NÁRODNÁ BANKA SLOVENSKA
EUROSYSTÉM

MEDIUM-TERM FORECAST

Q4
2013

Published by:
© Národná banka Slovenska

Address:
Národná banka Slovenska
Imricha Karvaša 1
813 25 Bratislava
Slovakia

Contact:
Monetary Policy Department
+421 2 5787 2611
+421 2 5787 2632
Press and Editorial Section
+421 2 5787 2146

Fax:
+421 2 5787 1128

http://www.nbs.sk

Discussed by the NBS Bank Board
on 10 December 2013.

ISSN 1338-1474 (online)

Contents

LIST OF BOXES

LIST OF CHARTS

CHARTS IN BOXES

LIST OF TABLES

1 Summary

This NBS forecast (MTF-2013Q4) was produced as part of Eurosystem-wide preparations for the ECB's macroeconomic projections for the euro area. It is based on the common technical assumptions of those ECB projections and on assumptions for external demand, while also incorporating flash estimates of economic growth and employment.[1]

After increasing slowly over the past two years, external demand is expected to return gradually to a stronger upward trajectory. This assumption is based on the continuing recovery of the euro area economy, which grew in the third quarter by 0.1% over the previous quarter to record a second successive quarter of growth. The projected upturn in external demand for Slovak products and services is moderately less pronounced in this forecast than in previously expected.

According to the flash estimate, the Slovak economy grew in the third quarter by 0.2%, as projected in the previous forecast. The composition of that growth, however, probably differed from expectations. Based on monthly indicators, it may be assumed that growth was driven mainly by domestic demand (including changes in inventories), rather than by exports. In addition to the flash estimate for third-quarter growth, the Statistical Office of the Slovak Republic (SO SR) made historical revisions to the national accounts for 2012 and 2013. Not only were there revisions to the overall level of GDP and partly to its rate of change, but also substantial revisions to its composition. This, along with growth composition being different from projections, resulted in a change to the outlook for contributions to growth, but not for overall GDP. **Growth is projected to be 0.9% in 2013, gradually accelerating to 2.2% in 2014 and 3.1 in 2015.** The main contributor to economic growth should continue to be exports. Over the projection horizon, growth is expected to be supported by domestic demand and a loosening of fiscal policy, thereby becoming more balanced as a result. As in the previous forecast, the main risks to the growth outlook are developments in external demand and any additional fiscal consolidation measures. The possibility of an increased consolidation effort has become more prominent following the European Commission's assessment of Slovakia's general government budget proposal for next year. The EC confirmed that the budget proposal complied with the Stability and Growth Pact, but it also pointed to slippage in the consolidation effort while noting that Slovakia cannot be considered at this stage eligible to benefit from the so-called "investment clause" as it is still subject to the excessive deficit procedure.

Turning to price developments, **the inflation rate is expected to decelerate further, down to 1.5% in 2013 and 1.3% in 2014**. The relatively low price growth should reflect weak consumer demand, falling energy prices, and the stabilisation of food prices. As domestic demand picks up, inflation is projected to **increase in 2015, to 1.8%.**

1 *The composition of GDP growth for the third quarter of 2013 was not known when the forecast was produced.*

2 Current developments in the external environment and Slovakia

Global economy maintained moderate growth

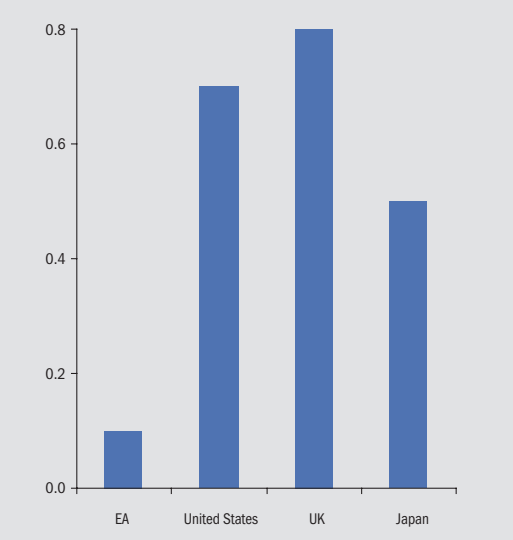
The global economy has recently seen a shift in the regional breakdown of its growth. In emerging economies, growth has decelerated as a result of constrained financial conditions, which reflect expectations of a less expansive monetary policy in the United States as well as the effect of volatility in financial markets. At the same time, some economies are dependent on external financing, and therefore are vulnerable to any reduction in such funds. In the case of China, however, economic growth began to accelerate again owing mainly to investment activity. On the other hand, private consumption and exports continued the weakening trend observed in the previous quarter.

Advanced economies, by contrast, are gradually beginning to make a more substantial contribution to global economic growth. In the United States, despite the short-term impact of fiscal tightening and uncertainty created by the postponement of a debt ceiling solution, economy activity growth was higher in the third quarter than in the previous quarter. This acceleration was driven mainly by net exports and changes in inventories. The private consumption and fixed investment components also contributed positively to US economic growth. The UK's economic performance strengthened in the third quarter, too. Japan's economic growth was lower compared to the second quarter, but nevertheless continued to benefit from monetary and fiscal stimulus.

Global growth expected to remain fragile

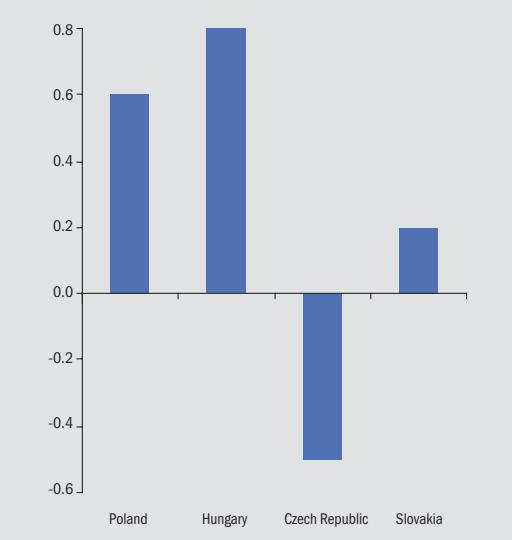
The gradual recovery of advanced economies is expected to continue in the medium-term horizon. Their growth may, however, be restrained by the ongoing re-emergence of private sector imbalances and by the impact of fiscal consolidation efforts (albeit to a lesser extent than before). At the same time, structural obstacles will dampen growth in emerging economies. Although the recent period has seen financial conditions stabilise, a combination of rising interest rates and a narrowing scope for expansive economic policy may moderate growth in these economies.

Chart 1 GDP growth in Q3 2013 (quarterly percentage changes)



Source: Eurostat.

Chart 2 GDP growth in Q3 2013 (quarterly percentage changes)



Source: Eurostat.

For a majority of the OECD's largest economies, the Composite Leading Indicator (CLI) continued its upward trajectory in the third quarter. For emerging economies, however, the CLI reading shows heterogeneous developments: for China, it confirms the acceleration of economic growth, while for certain other countries it suggests growth will stabilise or remain moderate.

Euro area economy grew in the third quarter of 2013

According to Eurostat's flash estimate, the euro area's economic growth slowed to 0.1% in the third quarter (from 0.3% in the second quarter). Across the largest euro area economies, however, the situation remained heterogeneous. The German economy continued to expand (by 0.3%), albeit more moderately than in the previous quarter, and the Spanish economy grew slightly (by 0.1%) after nine quarters of contraction. The Netherlands, too, reported modest growth (0.1%). By contrast, the Italian economy continued to shrink (by 0.1%), and French economic activity also declined (by 0.1%), after increasing quite substantially in the second quarter. Among the countries hardest hit by the debt crisis, Portugal saw a second successive quarter of growth. Business sentiment and consumer confidence remain positive, although according to certain indicators they have moderated in recent months. A number of forward-looking indicators point to further modest economic growth in the fourth quarter of 2013. Obstacles to a more robust recovery remain, however, in the form of persisting limited uncertainty about the debt crisis situation and the still depressed situation in the labour market, which is holding back consumer demand growth.

Czech economy surprisingly contracts in the third quarter

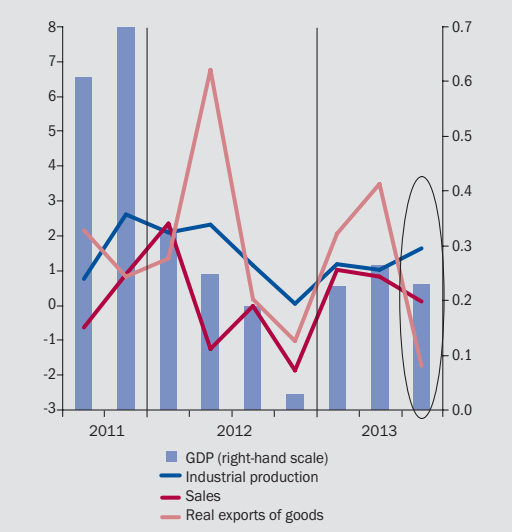
The Czech economy contracted substantially in the third quarter of 2013, by 0.5%[2] according to the flash estimate. After its growth in the second quarter, this development came as a surprise. The main negative contributors were probably net exports, with import growth significantly higher than export growth, and weak investment activity in non-construction sectors. The decrease in economic activity was the more surprising given that forward-looking indicators and sectoral data signalled positive developments in the Czech economy.

Slovakia's moderate economic growth reflected developments in the euro area

Slovakia's economic results for the third quarter confirmed the assumptions of the previous forecast. According to the SO SR's flash estimate, Slovak GDP grew by 0.2%. Monthly figures for sales, manufacturing production and exports indicated that the source of that growth was not exports, but other components of GDP. Exports of goods and services declined, in a partial correction of their marked growth in the second quarter, and import growth slowed. The overall trade balance was lower compared to the previous quarter, and therefore net exports probably had a negative impact on third-quarter economic growth.

The main driver of economic growth was probably consumption, and in particular a substantial contribution from changes in inventories. Subsequent to the publication of the flash estimate for growth, the SO SR historically revised the national accounts, in particular reducing the GDP figures of 2012 and the first half of 2013 (by between 0.5% and 0.8%) and adjusting the composition of GDP. In real terms, private consumption and exports for the first half of 2013 were revised down; this change contributed significantly to the revision of the components of this year's growth and had a partial impact on the figures for 2014.

Chart 3 GDP and industrial production (quarterly percentage changes)



Source: NBS and SO SR.
Note: Real exports of goods were calculated using export price deflator.

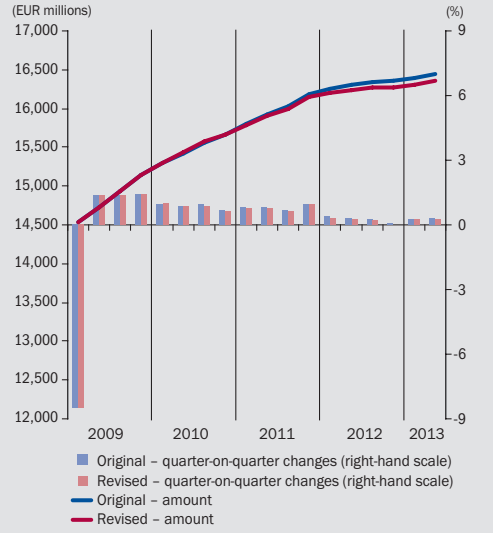
2 *According to the revised estimate, the Czech economy contracted by 0.1% in the third quarter.*

Box 1

REVISION OF NATIONAL ACCOUNTS RESULTED IN MODERATE REDUCTION OF HISTORICAL GDP FIGURES

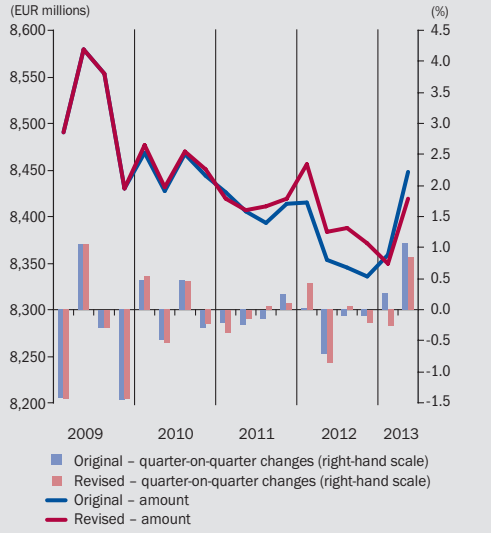
The SO SR revised the quarterly national accounts for the period from the first quarter of 2009 to the second quarter of 2013. Historical GDP figures were reduced, and quarter-on-quarter GDP, beginning with the fourth quarter of 2010, was also revised down slightly (by between 0.02 and 0.10 percentage point). In the composition of GDP, the largest average downward adjustment was to fixed investment and largest upward revision was to changes in inventories and the imputed category (statistical discrepancy and chain-linking errors).

Chart A GDP (real, seasonally adjusted)



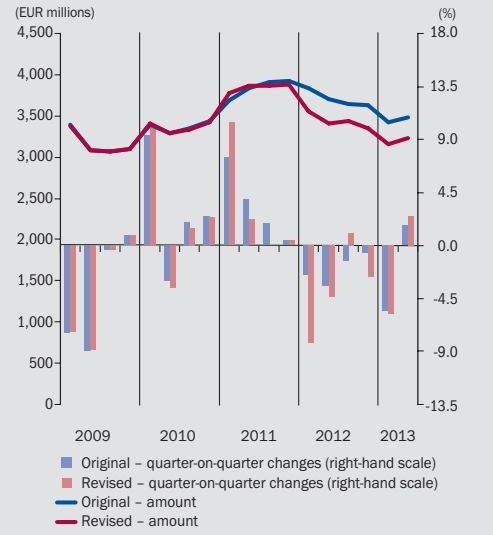
Source: SO SR and NBS.

Chart C Household final consumption (real, seasonally adjusted)



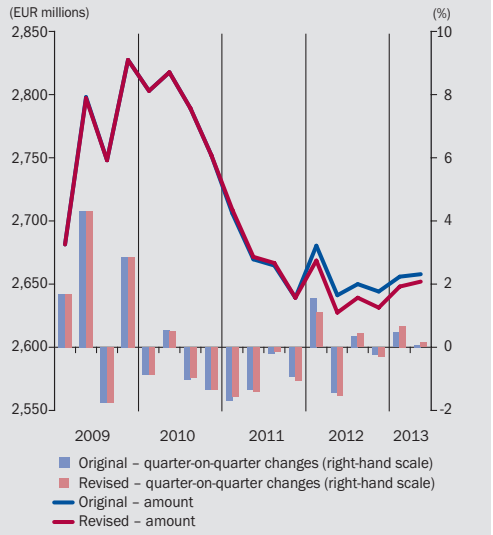
Source: SO SR and NBS.

Chart B Gross fixed capital formation (real, seasonally adjusted)



Source: SO SR and NBS.

Chart D General government final consumption (real, seasonally adjusted)



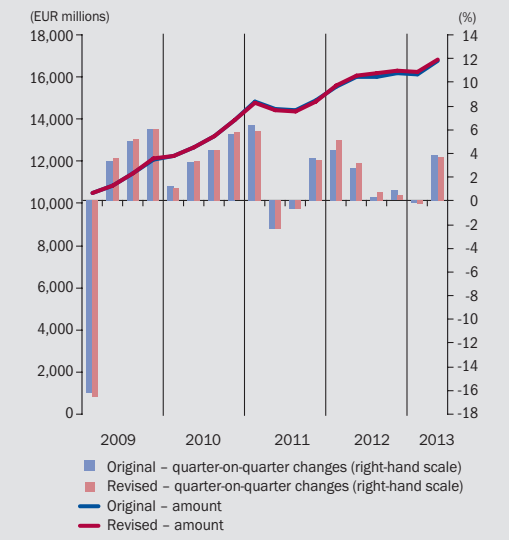
Source: SO SR and NBS.

The revisions to the GDP growth for the first two quarters of 2013 were the most moderate, as GDP growth was revised down by, respectively, 0.01 and 0.03 percentage point. However, the revision of the composition of that growth was more marked.

Looking at the revisions to quarter-on-quarter changes, private consumption for the first quarter of 2013 went from an increase of 0.3% to a decrease of 0.2%. Private consumption growth was also reduced in the second quarter, from 1.1% to 0.9% (with a negative impact on second-quarter GDP of 0.03 percentage point). By contrast, general government consumption growth was revised up in both the first quarter of 2013 (from 0.5 % to 0.8%) and second quarter (from 0.1% to 0.2%). As for fixed investment, its decline in the first quarter was slightly moderated, from 5.6% to 5.4%, and its growth in the second quarter was raised from 1.7% to 2.7%.

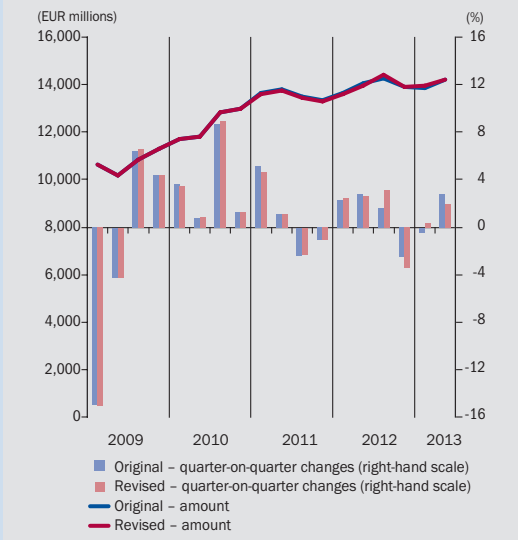
For the first quarter of 2013, the contribution of net exports to GDP growth was revised down, while for the second quarter it was revised up. As regards corrections in GDP composition, the amounts offset by changes in inventories were reduced, and therefore the overall impact on GDP composition was negligible.

Chart E Exports (real, seasonally adjusted)



Source: SO SR and NBS.

Chart F Imports (real, seasonally adjusted)



Source: SO SR and NBS.

Investment returned to decline

Investment is expected to have declined in the third quarter, after its partial upward correction in the previous quarter. This is indicated by a drop in demand for investment loans, as revealed in the bank lending survey and subsequently made evident in the further decline in long-term loans to enterprises. Another reason for assuming low investment activity is the relatively large production gap. General government was also a factor in lower investment demand, with the current consolidation of public finances being effected mainly through investment cuts. An obstacle to the recovery of infrastructure investment is the slow drawdown of EU funds, which stems from the protracted process of public procurement.

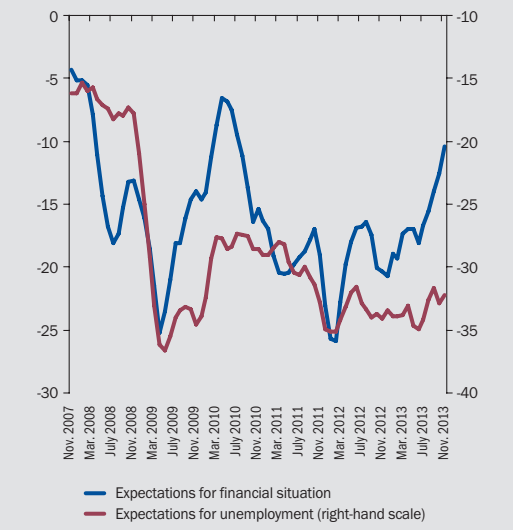
Weak private consumption

The revision of the national accounts resulted in a marked readjustment of past figures, and this has to some extent altered the assessment of private consumption in 2013. The revision for the first half of 2013 saw private consump-

Chart 4 Investment and long-term loans (annual percentage changes)

Source: SO SR.
Note: The figure for the third quarter of 2013 is a projection.

Chart 6 Household expectations (3-month moving average, balance of responses)



Source: European Commission.

tion growth reduced by 0.6 percentage point. Therefore private consumption developments in that period were not as positive as projected by the figures originally published. At the same time, monthly data on retail trade sales, the retail trade confidence indicator and new car registrations are indicating a substantial slowdown in private consumption growth in the third quarter. The revision also affected the savings rate, which was adjusted upwards. Although households saw their real income increase owing to falling prices, they remained cautious in their expenditure.

Chart 5 Consumer sentiment and private consumption (balance of responses; annual percentage changes)

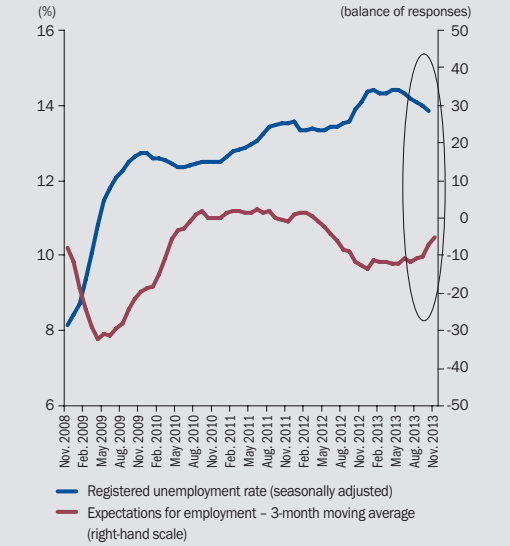
Source: SO SR and European Commission.

Labour market stabilising

Employment stabilised in the third quarter. According to the SO SR's flash estimate, the downward trend in employment came to a halt, in line with NBS projections. Furthermore, the level of employment in the first half of 2013 was revised up slightly. Thus the situation in the labour market appears moderately brighter than it was portrayed in the previous forecast. According to recent monthly indicators, employment has risen moderately in industry and services, but its growth in other sectors has been subdued. The unemployment rate maintained its downward course. Its decline in October was more pronounced that its falls in the summer months, which partly reflected methodological changes. In addition, the number of job vacancies increased.

Wage growth decelerated in the third quarter, owing partly to the base effect of relatively strong wage growth in the second quarter (driven by the payment of extraordinary bonuses

Chart 7 Current labour market indicators



Source: SO SR, Central Office of Labour Social Affairs and Family (ÚPSVR), and NBS.

Chart 8 Wage growth and labour productivity growth (annual percentage changes)

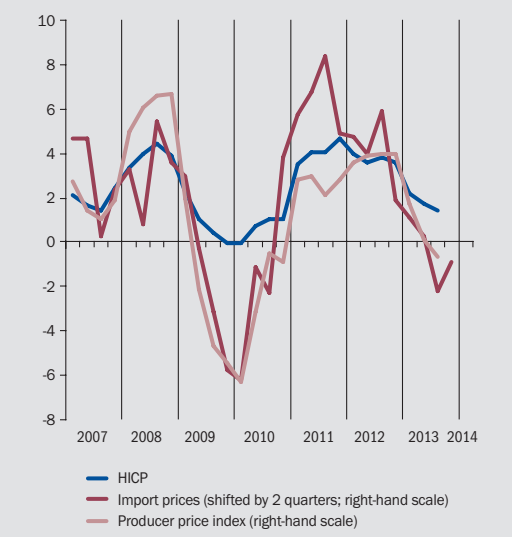
Source: SO SR.

and the entry into force of new collective agreements in key sectors of the economy), and partly to a weakening in labour productivity. Wage dynamics continue to track labour productivity growth. Real wage growth in the third quarter was boosted by falling prices, and therefore incomes rose sufficiently to allow a moderate increase in household consumption.

Price level fell in the third quarter and again more markedly in October

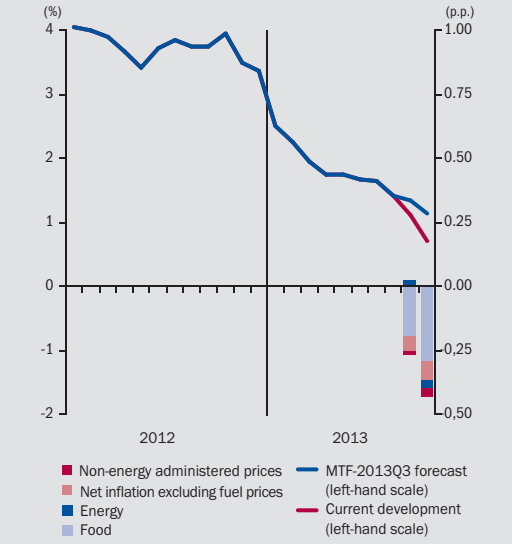
The annual inflation rate fell sharply in the third quarter, to less than 1%, owing mainly to quarter-on-quarter declines in prices of non-energy industrial goods and food. In the case of non-energy industrial goods, prices are largely determined by producer prices in the EU and Slo-

Chart 9 Price indices (%)



Source: SO SR and NBS forecast.

Chart 10 Inflation (annual percentage changes; contributions in p.p.)



Source: SO SR and NBS forecast.

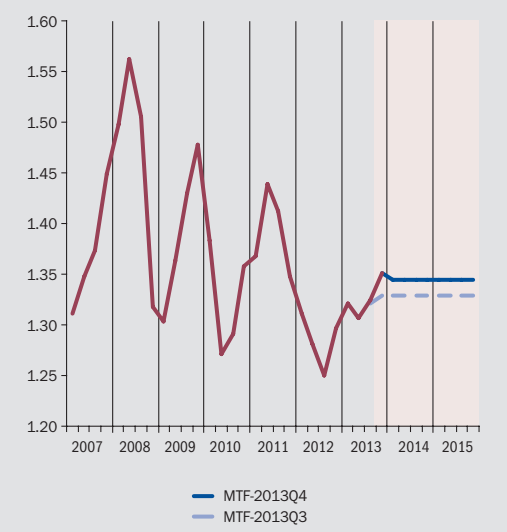
vakia, which fell in the third quarter. Industrial goods prices were also dampened through the exchange-rate channel by a decline in import prices from non-European countries. Prices of agricultural commodities remained stable or fell as a consequence of this year's good harvests, therefore easing pipeline pressures on food prices. Energy prices were largely unchanged. In the absence of demand-pull and cost-push effects, services prices remained flat. The price level continued to fall in October as prices again moderately decreased in month-on-month terms. Food prices had the largest downward effect on prices.

3 Technical assumptions[3]

Since the publication of the previous forecast, the **exchange rate** of USD per EUR depreciated in September and October before appreciating slightly in November. At the end of the period under review it had stabilised at around 1.35. This forecast assumes that the average exchange rate of USD per EUR will be 1.33 in 2013, and 1.34 in both 2014 and 2015.[4]

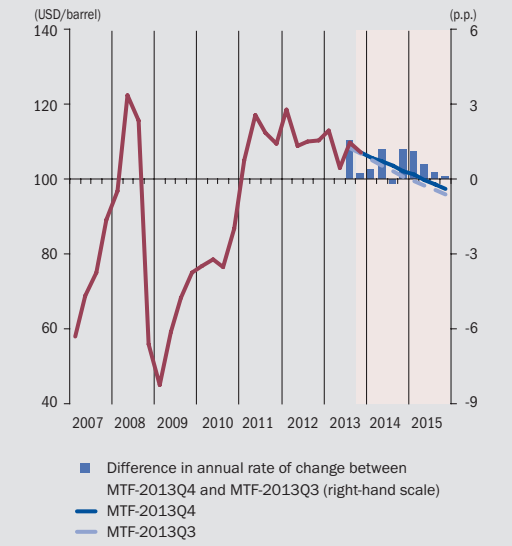
The oil price in the third quarter of 2013 fluctuated between USD 103 and 117 per barrel, and the average barrel price was almost 7% higher than in the previous quarter. The rising trend in oil prices from July to a peak at the beginning of September stemmed from a shortage of supply and geopolitical tensions in the Middle East and North Africa. As political tensions eased, the supply of oil increased and the barrel price fell towards the end of the quarter, down to USD 108. The price remained around this level in October and at the beginning of November. This forecast assumes that the average barrel price will be USD 108.2 in 2013, falling to USD 103.9 in 2014 and USD 99.2 in 2015, and that the price in euro will be €81.6 in 2013, €77.3 in 2014 and €73.8 in 2015.

Chart 11 USD/EUR exchange rate



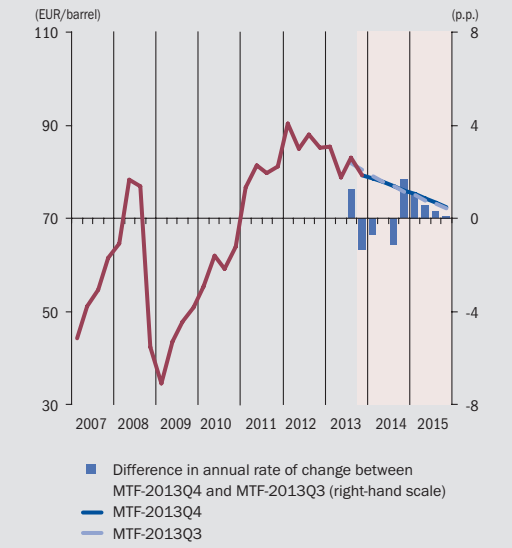
Source: NBS and ECB.

Chart 12 Price per barrel of Brent crude oil (USD)



Source: NBS and ECB.

Chart 13 Price per barrel of Brent crude oil (EUR)



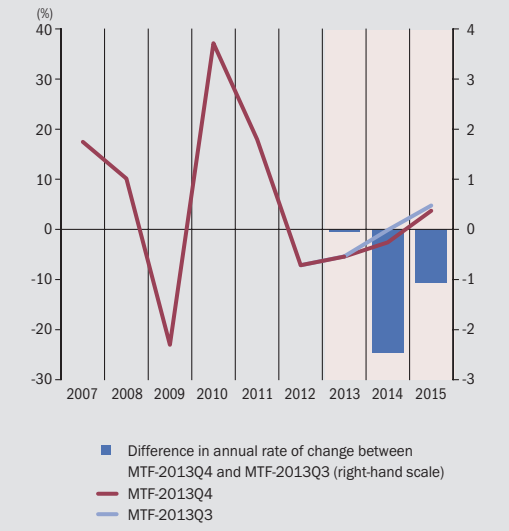
Source: NBS and ECB.

Prices of **non-energy commodities** decreased in the third quarter due to lower prices of foods and metals. The main factor in the food price decline was cereal prices. The fall in metal prices

3 *The technical assumptions of the Medium-Term Forecast are based on the "December 2013 Eurosystem Staff Macroeconomic Projections for the Euro Area", with a cut-off date of 14 November 2013.*

4 *The bilateral USD/EUR exchange rate is assumed to remain unchanged over the projection horizon at the average level prevailing in the ten-working day period ending on the cut-off date.*

Chart 14 Non-energy commodity prices (annual percentage changes)



Source: NBS and ECB.

was caused by the ongoing growth in mining and extraction, based on past investments in the sector, as well as by the cooling of China's property market. This forecast assumes that non-energy commodity prices will fall by 5.4% in 2013 and by 2.6% in 2014, before rising by 3.7% in 2015.

The assumption about **short-term interest rates**[5] (three-month EURIBOR) is that they will average 0.2% in 2013, 0.3% in 2014, and 0.5% in 2015.

5 *The technical assumptions about interest rates and commodity prices are based on market expectations, with a cut-off date of 14 November 2013. The assumption for short-term interest rates is of a purely technical nature.*

4 Forecast for the external environment[6]

The **world economy** grew by 3.2% in 2012 and its growth is expected to slow moderately in 2013, to 2.8%, before accelerating to 3.5% in 2014 and 3.7% in 2015. The downside risks to the medium-term forecast for global economic growth include mainly the euro area debt crisis, insufficient fiscal consolidation efforts in advanced countries (the United States and Japan), uncertainty about the future direction of the US Federal Reserve's monetary policy, and uncertainty and financial stability risks in China. Other risks include an extended period of slow growth in emerging economies and geopolitical tensions in certain regions of the world.

As for **euro area GDP growth,** forward-looking indicators point to a moderate acceleration in the fourth quarter of 2013. In the course of 2014 and 2015, the growth momentum is projected to increase. A gradual recovery in domestic demand is expected to be the main factor behind the pick-up in activity. Domestic demand should benefit from the following: improving confidence of economic agents in an environment of declining uncertainty; the accommodative monetary policy stance – further strengthened by the recent cut in the policy rate and by forward guidance; a less restrictive fiscal policy; and a drop in commodity price inflation that should support real disposable incomes. In addition, activity is expected to be increasingly supported over the projection horizon by the gradual strengthening of external demand. However, despite some progress in rebalancing in some stressed euro area countries, which has improved the conditions for export-led growth, the remaining need to adjust private and public sector balance sheets and high unemployment are expected to continue to weigh on the growth outlook over the projection horizon. GDP is expected to decline by 0.4% in 2013, before increasing by 1.1% in 2014 and 1.5% in 2015.[7]

Headline HICP **inflation in the euro area** is expected to be 1.4% in 2013, declining gradually to 1.1% in 2014, and accelerating slightly to 1.3% in 2015.[8] The decline in inflation over the course of 2013 (down from 2.5% in 2012) reflects, to a large extent, weaker contributions from energy and food prices as well as a subdued trend in services prices and in non-energy industrial goods prices. The moderate outlook for inflation in 2014 and 2015 reflects the assumed fall in oil prices over the projection horizon, the past appreciation of the euro and persistent slack in the economy. Food price inflation is expected to decline over the first three quarters of 2014, owing to downward base effects and to the expected decline in commodity prices, before picking up somewhat in 2015 as food commodity prices are assumed to rise again. HICP inflation excluding food and energy is expected to increase moderately, from 1.1% in 2013, to 1.3% in 2014 and then 1.4% in 2015, reflecting subdued domestic cost pressures in the context of the moderate recovery in activity. Inflation as measured by the HICP excluding food, energy and indirect taxes is projected to increase over the projection horizon, from 1.0% in 2013, to 1.1% in 2014 and 1.4% in 2015.

Turning to domestic price pressures, the annual growth rate of compensation per employee is expected to remain unchanged in 2013 and 2014, before increasing moderately in 2015. Unit labour cost growth is projected to decelerate in 2013 and 2014, owing to the cyclical increase in productivity growth, reflecting the lagged response of employment to a pick-up in activity, combined with a broadly unchanged growth rate of compensation per employee. In 2015 a slightly stronger pick-up in the growth rate of compensation per employee than in the growth rate of labour productivity is expected to lead to a small rebound in unit labour cost growth.

Profit margins are expected to stabilise in 2013, thanks to the modest improvement in activity, and to recover moderately in 2014 and 2015 amidst gradually improving economic conditions. Increases in administered prices and indirect taxes that are included in fiscal consolidation plans are expected to make significant upward contributions to the inflation rate in 2013 a 2014, albeit less than their contributions in 2012. Their impact on the inflation rate in 2015

6 The assumptions for developments in the international economy are based on the "December 2013 Eurosystem Staff Macroeconomic Projections for the Euro Area", which were prepared using information available up to 22 November 2013.

7 The figures are in the middle of the forecast range for GDP growth. The Eurosystem's projection ranges for GDP growth are -0.5% – 0.3% in 2013, 0.4% – 1.8 % in 2014, and 0.4% – 2.6% in 2015. The forecasts for 2014 and 2015 include Latvia.

8 The figures are at the middle of the forecast ranges for the HICP rate. The Eurosystem's projection ranges for the HICP rate are 0.6% – 1.6 % in 2014 and 0.5% – 2.1% in 2015. The forecasts for 2014 and 2015 include Latvia.

is expected to be less strong (there is, however, a lack of detailed information on fiscal measures for that year).

Global trade growth is projected to be 2.8% in 2013, thus ending a downward trend dating back to 2011, and should then strengthen significantly over the projection horizon, to 5.2% in 2014 and 6.1% in 2015, while remaining below its pre-crisis rates. The revival in global trade is expected to have a gradual upward effect on growth in **Slovakia's export markets**, which is projected to increase from 1.0% in 2013, to 4.3% in 2014 and 5.2% in 2015.

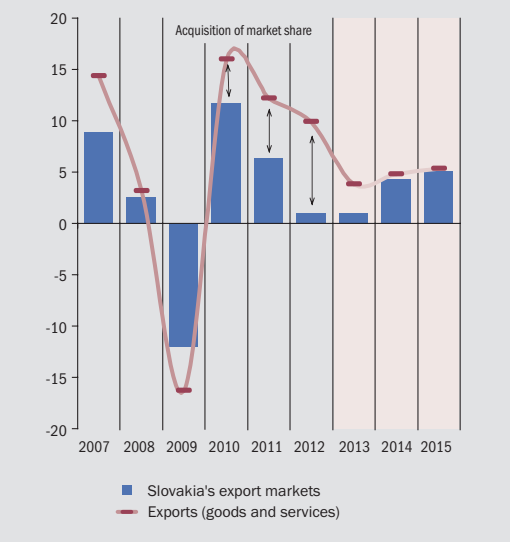
5 Macroeconomic forecast for Slovakia

5.1 ECONOMIC GROWTH

Bright outlook for exports over the projection horizon

After increasing substantially in the second quarter and correcting to a more subdued level in the third quarter, export growth is expected to increase over the projection horizon amid rising demand for Slovak goods and services. Firms' expectations are relatively optimistic; they see their competitive position as very strong both in and outside the EU, despite a slight decline in expectations for future export growth. Exports are expected to be boosted by the significantly undervalued exchange rate and sluggish inflation. Hence export growth represents an upside risk to the export outlook. A downside risk is that lack of significant new investment could prevent a more substantial acquisition of market share.

Chart 15 Slovak exports and export markets (annual percentage changes; constant prices)



Source: NBS.

Investment demand to increase gradually

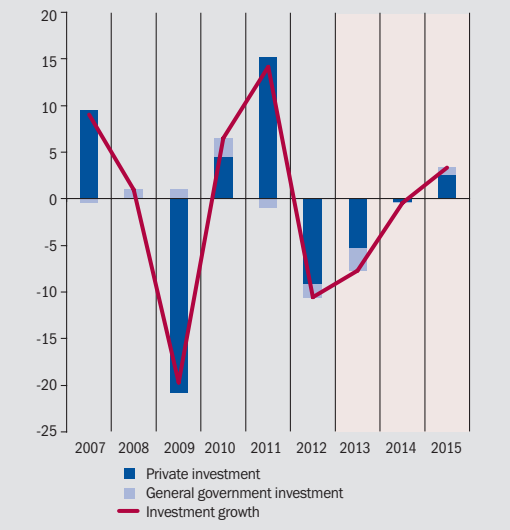
Current developments and forward-looking indicators point to investment demand remaining subdued until the end of 2013. Although construction production has increased moderately in recent months, sentiment in construction is still negative. An investment project in the automotive industry is now expected to come online in the last quarter of 2013, boosting investment growth. Abstracting from the impact of that investment, overall investment would decline until the end of the year and then pick up from the beginning of 2014. Over the medium-term horizon, investment demand is expected to rally in line with growth in overall economic activity.

Table 1 Forecast for gross fixed capital formation (annual percentage changes)

	2013	2014	2015
Gross fixed capital formation (GFCF) – total	**-7.7**	**-0.4**	**3.4**
– private sector	-5.8	-0.4	2.8
– adjusted to exclude a one-off investment in the automotive industry	-6.2	2.3	2.8
– general government sector	-25.9	-1.1	10.2

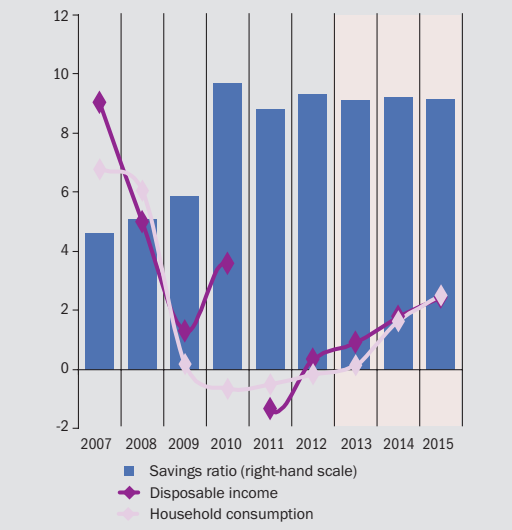
Source: SO SR and NBS.

Chart 16 Investment growth (annual percentage changes; contributions in p.p.)



Source: SO SR and NBS.

Chart 17 Household income, consumption (annual percentage changes), and savings ratio (%)



Source: SO SR and NBS.

Private consumption to continue recovering

The current slowdown in private consumption growth indicates that its strong performance in the second quarter was temporary. Nevertheless, forward-looking indicators continue pointing to a gradual revival in private consumption in the short-term horizon. The assumption is that it will increase in conjunction with projected real growth in household disposable income, which in turn will reflect low inflation. Over the medium-term horizon, economic growth will create scope for an increase in income and subsequent acceleration of private consumption. It is envisaged that households will fund all of their consumption growth out of disposable income, without dipping into savings.

General government consumption expected to increase amid fiscal expansion

General government final consumption is expected to increase over the projection horizon. This is largely because the fiscal consolidation effort is expected to be based heavily on one-off revenue measures that for the most part will not weigh on domestic demand. Thus fiscal policy for next year, as set out in the general government budget proposal, appears to be expansive. The combined impact of the fiscal impulse and inflow of EU funds is estimated at 0.9% of GDP.[9] Whereas the previous forecast projected that general government consumption would decline next year, this forecast projects a modest increase, supported also by an assumed increase in public sector wages.

Table 2 Forecast for general government consumption

	2012	2013	2014	2015
General government final consumption (at constant prices; annual percentage changes)	-1.1	0.3	0.2	1.6
Contribution of general government consumption to GDP growth (p.p.)	-0.2	0.1	0.0	0.2

Source: SO SR and NBS.

9 *An NBS analysis of the Draft General Government Budget for 2014–2016 is available in Slovak at: http://www.nbs.sk/_img/Documents/_komentare/AnalytickeKomentare/2013/AK05_RVS.pdf*

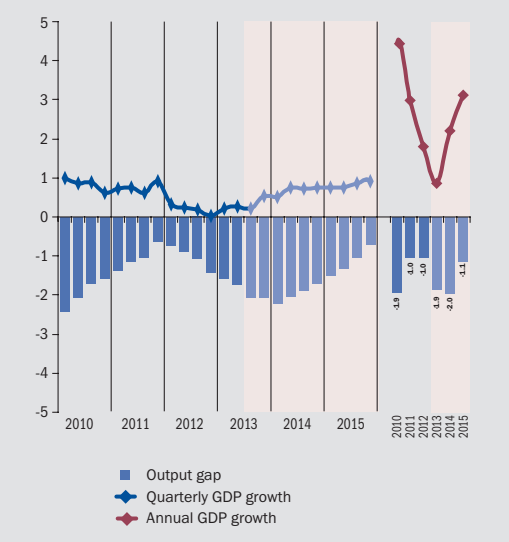
Import growth to strengthen as domestic demand picks up

This forecast envisages an upturn in import growth. Therefore import intensity, which fell significantly, in the previous period, is also expected to pick up. In the medium-term horizon, import growth is expected to remain stable, reflecting an improvement in export performance and recovery of domestic demand. External trade price developments are assumed to increase competitiveness in the period ahead and therefore to have a positive impact on the trade balance. In 2015, however, the terms of trade should increase, based on the assumed paths of commodity prices. The nominal trade balance is expected to increase, driven up mainly by an improvement in the overall current account balance.

Economic recovery to be gradual

The main component of economic growth over the forecast period is expected to be an improving export performance that reflects accelerating external demand. As confidence rallies, expectations rise and external demand picks up, domestic demand, too, should gradually begin contributing to economic growth. Therefore the economy is assumed to perform more robustly towards the end of the projection horizon, with its growth projected to be **0.9% in 2013, accelerating gradually to 2.2% in 2014 and 3.1% in 2015.** Nevertheless, economic growth will remain below potential. The output gap is currently widening, amid declines in private and public investment, and although it is expected to begin closing gradually from mid-2014, it will remain negative throughout the projection period.

Chart 18 GDP growth and the output gap (%)



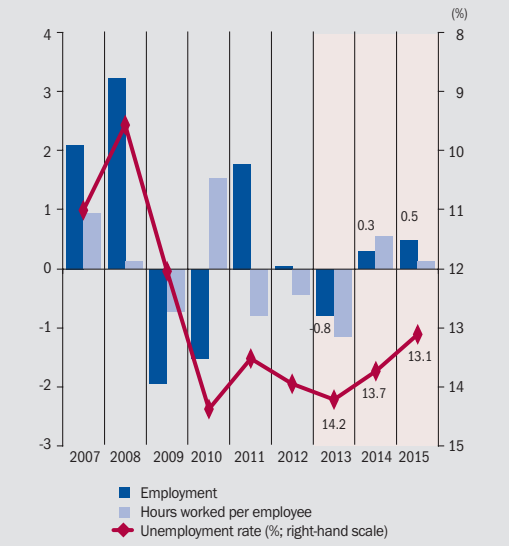
Source: SO SR and NBS.

5.2 THE LABOUR MARKET

Labour market stabilising and expected to improve gradually over the forecast period

The downward trend in employment bottomed out in the third quarter, as projected in the previous forecast. Among the signs that employment will increase in the period ahead are an improvement in employers' expectations; nevertheless, the rate of increase is expected to be very slow and job creation should somewhat lag activity growth. Employers will be seeking to use hours worked per employee to cover part of their increased output, especially in 2014, and it is only towards the end of the projection horizon that employment growth is expected to accelerate. The unemployment rate is expected to fall in line with employment growth, but will remain at relatively high levels (around 13%) until the end of the projection horizon. Labour productivity growth should create scope for an acceleration of wage growth throughout the forecast period, with an upward effect on disposable income. It is assumed that disposable income growth in 2014 will be boosted by public sector wage increases. Planned amendments to employment law, the drafts of which are already approved, are expected to have only a partial impact on the labour market as their effects may largely cancel each other out. On the one hand, an increase in the minimum wage scheduled for 2014 may contribute to nominal wage growth and consequently knock an estimated 0.1 percentage point off the employment rate. On the other hand, support for the employment of long-term unemployed in the form of reduced contributions may result in a moderate increase in employment.

Chart 19 Employment, hours worked (annual percentage changes) and the unemployment rate (%)



Source: SO SR and NBS.

5.3 LABOUR COSTS AND PRICE DEVELOPMENTS

Labour costs firmly anchored

Unit labour costs are expected to increase by just over 1% over the projection horizon. Therefore the increase in nominal compensation per employee should be slightly higher than labour productivity growth. Nominal compensation growth will be largely accounted for by broad-based increases in public sector wages. In the private sector, real wages are projected to increase in view of productivity assumptions, and this trend is not expected to be affected by impulses from public sector wage growth. A comparison of unit labour costs with the GDP deflator implies that firms' profit margins will increase over the projection horizon.

Table 3 Unit labour costs (annual percentage changes)

	2012	2013	2014	2015
Nominal compensation (ESA)	2.0	2.8	3.2	3.8
Real productivity	1.7	1.7	1.9	2.6
Unit labour costs	0.3	1.1	1.3	1.2
GDP deflator	1.3	0.9	1.5	2.1

Source: SO SR and NBS calculations.
Note: Real productivity deflated by the GDP deflator.

Table 4 Wages (annual percentage changes)

	2012	2013	2014	2015
Whole economy – nominal	2.5	2.6	3.2	3.8
Whole economy – real	-1.1	1.1	2.0	2.1
Public administration, education and health care – nominal	3.5	2.8	4.6	3.4
Public administration, education and health care – real	-0.2	1.3	3.4	1.7
Private sector – real	2.2	2.5	2.7	4.0
Private sector – nominal	-1.3	1.0	1.5	2.2

Source: SO SR and NBS calculations.
Note: Deflated by the CPI. Nominal wage growth in the general government sector (ESA S.13) is projected to be 1.1% in 2013, 3.2% in 2014 and 3.0% in 2015.

Low inflation until 2015

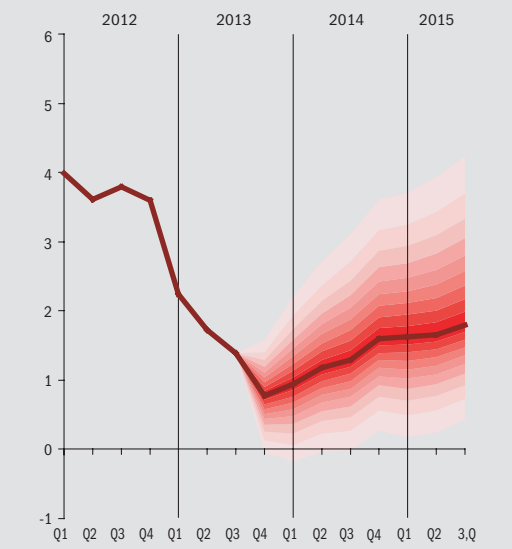
Inflation has been falling sharply and is expected to have bottomed out in October. The headline rate for the fourth quarter is projected to be unchanged from the previous quarter, and inflation should begin rising again from the beginning of 2014. The relatively low inflation rate reflects the cyclical position of the economy and the stabilisation or decline in commodity prices. The cyclical position is expected to continue weighing heavily on price growth. The indications are that energy commodity prices will follow a downward trend throughout the projection horizon, which is expected to result in declining energy prices in the consumer basket. Although agricultural prices are relatively volatile, current technical assumptions point to their stabilisation and therefore food price inflation may be only moderate. Demand-pull prices (those of non-energy industrial goods and of services) are expected to increase slowly as domestic demand gradually picks up.

6 Risks to the forecast

In this medium-term forecast, risks to the real economy outlook are balanced for 2014 and tilted to the downside for 2015. The main downside risk over the forecast period is external demand. Another risk lies in the public finances, in the event that additional fiscal consolidation measures (no longer one-off) prove to be necessary and adversely affect the real economy.[10] These risks, however, could be offset by a pick-up in infrastructure construction and increased utilisation of EU funds. The risks to the labour market forecast are balanced. The downside risks include approved higher-level collective agreements, which could lead to high labour costs and thus adversely affect employment growth.

Divergences in NBS assumptions for macroeconomic developments indicate that the collection of taxes and contributions may be more favourable over the projection horizon, based on high-

Chart 20 HICP inflation forecast (%)



Source: SO SR and NBS.

Table 5 Differences in the projected tax and contribution revenues of Slovakia's public finances

Difference (in EUR millions) between the current outlook for tax collection under the macroeconomic assumptions of the MTF-2013Q4 forecast and the assumptions of the Financial Policy Institute of the Ministry of Finance (November 2013)	2013	2014	2015
Total	**39**	**84**	**148**
Income tax of natural persons	22	13	19
Income tax of legal persons	0	-9	-2
Withholding tax	-4	-1	0
Value added tax	0	15	34
Consumption tax	24	9	18
Social and health insurance	-2	56	79

Source: NBS (based on the so-called IPP-calculator).

Table 6 Risks to the forecast

	2014	2015
GDP	↓ Additional fiscal consolidation measures, debt crisis, external demand ↑ EU funds, exports (market shares)	↓ External demand, fiscal consolidation measures ↑ EU funds, exports (market shares)
Inflation	↑ Technical assumptions	↑ Technical assumptions ↓ VAT reduction

Zdroj: NBS.

10 Eurostat is to assess whether the inclusion of certain one-off measures in fiscal consolidation plans conforms to the required methodology (including the new ESA 2010 methodology). Should any measures not be classified as revenue, there would be pressure to adopt additional measures.

er projections for private consumption and the wage base.

Risks to the inflation forecast are predominantly on the upside over the projection horizon, with technical assumptions representing the most significant risks. Inflation in 2014 may be higher owing to the euro depreciating against the US dollar and to imported inflation. In 2015 the upside risks encompass those present in 2014 plus oil price movements. A downside risk to the 2015 inflation forecast is the envisaged reduction in the VAT rate, from 20% to 19%.

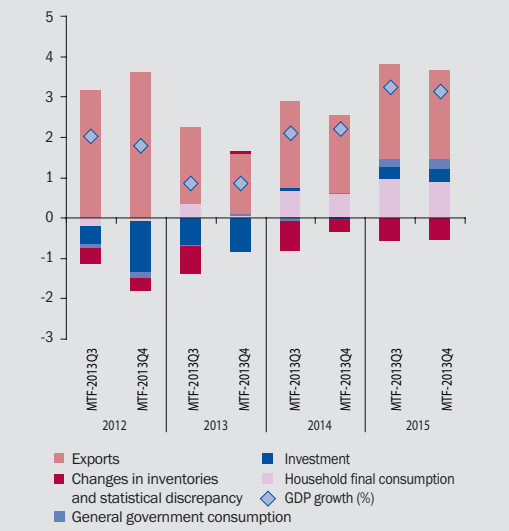
7 Comparison with the previous forecast

The differences in technical assumptions between this forecast and the previous forecast include a slight downward revision of external demand growth in 2014 and 2015 and a moderately stronger euro exchange rate. The oil price in US dollars is somewhat higher, although, as a consequence of the stronger exchange rate, the oil price in EUR is largely unchanged from the previous forecast.

Short-term economic outlook slightly altered by current developments

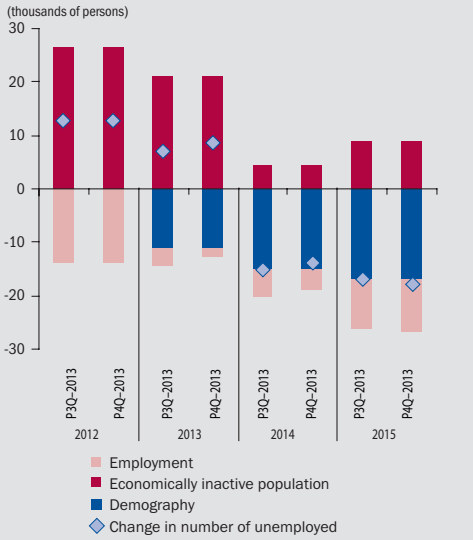
This forecast differs notably from the previous forecast (MTF-2013Q3) in that the outlook for the baseline situation was partially changed by the revision of national accounts. In addition, although overall economic growth for the third quarter was in line with the previous forecast, monthly indicators pointed to a probable difference in the composition of growth. These two factors affected the forecast for the short-term horizon. The growth forecast for 2013 was not changed from the previous forecast, but the composition of growth was adjusted. The contribution of exports was reduced slightly, following the slight downward revision of export growth for the second quarter and the fact that third-quarter export growth was lower than projected. Exports nevertheless remained the main driver of economic growth. The same situation was observed in private consumption, as its level for the second quarter was revised down and its monthly figures in the third quarter were weaker than projected. The combination of these negative adjustments was, however, offset by an upward revision of the contribution of changes in inventories. All of these revisions have to some extent been technically carried over to 2014, as has the downward revision of investment demand (with a negative effect). The change projected in general government consumption

Chart 21 Comparison of GDP growth forecasts[1] (annual percentage changes, contributions in p.p.)



Source: SO SR and NBS.
1) The composition of GDP growth is calculated as the contributions of components to GDP growth after deducting their import intensity. In this case the calculation uses the constant import intensity of the different GDP components (household final consumption – 30%, general government consumption – 7%, investment – 50% and exports – 60%). Remaining imports were included under changes in inventories and the statistical discrepancy.

Chart 22 Comparison of forecasts for labour market indicators (contributions to change in unemployment)



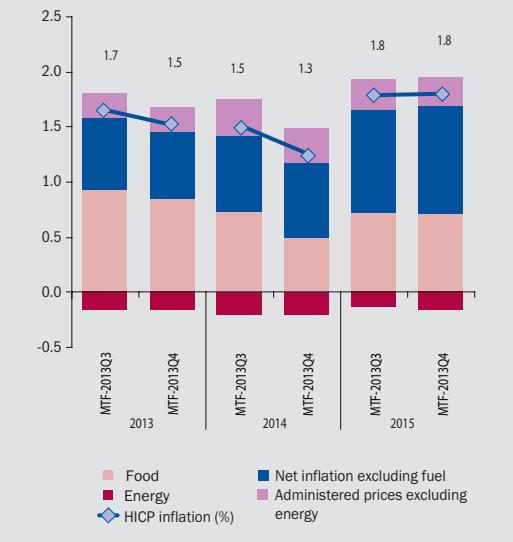
Source: SO SR and NBS.
Note: A negative contribution of employment denotes an increase in the number of employed persons, as is also the case with the economically inactive population. A negative contribution of demography denotes a decline in the working age population (people aged between 15 and 64 years).

in 2014 is not expected to dampen economic growth, since the assumptions for expenditure-based fiscal consolidation measures made in the September forecast should be effected mainly by the revenue-raising measure of postponing dividend payments from 2013 to 2014 (with no impact on economic growth). No significant revisions were made to the outlook for 2015; the only change from the previous forecast was that economic growth was revised down by 0.1 percentage point and, consequently, the projected external demand was marginally reduced.

The labour market projections are largely unchanged in this forecast. Although revisions to the historical data included an increase in the employment figure, the outlook for employment over the forecast period remained the same. The number of unemployed and the unemployment rate have been revised up marginally over the projection horizon, after unemployment figures for the third quarter of 2013 were slightly worse than projected. The forecast for nominal wage growth in 2014 has been revised up moderately, taking into account higher negotiated wages in the public sector. This, along with lower inflation, resulted in upward revisions to the projections for real compensation per employee and real wages in 2013 and, even more so, in 2014. Nevertheless, these positive effects have not been fully reflected in the forecast for disposable income growth, which assumes slower growth in the remuneration of self-employed persons.

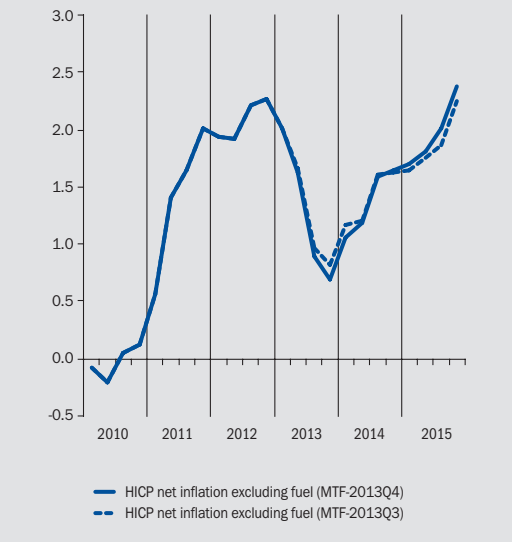
The forecast for price indices reflected actual inflation figures that were lower than projected. Hence the inflation forecast for both 2013 and 2014 has been revised down by 0.2 percentage point. With minimal movement in commodity prices, the forecast for energy prices in the consumer basket remains the same as in the previous forecast.

Chart 23 Comparison of inflation forecasts (annual percentages in the average HICP rate; contributions in p.p.)



Source: SO SR and NBS.

Chart 24 Comparison of HICP net inflation excluding fuel (annual percentage changes)



Source: SO SR and NBS.

Table 7 Medium-term forecast (MTF-2013Q4) of main economic indicators

Indicator (y-o-y change in % unless otherwise indicated)	2012	2013	2014	2015	2013	2014	2015
	Actual	Forecast			Difference versus MTF-2013Q3		
Prices							
HICP inflation (average)	3.7	1.5	1.3	1.8	-0.2	-0.2	0.0
CPI inflation (average)	3.6	1.4	1.2	1.7	-0.2	-0.2	-0.1
ULC[1] (comp. per employee at current prices / labour productivity at constant prices – ESA 95)	0.3	1.1	1.3	1.2	0.1	0.2	0.2
Labour productivity – ESA 95 (GDP at constant prices / employment – ESA 95)	1.7	1.7	1.9	2.6	-0.1	0.1	-0.2
Compensation per employee at current prices – ESA 95	2.0	2.8	3.2	3.8	-0.1	0.2	0.0
Nominal wages[2]	2.5	2.6	3.2	3.8	0.0	0.4	0.0
Real wages[3]	-1.1	1.1	2.0	2.1	0.0	0.7	0.1
Economic activity							
Real GDP	1.8	0.9	2.2	3.1	0.0	0.1	-0.1
Final consumption of households	-0.2	0.1	1.6	2.5	-0.9	-0.3	-0.2
Final consumption of general government	-1.1	0.3	0.2	1.6	0.6	0.6	0.2
Gross fixed capital formation	-10.5	-7.7	-0.4	3.4	-1.9	-1.3	0.2
Exports of goods and services	9.9	3.8	4.8	5.3	-1.0	-0.5	-0.2
Imports of goods and services	3.3	2.0	4.2	5.2	-0.3	-1.1	-0.1
Real gross disposable household income	0.3	0.9	1.8	2.4	-0.2	0.2	0.0
Output gap (% of potential output)	-1.0	-1.9	-2.0	-1.1	-0.2	0.2	0.4
Labour market							
Employment – ESA 95	0.1	-0.8	0.3	0.5	0.2	0.0	0.1
Employment – ESA 95 (thousands of persons)	2 209.4	2 192.0	2 198.6	2 209.0	3.7	4.6	5.6
Unemployment rate – Labour Force Survey (%)	13.9	14.2	13.7	13.1	0.0	0.1	0.1
Number of unemployed (thousands of persons)	377.5	386.0	371.7	353.7	1.6	3.0	2.0
Balance of payments							
Economic openess (% of GDP)	185.1	186.4	189.0	192.4	1.1	-0.5	-0.7
Trade balance (% of GDP)	5.0	6.4	6.5	6.9	-0.7	-0.9	-0.9
Services balance (% of GDP)	0.4	0.2	0.3	0.3	0.0	0.1	0.0
Current account (% of GDP)	2.2	3.3	2.8	3.5	-0.9	-1.9	-2.2
Current and capital account (% of GDP)	4.1	4.7	4.4	5.4	-1.0	-1.9	-2.1
External assumptions for the forecast							
External environment							
External demand growth for Slovakia	1.0	1.0	4.3	5.2	0.1	-0.1	-0.1
Technical assumptions							
Exchange rate (USD/EUR)[4]	1.28	1.33	1.34	1.34	0.8	0.8	0.8
Brent crude oil (USD per barrel)[4]	112.0	108.2	103.9	99.2	0.4	1.1	1.6
Brent crude oil (EUR per barrel)[4]	87.1	81.6	77.3	73.8	-0.1	-0.1	0.4
Oil price inflation (USD)	0.9	-3.4	-3.9	-4.6	0.3	0.7	0.5
Oil price inflation (EUR)	9.3	-6.3	-5.3	-4.6	0.0	-0.1	0.5
Non-energy commodity price inflation (USD)	-7.2	-5.4	-2.6	3.7	0.0	-2.5	-1.1
EURIBOR 3M (%)	0.6	0.2	0.3	0.5	0.0	-0.2	-0.3

Source: NBS, ECB, SO SR.
1) ULC – unit labour costs.
2) Average monthly wages according to SO SR statistical reporting.
3) Wages according to SO SR statistical reporting, deflated by CPI inflation.
4) Changes against the previous forecast in %.

Table 8 Medium-term forecast (MTF-2013Q2) of main economic indicators

Indicator (q-o-q change in % unless otherwise indicated)	Q1 2012	Q2 2012	Q3 2012	Q4 2012	Q1 2013	Q2 2013	Q3 2013	Q4 2013	Q1 2014	Q2 2014	Q3 2014	Q4 2014	Q1 2015	Q2 2015	Q3 2015	Q4 2015
	Actual						Forecast									
Prices																
HICP inflation (average)	2.0	0.7	0.3	0.6	0.7	0.2	-0.1	0.0	0.8	0.4	0.1	0.3	0.8	0.4	0.2	0.6
ULC[1)] (comp. per employee at current prices / labour productivity at constant prices – ESA 95)	0.3	1.7	-0.4	0.5	1.0	-1.1	0.5	0.3	0.8	0.1	0.2	0.2	0.3	0.4	0.4	0.4
Labour productivity – ESA 95 (GDP at constant prices / employment – ESA 95)	0.2	0.3	0.4	0.4	0.4	0.5	0.2	0.4	0.3	0.7	0.7	0.6	0.6	0.6	0.7	0.7
Compensation per employee at current prices – ESA 95	0.6	2.0	0.0	0.9	1.4	-0.6	0.7	0.8	1.1	0.8	0.8	0.9	0.9	1.0	1.1	1.1
Economic activity																
Real GDP	0.3	0.2	0.2	0.0	0.2	0.3	0.2	0.5	0.5	0.7	0.7	0.7	0.7	0.8	0.9	0.9
Final consumption of households	0.4	-0.9	0.1	-0.2	-0.3	0.8	0.1	0.4	0.4	0.4	0.5	0.6	0.6	0.7	0.7	0.8
Final consumption of general government	1.1	-1.5	0.4	-0.3	0.6	0.2	-0.4	0.7	-0.4	0.2	0.1	0.1	0.5	0.5	0.6	0.9
Gross fixed capital formation	-8.3	-4.3	1.1	-2.7	-5.7	2.5	-4.0	2.5	-2.1	0.9	0.8	0.8	0.8	0.8	0.9	0.9
Exports of goods and services	5.1	3.1	0.7	0.4	-0.3	3.7	-1.1	1.8	1.0	1.3	1.4	1.4	1.3	1.2	1.3	1.4
Imports of goods and services	2.4	2.6	3.1	-3.4	0.4	1.9	0.8	0.8	0.8	1.1	1.3	1.3	1.3	1.2	1.3	1.3
Real gross disposable household income	1.5	-0.6	-0.3	0.7	-0.2	1.1	0.0	0.4	0.5	0.4	0.5	0.6	0.6	0.7	0.7	0.7
Output gap (% of potential output)	-0.7	-0.9	-1.1	-1.4	-1.6	-1.7	-2.1	-2.1	-2.2	-2.0	-1.9	-1.7	-1.5	-1.3	-1.0	-0.7
Labour market																
Employment – ESA 95	0.1	-0.1	-0.2	-0.4	-0.2	-0.3	0.0	0.1	0.2	0.1	0.1	0.1	0.1	0.2	0.2	0.2
Unemployment rate – Labour Force Survey (%)	13.7	13.8	13.9	14.3	14.2	14.3	14.3	14.1	13.9	13.8	13.7	13.5	13.4	13.2	13.0	12.8

Source: NBS, ECB, SO SR.
1) ULC – unit labour costs.