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Opinion of the Bank Board of Národná banka Slovenska on the Medium-Term Forecast (MTF-2014Q4)

The Bank Board of Národná banka Slovenska (NBS) has discussed current macroeconomic and monetary developments and taken note of NBS's latest Medium-Term Forecast (MTF-2014Q4),[1] which was produced in an environment of zero interest rates, sharply falling oil prices, weakening growth in the euro area, and, so far, relatively strong economic growth in Slovakia. The technical projections for the forecast were finalised on 14 November.

Despite falling exports, Slovakia's real GDP growth for the third quarter remained relatively high, at 0.6% in quarter-on-quarter terms. Domestic demand was the main driver of that growth, with positive contributions from each of its components and most of all from investment. Household final consumption was supported by several factors. The economy boosted by domestic demand was conducive to job creation in services. The upward trend in real disposable income was further supported by the non-inflationary environment, which reflected mainly falling prices in essential goods such as energy and food. These factors combined to push up private consumption. Exports declined, as they had in the previous quarter, owing to decreasing demand for cars both within the euro area and outside it. In Germany, the principal destination for Slovak exports, GDP growth fell to just 0.1%, as against the previous quarter.

The latest projections for the euro area imply that growth will fall appreciably next year. In consequence, the forecasts for Slovakia's economic growth in 2015 and 2016 have been reduced, by 0.3 p.p. and 0.2 p.p., respectively. Despite the slowdown, GDP growth over the projection horizon is expected to accelerate moderately, from 2.3% in 2014, to 2.6% in 2015 and 3.3% in 2016. The main engine of growth in 2015 is assumed to be domestic demand, while 2016 should also see a pick-up in the contribution of exports. The risks to the GDP outlook are seen as balanced. On the one hand, euro area demand for Slovak exports could be bolstered by loosening of monetary policy and falling oil prices, while, on the other hand, there remain persisting geopolitical risks and risks of slower growth in world trade.

The annual inflation rate in October was -0.1%, one of the lowest levels in Slovakia's history. Further downward revisions in projections for energy and food price inflation were reflected in the headline inflation forecast for 2015, which has been reduced by 0.7 p.p. to 0.5%. The rate is expected to pick up in 2018, to 1.8%. Since the mid-November cut-off date for the MTF-2014Q4, oil prices have continued to fall and, at their current levels, there is a risk that next year's inflation rate could be as low as this year's.

[1] The MTF-2014Q4 was compiled as part of the Eurosystem's forecasting process, the output of which is the “Eurosystem Staff Macroeconomic Projections for the Euro Area”.

Although both employment growth and employment expectations of Slovak employers are cooling, they remain relatively favourable and therefore it was not necessary to adjust the employment outlook. Employment growth is expected to decrease over the projection horizon, since firms are assumed to increase hours worked as a flexible response to changing economic developments, without an impact on employment. As the number of employed persons is expected to continue rising, the unemployment rate is projected to decline. After a marked increase in wage costs in 2014, nominal wage growth is expected to decelerate next year and therefore more closely reflect labour productivity growth.

On the monetary front, the annual growth rate for loans increased from 7.4% in the second quarter to a current level of almost 9%. In addition to strong demand from households for housing loans there was increased demand among non-financial corporations for investment financing. Lending activity received a significant boost from accommodative monetary policy and declining nominal interest rates.

Although Slovakia's economic growth is expected to increase gradually, the output gap will not close by the end of the projection horizon, nor will investment return to its pre-crisis level. Long-term sustainable growth in GDP and employment in Slovakia requires further implementation of structural reforms that support the business environment and labour market flexibility. Through such reforms, fiscal policy is expected to supplement monetary policy and have a largely positive consolidation impact on future growth. This development should be supported in particular by improvements in the utilisation of EU funds.