



REVISED MONETARY PROGRAMME OF THE NBS FOR 2003 WITH A MEDIUM-TERM FORECAST FOR THE YEARS 2004 TO 2006

On 30 May 2003, the Bank Board of the National Bank of Slovakia approved the Revised Monetary Programme for 2003, which includes a medium-term forecast for the years 2004 to 2006. The material is based on actual macro-economic developments in 2002 and economic indicators for the first few months of 2003. The full version of the Revised Monetary Programme is available on the home page of the National Bank of Slovakia, at <http://www.nbs.sk> in the section 'Monetary Policy'.

In 2002, consumer prices showed weaker dynamics than were projected in the Monetary Programme. This was due primarily to a more favourable trend in food prices, coupled with lower cost effects, mainly in connection with the development of fuel prices, which were, together with food prices, defined as a risk area in price development. The real economy also



followed a different course of development, when gross domestic product increased at constant prices by 4.4% in 2002 (according to preliminary data), exceeding the upper limit of the projected interval. This was due to a different trend in domestic demand, with gross capital formation being affected by an unexpected increase in the volume of inventories. Other macro-economic indicators were basically in line with the projected figures.

In 2003, the slowdown in inflation has come to a halt, due primarily to an increase in regulated prices. Compared with the predictions of the NBS, however, price development follows a more favourable course, due to the same factors as in 2002, i.e. continued fall in food prices and a favourable trend in fuel prices. In the real economy, production in industry and construction shows dynamic growth, which, accompanied by favourable development of the trade balance on the export side, creates – despite the expected effect on demand of an increase in regulated prices – conditions for further economic growth.

The short-term predictions of the Revised Monetary Programme for 2003 did not give rise to substantial changes in the macro-economic scenario, which was outlined in the Monetary Programme of the NBS for 2003. The most significant changes in the short-term predictions of the NBS show, that the favourable trend in foreign

trade from the end of 2002 and the first months of 2003, has been taken into account, together with the relatively pronounced appreciation of the Slovak koruna vis-à-vis the US dollar, and that the estimate of inflation has been revised, partly due to the actual development of food prices, but mainly in connection with the increase in excise duties with effect 1 July

2003. On the whole, the development of the Slovak economy is expected to be affected, in line with the original assumptions of the NBS, by demand-based pressure through a reduction in the deficit in public finance (fall in the fiscal deficit, from 7.2% of GDP to 4.9% of GDP), and by a supply-side shock arising from the scope of adjustments to regulated prices and increases in excise duties.

The rate of inflation in 2003 is expected to be determined, first and foremost, by adjustments to regulated prices and indirect taxes, as well as the secondary effects of these administrative measures. The NBS expects no marked inflationary effect from demand factors in 2003 with regard to the predicted excess of growth in labour productivity over growth in real wages, and a slowdown in the dynamics of private consumption due to absorption of part of household incomes through an increase in regulated prices and indirect taxes.

Allowing for the change in excise duties to take effect from 1 July 2003, the NBS has increased the estimated rate of overall inflation in the Revised Monetary Programme. The year-end figure is expected to fluctuate between 8.4% and 9.7% (originally 7.7% and 9.7%). In comparison with the original Monetary Programme, however, average inflation is expected to reach a slightly lower value within the range of 8.3 – 8.8% (originally



8.2 – 9.3%). As a result of the previous course of price development, mainly in food prices, core inflation is also expected to reach a lower figure, within the range of 2.1 – 3.6% (originally 2.7 – 5.0%).

The main risks involved in the estimate of inflation are the developments in oil prices on the world market, the exchange rate of the koruna, and the change in the range of administrative measures with an impact on price levels.

The revised estimate of developments in foreign trade takes into account the relatively strong dynamics of Slovak exports, as well as the fall in the rate of growth in imports in connection with the appreciation of the Slovak koruna vis-à-vis the US dollar, which is reflected in the lower figure for imports of raw materials and semi-finished goods in terms of koruna. At the same time, the forecast takes into account the actual developments in imports over the first months of the year, mainly the smaller volume of imports in the category 'machinery and transport equipment'. With regard to the expected trend in the trade balance, and in other components of the current account, including the effect of changes in methodology, the current account deficit is expected to reach 4.5 – 5.0% of GDP in 2003, compared with the originally estimated 6.2% of GDP.

The expected improvement in foreign trade led to an increase in the predicted rate of economic growth, from 3.9% to 4.1% (medium value of the estimate). Within the scope of domestic demand, the NBS expects no marked deviations from the original Monetary Programme, with the exception of a change in the volume of inventories. The relatively dynamic growth in the volume of inventories in 2002 would presuppose a reduction in the predicted rate of growth in investment demand (gross capital formation). However, growth in fixed investments is more or less in line with the assumptions of the original programme. Fixed investments are expected to have the same share in GDP as in the Monetary Programme for 2003. In the area of consumer demand, the NBS expects somewhat weaker dynamics in private consumption in comparison with the Monetary Programme for 2003, since the faster price increase (connected with an expected increase in excise duties in July) will probably lead to slower growth in real wages.

Monetary policy will be implemented in an environment marked by relatively dynamic economic growth, which, however, will be dependent to a considerable extent on foreign demand (if domestic demand weakens) and the competitiveness of Slovak exporters. Hence, in implementing its monetary policy, the NBS will continue to take into account a wide spectrum of economic variables, i.e. price development, foreign trade, public finance, economic growth, including its structure, and last but not least, the exchange rate of the koruna, especially in

relation to economic fundamentals and their role in a small open economy. In addition to an unfavourable effect on the competitiveness of the Slovak economy, an unjustified appreciation in the exchange rate could, in future, turn out to be a stumbling block for the country in fulfilling the criteria for entry into the euro area.

In regulating the exchange rate of the Slovak koruna vis-à-vis the reference currency (euro), the NBS will also apply money market operations, mainly in reaction to short-term fluctuations.

In the medium term, the NBS will focus its monetary policy on the attainment of its primary objective – the maintenance of price stability, in order to create conditions for fulfilment of the Maastricht criteria and the entry of Slovakia into the euro area.

In connection with the creation of conditions for entry into EMU (Economic and Monetary Union), a medium-term forecast was prepared for the Slovak Republic for the years 2004 – 2006. The forecast parameters of economic development include the effects of Slovakia's entry into the European Union, as well as the implementation of pro-reform policies.

The most significant change in the medium-term outlook in comparison with the original estimates, is the inclusion of the draft tax reform from the beginning of next year, which is reflected mainly in the forecast of price developments for 2004. In the following period, the effect of administrative measures on inflation is expected to diminish step by step and the process of disinflation to accelerate towards the level of the relevant Maastricht criterion.

The rate of price increase is expected to slow gradually as a result of monetary policy implementation, consolidation in public finance, and improvement in the fiscal deficit in line with the medium-term outlook of the Ministry of Finance and the platform of the Government, to the level prescribed as a condition for admission to the euro area.

The timing of Slovakia's entry into EMU is not part of the revised medium-term forecast for the years 2004 – 2006. This issue will be analysed in a joint strategic paper prepared by the National Bank of Slovakia and the Ministry of Finance, which will be approved, after public discussion, by the Government of the SR. The Monetary Programme for 2004, which will include a schedule of individual steps of economic policy to be taken on the road towards the single currency, will also be based on this paper. The joint strategy is expected to represent a significant means of communication for the NBS and the Government of the SR in presenting the objectives of Slovakia to the public and domestic entities, as well as foreign institutions. At the same time, this strategy will provide a basis for the formulation of medium-term monetary policy objectives in the Monetary Programme of the NBS for 2004.

From the presentation of Marián Jusko, NBS Governor, at the press conference held on 3 June 2003