



NÁRODNÁ BANKA SLOVENSKA  
EUROSYSTEM



# MEDIUM-TERM FORECAST

Q4 2013  
UPDATE

Published by:  
© Národná banka Slovenska

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Discussed by the NBS Bank Board on  
28 January 2014.

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ISSN 1338-1474 (online)



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# 1 UPDATE OF THE MEDIUM-TERM FORECAST MTF-2013Q4<sup>1</sup>

For this update of December's medium-term forecast (MTF-2013Q4U), Národná banka Slovenska took account of the national accounts for the third quarter of 2013, as well as monthly economic data, and forward-looking indicators pointing to developments in the last quarter of 2013.<sup>2</sup>

The economy's **overall growth** in third quarter of 2013 **was in line with expectations**. Assumptions for the gradual pick-up in external demand were not revised in the updated forecast. The composition of economic growth, published subsequent to the cut-off date of the December forecast, differs from projections. Stronger figures for investment and **higher growth in general government final consumption were reflected in MTF-2013Q4U**. By contrast, **private consumption declined unexpectedly** in the third quarter. Its weaker performance did not, however, weigh directly on the outlook for 2014, since a marked decline in inflation may have had an upward effect on real wage growth, possibly causing household consumption to be moderately higher than projected. Hence **the macroeconomic outlooks are marginally brighter** in MTF-2013Q4U than in the December forecast, mainly owing to **stronger growth**

**on the domestic side of the economy** and, in 2015, partially also to expectations of improved export performance.

**The labour market situation has stabilised** as projected. The latest data point to a slight recovery in job creation in the last quarter of 2013. The assumption for employment in the first half of 2014, based mainly on employers' expectations, is that its gradual growth will continue. No revision has been made to the projected path of employment and, accordingly, the unemployment rate is expected to fall moderately.

**The inflation forecast has been significantly revised**. Cumulative inflation figures have under-shot projections by 0.5 percentage point, with the most marked divergence observed in the food component. This, together with new energy price tariffs, has prompted a downward revision of the inflation forecast for 2014, to 0.6%.

**The forecast for economic growth has been revised up to 2.3% in 2014** (by 0.1 p.p.) and to **3.3% in 2015** (by 0.2 p.p.). In 2015, as consumer demand recovers, **the inflation rate is expected to accelerate to 1.9%**.

<sup>1</sup> The update of the Medium-Term Forecast MTF-2013Q4 is hereafter referred to by the abbreviation MTF-2013Q4U. The need to update December's medium-term forecast relates to the participation of Národná banka Slovenska in the Macroeconomic Forecasting Committee, which under the Fiscal Responsibility Act is required to produce a macroeconomic and tax forecast by 15 February. The cut-off date for the last forecast of the year (published in December) is usually around the third week in November, before the detailed breakdown of GDP data is available. An update of the December medium-term forecast has been produced since 2013.

<sup>2</sup> The forecast was based on data with a cut-off date of 14 January 2013.

## 2 TECHNICAL ASSUMPTIONS<sup>3</sup>

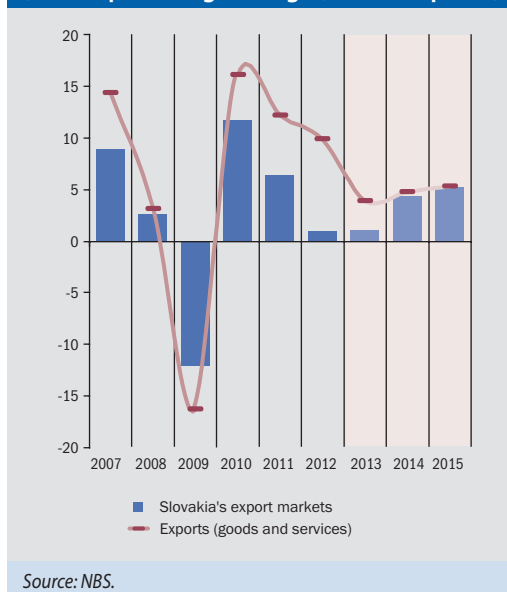
The updated forecast, MTF-2013Q4U, incorporates technical assumptions that are based on several external data as well as on NBS staff projections.

Looking at the exchange rate<sup>4</sup> of USD per EUR, the euro appreciated in the last two months of 2013 and, since the publication of the previous forecast, it has fluctuated at higher levels. Therefore the projected average exchange rate over the projection horizon has been revised up by 2% from the December forecast, to 1.37 USD/EUR. The updated forecast assumes that the **oil price** per barrel in US dollars will be higher than projected in the December forecast, at an average of USD 105.3 in 2014 and USD 100.4 in 2015, and that the price in euro will be lower than previously projected owing to the appreciation of the euro exchange rate against the dollar. Assumptions for **non-energy commodity prices** are unchanged from the December forecast, as are assumptions for the average level of **short-term interest rates** (three-month EURIBOR), at 0.3% in 2014 and 0.5% in 2015.

### FORECAST FOR THE EXTERNAL ENVIRONMENT

The projection for growth in **Slovakia's export markets** is unchanged from the December forecast. Available economic indicators still suggest that the euro area economy will continue recovering moderately in 2014. Although optimism remains concentrated in Germany, encouraging developments are also evident in several periphery economies. There is an upside risk to the outlook for external demand in 2014, given the relatively healthy industrial production figures in November and marked improvement in certain forward-looking indicators – including the Ifo and ZEW indices, economic sentiment indicator, and Purchasing Managers' Index (PMI) – as well as the projections of Now-Casting Economics for the euro area.<sup>5</sup> The Czech koruna depreciated in November after the Czech central bank, Česká národní banka (ČNB), began using the exchange rate as a monetary policy instrument. Some time will have to elapse before the impact of this measure on the Slovak economy can be evaluated. On the one hand, the strengthening of the

Chart 1 Slovak exports and export markets (annual percentage changes; constant prices)



Czech Republic's competitiveness could boost Czech economic growth and consequently have a positive effect on Slovak exports. On the other hand, Slovak export performance may be slightly impinged through the effect of the koruna's devaluation on the terms of trade.

### MACROECONOMIC FORECAST FOR SLOVAKIA

Since assumptions about external demand for Slovak goods and services remained unchanged, the updated forecast does not significantly revise the outlook for the Slovak economy's export performance. The latest figures for nominal exports in November and the revision of the October figures confirmed the correction, projected in the December forecast, of the previous period's unexpectedly weaker export performance. **Nominal export growth is assumed to accelerate** gradually over the projection horizon, while export growth is expected to be slightly higher than external demand growth, in accordance with convergence assumptions. Slovakia should therefore continue gaining market share, and this trend is expected to continue being supported by the undervalued real exchange rate.

- <sup>3</sup> The technical assumptions of MTF-2013Q4U, as well as the assumptions for external demand developments, are based on data with a cut-off date of 10 January 2014.
- <sup>4</sup> 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.
- <sup>5</sup> Published on 23rd January 2014, therefore after the cut-off date for this forecast, the PMIs for the euro area and Germany showed relatively strong increases (to 53.2 and 55.9, respectively), indicating that the upside risk to the growth forecast for Slovakia's export markets could materialise. According to Now-Casting Economics, which updates euro area GDP projections in real time based on the latest available economic data, as well as on various forward-looking indicators, the published PMI data prompted a substantial upward revision of the GDP growth forecast, to 0.37 in the first quarter of 2014 and 0.52% in the second quarter.



Turning to the composition of economic growth, the projection for **domestic demand** has been revised up owing to the current improvement in this component. It is clear from the composition of growth for the third quarter of 2013 and from monthly figures that public consumption and investment have performed better than projected, and this fact is also reflected in the projections for subsequent quarters.

**Consumer demand** in the third quarter of 2013 was worse than forecast, but its dip is considered temporary since monthly figures for October and November, as well as forward-looking indicators, suggest that private consumption began to pick up in the last quarter of the year. It is assumed, moreover, that lower than expected inflation should have an upward effect on real wages over the projection horizon and also boost private consumption. The projection for private consumption, which rebounded from a decline in the third quarter, has been revised up slightly.

**Investment demand** in the third quarter did not fall as much as projected, hence an improvement in the outlook for this component for the whole of 2013 and a positive carry-over effect on the outlook for 2014. Investment activity is expected to stop declining from the beginning of 2014 and to accelerate gradually in 2015. Both the private and public sector are expected to contribute positively to investment demand growth in 2015. The forecast for investment growth over the projection horizon has been revised up from the previous forecast, owing to current developments as well as to moderately higher economic growth.

The forecast for **public consumption** in the fourth quarter was revised up slightly in the light of this component's higher than projected growth in the third quarter of 2013 and data from the State Treasury for the fourth quarter. Public consumption is expected to make a positive contribution to economic growth not only in 2013, but also in 2014, as the assumed lower price level should have an upward effect on the amount of goods and services in the public sector.

**Import growth** over the projection horizon was also revised up, reflecting stronger growth on the domestic side of the economy and an improved export performance. The tendencies

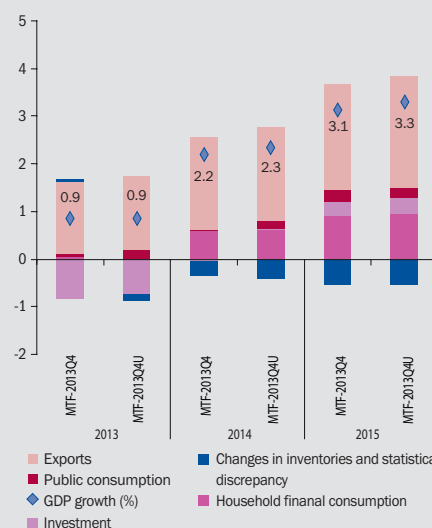
described in the previous forecast remained unchanged.

Economic growth in both 2014 and 2015 is expected to be slightly higher than projected in the previous forecast. The revision stems largely from the better than expected performance of the domestic side of the economy, and to some extent from stronger export figures.

Developments in the **labour market** were fully consistent with projections made in the December forecast. The assumption for 2014 is that employment will begin increasing tentatively and the unemployment rate will decline gradually.

Looking at **wage developments**, nominal wage growth is expected to be moderately slower than projected in the previous forecast, since collective agreements may have taken into account the lower than projected inflation rate. In real terms, income from labour is expected to be slightly higher, possibly giving a boost to private consumption. As for the breakdown of wages, the outlook for 2014 envisages substan-

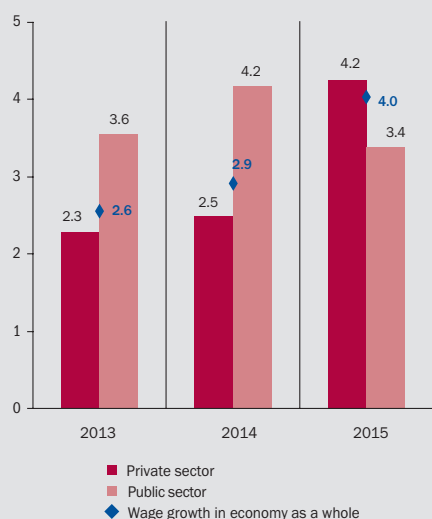
**Chart 2 Comparison of economic growth forecasts<sup>1)</sup> (annual percentage in GDP at constant prices; contributions to growth in p.p.)**



Source: 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 constant coefficients of import intensity of the different GDP components (household final consumption – 30%, public consumption – 7%, investment – 50%, and exports – 60%). Remaining imports were included under changes in inventories and the statistical discrepancy.

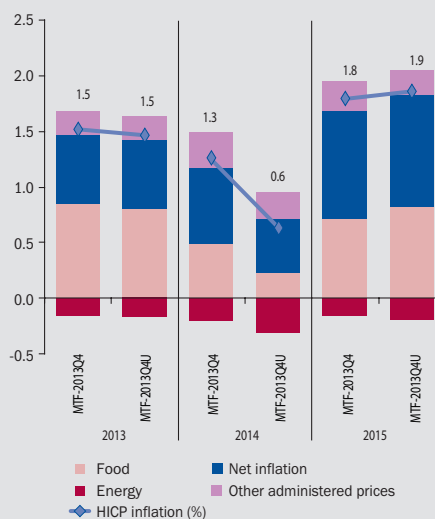
**Chart 3 Forecast for nominal wages by sector (annual percentage changes)**



Source: SO SR, NBS calculations.

Note: The public sector in the chart covers sections O, P and Q in the NACE Rev. 2 statistical classification of economic activities (Q, P and Q broadly refer to public administration, education and human health).

**Chart 4 Comparison of inflation projections broken down by component (annual percentage changes; contributions in p.p.)**



Source: NBS.

tially higher wage growth in the public sector, due mainly to the negotiated wage increase of €16 across the public sector and to the hike in salaries of doctors and teachers. In the private sector, wage growth is expected to be lower, reflecting a slower increase in labour productivity.

**Inflation** projections underwent the most substantial adjustment in the updated forecast. The inflation forecast was revised down by a margin of 0.5 percentage point since the disinflationary

trend in November was stronger than expected and prices in December declined month-on-month. Deviation from the December inflation forecast was most marked in food prices and was also observed in prices of non-energy industrial goods. Taking into account current developments and a more pronounced decline in electricity prices from January 2014, the inflation forecast for 2014 was revised down by 0.7 percentage point, to 0.6%. In 2015, as consumer demand rallies, the average inflation rate is expected to increase to 1.9%.



**Table 1 Update of the December Medium-Term Forecast (MTF-2013Q4U) for key macroeconomic indicators (year-on-year changes)**

Indicator (y-o-y change in % unless otherwise indicated)	2012	2013	2014	2015	2013	2014	2015
	Actual	Forecast			Difference with MTF-2013Q4		
<b>Prices</b>							
HICP inflation (average)	3.7	1.5	0.6	1.9	0.0	-0.7	0.1
CPI inflation (average)	3.6	1.4	0.6	1.7	0.0	-0.6	0.0
ULC <sup>1)</sup> (comp. per employee at current prices / labour productivity at constant prices – ESA 95)	1.0	-0.4	1.1	1.3	-1.5	-0.2	0.1
Labour productivity – ESA 95 (GDP at constant prices / employment – ESA 95)	1.7	1.7	2.0	2.8	0.0	0.1	0.2
Compensation per employee at current prices – ESA 95	2.8	1.3	3.2	4.0	-1.5	0.0	0.2
Nominal wages <sup>2)</sup>	2.5	2.6	2.9	4.0	0.0	-0.3	0.2
Real wages <sup>3)</sup>	-1.1	1.2	2.3	2.3	0.1	0.3	0.2
<b>Economic activity</b>							
Real GDP	1.8	0.9	2.3	3.3	0.0	0.1	0.2
Final consumption of households	-0.2	0.0	1.7	2.6	-0.1	0.1	0.1
Final consumption of general government	-1.1	1.3	1.0	1.4	1.0	0.8	-0.2
Gross fixed capital formation	-10.5	-6.9	0.4	3.6	0.8	0.8	0.2
Exports of goods and services	9.9	3.9	4.8	5.6	0.1	0.0	0.3
Imports of goods and services	3.3	2.1	4.4	5.4	0.1	0.2	0.2
Real gross disposable household income	-1.6	1.0	1.7	2.6	0.1	-0.1	0.2
Output gap (% of potential output)	-1.0	-1.7	-1.7	-0.9	0.2	0.3	0.2
Nominal GDP (EUR million)	71,096.0	72,182.9	74,464.8	78,461.1	-140.8	-550.4	-519.7
<b>Labour market</b>							
Employment – ESA 95	0.1	-0.8	0.3	0.5	0.0	0.0	0.0
Employment – ESA 95 (thousands of persons)	2,209.4	2,192.0	2,198.6	2,210.0	0.0	0.0	1.0
Unemployment rate – Labour Force Survey (%)	13.9	14.2	13.8	13.2	0.0	0.1	0.1
Number of unemployed (thousands of persons)	377.5	387.0	373.8	354.7	1.0	2.1	1.0
<b>Balance of payments</b>							
Economic openness (% of GDP)	185.1	186.8	190.7	194.5	0.4	1.7	2.1
Trade balance (% of GDP)	5.0	6.4	6.4	6.9	0.0	-0.1	0.0
Services balance (% of GDP)	0.4	0.2	0.3	0.3	0.0	0.0	0.0
Current account (% of GDP)	2.2	3.3	2.7	3.5	0.0	-0.1	0.0
Current and capital account (% of GDP)	4.1	4.7	4.3	5.4	0.0	-0.1	0.0
<b>External assumptions for the forecast</b>							
<b>External environment</b>							
External demand growth for Slovakia	1.0	1.0	4.3	5.2	0.0	0.0	0.0
<b>Technical assumptions</b>							
Exchange rate (USD/EUR) <sup>4)</sup>	1.28	1.33	1.37	1.37	0.0	2.2	2.2
Brent crude oil (USD per barrel) <sup>4)</sup>	112.0	108.7	105.3	100.4	0.5	1.3	1.2
Brent crude oil (EUR per barrel) <sup>4)</sup>	87.1	81.9	77.0	73.4	0.4	-0.4	-0.5
Oil price inflation (USD)	0.9	-2.9	-3.2	-4.6	0.5	0.7	0.0
Oil price inflation (EUR)	9.3	-6.0	-5.9	-4.6	0.3	-0.6	0.0
Non-energy commodity price inflation (USD)	-7.2	-5.4	-2.6	3.7	0.0	0.0	0.0
EURIBOR 3M (%)	0.6	0.2	0.3	0.5	0.0	0.0	0.0

Source: NBS, ECB, SO SR.

Note: The inflation data are not seasonally adjusted. The inflation and technical assumptions for 2013 refer to actual data.

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 2 Update of the December Medium-Term Forecast (MTF-2013Q4U) for key macroeconomic indicators (quarter-on-quarter changes)**

Indicator (q-o-q change in % unless otherwise indicated)	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	2012	2012	2012	2012	2013	2013	2013	2013	2014	2014	2014	2014	2015	2015	2015	2015
	Actual								Forecast							
<b>Prices</b>																
HICP inflation (average)	2.0	0.7	0.3	0.6	0.7	0.2	-0.1	-0.2	0.4	0.4	0.1	0.4	0.8	0.4	0.3	0.7
ULC <sup>1)</sup> (comp. per employee at current prices / labour productivity at constant prices – ESA 95)	1.4	0.9	-0.1	0.1	-0.6	-0.1	-0.3	0.6	0.4	0.3	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	0.5	0.4	0.6	0.7	0.7	0.7	0.7	0.7	0.7
Compensation per employee at current prices – ESA 95	1.6	1.2	0.3	0.5	-0.1	0.4	-0.1	1.1	0.9	0.9	0.9	0.9	0.9	1.1	1.1	1.1
<b>Economic activity</b>																
Real GDP	0.3	0.2	0.2	0.0	0.2	0.3	0.2	0.5	0.6	0.7	0.8	0.8	0.8	0.9	0.9	0.9
Final consumption of households	0.4	-0.8	0.0	-0.2	-0.2	0.9	-0.4	0.4	0.5	0.6	0.4	0.6	0.7	0.7	0.7	0.8
Final consumption of general government	1.2	-1.5	0.0	0.0	0.8	0.2	1.4	-0.3	-0.2	0.4	0.5	0.5	0.4	0.2	0.2	0.2
Gross fixed capital formation	-8.2	-4.2	0.7	-2.6	-5.4	2.7	-3.0	2.9	-2.1	0.8	0.9	0.9	0.9	0.9	0.9	1.0
Exports of goods and services	5.1	3.1	0.7	0.4	-0.3	3.8	-1.1	1.9	1.0	1.3	1.4	1.3	1.3	1.5	1.5	1.5
Imports of goods and services	2.4	2.6	3.1	-3.4	0.4	1.9	0.8	1.1	0.8	1.1	1.3	1.3	1.3	1.4	1.4	1.4
Real gross disposable household income	-1.6	1.2	0.8	-0.1	-0.1	0.6	-0.3	0.4	0.4	0.7	0.6	0.6	0.6	0.7	0.7	0.7
Output gap (% of potential output)	-0.8	-0.9	-1.1	-1.4	-1.5	-1.6	-1.9	-1.9	-1.9	-1.8	-1.6	-1.4	-1.2	-1.0	-0.8	-0.5
<b>Labour market</b>																
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	14.0	14.3	14.2	14.3	14.3	14.2	14.0	13.9	13.8	13.6	13.5	13.3	13.1	12.8

Source: NBS, ECB, SO SR.

Note: The inflation data are not seasonally adjusted; those for 2013 are actual figures.

1) ULC – unit labour costs.