



Národná banka Slovenska

Medium-Term Forecast (MTF-2006Q1)

January 2006

Equilibrium variables, development of potential output

In comparison with the October forecast (MTF-2005Q4), the development trends in the basic real equilibrium variables used in the January medium-term forecast (MTF-2006Q1), which include the equilibrium interest rates and the exchange rate, were not substantially reassessed. The prevailing view is that there is still some room for the long-term real equilibrium appreciation of the exchange rate, which corresponds to the parameters of a converging economy. The positive effect of productivity growth of production factors in sectors with foreign direct investments will gradually spread to other related sectors, which will consequently accelerate the growth in the economy's production potential. At the same time, the export performance of the economy is expected to increase in a wide spectrum of export-oriented sectors. This means that the growth in potential output is higher over the entire horizon of the forecast.

Factors affecting real equilibrium appreciation

The long-term trend of real equilibrium appreciation is currently affected by two opposing factors. It is supported by a greater than expected improvement in the export performance of the economy, which is expected to persist in the coming years. The increase in labour productivity creates conditions for the economy to achieve external equilibrium at stronger levels of real exchange rate. On the other hand, the reassessed wage growth is expected to boost domestic demand and thus stimulate growth in imports. In this way, the positive influence of growth in labour productivity on the real equilibrium exchange rate will probably be offset in part. Since the final effect of these factors represents no significant deviation from the original course of the real equilibrium exchange rate, its long-term trend was not reassessed in the January medium-term forecast.

Current position of the economy¹

Real economic growth over the third quarter of 2005 reached 6.2%, and thus exceeded the figure predicted in the October forecast (MTF-2005Q4), in which the rate of GDP growth was expected to remain at the level of the first half of 2005 (i.e. 5.1% at constant prices). As far as the structure of GDP is concerned, the MTF-2005Q4 was based on the assumption that overall economic growth was promoted by both domestic and foreign demand, while in relative contributions, GDP growth was expected to be stimulated largely by domestic demand. The faster GDP growth was primarily caused by an improvement in net exports of goods and services, whose pro-growth effect was 1.6 percentage points stronger than the figure predicted in the MTF-2005Q4 for the third quarter of 2005. The structure of foreign trade indicates that the accelerating growth in the exports of goods and services was caused by an improvement in the export performance of a larger number of small businesses, which will in all probability have a positive influence on the trade balance in the coming period. The development of domestic demand in the third quarter of 2005 was in line with our expectations, while private

¹ The current position of the economy refers to its state in the fourth quarter of 2005 (according to a GDP estimate), on which both the short-term as well as medium-term forecasts are based.

consumption contributed to the growth in overall final consumption more significantly than public consumption. A certain deviation occurred in gross capital formation, where fixed investments grew at a faster rate than inventories in comparison to the expectations. In the fourth quarter of 2005, the dynamic economic growth is expected to continue, while the trends in GDP components will remain unchanged in comparison with the previous quarter.

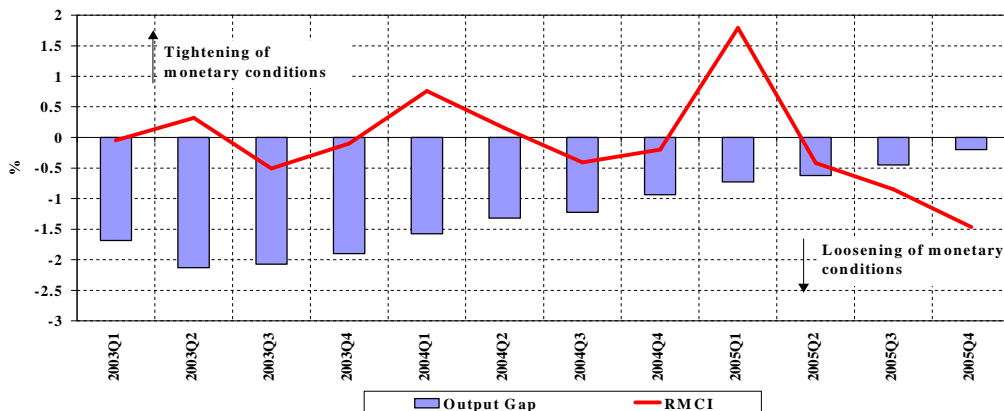
The faster year-on-year growth in nominal as well as real wages in the third quarter (compared with the expectations of the NBS set out in the MTF-2005Q4) was primarily a result of accelerated growth in nominal wages in services, mainly in public services, while wages in production sectors showed moderate growth. The stronger than expected real wage dynamics were influenced by a faster growth in nominal wages, as well as by lower inflation. In the fourth quarter of 2005, the NBS expects no marked change in nominal wages in comparison with the MTF-2005Q4, but with regard to developments in the third quarter, their dynamics in 2005 will probably be stronger. Real wages are expected to show faster growth in the fourth quarter (due to lower inflation compared with the October forecast), which will also be reflected in the increased dynamics of real wages in 2005.

Inflation, expressed in terms of the Harmonised Index of Consumer Prices (HICP), reached 3.9% in December 2005, with the prices of goods rising year-on-year by 3.7% and services prices by 4.2%. In total, excluding energy and unprocessed food prices (core inflation), consumer prices increased by 1.2% on a year-on-year basis. The average inflation rate in 2005 stood at 2.8%. In the fourth quarter, headline inflation followed a more moderate course in comparison with the MTF-2005Q4. This development was a result of slower than expected price increases in energy (especially heat), fuel, and food. In comparison with the Monetary Programme of the NBS until 2008, in which the inflation target for 2005 was set, the year-end headline inflation rate in 2005 reached a value close to the upper limit of the inflation target. The inflation target was achieved despite an increase in regulated energy prices in the last months of 2005, which considerably exceeded the level set in the escape clauses. Consumer price developments in 2005 again signalled no excessive demand-based inflationary pressures in the economy, with the inflation excluding energy and unprocessed food prices (core inflation) slowing from 4.9% in December 2004 to 1.2% in December 2005, and the year-on-year dynamics of services prices weakening from 10.0% to 4.2%.

The current estimate of the monetary policy position confirms the persistence of loosened monetary conditions through the Real Monetary Conditions Index (RMCI). In comparison with the MTF-2005Q4, the estimated monetary conditions loosened in the fourth quarter of 2005. Since the rate of real appreciation slowed gradually over the second half of 2005, monetary policy is expected to have had a stimulating effect on the economy through both of its components for several quarters. Thus, monetary policy might be one of the factors behind the accelerated closing of the output gap in 2005. The estimated initial monetary-policy loosening in the second half of 2005 is also expected to affect the pace of economic growth and the output gap in the course of 2006.

The updating of the medium-term forecast was influenced by the accelerated economic growth in the second half of 2005. The positive trend in the economy can be attributed to an improvement in its pro-export performance and a gradual acceleration in the growth of potential output as a result of a marked positive effect exerted by the overall productivity of production factors. On the other hand, the loosened monetary policy (in both components) and accelerated recovery in foreign demand (faster GDP growth in the euro area) are factors contributing to the more rapid closing of the negative domestic output gap.

Output gap and the Real Monetary Conditions Index (RMCI)



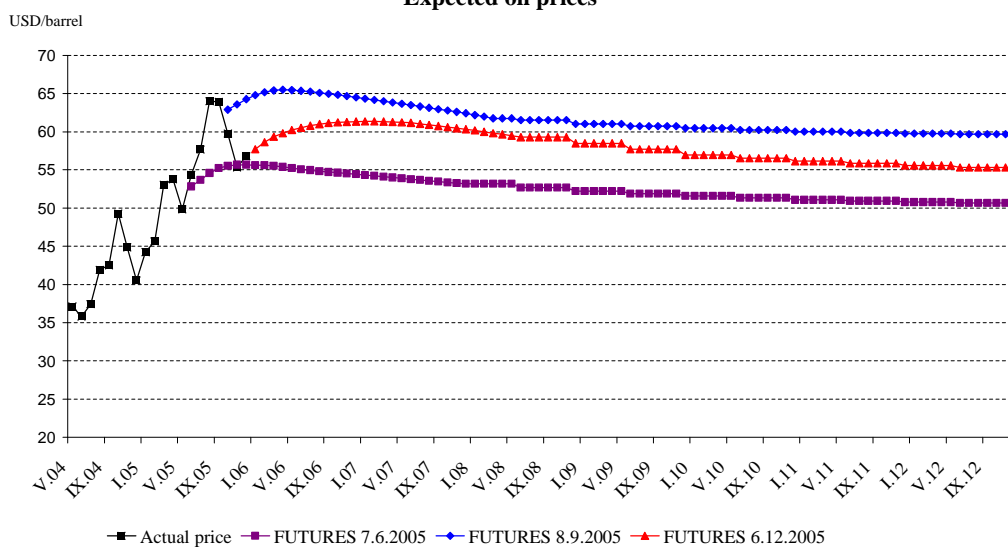
Medium-term forecast

External environment

The medium-term forecast of exogenous indicators is based on the December issue of the Consensus Forecasts². The expected developments in oil prices are based on futures prices as of 6 December 2005.

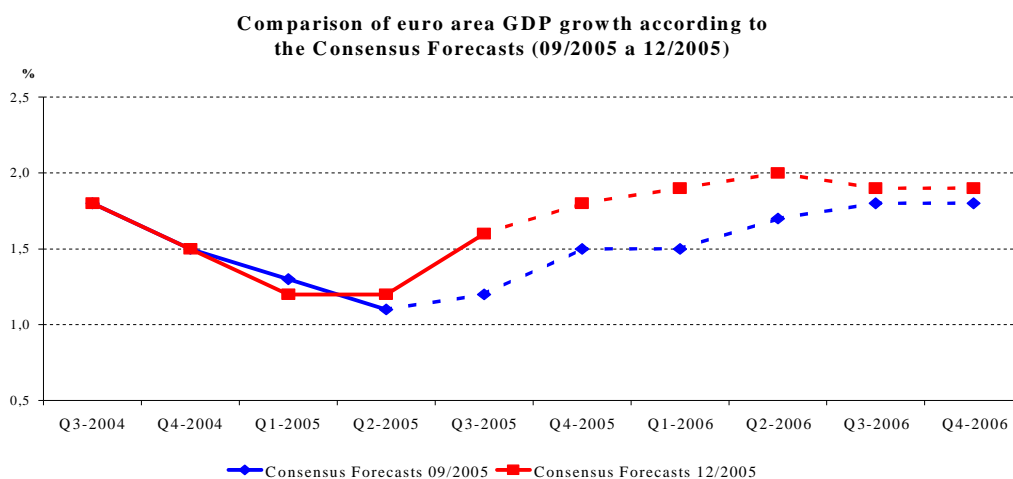
Compared with the developments in the external environment as predicted in the October forecast, changes occurred in the values of all exogenous indicators. The predicted price of oil corresponds to lower levels in comparison with the previous forecast; however, the average price of oil in 2006 will reach approximately USD 60/barrel. Within the scope of the USD/EUR cross-rate development, the USD is expected to strengthen in 2006 and 2007, which may have an upward effect on price levels in the euro area through import prices.

Expected oil prices



² A survey of forecasts made by international economic and financial institutions, from which an average is calculated. This ensures the most unbiased estimate of the trends in foreign sector indicators. With regard to the course and schedule of forecasting at the NBS, the values of input variables were obtained from the Consensus Forecasts of December 2005 and fixed at these levels throughout the forecasting process. Any new information will be taken into account in the next medium-term forecasts.

Economic growth in the euro area in the third quarter of 2005 signals a faster recovery in comparison with the October forecast (1.6%, compared with the predicted 1.2%). The increased economic activity was mainly stimulated by strong growth in domestic demand. The accelerated rate of economic growth is expected to persist throughout 2006, which will probably cause the negative output gap of the euro area to close more quickly in comparison with the previous forecast.



The accelerated economic growth, coupled with the effects of the USD/EUR cross-rate and the persistently high price of oil, is expected to result in a higher average inflation rate in the euro area (2.2% in 2006 and 2.0% in 2007). The faster closing of the negative output gap was also reflected in the forecast of short-term interest rates. Their higher expected level was also affected by the recent increase in key ECB interest rates (at the beginning of December 2005).

	2005	2006	2007
Euro area inflation in %			
CF 09/05 (annual average)	2.1	1.8	
CF 12/05 (annual average)	2.2	2.0	
Euro area GDP growth in %			
CF 09/05	1.3	1.7	
CF 12/05	1.4	1.9	
Oil prices in USD/barrel and EUR/barrel (annual average)			
8 September 2005	56.6 / 45.0	65.1 / 51.5	63.4 / 49.2
6 December 2005	55.0 / 44.1	60.3 / 49.7	61.0 / 48.6
Exchange rate: USD/EUR (end of the relevant quarter)			
CF 09/05	1.240 (Q4)	1.270 (Q3)	1.291 (Q3)
CF 12/05		1.192 (Q1) 1.248 (Q4)	1.259 (Q4)

The economic recovery in the euro area, ongoing since the second half of 2005, is expected to promote the growth of Slovak exports (which is also documented by developments in the third quarter of 2005). Compared with the October forecast, domestic price developments are expected to be dampened by a lower oil price forecast. On the other hand, an upward effect on price levels is expected from the stronger USD.

Forecast for 2005 and 2006

In December 2005, HICP inflation reached a lower level than was predicted in the MTF-2005Q4 and thus remained within the target range. The course of inflation was mostly influenced by a slower rise in energy prices (regulated heat prices for households), as well as in fuel prices, and by a year-on-year fall in food prices (in the MTF-2005Q4, they were projected to rise slowly from November, owing to the base effect of the entry of a new retail chain in the market in autumn 2004).

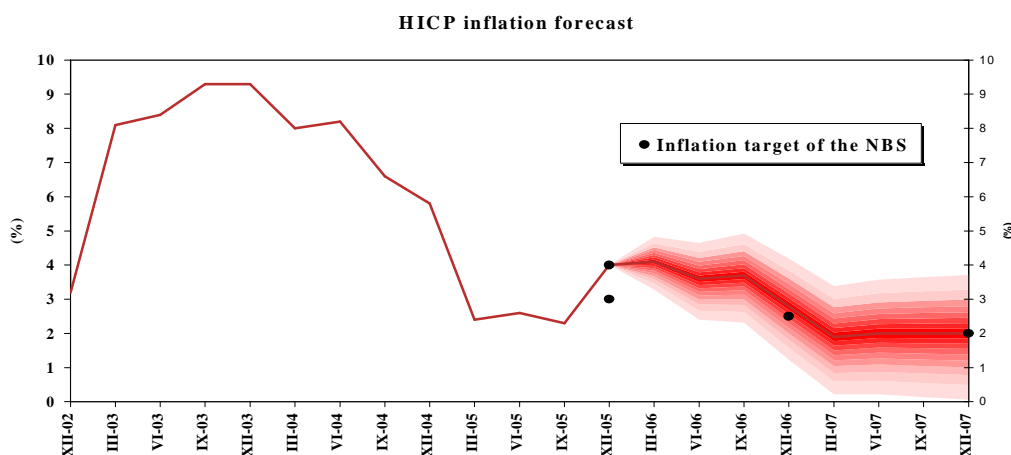
As a result of marked increases in regulated energy prices (compared with the MTF-2005Q4) and increase of excise duties on cigarettes and alcohol, the inflation rate is expected to accelerate at the beginning of 2006. Thus, according to the January forecast (MTF-2006Q1), average inflation will reach a slightly higher level in 2006 than previously forecasted. A greater difference is expected in the year-end inflation rate: inflation in December 2006 will probably reach a level slightly above the inflation target set by the NBS.

Expected developments in energy prices from 1 January 2006 and increases in excise duties (rise in %, contribution in % points)

	MTF-2005Q4		MTF-2006Q1	
	Expected rise	Contribution	Expected rise	Contribution
Gas	1.0	0.0	5.84	0.26
Electricity	1.6	0.1	5.02	0.20
Heat	2.2	0.1	5-7%	0.22-0.31
Water	10.0	0.1	14.2	0.09
Sewage	25.0	0.1	35.9	0.17
Total (energy)		0.4		0.94-1.03
Excise duty on cigarettes*	from SKK 1.4/pce to SKK 1.9/pce	0.43	from SKK 1.4/pce to SKK 1.7/pce	0.32
Excise duty on alcohol	from SKK 25,000/hl to SKK 28,300/hl	0.05	from SKK 25,000/hl to SKK 28,300/hl	0.05
Excise duty in total		0.48		0.37

* The initial proposal of the SR Ministry of Finance, presented in the amendment to the law on excise duties on tobacco products and alcohol, was an increase in the excise duty on cigarettes, from SKK 1.4/pcs to SKK 1.9/pcs; however, the National Council of the SR approved a smaller increase in the duty (i.e. to SKK 1.7/pce).

On the other hand, the forecast assumes that consumer prices will continue to be dampened by factors such as import prices and the competitive environment on the retail market. These factors should be reflected in particular in the prices of industrial goods (excluding energy) and foodstuffs.



In the MTF-2006Q1, compared with the previous forecast (MTF-2005Q4), the NBS foresees a somewhat faster wage growth in both 2005 and 2006.

The acceleration in nominal wage growth in 2005 was due to stronger growth in the third quarter than was expected by the NBS. Wages were not expected to further accelerate in the fourth quarter of 2005, since they were affected in this quarter by the base effect of the same period a year earlier, when some of the sectors recorded dynamic wage growth (trade, repair activities, financial intermediation, real estate business, and education).

More dynamic wage growth in 2006 compared with the MTF-2005Q4 is expected by the NBS for several reasons. In the productive sectors, industry and construction, the relatively moderate wage growth (compared with other sectors and the average figure for the national economy) and the favourable financial results achieved in 2005, together with the expected growth in labour productivity, have created room for stronger wage growth in 2006. Furthermore, real labour productivity in construction grows at a faster rate than wages in the long term. Wage growth in industry is expected to be dampened in the first quarter of 2006 by the base effect of rapid wage growth a year earlier, but this effect will probably fade away in the next quarters.

Among market services sectors, faster wage growth can be expected in transport, storage, post and telecommunications, where steep increases in 2005 were recorded in both labour productivity (real labour productivity increased over the first three quarters of 2005 by 13.5%, real wages by 5%) and profits. Stronger nominal wage growth in the first quarter of 2006 may also be expected in trade and repair activities, mainly as a result of the base effect. Owing to the high profits achieved, real estate, renting and other business activities will probably continue to enjoy dynamic wage growth in 2006.

A contribution to wage growth is also expected from public services, mainly education and public administration, including defence and compulsory social insurance, where wage adjustments are made with effect from July, which means that wage increases from the second half of 2005 will be reflected in the wage level in the first half of 2006. In education, within the scope of wage compensation, from July 2006 wages are again expected to grow at a faster rate (6%) than was agreed in the collective agreement for employees in public services. Room for wage growth has also been created in connection with the higher tax revenues of upper-tier territorial units and municipalities, which may be used in part for wage increases in municipalities.

The expected stronger growth in nominal wages in 2005 and 2006 should also be reflected in the projected increase in real wage dynamics.

The current forecast of real labour productivity growth, which is more favourable than the October forecast, is primarily based on the assumption of stronger real GDP growth in both 2005 and 2006, at an almost unchanged rate of growth in employment.

The unchanged growth in employment in 2005 and its almost unmodified development in 2006, compared with the previous forecast, are based on the assumption that faster economic growth will mainly be achieved through the increased export performance of a large number of small enterprises. Such enterprises can be generally characterised as highly productive, achieving dynamic production growth at the effective use of human capital, which is probably one of the main factors behind their competitiveness on foreign markets. Although small enterprises in industry currently employ approximately 6% of the total number of employees,

their productivity is growing almost six times faster than overall labour productivity in the sector. They are expected to have an even greater impact on the overall growth of productivity in the future in connection with the growing competitiveness of the Slovak economy.

The disparity between real wages and real labour productivity in 2005 did not represent, nor is expected to represent the inflationary impulse in the coming period, since labour productivity in 2006, as well as in the following years, is expected to grow more dynamically than wages. However, the continuation of the trend in wage development from 2005 at an insufficient growth in labour productivity may pose a risk to the future course of inflation.

Over the first ten months of 2005, current account of the balance of payments on resulted in a deficit of SKK 75.1 billion, representing a year-on-year increase of more than SKK 46 billion. The year-on-year increase in the deficit is in line with the MTF-2005Q4, and was caused largely by increased shortfalls in the income and trade balances. Compared with the predictions from the previous forecast, the trade balance achieves smaller deficits, as a result of which the balance of payments current account is expected to improve in 2005.

The foreign trade projection for the rest of 2005 and for 2006 takes account of the previous course of the trade balance in 2005, i.e. the increase (compared with the MTF-2005Q4) in export dynamics in particular. Increased exports tend to accelerate (owing to a certain degree of import intensity) the growth of imports, but since the increase in exports exceeds the increase in imports, the overall contribution to the trade balance is positive, when a smaller deficit is expected in comparison with the previous forecast. The new estimate is also influenced by a different trend in imports for the PSA³ investment.

Since the growth in exports is promoted by an improvement in the export performance of a larger number of small enterprises, the current trend is expected to continue in the future. This fact is reflected in the trade balance forecast as growth in the exports of machines and semi-finished goods, as well as goods for final consumption. Compared with the previous forecast, the increased exports are reflected in the imports of semi-finished goods. With regard to the strong economic growth and the current trend, the imports of goods for final consumption are also expected to increase in both years. The trade balance forecast covers the imports of investment goods for KIA in the amount of approximately SKK 24 billion. In the case of a change in the character of the investment³ in comparison with the expectations (as in the case of PSA³), the trade balance would improve and the pace of economic growth would accelerate in comparison with the forecast. Such changes led to reductions in the trade balance deficit for both 2005 and 2006 (by more than SKK 17 billion and SKK 11 billion respectively).

The developments in the services balance to date are in line with the previous forecast.

The previous developments in individual current account items, as well as the new forecasts of trade and services balance, caused the estimated current account deficit as a share of GDP to decrease in 2005, from 6.8% to 5.5%. In 2006, as in 2005, the balance of payments current account deficit as a share of GDP is also expected to diminish in comparison with the previous forecast, from 6.6% to 5.6%. Compared with the previous forecast, the degree of

³ In the case of the PSA investment, problems arose in connection with the provision of data to the Statistical Office of the SR for the purposes of foreign trade statistics. As a result, the recorded imports of investment units were substantially lower than the originally expected figures.

openness of the economy also increased, from 154.8% to 158.0% of GDP in 2005, and from 154.0% to 161.1% of GDP in 2006.

In the light of the results of economic development in the third quarter of 2005, the accelerated GDP growth is expected to continue in the fourth quarter. The acceleration of economic growth in the fourth quarter of 2005 was also indicated by a multi-component qualitative indicator of the NBS, based on information from business surveys, as well as by sales figures from the individual sectors.

The updated estimate of the annual rate of real growth in 2005 in terms of GDP structure will be mostly influenced by the reassessment of the contribution of net exports to overall economic growth. In connection with the predicted growth in the exports of goods and services in comparison with the previous forecast, the dynamics of gross capital formation are expected to moderate (with inventories falling in volume markedly in the fourth quarter, since the much stronger export dynamics in comparison with the MTF-2005Q4 will probably lead to a fall in inventories, otherwise GDP will grow at a rate faster than expected by the NBS). The assumptions concerning the other components of domestic demand will remain unchanged, owing to the joint effect of final consumption and gross fixed capital formation. The growth in final household consumption will be primarily influenced by wage developments, while the level of consumer spending as a share of GDP is expected to stabilise on a year-on-year basis. Investment activity in the non-financial sector, aimed primarily at creating new fixed assets, is a good impetus for an increase in the performance and competitiveness of the Slovak economy in the coming period.

A pro-growth effect on real GDP in 2006 will be exerted by both domestic and foreign demand. The acceleration in the rate of real GDP growth in 2006, compared with the previous forecast, will be stimulated by an expected improvement in export performance and faster growth in domestic demand due to changes in the assumptions concerning wage developments. Final household consumption will be influenced by the stronger dynamics of real wages, whose growth will be covered by real productivity. In comparison with 2005, final consumption of general government sector is expected to have a somewhat stronger pro-growth effect, which will be influenced by the political cycle. Within the investment component of domestic demand, the dynamic growth in fixed investments is expected to continue, primarily as a result of foreign direct investment (FDI) in the automotive industry. The total contribution of FDI to GDP growth will also depend on the share of investments coming from imports. Experience from developments in 2005 indicate that it may happen that a large portion of the declared investments might be satisfied from domestic supply, which will provide adequate impetus for stronger economic growth. This fact represents a risk for the forecast.

A shift in monetary policy settings should take place primarily in connection with the renewed appreciating trend in the exchange rate at the end of 2005 and the beginning of 2006. A stronger current exchange rate represents an immediate monetary policy tightening. At the same time, monetary conditions were also tightened to some extent through the interest rate component (though the basic rate of the NBS remained unchanged), when interbank market rates increased.

The forecast assumes that monetary policy tightening will continue throughout 2006. In such an environment, the economy is expected to operate close to its potential output. Hence, the output gap has been reassessed in comparison with the MTF-2005Q4, primarily for 2006, i.e.

from -0.7 % to -0.2 %. The faster economic growth is not yet expected to pose a risk of demand-based pressures with an undesirable impact on inflation.

Medium-term forecast (2007 and 2008)

In 2007 and 2008, the low-inflation environment is expected to persist (as according to the previous forecast), and will create conditions for meeting the NBS inflation target. The slight rise in inflation at the end of 2007 and in 2008 (on average), compared with the MTF-2005Q4, can be attributed to increased inflation expectations (resulting from a marked deregulation in 2006) and increased fuel prices. Among the main conditions of disinflation are import prices with a dampening effect (low imported inflation), a competitive environment on the retail market, and sustainable growth in real wages in line with the trend in labour productivity.

Comparison of HICP inflation forecasts (in %)

	2005	2006	2007	2008
MTF-2005Q4				
end of year	4.4	2.4	1.9	2.0
annual average	2.9	3.4	1.9	1.9
MTF-2006Q1				
end of year	3.9*	2.8	2.0	2.0
annual average	2.8*	3.6	1.9	2.0

/* Actual figure

The main risk in the inflation forecast are the higher oil prices, which may lead to increased fuel prices, and/or increased regulated prices in comparison with the forecast. The risks involved in the inflation forecast also include food prices. The forecast of food prices is based on the assumption of unchanged climatic conditions and expects no fundamental changes in the Common Agricultural Policy of the EU. The meeting of the inflation target may also be jeopardised by excessive growth in real wages, which is not in line with the development of labour productivity.

In the current forecast for 2007, the NBS expects faster nominal wage growth (compared with the MTF-2005Q4) in connection with the predicted pace of economic growth and the prepared wage compensation for teachers with effect from July 2006 (the wage increases in the second half of 2006 will continue to be reflected in the level of wages in the first half of 2007). In 2008, nominal wage dynamics are not expected to deviate considerably from the 2007 figures. The National Bank of Slovakia assumes that, after dynamic economic growth in 2007, the rate of nominal wage growth will not slow down substantially in 2008. After dynamic economic growth in 2007, profits are also expected to increase. Part of the profits may stimulate wage growth in the coming year. The growth in real wages in comparison with the MTF-2005Q4 is expected to accelerate in both years (despite a predicted slight rise in inflation); however, the rate of their growth should be slower than the dynamics of labour productivity.

In the conditions of accelerated economic growth and almost unchanged growth in employment, real labour productivity is expected to again grow dynamically from 2006 (at a rate faster than was predicted in the MTF-2005Q4) and to create sufficient room for real wage growth. Since wage growth is exceeded by the growth in labour productivity, no undesirable demand-based inflationary pressures are expected to emerge in the economy.

A slightly faster economic growth in 2007-2008, achieved primarily as a result of increased productivity in production factors, is not likely to provide impetus for marked changes in the development of overall employment.

The balance of payments current account forecast for 2007 and 2008 takes account of the trends in individual components in previous years and of the revised expectations concerning developments in the trade and services balances.

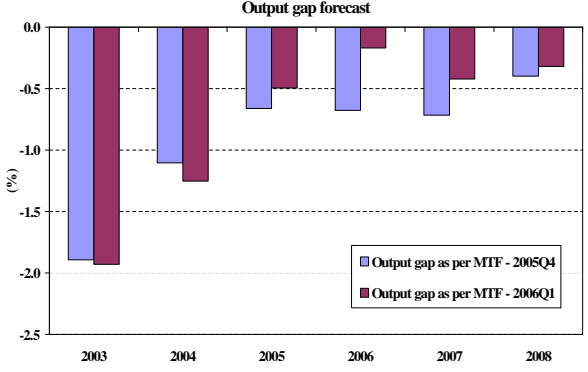
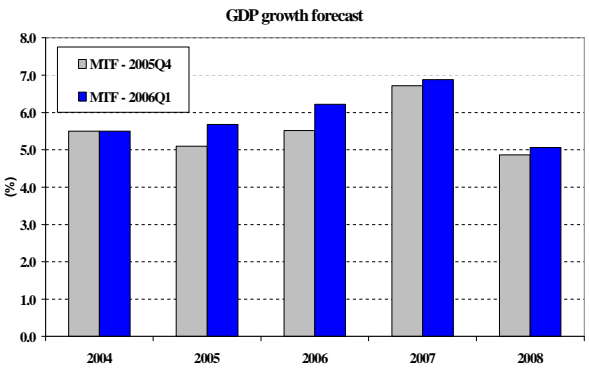
The volume of total exports and imports in 2007 and 2008 is expected to exceed the previous forecast. The increase in the value of exports and imports is mainly connected with the taking into account of the economy's export potential. In comparison with the October forecast, the basic assumption is still that the trade balance will be determined by the gradual launch of production and export in new automotive factories. In other commodity categories, the year-on-year growth in exports is expected to follow a stable course in line with the previous forecast; however, owing to the acceleration of exports in 2005, the absolute values of exports have increased in comparison with the previous forecast in all commodity groups, except for raw materials. On the other hand, the estimate of raw materials is somewhat lower, for it is based on lower oil prices. The higher export values in the new forecast are reflected in the higher imports of semi-finished goods and partly machines.

In view of the expected faster growth in the economy and final consumption, the import forecast was prepared with regard to the increased imports of goods for final consumption. A modest contribution to the faster growth of goods imports for final consumption is also expected from the higher real wage growth in comparison with the previous forecast. In the course of 2008 (and/or 2007), the PSA Factory in Trnava is expected to be expanded, while the growth in investment (as well as in production and exports in the following years) will correspond to approximately a half of the original investment (and/or exports). For the time being, the imports of investment goods for the new PSA investment are impossible to quantify precisely, while in the case of imports of investment units, the trade balance may deteriorate in 2008 by approximately SKK 5–10 billion. The inclusion of all of the above factors in the medium-term forecast caused the trade deficit for the years 2007-2008 to diminish annually by approximately SKK 10 billion in comparison with the previous medium-term forecast.

The balance of payments current account deficit is following a diminishing trend in line with the previous forecast, with its share of GDP decreasing in both 2007 (from 3.3% to 2.6%) and 2008 (from 3.1% to 2.3%). Compared with the previous forecast, the estimated degree of openness of the economy increased from 156.6% to 163.4% of GDP in 2007 and from 157.3% to 164.2% of GDP in 2008.

In 2007-2008, the rate of GDP growth is expected to accelerate slightly in comparison with the previous forecast in connection with its higher level in 2005, which will probably persist in the following period. In connection with the inflow and effect of FDI in the previous period, the NBS assumes that production factors will continue showing higher productivity, which will lead to more dynamic economic growth through increased export performance. The accelerated growth in the exports of goods and services through a larger number of small exporters is connected with the expected gradual recovery in demand in the countries of our trading partners, which will influence the supply side of the economy still further. In connection with the faster rate of economic growth, the real consumer expenses of households are expected to grow at a somewhat faster rate. The share of final household consumption of total GDP is not expected to decrease markedly in the coming period.

Over the medium-term horizon, the trends in individual GDP components will remain virtually unchanged in comparison with the MTF-2005Q4. Within the scope of domestic demand, gross fixed capital formation and final consumption in the household and general government sectors are expected to make a positive contribution to the overall GDP growth. Gross fixed capital formation will be a major pro-growth factor among the domestic demand components, primarily as a result of FDI. The high rate of GDP growth in 2007 is expected to be influenced by the cumulative effect of growth in production and exports in the two largest investments within the automotive industry, and by the expected continuation of export growth in all sectors, which should cause a significant pro-growth effect of net exports in 2007.



The setting of monetary policy in 2007 will focus on the elimination of possible risks in the course of inflation. The assumption that the output gap will close more quickly and inflation will be somewhat higher in 2006 may require further monetary policy tightening in 2007. The unambiguous commitment to meet the inflation target may again cause a slight opening of the negative output gap through monetary policy.

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Annex

Medium-term forecast (MTF-2006Q1) of main economic indicators

Indicator	2004	2005*	2006	2007	2008	2005	2006	2007	2008
	Actual	Forecast			Difference with MTF-2005Q4				
Prices (y-o-y change)									
HICP inflation (end-year)	5,8	3,9	2,8	2,0	2,0	-0,5	0,4	0,1	0,0
HICP inflation (average)	7,5	2,8	3,6	1,9	2,0	-0,1	0,2	0,0	0,1
CPI inflation (end-year)	5,9	3,7	2,5	1,9	2,0	-0,4	0,4	0,1	-0,1
CPI inflation (average)	7,5	2,7	3,1	1,9	2,0	-0,2	0,2	0,1	0,1
PPI (average)	3,4	4,6	2,4	1,4	1,3	0,8	0,1	0,0	0,0
GDP (y-o-y change)									
Nominal GDP	10,3	8,7	8,9	8,7	6,9	0,9	0,9	0,3	0,2
Domestic demand	11,0	9,7	9,0	5,7	6,7	0,0	0,9	0,5	0,2
Final consumption of households	10,7	8,9	8,3	7,0	6,9	0,2	0,5	0,2	0,2
Final consumption of general government	7,6	6,5	6,5	4,8	4,3	0,4	0,4	0,6	0,5
Final consumption of non-profit institutions	12,4	8,5	8,3	6,7	6,7	-0,5	0,0	0,0	0,0
Gross fixed capital formation	6,1	13,7	11,5	7,0	6,9	1,7	0,0	0,0	0,0
Exports of goods and services	9,1	9,9	10,6	12,1	7,6	4,2	3,2	-0,4	0,2
Imports of goods and services	10,8	10,3	11,0	8,1	7,3	2,6	3,4	0,0	0,1
Real GDP	5,5	5,7	6,2	6,9	5,1	0,6	0,7	0,3	0,2
Domestic demand	5,5	5,5	5,2	2,0	4,8	-1,0	1,0	0,2	0,1
Final consumption of households	3,5	5,7	5,3	5,2	5,1	0,0	0,4	0,2	0,3
Final consumption of general government	1,1	2,1	3,2	2,4	2,0	-0,2	0,0	0,0	0,0
Final consumption of non-profit institutions	5,8	3,8	5,0	5,0	5,0	-0,8	-0,6	0,0	0,0
Gross fixed capital formation	2,5	10,7	8,9	5,5	5,5	1,9	0,0	0,0	0,0
Exports of goods and services	11,4	9,5	13,4	15,2	8,9	4,2	2,9	0,6	0,2
Imports of goods and services	12,7	8,2	12,8	11,0	8,9	2,6	3,5	0,9	0,1
Labour market									
Nominal wage (monthly average, y-o-y change)	10,2	9,0	7,0	6,0	5,9	0,4	0,5	0,4	0,3
Real wage (monthly average, y-o-y change)	2,5	6,1	3,8	4,0	3,8	0,6	0,3	0,3	0,2
Employment (LFS, y-o-y change)	0,3	1,7	0,9	0,8	0,7	0,0	0,1	0,0	0,0
Employment (registered employment, y-o-y change)	0,3	1,8	0,9	0,9	0,7	0,0	0,1	0,0	0,0
Unemployment rate (LFS, %)	18,1	16,4	15,9	15,8	15,5	-0,3	-0,6	-0,1	0,0
Labour productivity (Real GDP/Employment, y-o-y change)	5,2	3,8	5,3	5,9	4,4	0,6	0,7	0,2	0,2
Balance of payments									
Import of goods (y-o-y change)	14,0	10,1	12,1	8,8	7,9	1,9	3,9	0,1	0,2
Export of goods (y-o-y change)	11,5	9,7	11,6	13,3	8,2	3,9	3,4	-0,5	0,2
Trade balance (bil. SKK)	-47,0	-55,0	-66,8	-22,9	-20,4	17,2	11,4	9,3	10,6
Trade balance (% GDP)	-3,5	-3,8	-4,3	-1,3	-1,1	1,3	0,8	0,6	0,7
Balance of services (bil. SKK)	8,6	12,8	13,9	15,0	16,0	0,8	1,4	2,0	2,0
Balance of services (% GDP)	0,6	0,9	0,9	0,9	0,9	0,1	0,1	0,1	0,1
Current account (bil. SKK)	-46,0	-79,0	-88,1	-44,0	-41,9	18,0	12,8	11,3	12,6
Current account (% GDP)	-3,5	-5,5	-5,6	-2,6	-2,3	1,3	1,0	0,7	0,8
Current and capital account (bil. SKK)	-41,6	-73,0	-81,1	-37,0	-35,9	18,0	12,8	11,3	12,6
Current and capital account (% GDP)	-3,1	-5,1	-5,2	-2,2	-2,0	1,3	0,9	0,7	0,8

*/ Inflation (HICP, CPI) - actual values