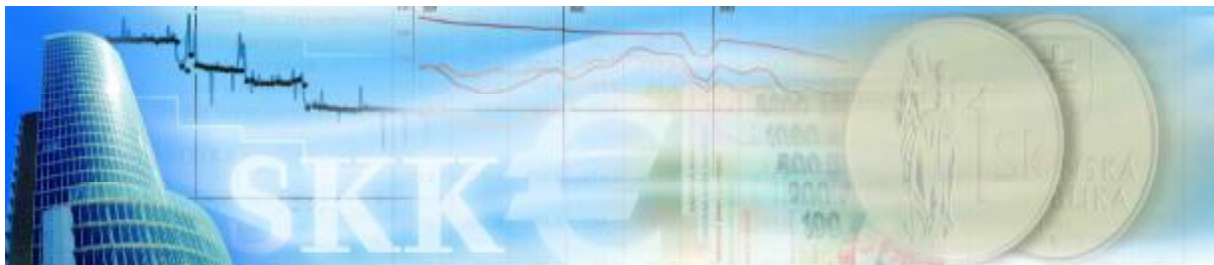




NÁRODNÁ BANKA SLOVENSKA

MEDIUM-TERM FORECAST (MTF-2006Q4)

October 2006



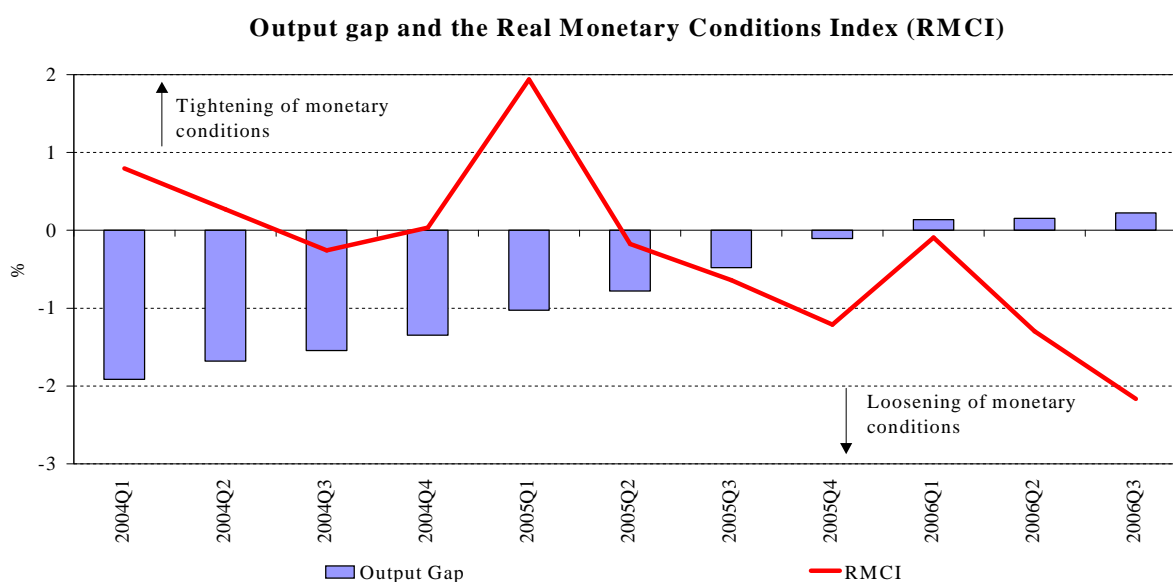
Equilibrium variables, development of potential output

The medium-term forecast is based on the assumption that Slovakia is a converging economy, with corresponding equilibrium trends in its main macroeconomic indicators. The basic framework of the forecast is provided by projections of equilibrium real interest rates, the real exchange rate, and non-inflationary growth in the economy (potential output). In comparison with the July forecast (MTF-2006Q3), no new information has emerged to justify a reassessment of the long-term trends in the key macroeconomic indicators.

Due to continuing investment activity, the forecast still assumes a gradual increase in the economy's productive capacities, which should lead to accelerating growth in its potential output in 2007. There is still room for a long-term equilibrium real appreciation in the exchange rate, which corresponds to the nature of a converging economy. The trends in real equilibrium interest rates have remained unchanged.

Current position of the economy¹

The estimate of the economy's current position is based on estimated deviations in the key macroeconomic indicators from their equilibrium trends. The monetary conditions in terms of the Real Monetary Conditions Index (RMCI) remained loose in the third quarter of 2006, with contradictory developments in the individual components. The assumed loosening of the exchange rate component is a result of developments in the nominal SKK/EUR exchange rate, whose average value in the third quarter of 2006 was by 0.4 of a percentage point weaker than in the second quarter of 2006. At the same time, real interest rate developments were affected by increases in the nominal NBS interest rates (by 0.5 of a percentage point with effect from 26 July 2006 and by 0.25 of a percentage point from 27 September 2006). Thus, in the third quarter of 2006, the real interest rates were slightly above the assumed equilibrium level. Consequently, they should to some extent offset the loosened monetary conditions and act against excessive growth in domestic demand.



¹ The current position of the economy refers to its state in the third quarter of 2006 (according to a GDP growth estimate), upon which the short-term as well as medium-term forecasts are based.

The estimate of the cyclical GDP component has remained unchanged in comparison with the July forecast. The data released on economic growth in the second quarter of 2006 and the forecast for the third quarter of 2006 indicate that the economy is still in a slightly positive output gap (0.2%). In addition to the domestic economy, another factor accelerating the rate of GDP growth is the gradually increasing foreign demand.

In the second quarter of 2006, the growth rate of gross domestic product (GDP) reached 6.7% at constant prices, and thus slightly exceeded the figure predicted in the previous forecast (MTF-2006Q3). The year-on-year acceleration of real economic growth (by 1.3 percentage points) was caused by pro-growth effect exerted by all GDP components.

Within the domestic demand, the most significant increase occurred in final consumption of general government, due to growth in both wages and employment, accompanied by increased purchases of goods and services from business entities. In the second quarter of 2006, the dynamic growth in investment continued throughout the economy, though at a slower rate than a year earlier. The investment activities of particular investors were relatively evenly spread over the sectors. Investors allocated their investment funds for the purchases of new fixed assets, which indicate an increase in the productivity of investment, followed by growth in economic performance also in the future.

On the basis of monthly indicators for selected sectors, the buoyant economic activity is expected to continue also in the third quarter of 2006. Regarding its structure, the most significant factor in GDP growth will probably remain domestic demand, with all its components having a pro-growth effect. In addition to domestic demand, real economic growth is expected to be stimulated by increasing foreign demand, whose influence is likely to strengthen in the period to come.

In the first half of 2006, the current account of the balance of payments resulted in a deficit of Sk 61.9 billion, representing a year-on-year increase of more than Sk 11.4 billion. The year-on-year increase in the deficit was in line with the expectations of the NBS, and was mainly caused by an increase in the trade deficit. Although the trade balance did not deviate from the previous projection, the acceleration in the year-on-year growth rates of exports and imports led to higher-than-expected exports and imports figures.

The growth in nominal and real wages in the second quarter of 2006 was faster than the figure expected by the NBS in the July forecast. The faster year-on-year growth in the average nominal wage over the second quarter of 2006 (compared with the MTF-2006Q3) was primarily caused by accelerated wage growth in manufacturing and general government, defence and social security. Thus, the risk of accelerated wage growth in manufacturing from the previous forecast has become a reality.

The dynamic wage growth is expected to continue in the third quarter of 2006, which is also indicated by preliminary data on wage developments in the selected sectors in July and August. However, wage dynamics will probably be somewhat weaker than in the previous quarter, mainly as a result of an expected slowdown in wage dynamics in public services (the impact of the election cycle, which is usually connected with the new government's attempt to reduce wage costs at the beginning of its term of office).

In the third quarter, real wage growth is expected to slowdown in comparison with the previous quarter, as a result of slower nominal wage growth and a higher average inflation rate.

Employment showed dynamic growth in the second quarter of 2006, reaching 2.3% according to statistical reports, which was a somewhat higher growth rate than predicted in the MTF-2006Q3. According to a Labour Force Sample Survey (LFSS), the year-on-year growth in employment reached 4.5%, a rate twice as fast as last year, mainly as a result of a marked increase in the number of persons working abroad.

On the basis of preliminary data on employment in the selected sectors, we can assume that employment growth according to statistical reporting will continue in the third quarter of 2006 at a somewhat faster rate than in the previous quarter. According to the LFSS, employment growth is expected to remain dynamic in the third quarter.

In the third quarter, the year-on-year increase in consumer prices measured by the Harmonised Index of Consumer Prices (HICP) continued to accelerate, from 4.6% in the second quarter to 4.8% in the third quarter, due to increases in the year-on-year dynamics in prices of goods and services. In prices of goods, the year-on-year growth accelerated in comparison with the previous quarter in prices of non-energy industrial goods and prices of processed food. This was mainly due to administrative measures, such as marked increases in the regulated prices of pharmaceuticals starting from July. The sector of regulated prices has remained the most dynamic sub-aggregate in consumer price developments, with a contribution of 3.0 percentage points to the rate of headline inflation. As of July, after the old stocks had been sold off, prices of cigarettes started to be affected by the higher excise duties.

Compared with the previous forecast (MTF-2006Q3), the level of inflation in the third quarter of 2006 was somewhat lower. This was mainly due to a slower-than-expected rise in prices of services, when all categories (except for services related to transport) recorded weaker price dynamics compared with the NBS forecast. Prices of food also increased at a slower rate on a year-on-year basis, due to a slower-than-expected rise in prices of processed food, which was connected with the smaller contribution of changes in indirect taxes on cigarettes in comparison with NBS expectations (by 0.1 of a percentage point). The other components of the HICP (non-energy industrial goods, energy, unprocessed food) recorded steeper-than-expected year-on-year increases in the third quarter.

Medium-term forecast

External environment

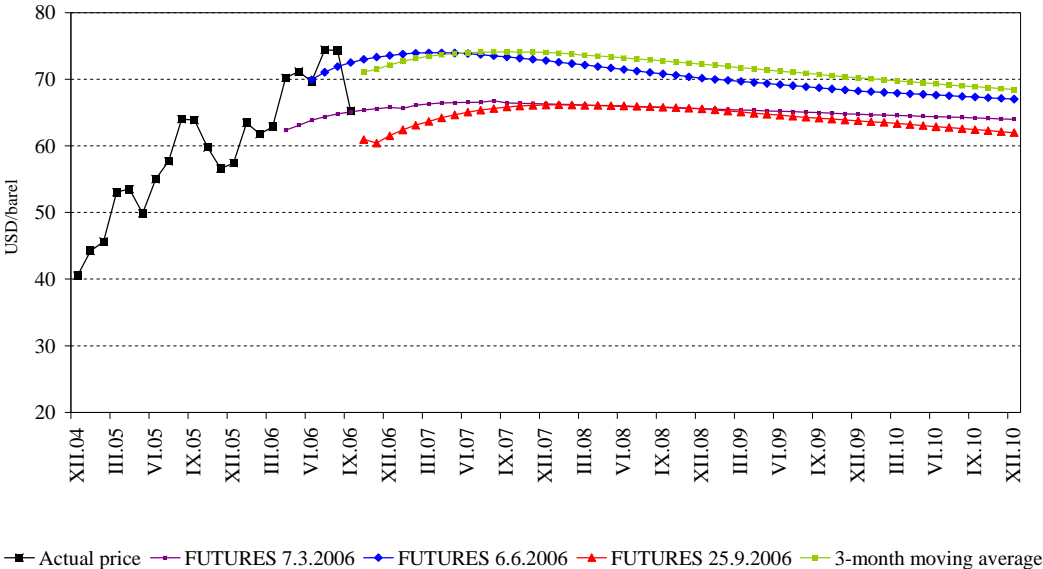
The present medium-term forecast of exogenous indicators is based on the September issue of the Consensus Forecasts (CF)². The expected developments in oil prices are based on the prices of futures as of 25 September 2006.

Compared with the assumptions of the external environment as predicted in the MTF-2006Q3, changes occurred mainly in the expected developments in oil prices, when their dynamics weakened significantly. The average price of oil in 2006 should reach USD 66.7/barrel; in 2007 it is expected to drop to USD 64.5/barrel. The expected course of

² A survey of forecasts made by international economic and financial institutions, from which an average is calculated. This ensures the most unbiased estimate of the trends in foreign sector indicators. With regard to the course and schedule of forecasting at the NBS, the values of input variables were obtained from the Consensus Forecasts of September 2006 and were fixed at these levels throughout the forecasting process. Any new information will be taken into account in the next medium-term forecasts.

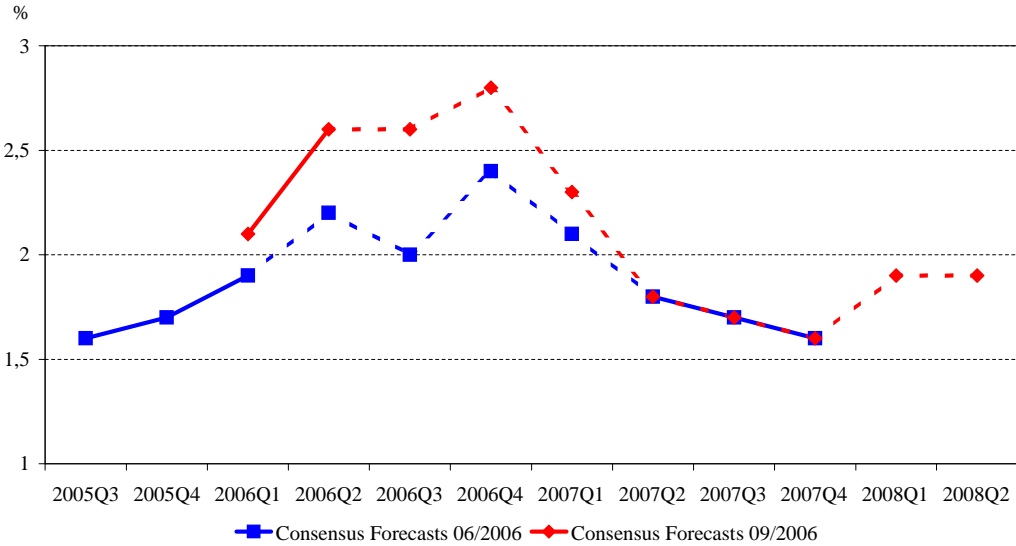
the USD/EUR cross-rate indicates a somewhat weaker USD vis-à-vis the EUR, compared with the previous forecast.

Expected oil prices



Economic growth in the euro area reached 2.6% in the second quarter of 2006, representing an acceleration of 0.4 of a percentage point compared with the figure predicted in the previous forecast. In comparison with the Consensus Forecasts of June 2006, faster economic growth is expected in 2006 (by approximately 0.4 of a percentage point). In 2007, however, the euro area is still expected to experience a downturn in economic activity.

Comparison of euro area GDP growth according to the Consensus Forecasts (06/2006 a 09/2006)



The euro-area inflation forecast based on the September Consensus Forecasts predicts a minor acceleration (0.1 of a percentage point) in the rate of inflation in both 2006 and 2007. Due to potential inflationary pressures and the inflation forecast above the inflation target of the ECB, a further increase in interest rates is expected.

	2006	2007
Euro-area inflation in %		
CF 06/06 (annual average)	2.2	2.1
CF 09/06 (annual average)	2.3	2.2
Euro-area GDP growth in %		
CF 06/06	2.1	1.8
CF 09/06	2.5	1.8
Oil prices in USD/barrel and EUR/barrel (annual average)		
7 June 2006	69.6 / 55.6	73.6 / 56.6
25 September 2006	66.7 / 53.0	64.5 / 49.4
USD/EUR exchange rate (end of the relevant quarter)		
CF 06/06	1.287 (Q3)	1.302 (Q2)
CF 09/06	1.302 (Q4)	1.31 (Q3)

The marked revival in economic growth in the euro area in 2006 compared with the previous forecast may, through foreign demand, stimulate the export performance of the Slovak economy. The slowdown in economic growth in the euro area in 2007 is not expected to have a major impact on the Slovak economy. Price developments in Slovakia should be favourably influenced by an expected slower rise in oil prices.

Forecasts for 2006 and 2008

The current medium-term forecast expects an end-of-year inflation rate of 4.1% in 2006 (an average rate of 4.4%), 2.6% in 2007 (an average rate of 2.8%), followed by a slowdown to 2.0% in 2008 (an average rate of 2.1%). Compared with the MTF-2006Q3, the current inflation forecast predicts a higher figure for 2006 and a lower one for 2007, while consumer prices in 2008 are expected to rise at the same rate as according to the MTF-2006Q3. The shift in the forecast for 2006 to a higher level in comparison with the previous forecast in 2006 was caused by increases in regulated energy prices in October and November (increase in heat and gas prices of 3% and 7% respectively, with a contribution of approximately 0.5 of a percentage point to headline inflation).

The lower inflation forecast for 2007 would be ascribed mainly to the slower rise in fuel prices caused by lower prices of oil in the global-market and Brent oil futures, the slower increase in regulated energy prices in January, and the cut in VAT rates from 19% to 10% for pharmaceuticals and sanitary goods with effect from January 2007. The current forecast assumes an increase in regulated energy prices in October, November, and a smaller increase in January, while the MTF-2006Q3 predicted an increase in regulated energy prices only from January.

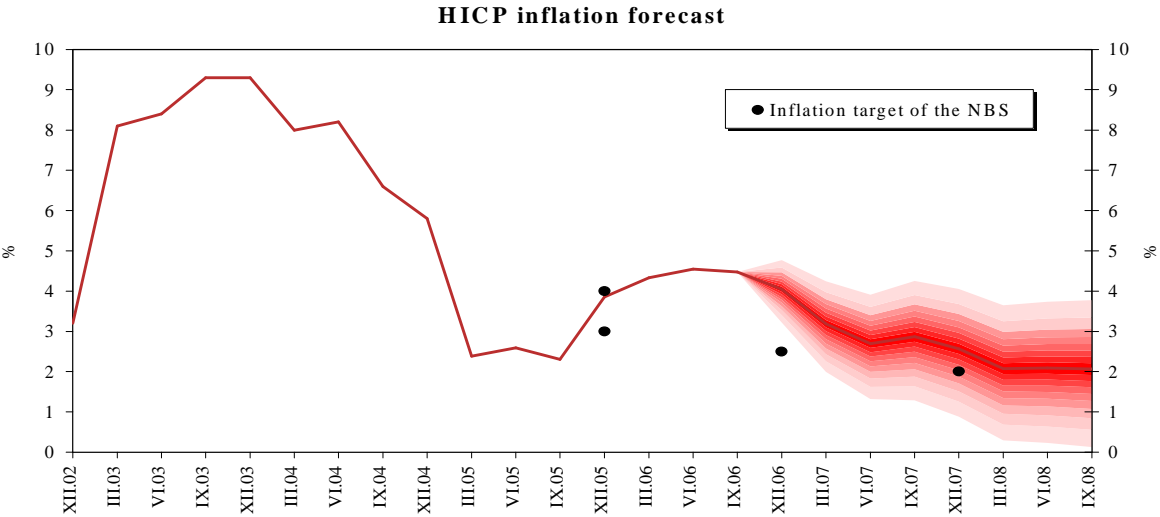
The NBS assumes that regulated energy prices will increase in 2007 by approximately 4.4%, with a contribution of approximately 0.8 of a percentage point to headline inflation. In 2008, regulated prices are expected to rise by 2.4%, with a contribution of approximately 0.4 of a percentage point. In 2008, regulated energy prices are expected to show the same dynamics as in the previous medium-term forecast, since developments in regulated prices in this period will probably be influenced by uncertainties caused by developments in the prices of energy commodities and the prepared legislative changes in the regulation of network industries. In compliance with European regulations, energy taxes are prepared to be levied (on gas and coal for households: EUR 0.3 per 1 GJ, on electricity: EUR 1 per 1 MWh); in 2007 they are to

be introduced at half rates for a temporary period, with an expected contribution of 0.1 of a percentage point to headline inflation. Since it is not yet clear when and at what rates these taxes will be introduced, they have not been taken into account in the current medium-term forecast. In total, regulated prices (energy prices and other regulated prices) are projected by the NBS to increase on average by 5.2% in 2007 and by 2.1% in 2008.

Within the basic structure of inflation, as measured by the HICP, a dampening effect is expected from the low-inflation environment in the tradable sector, which will be a result of low imported inflation and intense competition on the retail market.

In the first half of 2007, food prices are expected to continue rising at a fast rate, due to the current developments in the prices of agricultural products on EU markets, the markets of neighbouring countries, and on the Slovak market. On the whole, food prices are expected to show stronger dynamics in 2007, due to increases in the prices of bread, bakery products, and vegetables (especially potatoes), caused by a poorer harvest in 2006 and subsequent developments in agricultural commodity prices on the domestic and foreign markets. On a year-on-year basis, the effect of these factors should be reflected in food prices even in the first half of 2007 and their expected dynamics should be stronger than according to the previous forecast. The year-on-year growth in food prices may slow in the second half of 2007, but should still remain faster than in the MTF-2006Q3. This trend (a slowdown in year-on-year dynamics, but at higher levels) should continue in the first half of 2008, but in the second half of the year the year-on-year growth in prices of food is expected to slowdown to the level of the previous forecast.

Over the first half of 2007, prices of services are expected to maintain their dynamics at the level of the final quarter of 2006. The year-on-year dynamics should accelerate in prices of services related to transport, recreation and personal services, while slowing in services related to housing and miscellaneous services. Inflation in 2007 is also expected to be influenced by a slowdown in the dynamics in prices of services, caused by their slower actual increase in comparison with the previous forecast, which also reduces their expected increase in the period to come. In prices of services, cost factors should persist, however, with the slowdown in growth of energy prices which appear as a secondary effects, especially in prices of services related to housing, demand factors could become important in 2008. This is connected with stronger wage growth in the domestic economy, dynamic employment growth abroad, and the resulting steeper increase in the compensation of employees.



Comparison of HICP inflation forecasts (year-on-year change in %, average for the period)

		2006	2007	2008
TOTAL (HICP)	MTF-2006Q2	4.1	2.0	2.0
	MTF-2006Q3	4.4	2.9	2.0
	MTF-2006Q4	4.4	2.8	2.1

Comparison of HICP inflation forecasts (year-on-year change in %, end-of-year figures)

		2006	2007	2008
TOTAL (HICP)	MTF-2006Q2	3.7	2.0	2.0
	MTF-2006Q3	3.9	2.8	2.0
	MTF-2006Q4	4.1	2.6	2.0

The medium-term inflation forecast is associated with some risks, but with regard to the trend in oil prices, these risks are on average lower than in the previous medium-term forecast. The developments in oil prices and their impact on fuel prices and regulated energy prices may change the course of inflation in comparison with the current forecast. Another downward risk to inflation may be the fact that regulated gas prices will not be adjusted from January 2007. The uncertainty in the area of regulated prices is increased by legislative changes prepared in the regulation of network industries.

Risks persist also in prices of food and may be related to higher energy prices, weather conditions, and developments in the prices of agricultural commodities on the European market.

Another factor that may affect the inflation forecast is the development in prices of services, in which the secondary effects of increases in regulated energy prices may be reflected to an extent other than expected, especially in prices of services related to housing.

An upward risk to inflation is the uncertainty regarded to the timing and extent of the introduction of energy taxes and the increase in the excise duty on cigarettes. In the general government's draft budget for 2007-2009, additional income is expected from changes in indirect taxes on cigarettes. At the present time, it is not clear to what extent the excise duties will be changed (how the fixed and the percentual part of the tax will be changed and how this will affect the level of consumer prices). Based on past experience, a possible effect of stockpiling also contributes to the degree of uncertainty. With regard to these factors, the effects of excise tax increases have not been taken into account in the current medium-term forecast.

The faster growth in wages, employment, and the compensation of employees abroad may cause increased risks on the demand side.

Compared with the July forecast, the MTF-2006Q4 foresees a somewhat faster nominal wage growth in 2006. The NBS forecast is based on the accelerated growth in nominal wages over the first half of 2006, and its expected continuation in the following two quarters.

In 2007-2008, the NBS expects a slightly stronger nominal wage growth than was predicted in the July forecast. This reflects the expected impact of accelerated wage growth from 2006 and may subsequently influence the rate of wage growth in professions where wage adjustments are tied to the rate of average nominal wage growth in the national economy in the previous year (mainly in public services). Wage growth in the public sector may also be influenced by government measures designed to support wage growth in sectors with low wage levels and to realize changes in employment. The growth in nominal wages may also be promoted by the marked increase in the minimum wage from October (compared with the previous year), due

to the fact that in companies where the compensation of employees is not fixed in a collective agreement, the individual wage categories are derived from the minimum wage.

Real wage growth in 2006-2008 should be somewhat faster than the July forecast due to stronger growth in average nominal wages and in 2007 also in connection with the lower inflation forecast.

Growth in real labour productivity is expected to be somewhat higher in 2006-2008 compared with the July forecast, with employment growing at the same rate and real GDP at a somewhat faster rate. Although real labour productivity is expected to grow at a faster rate than real wages throughout the forecast period, the gap between the growth rates of labour productivity and wages will narrow in comparison with the MTF-2006Q3.

In the employment forecast, the National Bank of Slovakia assumes that the dynamic growth in employment over the first half of 2006, backed by preliminary data on employment in selected sectors in July and August, created conditions for continuing growth in employment in the last two quarters of 2006 (according to statistical reports), while employment should grow throughout the year at approximately the same rate as according to the MTF-2006Q3.

Compared with the previous forecast, the employment development did not change in the coming years, mainly due to the expected risk of impact of the minimum wage, which was markedly increased with effect from October 2006. The National Bank of Slovakia assumes that this factor may complicate the creation of new jobs, especially in small companies and among small businessmen. Labour demand will probably be influenced by increased labour costs, which may subsequently lead to a slowdown in the rate of employment growth in 2007 and 2008. A dampening factor should also be the expected reduction in employment in budgetary and subsidised organisations, declared in the general government's draft budget for 2007-2009.

The NBS expects faster growth in comparison with the July forecast in employment according to the labour force sample survey, due to the dynamically growing number of persons working abroad. The growth in employment abroad is expected to be influenced by the gradual opening of further labour markets within the EU for the new Member States (in May 2006, additional Member States removed or eased their labour market restrictions). This will contribute to the overall growth in employment in both 2006 and 2007. In 2008, the NBS expects a certain slowdown in overall employment growth, mainly due to the above reasons, while employment abroad should stabilise in connection with the persistence of temporary labour market restrictions in other EU Member States.

The current account of the balance of payments in the first half of 2006, coupled with new assumptions concerning the external factors affecting the current account, provided a basis for changes in the predicted values of current account components in the next years.

The foreign trade forecast for 2006-2008 is based on current trade balance developments in 2006. Exports grew year-on-year at a fast rate over the first half of 2006, and this trend continued at the beginning of the second half, when the rate of growth accelerates still further. This fact is reflected in the increase in exports in 2006, and also in the following years, when the export performance of the economy is expected to increase in comparison with the previous forecast. The most significant increase in exports is expected in 2006, and is to be followed by smaller increases in the following years, which will be reflected in the strengthening year-on-year dynamics of exports in 2006 and its subsequent weakening in 2007. The increasing export performance is reflected mainly in the growing exports of semi-finished products and machines. Higher exports led to increased imports expectations in both semi-finished goods and machines. A modest increase, resulting from higher wage forecasts

and the growth potential of the economy, is also expected in imports of goods for final consumption. In 2007 and 2008, lower exports and imports are expected in raw materials, due to lower oil price predictions in comparison with the previous forecast.

For the entire time horizon of the forecast, the increase in exports resulting from the economy's increased export performance is offset by an increase in imports resulting from the import intensity of the economy and increased imports of goods for final consumption. In 2006, the previous trend in raw material imports is expected to have a negative impact on the overall trade balance. In 2007 and 2008, however, imports of raw materials are expected to be lower (owing to the latest oil price estimates) and will have a downward effect on the trade deficit. In the trade balance forecast, the balance for 2006 is expected to deteriorate by a total of Sk 1.1 billion, while the figures for 2007 and 2008 are predicted to improve by Sk 1.0 billion and Sk 0.9 billion respectively.

The latest data on balance of services for the first half of 2006, when the component of services related to transport and tourism improved, were the main reason behind the higher estimated surplus on the balance of services (by Sk 4.0 billion) for the entire year 2006, compared with the previous forecast. In the medium-term, the estimated balance of services was reassessed, which led to a slightly larger surplus expected in 2007 and a virtually unchanged balance in 2008.

The projected overall deficit in income balance has been changed in comparison with the previous forecast, mainly due to a lower estimate of reinvested earnings and partly to a higher estimate of income from compensation of employees. The overall improvement in the income balance deficit amounts to roughly Sk 10 billion per annum for the entire forecast period and results from present developments in 2006.

Based on the latest estimates, the surplus in balance of transfers predicted for 2006-2008 has been reduced by Sk 6–10 billion. A risk for the expected surplus in balance of transfers may be the amount of funds drawn from the EU, which may affect the achieved balance of current transfers due to fixed payments to the EU budget.

The changes in the estimates of individual components in current account have led to a reduction of approximately Sk 4 billion in the deficits for 2006 and 2008. For 2007, the estimated current account balance has been improved only slightly, due to a marked deterioration in the estimated balance of current transfers that year. According to the latest estimates, net receipts from eurofunds are expected to reach approximately Sk 15–16 billion in 2006 and 2007; in 2008, they are likely to exceed Sk 19 billion. In line with the previous forecast, the current account deficit should decrease in 2006-2008, and its share of GDP should be smaller by 0.3 of a percentage point in 2006 and 2008; in 2007, it should remain at the level of the previous forecast.

On the basis of inflows in foreign direct investment (FDI) over the first half of 2006, the estimated inflow of equity capital has been reduced for the entire year 2006. At the same time, the estimate of reinvested earnings has also been reduced. On the other hand, the increased drawing of financial credits from foreign parent companies is reflected in the current developments in 2006 as an increase in estimated FDI inflows in the form of other capital, which also affected the overall FDI inflow in 2006, which is slightly higher than the previous forecast. As in 2006, the expectation of lower inflows in equity capital and reinvested earnings has also been incorporated into the forecasts for the next years. FDI inflows in the form of other capital should increase slightly, but to a lesser extent than in 2006, which will result in lower FDI inflows in 2007 and 2008 compared with the previous forecast.

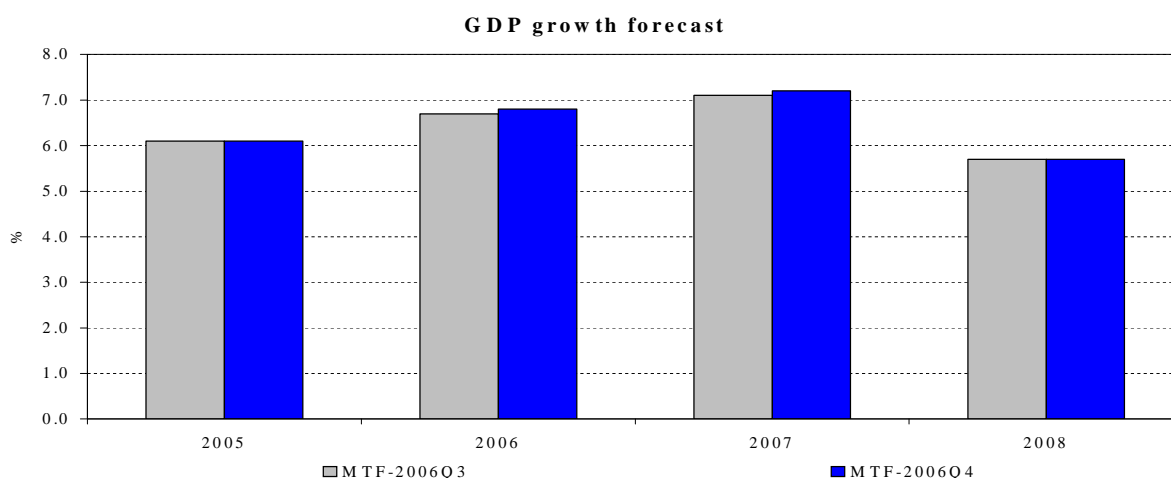
Developments in other investment in the first half of 2006, when a marked outflow of short-term funds was recorded in the banking sector, have had a significant influence on the estimate of other investment for the entire year 2006, while the inflow of funds from the previous forecast has changed into an outflow. This development is not expected to continue in the following years, which is indicated by the fact that the estimates of other investment for 2007 and 2008 have only been changed to a slight extent. Similarly, in portfolio investment, the changes in the forecast have caused only a minimum change in the balance.

The structure of financial account of the balance of payments indicates that the current account deficit should be covered by FDI inflows throughout the forecast period, which should be the precondition for external equilibrium.

In the economic growth forecast for 2006, the NBS expects a pro-growth effect from both domestic demand and net exports. Compared with the July medium-term forecast, the estimate of real economic growth for 2006 has been increased slightly, mainly as a result of developments in the second quarter of 2006 and changes in the final consumption forecast. Final consumption of households is expected to be influenced by a slight increase in wage dynamics, mainly in the third quarter of 2006. Growth in private consumption is also likely to be stimulated by the expected development of employment, as the increase in employment abroad may influence the level of domestic consumption through a modest increase in the compensation of employees. Final consumption of general government in the coming period represents a risk for the forecast, since its level will be connected with the timing and fulfilment of respective objectives within the scope of the government programme.

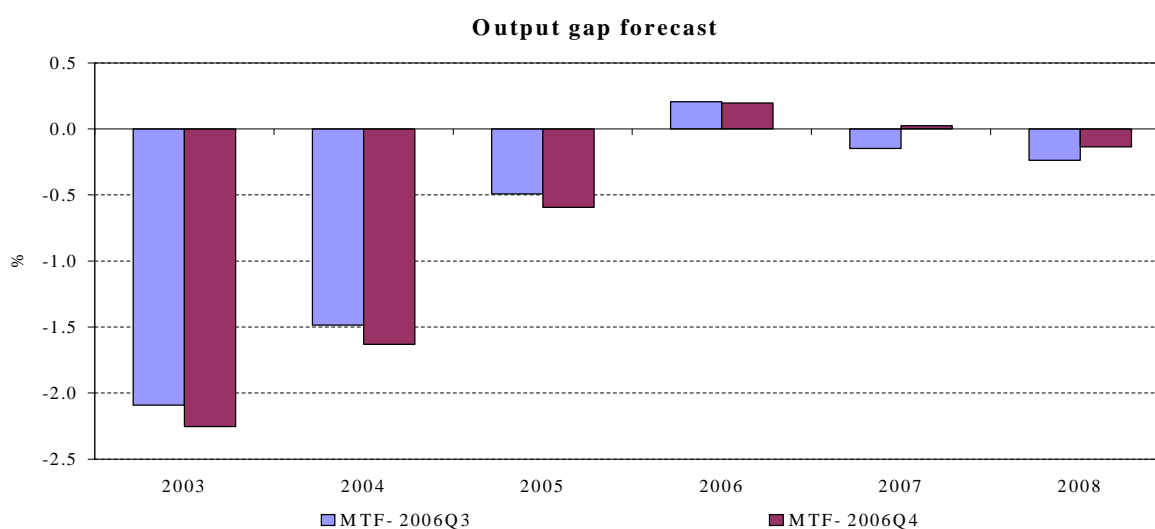
The increased investment activity in the key sectors will probably be the source of rapid gross fixed capital formation in the following quarters of 2006. Net exports are expected to be influenced first and foremost by the manufacture of vehicles, which may be partly offset by increased imports for final consumption. The MTF-2006Q4 predicts a gradually increasing contribution of net exports to GDP growth in the individual quarters. Thus, GDP growth in 2006 should be influenced by both domestic and foreign demand. On the basis of these assumptions, real economic growth is expected to reach 6.8% in 2006.

The trends in the real economy and GDP components are virtually unchanged in the medium term: real convergence is expected to continue and the output of the Slovak economy is expected to increase. In 2007, the NBS expects a slight acceleration in real GDP growth, to 7.2% (compared with 7.1% according to the previous forecast), mainly due to the modified expectations concerning wage developments with an expected impact on final consumption of households (a growth of 0.1 of a percentage point at constant prices in comparison with the MTF-2006Q3). The increased contribution of private consumption to GDP growth should be partly offset by increased imports of goods for final consumption. Final consumption of general government and its impact on overall economic growth will depend on the increases in the individual types of budget expenditures and revenues. The final effect of these changes will influence real growth through changes not only in final consumption of general government, but also in final consumption of households and fixed investments. Within the scope of preliminarily announced measures, real economic growth should be accelerated by increased government spending on social benefits. In addition to the pro-growth effect of domestic demand, the balance of goods and services will primarily be improved by exports of vehicles, when approximately one-third of the economic growth in 2007 is assumed to be associated with net exports. The NBS expects that the rate of GDP growth will be maintained in 2008, in line with the previous medium-term forecast (5.7%). Within the structure of GDP, its growth should be promoted by all components of domestic demand.



The setting of monetary policy for 2006 and 2007 is determined by the ongoing developments in the economy. Compared with the July forecast, the indicators of the real economy and foreign demand indicate another modest acceleration in the rate of economic growth in 2006 and 2007. Regarding to the structure of GDP, a shift has occurred in the estimated cyclical position of the economy, mainly in 2007, when the economy is expected to perform slightly above its potential. The risk of demand pressures persists, which is backed by the latest assumptions concerning wage and employment developments with a pro-growth effect on final household consumption. As for the real economy, there is still a need for restrictive monetary-policy setting with the aim to eliminate the risk of overheating of the economy with a subsequent impact on price developments.

The current developments in energy prices on the world markets mitigate the risks in the area of inflation to some extent. The smaller-than-expected contribution of regulated prices, coupled with a fall in fuel prices, slightly reduces the inflation forecast towards the target. However, the estimated developments in regulated prices continue to be the main reason for the expected exceeding of the inflation target in 2007. Under the assumption of stabilized development of autonomous factors together with restrictive monetary policy, the inflation rate should reach a level at the inflation target in 2008.



Annex

Medium-term forecast (MTF-2006Q4) of main economic indicators

Indicator	2005	2006	2007	2008	2006	2007	2008
	Actual				Difference with previous forecast		
Prices (y-o-y change)							
HICP inflation (end-year)	3.9	4.1	2.6	2.0	0.2	-0.2	0.0
HICP inflation (average)	2.8	4.4	2.8	2.1	0.0	-0.1	0.1
CPI inflation (end-year)	3.7	4.1	2.5	1.9	0.1	-0.3	0.0
CPI inflation (average)	2.7	4.5	2.7	2.0	0.0	-0.1	0.1
PPI (average)	4.7	8.9	3.3	1.6	0.6	0.6	0.0
GDP (y-o-y change, unless otherwise indicated)							
Nominal GDP (SKK bil.)	1 472.1	1 625.0	1 787.2	1 922.1	0.2	6.0	6.2
Nominal GDP	8.6	10.4	10.0	7.5	0.0	0.4	-0.1
Real GDP	6.1	6.8	7.2	5.7	0.1	0.1	0.0
Domestic demand	8.0	5.4	4.5	5.6	0.0	-0.1	-0.3
Final consumption of households	7.2	6.1	6.1	5.3	0.1	0.1	0.1
Final consumption of general government	0.5	4.5	2.9	2.0	0.6	0.5	0.0
Final consumption of non-profit institutions	-3.0	-0.4	5.0	5.0	-4.3	0.0	0.0
Gross fixed capital formation	13.8	10.9	5.9	6.8	-1.0	0.0	-1.2
Exports of goods and services	13.5	16.7	14.7	9.3	3.8	-0.1	-0.9
Imports of goods and services	15.5	14.5	11.8	9.2	3.4	-0.1	-1.2
Labour market							
Nominal wage (monthly average, y-o-y change)	9.2	8.0	7.2	6.3	0.2	0.2	0.3
Real wage (monthly average, y-o-y change)	6.3	3.4	4.4	4.2	0.2	0.3	0.2
Employment (LFS, y-o-y change)	2.1	3.7	2.5	1.7	0.8	0.7	0.5
Employment (registered employment, y-o-y change)	2.2	2.3	1.6	1.0	0.0	0.0	0.0
Unemployment rate (LFS, %)	16.2	13.7	12.5	11.9	-0.7	-1.2	-1.6
Labour productivity (Real GDP/Employment, y-o-y change)	3.8	4.4	5.5	4.7	0.1	0.1	0.0
Balance of payments							
Economic openness (% GDP)	158.0	169.2	168.1	167.8	5.7	3.6	3.4
Trade balance (SKK bil.)	-76.0	-78.4	-43.3	-45.6	-1.1	1.0	0.9
Trade balance (% GDP)	-5.2	-4.8	-2.4	-2.4	0.0	0.1	0.0
Balance of services (SKK bil.)	9.9	15.9	16.1	16.8	4.0	1.1	-0.2
Balance of services (% GDP)	0.7	1.0	0.9	0.9	0.3	0.1	0.0
Current account (SKK bil.)	-126.9	-109.3	-76.2	-73.2	3.8	0.4	4.5
Current account (% GDP)	-8.6	-6.7	-4.3	-3.8	0.3	0.0	0.3
Current and capital account (SKK bil.)	-127.4	-104.3	-70.7	-68.0	3.8	0.4	4.5
Current and capital account (% GDP)	-8.7	-6.4	-4.0	-3.5	0.3	0.0	0.3

Indicator	2005	2006	2007	2008	2006	2007	2008
	Actual	0			Difference with previous forecast		
Compensation per employee (ESA 95, curr.p., y-o-y change)							
Compensation per employee (ESA 95, curr.p., y-o-y change)	6.0	7.0	6.4	6.0	-0.4	0.0	0.0
Real gross disposable household income (y-o-y change)	7.8	6.4	6.1	5.2	1.8	1.1	0.6
Household saving ratio (% of disposable income)	7.8	7.9	8.1	7.6	0.7	1.2	1.0
Employment (ESA 95) (y-o-y change)	1.4	2.1	1.5	0.9	1.2	0.7	0.2
Labour productivity ESA 95 (Real GDP /Employment ESA 95, y-o-y change)	4.6	4.6	5.6	4.8	-1.0	-0.5	-0.3
ULC (Compensation per employee curr.p./ Labour productivity ESA 95)	1.3	2.3	0.8	1.3	0.6	0.5	0.5
Income balance and current transfers (SKK bil.)							
Income balance and current transfers (SKK bil.)	-60.8	-46.8	-49.0	-44.4	0.9	-1.7	3.8
Income balance and current transfers (% GDP)	-4.1	-2.9	-2.7	-2.3	0.1	0.0	0.3
FDI inflow (SKK bil.)							
FDI inflow (SKK bil.)	60.5	113.5	74.8	77.5	5.0	-20.2	-5.0
FDI inflow (% GDP)	4.1	7.0	4.2	4.0	0.1	-1.3	-0.4
Portfolio investment (SKK bil.)							
Portfolio investment (SKK bil.)	-31.3	4.0	0.0	-1.0	1.0	1.0	2.0
Portfolio investment (% GDP)	-2.1	0.2	0.0	-0.1	0.0	0.1	0.1
Other long-term investment (SKK bil.)							
Other long-term investment (SKK bil.)	-15.0	54.8	47.2	38.2	9.6	8.6	0.8
Other short-term investment (SKK bil.)							
Other short-term investment (SKK bil.)	163.0	-148.9	-7.4	-6.6	-174.3	-13.0	-22.3
Financial account (SKK bil.)							
Financial account (SKK bil.)	177.3	23.5	114.6	108.1	-158.6	-23.6	-24.5
Financial account (% GDP)	12.0	1.4	6.4	5.6	-10.1	-1.6	-1.6

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