REVISED MONETARY PROGRAMME OF THE NBS FOR 2002

The Revised Monetary Programme (RMP) is a standard material that follows up the Monetary Programme approved in December 2001. Compared with the Monetary Programme, the values in the RMP have been adjusted and updated as per definitive figures for 2001 and it takes into account the development of macroeconomic indicators since the beginning of 2002. The full version of the Revised Monetary Programme including developments in 2001 and revised outlook for 2003 – 2005 is available on the NBS website in the Monetary Policy section.

Inflation

In the Monetary Programme of the NBS for 2002, core inflation at the end of the year 2002 is expected in the interval from 3.2 to 4.7 percent. A slowdown of the deregulation process compared with the previous years constituted assumptions for a significant reduction of cost pressures, which should reflect in a decline of headline inflation. The prediction of development of consumer prices was based on an assumption of stabilization of prices of energy and industrial raw materials, crude oil prices within the OPEC reference interval (22 to 28 USD/barrel) and a stabilized development of the exchange rate. Persisting high unemployment, but above all domestic competitive environment and satisfaction of demand by foreign supply should be the major mitigating factors of core inflation. According to the MP 2002, headline inflation at the end of the year should reach a value within the interval 3.5 to 4.9 percent. This corresponds with average inflation in the interval from 4.1 to 4.9 percent.

Development of consumer prices so far is at the lower half of the interval expected in the Monetary Programme of the NBS, when year-on-year inflation in April 2002 was 3.6 percent and core inflation was 2.6 percent. Favorable development was recorded in particular in the segment of market services. Their year-on-year price dynamics dropped from 8.4 percent in 2001 to 3.5 percent in April 2002.

From domestic factors, as expected in the MP 2002 price development was influenced in particular by a slowdown of the deregulation process compared with the year 2001. In line with expectations of the Monetary Programme, at the beginning of the year within regulated prices an administrative upward adjustment of heat prices by 7 percent came into effect, which caused a slowdown of year-on-year inflation by 2.8 percentage points.

Within the structure of core inflation, price development until April 2002 indicated some differences compared with expectations in the MP 2002. An absence of inflation pressures causes to a greater extent on a general decline of the dynamics of consumer price growth.

This is most visible in the development of prices of market services, because in this segment a more significant than expected slowdown of price growth has taken place. Development of prices of market services that should be characterized by higher income elasticity however confirms that rising demand factors (growing real wages, increasing domestic demand) at present do not represent a sufficient impulse to accelerate price growth in the non-tradeable sector. A return to year-on-year growth of prices of market services to a level of about 7 percent can only happen in case of more visible demand pressures, which however we do not expect in the year 2002.

Decelerated price growth of market services significantly reduced also the so-called dual inflation (the difference of the price growth rate of market services and tradable goods without food). In April, dual inflation was 1.9 percentage points while in 2001 it represented around 7 percentage points. This indicates that a major part of dual inflation from 1999 to 2001 was not caused by Balassa-Samuelson effect, but by transmission of secondary effects of increased input costs (not wages) into consumer prices of market services.

The tendency of declining core inflation should continue in the course of the whole first half of 2002. In June it could reach a level of about 2 percent. The declining trend of core inflation in the first half of the year should to a great extent be the consequence of diminishing secondary effects of higher input costs of last year. In the second half of 2002, the trend should reverse and core inflation should grow again. In the course of the year, apart from aforementioned secondary effects, the trend of year-on-year inflation should be determined in particular by differing development of prices of food and motor fuels compared with their development in two half-year periods of 2001. While in the first half of 2001 the year-on-year growth of food prices accelerated, in the second half of the year food prices decreased (the mitigating effect in this period was supported by a significant decrease of motor fuel prices). A change of trend of the inflation rate in the second half of 2002 could be slightly pro-inflationary influenced by an anticipated recovery of external demand accompanied by price rises of industrial commodities.

Inflation estimate for the year 2002

	Price growth in percent Dec02/Dec01 (share in percentage points of total growth)			
	MP 2002		AMP 2002	
	min.	max.	min.	max.
Total	3.5	4.9	3.5	4.9
Regulated prices	4.7 (1.24)	5.5 (1.44)	3.4 (0.80	4.3 (1.02)
Influence of changes of indirect taxes in non-regulated prices	0.00	0.00	(0.41)	(0.41)
Core inflation	3.2 (2.28)	4.7 (3.42)	3.2 (2.33)	4.7 (3.52)
thereof: Food	1.8 (0.41)	4.0 (0.92)	2.4 (0.50)	4.4 (0.92)
Tradable goods (without food)	2.4 (0.85)	3.2 (1.10)	3.2 (1.15)	4.3 (1.58)
Market services	6.5 (1.03)	8.8 (1.40)	3.7 (0.67)	5.6 (1.02)

The influence of individual factors on the price level should be in line with expectations of the MP 2002 in the remaining months of the year. Their non-inflationary influence should continue. Determining mitigating factor in the development of core inflation will be the competitive environment and satisfying domestic demand by low imported inflation. Within the basic structure of core inflation, its volatility, similarly as in previous years, will be increased by food prices, in particular of so-called unprocessed food (fruit, vegetables, meat).

One of the few cost factors in 2002 should be the price of crude oil on the world markets. While the crude oil price drop in the fourth quarter of 2001 represented a mitigating effect on inflation in 2001, a return of prices of this strategic commodity into its reference interval (22-28 USD/barrel) means a pro-inflationary impulse for 2002. The effect of higher prices of motor fuels could in part be compensated by anticipated more favorable development of prices in other groups in the consumer basket. Inflation estimate in the RMP 2002 is based, similarly as in the MP 2002, on the assumption of prices of crude oil maintained in the OPEC reference interval. Though the RMP assumed the middle of the OPEC interval, a shift of approximately +/-2 USD/barrel however does not represent a significant risk. A risk could be a price of above 32 USD/barrel or below 18 USD/barrel maintained over a longer period. However, this is not expected to happen this year.

With regard to the aforementioned factors, in particular however the development of market services, it is likely that headline as well as core inflation in 2002 will reach levels at the lower half of the original programme intervals (MP 2002). This would enable narrowing the programme intervals of headline and core inflation. With regard to existing risks in the fiscal area, the NBS is keeping the original Programme intervals. **Core inflation should thus be in the interval 3.2 to 4.7 percent in December 2002. If no additional administrative measures into the development of the price level are made, headline inflation at the end of the year can be in the interval from 3.5 to 4.9 percent, which corresponds to average inflation in the interval from 3.6 to 4.2 percent.**

Risks associated with the inflation forecast for the year 2002

The inflation estimate is based on an assumption that in 2002 no significant measure into the sector of regulated prices will take place. In the opposite instance, headline inflation could exceed the programme interval.

A risk for the development of consumer prices in 2002 can be in nonfulfilment of basic assumptions in the area of public finances and effects associated with it on other macroeconomic variables. A risk of exceeding the planned deficit of the state budget as well as higher wage growth can cause a rise of demand pressure in the second half of 2002. In this environment, undesirable growth of consumer prices could occur.

A risk to inflation estimate for the year 2002 could also be in possible fluctuations of the exchange rate of the Slovak currency. More notable fluctuations of the exchange rate could influence price growth in particular in the tradable sector. With regard to weight representation of this sector in the consumer basket and a higher share of imported goods designed for final consumption, the effect of the exchange rate development could cause exceeding of the values of the programme interval.

Producer prices

According to the Monetary Programme for 2002, growth rate of producer prices in the year 2002 was expected to decrease to an average annual level of 5 percent. The prognosis took into account an increase of natural gas price for the production sector by 19.3 percent and price of heating for households by 7 percent, whereby significant indirect effects of adjustments of regulated prices were not expected. Prognosis come out from assumption of stabilization of crude oil price in the interval between 22-28 USD/barrel and a relatively stabilized development of the exchange rate of the SKK toward the EUR and the USD.

For the period from January to March, industrial producer prices grew year on year on average by 2.1 percent, which was caused primarily by higher prices of electricity, natural gas, steam, and hot water by 12.6 percent (influence of an increase of regulated prices of natural gas by 19.3 percent and heat by 7 percent in January). Prices of mining products and surface mines extraction grew moderately. Prices of manufactured products decreased by 0.6 percent primarily in connection with a price decline of crude oil refinery products. Also lower were prices of wood and wooden products, and prices of chemical products. On the other hand, relatively higher year-on-year growth since the beginning of the year has been represented by prices of other non-metal mineral products and leather and leather products.

From the view of market factors, the development of producer prices in 2002 will be influenced mainly by external prices. It can be expected that despite fluctuations of crude oil prices in the first months of the year, prices of basic world commodities (crude oil, metals) will not have an inflationary effect in the first half of the year, whereby an acceleration of their dynamics could accompany the recovery of the world economy in the second half of the year. In prices of local producers of pulp and paper products, higher demand for raw materials on the world markets will probably appear toward the end of the year. The effect of these external factors should subsequently have a pro-growth influence on prices of remaining production sectors with high energy intensity (construction materials, cosmetics and detergents, food industry).

As far as non-market factors are concerned, average year-on-year growth of producer prices in industry in 2002, in comparison with the MP 2002, should be influenced by changed circumstances:

• a more favorable development of prices of industrial producers in 2001, when their year-on-year growth in December was 3.4 percent, while the Monetary Programme expected growth of 4.5 percent.

• update of the weight system, as well as choice of price representatives within a revised scheme of the industrial producer price index, which should have come into force in 2002, and which at the time when the Monetary Programme was being prepared had not been known yet. The year 2001 was recalculated according to the new scheme, which caused that the growth of industrial producer prices at the end of 2001 decreased from 3.4 percent to 2.2 percent.

While these changed circumstances are influencing industrial producer prices in the downward direction, a pro-growth influence should come from a higher weight of the price of electrical energy, natural gas, steam, and hot water, which in the revised price index increased from 16 percent to 33.9 percent. According to a calculation of the NBS, this represents an increase of average annual price development of industrial producers compared with expectations by 0.5 percentage points.

With regard to aforementioned circumstances, growth of prices of industrial producers could decrease in 2002 compared with the MP 2002 by 1.5 percentage points to an average annual level of 3.5 percent.

Foreign Trade

Balance of payments

The Monetary Programme for 2002 predicted a current account deficit of SKK 81.2 billion and an inflow of resources on the capital and financial account of SKK 178.3 billion.

In the first quarter of 2002 the volume of imports decreased by 2.9 percent and exports by 3.8 percent. Lower exports resulted from lower prices of crude oil, which projected not only into exports of raw materials, but also some chemical products and a higher impact of recession on export of semifinished products, mainly iron and steel, and in particular a further delay of increasing output in the automotive industry.

Together with low price of crude oil, which influenced imports to even a greater extent than exports, a decline of imports unavoidably reflected also in a decline of exports and lower demand for imports of machinery from abroad. This, together with moderate appreciation of the exchange rate of the Slovak currency reflects in the Revised Monetary Programme in lower growth rates of imports and exports in year-on-year terms (in the MP we counted with a stable exchange rate and crude oil price of USD 26 on average.

Development of foreign trade in the first quarter of 2002 along with updated estimates of the volume of exports and imports for the full year led to a slight increase of the current account deficit and its share of GDP compared with the MP. In the RMP, the capital and financial account involves in particular more precise data of privatization revenues (for SPP, Transpetrol, Slovenska poistovna), including the shift of privatization of power distribution networks from 2003 to 2002. The update of the Monetary Programme also involves a higher inflow of short-term capital into the corporate sector, in line with its development and position for financing of the current account deficit in 2001.

The framework theses of foreign trade estimate that were based on an assumption that the first half of the year will be influenced by fading away of world's economic recession from 2001, while in the second half of the year, economy of our largest trading partners would take on an upward trajectory, remained unchanged. Compared with what was assumed in the Monetary Programme, risks emerged in the fiscal sphere with a potential impact on a rising public sector deficit, stimulation of domestic demand, and higher deficit of the trade balance.

Estimates of foreign trade are based on an assumption that the level of the SKK will appreciate toward the USD during the year by 2 percent, while the present level between the USD and the EUR will remain preserved.

If assumptions are fulfilled on which the RMP is based, export from the Slovak Republic in 2002 should reach a level of SKK 660.0 billion and its growth should be 8.1 percent (USD 13.9 billion and 10.0 percent growth). Import for the same period should be SKK 758 billion with year-on-year growth of 6.2 percent (USD 16.0 billion and 8.1 percent year-on-year growth).

Prediction of export is based on its division to three parts. The first part that represents export of raw materials (5 percent of total exports) is based on the development of crude oil prices, their present growth (low crude oil price at the beginning of 2002 moving around 21 USD/barrel was one of the reasons for decline of the exports in the first quarter of 2002). Assumption of crude oil price growth in upcoming months that could mean upholding the average price at the level of 24.5 USD/barrel will lead to growth of export of raw materials in further months, whereby the value of exported raw materials could reach the level of last year.

The second group comprises export of the automotive industry (in 2001, a 15 percent share of total export), where the anticipated start of production of a new type of vehicle should reflect in a year-on-year acceleration of export of this group to by 16 percent. A delay of the launch of the new vehicle from January (MP) to April (RMP) led to a decrease of dynamics of export and subsequently import in the RMP in the group of reprocessing compared with expectations of the Monetary Programme. Export of passenger cars should be an important factor of growth in upcoming months with acceleration in the last quarter of 2002.

Growth rate of other export (80 percent of total export), the volume of which is calculated based on growth of import in partner countries, price growth on world markets, and the influence of appreciation of the Slovak currency on the competitive potential of Slovak production could reach 11 percent. A downward revision of the prognosis of growth of the German economy from 1 percent to 0.6 percent and associated impacts on exports of Slovak semifinished products led to a reduction of estimated dynamics of exports in this group of goods.

Development of domestic demand and inflation in the EU were the main factors on which the prediction of import was made (cleared of import of raw materials and import within reprocessing). Lower growth rate of domestic demand compared with last year will cause that in this part of import, there should be substantially lower growth compared with last year (lower growth is considered also compared with estimates in the MP). A decline of import of machines and equipment in the first quarter shows that specifically this group will have a major impact on the development of import in 2002. In import of raw materials, we assume only a moderate decline compared with 2001. High import intensity of exports will cause that a decline of imports will also result in a lower growth rate of exports.

Current account items in SKK bln.	2002 – MP	2002 – RMP
Trade balance	–92.0	–98.0
Export	720.0	660.0
Import	812.0	758.0
Balance of services	18.6	20.0
Balance of incomes	–16.8	–16.9
Thereof: balance of interest	–14.6	–14.1
Current transfers	9.0	9.0
Current account	–81.2	–85.9
Share of current account of GDP	–7.9	–8.3

Expected more noteworthy demand stimuli on part of public finances will presumably cause a higher trade balance deficit compared with what the Monetary Programme assumed. A negative trade balance should reach SKK 98 billion, and its share GDP 9.5 percent (the MP counted with a deficit of SKK 92 billion).

With regard to results of 2001, the balance of services should increase in value to SKK 20 billion (the MP counted with SKK 18.6 billion). In its structure, compared with original estimates net revenues from tourism were increased and total deficit in other services was revised upward. In the revenues part of tourism, growth is not expected in foreign exchange accounts, and therefore its value is lower than in 2001.

The negative balance of incomes of SKK 16.9 billion and a surplus of current transfers of SKK 9.0 billion were left unchanged.

As a result of the aforementioned changes, the deficit on the current account in the MP of SKK 81.2 billion, i.e., 7.9 percent of GDP will increase in the RMP to SKK 85.9 billion, i.e., 8.3 percent of GDP.

Revised prediction of the capital and financial account assumes a surplus of SKK 244.4 billion (the MP assumed a surplus of SKK 178.2 billion).

SKK billion

Capital and financial account items	2002 MP	2002 RMP
Capital transfers	1.0	5.0
Direct investments	147.0	197.4
In the Slovak Republic	149.0	198.4
FDI – commercial sector	28.5	28.5
FDI – official sector	120.5	169.9
Portfolio investments	20.1	35.4
Remaining long-term financial account	4.8	0.0
Liabilities	4.8	0.0
Government and the NBS	–11.8	–12.5
Commercial banks	0.6	2.6
Corporate sector	16.0	9.9
Short-term financial account	5.3	6.6
Capital and financial account	178.2	244.4

Official sector FDI – from data of the NPF revenues have been included for the sale of SPP, Transpetrol, SLSP, SLKP, VUB, and ZSE, VSE, SSE.

An estimate of capital transfers, the volume of which the MP 2002 assumed at the level of SKK 1 billion has been revised upwards based on an expected inflow of resources from the PHARE programme and programmes of the EU to SKK 5 billion.

Total net inflow of foreign direct investments increased from originally SKK 149.0 billion to SKK 198.4 billion as a result of several rather significant changes on the side of privatization activities (higher price for the sale of SPP, where instead of expected SKK 100 billion the transaction was worth SKK 130 billion, and a shift of privatization of power distribution networks from 2003 to 2002). On the other hand, the RMP does not expect revenues for RIF, Banka Slovakia, and Slovenske pristavy (a total of SKK 6 billion). The inflow of FDI into the commercial sector (apart from privatization resources) should be sufficient to cover about one-third of the current account deficit.

In the original MP portfolio investments (POI) were estimated at SKK 20.1 billion. Their assumed value in the RMP is SKK 35.4 billion, and is based on development in the first months of the year 2002, when commercial banks were selling foreign securities that they bought mainly in 2001.

Within other long-term capital on the liabilities side, the most significant change occurred in the corporate sector. Large volume repayment of financial loans drawn in 2001 indicates higher installments also in 2002. Therefore, an inflow as well as outflow of other long-term capital will be balanced, while the MP assumed a slight inflow of SKK 4.8 billion.

The level of short-term capital should remain at about the value of the MP, whereby its structure would change. In the RMP, we assume an increased level of short-term liabilities, in particular of the corporate sector, which is associated with growing importance of short-term financing of the current account deficit in 2001 and assumed continuation of this tendency in 2002. Moderate increase of short-term liabilities of commercial banks is based on an assumption of growth of short-term loans and is not associated with expectation of an inflow of speculative capital (the volume of SKK deposits in the banking sector in 2002 is expected to remain unchanged compared with the previous year), which with its large volatility could generate pressure on the change rate of the Slovak currency. An increase of short-term assets of the banking sector will be a consequence of a change of the structure of assets of commercial banks, when a shift will take place between securities and deposits (in the balance of payments in the part portfolio investments). This means that sale of securities on the one hand will increase the volume of POI and on the other, these resources will be transformed to deposited assets of commercial banks, whereby the volume of their short-term assets will increase.

Growth of reserves of the NBS by USD 3,336.2 million will be caused not just by higher revenues from privatization, but also a change of the way how privatization revenues are deposited (originally it was assumed that a part of the privatization revenues will be in accounts of the NPF in commercial banks). Foreign exchange reserves until the end of 2002 will reach USD 8,455.3 million and will be sufficient to cover 5.6 months of average import of goods and services.

Surplus on the capital and financial account in 2002 will cover the deficit on the current account to 278 percent, which is primarily related to privatization activities of the government. When activities of the government and the NBS are abstracted within the balance of payments, the adjusted capital and financial account will cover the current account deficit to 93 percent. The remaining part should be financed from a decrease of net foreign assets of commercial banks of SKK 6.2 billion. This volume that represents USD 130 million does not exceed the framework of normal volatility of this item, and we therefore do not assume that the estimated decline of net foreign assets could influence the exchange rate of the Slovak currency.

Gross domestic product

The Monetary Programme of the NBS for 2002 assumed GDP growth at constant prices in the interval from 3.5 to 3.8 percent (middle value 3.6 percent), under the influence of pro-growth effect of foreign as well as domestic demand.

Higher initial base of 2001 (GDP growth by 3.3 percent) and current development of selected indicators of the real economy since the beginning of the year indicated that real GDP growth will be maintained in the interval from 3.5 to 3.8 percent. We assume that GDP growth rate will approach the upper limit of the Programme interval and reach 3.7 percent at constant prices.

In relationship to achieved structure of economic growth in 2001, development tendencies of individual components of domestic demand predicted in the MP 2002 remain almost preserved in the RMP 2002. Major changes in growth rates compared with the Monetary Programme can be assumed in import and export of goods and services.

Compared with the Monetary Programme for the year 2002, its update does not assume a major change of development tendencies of individual components of domestic demand. Domestic demand can grow by 2.5 percent and effective domestic demand that abstracts from changes in inventory and statistical discrepancy could grow by 4.3 percent.

A decline of dynamics of creation of gross capital in the RMP compared with the Monetary Programme is a consequence of a change in inventory in 2001. Last year's increase of inventory greatly exceeded estimates of the NBS (it was the highest since 1993) and thus increased the starting level for 2002. Despite relatively high positive growth of inventory that is expected in 2002 (SKK 19.4 billion) the higher creation last year will subsequently result in growth of gross investments by 0.7 percent.

The Revised Monetary Programme assumes growth of fixed investments by 6.3 percent. Relatively high investment demand can be expected in the business sector, which will be oriented at investments in energy saving, automation, and rationalization of production.

Year-on-year growth of final consumption of households could grow by 3.8 percent. Expected development of final consumption of the government takes into account consumption of nonprofit institutions serving households,

Gross domestic product by sectors (SKK billion in fixed prices of 1995)

	Result 2001	RMP 2002	index 2001/2000	index 2002/2001
GDP in market prices	689.7	715.5	103.3	103.7
thereof:				
agriculture	33.7	34.2	102.5	101.5
Industry total	188.7	198.2	99.9	105.0
thereof: manufacturing	171.5	181.3	105.5	105.7
Construction	21.3	21.3	101.4	100.2
Market services	296.9	310.7	106.5	104.6
thereof: retail, hotels, and restaurants	104.5	110.9	104.8	106.1
transport	59.1	62.3	116.8	105.4
Nonmarket services	87.8	91.3	102.8	104.0
Miscellaneous[1]	61.4	59.8	101.0	97.4

[1] value added tax, excise tax, customs duties, subsidies, input production of bank services

whereby its growth rate should reach 2.5 percent.

In case of these growth rates of individual components of effective domestic demand, its growth (4.3 percent) will remain faster than growth of domestic offer (3.7 percent), which indicates a continuation of an internal imbalance from 2001.

The RMP assumes a deficit of SKK 20.9 billion in fixed prices (Monetary Programme SKK 9.3 billion). Higher deficit compared with the Monetary Programme stems also from the real achieved level of net export in 2001, which significantly exceeded the estimated value in both current prices and fixed prices. In current prices the deficit was SKK 11.2 billion higher, which with regard to more moderate growth of deflators of exports and imports compared with the estimate (in particular under influence of lower growth rate of prices of industrial producers and world prices of raw materials), represented in fixed prices an increase of SKK 13.7 billion.

The share of market services is expected to have a decisive contribution to the creation of GDP. Foreign demand together with an expected contribution of foreign direct investments are creating conditions for a slightly higher share of manufacturing on the creation of GDP. As a result of lowered tax burden, we can expect a decline in creation of GDP in the item miscellaneous. A slight acceleration of GDP growth in association with growing public consumption is expected also in non-market services.

Wages and employment

The Monetary Programme for 2002 assumed year-on-year growth of nominal wages by 7.0-8.0 percent and real wages by 2.4-3.3 percent, at average annual inflation of 4.5 percent (middle of the interval). The National Bank of Slovakia in its Monetary Programme emphasized that it considers 6 percent as maximum desirable nominal wages growth, which is a level that would guarantee faster growth of labor productivity over growth of real wages.

Development of nominal wages in the first quarter of this year confirms expected year-on-year growth in line with the Monetary Programme for 2002. Likelihood of achieving estimated growth stems also from wage development in 2001, which did not greatly differ from starting points of the MP 2002 as well as preliminary results of collective bargaining. According to available information, within collective bargaining a tendency of growth of nominal wages by up to 8 percent is being considered, since there is an effort to balance the extensive decline of real wages from previous years. However, a part of higher level collective agreements are being concluded without resolving wage matters, whereby companies are handling wage questions individually.

Revised Monetary Programme assumes growth of nominal wages by 7.5 percent, which is in the middle of the interval set out in the MP 2002 (7 – 8 percent).

When data of average inflation in RMP 2002 is specified (based on current development of consumer prices in the first four months), growth of real wages can be higher compared with the MP 2002 and reach 3.5 percent.

No major changes are expected in the development of employment compared with the MP 2002. Development in the second half of 2001 and in the first quarter of this year in selected branches signals however that growth rate of employment could be even slower than expected. This means growth can be expected in the interval from 0.6 to 0.9 percent (center of the interval 0.7).

Subsequently to prognosticated economic growth and development of employment, real labor productivity from GDP per employee should grow by about 3 percent (middle of interval). This would mean that real wages would grow faster than labour productivity by 0.6 percentage points. Growth of real wages and labour productivity would be equal only at the lower border of the interval of wage growth assumed in the MP 2002. Growth of nominal wages exceeding the level of 7 percent, which represents real wage growth of 3 percent when the effect of average consumer price growth is taken into account, whereby this wage growth would not be covered by growth of productivity, can constitute a potential demand impulse causing inflation pressures. With regard to development of the trade balance and possible risks in the fiscal area, as well as possible influence of use of privatization revenues for consumption, in the present situation we consider as acceptable growth of nominal wages by a maximum of 6 percent, i.e., up to the level ensuring that productivity growth rate is at least slightly faster than real wage growth, hence not heightening pressure on private consumption.

Public sector

The State Budget Act for 2002 sets the state budget deficit at SKK 38.0 billion and the public sector deficit at SKK 36.8 billion.

Development of tax revenues so far, which constitute about 82 percent of total budgeted revenues, creates good conditions for their fulfillment and possibly moderate overstepping at the end of the year.

However, performance of public finances will be negatively influenced by the use of some privatization revenues, which could stimulate domestic demand by SKK 6 billion to SKK 20 billion, whereby the NBS counts for 2002 with an effect of SKK 10 billion. The fiscal deficit without costs of bank restructuring according to NBS estimates will reach 4.5 percent of GDP (compared with 3.5 percent in the MP 2002).

In IMF methodology that excludes from revenues a part of non-tax revenues stemming from sale of assets, the deficit of public finances would reach 5.5 percent of GDP.

When the deficit of public finances is evaluated however, costs of bank restructuring and exercising state guarantees will have to be taken into account, with regard to the fact that when privatization revenues become exhausted, these will have to be settled directly from the state budget.

National Property Fund

In the Monetary Programme for 2002, the NBS assumed privatization revenues of SKK 120 billion, thereof SKK 100 billion for SPP. With regard to great uncertainly concerning the use of privatization revenues, the NBS assumed the realization of all planned expenditures in the sense of government resolutions (apart from social reform and repayment of government debt), whereby the remaining part was considered for the repayment of domestic debt (SKK 69 billion).

The actual price for the sale of SPP to a strategic investor reached SKK 130 billion, whereby expected revenues from other privatization projects will also be higher (privatization programme was widened by the sale of three power distribution companies). The volume of revenues, or available resources of the National Property Fund (NPF) should thus reach almost SKK 170 billion at the end of 2002 (the volume in the Slovak currency will however depend on the current exchange rate of SKK/USD, at which these revenues will be converted).

The largest volume of privatization revenues is designed for a reform of pension insurance (SKK 66.3 billion). This money should be deposited in time deposit accounts of the NBS and will thus influence the performance of the NBS (increased interest cost). In 2002 and in 2003, this money will not represent an additional impulse for growth of domestic demand or necessitate an increase of the sterilization position of the NBS toward the banking sector. Its effect on domestic demand and higher sterilization can only be expected when this money is gradually released (expected from 2004).

Another important item is SKK 50 billion designated for the repayment of government debt. From the viewpoint of performing monetary policy, the NBS would prefer their use to pay installments of foreign debt, because in 2003 foreign debt of SKK 37 billion will be payable (a majority in the second quarter). Repayment of foreign debt would not influence growth of domestic demand or liquidity of the banking sector. Based on a decision of the government of the Slovak Republic (from May 9, 2002) however, SKK 36.3 billion will be used to settle the deficit of the state budget for 2001 (maturing treasury bills issued in 2001) and SKK 10.4 billion is designed for repayment of domestic debt payable in 2002. This use of privatization revenues will reflect in growth of liquidity of the banking sector, and an increase of the sterilization position of the NBS (by SKK 46.7 billion). Only SKK 3.3 billion was allocated for the repayment of foreign debt, which should be used in 2002. Repayment of both local and foreign debt will result in lowering of the net loan to the government.

Simultaneously, SKK 9.1 billion should be used to buy back bonds in possession of VUB, which basically represents a repayment of the government's domestic debt. On the one hand, this operation will cause a decrease of the net loan to the government, while on the other hand this will increase liquidity of the banking sector and sterilization position of the NBS.

Other purposes of use of privatization revenues are significantly lower by their volume, however, together they represent SKK 44 billion, and their effect on the monetary environment will not be negligible.

Almost SKK 4.1 billion is allocated as compensation of costs of municipalities incurred when they built local gas distribution networks, which approximately corresponds with the aggregate volume of debts of municipalities toward commercial banks (which currently stand at SKK 4.3 billion toward the local banking sector, thereof SKK 0.55 billion are classified claims and standard claims with a reservation). The whole volume of these funds will presumably be paid to municipalities that participated in development of gas distribution networks (regardless of whether the municipalities have debts or not). This will likely have an additional stimulating effect on domestic demand.

Allocated for state guarantees are SKK 5.1 billion, thereof SKK 3.0 billion for state guarantees in 2002 and SKK 2.1 billion for state guarantees provided in 2001. These funds will completely be paid abroad and will not influence liquidity and domestic demand.

Almost SKK 1.1 billion should be used to compensate for property damage in favor of Konsolidacna banka resulting from division of federal assets (presently it is a constituent of Slovenska konsolidacna agentura). This money should be used to repay a redistribution loan from the NBS, whereby it should influence neither liquidity nor domestic demand. Simultaneously the operation will cause a decline of the net loan to the government.

Almost SKK 3.7 billion is allocated to settle liabilities of health care facilities and health insurance companies.

Their use will very probably have an effect on growth of domestic demand and liquidity of the banking sector, since the money will be paid to suppliers (energy, medicaments, etc.).

Settling old commitments ensuing from agreements on services in public interest in railway passenger transport and settlement of old debts towards social security provider Socialna poistovna, a total of SKK 2.9 billion was allocated for 2002. In total the settlement of these debts should total SKK 4.4 billion, whereby the remainder should be settled from revenues for the sale of power utility Slovenske elektrarne (in 2003 or 2004). Until this money is used, it will be improving the position of the public sector. Its use will cause growth of liquidity in the banking sector and probably also domestic demand. Simultaneously, a repeated growth of net credit to government would again occur.

Similarly, the sum of SKK 1.2 billion is allocated to settle old debts of railway passenger transport in relationship to services in public interest. The effect on liquidity and demand will probably be more obvious than in the previous instance.

Approximately SKK 0.7 billion should be used to settle price differences in heat and hot water supplies for 1997-1998, which will have an effect on growing liquidity and domestic demand (use for the installment to the suppliers).

Another relatively large group of expenditures will comprise funds used to repay existing liabilities of the NPF (SKK 25.4 billion), of which SKK 16.7 billion is for loans of the NPF and the rest in line with the Large-scale privatization Act.

As long as loans for the NPF are concerned, approximately SKK 5.0 billion is represented by renewal of liabilities towards local financial institutions ensuing from NPF bonds (local banks) in the sense of agreements, the subject of which is the cessation of a commitment linked with a redemption of NPF bonds and the origination of a new liability. Repayment of this volume will have an impact on rising liquidity in the banking sector. Other loans of the NPF of approximately SKK 11.7 billion are drawn by the fund in the form of a fiduciary loan from a nonresident, whereby about SKK 6.5 billion (principal) was provided in Slovak crowns and SKK 4.2-4.3 billion in euro (EUR 100 million; principal). This loan provided by the nonresident was linked with a bond issue of the nonresident (denominated in the same currency structure) that was purchased by Slovak banks. Repayment of this fiduciary loan should mean an inflow of resources into the banking sector, whereby more than SKK 4 billion will be denominated in EUR and will not influence SKK liquidity.

From the issue of privatization bonds of the NPF, SKK 0.9 billion remain to be redeemed in 2002. This redemption will increase liquidity as well as domestic demand.

Costs linked to privatization (SKK 3.0 billion) include rewards to privatization advisors of approximately SKK 2.4 billion. This money should be used for payments abroad and will not increase liquidity or domestic demand. The rest of the sum will be used to settled commitments associated with court litigation, etc. (SKK 0.6 billion). Realization of these payments can have an impact on growth of demand and liquidity of the banking sector.

The NPF should further use privatization revenues for payments to persons eligible to restitution, to cover NPF costs, costs associated with withdrawal from contracts, share capital increase, purchase of equity shares to which it has an option (SKK 2.9 billion). These payments should increase the liquidity of the banking sector (and sterilization position of the NBS) and potentially can also have an effect of an additional demand stimulus. Simultaneously the NPF will be paying a share from privatization revenues of companies under the responsibility of the Ministry of Health and the Ministry of Agriculture. These resources however can represent an increase of liquidity as well as stimulate domestic demand.

This expected use of privatization revenues will reflect into growth of liquidity of the banking sector and sterilization position of the NBS by over SKK 82 billion. Impact on potential stimulation of domestic demand can be approximately in the range of SKK 6 billion to SKK 20 billion, whereby the RMP assumes this effect on domestic demand at SKK 10 billion.

The use of privatization revenues will also have an effect on growth of M2 money supply (at the same volume as the impact on domestic demand). This effect will probably be spread over 2002 and 2003, depending on when the payments are settled in health care and railway transport.

The National Bank of Slovakia assumes at the end of 2002 the level of net credit to the NPF close to zero as a result of balanced revenues and expenditures of the NPF.

With regard to persisting great extent of uncertainty concerning the use of privatization revenues, this factor remains a risky element of the Revised Monetary Programme. The overall impact will depend on the timetable of individual payments as well as concrete purpose of individual payments, which at present are impossible to precisely identify.

Monetary aggregates

Development of monetary aggregates in 2002 will primarily be influenced by revenues from privatization of state property and their use. In total the inflow of privatization revenues should increase net foreign assets by 115.4 percent, i.e., by SKK 158.1 billion.

Net credit to the government should decrease by SKK 79 billion. The use of privatization revenues should reduce the net credit to the government in 2002 in the following way:

- SKK 66.3 billion for the social insurance reform,
- SKK 36.3 billion to settle the deficit from 2001,
- SKK 10.4 billion to repay domestic state debt in 2002,
- SKK 3.3 billion to repay foreign government debt in 2002,

– SKK 9.1 billion a premature redemption of restructuring bonds possessed by VUB.

A pro-growth effect on development of the net credit to the government will come from the fiscal deficit budgeted at SKK 36.8 billion and a loan drawn from the World Bank. At the same time, the net credit to the government will increase by a bonds issue for interest cost of restructuring with a volume of SKK 9.5 billion.

With regard to balanced revenues and expenditures of the NPF, its end-year position should be zero, i.e., decrease from a debtor position of SKK 10.4 billion, and the net position of the public sector should decrease by SKK 89.5 billion.

Growth of money supply in 2002 should reach approximately 11.4 percent compared with 10.5 percent assumed in the Monetary Programme. Development of money supply should be influenced by the use of a part of privatization revenues. Higher growth of money supply should reflect the expectation that compared with the Monetary Programme, a higher volume of resources from privatization will return to the economy through expenditures to settle debts of the railway company, compensation to municipalities for gas distribution network costs, heat subsidies, court litigation costs, share capital increases, etc. The NBS assumes that from these privatization revenues, not the whole volume would be used for consumption and wages, but a part will improve the economic performance of these organizations and will not contribute to worsening of the trade balance.

With regard to assumed development of individual components of a monetary survey, space should be created for growth of credit activity by 6.9 percent at most (methodology of past adjustment – reduction), which represents year-on-year growth by approximately SKK 21 billion (when the time series of credits to enterprises and households are adjusted using the methodology of increasing the present value, growth would represent 4.7 percent). The volume added to the credits is thus comparable with original assumptions of the Monetary Programme.

Liquidity – monetary basis

The Revised Monetary Programme for 2002 assumes the end-year level of net foreign assets at SKK 381.4 billion, compared with SKK 296.8 billion in the original Monetary Programme. This difference results from the following corrective factors:

1) A different starting level of exchange rates in 2001 and 2002 influenced the starting level of the Revised Monetary Programme compared with the Monetary Programme.

2) The largest difference is represented by privatization revenues the projection of which in the Monetary Programme was SKK 120 billion, while in the Revised Monetary Programme it was revised to SKK 170 billion.

Within net domestic assets compared with the Monetary Programme, in the Revised Monetary Programme the starting level of other assets net is changed because of changed methodology of net foreign assets. The Revised Monetary Programme assumes end-year sterilization position of the NBS of SKK 159.6 billion, while the Monetary Programme counted on SKK 171 billion as the need for sterilization. Lower requirement for direct sterilization despite higher volume of privatization revenues results in particular from a decision to deposit money allocated for social reform in form of time deposits in the NBS (SKK 66.3 billion). The total volume of money that will need to be sterilized directly (from the banking sector) or indirectly (in special accounts in the NBS) will reach approximately 226 billion in the Revised Monetary Programme compared with SKK 171 billion in the Monetary Programme, which is associated with a higher volume of privatization revenues.

The average sterilization position of the NBS toward the banking sector in 2002 should reach SKK 109.5 billion, and SKK 33 billion should be deposited on average in special accounts in the NBS. Interest costs of the NBS at 8.25 percent interest rate in this instance would reach SKK 11.8 billion. The average value of net foreign assets represents approximately SKK 300 billion (under the condition of an increase of NBS reserves at the beginning of the second half of the year and assumed fixed exchange rate), which at average yield rate of the NBS portfolio at a level of 3 percent would represent income of SKK 9 billion. Total loss of the NBS from depositing and converting foreign currency revenues should thus be in the range close to SKK 2.8 billion.

Implementation of monetary policy

The Monetary Programme for 2002 defined several risks of economic and monetary development associated in particular with the development of public finances. These included especially the use of privatization revenues, but also the revenue and expenditure side of the state budget.

As far as the use of privatization revenues is concerned, most of them will be used for social reform and for a reduction of government debt, however, at the same time payments will be made that although being associated with debt reduction of some elements of the public sector, they can at the same time contribute to growth of domestic demand and M2 monetary aggregate. This above all includes debt reduction in the health care system, social and health insurance providers, as well as compensation of municipalities for developing local gas distribution networks. This money can potentially increase domestic demand (payments to suppliers, etc.) and if reasons are not eliminated for the accumulation of these debts in the future, this use of privatization revenues will only represent delaying a systemic solution.

Another important category of use of privatization revenues that can have an impact on domestic demand is compensation for municipalities for developing local gas distribution networks. If however this money is only used to repay debts, domestic demand would not be stimulated, while at the same time this can improve development in the fiscal area.

The overall impact of the use of privatization revenues (resources of the NPF) on domestic demand in 2002 represents according to calculations of the NBS approximately SKK 10 billion. The real impact of the use of privatization revenues however will depend on their concrete use depending on decisions of the government or other authorities of public administration.

A full effect of the use of privatization revenues cannot be expected in 2002, but it will be extended also into next year.

Conclusions

Objective of the Monetary Programme

The Revised Monetary Programme of the NBS for 2002 assumes achieving end-year headline inflation within the interval from 3.5 to 4.9 percent, which corresponds with average annual inflation of 3.6-4.2 percent. Core inflation should be in the interval from 3.2 to 4.7 percent.

Assumptions of the Monetary Programme

• relatively stable development of the exchange rate of the Slovak currency toward the EUR, corresponding with the efficiency of the economy,

• GDP growth in fixed prices by 3.5-3.8 percent,

• fiscal deficit without costs of restructuring of banks should reach SKK 46.8 billion, i.e., 4.5 percent of GDP (5.5 percent when use of some non-tax revenues of the state budget is abstracted, according to IMF methodology),

• share of deficit of the current account of the balance of payments to GDP should reach 8.3 percent.

Indicative growth rates of monetary aggregates

• growth of money supply should not exceed 11.4 percent,

• with regard to development of the balance of payments, net foreign assets should grow by 115.4 percent,

• net credit to the government and the National Property Fund should decrease by 24.1 percent, which is consistent with assumed development of the fiscal deficit, expected development of revenues and expenditures of the NPF, as well as assumed use of privatization revenues to repay government debt,

• with regard to the development of preceding aggregate indicators, there will be created room for a year-on-year growth of credits to enterprises and households by a maximum of 6.9 percent. With regard to the higher dynamics of M2 aggregate it would be desirable to achieve a lower growth of credits, in particular with regard to excess liquidity from the public sector. Hence in practice, excessive expansion of public finances can crowd out credits to enterprises.

Risks of the Monetary Programme

• PUBLIC SECTOR: Part of the risk in the area of public finances has already been incorporated in assumptions of the Revised Monetary Programme (increased estimate of the fiscal deficit from 3.5 to 4.5 percent of GDP as a result of the use of a part of privatization revenues; or from 4.5 to 5.5 percent of GDP in IMF methodology). Other risks stem from the full impact of the use of privatization revenues.

• WAGES: Faster growth of nominal wages than recommended 6 percent together with changed behavior of the households (growth of consumption at the expense of a lower saving rate) could cause worsening of the trade balance.

• PRICES OF RAW MATERIALS: Under influence of political factors as well as revival of demand can cause a major increase of prices of strategic raw materials and subsequently higher growth of consumer prices and imports.

• DEVELOPMENT OF WORLD ECONOMY: Lower than expected growth of German economy can have a negative impact on the development of Slovak exports.