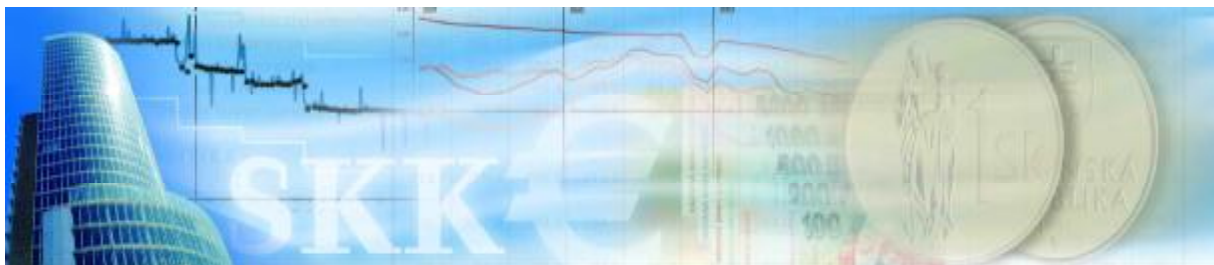




NÁRODNÁ BANKA SLOVENSKA

# **MEDIUM-TERM FORECAST (MTF-2008Q3)**

**July 2008**



## **Equilibrium variables, development of potential output**

The medium-term forecast is based on the assumption that Slovakia is a converging economy, with corresponding equilibrium trends in its main macroeconomic indicators. The basic framework of the forecast is formed by equilibrium real interest rates, the equilibrium real exchange rate, and non-inflationary growth in the economy (potential output). Compared with the April forecast (MTF-2008Q2), the long-term trends in the key monetary variables used in the current medium-term forecast (MTF-2008Q3) have been reassessed in some respects.

The current medium-term forecast expects neither additional investments, nor a further increase in the economy's production capacity in comparison with the previous forecast. The short-term forecast of GDP growth has been reassessed, owing to the slightly faster than expected GDP growth recorded in the first quarter of 2008. The actual and expected growth in domestic demand has caused a shift in the actual position of the economy, while its potential output has remained unchanged.

### **Current position of the economy<sup>1</sup>**

The estimate of the economy's current position is based on the estimated deviations of its key macroeconomic indicators from the equilibrium trends. In view of the pronounced appreciation of the nominal exchange rate (SKK/EUR) over a period of more than one year without any apparent dampening effect on the economy, the NBS has reassessed the underlying trends in the equilibrium monetary variables to some extent. Thus, the individual components of the real monetary conditions have been loosened in comparison with the April forecast (the restrictions have been eased, gradually since 2007, except for the second quarter of 2008). Broken down by component, the interest-rate component of the monetary conditions has been gradually loosened, while the base rate of the NBS has remained unchanged, with the inflation expectations on the increase. Despite the marked real equilibrium appreciation, the exchange-rate component has remained restrictive. In the second quarter, the real exchange rate deviated from the equilibrium level to an even greater extent (owing to the strengthening nominal exchange rate) and thus created conditions for the dampening of the economy's export performance in the following period.

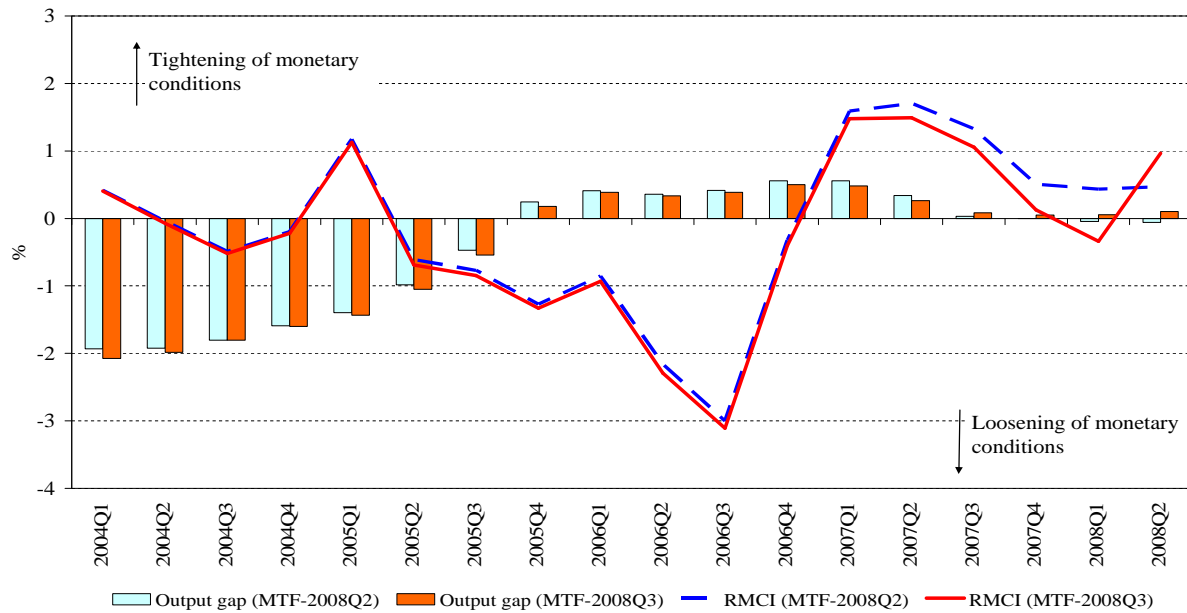
In the first quarter of 2008, the rate of real economic growth reached 8.7%. The previous forecast (MTF-2008Q2) was based on the assumption that the production of transport vehicles, electrical appliances, and optical instruments is driven by foreign demand and value-added growth. Real economic growth in the first quarter of 2008 was mostly influenced by domestic demand.

Regarding real economic development in the second quarter of 2008, GDP growth will be again stimulated by domestic demand in particular, while the contribution of net exports is expected to be stronger than in the first quarter of 2008. Final consumption in the household sector is expected to grow year-on-year at a relatively fast pace, as a result of the rapid wage growth (mainly in the public sector), coupled by an accelerated growth in employment in comparison with the April forecast.

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<sup>1</sup> The current position of the economy refers to its state in the second quarter of 2008 (according to a GDP growth estimate), upon which the short-term as well as medium-term forecasts are based.

**Output gap and the Real Monetary Conditions Index (RMCI)**



The cyclical position of the economy still has a neutral effect on price developments. The faster growth household final consumption in the first quarter of 2008 indicates that the output gap may fluctuate between slightly positive values, but without indicating a clear tendency.

The growth in nominal and real wages in the first quarter of 2008 was stronger than expected by the NBS in the April forecast, mainly as a result of wage growth in the general government sector. Wage growth in this sector was mainly influenced by the revaluation of wage tariffs, wage increases in self-governments, and the payment of extra bonuses. The dynamic nominal wage growth is expected to continue in the second quarter of 2008, which is also indicated by preliminary data on wage developments in the selected sectors in April and May 2008.

In the second quarter of 2008, real wage growth is expected to slow in comparison with the previous quarter, as a result of higher year-on-year inflation.

The continuing strong GDP growth in the first quarter of 2008 was also reflected in the growth of employment (ESA95), which was faster than according to the MTF-2008Q2 forecast. On the basis of the previous trend, the dynamic growth in employment is expected to continue in the second quarter of 2008 (this is also indicated by the preliminary results of employment surveys carried out in the selected sectors in April and May 2008), at a faster pace than according to the previous forecast (MTF-2008Q2).

In the first quarter of 2008, the balance of payments on current account resulted in a deficit of SKK 6.5 billion (EUR 0.2 billion), representing a year-on-year deterioration of SKK 9.4 billion (EUR 0.3 billion). The year-on-year deterioration in the balance of payments current account was caused by changes in the income and services balances, from surpluses recorded last year to deficits, coupled by an increase in the negative balance of current transfers. On the other hand, the trade balance surplus has increased in comparison with the figure recorded a year earlier, in line with the expectations of the NBS. In terms of volume, both exports and imports have satisfied the expectations of the NBS from the previous forecast. The growth in volumes was also supported by the rising prices of crude oil and natural gas; this impact may be even stronger in the second half of the year. The year-on-year increase in the current

account deficit was also reflected in the ratio of the current account balance to GDP, which reached  $-1.7\%$ , compared with  $0.7\%$  in the first quarter of 2007. In terms of this indicator, the trade balance recorded an improvement of 0.2 of a percentage point, to  $1.3\%$ .

Over the second quarter, the year-on-year rate of increase in consumer prices accelerated to  $4.0\%$ , which is 0.6 of a percentage point more than the figure predicted in MTF-2008Q2. This development can be ascribed to increases in year-on-year price dynamics in all groups of the basic structure of consumer-price inflation, except for prices in telecommunications. Compared with the assumptions of the MTF-2008Q2, the steepest increases were recorded in the dynamics of food prices, which strengthened by approximately 1.3 percentage points, representing a contribution of additional 0.29 of a percentage point to overall HICP inflation and half of the total (larger-than-expected) increase. Food prices are still affected by the global increase in agricultural commodity prices, resulting from a growing demand for agricultural commodities. Within the scope of food prices, the rate of increase accelerated in processed food prices and, especially, in unprocessed food prices. Unprocessed food prices were mostly influenced by a sharp rise in fruit prices, a slowdown in the rate of decline in vegetable prices, and developments in meat prices. Among processed foodstuffs, cooking oil recorded the most rapid price increase. The second most significant basic inflation component, which was responsible for the higher than expected rate of headline inflation in the second quarter of 2008, was services prices, the year-on-year dynamics of which were 0.6 of a percentage point stronger than expected (contributing 0.20 of a percentage point to headline inflation). Within the scope of services prices, accelerated price increases were recorded in recreational, personal, sporting, and medical services. The year-on-year increase also accelerated in the prices of non-energy industrial goods. After falling for five successive quarters on a year-on-year basis, non-energy industrial goods prices recorded a year-on-year increase ( $0.2\%$ ), though they had been expected to remain unchanged on a year-on-year basis (an additional contribution of 0.06 of a percentage point to headline inflation). Non-energy industrial goods prices were influenced by a slower decline in automobile prices, accompanied by accelerated increases in the prices of furniture, clothes, and footwear. The acceleration in the year-on-year increase in energy prices in the second quarter of 2008 (compared with the previous quarter) was caused by fuel and heating prices, which were adjusted in April and May (a 0.2 of a percentage point higher increase of in year-on-year dynamics, with a contribution of 0.04 of a percentage point to headline inflation).

## **Medium-term forecast**

### **External environment**

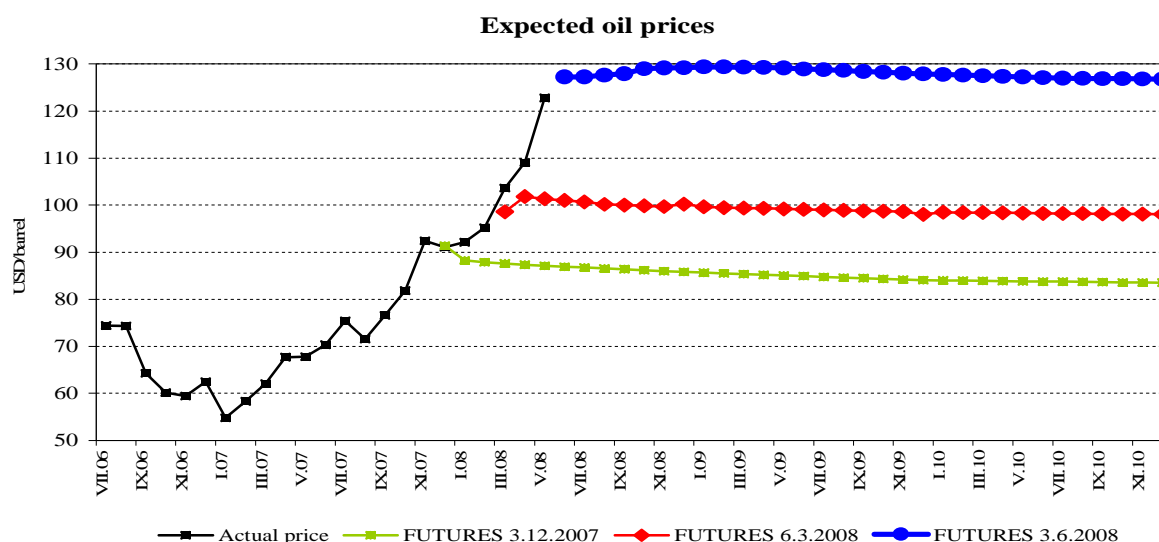
The current forecast of exogenous indicators is based on the June issue of the Consensus Forecasts (CF)<sup>2</sup>. The expected developments in oil prices are based on the prices of futures as of 3 June 2008.

Compared with the MTF-2008Q2, the oil price forecast predicts another upward shift for the entire projection horizon. Oil prices are expected to be higher by approximately 30% in comparison with the previous forecast. Their year-on-year growth is also likely to accelerate, mainly in 2008. While MTF-2008Q2 predicted a year-on-year fall in oil prices starting from

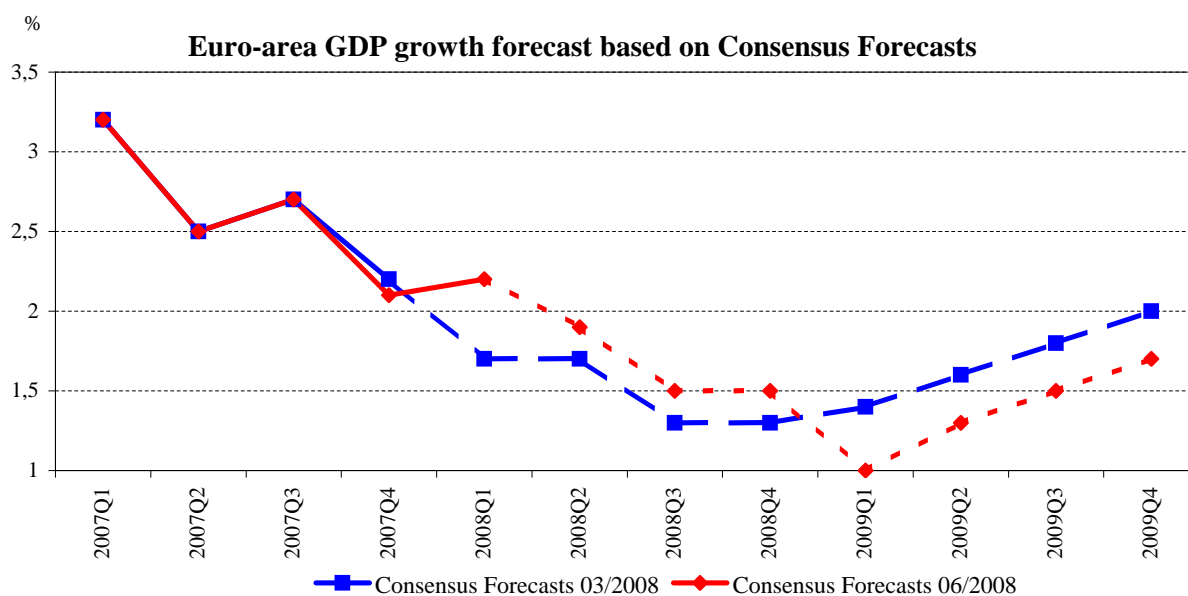
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<sup>2</sup> A survey of forecasts made by international economic and financial institutions, from which an average is calculated. This ensures the most unbiased estimate of the trends in foreign sector indicators. With regard to the course and schedule of forecasting at the NBS, the values of input variables were obtained from the Consensus Forecasts of June 2008 and fixed at these levels throughout the forecasting process. Any new information will be taken into account in the next medium-term forecasts.

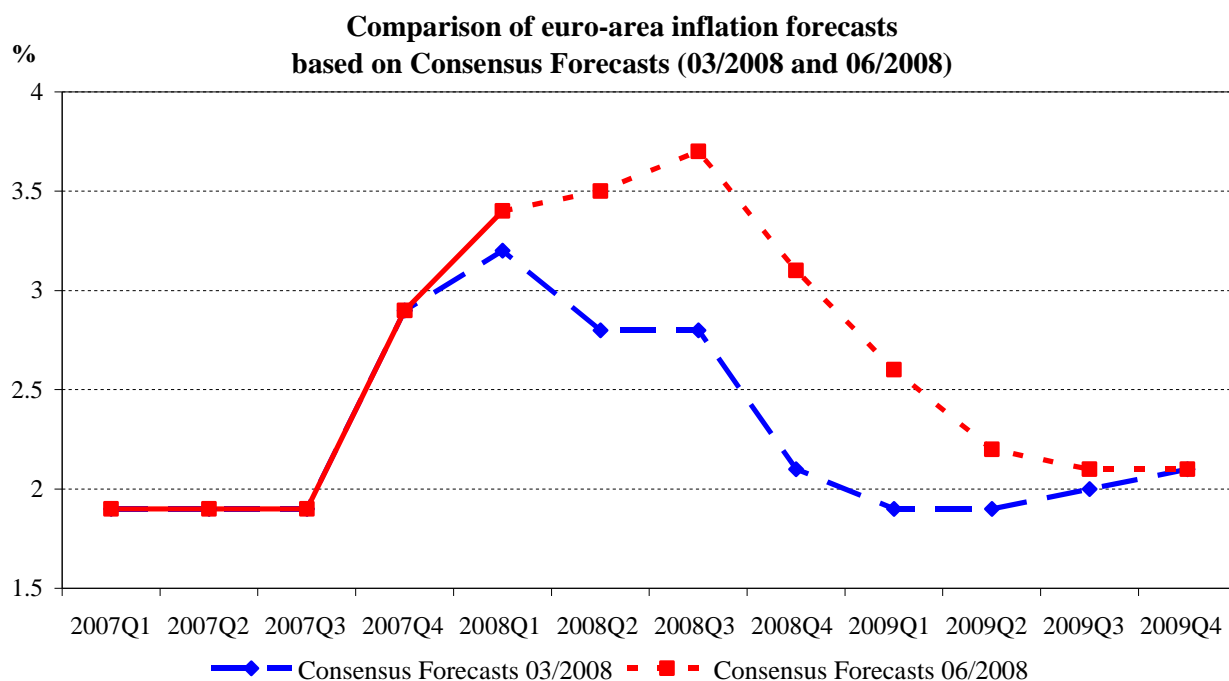
April 2009, the actual prices of futures indicate that this fall will begin at the end of 2009 and will continue in 2010. However, the current developments in the EUR/USD cross-rate may have a dampening effect on the koruna equivalents of oil prices.



The relatively favourable economic growth in the euro area in the first quarter of 2008 is reflected in its estimate in the June CF for the entire 2008, representing an improvement of 0.2 – 0.3 of a percentage point. By contrast in 2009, economic growth is expected to slow in comparison with the previous forecast, by 0.3–0.4 of a percentage point.



Compared with the MTF-2008Q2, the rate of euro-area inflation estimated for 2008 has increased again by 0.7–1.0 percentage point, exceeding the inflation target of the ECB by 1.1–1.7 percentage points. This development is influenced by the rapid increase in oil prices and the persistent rise in food prices, the impact of which is expected to start fading towards the end of 2008. In 2009, inflation is likely to continue falling, to a level close to the inflation target of the ECB.



Compared with the assumptions of the March CF, the actual level of money market rates rose significantly in the second quarter of 2008. In the coming period, money market rates are expected to fall, but to a lesser extent than was predicted in the previous forecast.

	2007	2008	2009	2010
<b>Euro-area inflation in %</b>				
CF 03/08 (annual average)	2.1	2.7	2.0	2.0*
CF 06/08 (annual average)	2.1	3.4	2.3	2.1*
<b>Euro-area GDP growth in %</b>				
CF 03/08	2.7	1.5	1.7	2.2*
CF 06/08	2.6	1.8	1.4	1.9*
<b>Oil prices in USD/barrel and EUR/barrel respectively (annual average)</b>				
6 March 2008	72.5/52.9	99.2/67.1	99.0/70.2	98.3/71.2*
9 June 2008	72.5/52.9	118.4/77.5	128.8/89.0	127.2/92.0
<b>Interest rates (3-month EURIBOR) (end-of-quarter figures)</b>				
CF 03/08	4.7 (Q4)	4.1 (Q2)	3.8 (Q1)	3.9* (Q4)
CF 06/08	4.7 (Q4)	4.7 (Q3)	4.2 (Q2)	4.0* (Q4)
<b>USD/EUR exchange rate (end-of-quarter figures)</b>				
CF 03/08	1.456 (Q4)	1.491 (Q2)	1.419 (Q1)	1.378 (Q1)
CF 06/08	1.456 (Q4)	1.528 (Q3)	1.443 (Q2)	1.387 (Q2)

\* NBS forecast.

## Forecasts for the years 2008 to 2010

The current medium-term forecast expects a year-end inflation rate of 4.0% in 2008 (an average rate of 3.9%), followed by a slowdown in 2009 to 2.8% (an average rate of 3.4%). In 2010, the HICP inflation rate is expected to reach 2.9% (3.1% on average). Compared with the MTF-2008Q2, the current medium-term inflation forecast predicts higher figures for this period (except for the year-end figure for 2009). Since the exchange rate appreciation was only slightly reflected in the level of consumer prices in 2007 and in the first half of 2008, the exchange rate appreciation from the end of May 2008 is not expected to have a marked impact on price levels in 2008 and 2009.

The higher inflation rate in 2008 (by 1.2 percentage points compared with the figure from the MTF-2008Q2) is attributable to the higher-than-expected actual inflation rate in the second quarter and the higher figures predicted for the next period. Within the basic structure of inflation, goods and services prices are expected to show increased dynamics (compared with the previous forecast) at the end of 2008. The strongest additional impact in the coming period is expected from energy price developments: regulated prices are expected to be raised with effect from August (heating) and October (gas), and faster increase in fuel prices also. Energy prices will probably show stronger dynamics at the end of the year (by approximately 3.4 percentage points), which represents an additional contribution of 0.57 of a percentage point to headline inflation. Another important factor behind the higher headline inflation rate in comparison with the MTF-2008Q2 is the rising food prices. Sharper increases are expected in processed and unprocessed food prices in particular (fruit, vegetables, meat), the year-end dynamics of which will probably be 2.5 percentage points stronger, as well as their contribution to overall inflation (by 0.57 of a percentage point). On the basis of agricultural price developments, the NBS assumes that the current dynamic food price increase is only a temporary factor and that the year-on-year dynamics of food prices will therefore weaken (a base effect) in the final quarter. The expected increase in excise tax on cigarettes is also incorporated in the level of food prices. Non-energy industrial goods prices are expected to be influenced to some extent by the exchange rate appreciation recorded in the recent period. They are likely to fall somewhat at the end of the year (MTF-2008Q2 predicted a slight increase in their year-on-year dynamics) with a negative contribution to headline inflation (0.04 of a percentage point) in comparison with the previous forecast. In 2008, the prices of services are likely to be affected by the increased cost stimuli resulting from the faster rise in regulated prices and the stronger exchange rate during the year. Like food prices, services prices are also expected to slow on a year-on-year basis, owing to a base effect (financial services). At the end of 2008, services prices are likely to show stronger dynamics than according to the MTF-2008Q2 (by approximately 0.2 of a percentage point), with an additional contribution of 0.07 of a percentage point to overall inflation.

At the end of 2009, HICP inflation is likely to be 0.3 of a percentage point lower than according to the MTF-2008Q2. During 2009, goods and services prices are expected to follow the rising trend from the end of 2008, but their year-end dynamics will probably be weaker than according to the MTF-2008Q2, owing to the strengthening exchange rate. At the end of 2009, non-energy industrial goods prices are likely to show weaker dynamics (by approximately 0.4 of a percentage point compared with the MTF-2008Q2), with an additional contribution of -0.11 of a percentage point to headline inflation. After the changeover to the single currency, goods prices are expected to be influenced by the simplified conditions for trade and price comparison. The rate of increase in non-energy industrial goods prices could slow more significantly under the influence of the exchange rate, but industrial goods prices

will also be affected by the accelerated euro-area inflation rate and the changeover to the euro (changeover effect). The effect of rounding will probably be reflected not only in goods prices but also in food and services prices. At the end of the year, the dynamics of services prices are likely to be approximately 0.4 of a percentage point weaker (a slowdown from 5.8% to 5.4%), owing to the weaker impact of changes in regulated prices on services prices (secondary effects) and exchange rate developments. Thus, the contribution to overall HICP inflation will be 0.16 of a percentage point smaller at the end of the year. Due to uncertainty about their further course, the other components of inflation (food, energy prices) have been left unchanged; they should show roughly the same year-on-year dynamics at the end of the year as according to the MTF-2008Q2. In 2009, the dynamics of food prices are expected to correspond to their long-term tendency (irrespective of the supply shocks).

Inflation is expected to stabilize in 2010. The accelerating rise in non-energy industrial goods and services prices is likely to continue in 2010, though consumer prices will no longer be affected by one-off factors, such as the changeover effect or changes in excise taxes. Despite this, the current medium-term forecast predicts a slight increase in their year-end dynamics (0.1 of a percentage point) compared with the MTF-2008Q2. This increase is the result of accelerating rise in regulated prices, the rate of which is accelerating in connection with the rise in average core CPI inflation in 2009 (regulated energy prices according to the valid formula are also influenced by the rate of core inflation from the previous period). The dynamics of energy prices are likely to strengthen by 1.0 percentage point, which would represent a contribution of approximately 0.16 of a percentage point to overall inflation. As a result of increased energy price dynamics, services prices are also likely to rise year-on-year at a faster rate (secondary effects). The year-end dynamics of services prices are expected to be 0.3 of a percentage point stronger than according to the MTF-2008Q2, which represents an additional contribution to headline inflation of 0.08 of a percentage point. On the other hand, non-energy industrial goods prices, as well as food prices, are likely to show somewhat weaker dynamics at the end of 2010, hence their contribution to headline inflation will be approximately 0.09 of a percentage point smaller.

In 2008, regulated prices in total (energy and other regulated prices) will, according to the estimates of NBS, increase to a greater extent than was predicted in the MTF-2008Q2 (as a result of steeper-than-expected increases in prices for heating and gas during 2008), i.e. by an average of 4.4%.

In 2009, the dynamics of regulated prices are expected to increase by an average of 4.7%, representing a steeper increase than according to the previous forecast. In 2010, the rise in regulated prices is likely to slow, to 3.9%. Their contribution to headline inflation is estimated to be approximately 1.19 percentage points in 2008, 1.26 percentage points in 2009, and 1.06 percentage points in 2010. By the end of 2008, regulated prices are estimated to have risen by 6.1% with a contribution of approximately 1.63 percentage points to annual headline inflation, by the end of 2009 annual rate of increase should reach 3.0% with a contribution of approximately 0.82 of a percentage point, and by the end of 2010 should record 3.6% rate of annual increase with a contribution of approximately 0.98 of a percentage point.



Comparison of HICP inflation forecasts (year-on-year changes in %, average for the period)

		2006	2007	2008	2009	2010
TOTAL (HICP)	MTF-2008Q1	4.3	1.9	2.8	3.1	
	MTF-2008Q2	4.3	1.9	3.2	3.0	3.0
	MTF-2008Q3	4.3	1.9	3.9	3.4	3.1

Comparison of HICP inflation forecasts (year-on-year changes in %, end-of-year figures)

		2006	2007	2008	2009	2010
TOTAL (HICP)	MTF-2008Q1	3.7	2.5	2.8	2.9	
	MTF-2008Q2	3.7	2.5	2.8	3.1	2.8
	MTF-2008Q3	3.7	2.5	4.0	2.8	2.9

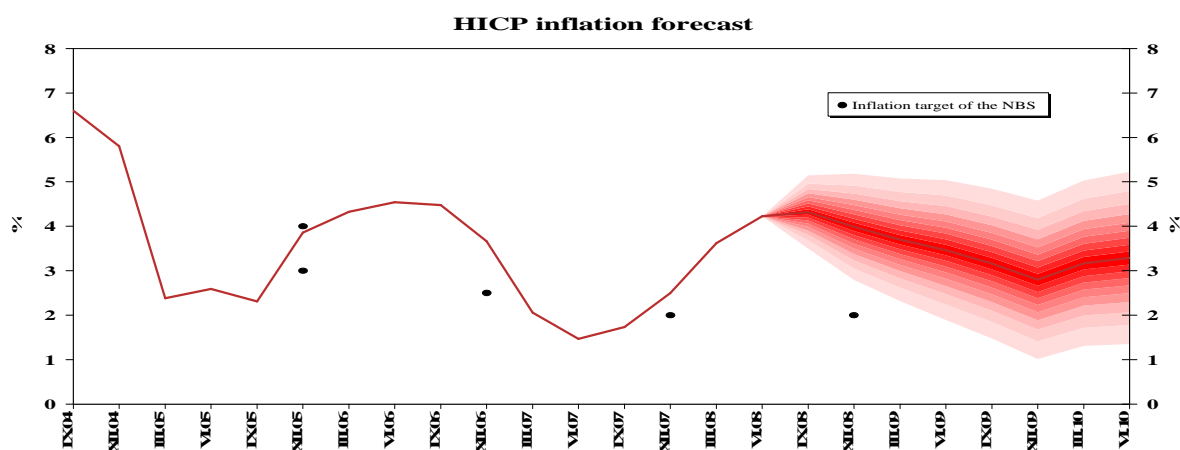
## Risks to the forecast

Upside risks are posed by developments in oil prices and the resulting upward pressure on regulated energy prices (with increases planned for October 2008 and January 2009), to a larger extent than according to the current forecast. A risk is also involved in the price of electricity, which reached EUR 80/MWh on the European energy market. This points to a risk of higher-than-expected energy prices.

Food prices have shown stronger dynamics in the last few months (compared with the NBS expectations), but no marked supply shocks are expected in the period to come. There is a persistent upside risk, posed by developments in agricultural commodity prices. Further risks in food prices are the time and range of the impact of increased excise taxes on cigarette prices with regard to the stocking-up on tobacco products.

Prices for services are also exposed to the risk of further and more pronounced increases in regulated energy prices and/or food prices (in restaurants).

A downside risk to inflation in 2009 is the effect of exchange rate appreciation from the recent months, which may contribute to the slow rise in goods and services prices in 2009.



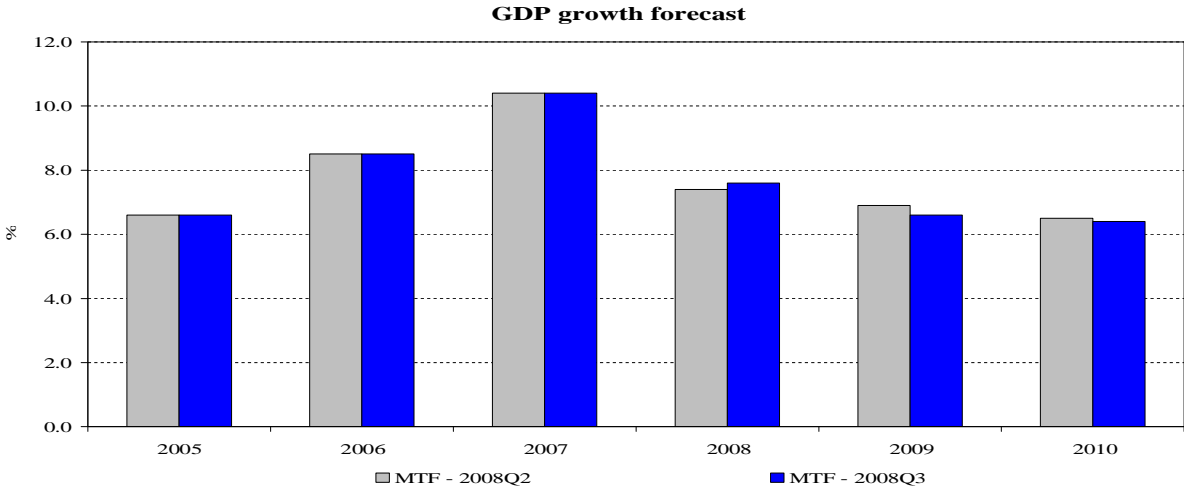
In the medium-term forecast of the real economy for the years 2008-2010, the rate of real GDP growth has been changed in comparison with the MTF-2008Q2 (the figure for 2008 is 0.2 of a percentage point higher, and those for 2009-2010 are lower by 0.3 and 0.1 of a percentage point respectively, due to the appreciating Slovak koruna).

In the forecast of household final consumption, the rate of growth is expected to slow in 2009 (by 0.2 of a percentage point compared with the MTF-2008Q2), owing to a fall in real wages (by 0.3 of a percentage point).

In the general government sector, the growth of final consumption in 2008 is faster than according to the MTF-2008Q2, mainly as a result of higher wages and social payments (on the basis of data from the first quarter of 2008). The forecasts for 2009 and 2010 have remained unchanged: final consumption will depend on the general government’s budgetary policy, overall economic development, and inflows from EU structural funds. In the current tax revenue forecast (July 2008), the SR Ministry of Finance expects increased tax revenues in 2009-2010 compared with the General Government Budget for 2008-2010 and the Draft General Government Budget for 2009-2011. This represents an upside risk for the development of final consumption in the general government sector.

In 2009-2010, gross fixed capital formation is expected to grow year-on-year by 7.3% in real terms, but the rate of growth is likely to slow in 2010. The growth of fixed investments should be stimulated by the stable business environment and the entry of Slovakia into the euro area. The year 2009 is likely to witness a record increase in inflows from EU funds on a year-on-year basis. An upside risk is represented by the planned motorway investments and/or the announced investments in the power industry.

Looking at net exports, the current forecast predicts a smaller average contribution to GDP growth for 2008-2010 (by 0.1 of a percentage point), compared with the April forecast. The smaller contribution of net exports in 2008 can be explained by developments in the first quarter of 2008, coupled with a deterioration in the services balance and increased imports for final consumption. In 2009-2010, the balance of services is also likely to deteriorate and exports are expected to be affected unfavorably by the appreciation of the Slovak koruna, which will reduce their value.



The current medium-term forecast (MTF-2008Q3) expects an upward change in the rate of nominal wage growth in 2008 (to 8.7%). The stronger nominal wage growth reflects the current trend in nominal wages as well as the expected continuation of the accelerated wage growth, mainly in the general government sector. At the same time, the forecast expects that the impact of wage tariff revaluation under the collective agreement will fade away in the second half of 2008. In 2009-2010, the average nominal wage growth is likely to accelerate somewhat, as a result of a steeper rise in consumer prices. On the other hand, the wage growth

is likely to be dampened by the appreciation of the koruna, which may reduce the growth of koruna revenues of companies. This may result in a slower-than-expected wage growth or a slowdown in the creation of new jobs.

The current medium-term forecast (MTF-2007Q3) expects a faster rate of employment growth (ESA95) in 2008 (2.1%) than the previous forecast. In 2009-2010, employment growth is likely to slow somewhat in comparison with the April forecast, due to the strengthening exchange rate of the Slovak koruna. Employment growth is likely to be influenced by the favorable economic environment. The main factors in employment growth will again be investment and demand for services.

The number of unemployed in the first quarter of 2008 was approximately at the level predicted by the NBS in the MTF-2008Q2. This indicates that the rate of unemployment (based on a Labor Force Sample Survey) may reach the same figure as according to the MTF-2008Q2 (10.0%). In 2009-2010, the unemployment rate is unlikely to be influenced significantly by a moderate slowdown in employment growth and is expected to reach the same figures as according to the MTF-2008Q2 (9.8% in 2009 and 9.6% in 2010).

Within the current account balance, the economy is expected to maintain its strong export performance in the years 2008 to 2010, with the rate of export growth exceeding the 15% level in 2008 and reaching approximately 10% in 2009 and 2010 (in line with the previous forecast). Companies with foreign capital participations are expected to continue in having a significant influence; the strongest growth is expected in the automotive and electronics industries. The balance of trade is expected to be influenced significantly throughout the projection horizon by the higher oil price forecasts, which have already been reflected in the previous developments. The expected rise in raw materials prices is also a major factor in the slightly increased export and import volumes in comparison with the MTF-2008Q2. In the second half of 2008, the growth in the volume of imports is likely to be supported by a possible increase in goods imports for final consumption, resulting from the anticipated growth in final consumption. The negative impact of the appreciating SKK/EUR rate from the first half of 2008 is expected to appear in 2009 and 2010, in the form of a moderate slowdown in export performance and in increased imports (owing to the stronger exchange rate, Slovak producers may be pushed out of the market by foreign producers). Compared with the previous forecast, the trade balances predicted for the individual years are worse by more than Sk 20 billion (EUR 0.7 billion).

The export performance of the economy will be supported, particularly in 2009, by the anticipated entry of Slovakia into EMU. Since there will be no transaction costs, exports are expected to be influenced mostly favorably; this influence is likely to produce an improvement in the trade balance in the long term. On the other hand, the trade balance may be influenced unfavorably over the period under review by the potential construction of new nuclear and steam power plants (which are currently under consideration), which may cause a temporary deterioration in the trade balance through increased imports.

The rather unfavorable trend in the balance of services in the final quarter of 2007, and its deterioration in 2008, were the main factors that caused the originally estimated surplus in the services balance to decrease in the following years. The new assumptions of the amount of inflows from EU funds have led to an increase in the estimated deficit in the balance of current transfers in comparison with the previous forecast.

The current account deficit is expected to decrease in line with the previous forecast. The changed estimates of its individual components have led to deteriorations in the deficits predicted for the years 2008 to 2010, by SKK 26 to 35 billion (EUR 0.9 to 1.2 billion).

**Box : Impact of oil prices on the trade balance**

Compared with the previous forecast (MTF-2008Q2), the assumptions about the external environment in the area of raw materials prices have been modified. Oil prices are expected to increase significantly in comparison with the MTF-2008Q2, throughout the projection horizon. In 2008, the price of crude oil is expected to increase by USD 19 per barrel (19%), in 2009 by USD 30 per barrel (30%), and in 2010 by USD 29 per barrel (29%). In koruna terms, the increase in oil prices is more moderate (owing to the SKK/EUR and EUR/USD exchange rates): it is expected to reach 10% in 2008, 11% in 2009, and 9% in 2010.

The expected rise in oil prices is reflected in the increased volumes of exports and imports, with a negative impact on the trade balance. The deterioration in the trade balance in comparison with the MTF-2008Q2 will be caused in large part by the price effect; the trade balance is expected to deteriorate by SKK 11.0 billion (EUR 0.4 billion) in 2008, by SKK 14.0 billion (EUR 0.5 billion) in 2009, and by SKK 12.0 billion (EUR 0.4 billion) in 2010.

The current rapid GDP growth exceeds the expansion of the economy’s production capacity to a negligible extent only. Nor do price developments show signs of an overheated economy. In the period to come, the NBS expects a certain slowdown in the rate of economic growth owing to the strong exchange rate; this will reduce the room for the economy to become overheated. Like according to the previous forecast, price developments are expected to be influenced by factors that are outside the domain of monetary policy – food and energy prices, the contribution of which to the price increase has strengthened in comparison with the previous forecast.

**Output gap forecast**

