THE REVISED MONETARY PROGRAMME OF THE NBS FOR 2001

The revision of the Monetary Programme of the NBS is based on acceptance of the principles of the Staff Monitored Programme, the essence of which was to prepare the Statement of Economic Policies, which refers to the aims of the government for the next 12 months and contains also the basic orientation of economic policy for the coming period.

According to the current development of foreign trade in the first quarter of 2001, the Revised Monetary Programme contains a forecast of the development of the current account of the balance of payments. In comparison with the original Monetary Programme, an increased deficit of the current account on GDP of 5.7% (originally 4%) is expected.

Due to actual information concerning delays in the financial settlement of some privatisation projects, changes in assumptions with regard to the drawing of the EFSAL loan, drawing of loans by the National Property Fund (NPF), including revenues and expenditure, as well as NPF bonds redemption, predictions of the development of the capital and financial accounts of the balance of payments, the net position of the NPF and the development of monetary aggregates were revised.

In the Revised Monetary Programme, no changes are expected in the figures for the development of headline and core inflation. Current predictions indicate that the state of inflation at the end of the year (headline and core) should be within the planned range.

Fulfilment of the Monetary Programme for 2000

Monetary development in 2000 was realised in an environment of continuing macro-economic stabilization characterized by reduction of the current account deficit ratio and the fiscal deficit ratio to GDP, a relatively stable exchange rate of the Slovak crown (Sk) and favourable development of inflation. Monetary development was also affected by the process of credit portfolio restructuring of selected commercial banks and by the decision of the Slovak government on Slovak Telecommunications privatisation.

In 2000, consumer prices grew overall by 8.4% and core inflation reached 4.6%, which represented slightly lower levels in comparison with the forecasts of the Revised Monetary Programme for 2000 (headline inflation 8.8-9.9%, core inflation 4.7 – 5.8%).

Although in the course of the year, several cost factors affected the growth of consumer prices (a sharp rise in oil prices, the strengthening of the American dollar, the rise in regulated energy prices for companies), an inflation rate below the lower limit of the forecast figures was achieved mainly by low consumer demand, but also by increased competition in retail business. The low purchasing power of households became the chief dampening factor in reducing the year-on-year dynamics of headline and core inflation.

According to preliminary data, the gross domestic product grew year-on-year by 2.2% in 2000 at constant prices and by 8.6% at current prices, and corresponded with the NBS forecast; the updated NBS estimate from the end of last year expected a real year-on-year GDP growth rate of 2.1%, and nominal GDP growth of 8.7%. The real economy growth, on the demand side, was influenced by a growth in foreign demand of 15.9% at constant prices. The growth in exports was higher than the growth in imports, as a result of which net exports increased by more than Sk 23 billion in comparison with 1999. In absolute terms, the deficit of net exports reached Sk 1.6 billion at constant prices, i.e. 0.2% of the GDP.

Domestic demand declined by 1.3% year-on-year, especially in connection with lower private sector consumption. There was also a moderate reduction in government spending and gross fixed capital generated.

GDP creation showed especially the effect of added value in market services. The added value growth rate in industry decreased as a whole, but added value in industrial production showed favourable development, which was associated especially with a growth in foreign demand. Added value in agriculture and non-market services had moderately pro-growth influence on the development of GDP.

The development of total final consumption and gross fixed investments at constant prices also did not differ substantially from the estimates of the NBS. In comparison with the NBS forecast, the value of net exports showed significant deviations; at current prices, the deficit increased by Sk 8.1 billion, reaching a total of Sk 22.1 billion, and at constant prices, the deficit in net exports reached Sk 1.6 billion, while the NBS forecast a surplus of Sk 10.6 billion. The foreign trade results a constant prices were also influenced by the fact that at the beginning of 2001 the Statistical Office of the Slovak Republic revised the deflators of exports and imports of goods and services (retrospectively from 1998), as a result of which the absolute values and rate of growth of exports and imports changed. The statistical discrepancy from the revision was reflected in the change in inventories.

In comparison with the estimate of the NBS of October 2000, affected by expectations arising from the favourable development of current account items in the first three quarters of 2000, the real development was different, especially in the trade balance area. Accelerated growth in imports compared to exports, due to growth in the prices of strategic raw materials (oil, gas) on world markets, resulted in the foreign trade deficit reaching Sk 42.4 billion (i.e. Sk 10.4 billion more than forecast). In connection with the trade balance development, the real deficit of the current account reached Sk 33 billion (the year-end figure was Sk 19.8 billion), by which its share on GDP increased to 3.7% (in comparison with an estimated 2.2%). In spite of this development, results achieved were more favourable than the forecasts of the Revised Monetary Programme (the current account amounting to Sk 43.6 billion and its ratio to GDP 5.1%).

The deficit of the current account of the balance of payments was covered almost twice over by the surplus in the capital and financial account, the size of which (Sk 63.4 billion) was in line with the estimate of the NBS (Sk 61.0 billion). The estimated and real development of the capital and financial account of the balance of payments in terms of structure differ mainly in foreign direct investment (FDI). The estimate of the flow of FDI into the commercial sector (Sk 35.7 billion) was underestimated compared to figure actually achieved (Sk 66.3 billion). The increase in FDI was directed towards industrial production, especially in the production of metals, petroleum products, cellulose and paper.

According to the assumptions of the NBS, the central government deficit would amount to Sk 18.0 billion in 2000, and the total fiscal deficit of the general government would be Sk 28 billion. Up to the end of December 2000, the state budget resulted in a deficit of Sk 27.7 billion. This consisted of the deficit of the current use of the state budget of Sk 15.1 billion, which was Sk 2.9 billion less than the deficit authorized by Act no. 372/1999 Col., and the deficit derived from use of § 12 of this Act. This concerned state bond issues designated for restructuring the commercial banks (Sk 8.5 billion) and to meet obligations from state credit guarantees (Sk 4.1 billion).

According to the preliminary data of the Ministry of Finance, the total government deficit (in the IMF methodology) reached a level of Sk 30.2 billion (3.4% of GDP). Excluding the effects of § 12, it amounts to Sk 17.8 billion (2.0% of GDP).

Monetary aggregates development in 2000 may be considered favourable. M2 money supply (at fixed 1993 rates) grew year-on-year by Sk 72.1 billion, and the growth rate reached 14.2%. Foreign resources in the form of the FDI in-flow, but especially domestic resources connected with the development of net credit to the government and the NPF and the release of resources from privatisation of Slovak Telecommunications to the economy, had a pro-growth affect. The Revised Monetary Programme for 2000 assumed the M2 aggregate growth at a level of 12.6%, but did not include the effect of the in-flow of funds from the privatisation of Slovak Telecommunications into the banking sector (part of the income intended for increasing equity capital). The up-dated forecast of the growth of money supply of October 2000, at 17.9% had already allowed for this effect. The real M2 aggregate year-on-year growth rate at the end of 2000 reached 14.2%, which was lower than the estimated value, and was mainly due to improved development of public finances.

Net credit to the government including the NPF (at fixed 1993 rates) grew year-on-year by Sk 22.8 billion. The figure of 15.8% was in line with the forecasts of the Revised Monetary Programme for 2000. The level of net credit to the government and NPF was influenced by an improvement in the deficit in the state budget in comparison with that originally authorized and by the cost of restructuring of selected commercial banks.

When evaluating the development of credit activities in 2000, several facts had to be considered for the purpose of obtaining comparable data: changes in accountancy in connection with restructuring, the closure of three commercial banks and the conversion of credit to SE into bonds. After adjusting the total amount of credit from these factors, the year-on-year rate of growth of loans to companies and households amounted to 4.1%, which may be regarded as a value consistent with the intentions of the Revised Monetary Programme.

The Monetary Programme for 2001

The aim of the Monetary Programme of the NBS for 2001 is: to achieve a year-on-year core inflation rate in the range 3.6 – 5.3%, accompanied by the year-end headline inflation at around 6.7-8.2% and average inflation of 7.1 – 8.3%.

The estimated ranges for the development of inflation are based on the presumed stable or moderately declining oil prices and a stable Slovak crown exchange rate development to the US dollar. The schedule for adjustments to regulated prices was also taken into account in forecasting inflation. The Monetary Programme does not foresee more significant demand pressures on the development of consumer prices, but a significant increase in household purchasing power could create price inflation pressure in 2001. The most doubtful factor in the Monetary Programme could be the possible higher transfer from rising producer prices into the index of consumer prices (especially in the food sector).

The above-mentioned goals are based on the following:

– a relatively stable Slovak crown exchange rate to the euro, assuming real appreciation

– GDP growth at constant prices of 2.8-3.2%, or an average of 3%, whereby a revival in domestic demand (both consumption and investment) and continuing favourable development of foreign demand is expected. The GDP development at constant prices will depend on progress in restructuring the banking and business sector, FDI in-flow, price development, wages and labour productivity, and development of foreign demand.

Which should result in:

– the share of the current account deficit in GDP reaching a level of 4%, influenced by the import of technology financed by FDI in-flow,

– fiscal deficit not exceeding Sk 38 billion, or 4% of GDP (increase due to expenditures connected with restructuring the banking and enterprises sector is accepted).

According to the forecasts of the Monetary Programme, the indicative value of the year-on-year growth in M2 should vary around the level of 16%, with gradual revival in lending, which will again depend on development in the public finance and foreign sectors.

The starting points for the Revised Monetary Programme for 2001

The basic starting point for the revision of the Revised Monetary Programme is the Statement of Economic Policies, as the basic document on cooperation with the International Monetary Fund according to the Staff Monitored Programme (SMP) principle.

In the framework of the SMP, the level of the fiscal deficit of 37.8 billion SK or 3.9% of GDP was determined as a criterion, and this has been included in the assumptions contained in the Revised Monetary Programme of the NBS for 2001. The Revised Monetary Programme respects the methodological principles of the SMP, whereby the predicted values of the selected economic parameters are updated according to actual development during the first quarter of 2001 and more precise information, with respect to that of the public sector.

The Revised Monetary Programme also presupposes a lower in-flow of FDI, due to a delay in financial settlement of some privatisation projects, which will probably only be concluded at the beginning of 2002. However, the size of these transactions will have significant effect on the end of year value of selected monetary aggregates and the capital and financial account.

In comparison with the forecasts of the Monetary Programme of the NBS for 2001, the Revised Programme allows for a higher deficit in foreign trade, which is based on the real development in imports and exports in the first quarter of 2001. The higher negative balance in trade of goods and services should result in moderately lower economic growth – at the lower limit of the figure in the original monetary programme. Delay in the financial settlement of some privatisation projects will be reflected in a reduced in-flow of direct foreign investment and will have an effect on the funds available for NPF financing.

Due to higher deficit in foreign trade, the real rate of growth of GDP should be at the lower limit of the monetary programme for 2001 (2.8-3.2%). Economic growth should be fuelled by a revival in domestic demand, especially investment, while the influence of the negative balance of net exports will have an dampening effect.

The current development of consumer prices, as well as forecasts for inflation up to the end of 2001 indicate that the actual rate of inflation should vary in the range of the programme figures (both headline and core inflation). Deviation of the real development of inflation from the programme values is unlikely. A possible downward deviation may be exerted by an increased dampening effect of the development of competition in the retail trade (in comparison with forecasts). To some extent, price development could also be dampened by a higher deficit in foreign trade, and the associated „import“ of low foreign inflation. However, the cost effects derived from processing (especially in the food sector), should work against such a development to some degree. Overstepping the upper limit of the programme range could only result from a strong unexpected external shock. From the point of view of support for economic growth, as well as adaptation of the domestic price level to the level of prices in the EU, any significant variation in the predicted rate of inflation (in the Monetary Programme for 2001) would be counter-productive in the area of real and nominal convergence of the Slovak economy. Therefore, the Revised Monetary Programme of the NBS for 2001 assumes development of inflation of consumer prices at the same levels as in the original monetary programme. Possible deviation of the real development of inflation from programme levels should be countered by monetary policy measures, which is also in line with the assumptions of the SMP and the Statement of Economic Policies.

The Balance of Payments

Revision of the forecasted balance of payments for 2001 is based on up-to-date information including the development of foreign trade during the last quarter of 2000 and the first quarter of 2001, the issue of Eurobonds by the NPF and reduced borrowing from the World Bank. It also assumes a shift in the financial settlement of some privatisation projects from 2001 to 2002.

The basic assumptions for predicted foreign trade remain unchanged. The exports of the Slovak Republic will be determined by the reduced economic growth of our largest foreign partners (especially Germany). Imports will be influenced by a higher in-flow of direct foreign investment, abolition of import surcharges and redemption of bonds of the NPF.

The levels of exports and imports during the first three months of 2001, show a large deficit in the trade balance (Sk 19.2 billion). The original Monetary Programme assumed a negative balance of trade, Sk 4.0 billion lower in the first quarter, i.e. only Sk 15.0 billion. Assuming that the tendency of foreign trade development in the first quarter continues through the whole of 2001, a change in the dynamics of the turnover of items in the trade balance will take place. The growth of exports in 2001 compared to 2000 should reach 12% (the forecast year-on-year dynamic in the Monetary Programme for 2001 was 10.3%). Similarly, the year-on-year growth of imports is expected to increase to 14.8% (the Monetary Programme for 2001 predicted 11.0%). The lower dynamic of exports and imports in 2001 in comparison with last year is a result of the high level of turnover in foreign trade achieved in 2000. On the assumption there would be a significant increase in imports over exports, the predicted volume of foreign trade for the year as a whole has been increased in the Revised Programme.

The increase in exports and imports (Sk 614.3 billion and Sk 678.4 billion, respectively) in the Revised Monetary Programme for 2001 in comparison with the original Monetary Programme (exports of Sk 604.8 billion, imports of Sk 655.6 billion) will be reflected in a higher deficit of the trade balance (by Sk 13.4 billion). The foreign trade deficit should reach Sk 64.1 billion in 2001.

The balance of services is expected to further develop according to the intentions of 2000. The surplus in the balance of services will be mainly secured by regular revenue from transport as a result of paid and unpaid collections for the transit of gas and oil to the Czech Republic, Germany, Croatia and Slovenia. We do not expect to see a change in the positive services balance (Sk 18.5 billion).

The development of indebtedness to date will be reflected in the growth of interest payments to foreign countries. As a result of revision of interest costs in 2000, we expect a higher negative balance of income on debt (Sk 14.5 billion) and a higher resulting deficit in the balance of income.

The balance of current transfers, in line with the trend of inflow of unilateral transfers in the form of support, pensions and compensation on the part of physical persons remains unchanged and should reach a level of Sk 5.5 billion.

Based on changed assumptions in the area of the trade balance and balance of income, the deficit of the current account in the Revised Monetary Programme should reach Sk 54.8 billion, compared to Sk 38.4 billion in the Monetary Programme for 2001.

(Sk billions)

Items of the Current Account	Monetary Programme 2001	Revised Programme 2001
Trade balance	-50.7	-64.1
exports	604.8	614.3
imports	655.6	678.4
Services balance	18.5	18.5
Income balance	-11.7	-14.7
from this income on debt balance	-12.3	-14.5
Current transfers	5.5	5.5
Current account	-38.4	-54.8
Share of current account in the GDP	-4.0	-5.7

The updated forecast for the capital and financial account assumes a delay in the financial settlement of some privatisation projects, and allows for the fact that part of the already realized issue of Eurobonds of the NPF was bought by non-residents (about Sk 4.0 billion).

These facts should be reflected in a lower in-flow of direct foreign investment, with Sk 54.8 billion instead of the Sk 122.0 billion predicted in the Monetary Programme for 2001.

With respect to the other long-term financial account, the Monetary Programme for 2001 assumed the drawing of a loan from the World Bank amounting to USD 300 million. In fact, it should only be USD 117 million (Sk 5.6 billion). The development of the other long-term financial account should also be affected by the realization of state guarantees (Sk 7.7 billion), which should also be reflected in a reduction in commercial loans, which should reach Sk 21.6 billion.

The expected higher deficit of the current account in the Revised Monetary Programme for 2001 should also be reflected in the reduction in the amount of short-term assets of commercial banks, in comparison with the Monetary Programme for 2001. Thus, the out-flow of capital in the short-term financial account should amount to Sk 4.6 billion, in comparison with Sk 20.8 billion.

(Sk billions)

Items of the Capital and Financial Account	Monetary Programme 2001	Revised Programme 2001
Capital transfers	5.4	5.4
Direct foreign investment	122.0	54.8
in SR	124.0	56.8
of which government sector	94.5	27.3
Portfolio investment	17.3	28.5
in SR	23.3	34.5
of which drawing by NPF	–	4.0
of which payments of governmen sectort	-17.4	-17.4
Other long-term financial accounts	6.4	-10.3
Liabilities	5.9	-10.8
of which drawings by government sector	16.5	7.8
of which drawings by company sector	29.3	21.6
Short-term financial account	-20.8	-4.6
of which bank assets	-19.6	-3.4
Total Capital and Financial Account	130.3	73.8
Reserves of the NBS (-. growth)	-92.0	-19.1

The revised forecast of individual items of the balance of payments (especially in the capital and financial account in the government sector) will be reflected in lower growth of the foreign exchange reserves of the NBS in comparison with the assumptions of the original monetary programme. The state of the foreign exchange reserves at the end of 2001 should suffice to cover 3.3 times the average monthly imports of goods and services.

Public finance

With regards to public finance, the 2001 Revised Monetary Programme is based on SMP values.

Fiscal deficit is expected to reach Sk 37.8 billion (3.94% of GDP), covering both development projects (Sk 1.1 billion) and a portion of expenditures specified in Article 12 of the State Budget Act, which includes a bond issue floated to finance highway construction (Sk 6.5 billion) and foreign loans obtained from several international institutions (around Sk 2.4 billion). The SMP assumes an additional Sk 9.8 billion will be spent by the NPF to pay for interest expenses resulting from the restructuring of selected banks, included in Article 12 of the State Budget Act. In fact, these expenditures are incurred by the Ministry of Finance. However, these expenditures have not been included in the budget deficit (according to SMP methodology).

As in the SMP, the Revised Monetary Programme measures fiscal deficit as a change in net credit to the government. For the sake of comparison, the volume of restructuring-related bonds (Sk 105 billion) is added to the opening balance of net credit to the government. Since the interest expenses of restructuring is borne by the Slovak Ministry of Finance (MFSR), the amount was included in growth in net credit to the government (NCG) in the Revised Monetary Programme for 2001, but was disregarded in budget deficit calculations. The rationale behind having this amount included in NCG is to obtain a more realistic view of this aggregate. However, in the final revision of NCG, or its change (fiscal deficit), this particular item needs to be excluded. Net credit to the government is forecast for the end of 2001 at Sk 353 billion, including restructuring-related interest expenses (Sk 9.8 billion) which do not affect the fiscal deficit (SMP methodology). As a result, the change in NCG should amount to Sk 47.6 billion, with fiscal deficit accounting for Sk 37.8 billion and restructuring-related interest expenses of Sk 9.8 billion.

When it comes to the performance of the NPF, the Revised Monetary Programme forecasts differ from SMP forecasts by a greater margin. In particular, the revenue forecasts are different, with no income being mentioned from expected, though delayed, financial settlement of privatisation projects. NPF raised a part of its revenues, and increased its debt, in an Sk 10.9 billion April Eurobond issue with proceeds assumed to cover its costs. Another difference lies in a revised figure for NPF bond redemption costs, some Sk 26.4 billion in total, with companies holding about Sk 11.4 billion of the issue. The amount held by companies is, according to NPF, not due for payment until 2002. As a result, the actual amount for redemption this year has been forecast at Sk 15 billion.

Gross domestic product and wages

According to the NBS Monetary Programme for 2001, measures adopted to stabilise the economy in 1999-2000 should pave the way for progressive economic growth. Real GDP growth of 2.8-3.2% in 2001 should be driven by both foreign demand and a rebound in domestic demand brought about by revived consumption and growing investment demand. Provided that total consumption and investments continue growing at the present rate, the 2001 Monetary Programme assumed domestic demand should result in a 3.9% rise at constant prices year-on-year.

The 2001 Monetary Programme also counted on the growth-stimulating effect of net exports on real GDP. Even with a slowdown in year-on-year export growth, exports are still expected to exceed imports. The foreign trade balance, adjusted for price effects, is expected to result in a surplus of about 0.7% at constant prices.

Actual trends in selected industries, as well as in the labour market, observed from the beginning of the year, appear to support the assumptions for assessing the growth of domestic demand components. That is why we believe the structure of real domestic demand is unlikely to be significantly different from the values assumed in the 2001 Monetary Programme. Looking at last year's regular government expenditures and this year's spending budget, we can see a slight reduction in government spending. Meanwhile, we expect gross capital formation to increase, spurred in particular by FDI, falling interest rates and financial consolidation in the company sector. As opposed to the Monetary Programme (with an eye on 2000 trends), we also foresee an increase in inventories.

Based on the latest foreign trade figures for the first quarter of 2001, we have made allowance for the dampening effect net exports have on real economic growth (contrary to the 2001 Monetary Programme, which expected net exports to actually boost GDP). The foreign trade shortfall in goods and services at current prices is likely to outstrip the Monetary Programme estimate of Sk 32.2 billion to close at Sk 45.6 billion, an increase of Sk 23.5 billion over 2000. Translating this into constant prices, we referred to updated forecasts of consumer prices, prices of industrial producers, and foreign trade deflators. Based on these calculations, net exports of goods and services should, contrary to Monetary Programme forecasts, end with a deficit of Sk 11.9 billion.

The anticipated foreign trade developments might be expected to dampen economic growth and push the growth rate of GDP at constant prices more toward the bottom of the targeted range.

According to the 2001 Monetary Programme, gross domestic product at current prices was set to rise year-on-year by 8.4%, and a deflator increase of 5.2%. However, as more recent consumer and industrial price predictions suggest (the

	Sk billion		year-on-year growth in %	
	Monetary Programme 2001	**Revised Monetary Programme 2001**	**Monetary Programme 2001**	**Revised Monetary Programme 2001**
GDP at constant 1995 prices	687.0	686.5	2.8 – 3.2	2.8 – 3.0
Domestic demand of which:	682.1	698.4	3.9	4.3
Total final consumption	463.7	470.0	2.0	1.6
Households	333.3	330.8	2.1	2.5
State administration	130.4	130.8	1.7	-0.8
Gross capital formation	218.4	236.8	8.3	10.2
Gross fixed capital formation	200.7	208.9	3.5	9.4
Change in inventories	17.7	27.9	x	x
Net exports	4.9	-11.9	x	x
Exports of goods and services	548.0	535.0	5.5	3.0
Imports of goods and services	543.1	546.9	6.8	5.0

	Sk billion		year-on-year growth in %	
	Monetary Programme 2001	Revised Monetary Programme 2001	Monetary Programme 2001	Revised Monetary Programme2001
GDP at current prices	960.0	962.0	8.4	8.4
GDP deflator	139.9	140.2	5.2	5.5

* Note: Deflator calculations used in the Monetary Programme were based on the original price deregulation schedule.

2001 Monetary Programme prepared in October was based on different estimates)*, the annual increase in the GDP deflator is likely to be higher. With GDP deflator gaining 5.5%, nominal GDP could amount to Sk 962 billion in 2001.

Wages

The 2001 Monetary Programme assumed real wages growth between 1.0 and 1.5%, on taking the 6.9% year-on-year inflation rate into account.

The ongoing corporate restructuring and planned downsizing in the health care sector are bound to result in lower employment and, subsequently, a fallacious increase in average nominal wages. However, the average rise in nominal wages will have far less to do with an actual increase in total wages, than with a reduction in employment. Although these factors might increase the average real wage year-on-year by 1.5 – 2.0%, as we have explained above, the rise is unlikely to lead to any major increase in household spending.

Inflation

Actual performance in the first quarter of 2001

Consumer prices were, at the end of the first quarter 2001, some 5.1% above those at the beginning of the year. Administrative changes in regulated prices take credit for nearly three-quarters of the increase. Triggered by an increase in regulated prices in the energy sector, the additional cost began to show in the prices of market services and food in the first quarter of 2001. The effect on food prices was compounded by a major upswing in the price of food production commodities subsequent to the poor harvest in 2000 due to bad weather conditions. This effect was countered by a strong koruna and favourable developments in prices of industrial commodities on world markets, in particular of crude oil. These two factors combined in a dampening effect the fuel prices had on inflation in the first quarter.

So far, consumer prices have moved within the lower half of the range assumed by the NBS Monetary Programme, with year-on-year inflation recording 7.1% in March 2001 and core inflation of 4.0%. The 2001 Monetary Programme assumed end of March inflation around 6.9 – 7.6% and core inflation ranging from 4.0% to 4.6%. The main reason consumer prices have fared so well is due to the increased retail competition demonstrated by a slowdown price growth in the tradable goods sector (food excluded). Abolition of the import surcharge is likely to have played a role in dampening price growth in tradable goods.

Monetary Programme forecasts of expected developments during the year

According to the 2001 Monetary Programme, several external and internal factors are expected to shape the path of consumer prices. Concerning internal factors, the Monetary Programme foresees a compensatory effect of cost incentives in the absence of demand pressure. As in 1999 and 2000, inflation is expected to be fuelled by both the direct and indirect effects of some extensive changes in the regulated prices sector. Continued low household purchasing power, partly due to regulated price increases, high unemployment and sluggish wage growth, is expected to keep consumer prices down to reasonable levels. As far as external factors are concerned, the Monetary Programme assumes a steady or slightly strengthening koruna and stable world prices for industrial commodities.

Taking all the above factors into consideration, the 2001 Monetary Programme expects the disinflationary trend to continue. Headline inflation should range from 6.7% to 8.2% (average inflation between 7.1% and 8.3%) with core inflation at 3.6 – 5.3%.

As early as the first quarter of 2001 the deflationary factors dominate, with core inflation reaching the lower end of the year-end target range at 3.6% year-on-year in February. This relatively slow consumer price growth can be attributed to favourable net inflation (core inflation with food products excluded) whose share in headline inflation has been waning steadily since the second half of 1999. As net inflation takes no account of the seasonal volatility of food prices, it is a better indicator of the impact of monetary policy factors on price growth. A continuing slowdown in net inflation comes as a proof of a weak demand pull on price level. We expect the situation to last until the end of the year.

In ensuing months we expect consumer

Consumer prices in March 2001

Consumer basket composition	Constant weights %	Change over February 2001	Change over March 2000	Change over December 2000
Total in %	100,0	0,8	7,1	5,1
Regulated prices in %	17,8	1,2	17,1	15,7
share in total in percentage points		*0,32*	*4,17*	*3,80*
Impact of change in indirect taxation on nonregulated prices – share in total in percentage points		*0,00*	*0,00*	*0,00*
Core inflation in %	82,2	0,7	4,0	1,7
share in total in percentage points		*0,49*	*2,95*	*1,28*
thereof: Food prices in %	26,8	1,2	5,3	2,4
share in total in percentage points		*0,27*	*1,19*	*0,55*

Consumer prices	1999		2000				2001	
	VI.	IX.	XII.	III.	VI.	IX.	XII.	III.
Headline inflation in %	**7,1**	**14,7**	**14,2**	**16,6**	**15,4**	**8,7**	**8,4**	**7,1**
Core inflation in %	**5,1**	**7,3**	**7,0**	**7,0**	**5,8**	**4,9**	**4,6**	**4,0**
share in total in percentage points	4,20	5,95	5,75	5,66	4,69	3,72	3,55	2,95
of which:								
Food prices in %	**-0,6**	**1,1**	**1,3**	**3,3**	**2,9**	**4,6**	**6,0**	**5,3**
share in total in percentage points	-0,17	0,29	0,33	0,84	0,71	1,06	1,38	1,19
Net inflation	**7,9**	**10,2**	**9,7**	**8,7**	**7,1**	**5,0**	**4,1**	**3,4**
share in total in percentage points	*4,36*	*5,66*	*5,42*	*4,82*	*3,98*	*2,66*	*2,18*	*1,75*

price growth to pick up as rising production costs start to translate into consumer prices. A full cost transmission to end-user prices will however be prevented by retail competition. The strain of inflationary factors could be over as the year moves into its second half, putting core inflation back on a disinflationary track. Meanwhile, an expected modest appreciation of koruna's exchange rate against the benchmark currency should continue to benefit prices in the tradable goods sector. Annual price growth in the sector is expected to copy or undercut EU inflation levels. Anticipated increases in real wages in 2001 should not put any significant pressure on prices just yet.

One of the riskier elements considered in the 2001 Monetary Programme was the unpredictable nature of food prices. A considerable increase in operating costs of food producers and processors threatened to spread inflationary pressure to end-user prices. A look at the core inflation structure reveals a growth in impact of food prices. Since back in July 1999 food prices had dropped from year ago to actually check core inflation, the effect has been growing stronger ever since. In March 2001, their share in annual core inflation was as much as 40%. However, as our recent observations indicate, the current market situation does not permit producers to pass on all the additional costs over to the consumer. After the 20% annual rise in food grain prices was dampened by the processing industry and trade chain, it resulted in a mere 6.2% increase in bread and grain product prices at the consumer end. The trade and consumer prices of basic food products, especially meat, have been moving slowly closer together. Still, there is the possibility that higher production costs, or rather their transmission into consumer prices, could boost inflation in coming months. Given good weather, a steadier set of food prices could help reduce core inflation in the second half of the year (in 2000 food prices grew faster due to poor harvests, especially the cereals harvest).

As the forecasts of year-end core and headline inflation are well within the targeted range (2001 Monetary Programme), there is no need to adjust the Revised Monetary Programme.

Since the current end-year core inflation forecast lies slightly below the centre of the target zone, there is little risk it could break through the ceiling. This would only happen with a major external shock, which is quite unlikely. On the other hand, should the disinflationary factors grow stronger, with food prices staying normal in the second half of the year (given good weather and sufficient domestic production of food commodities), there is a fair chance that core inflation could end the year close to the lower figure of the target band. This result could be helped by increased competition as foreign retail chains move into the market, absorbing an even greater share of the pressure on price growth in the tradable goods sector. Although very hard to predict, their influence can be quite significant (e.g. in the Czech Republic, the sector with tradable goods, other than fuel, has experienced very little growth since mid-1999). The final effect may depend on several factors coming into effect at the same time. Then again, the existing producer pressure to increase prices is bound to contain the risk.

Overdoing disinflation could damage Slovakia's integration efforts. Excessive inflation cuts during the transition period could delay the alignment of our price levels with that of EU countries significantly. However, there are things beyond the central bank's control, which might cause core inflation to stray from its projected path. The effect of weather on food prices and, in particular, the impact of the new hyper-markets on prices of goods, as discussed above, are the main external factors to take note of.

Monetary policy

The NBS Monetary Programme for 2001 assumed a 15.9% annual growth in money supply, with part of it coming from NPF bond redemption. The volume of the issue to be redeemed, directly increasing money supply, was estimated at Sk 18 billion. Apart from maturing NPF bonds, money supply was expected to be driven primarily by developments in the capital and financial account of the balance of payments and a related increase in net foreign assets. Net foreign assets were expected to grow mainly in the wake of the government's privatisation activities.

The government's contribution (NCG) to money supply growth was estimated at Sk 38 billion (fiscal deficit) in the Monetary Programme.

Due to large expected privatisation revenues, the NPF net position was estimated at Sk 35 billion (deposit).

The Monetary Programme projected a growth in lending of about 1.6% (annual).

As regards anticipated developments in NBS net foreign assets, its sterilisation position was expected to mount to Sk 160 billion by the end of 2001.

In the light of changes in monetary aggregate values (31 December 2000), as compared to original assumptions (October 2000), and the emergence of new facts, in particular those concerning the financial settlement of certain privatisation projects, NPF bond redemption, NPF Eurobond issue, NPF expenditures and revenues, EFSAL facility drawdown and a higher-than-expected foreign trade deficit, the Revised Monetary Programme expects different rates of growth in individual monetary aggregates, in particular net foreign assets.

The change in growth projections in net foreign assets stems in particular from an updated forecast for the balance of payments (capital and financial account, and current account), as well as a different opening figure for net foreign assets. Allowing for this new situation, net foreign assets should increase by 15.9% annually, rather than by the 144.5% projected in the original Monetary Programme. The slower growth will be influenced in particular by delayed settlement of certain privatisation projects. Another departure from the original Monetary Programme concerns the opening value of net foreign assets which, unlike the projected Sk 80 billion, actually stood at Sk 104 billion at the end of 2000 (excluding government securities held by non-residents). With a higher starting point, the estimated rate of growth had to be scaled down.

The increase in the net credit to the government estimated at Sk 38 billion in the original Monetary Programme is virtually identical with that set out in the SMP (Sk 37.8 billion). The Revised NBS Monetary Programme for 2001 assumes the same fiscal deficit as the SMP. To make comparison easier, an Sk 105 billion restructuring bond issue was added to the opening balance of net credit to the government. The year-end net credit to the government also includes the restructuring-related interest expenses of Sk 9.8 billion, which do not form a part of the fiscal deficit (by SMP definition) and should be disregarded in the final review of public finance performance (for details, see Public Finance Section). Net credit to the government should end the year at Sk 353 billion, representing a 15.7% rise from a year ago.

Delays in financial settlement of certain privatisation sales and an NPF Eurobond issue will have a major impact on the NPF net position, which the original Monetary Programme envisioned as an Sk 35 billion on the creditor-side (deposit). The change in NPF net position reflected in the Revised Monetary Programme (a debit of Sk 13-14 billion) as compared to the original Monetary Programme and the SMP, however, does not pose a monetary risk in the long run, as the privatisation projects concerned should be settled in early 2002, immediately improving NPF 's standing.

Annual growth in M2 money supply has tended to slacken since January. Unlike in the original Monetary Programme (Sk 18 billion), we expect the NPF to redeem Sk 15 billion of its bond issue (from natural-person holders). The money supply growth estimates remain basically unchanged, with year-end growth projected at 15.5% (Monetary Programme 2001 – 15.9%). Depending on the actual extent of lending activity, money supply growth could result in an even lower figure.

Despite the fact that the net position of the public sector (NCG and NPF) has taken a turn for the worse, a considerably lower growth in net foreign assets expected in the Revised Monetary Programme, as opposed to the original Monetary Programme, still allows commercial banks room to expand their lending business by up to 5.8% annually. The actual lending expansion will hinge on the quality and pace of corporate restructuring and on whether or not commercial borrowers are able to submit quality projects which banks deem worth taking a credit risk for.

Based on the IMF balance of payment estimates, the SMP Programme sets a base limit for net international reserves of the NBS. According to IMF figures, NBS net international reserves should reach USD 5,515 million at the end of 2001. On the other hand, in its Revised Monetary Programme, the NBS projects reserves of USD 4,184.2 million. The difference stems in particular from delays in financial settlement of certain privatisation projects. With expected privatisation income added, NBS estimated net international reserves would amount to USD 5,491.2, which is almost in line with the SMP projection. The USD 24 million shortfall results from additional information on the government's foreign borrowing and repayments.

The main reason NBS sterilisation position is going to be projected to end at about SK 78 billion (which is well below original expectations of SK 161 billion in the 2001 Monetary Programme), is the reduced in-flow of FDI projected in the Revised Monetary Programme. During 2001, however, it should rise by about SK 16 billion over the opening balance figure.

Monetary policy instruments

The Revised Monetary Programme of the NBS for 2001 foresees no changes in monetary policy instruments.

Conclusion

Monetary policy target

NBS Revised Monetary Programme of the NBS for 2001 aims at core inflation in the 3.6 – 5.3% range, with headline inflation expected to reach 6.7 – 8.2% and average annual inflation of 7.1 – 8.3%. These inflation targets are consistent with the original NBS Monetary Programme for 2001.

Monetary policy assumptions

- relatively stable exchange rate of Slovak crown against the euro
- GDP growth in constant prices at 2.8-3.0%, driven by domestic demand and held back by net exports
- current account deficit on GDP at 5.7%
- fiscal deficit at SK 37.8 billion, i.e. 3.9% of GDP

Money supply growth indicators

- money supply growth should reach 15.5%
- given the balance of payments performance, net foreign assets to increase by 15.9%
- growth in net credit to the government and the National Property Fund should reach 20%, which is consistent with the expected fiscal deficit and the revenues and expenditures of the FNM
- given the developments in the above aggregates, there should be room for year-on-year commercial and personal lending to grow by 5.8%, with actual expansion depending on banking and business sector restructuring.

The NBS Bank Board has approved the Revised Monetary Programme for 2001 on 25 May 2001.