NÁRODNÁ BANKA SLOVENSKA
EUROSYSTÉM

Medium-term forecast

Q1
2013

Published by:

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Discussed by the NBS Bank Board
on 26 March 2013.

ISSN 1338-1474 (online)

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1 Summary

The latest Medium-Term Forecast of Národná banka Slovenska (MTF-2013Q1) is based on the most recently published economic growth figures for the fourth quarter of 2012, monthly data on the real economy, forward-looking indicators, and ECB technical assumptions. At the same time, the projection horizon has been extended until 2015. This forecast takes into account the current deterioration in the domestic part of the economy, a slowdown in external demand in the short-term horizon, the worsening labour market situation, lower price pressures, and, on the other hand, moderately positive monthly data.

From the detailed figures for economic growth in Slovakia's main trading partners in the fourth quarter of 2012, it is clear that external demand for Slovak products and services slumped towards the end of last year. The assumption is that external demand is bottoming out and will remain unchanged in the first quarter of 2013; it is then expected to pick up gradually, before accelerating more sharply in 2014 and 2015.

The Slovak economy's growth is expected to reflect developments in external demand, while at the same time being considerably slowed by headwinds from the domestic side of the economy, which is feeling the repercussions of fiscal consolidation, among other things. **The worse than expected domestic economic situation had the greatest impact on this forecast.** Given the weaker economic activity, it is assumed there will be limited scope for job creation and the labour market situation will therefore remain difficult. As external demand picks up in the medium-term horizon, the Slovak economy is expected to accelerate as well, bringing about an increase in employment and ultimately a decline in the unemployment rate.

The macroeconomic outlook has again deteriorated from the outlook in the previous forecast (MTF-2012Q4), due largely to the worse than projected position of the economy at the beginning of the reference period. **Economic growth is expected to slow to 0.7% in 2013, and then to accelerate to 2.8% in 2014 and 3.8% in 2015.** The output gap will become more negative in 2013 due to the slowdown in economic growth, and is expected to close over the projection horizon. In the absence of cost-push and demand-pull factors, inflation is assumed to remain stable at just below 2% over the projection horizon. **The inflation rate is expected to slow to 1.9% in 2013 and 1.6% in 2014, before increasing slightly to 1.9% in 2015**.

The risks to this forecast's projections for the real economy are predominantly on the downside and relate mainly to developments in external demand. The risks to the inflation projections are moderately on the upside and largely concern movements in oil prices and external inflation.

2 Current developments in the external environment and Slovakia

The global economy outside the euro area continued to grow

The world economy expanded moderately in the fourth quarter of 2012, although its growth remains at low levels. Global economic recovery continues to be slow and volatile, but there are signs that growth is picking up. The greatest obstacles to stronger economic growth in advanced countries remain the euro area debt crisis, weak labour markets, and the financial situation of households. Downside risks to economic growth include the necessity for advanced economies to implement further fiscal consolidation measures and, in the United States, the prospect of the automatic activation of spending cuts. Although developing economies decelerated to some extent during 2012, they are gradually recovering and this trend is expected to continue in 2013. The OECD's composite leading indicator (CLI)[1] of economic confidence in OECD countries increased moderately in the fourth quarter of 2012, and therefore, despite being at low levels, points to optimism about the future economic situation.

The euro area fell further into recession.

The euro area economy contracted by 0.6% in the fourth quarter of 2012, shrinking for a fourth consecutive quarter and by a greater margin than it did in the third quarter. Even some of the strong core euro area countries saw a decline in GDP. Economic activity remains heavily affected by the repercussions of the debt crisis, and although confidence among firms and consumers has improved slightly, it is still far below the long-run average.

Global developments are heterogeneous

Economic activity in the OECD area decelerated sharply in the last quarter of 2012, with a majority of advanced countries falling into recession. The Japanese economy shrank for a third successive quarter and the UK economy was also in recession. In the United States, GDP growth was far slower than in the previous quarter, reflecting the effects of a decline in private inventories and a marked decrease in government expenditure. There were positive contributions from private consumption (which increased at a moderately faster pace due largely to growth in the durable goods segment), from residential and non-residential investment, and from net exports (which, however, continued their declining trend confirmed by the third quarter figures). The ISM[2] manufacturing index declined slightly in the fourth quarter; however, it increased at the end of the period, and in January and February 2013, thereby indicating an improvement in sentiment.

In China, economic activity slowed moderately in the fourth quarter and the main drivers of growth were private consumption and investment. Although the PMI[3] manufacturing output index rose back above its no-growth threshold in the fourth quarter, it gradually deteriorated over the course of the quarter and this trend continued into March.

The Slovak economy contracted

The worsening euro area recession affected Slovakia more severely in the fourth quarter, with economic activity decelerating sharply. The slowdown was greater than projected in the December Medium-Term Forecast, and after adjusting GDP for the effect of a one-off VAT payment (Box 1), the economy actually contracted in the fourth quarter. This was confirmed by monthly industrial data. The most significant downward pressure on growth came from the automotive industry, which was responding to weakening demand. The decline in external demand was accompanied by a further slump in the domestic part of the economy which added to the fourth-quarter headwinds. The slowdown in imports went hand in hand with a decline in domestic demand, and resulted in net exports making a positive contribution to GDP growth.

1 The CLI indicators are published by the OECD on a monthly basis – the latest available data, published in March 2013, are for January 2013.

2 The ISM (Institute for Supply Management) Purchasing Managers Index – the index is a barometer of business sentiment in US industry. Although the survey collects data only from the industry sector, it is treated as a key indicator of sentiment in the economy as a whole.

3 The China Manufacturing PMI – an indicator of economic sentiment in Chinese industry published by the Chinese National Bureau of Statistics.

Box 1

ANALYTICAL GDP TIME SERIES AND FORECAST BASED ON SO SR DATA

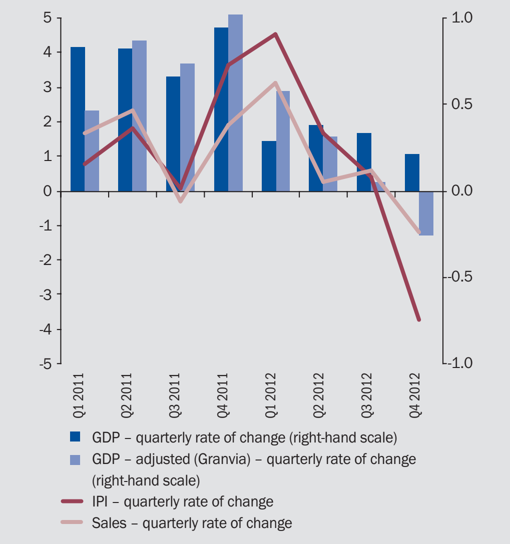
According to figures published by the Slovak Statistical Office (SO SR) at the beginning of March, the Slovak economy's seasonally adjusted growth rate in the last quarter of 2012 was 0.2% quarter-on-quarter. **Since the monthly indicators pointed to slower growth, it was necessary to look more closely at the breakdown of GDP growth.**

On the production side, the revised historical data showed a marked annual decline in taxes in the last quarter of 2012 and, by contrast, a significant increase in taxes in the fourth quarter of 2011. The cause was a single VAT payment made by the PPP concessionaire for the R1 high-speed road project, following the completion of the first stage of the project. Another such VAT payment, only lower, was made in the third quarter of 2012 after completion of the second stage of the project (the Banská Bystrica bypass). These payments may have affected the seasonal adjustment procedure and therefore distorted the picture of the economy's current position (i.e. the position on which the forecast was based). It is crucial for the production of forecasts that the economy's position is correctly determined.

The next step was therefore (on the basis of information from the Slovak Finance Ministry) to break down the amount and attach the individual figures to periods during which the whole R1 construction project could feasibly be completed. These data were then used to adjust the quarterly GDP figures (nominal, seasonally adjusted), with the paid VAT being spread over the period when the work was being carried out. **After seasonal adjustment,[4] a new GDP time series was established, and this so-called "analytical time series" showed that GDP for the fourth quarter declined in quarter-on-quarter terms., The new time series probably captures the real state of the economy more accurately**, as can be seen in Chart B.

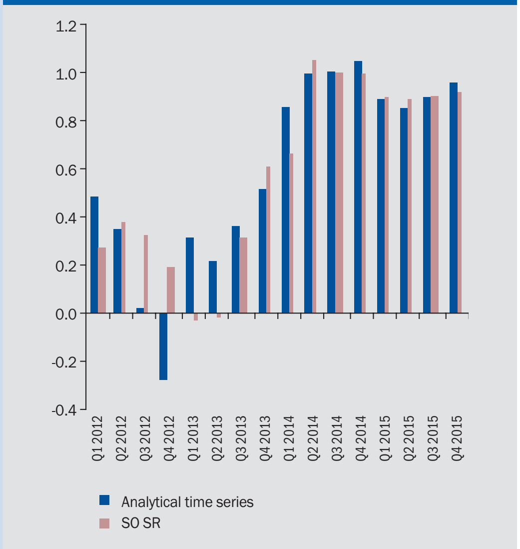
Such an adjusted analytical time series was used in the production of the latest forecast.[5]

Chart A Economic activity (percentage changes; constant prices)



Source: SO SR, NBS calculations.

Chart B GDP forecast (quarterly percentage changes; constant prices)



Source: SO SR, NBS calculations.
Note: The first quarter of 2013 is expected to see a correction of the negative development in the last quarter of 2012. Further evidence for this assumption can be found in the monthly data for January 2013.

The resulting time series and forecast data then had to be incorporated into the orginal seasonally adjusted data of the SO SR,[6] for the

4 The amounts were converted to real values using a GDP deflator and then seasonally adjusted in the DEMETRA+ program using the TRAMO/SEATS procedure in standard setting (RSA5). In order to preserve the annual amounts of seasonally adjusted and unadjusted GDP, the ECOTRIM program was used to calculate differences between the two time series.

5 The seasonally adjusted level of the Slovak economy in the fourth quarter was lower than that reported by the SO SR; this fact contributed to the deceleration of economic growth in 2013.

6 In other words, the opposite approach to that taken for the analytical time series.

reporting and general application of the official data. The final seasonally adjusted amounts for the projection horizons were combined with the SO SR's official historical data, and then the annual and quarterly rates of change were calculated. Consequently, the official NBS forecast is based on the SO SR's official historical data.

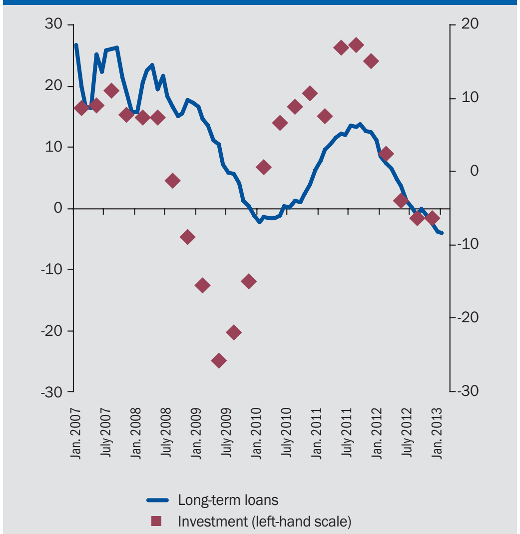
Besides providing a more realistic view of the economy, the purpose of producing an analytical time series is also to avoid a situation in which whenever new quarterly data are published, the historical profile of quarter-on-quarter data is changed due to the seasonal adjustment procedure (usually in the most recent quarters; the more distant history remains therefore almost unchanged).[7] **Therefore it can be expected that as the data gradually mounts, the quarterly profile for 2012 will change and become more in line with the analytical time series. Since the officially published quarterly changes in the historical time series of GDP will probably change after each new quarter, the analytical time series of GDP is being used in order to better assess the current state of the economy as well as the forecast of future developments.**

Decline in investment activity

The domestic demand component that recorded the largest decline was investment activity, which was affected by the adverse economic outlook, persisting uncertainty, and falling profitability. Banks tightened credit standards moderately in the fourth quarter of 2012, and there were both supply and demand factors behind the decline in lending activity. According to the bank lending survey, firms had less appetite for loans since they were cutting back on capital investments.

Non-financial corporations in particular were reining in investment plans, as developments in the manufacturing and construction sectors demonstrate. Investment in infrastructure construction slumped amid a slowdown in the construction of motorways and high-speed roads. Household investment surprisingly grew year-on-year in the fourth quarter of 2012, due to an increase in purchases of apartments and houses. This trend is confirmed by figures for newly finished and unfinished apartments. The housing market may also have benefited from low property prices and the fact that lending growth remains relatively strong.

Chart 1 Investment and long-term loans (annual percentage changes)



Source: SO SR.

Private consumption still depressed

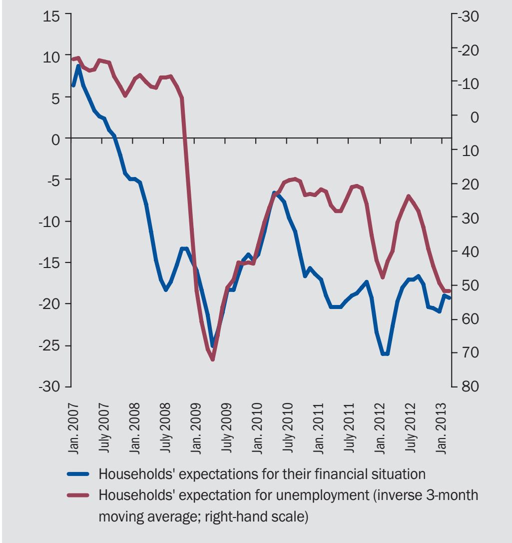
The slump in consumption demand became more pronounced in the fourth quarter of 2012 and may be partly explained by an increasing propensity to invest. The main cause, however, was decelerating growth in real disposable income and the deteriorating situation in the labour market. Although firms took a cautious approach to wages, compensation growth accelerated in the fourth quarter, probably because bonuses for 2013 were paid in 2012 so as to avoid an increase in related taxes and contributions. It is assumed that this higher wage growth was a one-off and will weigh on wage growth in the first quarter of 2013. Other components also contributed to the higher increase in household disposable income. A significant rise in social benefits was observed in the fourth quarter, probably caused by automatic stabilisers (increases in the number of unemployed and the number of people incapable of work). Among self-employed people, income growth fell slightly owing to the slowdown in economic activity. Consumer demand is heavily affected by consumer confidence, which although it has

7 *For example, the latest published data caused a sharp downward revision of economic growth in the first three quarters of 2012, to the surprise of the analytical community.*

Chart 2 Consumer sentiment and private consumption (balance of responses; annual percentage growth)

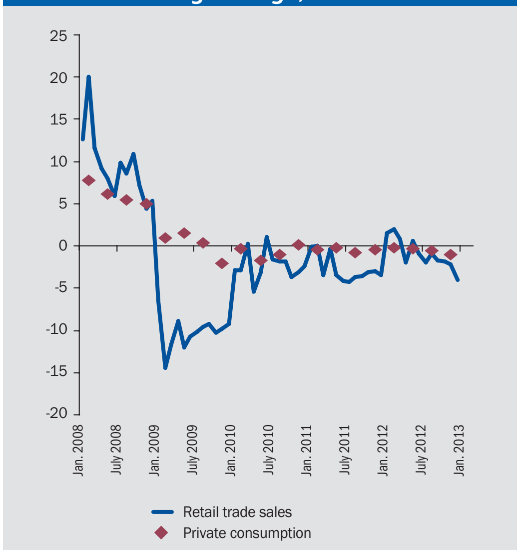
Source: SO SR.

Chart 4 Household expectations (balance of responses)



Source: SO SR.

Chart 3 Retail trade sales and private consumption (annual percentage real growth; 3-month moving average)



Source: SO SR.

stabilised, remains relatively subdued. So far in the first quarter of 2013, short-term indicators show no signs of an improvement in consumer confidence.

Household lending growth remains relatively strong

The last quarter of 2012 saw further consumer lending growth, as a consequence of declining real income and the continuation of household consumption spending levels; this trend, however, is unsustainable and may lead to a future decline in consumer demand as households face loan repayments that could significantly cut into their disposable income. This scenario is not yet weighing on household expectations, and although consumers are negatively assessing their financial situation, their assessments are no long deteriorating.

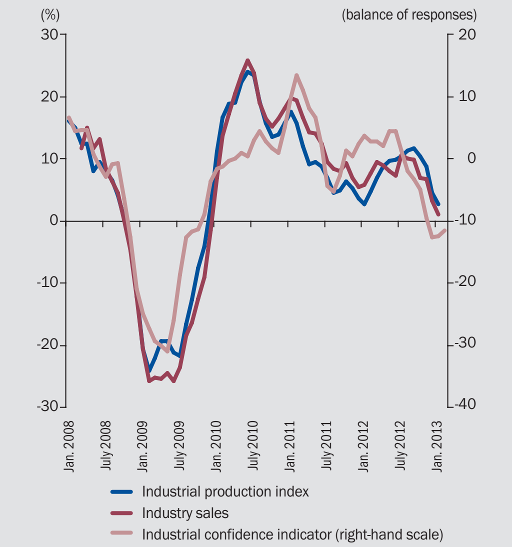
Government cut spending

Government consumption declined year-on-year in the fourth quarter of 2012 due to a decrease in intermediate consumption. However, compensation in the public sector increased markedly after a long period of stagnation or decline.

Moderate optimism at the beginning of the year

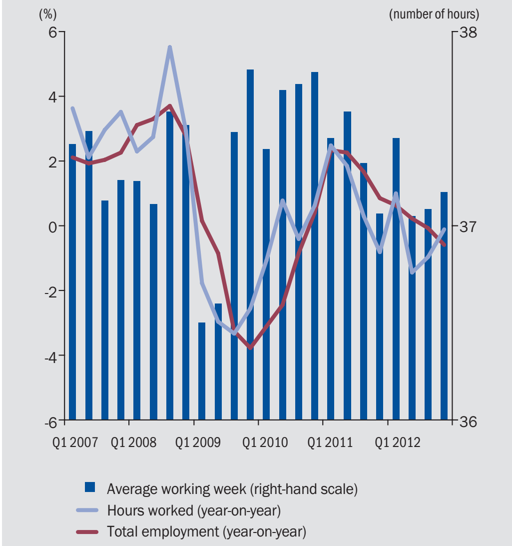
The latest "hard" and "soft" indicators for the economy suggest there has been no more than a correction of December's adverse developments. The monthly data for January 2013 (production and sales) were moderately better than expected, but sentiment indicators showed a slight deterioration in firms' expectations (particularly in key industrial sectors). In industry there was a further deterioration in production expec-

Chart 5 Current indicators (3-month moving average; annual percentage growth; balance of responses)



Source: SO SR, European Commission.

Chart 6 Current labour market indicators (percentages; number of hours)



Source: SO SR.

tations, while in other sectors sentiment stabilised, albeit at relatively low levels.

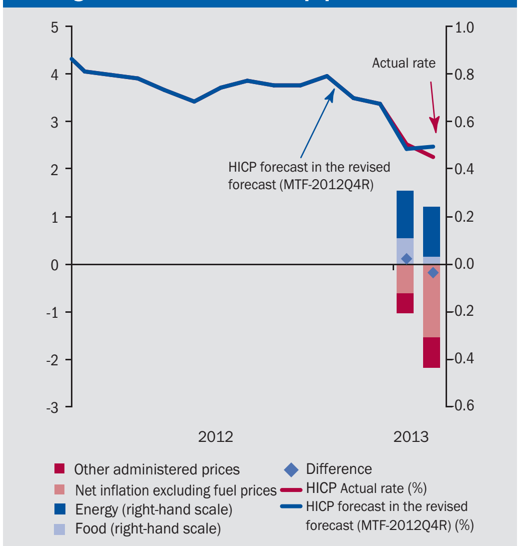
The labour market situation still difficult

The labour market situation remained difficult in the fourth quarter of 2012; the quarterly decline in employment increased to -0.4% (compared to -0.1% in the previous two quarters), although that figure was marginally better than projected in the revision of December's Medium-Term Forecast. Most of the job losses were in industry, which faced shrinking order books and therefore lower production, sales and exports. Employment fell also in services, amid a decline in domestic demand. The increase in the unemployment rate was rather sharp, despite being tempered by the reclassification of some unemployed people as economically inactive due to incapacity to work. Once, however, the period of their incapacity to work ends, the opposite effect will be observed, with a negative impact on the unemployment figures for the first quarter of 2013. Signs of such development were provided by the monthly data for December 2012 and January 2013. The slight drop in the unemployment rate in February was caused by a higher number of unemployment entering internships. Without this factor the unemployment rate would have remained at around January's level. The decline in the number of hours worked slowed in the fourth quarter of 2012, which was reflected in economic activity. As the number of people in employment fell, the average working week increased slightly. As a consequence nominal wages increased.

Recent slowdown in inflation

Inflation was more or less in line with projections made in the revised Medium-Term Forecast

Chart 7 Inflation (annual percentage changes; contributions in p.p.)



Source: SO SR; NBS forecast.

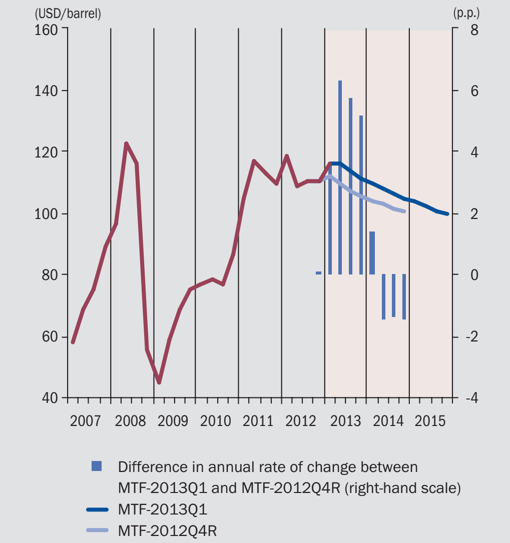
(published in January). The inflation rate slowed notably in the last quarter of 2012, and the disinflationary trend continued in the first two months of 2013. The headline rate approached 2% (at 2.2% in February). The price growth was driven mainly by cost-push factors (commodity prices), although their contribution declined. In the absence of demand-pull pressures, net inflation excluding fuel prices was lower than expected.

3 Technical assumptions[8]

After the publication of the previous projections, the **exchange rate** of the euro against the US dollar remained volatile. The euro appreciated until February and then began to weaken, its movement affected mainly by the situation in specific euro area economies as well as in the United States. The current forecast assumes that the exchange rate of USD per EUR[9] will be 1.35 over the projection horizon.

The **oil price** was relatively stable in the fourth quarter, and at an average of USD 110 per barrel it was slightly higher than in the previous quarter. The oil price movements reflected, on the one hand, fears about geopolitical tensions and, on the other hand, weak demand and concerns about the global economic situation. Although oil production declined in January, it is expected to rebound to its original level during the course of the year. In January the International Energy Agency increased its estimate for oil demand in 2013. This forecast assumes that the average barrel price in US dollars will be USD 114.1 in 2013, falling to USD 106.8 in 2014 and USD 101.3 in 2015, and that the price in euro will be €84.8 in 2013, €79.2 in 2014 and €75.2 in 2015.

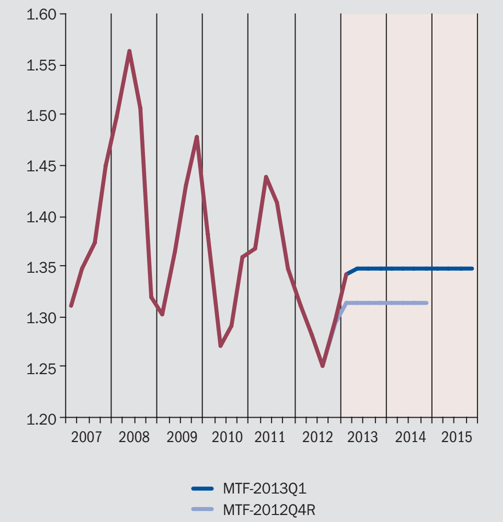
Chart 9 Price per barrel of Brent crude oil (USD)



Source: NBS, ECB.

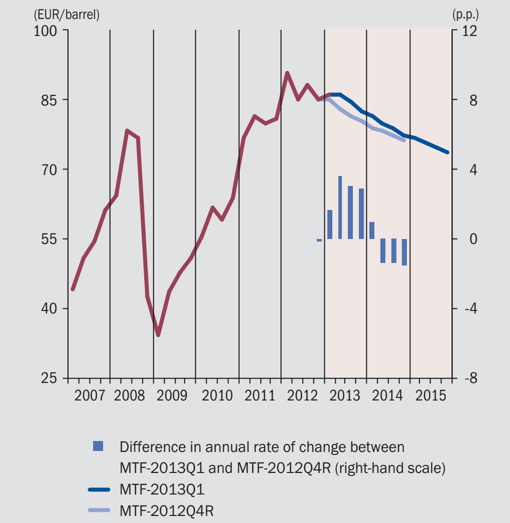
Prices of **non-energy commodities** increased moderately in the fourth quarter of 2012. Metals prices accounted for most of that growth, as they climbed towards the end of the period amid elevated demand for metals. By contrast, agricul-

Chart 8 USD/EUR exchange rate



Source: NBS, ECB.

Chart 10 Price per barrel of Brent crude oil (EUR)



Source: NBS, ECB.

8 *The technical assumptions of the Medium-Term Forecast, as well as the assumption for developments in the international economy, are based on the „ECB Staff Macroeconomic Projections for the Euro Area" of March 2013, with information available up to 16 February 2013.*

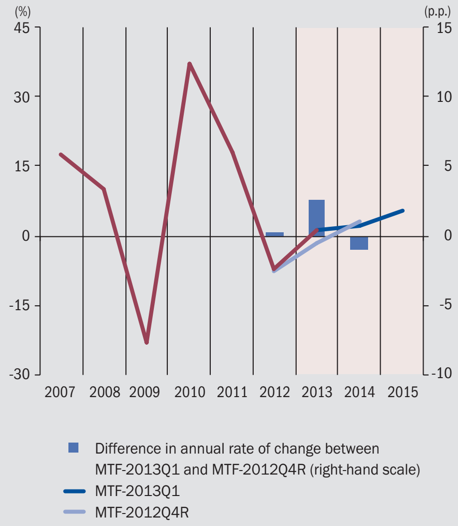
9 *The bilateral USD/EUR exchange rate is assumed to remain unchanged over the projection horizon at the average level prevailing in the ten-working day period ending on the cut-off date.*

tural commodity prices declined in the fourth quarter. This forecast assumes that non-energy commodity prices will increase by 1.2% in 2013, by 2.3% in 2014, and by 5.2% in 2015.

The average level of **short-term interest rates**[10] (three-month EURIBOR) is expected to reach 0.3% in 2013, 0.5% in 2014, and 0.9% in 2015.

This forecast explicitly takes into account the fiscal consolidation measures introduced for 2013 and 2014 in the General Government Budget for 2013–2015, and it also accepts the assumption that the government will meet its target of reducing the general government deficit to 3% of GDP in 2013. Also taken into account were measures to offset the deteriorating macroeconomic situation and tax revenue shortfalls, including hikes in non-tax revenue and cuts in expenditure.

Chart 11 Non-energy commodity prices (annual percentage changes)



Source: NBS, ECB.

10 The technical assumptions about interest rates and commodity prices are based on market expectations, with a cut-off date of 14 February 2013. The assumption for short-term interest rates is of a purely technical nature.

4 Forecast for the external environment

The global economy grew by 3.1% in 2012 and it is projected to grow by 3.2% in 2013, gradually accelerating to 4.0% in 2014 and 4.1% in 2015. The main downside risks to the growth forecast are the euro area sovereign debt crisis, the uncertainty about how to proceed with fiscal consolidation in the United States, the possibility of a severe slowdown in global trade, and the geopolitical tensions in certain regions of the world.

Euro area GDP in the fourth quarter of 2012 was negatively affected by a decline in domestic demand. Exports also fell, reflecting the weakness of trade developments observed at the end of last year. The unemployment rate remained high, while business and consumer confidence remained low, although showing a modest improvement. Since these factors are unlikely to fade quickly, the forecast assumes that real economic activity will do no more than stabilise gradually in the first half of 2013 and then progressively recover in the following period. This outlook is supported by the gradual strengthening of euro area foreign demand, although that is projected to be partly moderated by strengthening of the euro. The recovery is also expected to be supported by a favourable impact on domestic demand of the accommodative monetary policy stance, as well as by the favourable impact on real disposable income of a decline in inflation. However, domestic demand is assumed to recover only gradually over the projection horizon, given the low levels of sentiment and the remaining deleveraging and fiscal consolidation needs in some countries. In annual terms, real GDP is expected to grow by -0.5% in 2013 and by 1.0% in 2014.[11] The ECB projections for the euro area were made before the results of the Italian elections and the escalation of tensions in Cyprus. Among the risks to the projections are developments in financial markets as well as in the euro area banking sector. Lending is declining at a surprisingly fast pace in several euro area countries, and it will therefore be important to monitor the outstanding amount of non-performing loans.

The average HICP inflation rate in the **euro area** is expected to decline gradually over the projection horizon, from 2.5% in 2012, to between 1.2% and 2.0% in 2013, and between 0.6% and 2.2% in 2014. Inflation in 2013 is expected to slow due to the continuing decline in energy price inflation and, to a lesser extent, food price inflation. Turning to domestic price pressures, the annual growth rate of compensation per employee is expected to remain subdued over the projection horizon on account of the weakness of the labour market situation. In 2013, however, unit labour cost growth is projected to remain relatively elevated as productivity growth will be substantially weaker than wage growth. In 2014 unit labour cost growth should decline, since economic activity is expected to grow faster than employment. As part of fiscal consolidation plans, increases in administered prices and indirect taxes are expected to make a relatively large contribution to inflation over the projection horizon, even if this consolidation is slightly less pronounced than in 2012.

The annual **growth rate of global trade** fell to 2.8% in 2012, from 6.3% in 2011. It is expected to accelerate slightly in 2013 (to 3.7%) and more markedly in 2014 (6.5%) and 2015 (7.1%). The growth of **Slovakia's export markets**[12] fell sharply in 2012, to 0.9%, from 6.2% in 2011. It is projected to increase modestly in 2013 (to 1.3%) and then to accelerate further in 2014 (5%) and 2015 (6.1%).

11 The ECB projections assume that average annual real GDP growth will range between -0.9% and -0.1% in 2013 and between 0.0% and 2.0% in 2014. These values represent a median of ranges (arithmetic average).

12 The assumptions for growth in Slovakia's export markets are based on information with a cut-off date of 8 March 2013 and refer to expert estimates made by NBS analysts.

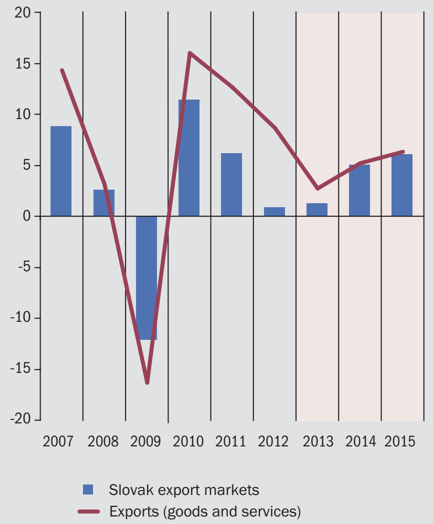
5 MACROECONOMIC FORECAST FOR SLOVAKIA

5.1 ECONOMIC GROWTH

RECOVERY OF EXPORT MARKETS TO BE SLOW IN THE FIRST HALF OF 2013 AND THEN ACCELERATE OVER THE MEDIUM-TERM HORIZON

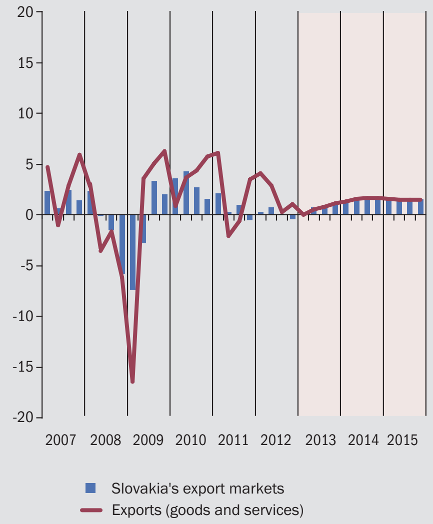
Export markets contracted in the last quarter of 2012, but should begin to recover slowly in the following period. Firms' export expectations improved in the first quarter of 2013, and firms expect their competitive position to strengthen in non-EU markets while remaining unchanged in EU markets. The automotive industry's exports are assumed to be at the same level in 2013 as in 2012. In the following period, car export growth is expected to match demand for products and services.

Chart 12 Forecasts for external demand and for Slovak exports of goods and services at constant prices (annual percentage changes)



Source: NBS.

Chart 13 Forecasts for external demand and for Slovak exports of goods and services at constant prices (quarterly percentage changes)



Source: NBS.

INVESTMENT DEMAND TO DECLINE FURTHER IN 2013 AND THEN PICK UP SLIGHTLY OVER THE PROJECTION HORIZON

After falling substantially in 2012, investment demand is expected to decline further in 2013. This trend should be partially mitigated by a moderate increase in so-called "core" private investment[13] and continuing investment in the automotive industry (a one-off positive effect in 2012 and 2013). Low investment activity is expected to reflect a combination of factors, including a decline in firms' profits, the still elevated uncertainty among investors, the tightening of credit standards, the impact of fiscal consolidation measures, and low utilisation of production capaci-

Table 1 Forecast for gross fixed capital formation (annual percentage changes)

	2013	2014	2015
Gross fixed capital formation (total)	-0.4	0.6	4.0
GFCF (adjusted to exclude one-off investment in the automotive industry)	-0.7	2.7	4.0

Source: SO SR, NBS.

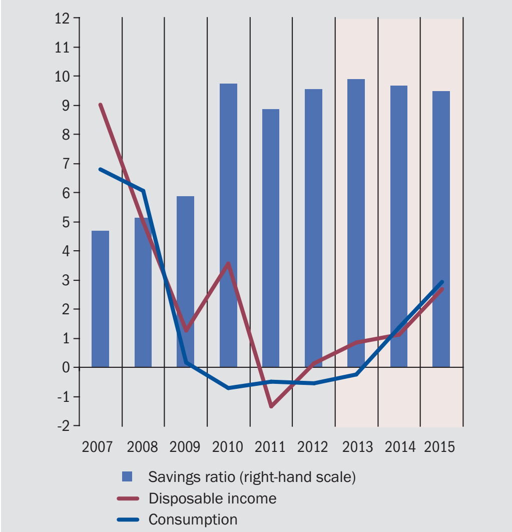
13 Core private investment is considered to be private investment excluding one-off factors.

ties. Banks tightened credit standards slightly in the last quarter of 2012, and they are expected to tighten them further in the first quarter of 2013. The reduction in lending activity is expected, however, to reflect also a fall in demand for loans. Corporate demand for capital investment loans is declining, and therefore the effect of the accommodative monetary policy stance on the real economy is expected to be very limited. In the first quarter of 2013 firms assessed their utilisation of production capacities as inadequate (far below the long-run average), and they are therefore expected to ramp it up this year. Only later will they invest more heavily into production capacities.

Private consumption to continue falling in 2013 and to recover tentatively in subsequent years

The decline in private consumption in 2013 is technical in nature, with the negative impact of a pronounced decline in the second half of 2012 carrying over into the full-year figures for 2013. In quarterly terms, private consumption is not expected to decline further this year. Monthly indicators point to a stabilisation of the labour market situation, while consumers' expectations for future income and unemployment are no longer sliding into more negative territory. Real disposable income growth is expected to increase moderately, based on a relatively small rise in nominal wage growth and mainly on a slowdown in the inflation rate. Nominal compensation per employee will rise substantially in 2013, but wage growth is expected to account for only around half of that increase; the rest should be attributable to an administrative decision to raise taxes and levies as part of the fiscal consolidation efforts. These increases are assumed to dampen disposable income growth among self-employed people as well. The assumptions for household income include no increase in public sector wages, which, given the environment of persisting uncertainty and disinflation, is not expected to have any significant effect on wage bargaining in 2013. Wage bargaining is not expected to become a significant factor until the economy accelerates (mainly after 2015), when its effect will be reflected in rising consumption. As confidence gradually returns and the economy picks up, the savings ratio is expected to decline in line with consumption growth.

Chart 14 Income, consumption and the savings ratio of households (annual percentage changes; %)



Source: SO SR, NBS.

General government spending to decline in 2013

Real general government final consumption is projected to continue declining in 2013, based on the assumption that the general government deficit target of less than 3% of GDP in 2013 will be met. Account is also taken of consolidation measures adopted in 2012. Wages of public sector workers other than teachers are expected to be frozen and intermediate consumption is projected to decline. No assumptions have yet been made for expenditure-based consolidation measures over the projection horizon. Nominal wage growth is expected to be moderately higher than inflation growth. Public sector wages are projected to increase up to the level of private sector wages by the end of the projection horizon, possibly reflecting a combination of their catch-up in previous years and the political cycle. Nominal intermediate consumption is expected to increase in line with inflation. Health-care expenditure over the projection horizon is coupled with the growth rate of health-care contributions.

The revision of December's Medium-Term Forecast (MTF-2012Q4R) included a slight upward revision of the risk of a shortfall in fiscal and contribution revenue. In other words, under NBS's baseline scenario, the gap between these revenues and the budgeted amount would be €495 million.[14] By the cut-off date for this fore-

14 Using the so-called IFP calculator.

cast, the government had announced additional revenue and expenditure consolidation measures worth €144 million in total (Table 2). Taking into account the expenditure-side risks specified by the Fiscal Responsibility Board and the amount of the budget reserve, the uncovered risks to meeting the general government deficit target of 3% of GDP amount to €0.4 billion (or 0.5% of GDP). This forecast (MTF-2013Q1) assumes that the general government deficit in 2013 will be close to target.

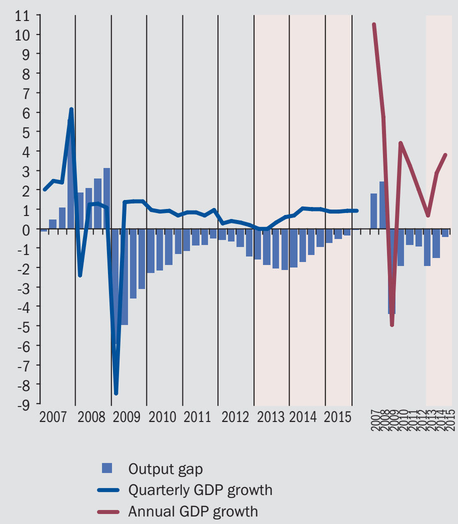
Imports expected to grow as economy recovers

The declines in import intensity and in imports for the domestic part of the economy in the last quarter of 2012 were probably of a temporary nature, which in the context of total GDP were offset by a decrease in the statistical discrepancy item. Consequently, this forecast projects an upward correction in imports in the first quarter of 2013, as import growth outpaces export growth. The technical assumption is therefore that import intensity will return to its level of the previous period. Over the projection horizon a gradual acceleration in import intensity will reflect export performance and increasing domestic demand. Import growth will be curbed to some extent by a decrease in import intensity in the automotive industry following the launch of production under an investment project from 2014. It is still assumed that the export-oriented economy will continue to acquire market share. Hence the nominal trade surplus should increase and not be significantly affected by foreign prices.

Growth to slow in 2013 and then accelerate over the medium-term horizon

Economic growth in 2012 mainly reflected developments in export markets. Slovakia's export markets accounted for all the country's economic growth, while the domestic part of the economy remained subdued. In 2013 net exports should again drive growth and the domestic economy is expected to revive on the assumption of a gradual improvement in the euro area situation. **Economic growth is projected to slow to 0.7% in 2013 and then accelerate to 2.8% in 2014 and 3.8%**

Chart 15 GDP and the output gap (%)



Source: SO SR, NBS.

Table 2 Summary of risks to the general government budget for 2013 (EUR millions)

1.	Shortfall in fiscal revenue due to worse than projected macroeconomic developments and the actual tax revenues	-495
2.	Risks on the expenditure side of the budget (specified by the FRB):	275
	– higher than projected expenditure on public health insurance (unbudgeted liabilities)	100
	– over-estimation of local government savings (given lack of scope to directly enforce savings)	175
3.	Budget reserves – one-off revenue from the opening of the second pillar	235
4.	Announced additional measures (spending cuts and an increase in revenues from state-owned companies)	144
	– increase in dividend revenue (from the gas utility SPP and the electricity transmission company SEPS)	69
	– cuts in expenditure on public health insurance	39
	– cuts in expenditure on Operational Programme Transport	26
	– other expenditure cuts	10
5.	Potential risks to the general government budget (1 - 2 + 3 + 4 + 5)	-390

Source: MF SR, FRB, NBS.

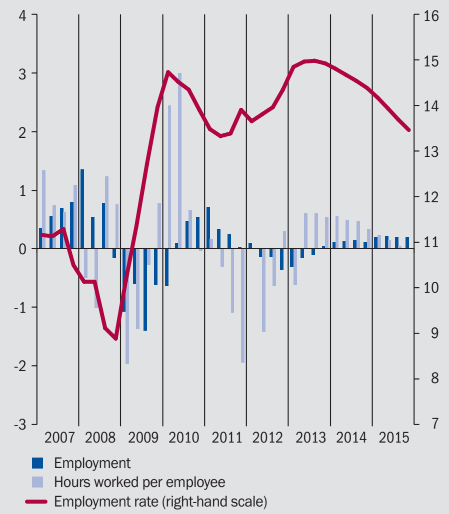
in 2015. Balanced growth is assumed for 2014 and 2015 with both net exports and domestic demand making positive contributions. Given relatively low external demand and weak domestic demand in 2013 (caused to some extent by fiscal consolidation measures), the output gap is expected to widen substantially. Economic growth is projected to be far below potential due to lower utilisation of production and human capacities. The output gap should close gradually over the projection horizon, as both foreign and domestic demand accelerate.

5.2 THE LABOUR MARKET

Labour market situation to remain difficult this year and to recover only slowly over the projection horizon

The labour market situation over the next four quarters is expected to be significantly affected by a slowdown in economic activity and legislative amendments that enter into force in 2013. Employment growth is projected to reflect economic fundamentals, while being adversely affected by a decline in the number of people employed on limited work agreements (data available in mid-February 2013). Forward-looking indicators in the first two months of 2013 point to a stabilisation in employment, and although employment expectations in a majority of sectors are negative, they are no longer deteriorating. Employment is not projected to begin increasing until the beginning of 2014. With economic growth accelerating over the projection horizon, employment growth is expected to become faster only in 2015. This projection also reflects the unemployment rate as estimated from the labour force survey (LFS). The rate is expected to increase as high as 15% in 2013 and then gradually decline down to 13.5% at the end of the projection horizon. In contrast to the registered unemployment rate, which stabilised at the beginning of the year, the LFS is probably capturing with a lag a reclassification of people who are incapable of work, and is probably also capturing people whose limited work agreements have terminated and who subsequently do not need to reregister at a labour office (providing they were already registered). The assumption for the years ahead is that as economic activity grows, firms will increase labour productivity by raising the number of hours worked and that therefore employment will not rise significantly. An increase in employment alongside a plateauing of the number of hours worked is not projected until 2015.

Chart 16 Employment, hours worked and the unemployment rate



Source: SO SR, NBS.

5.3 LABOUR COSTS AND PRICE DEVELOPMENTS

Labour costs to rise slowly

Labour costs are expected to remain subdued amid the ongoing uncertainty, as firms buffer

Table 3 Compensation per employee (annual percentage changes)

	Economy as a whole	Economy as a whole, real terms	Public sector	Public sector, real terms	Private sector	Private sector, real terms
2012	2.0	-1.6	1.5	-2.1	1.7	-1.9
2013	2.8	0.8	1.1	-0.8	3.3	1.3
2014	3.4	1.0	2.3	0.0	3.7	1.4
2015	4.3	2.0	4.2	1.9	4.3	2.0

Source: SO SR, Eurostat, NBS calculations.
Note: deflated by the private consumption deflator.

Table 4 Wages (annual percentage changes)

	Economy as a whole	Economy as a whole, real terms	Public sector	Public sector, real terms	Private sector	Private sector, real terms
2012	2,5	-1,1	3,7	0,1	2,2	-1,4
2013	1,4	-0,6	0,1	-1,9	1,8	-0,2
2014	3,4	1,7	2,3	0,7	3,7	2,0
2015	4,3	2,3	4,3	2,3	4,3	2,3

Source: SO SR, Eurostat, NBS calculations.
Note: deflated by the CPI.

themselves to some extent by not proportionally reflecting labour productivity gains in wages. This will allow firms to increase their profit margins without having to raise prices. The risk remains that as labour productivity gains mount, they will translate into higher wage growth within the projection horizon.

Inflation to remain stable at close to 2% over the projection horizon

After the inflation rate increased substantially in 2011 and 2012, due mainly to increases in commodity prices, taxes and fees, it is now decelerating. Over the projection horizon, inflation is expected to fluctuate at close to 2%, assuming that energy commodity prices decline, agricultural commodity prices are stable, and that developments in the real economy have a dampening effect (with weak consumer demand putting downward pressure on prices). Labour costs, too, are expected to check inflation. All inflation components are projected to decelerate, and the energy component should enter deflationary territory. The slowdown in non-energy industrial goods inflation is expected to reflect lower increases in import prices and in domestic producer prices. Food prices should increase only moderately given the stabilisation of agricultural commodity prices in world markets. Services price inflation is projected to slow on the basis of weak consumer demand, but as the economy revives in the medium-term horizon, it should begin to accelerate moderately.

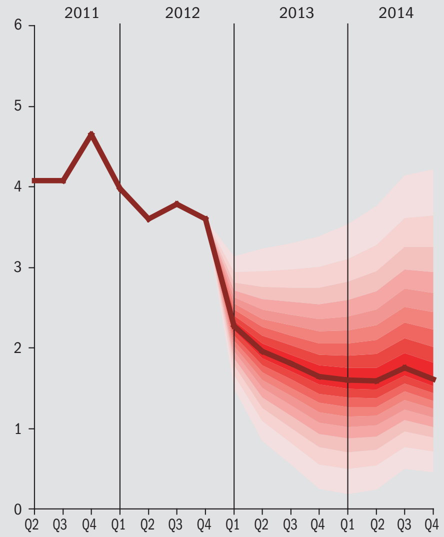
6 Risks to the forecast

The risks to the medium-term forecast for the real economy are predominantly on the downside. The principal risk is in foreign demand, which could face headwinds from deteriorating sentiment in financial markets, from developments in the banking sector and, especially in 2014 and 2015, from euro area countries having to reduce fiscal deficits.

The risk in the labour market is that the situation will be slightly worse than projected. The decline in the number of people employed on limited work agreements could have a greater negative impact on employment. Likewise, the decrease in the number of self-employed people could have a similar impact. While some them may have switched their form of business (by establishing a firm), others may have ceased to be active.

The risks to the inflation forecast over the whole projection horizon are moderately on the upside. They include mainly technical assumptions for the exchange rate, external inflation, and the price of oil. There are slight downside risks from lower than projected foreign demand and compensation per employee.

Chart 17 HICP inflation forecast (%)



Source: SO SR, NBS.

Table 5 Risks to the forecast

	2013	2014	2015
GDP	↓ Sovereign debt crisis, fiscal consolidation measures	↓ Fiscal consolidation measures, sovereign debt crisis, external demand	↓ External demand, ↑ Political cycle, wage developments
Inflation	↓ Domestic demand, labour market ↑ Technical assumptions	↑ Technical assumptions	↑ Technical assumptions

Source: NBS.

7 Comparison with the previous forecast

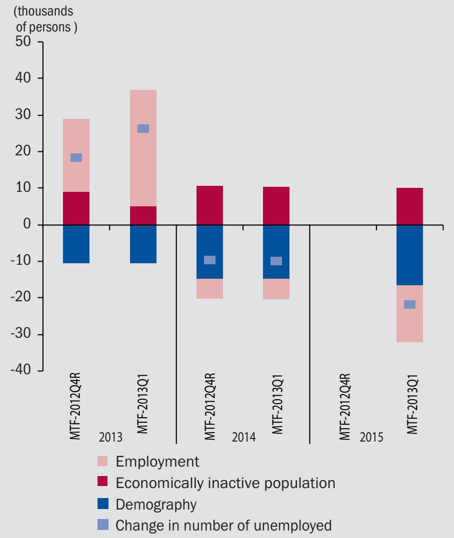
Looking at the technical assumptions of this forecast in comparison with those of the previous forecast (MTF-2012Q4), external demand has been revised down over the projection horizon and most markedly in 2013. The euro exchange rate is projected to be stronger, which should put downward pressure on imported inflation. Oil price projections have been revised up slightly in both 2013 and 2014. Fiscal consolidation measures remain unchanged.

Recent developments have substantially altered the outlook for the domestic part of the economy

The most pronounced change from the previous forecast stemmed from developments in the real economy in the fourth quarter of 2012. The economic growth forecasts for 2013 and 2014 have been revised down in the light of the weaker than expected performance of the domestic part of the economy, and also due to slower growth in external demand.

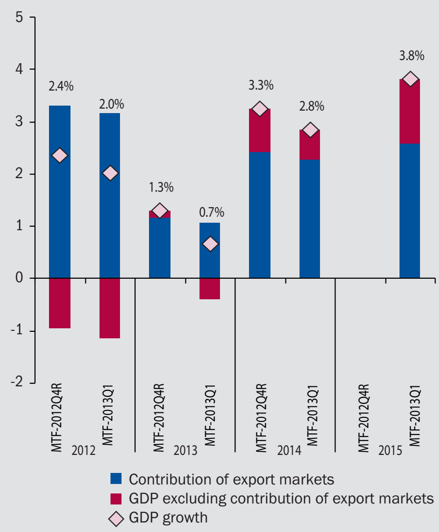
In the projections for 2014, by contrast, the contribution of the domestic part of the economy has been revised up and the contribution of net exports has been revised down. The projected contribution of investment is expected to be higher due to a reassessment of the timing of a one-off investment in the

Chart 19 Comparison of labour market indicators (contributions to unemployment)



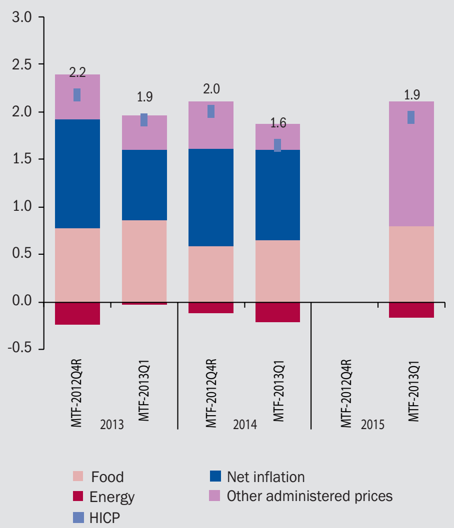
Source: NBS.

Chart 18 Composition of GDP growth (annual percentage changes; contributions in p.p.)



Source: SO SR, NBS.

Chart 20 Comparison of inflation projections broken down by component (p.p.; %)



Source: NBS.

automotive industry (the bulk of which was made in 2012). The growth projection for economic activity has been revised down, which is reflected also in other economy indicators. A downward revision of labour productivity growth has had a negative effect on the projections for compensation per employee and for private consumption. Although compensation per employee growth in 2013 is higher than projected in the previous forecast, that is solely due to the effect of strong wage growth in the fourth quarter of 2012.

Given the deterioration in the economic situation, the labour market projections have been revised to include a larger drop in employment and higher unemployment rate.

The inflation forecast has been revised down slightly to take account of more favourable recent developments and a decline in oil prices over the projection horizon. Other prices indices have been adjusted accordingly. A downward revision of foreign prices over the projection horizon was also reflected in domestic prices.

Table 6 Medium-Term Forecast (MTF-2013Q1) – main macroeconomic indicators (year-on-year changes)

Indicator (annual percentage changes unless otherwise indicated)	2012	2013	2014	2015	2013	2014	2015
	Actual	Forecast P1Q-2013			Difference with MTF-2013Q4A		
Prices							
HICP inflation (average)	3.7	1.9	1.6	1.9	-0.3	-0.3	-
CPI inflation (average)	3.6	2.0	1.6	2.0	-0.2	-0.4	-
ULC[1] (Compensation per employee at current prices / labour productivity at constant prices according to ESA 95)	0.1	1.2	0.7	1.1	0.8	0.3	-
Labour productivity (ESA 95)	2.0	1.5	2.6	3.1	-0.6	-0.4	-
Compensation per employee (ESA 95)	2.0	2.8	3.4	4.3	0.3	0.0	-
Nominal wages[2]	2.5	1.4	3.4	4.3	-0.1	0.0	-
Real wages[3]	-1.1	-0.6	1.7	2.3	0.1	0.2	-
Economic activity							
Real GDP	2.0	0.7	2.8	3.8	-0.6	-0.5	-
Final consumption of households	-0.6	-0.3	1.4	2.9	-0.3	0.0	-
Final consumption of general government	-0.6	-0.4	1.6	1.9	0.4	0.1	-
Gross fixed capital formation	-3.7	-0.4	0.6	4.0	-2.6	0.6	-
Exports of goods and services	8.6	2.7	5.2	6.3	-0.3	-0.4	-
Imports of goods and services	2.8	2.8	4.1	6.0	-0.9	0.4	-
Real gross disposable household income	0.1	0.9	1.1	2.7	0.6	-0.1	-
Output gap (% of potential output)	-0.9	-1.9	-1.5	-0.4	0.2	0.2	-
Labour market							
Employment (ESA 95)	0.1	-0.8	0.2	0.7	-0.1	0.0	-
Employment in persons (thousands, ESA 95)	2 209.4	2 190.9	2 196.1	2 211.8	-2.8	-2.7	-
Unemployment rate (LFS[4]; percentage)	13.9	14.9	14.6	13.8	0.3	0.3	-
Number of unemployed people (LFS[4]; thousands)	377.5	403.6	393.6	371.7	7.0	6.7	-
Balance of payments							
Economic openess (% of GDP)	186.0	186.9	189.7	193.5	-0.2	-0.1	-
Balance of trade (% of GDP)	5.1	4.9	5.7	6.3	1.0	0.3	-
Balance of services (% of GDP)	0.4	0.4	0.4	0.5	0.0	0.0	-
Current account (% of GDP)	2.3	2.9	3.8	4.6	0.7	0.1	-
Current and capital account (% of GDP)	4.2	4.7	5.5	6.3	0.7	0.0	-
External assumptions for the forecast							
External environment							
Slovak foreign demand growth	0.9	1.3	5.0	6.1	-0.7	-0.1	-
Technical assumptions							
Exchange rate (USD/EUR)[5]	1.28	1.35	1.35	1.35	3.1	3.1	-
Brent crude oil (USD per barrel)[5]	111.9	114.1	106.8	101.3	5.4	4.5	-
Brent crude oil (EUR per barrel)[5]	87.1	84.8	79.2	75.2	2.9	1.9	-
Oil price inflation (in USD)	0.8	2.0	-6.4	-5.1	5.2	-0.7	-
Oil price inflation (in EUR)	9.3	-2.7	-6.5	-5.1	2.7	-0.8	-
Non-energy commodity price inflation (in USD)	-7.2	1.2	2.3	5.2	2.7	-1.0	-
3M EURIBOR (%)	0.6	0.3	0.5	0.9	0.1	0.2	-

Source: NBS, ECB, SO SR.
1) ULC – unit labour costs.
2) Average monthly wages based on SO SR statistical reporting.
3) Wages based on statistical reporting and deflated by CPI inflation.
4) Labour force survey.
5) Changes against the previous forecast in %.

Table 7 Medium-Term Forecast (MTF-2013Q1) – main macroeconomic indicators (quarter-on-quarter changes)

Indicator (quarterly percentage changes unless otherwise indicated)	2012				2013				2014				2015			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
	Actual				Forecast											
Prices																
HICP inflation (average)	2.0	0.7	0.3	0.6	0.7	0.4	0.1	0.5	0.6	0.3	0.3	0.3	0.7	0.5	0.5	0.5
ULC[1)] (Compensation per employee at current prices / labour productivity at constant prices according to ESA 95)	0.1	1.3	0.3	0.7	-0.1	0.0	0.4	0.1	0.3	0.0	0.1	0.2	0.4	0.4	0.4	0.4
Labour productivity (ESA 95)	0.2	0.5	0.5	0.6	0.3	0.1	0.4	0.6	0.6	0.9	0.9	0.9	0.7	0.7	0.7	0.7
Compensation per employee	0.5	1.8	0.5	0.8	0.5	0.4	0.9	0.7	0.8	0.9	0.9	1.1	1.1	1.0	1.1	1.2
Economic activity																
Real GDP	0.3	0.4	0.3	0.2	0.0	0.0	0.3	0.6	0.7	1.1	1.0	1.0	0.9	0.9	0.9	0.9
Final consumption of households	0.0	-0.3	-0.4	-0.4	0.2	0.1	0.1	0.2	0.4	0.5	0.6	0.7	0.8	0.8	0.8	0.8
Final consumption of general government	2.0	-2.4	0.9	-0.6	0.7	-0.8	0.0	0.4	0.4	0.5	0.9	1.0	0.2	0.3	0.3	0.5
Gross fixed capital formation	-5.1	-1.7	-0.4	0.8	-0.7	0.1	0.3	0.4	-1.3	0.9	1.0	1.0	1.0	0.9	0.9	1.0
Exports of goods and services	4.1	2.9	0.2	1.1	0.0	0.5	0.8	1.1	1.3	1.6	1.6	1.6	1.6	1.4	1.5	1.5
Imports of goods and services	1.6	3.0	1.9	-2.1	1.2	1.1	1.0	0.9	0.5	1.3	1.5	1.5	1.5	1.4	1.5	1.5
Real gross disposable household income	0.6	0.0	0.2	0.5	0.6	-0.1	-0.4	0.2	0.4	0.5	0.6	0.6	0.7	0.7	0.8	0.8
Output gap (% of potential output)	-0.6	-0.7	-0.9	-1.4	-1.6	-1.9	-2.0	-2.1	-2.0	-1.7	-1.4	-1.0	-0.7	-0.5	-0.3	0.0
Labour market																
Employment (ESA 95)	0.1	-0.1	-0.1	-0.4	-0.3	-0.2	-0.1	0.0	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2
Unemployment rate (LFS[2)]; percentage)	13.7	13.8	14.0	14.4	14.8	15.0	15.0	14.9	14.8	14.7	14.5	14.4	14.2	13.9	13.7	13.5

Source: NBS, ECB, SO SR.
1) ULC – unit labour costs.
2) Labour force survey.