NÁRODNÁ BANKA SLOVENSKA
EUROSYSTÉM

Medium-term forecast

Q3
2011

Published by:

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Approved by the NBS Bank Board
on 27 september 2011.

ISSN 1338-1474 (online)

Contents

1 Summary

The NBS Medium-Term Forecast published in September 2011 (MTF-2011Q3) was produced amid uncertainty about future developments in financial markets and their repercussions for the global macroeconomic situation. As with the available projections of other institutions, the baseline scenario of this Medium-Term Forecast is based on a gradual stabilisation in financial markets (and hence also in sentiment indicators) as well as on there being no further deterioration in the overall confidence of economic agents. Like the previous forecast, MTF-2011Q3 is based on the same technical assumptions that the ECB uses in its projections[1]. In the absence of any substantial changes in commodity prices or the exchange rate, MTF-2011Q3 was influenced most of all by household consumption growth declining in response to current developments as well as by the lower growth in external demand, particularly over the short-term projection horizon. The forecast was also affected by the published data of the Statistical Office of the Slovak Republic, especially in the area of national accounts for the first and second quarters of 2011, which were not available for the previous forecast.

The Slovak economy's performance in the first half of 2011 was better than projected; this was largely due to external demand, the improvement in which was reflected in the high contribution of net exports to economic growth. The domestic part of the economy remained somewhat subdued, with only the investment component making a positive contribution to GDP growth; both government and household consumption declined. GDP is expected to grow more slowly this year than in 2010, due to the projected (ongoing) consolidation of public finances and the easing of external demand in the second half of the year. Given current developments and the persisting negative consumer sentiment, the propensity of households to save is expected to increase at the expense of household consumption expenditure. In the medium-term horizon, economic growth is assumed to accelerate moderately as both the domestic part of the economy picks up and the world economy continues to grow. The upturn in domestic demand should be accompanied by a gradual diminution of the net export contribution. Economic growth over the whole projection horizon has been revised down from the previous forecast owing to a decline in projected external demand growth.

According to SO SR data, employment growth in the first half of 2011 was also slightly higher than projected in the previous forecast. The anticipated easing of external demand and related slowdown in GDP growth is expected to be reflected in employment figures in the second half of the year. Nevertheless, employment growth in the second half of 2011 is not expected to be so much slower that it would offset the relatively higher growth recorded at the beginning of the year, and therefore the number of employed people is assumed to rise more sharply in the year as a whole than projected in MTF-2011Q2. The increase in the number of employed people over the medium-term horizon is expected to be lower than projected in the previous forecast, owing to the slowdown in economic growth.

Prices are gradually beginning to stabilise after rising sharply at the beginning of the year, thus reflecting the slowdown in food price inflation. At the same time, however, inflation is coming under upward pressure from energy prices, prices of non-energy industrial goods, and services prices. The HICP inflation rate since May has, on the whole, been lower than projected in the previous forecast, but it is assumed to accelerate temporarily in the period ahead owing to an increase in regulated prices. From 2012, price growth is projected to ease gradually due to the fading of the effects indirect tax rises and high prices of food and fuel. The only (moderate) upward pressure on inflation is expected to come from prices of industrial goods and prices of services.

The risks to the current forecast for GDP are predominantly on the downside over the whole projection horizon. The most significant risk is the potential continuation of the current slump in economic sentiment, reflecting the situation in euro area financial markets and a subsequent slowdown in global economic growth. Another

1 *ECB Staff Macroeconomic Projections for the Euro Area, September 2011. Further details can be found on the ECB website at www.ecb.int*

downside risk is the implementation of further consolidation measures in the medium-term horizon. As regards risks to the inflation forecast, they are slightly downward in 2011, when relatively substantial cost factors may be dampened by low consumer demand. Downside risks are expected to persist in 2012, as slower growth in external demand may result in domestic demand having a lowering effect on the price level. In 2013, the risks are projected to be balanced and to continue including the downside risk of weaker external demand.

The economic growth forecast for the whole projection horizon has been revised (especially for the domestic part of the economy). Forward-looking indicators abroad imply current negative tendencies in the form of lower export performance, and these have affected mainly the growth outlooks for the second half of 2011 and first half of 2012. The outlook for the domestic part of the economy has also been revised down, with household consumption assumed to be lower. The revision to the economic growth forecast is accompanied by a slight deterioration in projections for the labour market situation. The inflation rate in the projection horizon is expected to be moderately lower than stated in the previous forecast.

2 Technical assumptions and the international environment

Both the technical assumptions for the medium-term forecast and the assumptions with regard to the international economic situation were taken from the ECB's September forecast (Eurosystem Staff Macroeconomic Projections for the Euro Area)[2].

The technical assumptions for interest rates and commodity prices are based on market expectations, with a cut-off date of 18 August 2011. The average level of short-term interest rates is expected to decline gradually, to 1.3% for 2011 and 1.0% for 2012. The market expectations for euro area ten-year nominal government bond yields imply an average level of 4.2% in both 2011 and 2012. In countries where tensions in sovereign bond markets exist, the pass-through from market rates to bank lending rates is expected to be accompanied by adverse effects on bank credit risk premia. Credit supply conditions are therefore assumed to weigh somewhat on economic activity over the projection horizon. As regards commodity prices, the price of a barrel of Brent crude oil is assumed to average USD 110.1 in 2011 and USD 106.5 in 2012. The prices of non-energy commodities in US dollars are assumed to rise by a substantial 19.6% in 2011 and to decline by 0.8% in 2012.

The bilateral EUR/USD 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. This implies an exchange rate of EUR/USD 1.42 in 2011 and EUR/USD 1.43 in 2012, and an effective exchange rate of the euro that, on average, appreciates by 0.2% in 2011 and decreases by 0.2% in 2012.

Compared with the projections published in June, oil prices are revised down in the September medium-term forecast and the euro's exchange rate against the dollar is assumed to remain unchanged. By contrast, prices of non-energy commodities are expected to rise more moderately in 2011 and to decline in 2012.

The pace of global growth has moderated in recent months. This slowdown partly reflects temporary factors, such as the impact of the Japanese natural and nuclear disasters on global supply chains, as well as the dampening effects of high commodity prices on incomes in the majority of advanced economies. These factors are projected to wane gradually; however, the higher than expected unemployment rates, lower confidence indicators in advanced economies, and continued weakness in the housing market in the United States are expected to weigh adversely on growth. In addition, the recent shift in sentiment in global financial markets is anticipated to have further negative repercussions on economic growth through both confidence and wealth effects in the second half of 2011. In the medium term, the legacy of the financial crisis is expected to continue to weigh adverse-

Table 1 Technical assumptions

	Published in	Projection for 2011	Projection for 2012
Oil (USD/barrel)	June 2011	111.1	108.0
	September 2011	110.1	106.5
Non-energy commodities (annual percentage chenges)	June 2011	20.4	1.2
	September 2011	19.6	-0.8
USD/EUR exchange rate	June 2011	1.42	1.43
	September 2011	1.42	1.43

Source: ECB.

2 *For further details about the ECB projections, see www.ecb.int*

ly on the strength of the recovery in advanced economies, reflecting the need for balance sheet adjustment in various sectors. This hampers the prospects for a swift improvement in labour markets in advanced economies. By contrast, growth in emerging economies is expected to remain robust, with overheating pressures persisting. World real GDP outside the euro area is assumed to grow, on average, by 4.1% in 2011 and 4.4% in 2012, both estimates being lower than those in the previous forecast. Growth forecasts for euro area foreign demand have also been revised down, to 7.0% in 2011 and 6.8% in 2012. The NBS forecast for 2013 assumes a continuing decline in oil prices, a moderate rise in non-energy commodity prices and an ongoing recovery in the global economy and in euro area foreign demand.

3 Medium-term forecast for the euro area

Following strong growth in the euro area in the first quarter of 2011, driven by a rebound in construction output, there has been a significant deceleration in economic activity in the past few months. As was the case for the global economy, euro area activity was dampened by adverse effects related to the Japanese natural and nuclear disasters, as well as by the lagged impact of past oil price increases. The underlying momentum in the euro area also weakened as a result of domestic factors, such as lower equity prices, the tightening of the fiscal stance, more strict credit supply conditions and heightened uncertainty, as reflected in rising risk premia related to the sovereign debt crisis as well as in deteriorating business and consumer confidence. As several of these factors are expected to continue to have an adverse impact in the near term, real GDP is projected to increase only modestly during the second half of 2011. Thereafter, activity is expected to gradually gain momentum as euro area exports benefit from rising foreign demand, while domestic demand is projected to gradually strengthen, supported by the accommodative monetary policy stance, the measures to restore the functioning of the financial system and, eventually, the impact of robust global demand on domestic income. Compared with the June forecast for GDP, the revisions for the outlook for 2011 and 2012 reflect both lower foreign demand and weaker domestic demand.

Overall HICP inflation is projected to stay above 2% for the rest of 2011, largely owing to the impact of past strong increases in oil and non-oil commodity prices on energy and food prices. Thereafter, on the basis of current futures prices for commodities, import price increases are projected to moderate. By contrast, domestic price pressures are expected to rise slowly, reflecting increasing labour costs as well as the pass-through of the past hikes in commodity prices, leading to a gradual rise in the inflation rate of the HICP excluding food and energy over the projection horizon. Growth in compensation per employee is projected to remain rela-

Table 2: Projections of selected euro area indicators (average annual percentage changes)

	Published in	Actual figures	Prediction for	
		2010	2011	2012
HICP	June 2011	1.6	2.5 – 2.7	1.1 – 2.3
	September 2011		2.5 – 2.7	1.2 – 2.2
Real GDP	June 2011	1.7	1.5 – 2.3	0.6 – 2.8
	September 2011		1.4 – 1.8	0.4 –2.2
Private consumption	June 2011	0.8	0.6 – 1.2	0.4 – 2.2
	September 2011		0.3 – 0.7	0.0 – 1.6
Government consumption	June 2011	0.5	-0.4 – 0.6	-0.5 – 0.9
	September 2011		-0.2 – 0.8	-0.7 – 0.5
Gross fixed capital formation	June 2011	-0.8	2.0 – 4.2	1.1 – 5.9
	September 2011		2.2 – 3.6	0.8 – 5.4
Exports (goods and services)	June 2011	11.0	5.8 – 9.6	2.6 – 10.6
	September 2011		5.6 – 8.4	2.3 – 9.7
Imports (goods and services)	June 2011	9.3	4.3 – 7.9	2.6 – 10.0
	September 2011		4.7 – 7.3	2.0 – 9.2

Source: ECB.

tively moderate over the projection horizon, reflecting the expected muted improvement in labour market conditions. Owing to the partial and lagged response of nominal wages to consumer price inflation, real compensation per employee is projected to decline in 2011. Thereafter, it is expected to increase slowly. As labour productivity growth is projected to moderate, unit labour costs are expected to rebound in 2011 and to grow at a faster pace in 2012. As a consequence, profit margin growth is projected to be curtailed in 2011 and 2012, also reflecting the expected moderate growth of aggregate demand.

Compared with the June forecast, the projection range for HICP inflation has been left unchanged for 2011, but it is slightly narrower for 2012.

4 Medium-term forecast for Slovakia

The September medium-term forecast is based on the same technical assumptions that the ECB uses in its projections[3]. In the absence of any substantial changes in commodity prices or the exchange rate, MTF-2011Q3 was influenced most of all by household consumption growth declining in response to current developments as well as by lower growth in external demand, particularly over the short-term projection horizon. The assumptions for Slovakia's external demand also took into account the signals being sent by sentiment indicators when the forecast was produced. This resulted in a downward revision of Slovak economic growth over the projection horizon, particularly in 2012.

The substantial degree of uncertainty about the further developments in financial markets and their subsequent impact on confidence indicators means there are several potential scenarios for the macroeconomic situation. This Medium-Term Forecast, like the projections of other institutions available at the time of its production, is based on a gradual stabilisation in financial markets (and hence also in sentiment indicators) as well as on there being no further deterioration in the overall confidence of economic agents.

4.1 The real economy

Current account

In the balance of payments current account for the second quarter of 2011, exports and imports continued to record annual growth based on positive developments in external demand. With external demand expected to continue rising, it may be assumed that the annual rate of change in exports and imports will be positive over the projection horizon, with the trade surplus recording a gradual increase in year-on-year terms. However, the growth forecast for external demand has been revised down from the previous forecast, and consequently so has the rate of growth and levels of imports and exports. The projected trade balance for the whole of 2011 has improved slightly, since the adverse effect of lower growth in external demand was outweighed on the import side by lower domestic demand. In 2012 and 2013, the positive effect of lower domestic demand on the trade balance is expected to diminish, and this, in combination with the lower level of external demand, has resulted in the trade balance projection being revised down from the previous forecast.

The main risk to the trade balance forecast is a continuation of the slowdown in external demand over a longer time horizon. A downside risk on the import side is lower domestic demand.

The projection for the services balance is the same in MTF-2011Q3 as in the previous forecast, since current developments in the balance are essentially unchanged from the assumptions made in June. The income balance forecast has been revised down for each year of the projection horizon owing to interest payments in 2011 being higher than previously anticipated. The forecast for the current transfers balance has been affected by current developments in the utilisation of EU funds. The projected current transfers balance for 2011 has been revised down (on the basis of current developments), while the balance for 2012 and 2013 is assumed to improve moderately due to a higher utilisation of EU funds, with a positive effect on both the current account and capital account.

In line with the previous forecast, the current account to GDP ratio in the years 2011 to 2013 is expected to improve in year-on-year terms due to steady growth in external demand. The estimate for the balance of payments current account in 2011 has been revised up slightly owing to lower domestic demand. In 2012 and 2013, by contrast, the trade balance and consequently the current account are expected to deteriorate as a result of lower external demand.

Labour market

According to SO SR data, employment growth in the first half of 2011[4] was slightly higher than projected in the previous forecast. The upturn

3 *ECB Staff Macroeconomic Projections for the Euro Area, September 2011. Further details can be found on the ECB website at www.ecb.int*

4 *During the production of the previous forecast (MTF-2011Q2), GDP and employment data were flash estimates and their structure was unknown. Therefore, the developments over the whole first half of the year were evaluated.*

reflected both growth in the number of people employed in the industry sector and the higher contribution of employment in the services sector. The anticipated easing of external demand and related slowdown in GDP growth is expected to feed through to employment figures in the second half of the year. Nevertheless, employment growth in the second half of 2011 is not expected to be so much slower that it would offset the relatively higher growth recorded at the beginning of the year, and therefore the average number of employed people for the full year is assumed to rise more sharply than projected in MTF-2011Q2.

The number of employed people is expected to rise in the medium term, but although average employment growth is estimated at around 1% over the projection horizon, the number of people in work will not have reached pre-crisis levels by the end of the period. Employment growth has been revised down from the previous forecast, owing to the slowdown of economic growth.

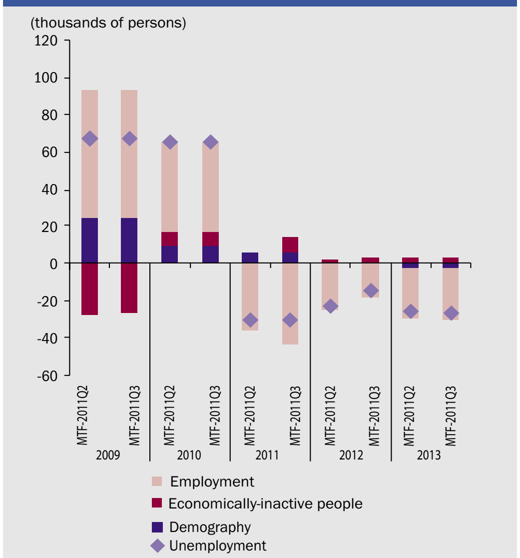
Unemployment is gradually responding to the developments in employment. In the medium-term horizon, the unemployment rate is assumed to decline by 1.5 percentage points from its current level. With the recovery in the labour market expected to be slower than projected in the previous forecast, the decline in the unemployment rate has been revised down.

The annual rate of growth in compensation per employee is assumed to be higher in 2011 than in 2010, on the basis of developments in the first half of 2011. During this period, the number of hours worked increased relatively sharply, which may have passed through to higher real wage growth. Employee compensation is expected to continue rising in the second half of 2011, albeit more moderately than in the first half. This slowdown is predicated on the assumption that real wage growth in the private sector will be lower in the second half of the year, owing to a projected slowdown in output and subsequent reduction in the number of hours worked. Although compensation per employee growth is expected to accelerate in the medium term, the projected pace of this increase has been revised down on grounds of slower growth in labour productivity alongside lower demand for labour. In an environment of slower employment growth and moderately higher wage rises, the estimated increase in total labour costs over the projection horizon has been revised down from the previous forecast (MTF-2011Q2), which may translate into weaker upward pressure on the price level throughout the economy.

The risks to the current forecast for labour market indicators are predominantly on the downside. Not only may the currently projected slowdown of economic growth result in fewer than expected jobs being created, but there may also be a further easing of economic growth. Another downward risk could be potential lay-offs in the public sector, made in order to cut wage costs as part of a further round of consolidation measures.

The approved amendment to the Labour Code could have a short-term effect on employment, given that redundancy-related costs are expected to be lower under the new legislation and that employers may therefore postpone planned redundancies until it enters into force. At the same time, however, the Labour Code amendment may bring greater flexibility to the

Chart 1 Contributions of labour market indicators to unemployment



Source: SO SR; NBS calculations.
Note: The contributions of individual labour market indicators refer to their effect on the number of unemployed: for example, unemployment is reduced by a rise in employment, a drop in the number of people of productive age (demographics), and an increase in the economically-inactive population. In the medium-term horizon, the increase in employment is expected to have the most significant effect on the unemployment rate.

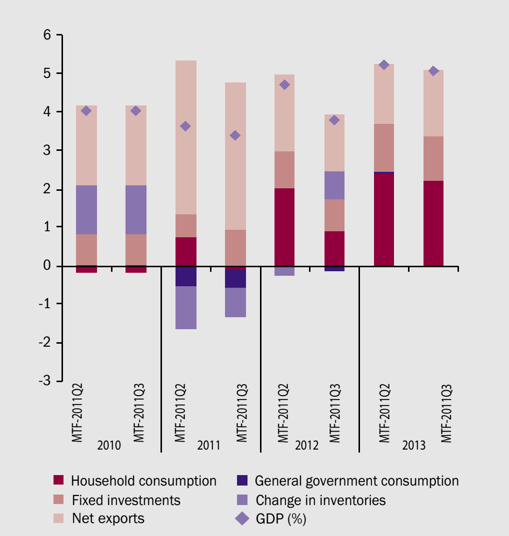
labour market, which may in the long term help to create scope for further employment growth.

Gross domestic product

According to SO SR data, GDP growth in the first half of 2011 was moderately faster than projected in the previous forecast, largely due to higher net exports. The domestic part of the economy continued to contract as a consequence of lower consumption demand. In the second half of the year, however, the anticipated slowdown in external demand and further stagnation of domestic demand are expected to result in lower GDP and therefore a slowdown in the economic growth for the whole of 2011. Growth is assumed to rise moderately in subsequent years owing to a gradual recovery of the domestic part of the economy and continuing growth of the world economy.

The current forecasts for growth in GDP at constant prices are 3.4% in 2011, 3.8% in 2012, and 5.1% in 2013. These growth projections are lower than in the previous forecast (MTF-2011Q2) due to the downward revision of projected growth in external demand and to the partial incorporation of confidence indicator signals. The overall uncertainty in financial markets and among economic agents in surrounding countries is expected to be reflected in lower external demand in the second

Chart 2 Contributions to GDP growth at constant prices (p.p.)



Source: NBS.
Note: 2010 – actual figures.

half of this year and at the beginning of 2012. It is assumed that subsequently the situation will gradually stabilise and that external demand will continue to increase. The currently projected temporary slowdown in external demand growth means, however, that this demand will remain at lower levels than estimated in the previous forecast. The slowdown in export production is expected to be reflected in labour market indicators. This, together with the current decline in household consumption and the continuing cautiousness of consumers in the form of their propensity to save, is therefore reflected in a more moderate growth forecast for the domestic part of the economy over the whole projection horizon.

Domestic demand

Household final consumption is expected to decline moderately in 2011. Although the current upturn in the labour market is feeding through to growth in household incomes, the fiscal consolidation measures implemented by the Government are eating into household consumption expenditure, and persisting negative consumer sentiment is reducing the propensity to consume. This situation is expected to continue in the second half of 2011, with a contributing factor being the uncertainty surrounding further economic developments. It is assumed that the household approach to consumption will still be cautious at the beginning of 2012. In the medium-term horizon, the effect of labour productivity growth and a gradual improvement in the labour market situation should create scope for an increase in household incomes and growth in final consumption.

Gross fixed capital formation is the only component of domestic demand that is projected to make a positive contribution to GDP growth in 2011. The main factors contributing to the pick-up in investment activity are assumed to be the current growth in corporate profits (driven by the acceleration in industrial production) and the still relatively low level of real interest rates. The completion of infrastructure investments is also expected to have a positive effect, boosted by the utilisation of EU funds. In 2012, gross fixed capital formation is expected to be slightly lower owing to persisting uncertainty. This effect, however, should only be temporary, and a return to investment growth is projected in 2013.

General government consumption is assumed to decline in 2011 due to the effect of adopted measures. The forecast for 2012 takes into account the austerity measures so far proposed in the area of final consumption expenditure, namely wage freezes for public sector workers (except for teachers) and the reduction of the Government's operating expenditure.

The current forecast expects change in inventories to make a slightly negative contribution to economic growth in 2011, as existing stocks are used in the production process. The necessary replenishment of these stocks is expected to contribute positively to economic growth in 2012. In 2013, GDP growth is not assumed to be affected by change in inventories.

The contribution of domestic demand to GDP growth over the whole projection horizon has been revised down from the previous forecast, largely due to the lower forecast for household consumption.

Chart 3 Forecast for GDP growth at constant prices (%)

Source: NBS.
Note: 2008-2010 – actual figures.

Net exports

With the upturn in exports in the first quarter of 2011 and the continuing rise in external demand, the export performance of the economy is expected to improve this year. Imports of goods and services are assumed to be affected by low domestic demand, and their rate of growth is projected to lag behind export growth. Consequently, net exports are expected to come out positive and to be the main driver of GDP growth this year. Since domestic demand is expected to rise more sharply, its contribution to GDP growth in the medium-term horizon is assumed to increase at the expense of net exports.

Compared with the previous forecast, the positive contribution of net exports to GDP is expected to decline, largely due to lower external demand in 2011 and at the beginning of 2012.

The risks to the current GDP forecast are predominantly on the downside over the whole projection horizon. The most significant risk is the potential continuation of the current slump in economic sentiment, reflecting the situation in euro area financial markets and the subsequent slowdown in global economic growth. Another downside risk is the implementation of further consolidation measures in the medium-term horizon.

Box 1

SCENARIO OF A FURTHER SLOWDOWN IN EXTERNAL DEMAND GROWTH

The baseline scenario of the Medium-Term Forecast was based on the technical assumptions used in the ECB Staff Macroeconomic Projections and on the information available at the time of the forecast's preparation. The principle assumption was that falling confidence indicators are to stabilise gradually and that external demand will increase. There were also, however, risks of a potential further slowdown of economic growth, depending on developments in financial markets. The purpose of this scenario was therefore to quantify one of the risks of the forecast, namely the impact of a further easing of external demand growth on the Slovak economy, while maintaining the baseline assumption that it will not enter negative territory.

If the current uncertainty and negative sentiment in external markets persist, they could reduce the rate of growth in external demand and subsequently also the export performance of the Slovak economy. Such developments have already been indicated by the recently published euro area Economic Sentiment Indicator for August, which recorded a relatively sharp fall. The downturn in economic sentiment in recent months may be compared with a similar period in 2008, when a decline in the confidence indicator was subsequently accompanied by downward revision of the estimate for external demand growth.

This forecast (MTF-2011Q3) takes into account a partial slowdown in external demand brought on by the negative sentiment referred to above and by falls in confidence indicators and also in economic sentiment. It does not, however, reflect either the signals being sent by the most recent data – which were not made available until after the cut-off date for the forecast's assumptions – or the possibility of a further deterioration of these indicators. This scenario therefore takes this risk to the forecast into account.

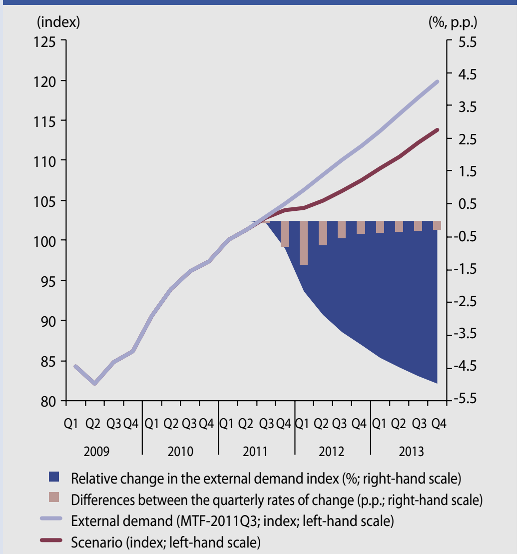
The starting point for assessing its impact on external demand is to make a comparison with 2008, when a similar decline in economic sentiment was recorded in the third quarter and the forecast for external demand had to be revised. This period also saw industrial production growth in the euro area decelerate and even enter negative territory. If the uncertainty so far indicated in the survey questionnaire were fully reflected in the real economy, the quarters ahead could see a slowdown in external demand similar to that estimated in the technical assumptions made in 2008. Like the baseline forecast, this scenario assumes a stabilising situation in financial markets without any further substantial deterioration and without any slump in the global economy. Given the nature of the scenario, economic growth in Slovakia's trading partners might only decelerate, or come to a halt, and then recover gradually in the second half of 2012. The scenario reflects only a revision of the external demand forecast, similar to that made for the period from June 2008 to September 2008. Compared with the current forecast (MTF-2011Q3), this scenario assumes that external demand for Slovak exports will decrease by an additional 5% (cumulative) before the end of 2013 (in contrast to the 6.5% decrease projected in MTF-2011Q2).

The pass-through of the lower growth rate in external demand to the export performance of the Slovak economy is expected to be immediate

Chart A Economic sentiment indicator and industrial production (euro area)

Source: NBS.

Chart B Scenario of external demand developments



Source: NBS.

and to act as a brake on GDP growth. The constraints on external demand are assumed to be accompanied by a gradual fall in all components of domestic demand growth and, eventually, by price changes. In the case of households, it is not expected that the decline in disposable income will be fully reflected in consumption, but that shortfalls in income will to some extent be covered by savings. Overall, the downward effect of lower external demand on economic growth in Slovakia is put at -1.7 percentage points in 2011 and -0.9 percentage point in 2013.

GDP (%)	2011	2012	2013
MTF-2011Q3	3.4	3.8	5.1
Scenario	3.3	2.1	4.2
Difference (p.p.)	-0.1	-1.7	-0.9

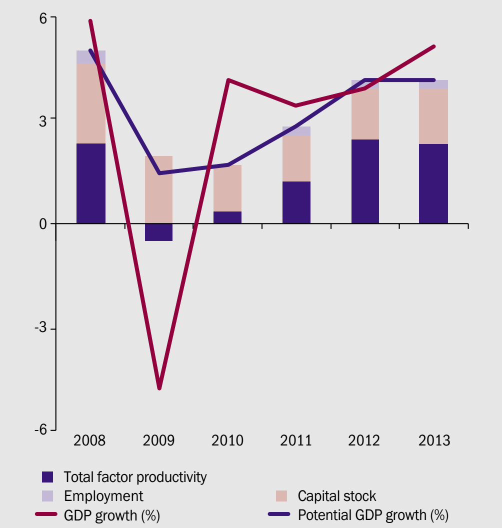
HICP (%)	2011	2012	2013
MTF-2011Q3	4.2	3.0	2.4
Scenario	4.2	2.8	1.8
Difference (p.p.)	0.0	-0.2	-0.6

Potential GDP and the output gap

The potential growth of the Slovak economy is expected to reach around 4% in 2012 and 2013, driven up mainly by an increase in total factor productivity. Potential output is assumed to be boosted at the end of this year by the expansion of production in the automotive industry. The effects of this one-off impulse should be seen mainly in 2012, when the new production is expected to reach full capacity. Despite slower investment growth in 2012 and 2013, capital stock is projected to continue increasing at a fast pace. As in the previous forecast, potential employment is expected to make a positive contribution to potential output growth, albeit limited by demographic developments. The projection for potential output growth has been revised down slightly from the previous forecast (MTF-2011Q2), mainly due to the revision of total factor productivity.

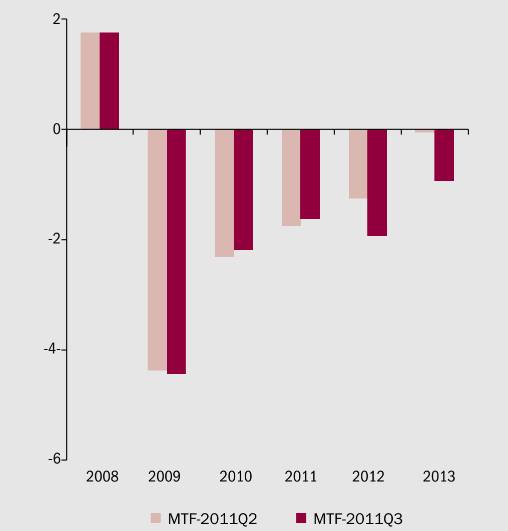
The assessment of the cyclical position of the economy differs from the previous forecast in that it reflects slowdowns in both external demand and domestic demand, particularly in 2012. It is assumed that next year will see lower growth in GDP than in potential output and the reopening of a negative output gap. This development is not, however, expected to last, and even in 2013 the

Chart 4 Contributions to potential GDP growth (p. p.)



Source: NBS.
Note: 2008-1010 – actual figures.

Chart 5 Output gap (%)



Source: NBS.

rate of economic growth should be contributing to a relatively rapid closing of the negative output gap.

4.2 INFLATION

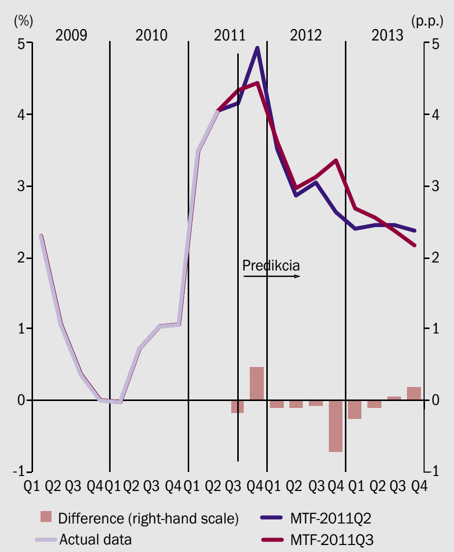
The rate of HICP inflation, after accelerating from the beginning of the year due to increasing prices of goods, has stabilised, and decelerated moderately, since May as a result of developments in food prices – particularly prices of unprocessed food, which were affected by consumer fears over an E. coli outbreak. The annual rate of change in energy prices increased again in August, owing to hikes in the prices of gas and heat. The annual growth in services prices continued to accelerate moderately, reflecting higher prices of transport, recreational, and personal services. The HICP inflation rate since May has, on the whole, has been lower than projected in the previous forecast.

The inflation rate until the end of 2011 is assumed to accelerate gradually, driven up mainly by an expected increase in regulated energy prices (including a further rise in heat prices). Food prices in the coming period are expected to continue reflecting high prices of agricultural commodities (rice, oilseed rape), although it is assumed that this year's better harvest will have a downward effect in the latter months. Prices of services and non-energy industrial goods are assumed to rise gradually in 2011, owing to a sharper rise in import prices and also to the pass-through of cost impulses.

The inflation rate is expected to decelerate at the beginning of 2012, as the effects of indirect price rises and high prices of agricultural commodities and fuel continue to fade. The increases in regulated energy prices over the course of 2011 mean that it should not be necessary to raise these prices in January 2012 to the extent assumed in the previous forecast. In other words, part of the originally projected increase in regulated prices has already been carried out several months in advance. At the same time, the oil price is lower than forecast in MTF-2011Q2, which is also reducing the need for a further hike in energy prices. The overall price level in 2012 is expected to be pushed up not only by the projected rise in energy prices in January, but also by higher rates of growth in prices of services and of non-energy industrial goods, owing to a sharper rise in import prices in both 2011 and 2012. Services prices are assumed to reflect higher prices of industrial goods as well as the secondary effect of rising energy prices. The rate of change in food prices in 2012 is expected to be moderated by this year's good harvest. Consumer price growth is projected to decelerate again in 2013, largely due to stagnation in regulated energy prices (following their rise in January 2012, and with oil prices recording a modest year-on-year decline in 2013).

This forecast assumes that the average rate of consumer price inflation will be 4.2% in 2011, 3.0% in 2012 and 2.4% in 2013. Based on current developments in inflation, the projected rate of change in inflation for 2011 has been revised up from the previous forecast (MTF-2011Q2). Although the inflation rate since May has been lower than projected in MTF-2011Q2, that forecast did not envisage hikes in regulated energy prices in August, September and October, which have put the inflation forecast for these months on a higher trajectory and also affected the inflation forecast for the year as a whole. Consumer prices are expected to rise more moderately in 2012, mainly due to lower growth in regulated

Chart 6 Changes in the HICP inflation forecast

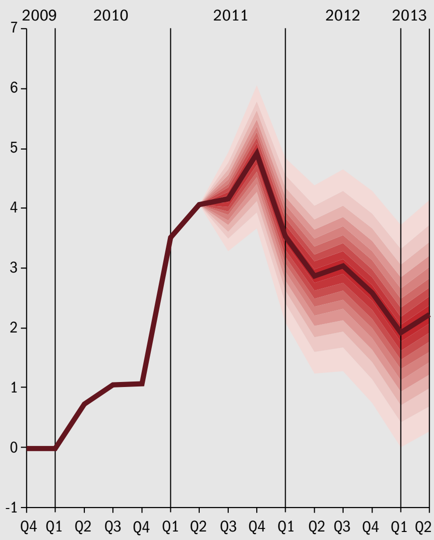


Source: NBS.

energy prices and food prices. In 2013, consumer price inflation is projected to decelerate on the basis of lower rates of change in prices of food and services; these prices are assumed to reflect levels of growth in compensation and in household consumption in 2012 and 2013 which have been revised down from the previous forecast.

The risks to the inflation forecast are moderately on the downside in 2011, when relatively substantial cost factors may be dampened by lower consumer demand. Downside risks are expected to persist in 2012, as slower growth in external demand may be reflected in a downturn in the labour market as well as in lower import price growth. This may subsequently have a dampening effect on the domestic price level. In 2013, the risks are projected to be balanced and to continue including the downside risk of weaker external demand.

Chart 7 HICP forecast (%)



Source: NBS.

Box 2

TECHNICAL CALCULATION OF THE EFFECT OF CERTAIN FISCAL CONSOLIDATION MEASURES ON HICP

This forecast does not take into account the potential impact on the HICP inflation of certain fiscal consolidation measures due to be voted on by the Slovak Parliament. These comprise proposals to raise excise duty on cigarettes (by around €0.10 per packet), to introduce a bank tax and to increase the fee that ENEL Slovenské elektrárne (the country's sole nuclear power station operator) pays to the National Nuclear Fund. This Box provides for a projection of their impact on the HICP. However, only the increase in the cigarette excise tax would have an unambiguous impact on the HICP rate.

Given current competition in the banking sector, it is not certain that any or all of the bank tax would be passed on to customers. If the levy is passed on through lending rates and deposit rates, it will not affect inflation directly (since interest rates are not included in the consumer basket). If, however, the levy is passed on through bank charges, it could be

HICP (%)	Projected impact on the HICP rate in 2012 in percentage points
Excise duty on cigarettes	0.10[1)]
Bank tax	0.07[2)]
Fee paid by Slovenské elektrárne to the National Nuclear Fund	0.02[3)]
Total	0.1– 0.19

[1)] The current forecast assumes an increase in excise duty on cigarettes from February 2013. The imposition of higher excise duties a year earlier would increase the inflation rate in 2012 and reduce it in 2013.
[2)] Where the bank tax is passed through only to charges included in the consumer basket (theoretical maximum impact on inflation).
[3)] Where the increase in the fee to the National Nuclear Fund is passed on to the electricity price per kWh (theoretical maximum impact on inflation).

reflected in consumer prices. The contribution stated in the table represents the maximum possible pass-through of the whole levy on overall HICP inflation rate, i.e. only through charges included in the consumer basket (services charges for current accounts and credit accounts, and ATM withdrawal charges).

The same applies in the event that ENEL Slovenské elektrárne has to pay a higher fee to the National Nuclear Fund, since such a rise may not necessarily be directly included in eligible costs and therefore would not necessarily show up in the consumer price. The table again states the maximum possible impact of this measure.

Table 3 Medium-term forecast (MTF-2011Q3) – main macroeconomic indicators

Indicator (y-o-y change in % unless otherwise indicated)	Actual data	Projection in MTF–2011Q3			Difference versus MTF-2011Q2		
	2010	2011	2012	2013	2011	2012	2013
Prices (annual percentage changes)							
HICP inflation (average)	0.7	4.2	3.0	2.4	0.1	-0.3	-0.1
CPI inflation (average)	1.0	4.1	3.0	2.4	0.0	-0.2	-0.1
ULC[1] (compensation per employee at current prices / labour productivity ESA 95 at constant prices)	-2.7	2.9	1.8	2.0	0.6	-0.8	-0.2
Labour productivity ESA 95 (GDP at constant prices / employment ESA 95)	5.5	1.6	3.0	3.8	-0.4	-0.6	-0.2
Compensation per employee (current prices)	2.7	4.6	4.9	5.9	0.3	-1.4	-0.,4
Economic activity							
Real GDP	4.0	3.4	3.8	5.1	-0.2	-0.9	-0.2
Final consumption of households	-0.3	-0.1	1.7	4.4	-1.5	-2.1	-0.3
Final consumption of general government	0.1	-2.8	-0.7	-0.1	0.2	-0.6	-0.2
Gross fixed capital formation	3.6	4.2	3.9	5.2	1.5	-0.5	-0.4
Exports of goods and services	16.4	11.4	8.2	9.3	-0.3	-1.6	0.1
Imports of goods and services	14.9	8.0	7.6	8.6	0.0	-1.1	-0.1
Gross real disposable income of households	-1.4	1.3	2.4	4.3	0.3	-1.4	-0.12
Output gap (% of the potential output)	-2.2	-1.6	-1.9	-0.9	0.2	-0.6	-0.8
Labour market							
Employment, based on ESA 95	-1.4	1.8	0.8	1.2	0.2	-0.3	0.0
Unemployment rate, LFSS-based[2] (%)	14.4	13.2	12.6	11.7	0.0	0.2	0.2
Balance of payments							
Economic openness (% of GDP)	162.3	177.3	183.1	189.2	-1.0	-1.3	-0.4
Balance of trade (% of GDP)	0.2	1.7	2.4	2.8	0.3	-0.2	-0.3
Balance of services (% of GDP)	-1.1	-0.8	-0.8	-0.6	0.0	0.0	0.1
Current account (% of GDP)	-3.5	-1.5	-0.4	0.0	0.1	-0.2	-0.4
Current and capital account (% of GDP)	-1.9	0.3	1.5	1.8	0.0	-0.2	-0.4

Source: NBS.
1) ULC – unit labour costs.
2) LFSS – Labour Force Sample Survey.