the year, as labour productivity outpaced wages in most industries.

Assumptions made in the Updated Monetary Program and expected development till the end of the year

The development in nominal wages three months into the year in selected industries, in particular in manufacturing industries, retail and transportation, as well as other factors, indicate the possibility of lower wage growth than reckoned in the 2003 Monetary Program.

In manufacturing industries and a part of market services, employers are bound to take a cautious approach to wage raises, as their financial performance is likely to be hit, heavier than expected in the 2003 MP, by deregulated prices of electricity, natural gas and water, as well as a hike in fuel prices set off by a raise in consumption taxes slated to take effect on 1 July 2003. In the transportation sector, wage development may also be expected to veer off the path outlined in the monetary program, as both national railway companies intend to freeze wages in 2003 due to losses suffered in a strike earlier this year.

Wage development in non-market services, subject to laws on state and public service, embedded in the 2003 state budget, along with revisions to other laws designed to check excessive wage growth in the sector (including an amendment to the Public Service Act passed by the National Council of the Slovak Republic in May 2003, which cancels the 13th salary), also hint at slower wage growth than envisaged by the NBS.

The NBS Updated Monetary Program therefore expects nominal wages to grow at 7.5-9.5% in 2002 (8.5% mid-range) which, assuming a 8.6% inflation (updated value), means that real wages would range between –1.0% and 0.8%.

The bottom of the range seems more likely if the slowdown in nominal wage growth observed in selected industries earlier this year continues into the following months and if wages in the public sector do not cross the limits fixed in the 2003 state budget and in the amendment to the Public Service Act adopted this year in May.

Wages could be pushed closer to the centre, or the ceiling, of the interval by stronger wage growth in industries than in the period from January to March, massive layoffs connected with severance payments and/or other factors.

Predicted development in wages and labour productivity in 2003 year-on-year change in %

	2002 forecast (mid-range)	2002 actual	2003 MP {mid-range)	2003 UMP (mid-range)
Average monthly nominal wage	9.7	9.3	10.0	8.5
Average monthly real wage	6.0	5.8	1.2	-0.1
Labour productivity in GDP at c.p.	3.6	4.3	3.4	3.7
Real productivity – wage in perc. points	-2.4	-1.5	2.2	3.1
Average inflation	*3.5*	*3.3*	*8.7*	*8.6*

Based on the predicted economic growth and employment, real labour productivity in GDP per employee should rise approximately 3.7%. At that rate, it would grow some 3.8 percentage points faster than real wages (mid-range).

Employment, unemployment

According to the Monetary Program, active workforce in the Slovak economy should increase by 0.5% annually in 2003, while unemployment is expected to close the year at 17.5-18.0% (17.75% mid-range).

Latest development since the beginning of the year

By data on selected industries of the Slovak economy for the January-March 2003 period, employment went up in the construction industry and manufacture, but dropped in wholesale, retail, transportation, post and telecommunications, real estate, leasing, trade activities and other services. In April, the rate of registered unemployment dropped 2.63 percentage points from the same period year earlier to 15.44%.

Assumptions made in the Updated Monetary Program and expected development till the end of the year

The development seen in late 2002 and early this year in selected industries indicates that employment is likely to grow slower than expected in the 2003 MP, while unemployment will fall at a greater pace than predicted by the NBS.

This scenario will be the product of several factors, with growth stimulated by an anticipated heavier inflow of foreign investments related to Slovakia's pending accession to the European Union and NATO, construction of industrial parks, largely in connection with a continuing expansion of the car industry, investments and expanding capacity in other manufacturing industries, such as construction materials, light and electrotechnical industry, a continued pro-active policy in the labour market carried out by employment offices, and stricter conditions for unemployment welfare.

On the contrary, lowering in employment can be expected in connection with privatisation and cost-cutting campaigns in transportation (SAD privatisation, streamlining in railway transportation), gas and petrochemical industry, power networks, financial sector, as well as in connection with the sell off of the government's equity holdings, ownership reshuffles, and restructuring manufacturing industries (production streamlining, shedding of non-core lines, narrower specialisation, production upgrading to EU standards and norms, etc.).

In the light of the above, employment could rise 0.4% from year ago in 2003, with registered unemployment rate reaching 17.2% at year-end.[5]

Predicted development in employment and unemployment in 2003

	2002 estimate (mid-range)	2002 actual	2003 MP {mid-range)	2003 UMP
Employment – year-on-year change in %	0.2	0.1	0.5	0.4
Unemployment rate at year-end in %	17.5	17.4	17.75	17.2

3.6 Public sector

The 2003 State Budget Act targets a budget deficit of SKK 56.0 billion and a public budget deficit by ESA 95 methodology of SKK 56.9 billion (4.9% of gross domestic product).

Actual performance in first three months of 2003 points out certain risks, especially to achieving the tax revenue targets. As at March 31, tax revenues fell about SKK 7 billion short of expectations (net of seasonal effects). Most of the failure can be blamed on the value-added tax, where February and March brought enormous VAT refunds. This was likely the consequence of an amendment to the VAT law concerning tax assessment, as well as a cut in the basic VAT rate from 23% to 20%, while an increase of the lower VAT rate from 10 to 14% has yet to show its full effect. In May, the government took measures to eliminate these risks, including an increase in consumption taxes to come into force on 1 July 2003. As a result, we have kept the original values set out in the 2003 Monetary Program in respect of the budget deficit and fiscal deficit of the public sector in the Updated Monetary Program.

Non-tax income, as well as other types of taxes, have met expectations so far. In reviewing the development in the income tax, we allowed for the possibility of a 3-month deadline extension for filing tax returns.[6]

3.7 Monetary policy

Assumptions made in the Updated Monetary Program and expected development till the end of the year

Compared to the original Monetary Program, the Updated Monetary Program revises the following assumptions:

1. An estimated SKK 38 billion of foreign government debt falling due in 2003 will not be floated on the national market and, as a result, will not have a full impact on domestic indebtedness. According to the latest statements, a certain part of payable debt (EUR 500 million) will be settled by proceeds of (2-

[5] A decline in the rate of unemployment coinciding with a still relatively low employment growth could be caused by a part of workforce leaving the Slovak labour market or the labour market altogether.
[6] Which is why direct taxes cannot be evaluated by time of performance (pro rata share of the annual budget amount). Although the bulk of these payments take place in April (based on tax returns filed by March 31), the Act on administration of taxes and imposts allows the tax authority to grant a 3 months' extension to the tax return deadline. As a result, we will have to wait until July 2003 to draw some valid conclusions on income tax developments.

year) eurobond issues on foreign markets, with the rest placed on the domestic market. This will also increase, compared to the Monetary Program, the need for the NBS to drain excess liquidity off the domestic market.

2. In public finance, we are not expecting the ratio of the fiscal deficit to GDP to dwindle before 2004. Since 2002, we have recorded the fiscal deficit by ESA 95 methodology.

The Updated Monetary Program revises the Monetary Program assumptions concerning monetary aggregates because of different-than-expected actual development in late 2002 and a transition to a new bank accounting methodology in 2003. Larger differences are caused by missed estimates.

In 2003, the NBS will carry out its monetary policy against a backdrop of a robust economic growth, an improving balance of trade, and a mounting inflation fuelled by administrative price alignment. Price deregulation will have a temporary effect on the speed of price growth. Demand pressure on inflation will continue to be absorbed by low or even negative real wage growth.

Monetary policy implementation

Until the end of 2003, the monetary policy will be implemented in an environment characterised by a slightly higher-than-expected inflation, better performance in the balance of trade, and a fairly high GDP growth. In this kind of macroeconomic setting, there should be no need to make any major changes to the conduct of monetary policy.

When exercising its monetary policy the NBS will, as it always did, also take account of developments in other economic fundamentals, including the balance of trade and current account, and developments in real economy and the public sector. At the same time, the NBS will also watch the exchange rate development, especially against a backdrop of the situation in economic fundamentals. If the exchange rate is affected by short-term capital flows, rather than by actual economic development and the current account of the balance of payments in particular, the NBS stands ready to intervene both in the foreign exchange and money markets.

In its decision-making, the NBS will flexibly evaluate economic developments and take interest rate measures deemed best for a small and open economy. The most important thing is to prevent the economy from overheating, a loss of competitiveness, unsubstantiated deterioration of the balance of trade, and demand-driven inflationary pressure.

The NBS will conduct its monetary policy with due regard to short-term objectives, as well as to economic development in the medium-term horizon, to ensure price stability and compliance with the Maastricht criteria.

4. Conclusion – 2003 UMP summary

The Updated NBS Monetary Program for 2003 envisages year-end inflation within a 8.4-9.7% interval, with average inflation annual inflation at 8.3-8.8%. Core inflation should range between 2.1% and 3.6%.

Monetary program assumptions

- relatively stable exchange rate of the Slovak koruna against the euro, corresponding with actual economic performance
- oil price drifting within the OPEC reference band of USD 22-28/barrel (an average USD 25/barrel)
- 3.9-4.4% GDP growth at constant prices
- ratio of current account deficit to GDP at 4.5-5%
- SKK 56.9 billion fiscal deficit
- money supply growth at 10%
- enough room for corporate and personal loans to expand by 11.5%

Risks:

- heavy pressure on exchange rate appreciation
- slower economic growth in our trade partners

- different extent of changes in regulated prices and indirect taxes
- volatile oil price development (breaking outside the OPEC reference range of USD 22-28/barrel)
- volatile exchange rate against the USD, which affects both oil prices and the SKK equivalent of the balance of payments (the SKK/USD exchange rate applied in the UMP forecast and in the medium-term outlook was the current rate applicable in early May at the time the 2003 UMP was prepared)

5. Outlook till 2006 – Updated

In anticipation of the forthcoming tax reform, the updated medium-term outlook makes an upward adjustment to the inflation forecast for 2004. In the following years, the disinflation process should resume.

A positive development in GDP and the current account of the balance of payments in 2003 is also reflected in the medium-term outlook values, where a slight correction was made to improve the balance of trade deficit in individual years. Since no additional or other information on the government's privatisation plans was available, the relevant forecasts set out in the 2003 MP remain unchanged. The fiscal deficit predictions take account of the Slovak government's intentions.

5.1 Inflation

The main determinants of price development in the medium term will include ongoing deregulation, legislative approximation, notably in excise taxes, to EU standards, and a gradual alignment of core inflation. The speed and extent of administrative measures should be largely limited by the reference date of Slovakia's accession to the EU, i.e. 1 May 2004.

As regards regulated prices, the medium-term outlook for 2004-2006 is based on identical assumptions as the 2003 MP. Price regulation in network industries is supposed to follow the current rules, i.e. that prices will be set by the independent Network Industries Regulation Authority, based on valid and published assessments running into 2004-2006. After that period, prices are expected to cover eligible costs and reasonable profits and their further development is likely to reflect liberalisation of the energy market, behaviour in energy commodity prices on world markets and/or other cost factors.

In case of bus and railway transportation, were are expecting the implementation of a mechanism for regular price adjustments to actual price trends in the Slovak economy (annual growth at least equal to the previous year's inflation). Presumably, social discounts will be restricted and addressed, paving the way for a price liberalisation later on.

Expected changes in regulated prices and their impact on headline inflation

Proxy	2004		2005		2006	
	Expected growth including VAT change	Contribution	Expected growth	Contribution	Expected growth	Contribution
Electricity	9.6	0.4	7.0	0.3	3.5	0.2
Heat*	8.7	0.4	4.5	0.2	3.5	0.2
Natural gas*	37.6	1.3	3.0	0.1	1.5	0.1
Railway transportation*	8.6	0.0	8.1	0.0	4.7	0.0
Bus transportation	8.6	0.2	8.1	0.2	4.7	0.1
Water*	33.4	0.2	20	0.1	3.9	0.0
Sewage disposal*	30.3	0.1	20	0.1	3.9	0.0
Postage	8.6	0.0	8.1	0.0	4.7	0.0
Rent	60.0	0.5	8.1	0.1	4.7	0.0
SUM		3.2		1.1		0.6

* price growth at the rate of inflation in case of railway and bus transportation, and postage since 2004, in case of rent since 2005

A rise in other practically controlled prices (such as university dormitory accommodation, school boarding, health care prices) should add 0.4 percentage points to inflation in 2004, about 0.2 in 2005, and 0.1 percentage points in 2006 (estimate based on similar behaviour in recent years).

Other assumptions include a continuing approximation of taxes to EU standards (with taxes on tobacco and tobacco products scheduled to rise every year) and the adoption of the common agricultural policy upon Slovakia's entry to the EU in 2004, which is bound to spark growth in consumer prices. However, its impact on food prices may be offset in part by retail competition. In addition, a single VAT rate is expected to apply since 2004.

In the medium-term horizon, the intensity of changes in regulated prices should go down, and gradual come to reflect overall price developments in the Slovak economy (endogenous price development) and possible changes in world commodity prices and the exchange rate of the Slovak koruna. The scope of administrative measures should be largely limited by the reference date of Slovakia's accession to the EU, i.e. 1 May 2004. Following a sharp upturn in regulated prices in 2003, rapid growth is set to continue in 2004 and then let up in the following years. As a result, the impact of regulated prices on inflation is supposed to wane in 2005 and 2006. Towards the end of the medium-term horizon, headline inflation could thus draw closer to core inflation, with any remaining gaps due in particular to ongoing changes in indirect taxes.

An element of uncertainty about the inflation trend in 2004-2006 comes from several factors. One of them is the impact of the adoption of the common agricultural policy on consumer prices. What is positive, in contrast, is a clear-cut regulatory framework laid down by the Network Industries Regulation Authority in respect of prices of individual regulated items with the heaviest weight in overall regulated prices. Besides, regulated prices, which already cover eligible costs and reasonable profits, are expected to grow at or below the rate of previous year's inflation.

The development in core inflation so far suggests that its growth is more affected by domestic cost factors than by demand pressure. That is why the core inflation trend till 2006 should be tied closely to the intensity of cost pressure which, in turn, will be determined by the extent of deregulation. Assuming a stabilised exchange rate, diminishing administrative interventions in 2005-2006 should lead to a downtrend in core inflation.

2006 outlook – updated

2006 inflation outlook (MP and UMP forecasts) as in December of given year

		MP 2003	2003 UMP	2004	2005	2006
Inflation {%)	year-on-year	8.7 (7.7-9.7)	9.1 (8.4-9.7)	8.3 (7.5-9.0)	3.6 (2.8-4.3)	2.9 (2.1-3.6)
	average year-on-year	8.8 (8.2-9.3)	8.6 (8.3-8.8)	8.1 (7.6-8.6)	4.7 (4.2-5.2)	3.1 (2.6-3.6)
Core inflation	year-on-year	3.9 (2.7-5.0)	2.8 (2.1-3.6)	4.8 (4.0-5.5)	1.9 (1.1-2.6)	1.6 (0.8-2.3)
	average year-on-year	3.5 (2.9-4.1)	2.5 (2.2-2.8)	3.6 (3.1-4.1)	2.9 (2.4-3.4)	2.3 (1.8-2.8)

5.2 Industrial producer prices

The industrial producer price predictions for the 2006 horizon rest on identical assumptions as the 2003 MP. Namely, ongoing structural changes in the business sector, with privatisation nearing its end and a related gradual growth of performance and competitiveness, translating into rising export performance, productivity of labour and new job creation.

The development in domestic cost factors will be characterised by the price deregulation process reaching its final stages, with a consequent impact on gradual disinflation in the manufacturing sector. In 2005-2006, energy prices will largely depend on market conditions (prices of oil and natural gas on world markets, rate of growth in domestic consumer prices), while liberalisation in network industries (already underway) will allow an increasing number of firms to freely choose their energy (national and foreign) suppliers and thus cut their costs.

Unlike the cost of energy, price developments in the food-processing industry will have a pro-inflationary effect on producer prices. Following the adoption of the common agricultural policy (CAP) upon EU entry in May 2004, several farming products will become more expensive, spurring price growth in the processing industry in the process.

With respect to external cost factors in the 2006 horizon, we are expecting a steady trend in oil and natural gas prices on world markets, which should settle below current levels and thus help reduce producer prices in the medium run.

2006 producer prices outlook the same period of previous year = 100

	2003 UMP	2004	2005	2006
Average annual index	108.0	105.1	103.6	102.7

The basic assumption underlying the forecast for farming product prices in the medium run is the adoption of the CAP upon Slovakia's accession to the EU in May 2004. Most agricultural products will be subject to the EU's intervention policy, which means their prices will move up to EU levels. Besides the efficiency of national producers, their growth will depend on the cost of labour, land and capital, which may step up their rise.

5.3 Foreign accounts

5.3.1 Balance of payments

The predicted development in the balance of payments in 2003 and the arrival of an investor into the automobile industry are the main assumptions behind the changes in the performance of the balance of payments in 2004-2006. During this period, the deficit of the balance of trade should widen in 2004 and 2005 in all probability, fuelled by heavier imports of machinery and equipment for the car industry, and then drop sharply in 2006 when car exports begin.

The balance of services will move along the lines of its volume and composition in 2003. Transportation and travel are set to remain the chief components generating net income on Slovak services. The balance of services will reach an aggregate surplus between SKK 16 billion and SKK 18.5 billion. A moderate increase in the balance of services in consecutive years should be driven by mounting travel income. This is only a general prediction, which does not allow for possible setbacks in competitiveness of domestic service providers (in the "other services total" item) in the aftermath of EU entry, which could increase imports of these services (the fact that "other services total" already carry a large deficit, or a possible yet further increase in their imports, would adversely affect the balance of services and, consequently, the current account of the balance of payments).

The balance of income (less employee compensation) will be determined, apart from corporate lending performance, by mounting dividend payments to (direct and portfolio) foreign investors (government bonds held by non-residents). The annual deficit of the balance of investment income will range between SKK 27.4 billion and SKK 30.7 billion. The deficit will be reduced by income from compensation of employees working abroad. This item may also experience major changes coming in the wake of labour market liberalisation and Slovak citizens' willingness to work abroad (swelling employee compensation income will have repercussions on travel expenditures, which include expenditures incurred by expatriate workers).

The deficit of the balance of trade is bound to be the determining factor of current account behaviour. Expanding imports, driven by machinery and equipment imports, will trigger a temporary upsurge in current account deficit in 2004 and 2005, as compared to 2003. The current account deficit could retreat more significantly in 2006 thanks to rising exports of conveyances. The ratio of current account deficit to GDP will stay below 5% during the entire prediction period.

SKK billion

	2004	**2005**	**2006**
Balance of trade	-74.0	-72.0	-58.0
Balance of services	16.0	17.5	18.5
Balance of income	-8.8	-10.7	-12.2
Current transfers	4.0	3.0	2.5
Current account	-62.8	-62.2	-49.2
Ratio of current deficit to GDP in %	-4.8	-4.4	-3.3

Apart from typical sources (direct and portfolio investments and trade and financing credits), the current account deficit should also be financed by EU pre-accession funds – capital transfers. In the period considered, net income from the European Communities (the difference between contributions received from EU budget and funds and paid to EU budget) is estimated at roughly SKK 43.0 billion. However, some of the authorised income of SKK 88.0 billion may not be realised, as over 75% of ES funding is project-based, meaning that the right to draw arises only after the presentation of acceptable draft projects, with a failure to do so possibly resulting in much lower actual drawdown.

A stabilising political and economic development could mean larger FDI inflow into the commercial sector, with the construction of an automobile factory in Slovakia bound to play the main role in 2004 and, in part, in 2005, possibly attracting other foreign investors. During this period, a changing structure will be important, as the bulk of foreign direct investments will stream into the industry, and the construction of shopping centres will no longer be so extensive as in the previous years.

The sell off of state-held interests in Slovak enterprises is set to continue with the privatisation of Slovenské elektrárne (power utility) in 2004 (put off from 2003). Further privatisation activities will depend on the government's decision to sell its remaining interests in strategic enterprises privatised in earlier years (the NBS prediction expects some remaining holdings in strategic enterprises to be sold in 2004 – worth SKK 50.0 billion, in 2005 – SKK 50.0 billion, and 2006 – SKK 100.0 billion).

Portfolio investments are likely to be influenced both by corporate and government sector transactions. The item should experience no major swings and the value of portfolio investments could lie between SKK 8.1 billion and SKK 10.6 billion.

In other long-term investments, 2004 is supposed to end with a deficit of SKK 34.9 billion, going up to SKK 38.3 billion in 2005. Redemption of foreign currency denominated government bonds (USD 575.0 billion maturing in 2004 and USD 525.0 billion in 2005) will have an impact on other long-term investments in 2004 and 2005. In 2006, the shortfall in other long-term investments should shrink (SKK 19.5 billion) from previous years due to lower government debt service.

In sectoral breakdown, the corporate sector is expected to turn down its foreign lending amid falling interest rates and better access to domestic loans. The borrowing volume will depend on the ability to draw pre-accession funds which, like financing loans, will flow into the corporate sphere and, in the process, should bolster competitiveness both on domestic and foreign markets.

The forecast does not see short-term capital playing any major role in financing the economy's needs. The business sector, with its export receivables and import payables, is expected to stand out as the most active component in its structure.

SKK billion	2004	2005	2006
Capital transfers	11.0	15.0	17.0
Direct investments	105.0	90.3	130.0
Portfolio investments	8.1	10.6	9.1
Other long-term financial account	-34.9	-38.3	-19.5
Short-term financial account	0.2	0.4	-4.2
Capital and financial account	89.3	77.9	132.4

Assuming the predicted privatisation income in 2004-2006, NBS foreign exchange reserves will swell during the entire period. Their growth (USD 0.7 billion in 2004, USD 0.4 billion in 2005, and USD 2.1 billion in 2006) will allow them to reach USD 12.6 billion by the end of 2006. This, coupled with the development in imports of goods and services, will increase the average coverage of imports of goods and services from 4.9 months in 2004 to 5.2 months in 2006.

Adjusted balance of payments

SKK billion	2004	2005	2006
Current account	-59.6	61.5	51.8
Capital and financial account (CFA)	61.7	61.8	51.8
Foreign direct investments (FDIs)	45.0	42.0	32.0
NBS interventions	0.0	0.0	0.0
Change in net foreign assets (- increase)	-2.1	-0.3	-3.2
Current account coverage by CFA in %	103.5	100.5	106.6
Current account coverage by FDIs in %	75.5	68.0	65.8

The adjusted balance of payments, stripped of the effects of Slovak government and NBS activities not affecting commercial banks' positions against non-residents and not representing current account financing, should be more or less even in 2004-2006, meaning that the inflow of funds into the corporate sector will be sufficient to cover the current account deficit, and net foreign assets held by commercial banks will grow just slightly. Direct foreign investments are expected to add a major share to the inflow of funds into the corporate sector, covering nearly 3/4 of the current account deficit.

5.3.2 Foreign debt

During the entire forecast period, foreign debt will barely move, edging down from USD 13.1 billion to USD 12.6 billion.

Position -end of period in USD billion	2004	2005	2006
Total gross foreign debt of the Slovak Republic	13.1	12.6	12.6
Total long-term foreign debt	8.2	7.5	7.2
thereof: official government and NBS debt	3.1	2.5	2.5
foreign debt of the commercial sector	5.1	5.0	4.7
Total short-term foreign debt	4.9	5.1	5.4
Net foreign debt of the Slovak Republic	-2.1	-3.2	-5.8

Slovakia is supposed to be in the creditor position in net foreign debt between 2004 and 2006. Its amount will depend on growth in NBS foreign exchange reserves resulting from privatisation income.

5.4 Gross domestic product

Progress in the approximation of Slovakia's standards of living to European Union levels can be ensured by higher GDP increments. The priority is to step up economic performance at a pace which is sustainable in the long run, to increase competitiveness, and to improve the labour market situation which, added to other factors, could help real convergence. After slackening temporarily in 2003, we expect real GDP growth above 4% year-on-year (within 4.2-4.6%) in the 2006 outlook, letting up slowly towards the end of the period.

	2003 UMP	2004	2005	2006
GDP in SKK billion, constant prices	768.5	800.5	835.5	874.0
GDP in SKK billion, current prices	1,1865.0	1,305.0	1,410.0	1,510.0
Year-on-year GDP growth, constant prices	4.1	4.2	4.4	4.6
Growth in domestic demand	2.1	4.5	4.1	3.9
Growth in foreign demand	7.6	4.2	5.9	11.5
Net export deficit, constant prices	-13.0	-16.5	-15.0	-10.0

Within the GDP structure, export performance of the Slovak economy must necessarily strengthen, which seems likely in the light of expanding economic capacity and FDI inflow. Accelerating investment growth, to the verge of 8% annually, should be owed to an ongoing technical and technological innovation of production facilities, and to the implementation of environmental projects designed to maintain and enhance the competitiveness of local companies. In domestic demand, private consumption is expected to grow at 3-4%, trailing GDP. A moderate increase in public consumption projected at 1.2-1.5% should reflect a decreasing government share in GDP generation due to public finance consolidation. Higher gains in final consumption of government towards the end of the period may be related to Slovakia's presence in EU administrative bodies, development of an institutional system within the EU organisation structure, as well as to pre-election activity. Greater opportunities for EU funding should coincide with a phaseout of various forms of assistance provided to national businesses and with a standardisation of its regulation with EU conditions (guarantees, subsidies, government aid).

Strengthening export performance and accelerating investment demand require the acceptance of heavier investment and intermediate consumption imports, at the expense of an eroding share of consumption imports. We may expect that, largely due to higher imports of production technologies for the car industry, the net export deficit could stage a temporary upswing in 2004. After that, however, the net export deficit is likely to diminish and make a larger contribution to GDP growth as a result of stronger growth in exports of goods and services.

5.5 Wages and employment

Wage development in the medium-run should be driven by a gradually rising economic performance, a heavier inflow of foreign direct investments in connection with Slovakia's entry into NATO and the EU, a growing investment demand by national firms, as well as a decreasing overemployment and pressure on higher productivity of labour in the private sector. While in 2004, we may still expect restricted nominal wage growth both in the public and private sector (up 8.1% combined, i.e. around the 2004 average inflation forecast, but below the 2003 average inflation target in the 2003 Monetary Program)[7], at the end of the forecast period, especially in the run-up to the 2006 elections, wage restraints in the public sector could ease up. This assumption, combined with a vigorous labour productivity growth in the private sector could send nominal wages rising 6.0% annually in 2005-2006. Wage growth may also be influenced by the fact that Slovakia's wage level is well behind the EU member states, and the lowest in Central Europe. Although the wage level will take a long time to catch up with other countries, we need to expect this factor to have some effect in the medium-term horizon as well.

Nominal wage levels in the Slovak Republic, Czech Republic and Hungary
*/ Hungary's 2002 data is for quarters I-III

Wage growth will still be curbed by supply in the labour market, leading demand by a long distance, by just slowly relaxing restraints to free movement of workers in new EU members, and by the necessity to ensure domestic and foreign competitiveness of Slovak firms primarily by keeping labour productivity growth ahead of wage growth.

The hazard to projected development lies in wage development in the public sector, where it is desirable to steer wages so as to support the consolidation of public finance required for joining the EU and EMU. That is also why we are expecting restrained growth in nominal wages paid to state and public employees in 2004 again (early growth estimate at 5%). The question is to what extent this intention, after wage restrictions adopted in 2003, can be fulfilled in 2004 as well. If amendments fail to pass to laws on state and public service, which establish claims to so-called additional salaries, as well as to other related laws concerning special groups of persons, the public sector could stage a sharp rise in wages and break the expectations. Since nominal wages in the public sector are lower than in other sectors, they can be expected to outgrow the national economy average. Such growth would be acceptable if it were an intensive, rather than extensive growth, i.e. generated by falling employment and without any adverse impact on the fiscal deficit.

Annual real wage growth, mainly in the light of the anticipated upturn in economic performance and gradually declining average inflation in the second half of the forecast period, should pick up from 0% in 2004 to near 3.0% in 2006.

Given a fairly steady growth in economic performance and a gradually accelerating, though slight, growth in employment, the productivity of labour in GDP per employee of the national economy should stay ahead of real wages in the medium run, even though its advantage is likely to shrink after 2004.

Development in wages and productivity of labour – 2006 outlook year-on-year change in %

	2003 UMP	2004	2005	2006
Average monthly nominal wage	8.5	8.1	6.0	6.0
Average monthly real wage	-0.1	0.0	1.2	2.9
Labour productivity of GDP at constant prices	3.7	3.5	3.7	3.9
Average inflation rate	*8.6*	*8.1*	*4.7*	*3.0*

Development in wages and labour productivity till 2006 – cumulative
Nominal wage index – cumulative

[7] Wage negotiations often look at previous year's inflation.

Nominal labour productivity index – cumulative
Real wage index – cumulative
Real productivity of labour index – cumulative

Development in nominal wages in SKK, EUR, USD till 2006
index, same period last year = 100

Nominal wage level in the Slovak Republic in EUR and USD
Nominal wage in USD
Nominal wage in EUR

Employment, unemployment

In the medium run, employment should be encouraged by several factors, notably a larger inflow of foreign investments in connection with the Slovak Republic's accession to the EU and NATO, and the implementation of projects supported by EU structural and cohesion funds, which might spark investment activity and create more jobs also in underdeveloped regions with higher unemployment rates (even though the resolution of the problem of regions lagging behind is a long term process). The construction, preparation and start-up of a PSA Peugeot Citroen car plant, as well as the development of other industrial and technological parks, are seen as major investments with an impact on employment. Based on the above, employment can be expected to pick up slowly in the period to 2006, with a 0.6% year-on-year increase in 2004 possibly edging up to 0.7% annually in 2005-2006.

In 2004-2006, we are expecting only a minor improvement in the unemployment trend, as the economy is unlikely to generate the kind of job opportunities required to produce any major decline in the rate of unemployment.

Development in employment and unemployment – 2006 outlook

	2003 UMP	2004	2005	2006
Employment – year-on-year change in %	0.4	0.6	0.7	0.7
Unemployment rate at year-end in %	17.2	17.0	16.5	16.5

5.6 Public finance

In public finance, the NBS expects to see the fiscal deficit to dwindle in line with the Slovak government's intentions. According to this medium-term outlook, the public finance deficit should fall to the point where it will allow the Slovak Republic to meet the Maastricht criterion in 2006.

	2002	2003	2004	2005	2006
Deficit by IMF methodology (% of GDP)	-4.9	-4.5	-4.0	-3.4	
Deficit by ESA methodology (% of GDP)	-7.8	-4.9	-3.9	-3.3	3.0

By our predictions, the public sector performance should develop as follows in the period from 2003 to 2006:

	2003	2004	2005	2006
State budget revenues	235.0	264.0	280.0	305.0
State budget expenditures	291.0	316.0	320.0	340.0
State budget deficit	-56.0	-52.0	-40.0	-35.0
% of GDP	4.8	4.0	2.8	2.3
Fiscal deficit				
by ESA 95 methodology	-56.9	-51.8	-48.0	-46.0
% of GDP	4.9	4.0	3.4	3.0

Anticipated financial impacts of the pension reform, with repercussions on public sector deficits, call for swifter cuts in the state budget deficit. This, combined with an effort to measure up to the Maastricht criterion, will require setting aside adequate reserves in central government finances.

5.7 Monetary development and monetary policy

Both in connections with a gradually falling inflation, and in anticipation of convergence in published (i.e. short-term) interest rates to euro area rates (we are already meeting the Maastricht interest rate criterion on long-term rates), we suppose interest rates to go down in the medium run. Besides falling inflation, other macroeconomic indicators, in particular the fiscal deficit and the balance of trade, should also pave the way for interest rates to develop as predicted. An interest rate decline will not only be in accordance with the overall economic development, but a narrowing interest rate differential will relieve exchange rate appreciation pressure.

In the medium-term horizon, the method used for the calculation and monitoring of and interest accrual on required reserves will be harmonised. With an expected large volume of excess liquidity sterilisation, the additional cost of around SKK 1 billion of interest accrued thereon can be neglected. Another estimated SKK 7 billion drop in the volume of required reserves in 2004-2005, triggered by a RR rate cut from today's 3% to 2%, will take their level down to SKK 15 billion.

Growth in money supply should be flagging as a result of a disinflation trend and public finance consolidation. Likewise, the interest rate level, which has an impact on money supply expansion, should also head down to euro area level. In contrast, growth in net foreign assets will step up, fuelled by privatisation projects delayed from 2003 and a sell off of remaining government shares in strategic enterprises. Such a development will create room for expanding lending activity, which should ensure lasting economic growth. The credit expansion is also necessary in connection with the co-financing of projects from pre-accession funds. As long as real wage growth keeps a "safe" distance from productivity of labour, the credit expansion should not put any demand pressure on price growth.

The monetary policy will be conducted against a backdrop of falling inflation, a temporary rise in the balance of trade deficit, financed by a sufficient inflow of foreign capital, consolidating public finance, and pressure on appreciation of the Slovak koruna. This will continue to determine a sterilising nature of monetary policy actions, which is likely to reinforce.

Main economic and monetary indicators

	2001	2002	2002	2002	2003	2003	2003	2004	2004	2004
	Actual*	**Monetary Program**	**Updated Monetary Program**	**Estimate**	**Actual**	**Monetary Program**	**Updated Monetary Program**	**Outlook**		
(year-on-year change in %)										
Gross domestic product (constant prices)	3.3	3.5-3.8	3.5-3.8	3.8	4.4	3.7-4.1	3.9-4.4	4.2	4.3	4.6
Core inflation (year-end)	3.2	3.2-4.7	3.2-4.7	1.9-2.2	1.9	2.7-5.0	2.1-3.6	4.0-5.5	1.1-2.6	0.8-2.3
Consumer price index (annual average)	7.3	4.1-4.9	3.6-4.2	3.3-3.4	3.3	8.2-9.3	8.3-8.8	7.6-8.6	4.2-5.2	2.6-3.6
Consumer price index (year-end)	6.5	3.5-4.9	3.5-4.9	2.9-3.2	3.4	7.7-9.7	8.4-9.7	7.5-9.0	2.8-4.3	2.1-3.6
Gross domestic product (nominal, SKK billion)	989.3	1,032.0	1,032.0	1,063.0	1,073.7	1,170.0	1,185.0	1,305.0	1,410.0	1,510.0
Money supply (M2)	11.9	10.5	11.4	10.4	3.3	10.0	10.0	10.0	8.0	7.0
Corporate and private loans	4.7	7.5	6.9	12.2	11.7	9.3	11.5	9.3	7.4	7.0
Sterilising position vis-à-vis the banking sector (SKK billion)	-67.3	-170.8	-159.6	-156.6	-137.2	-122.6	-173.5	-181.9	-173.4	-208.4
Import coverage (monthly average goods and services) by reserves	3.1	4.1	5.6	5.8	5.9	4.4	4.9	4.9	4.8	5.2
Balance of payments current account deficit to GDP (%)	-8.6	-7.9	-8.3	-8.4	-8.2	-6.2	-4.5	-4.8	-4.4	-3.3
Official NBS reserves (USD million)	4,346.4	6,575.9	8,455.3	8,976.9	9,195.5	8,058.9	9,405.7	10,075.9	10,473.6	12,580.8