

Monetary Programme for the Year 2001

1. Introduction

The focus of the paper is the monetary programme of the NBS for 2001, which expects a substantial inflow of capital from the privatisation activities of the Slovak Government and a fiscal deficit at the level of 4% of GDP. In view of the fall in domestic demand in the previous two years, we expect no significant pressure either on the balance of trade or inflation (even if domestic demand undergoes a revival in 2001), while the money supply is predicted to grow at a rate approaching 16% (at current exchange rate), due to the redemption of privatisation bonds. The unspecified range of increase in regulated prices in 2001 on the one hand, and the expected moderate demand pressure, coupled with the stabilisation of oil prices and the exchange rate of the Sk against the US\$, are expected to lead to widening of the range of overall inflation to 6.0 – 8.5% and that of core inflation to 3.2 – 5.3%. A favourable trend is expected in the balance of payments, where the surplus of the capital and financial account over the current account should create conditions for the stability of the crown's exchange rate against the euro.

2. Comparison of the Revised Monetary Programme with the forecast for the end of 2000

Based on the previous course of development, a forecast was made for the end of the year, which updates the figures used in the revised monetary programme. Since the revised monetary programme is based on figures from the beginning of the year and the expected effects of external and internal factors (which were different in several cases), the figures of the revised monetary programme were changed or updated.

| Main economic and monetary indicators of the SR | Revised monetary programme | Forecast |
|--|----------------------------|-----------|
| Gross domestic product (constant prices) | 2.5 | 2.1 |
| Consumer price index (end of year, core inflation) | 4.7 – 5.8 | 4.6 – 4.8 |
| Consumer price index (annual average) | 12.4 – 12.9 | 12.1 |
| Consumer price index (end of year) | 8.8 – 9.9 | 8.4 – 8.7 |
| Loans to households and enterprises | 3.7 | 1.5 |
| Money supply (M2) | 12.6 | 17.9 |
| Current account deficit as a share of GDP | -5.1 | -2.2 |

More substantial than expected fall in domestic demand, which was mirrored in the development of GDP over the first six months, affected the forecast for economic development until the end of the year and had a dampening effect on inflation. As a result, GDP is expected to grow at a rate somewhat slower than projected in the revised monetary programme and the rates of overall and core inflation to reach the lower limit of the projected range.

The fall in domestic demand together with accelerated growth in exports (stimulated by an increase in foreign demand) led to more a favourable development in the balance of payments on current account than had been expected.

As a result, we have adjusted our forecast for the end of the year by reducing the share of the current account deficit on GDP.

In connection with the cessation of operations at selected commercial banks, the total volume of loans fell, therefore our expectations for the end of the year are different in comparison with the revised monetary programme. The expectation of a higher than projected rate of growth in the money supply is connected with the privatisation of Slovak Telecom (ST) in its concrete form (i.e. increase in equity capital and the amount of funds deposited in commercial banks), the timing and volume of which had not been specified at the time when the monetary programme was revised.

3. Evaluation of developments in 2000 and the forecast for the end of 2000

3.1. Inflation

From the beginning of the year to September, consumer prices increased by 7.3%. Almost two thirds of this increase was due to adjustments of regulated prices and changes in indirect taxes. Core inflation has risen by 3.2% since the beginning of the year. Recent development has been affected by a variety of external and internal factors. The price of oil on the world market and the permanent appreciation in the exchange rate of the US dollar against the Slovak crown were the most significant cost factors. These factors had a direct upward effect on fuel prices, which belong to items with the highest volatility among consumer prices. The rise in cost-push inflation was caused by a higher than expected increase in energy prices for the production sector, which led to a significant increase in food prices in particular at the beginning of the year. Pro-inflation factors were dampened by a lack of consumer demand and the positive effect of competition in retail trade. Dampening factors became dominant and caused a gradual fall in the 12-month rates of overall and core inflation.

Consumer prices in September 2000

| Structure of the consumer basket | Constant weight in % | Change compared with | | |
|--|----------------------|----------------------|----------------|---------------|
| | | August 2000 | September 1999 | December 1999 |
| Total in % | 100.0 | 0.6 | 8.7 | 7.3 |
| Regulated prices in % | 17.8 | 0.2 | 21.3 | 20.5 |
| <i>Share of total, in % points</i> | | 0.05 | 4.66 | 4.46 |
| Effect of changes in indirect taxes on non-regulated prices | | 0.00 | 0.31 | 0.31 |
| <i>Share of total, in % points</i> | | | | |
| Core inflation in % | 82.2 | 0.7 | 4.9 | 3.2 |
| <i>Share of total, in % points</i> | | 0.55 | 3.72 | 2.49 |
| of which: Food prices in % | 26.8 | 1.4 | 4.6 | 2.9 |
| <i>Share of total, in % points</i> | | 0.32 | 1.06 | 0.66 |
| Tradeable goods ^{1/} | 40.2 | 0.6 | 3.9 | 2.2 |
| <i>Share of total, in % points</i> | | 0.21 | 1.47 | 0.83 |
| Market services ^{1/} | 15.2 | 0.1 | 7.5 | 6.2 |
| <i>Share of total, in % points</i> | | 0.02 | 1.19 | 1.00 |

Source: Statistical Office of the SR (SO SR)

^{1/} Estimates of NBS based on data from SO SR

On the basis of developments in consumer prices until September 2000 and the expected effects of individual factors on consumer prices, we assume that the 12-month rate of inflation will range from **8.4 to 8.7%** in December, corresponding to an average inflation rate of **12.1 – 12.2%**. The 12-month rate of core inflation is expected to reach **4.6 – 4.8%** and average core inflation **5.7 – 5.8%**.

| | Revised monetary programme for 2000 | Forecast for 2000 |
|------------------------------------|-------------------------------------|-------------------|
| Year-end rate of core inflation | 4.7 – 5.8% | 4.6 – 4.8% |
| Year-end rate of overall inflation | 8.8 – 9.9% | 8.4 – 8.7% |
| Average rate of overall inflation | 12.4 – 12.9% | 12.1 – 12.2% |

The expected development in 2000 does not differ considerably from the assumptions of the Revised Monetary Programme. The estimated values of overall and core inflation are close to the lower limits of the corresponding intervals projected in the RMP. In the case of a moderate acceleration in the rate of inflation towards the end of the year, both inflation rates under review would reach values slightly above the lower limits of the relevant intervals, due to the simultaneous action of pro-inflation factors.

The estimated values fluctuate around the lower limits of the intervals due mainly to the low level of effective demand, the anti-inflationary effect of which was stronger than expected. The limited effective demand also dampened the expected upward cost pressure on consumer prices on the part of producers. This slightly accelerated the process of disinflation, which is expected to be supported by the growing competition in retail trade as well.

Based on recent developments in industrial producer prices and the expected course of factors having an upward effect on price levels, we assume that industrial producer prices will rise year-on-year by **8.5%** (compared with 9.1% in September 2000), representing an average 12-month rate of **9.7%** (Provided that electricity and gas prices are being increased with effect from 1 January 2001. If they are raised from 1 December 2000, the rate of price increase is expected to be higher by at least 0.5 of a percentage point). Compared with the assumption of the Revised Monetary Programme for 2000 (a rise of 6.8% on average), this represents a significant acceleration in price dynamics. The difference between expectations and reality was caused by a significant increase in commodity prices, mainly the price of oil, and the ongoing appreciation of the US dollar.

3.2. GDP, real economy

During the first half of 2000, gross domestic product (GDP) grew year-on-year by 8.4% at current prices. The rate of growth in real GDP reached 1.7% (compared with 2.4% in the same period a year earlier).

The slowdown in the rate of economic growth was connected with the measures taken by the Government last year for the elimination of macro-economic imbalances, and with the administrative adjustments to prices and excise duties at the beginning of the year. The above measures affected the level of domestic demand, which fell in real terms by 5.7% during the first half of the year, due

to decline in final household consumption. The decline was caused mainly by a fall in real wages and the persistent high rate of unemployment.

The level of domestic demand was also affected by a fall in the creation of gross fixed investments, which was, however, more moderate than a year earlier. In the first half of last year, gross fixed investments recorded a year-on-year decline of more than 14%; in the first half of this year, the rate of decline slowed to 4.4%. This fact indicates that investment in the Slovak economy is in the process of revival.

A pro-growth effect on GDP was exerted by foreign demand. The boom in the economies of our major trading partners created favourable conditions for the export of goods and services, which achieved a real year-on-year growth of 18% over the first half of the year. With imports growing at a slower rate, the relatively fast rate of growth in exports generated a surplus in the actual balance of trade in goods and services, amounting to Sk 8.7 billion at constant prices (compared with a deficit of Sk 16.2 billion in the same period a year earlier).

The creation of GDP was marked by a fall in the added value (1.3% at constant prices) and a relatively steep increase in indirect taxes. The fall in the added value was caused by the relatively large share of intermediate consumption in gross production and the fall in domestic demand. In a breakdown by sector, a fall in the added value was recorded in industry, construction, transport, postal and telecommunications services. The added value increased in agriculture, trade, other market services, and non-market services.

The price deflator of GDP increased by 6.6% in comparison with the 1st half of 1999, and thus deviated significantly from the course of consumer prices and industrial producer prices. Of partial deflators, the most rapid increases were recorded in the deflators of final household consumption (15%), exports of goods and services (10.1%), and imports of goods and services (10%).

Developments in selected macro-economic indicators over the first eight months of 2000 indicate that the Slovak economy continues to stabilise. Production improved in industry and construction, while the fall in domestic demand was reflected in market services, where decline was recorded in several sectors.

From January to August, production in industry grew year-on-year by 9%, due mainly to an increase in the output of the manufacturing industry (10.5%).

The output of the construction sector over the first eight months of the year fell by 6.5% year-on-year (compared with 26% in 1999). Output during the remaining months indicates a trend of gradual revival. Production increased in the construction of transport infrastructure, hydro-engineering projects, and in new construction, reconstruction, and modernisation projects.

Receipts from retail sales during the eight months under review remained somewhat below the level of last year, before they started to increase again in July and August. A marked year-on-year fall in receipts was reported by companies

specialising in the sale of fuels, while receipts at hotels and restaurants also continued to fall.

According to the assumptions applied in the Revised Monetary Programme for 2000 (RMP), real GDP is expected to grow year-on-year by 2.5%. Growth is expected to be stimulated mainly by foreign demand and, to some extent, by private and public consumption. The creation of fixed investments is expected to remain at the level of 1999.

Developments in basic macro-economic indicators in the first half of 2000 indicate that real GDP will probably fail to reach the projected rate of growth. A detailed explanation of the differences between the projected values and the revised estimates is complicated by the fact that, at the beginning of the year, the Statistical Office of the SR made several methodological changes in the calculation of GDP. The most significant change was the introduction of an internationally comparable method for the compilation of national accounts (the European System of National Accounts – ESA 95). The use of the new method affected the rate of GDP growth only to a small extent, while the structure of GDP components changed significantly (e.g. the share of private consumption increased).

The general comparison of the projected values (according to the ESA 79 methodology) and the updated values of GDP components according to ESA 95) indicates that, in formulating the RMP, we did not expect such a marked fall in consumption (in connection with the package of economic measures) which was responsible for the slowdown in the rate of real economic growth in the first half of the year. As is evident from the table below, we used the following assumptions in the revised monetary programme:

- moderate growth in total final consumption;
- stagnation in gross fixed capital formation;
- very moderate growth in domestic demand;
- surplus in net exports of goods and services, due to faster growth in exports than imports.

| | Revised MP 2000 (according to ESA 79) | Actual figures for H1, 2000 (accord. to ESA 95) | Forecast for 2000 (according to ESA 95) |
|------------------------------------|---|---|---|
| GDP at constant 1995 prices | 2.5 | 1.7 | 2.1 |
| Domestic demand | 0.4 | -5.7 | -3.1 |
| of which: | | | |
| Final consumption in total | 0.9 | -6.7 | -2.7 |
| Households | 1.0 | -7.1 | -2.3 |
| Government * | 0.6 | -5.7 | -3.5 |
| Gross capital formation | -0.7 | -3.7 | -4.0 |
| Gross fixed capital formation | 0.0 | -4.4 | 0.9 |
| Change in stocks | x | x | x |
| Net exports | x | x | x |
| Exports of goods and services | 13.4 | 18.0 | 15.7 |
| Imports of goods of services | 10.3 | 6.1 | 7.6 |

* Including non-profit institutions serving households.

With regard to the previous course of development, methodological changes in the calculation of GDP, and the forecast for the second half of the year, we expect the following trends in 2000:

- fall in the level of private and public consumption (by 2.7%), with a trend of slowdown in the rate of fall towards the end of the year;
- moderate increase in gross fixed investments (0.9%);
- fall in domestic demand (roughly 2%), with a trend of slowdown in the rate of fall during the second half of the year;
- maintenance of the positive effect of net exports, the surplus of which may reach roughly Sk 11 billion.

From the revised estimate of the level of domestic demand, we can assume that the rate of real economic growth will probably remain below 2.5%, the figure projected in the Revised Monetary Programme. According to a revised estimate, real GDP will grow year-on-year by **2.1%** in 2000, to Sk 667.0 billion at constant prices.

In the creation of real GDP, we assume that the added value will continue to increase in agriculture, market and non-market services. The creation of GDP will again be affected most significantly by market services, the added value of which may increase year-on-year by 3.0%.

According to the revised monetary programme for 2000, gross domestic product at current prices will increase by 9.6%, with the GDP deflator rising by 6.9%. The revised estimate of nominal GDP in 2000 is based on the estimate of real GDP, the overall GDP deflator, and the values of partial deflators, which are dependent on the revised estimate of consumer prices and industrial producer prices.

The estimation of the GDP deflator is still a complex task. According to our estimates, the GDP deflator will grow year-on-year by 6.4%. With the described trend in prices, nominal GDP may reach Sk 886 billion in 2000, representing an increase of 8.7% compared with the figure for 1999.

| | Revised MP 2000 (according to ESA 79) | Actual figures for H1, 2000 (according to ESA 95) | Forecast for 2000 (according to ESA 95) |
|---------------------------------------|---|---|---|
| GDP at current prices | | | |
| in billions of Sk | 854.0 | 429.3 | 886.0 |
| year-on-year growth in % | 9.6 | 8.4 | 8.7 |
| Year-on-year increase in the deflator | 6.9 | 6.6 | 6.4 |

Labour market

During the first half of the year, the average monthly nominal wage of an employee in the Slovak economy increased by 7.2% compared with the same period a year earlier, while falling in real terms by 7.3% (compared with an increase of 0.4% a year earlier). Real wages fell in all sectors, mainly in health care (by 12.5%) and education (by 10.4%).

A favourable trend was recorded in labour productivity, which increased at constant prices by 3.9% year-on-year. With real wages falling by 7.3%, this means an excess of 11.2 points in favour of labour productivity.

Based on data on wage developments in selected sectors from January to August, average nominal wages increased in all the sectors under review, except for the wholesale trade. The steepest increases were recorded in industry (10.3%) and transport (10.2%), while nominal wages in the wholesale trade fell by 1.5%.

Taking the level of consumer prices of goods and services into account, real wages fell in all the sectors under review during the first eight months of the year. On a year-on-year basis, the rate of fall increased in all sectors, except construction. The most significant fall in real wages took place in the wholesale trade (13.5%, compared with 5.4% a year earlier) and the retail trade (11.5%, compared with 1.1% a year earlier). In the other sectors, there were no appreciable differences in wage dynamics. The fall in real wages was most affected by the average rate of year-on-year inflation, which was 5.2 percentage points higher than in the same period a year earlier.

Unemployment recorded a marked fall in August. The number of registered unemployed fell by 54.7 thousand in comparison with the figure for July. The rate of unemployment based on the disposable number of unemployed fell by 2 percentage points, to 17.4% in August and 16.6% in September.

The fall in the number of registered unemployed was caused, first and foremost, by the number of persons excluded from the registers of labour offices, as a result of an amendment to the law on employment, which became effective on 1 August 2000. On the basis of this amendment, labour offices began to offer employment on public works to the long-term unemployed.

The forecast for wage developments in 2000 was made with respect to the following:

- wage developments in the previous year, the first two quarters of the current year, and actual wage developments in selected sectors from January to August 2000;
- expected wage developments in selected sectors until the end of the year. According to our expectations, the trend of growth in nominal wages will continue in industry, transport, telecommunications, and construction. In trade, nominal wages are expected to fall in the coming months, with regard to the level of wages achieved in 1999 and 2000;
- realisation of the proposed wage increase in the budgetary sector (5%) with effect from July and a one-off increase in the salaries of teachers (Sk 500) with effect from September. According to our estimates, these measures are expected to contribute roughly 0.5% to the rate of year-on-year increase in nominal wages.

Based on the above assumptions, nominal wages are expected to grow by 7.8% in 2000. With the 12-month rate of inflation reaching 12.1% on average, real wages are expected to fall by 3.8%. In the revised monetary programme, we projected a 2.0 to 3.7% fall in the level of real wages. The estimate for the year 2000 (at the upper level of the fall projected in the Revised Monetary Programme) is based on the results achieved in the first half of the year, mainly the lower rate of growth

in nominal wages in comparison with the original assumptions laid down in the General Agreement.

A favourable trend is expected in the relationship between wages and labour productivity expressed as a share of GDP. With regard to the expected growth in GDP, the reduction in real wages and the continued fall in the level of employment (though at a slower rate than in 1999), we assume that the excess of labour productivity over wages will be preserved in 2000. At the projected fall in employment (1.4%) and growth in GDP, labour productivity should increase in nominal terms by 10.2% and in real terms by 3.6%.

The average number of unemployed is expected to reach 520.4 thousand in 2000 (according to our estimates), of which the number of disposable unemployed will probably account for 494.4 thousand. The average rate of unemployed, based on the disposable number of people out of work, could reach 18.3%, and the figure calculated from the total number of registered unemployed 19.3% (which is also affected by the number of persons returning from employment on public works into unemployment status).

3.3. Balance of payments

The basis for setting the rate of exchange for 2000 was the average cumulative rate of the Slovak crown (SKK) to the US dollar (USD) over the first 10 months (SKK/USD 45.5). Assuming that the rate will be SKK/USD 50.0 in the following two months, the average cumulative rate will be SKK/USD 46.2 in 2000 (rounded off to SKK/USD 46.0).

The majority of international institutions assume, that development in oil prices on the world market will fluctuate between US\$ 28 and 30/barrel until the middle of the next year; and in the course of second half-year the decline is expected. In 2002 this trend might continue up to level of US\$ 27/barrel.

During the first eight months of 2000, the balance of payments on current account (CA) resulted in a deficit of Sk 6.8 billion. Compared with the same period a year earlier, the deficit diminished by Sk 25.6 billion.

Within the structure of the current account, changes occurred first and foremost in the balance of trade and that of services. The trade balance, which most contributed to the fall in the balance of payments on current account, depended on a variety of factors. They included the effect of government measures from 1999, the rising price of oil, the degree of import intensity of production, economic development in the countries of our main trading partners, and the appreciation of the US dollar.

The environment in which the foreign transactions of Slovak economic entities have so far been carried out, is expected to be affected by the same external factors until the end of 2000. The favourable trend in foreign demand, due to the culmination of the boom in the economies of our foreign partners makes it possible for us to reach, in all probability, a rate of year-on-year growth of 26.3% in exports (in 9 months, the dynamics of export reached 29.9%). The expected growth

in imports in the last few months of 2000 – resulting from a seasonal increase, occurring on a yearly basis in the last months of the year – will generate a 20.9% year-on-year increase in imports (in 9 months, the dynamics of import reached 22.4%). The negative balance of trade will amount to Sk 32.0 billion, i.e. Sk 23.2 billion less than in 1999.

The balance of trade is affected, to a large extent, by the rise in the price of oil and gas and the change in the exchange rate of the Sk to the US\$. If the trend of development from the first eight months continues, the year 2000 will see imports in the amount of Sk 567 billion, including imports stimulated by a price increase in the category ‘mineral-based fuels’ in the amount of ca Sk 40 billion. Similarly, exports will total Sk 535 billion in 2000, including exports caused by a price increase of ca Sk 16 billion. These price effects will increase the balance of trade by ca Sk 24 billion.

Due to growth in receipts from transport and improvement in the balance of other services (i.e. fall in the deficit caused by a fall in expenses for business, telecommunications, and construction services), the balance of services will reach a surplus of Sk 18 billion at the end of the year (compared with Sk 2.1 billion in 1999). The increase in the price of gas accounted for 67% (i.e. Sk 7.7 billion) of the growth in receipts from transport.

The end of year balance of income (roughly –Sk12 billion) will continue to be dominated by the interest balance, determined by the volume of credits and loans provided to the individual sectors of the Slovak economy in the past. The final balance of current transfers is expected to reach Sk 6.5 billion in 2000, due to the lower level of receipts from the transfer of funds from abroad by natural and legal persons in the form of gifts, benefits, damages, etc..

The expected year-end values of the above items may result in a current account deficit of ca Sk 20 billion in 2000, and its share of GDP is expected to reach 2.2%.

The monetary programme was revised in May 2000. At that time, data were available only for the first two months of 2000, due to delay in the compilation of the balance of payments. Since assumptions for the entire year could not be derived from those data, the prediction of the balance of payments in the Revised Monetary Programme (RMP) was based on the trends established in 1999. At the time when the prediction was made, there was no indication of such a rapid increase in the price of oil, oil products, and gas on the world market, or of the future course of the exchange rate. As a result of these factors, the estimated deficit in the balance of trade and the surplus in the services balance for 2000 were close to the figures for 1999.

The comparison of the estimated developments in the current account with the RMP indicates two major differences in its structure. The lower deficit in the balance of trade (by Sk 12 billion) and the higher surplus in that of services (by Sk 13 billion) were due, for the most part, to developments in oil and gas prices on the world market. While the growth in exports (Sk 17 billion) fully reflects the increase in the exports of mineral-based fuels (Sk 5 billion), the structure of exports has changed considerably. The expected imports of machines and technologies were replaced by

imports of raw materials and semi-finished goods, due to growth in the cost of oil, gas, and related commodities.

The balance of services followed a similar course of development as the trade balance. While the increased surplus in transport services (Sk 10 billion higher than expected) was due to charges for the transit of gas and oil, the reduced deficit in other services (by Sk 4 billion) was connected with the change in the structure of foreign trade and the resulting demand for business services.

The improvement in the balance of trade and that of services resulted in a fall in the current account deficit, by roughly Sk 24 billion in comparison with the RMP.

The increased interest of foreign investors in increasing their capital stakes in Slovakia and the privatisation activities of the Government in particular, indicate that foreign direct investment (FDI) will reach ca Sk 60 billion by the end of 2000. As a result of the sale of State holdings through the National Property Fund (NPF), foreign direct investment in the government sector will reach ca Sk 26 billion, including the sale of Slovak Telecom (ST) for EUR 600 million. The remaining amount is ascribable to growth in FDI in the commercial sector, stimulated by an increase in the equity capital of ST, Slovnaft, Polnobanka, etc. This will in large part cover the negative balance of payments on current account. At the end of 2000, the inflow of FDI will be three times greater than the deficit in the current account.

Due to issues of securities in the government and corporate sectors and trading in bonds, portfolio investment (PI) has become the most significant form of debt capital. The drawing of loans in the form of portfolio investment (ca Sk 22 billion) in the commercial sector (ca Sk 19 billion) takes place through the issue of bonds by Slovak Railways, the Slovak Gas Company, Eurotel, and the municipality of Bratislava. In the government sector, the drawing of loans in the form of PI takes place mostly in the form of eurobond issues or the inflow of capital from the sale of government bonds issued in Sk. The outflow of capital, i.e. increase in PI on the assets side from the expected Sk 4 billion to Sk 16.5 billion, was affected by the purchase of securities from abroad in the amount of ca Sk 13 billion for funds obtained by Slovak Telecom for an increase in foreign capital participation. As the deposits of commercial banks abroad will fall by the same amount, the said transaction will have no effect on the capital and financial account (CFA).

The most significant transactions in the category 'other long-term investment' (OLI) took place on the liabilities side. Their volume (ca Sk 9 billion) results from the drawing and repayment of long-term financial credits in the corporate sector. Government loans drawn in the amount of Sk 11 billion will be used mostly for financing the construction of motorways (the said amount includes a loan to the former GDR in the amount of US\$ 58 million, i.e. roughly Sk 2.6 billion). After the Bank Board of NBS decides to repay the remainder of a liability to the IMF in the amount of Sk 5.0 billion (SDR 75.0 million), debt servicing in the official sector will increase to ca Sk 11 billion. The volume of repayments will exceed the volume of loans drawn, which will cause the year-end negative balance of OLI to increase to Sk 9.4 billion, after the repayment of SDR 75 million to the International Monetary Fund.

The volume of short-term capital at the end of the year will be determined by an increase in the deposits of commercial banks abroad and/or the increased provision of commercial credits by the Slovak corporate sector. As a result of this tendency, we expect a capital outflow of ca Sk 17 billion via the short-term capital account. The increased imports in the last few months are likely to change the trend in the short-term liabilities of the corporate sector, which will lead to an excess of drawing over repayment.

The total volume of short-term financial credits is expected to reach Sk 61.0 billion at the end of 2000. Short-term financial credits will exceed the balance of payments on current account, which will enable a positive balance of payments in the amount of ca Sk 41 billion. This will, in actual fact, mean an increase in NBS reserves. At the end of the year, the volume of reserves (ca US\$ 4,300 million) will be 3.7 times greater than the average volume of monthly imports of goods and services to Slovakia in 2000.

The expected balance of payments on the capital and financial account (Sk 61 billion) will mean a fall of Sk 32 billion in comparison with the Revised Monetary Programme. The said fall is a result of several (concluded and/or non-concluded) transactions.

An increase with respect to the monetary programme was recorded only in direct investment (Sk 14.6 billion), which reflects the increase in receipts from the sale of Slovak Telecom. On the other hand, the purchase of securities from abroad for funds obtained from the sale of Slovak Telecom, was a key factor behind the fall in portfolio investment (Sk 16 billion).

In other long-term investments, the most significant difference (a fall of Sk 15.2 billion) occurred in the corporate sector, due to a fall in the volume financial credits drawn (by ca Sk 16 billion). In the RMP, the expected growth in long-term loans drawn in the corporate sector was connected with the expected increase in the trade deficit and the import of technologies financed from the loans.

The increase in the negative balance of short-term capital over the figure projected in the RMP (ca Sk 15 billion) was caused by an outflow of capital in connection with the growth in the reserves of commercial banks. Apart from the effect of the current account deficit reduced by the balances of trade and services, the increase in the short-term assets of commercial banks (reserves) over the original values was also affected by the expected realisation of a government guarantee, whereby the repayment of corporate loans was covered from the foreign exchange reserves of the NBS.

3.4. External debt

On 31 July 2000, the total gross external debt of the Slovak Republic stood at US\$ 11.053 billion, representing an increase of US\$ 543.7 million over the beginning of the year.

In the remaining months of the year (August to December 2000), total gross external debt is expected to change due the effects of exchange rate differences (weakening of the euro in relation to US\$). In comparison with the latest data recorded

on 31 July 2000 (US\$ 11.053 billion), the level of gross external debt will fall by roughly US\$ 950 million (to US\$ 10.104 billion), due to depreciation in the EUR (mainly during the period August to October 2000), the repayment of several large foreign loans by public sector entities (redemption of NBS bonds, early repayment of an STF loan, and a loan provided to Vodohospodárska výstavba).

Gross external debt of Slovakia as at 31 December 1999 and 31 July 2000, and a forecast of this indicator for 31 December 2000 (US\$ millions)

| | 31.12.1999 | 31.07.2000 | 31.12.2000 |
|---|------------|------------|------------|
| Total external debt of the SR | 10,517.9 | 11,052.7 | 10,104.5 |
| Medium- and long-term foreign debt | 7,811.9 | 8,645.2 | 7,719.4 |
| of which: | | | |
| Official debt of the Government and the NBS | 2,541.1 | 3,101.5 | 2,583.6 |
| Government agencies | 208.4 | 298.5 | 312.0 |
| Municipalities | 64.1 | 59.6 | 100.0 |
| Foreign debt in the commercial sector | 4,998.3 | 5,185.6 | 4,723.8 |
| of which: | | | |
| Commercial banks | 345.4 | 313.0 | 255.4 |
| Non-bank entrepreneurial entities | 4,652.9 | 4,872.6 | 4,468.4 |
| Short-term debt in the commercial sector | 2,706.0 | 2,407.5 | 2,385.1 |
| of which: | | | |
| Government of the SR and the NBS | 5.9 | 4.7 | 0 |
| Commercial banks | 335.0 | 321.9 | 300.0 |
| Non-bank entrepreneurial entities | 2,365.1 | 2,080.9 | 2,085.1 |

In 2000, the level of net foreign debt is expected to fall year-on-year by US\$ 1 billion, to US\$ 3.4 billion.

3.5. Public finances

The Monetary Programme of the NBS for 2000 expects the budget deficit of Sk 18 billion (of the central government) and the fiscal deficit of Sk 28 billion (of the general government). Previous development created real conditions for the fulfilment of the above indicators. On 30 September 2000, the budget deficit stood at Sk 7.8 billion, with total revenue exceeding the aliquot ratio of the budgeted figure by Sk 5.1 billion. Without the effect of expenditures concerning loan portfolio restructuring of banks and the consequences of agricultural drought, the 'net' budget deficit amounted to Sk 1.0 billion, i.e. 5.6% of the figure projected for the entire year. Favourable results were also achieved in public finances as a whole (the latest result is a deficit of Sk 1.2 billion from 30 June 2000, i.e. 4.3% of the figure for the whole year).

3.6. Monetary aggregates

During the first nine months of the year, development of monetary aggregates did not follow expectations of the RMP.

| Fixed exchange rate from 1993 | Ten-day figures | Estimate of RMP for September | RMP December |
|---------------------------------------|-----------------|-------------------------------|--------------|
| | 30.09.2000 | | |
| Net foreign assets | 82.5 | 52.3 | 62.7 |
| M2 | 563.3 | 521.2 | 572.4 |
| Net credit to the Government | 149.0 | 168.6 | 191.6 |
| National Property Fund (NPF) | -14.4 | 0.0 | 0.0 |
| Credits to households and enterprises | 399.6 | 407.2 | 412.3 |
| Net domestic assets | 480.8 | 468.9 | 509.6 |
| Other items net | 53.4 | 106.9 | 94.3 |

This development was caused by facts which were not taken into account in the monetary programme for 2000:

1. The cessation of operations of specific commercial banks, which affected development in bank lending, other items net, and the money supply. The cessation of reporting of these banks led to a fall of Sk 9 billion in the volume of credits, a fall of Sk 5 billion in other items net, and a fall of ca Sk 1.1 billion in the M2 aggregate. Credit advanced to the Deposit Protection Fund from the NBS in the amount of Sk 5 billion also resulted in a fall in other items net (OIN).
2. The sale of Slovak Telecom (ST), leading to changes in OIN, the money supply, and the position of the NPF. The use of 40% of the receipts from the sale of ST for an increase in equity capital, led to growth in the money supply, the rate of which reached 17.4% at the end of September. Without taking this effect into account, the rate of growth would reach 14.5%, which would be above the projected figure. Since part of the funds intended for an increase in the equity capital of ST was used for the purchase of foreign securities in October, the year-on-year dynamics of M2 fell to 14.6% (13.3% after adjustment).

The remaining funds were kept in the account of NPF with the NBS, as a result of which the position of NPF vis-à-vis the banking sector became that of a creditor (Sk 19.7 billion) at the end of August. Other items net were also affected, because the growth in net foreign assets caused by the inflow of EUR 1 billion took place at fixed 1993 exchange rate; as well as the increase in M2 in the equivalent of EUR 400 million. The improvement in the NPF position took place at current rates, in the equivalent of EUR 600 million, which led to a fall of Sk 6 billion in OIN.

3. The issue of eurobonds also led to an improvement in net credit to the Government and to a fall in other items net (ca Sk 5 billion) as a result of the application of a fixed exchange rate. This is connected with the fact that the crown equivalent of the external debt of the Government is calculated at fixed exchange rates, while the volume of funds credited to the summary account is calculated at current rates.
4. Loan portfolio restructuring of commercial banks affected not only lending activities, but developments in other items net and net foreign assets as well. As a result of loan portfolio restructuring and the reclassification of loans from classified to standard loans, capitalised interest was not created or added to the

volume of loans in 2000, which led to a fall of Sk 2 billion in the volume of loans. Classified loans to non-residents were converted into standard loans to residents in the amount of Sk 4 billion, which reduced the volume of net foreign assets and increased the volume of loans by the same amount. Another fall in loans (Sk 3 billion) was caused by the creation and use of loan-loss provisions for part of the bad loans, which resulted in a fall in the total volume of loans and in an impact on other items net.

| | Growth rate at fixed exchange rate | Growth rate at fixed exchange rate | Adjusted growth rates | RMP |
|---------------------------------------|------------------------------------|------------------------------------|-----------------------|------|
| | 30.09.2000 | 30.09.1999 | 30.09.2000 | |
| Net foreign assets | 202.7 | -23.0 | 202.7 | 49.4 |
| M2 | 17.4 | 9.1 | 14.5 | 12.6 |
| Net credit to Government | -1.8 | 18.7 | 8.5 | 16.3 |
| Credits to households and enterprises | 1.1 | 3.8 | 4.0 | 3.7 |
| Net domestic assets | 6.2 | 11.9 | 3.1 | 9.3 |
| Other items net | -44.4 | -8.2 | -1.7 | -1.8 |

The adjusted data indicate a trend of gradual, though moderate, revival in lending activity, with the growth rate reaching roughly the level of the previous year.

In August and September, the money supply showed increased dynamics (in both actual and adjusted terms) in comparison with the revised monetary programme. In response to the activities of ST, the rate of growth moderated in October, while the adjusted rate was somewhat higher than the figure projected in the revised monetary programme. At the end of the year, the M2 aggregate is expected to reach 17.9% (at current exchange rates) on a year-on-year basis, provided that the securities acquired in October by Slovak Telecom have not been sold. The increase in dynamics will be affected first and foremost by the expectation that the fiscal deficit reaches the projected level, i.e. Sk 28 billion. Increased budget expenditure (compared with the past year) will lead to a steeper increase in M2 in the last two months of the year. (The adjusted value of the budget deficit, which is comparable with the deficit approved in the amount of Sk 18 billion, stood at roughly Sk 5 billion at the end of September).

However, it is also possible that the money supply will grow at a lower rate, which may be connected with the smaller amount of interest credited, as a result of the downward trend in interest rates (which, however, may be offset by a higher volume of deposits).

In the light of developments in the money supply (including the inflow of funds for an increase in equity capital), a two-digit rate of growth may be accepted. As far as we know, these funds were to be used by ST for the purchase of technologies. Therefore, the deterioration in the balance of payments on current account will not be regarded as a negative development, since the deficit of trade balance will be financed from non-debt capital or existing sources of foreign exchange in the SR. Such a use of M2 will have no effect either on inflation or the exchange rate. The use of part of the funds obtained by ST for consumption could affect inflation via increased demand (which is, however, difficult to quantify and may be offset by other factors), but without any effect on the exchange rate if consumption

is satisfied from imports. As the funds obtained from privatisation will, in all probability, be used for the purchase of technologies, the effect of this factor on M2 may be left out of consideration when monetary-policy decisions are to be made. The rate of growth in the adjusted money supply, though it probably exceeds the figure projected in the revised monetary programme, does not necessarily mean pressure on inflation and the exchange rate, since it could be affected by a change in demand for money, which is difficult to quantify. At present, the money supply represents only one of the indicators of monetary development in relation to inflation and the exchange rate; its development should, therefore, be seen in the light of other macro-economic variables. If their combined effect is favourable or their effects offset each other, the projected value of M2 may be exceeded to some extent.

With regard to the low level of domestic demand and the favourable trend in inflation, the development of the money supply is not expected to have a direct negative effect on the position of the SR vis-à-vis the external sector or the course of inflation. Until the end of 2000, bank loans and net foreign assets will probably remain at the level of 30 September 2000.

In monitoring the monetary aggregates, differences will occur in the calculated values of crown equivalents, due to the inflow of further funds from privatisation. The monetary survey will, therefore, be published and evaluated at the exchange rate that was used in setting the values of the monetary programme.

Differences in monetary aggregates resulting from the use of different exchange rates in calculating the crown equivalent of foreign resources

| | Change at fixed 1993 exchange rate | | Change at current exchange rate | |
|---------------------------------------|---------------------------------------|--------------|------------------------------------|--------------|
| | 30.9.-1.1.00 | 30.9.-1.1.99 | 30.9.-1.1.00 | 30.9.-1.1.99 |
| Net foreign assets | 41.7 | -7.3 | 73.5 | -5.0 |
| M2 | 55.0 | 20.9 | 68.4 | 24.8 |
| Net credit to Government | 5.4 | 11.9 | 12.4 | 16.8 |
| National Property Fund (FNP) | -15.3 | 1.3 | -15.6 | 1.3 |
| Credits to households and enterprises | 2.5 | 12.9 | 5.8 | 16.4 |
| Net domestic assets | 13.3 | 28.3 | -5.1 | 29.8 |
| Other items net | -20.7 | -2.2 | 7.7 | 4.7 |

At the end of 2000, the sterilisation position of the NBS is expected to reach Sk 70 billion.

4. Monetary programme for 2001

The monetary programme for 2001 is based on forecasts for the end of 2000, i.e. inflation at the lower limit of the projected interval, slower growth in GDP, and improvement in the current account deficit as a share on GDP. In 2001, it is expected a revival of domestic demand and persistent favourable effect of foreign demand which would result in increase in GDP. The growth in domestic consumption, and in particular the expected import of technologies financed and stimulated by an inflow of FDI (from last year as well), are expected to cause the deficit in the balance of payments on current account to increase. The expected receipts from the privatisation activities of the Government will create room for growth in the foreign exchange reserves of NBS and a source for financing the

balance of trade. For that reason, we, paradoxically enough, expect pressure for depreciation of the exchange rate.

This will, together with the expected stabilisation of the USD/EUR cross-currency rate and the price of oil, create favourable conditions for a further fall in inflation on a year-on-year basis. However, overall price development will depend on the approach of the Government to the increase in regulated prices, where the approved schedule of deregulation is expected to be observed. However, the course of overall and core inflation in 2001 carries with it some risk, which was taken into account when the upper limit of the projected interval was set.

We expected a fiscal deficit of 4% and the use of funds obtained by NPF from privatisation for purposes approved by the Government. If the surplus receipts from privatisation (above the planned amount) are deposited in an account with the NBS, there will be no need for a tightening of monetary policy in 2001, as a 16% rate of growth in M2 will create room for growth in lending to the economy.

In connection with the inflow of funds from the capital and financial account of the balance of payments and the continued reduction in minimum required reserves, the sterilisation position of NBS will continue to increase.

4.1. Inflation

As in the previous two years, consumer prices in 2001 will again be affected by the administrative measures of the Government. The estimation of overall inflation is, however, complicated by the unknown range of these measures. According to the Schedule of Adjustments to Regulated Prices (approved by the Government in May 1999) or the supplement to this material, the range of price adjustments will be less than in 2000 or 1999. The prices of items which are subject to adjustment pursuant to the said schedule, are expected to increase by an average of 16.6% and their contribution to overall inflation is to reach 3.0 percentage points in 2001. In 2000, price deregulation contributed 4.0 percentage points to inflation.

Indirect contribution of the planned adjustments to regulated prices to ISC in 2001

| Name of item | Converted norm. weights | Proposed increase in %* | Contributions in % points |
|--------------------|----------------------------|----------------------------|------------------------------|
| | (%) December 2000 | | |
| Electricity | 4.1 | 10.0 | 0.41 |
| Heat energy | 6.2 | 20.0 | 1.23 |
| Natural gas | 1.9 | 15.0 | 0.29 |
| Railway traffic | 0.4 | 13.0 | 0.05 |
| Bus transport | 1.2 | 7.0 | 0.08 |
| Water and sewage | 1.1 | 21.0 | 0.23 |
| Postal services | 0.1 | 10.0 | 0.01 |
| Telecommunications | 1.5 | 11.0 | 0.17 |
| Rents | 1.4 | 35.0 | 0.49 |
| TOTAL | 17.8 | 16.6 | 3.0 |

* The range of price adjustments according to the Government's schedule of adjustments to regulated prices of May 1999. Thus, regulated prices should increase by 12.5% on average.

Based on the statements of SE and SPP, it is also possible to assume that regulated prices will show a steeper increase. The price of electricity is expected to rise by

20% and that of natural gas by 25%. In this case, adjustments to regulated prices will contribute 3.6 percentage points to overall inflation in 2001. In connection with the marked increase in costs in 2000, fares for bus and railway transport and the price of heating are likely to be adjusted to an even greater extent. This means that the contribution of price adjustments to overall inflation could reach 4.0 percentage points in 2001. An additional stimulus to inflation could also be provided by an increase in the prices of pharmaceuticals, payments for educational services (fees at nursery schools, etc.).

Although private consumption is expected to grow again in 2001, consumer demand is unlikely to cause an increase in price levels. We assume that the persistence of high unemployment, and the performance of competition in trade in particular, will be the key factors in the development of core inflation and are expected to result in a lower rate than in 2000.

Although food prices had a stabilising effect on inflation in previous years, price dynamics in this sector began to increase in the second half of 2000 and this trend is expected to continue in 2001. The unfavourable situation in agriculture poses a risk of accelerated price increase, as most primary producers operate at a loss and are dependent on state subsidies. On the other hand, the inflow of investment capital into the food industry may increase the effectiveness of production at food processing companies and thus have a stabilising effect on the food market. Food prices are exposed to the risk that the increased costs of producers in 2000 and the expected adjustments to energy prices in 2001 will be transferred, causing an accelerated price increase in this sector in the first few months of the year. During the remaining months, the rise in food prices and the prices of other tradeable goods is expected to be dampened by the effect of competition and the cancellation of the import surcharge. As a result, prices in the tradeable sector will follow the trend of moderate increase from 2000. However, weak competition in the sector of services enables the transfer of increased costs into prices; consequently, prices in the services sector will increase at a faster rate than in the sector of tradeable goods.

Minimum alternative:

- increase in regulated prices in line with the approved Schedule ... ('99);
- moderate appreciation in the exchange rate of the crown to the euro, accompanied by appreciation in the rate of the euro against the dollar;
- positive trend in the price of oil, i.e. US\$ 27 – 29/barrel;
- persistence of increased unemployment;
- low purchasing power of households, supported by a planned increase in regulated prices;
- effect of competition – increase in the efficiency of chain stores (there is room for a reduction in the gross profit) will dampen the pressure exerted by industrial producer prices;
- the steps of the Government and SFTR in implementing the country's food policy are co-ordinated – the effects of inadequate crops in 2000 on food prices are dampened;
- moderate wage development, i.e. minimum increase in real wages.

Maximum alternative:

- steeper increase in regulated prices than projected in the Schedule of Adjustments ... (according to the latest information released in the press ...);
- stable exchange rate of the crown to the reference currency and a stable rate of the euro against the dollar;
- continued unfavourable trend in oil prices – stagnation at the current level or a moderate increase, i.e. US\$ 30 – 35/barrel;
- gradual reduction in the rate of unemployment;
- restored consumer demand may increase the dynamics of consumer prices in the second half of 2001;
- transfer of the rapid increase in industrial producer prices of 2000 to consumer price dynamics;
- food prices are affected by the crop failure in 2000. If the differences between the prices of domestic agricultural producers and those of imported agricultural commodities are inadequately covered, food prices may rise significantly, particularly the prices of meat and meat products. The increased dynamics of food prices will be supported by an increase in input costs in the manufacturing industry, or an increase in transport costs (fuels);
- compensation of the fall in real wages in 2000, i.e. restored growth in real wages.

With the individual factors affecting the level of consumer prices taken into account, **core inflation** could reach a value in the range of **3.2 – 5.3%** at the end of 2001. If administrative measures are applied in the range agreed in the Schedule of Adjustments to Regulated Prices in May 1999, **consumer prices will increase year-on-year by 6.0 – 8.5%** in 2001, corresponding to an **average inflation of 6.6 – 8.5%**

Estimate of inflation in 2001

| | Converted values of norm. weights | Monetary programme for 2001 | |
|---|--------------------------------------|--|-------------|
| | | Increase in prices in per cent Dec.01/Dec.00 (share of total increase in % points) | |
| | (%) Dec.2000 | min. | max. |
| TOTAL | 100.0 | 6.0 | 8.5 |
| Regulated prices | 24.6 | 14.7 (3.60) | 18.7 (4.55) |
| Effects of changes in indirect taxes on regulated prices | | (0.00) | (0.00) |
| Core inflation | 75.4 | 3.2 (2.38) | 5.3 (3.91) |

The range of price regulation is connected with the expected range of further adjustments to prices in other categories, such as health care, education, the regulated prices of local authorities, etc..

On the basis of updated adjustments of regulated prices, the forecast of price developments for 2001 was modified. The contribution of market (non-administrative) effects to the price increase is expected to amount to roughly 3.3 percentage points, which corresponds to a core inflation of 3.6 – 5.3% at the end of the year. With the administrative adjustments taken into account, the 12-month rate of overall inflation is expected to reach 6.7 – 8.2% at the end of December 2001. Thus, the average annual rate of inflation in 2001 will probably range from 7.1 to 8.3%. This comparison indicates that the revised estimate is closer to the upper level of the original interval. (Communiqué from the 28th meeting of the Bank Board of NBS, 22 December 2000).

Industrial producer prices

The increase in regulated prices in 2001 is expected not only in the categories of final household consumption but for entrepreneurs as well. According to the Schedule of adjustments to regulated prices approved by the Government in May 1999, the price of electricity for entrepreneurs is to be increased by 10% and that of natural gas by 10%. The prices of postal services and telecommunications will be raised for the entrepreneurial sector to the same extent as for households. With regard to the growing pressure of SE and SPP, the price of natural gas for entrepreneurs is expected to be increased in the categories 'wholesale trade' by 30% and 'retail sale' by 25% with effect from 1 December 2001 and 1 January 2001 respectively, and the price of electricity by 10% with effect from 1 January 2001.

The effect of deregulation on producer prices can be divided into two stages. The first stage represents the direct effect of an increase in energy prices through the price for electricity supply and the distribution of natural gas. The quantification is, however, only of tentative nature, since there is no detailed information about the structure of fuel and energy prices and their weights in the basket of industrial producer prices. The direct effect of a possible increase in energy prices on industrial producer prices will be spread over several months.

Apart from direct effects, the increase in energy prices for entrepreneurs will be reflected in prices of other sectors as well. Since the energy-intensity of production in individual sectors is unknown, it is very difficult to assess the effects on price developments in the individual sectors of the manufacturing industry. The structure of fuel and energy consumptions and their share in gross production indicates that the following sectors will be most affected by fuel and energy prices: the production of base metals and metal goods, other non-metal mineral goods, chemical industry, processing of refined oil products, food industry, and paper industry.

On the basis of recent developments, a flexible reaction can be expected in food prices in particular, which may show increased dynamics in the first months of the year. On the other hand, the price of oil on the world markets may stabilise or fall during the year, thus the sectors with a high share of processing this commodity could become stabilising factor in development of industrial producer prices. The rate of year-on-year increase in **industrial producer prices** is expected to reach **6.0 – 7.5%** in 2001.

Risks involved in the development of consumer prices in 2001

The quantification of the effects of individual stimuli on inflation in 2001 is complicated by the number of factors acting simultaneously. In practice, it is not possible to rely exclusively on analyses from the past. During the last two years, inflation has been affected not only by cost and demand-based shocks, but also by a change in monetary policy. Under these conditions, the elasticity examined often changes and the final effect of individual stimuli depends mainly on other factors.

The forecast of inflation for 2001 is based on a number of factors affecting the level of consumer prices, though many of them have conflicting effects. Although there are real conditions which indicate that some factors will have a dampening effect on

consumer prices, there is a greater risk that the projected values of core and overall inflation will be exceeded where the inflationary pressure is strong. The year 2001 is expected to be a turning point in the development of real wages and consumer demand, since both indicators are likely to experience a revival. Although we do not expect increased demand-based pressure on inflation, a modest increase in the purchasing power of households may create room for the transfer of cost-push inflation to consumer prices. The most risky factors include the delayed transfer of increased costs of producers from 2000, when the rate of increase in industrial producer prices well exceeded the dynamics of core inflation. This pressure may be even stronger owing to the planned increase in the price of electricity and natural gas for entrepreneurs in 2001. In connection with the growth in costs, however, prices also showed a steep increase abroad. Hence, it is possible to expect that imported inflation in 2001 will be higher than in previous years. The relatively high inflation in the last two years, caused by administrative measures, may generate increased pressure in wage negotiations and consequently an increase in unit wage costs, which may be reflected in the prices of goods and services.

On the other hand, the positive effect of growing competition in trade may lead to a lower rate of inflation than projected, due to a favourable trend in exchange rate development and commodity prices on the world market. It is very difficult to estimate the effect of competition on inflation, but experience from the Czech Republic indicates that the effect of this factor should not be underestimated. The dampening effect of competition may be even stronger where the purchasing power of households is low.

The risk of excess of the projected interval of inflation is also supported by the range of price deregulation. The relatively wide intervals of core and year-end inflation will be adjusted (reduced) after the scope of increase in regulated prices is specified, probably during the first quarter of 2001.

4.2. GDP, real economy

The estimate of gross domestic product is based on the assumption that measures taken for the stabilisation of the Slovak economy in 1999-2000 will create conditions for a gradual increase in the output of the Slovak economy in the coming period. In the short term, the growth in economic performance will be stimulated mostly by restructuring in the banking and corporate sectors, which is expected to produce the first positive results as early as next year.

In 2001, the growth in real GDP is expected to be accelerated not only by foreign demand, but also by domestic demand in connection with a revival in consumption and an increase in investment demand.

The most dynamically growing component of domestic demand will be, according to our estimates, gross fixed capital formation. Demand for investment is expected to experience a moderate revival in 2000, hence fixed investments may increase at constant prices by 3.5% next year. Funds obtained through the restructuring of the banking sector, the consolidation of the corporate sector in terms of financial performance, and the lowering of tax rates for legal entities and interest rates, are expected to be the main stimuli to growth in investment demand in the corporate

sector. A pro-growth effect is also expected from foreign direct investments, which are estimated by NBS to increase by almost twofold in 2001 in comparison with their inflow in 2000 (though only part of them will affect fixed investments directly, since part of the funds will be used for other than development purposes, e.g. the repayment of government guarantees and the discharge of public sector debts). Next year, investment demand is also expected to experience a revival in the government sector, in connection with an upturn in motorway construction.

The rate of gross investment is expected to reach ca 32% (at constant prices), due to growth in fixed investments and stocks. It will be covered in large part by gross domestic savings, the rate of which is estimated by NBS to reach ca 33% in 2001. (According to forecasts and the evaluation of previous developments, the most problematical component of GDP is the change in stocks. This indicator includes the statistical difference between the values of created and used GDP, which are only be estimated by the Statistical Office before the national accounts are compiled. Changes in stocks vary considerably from quarter to quarter or year to year – the stocks often follow a different course even in the short term, as a result of which the change in the volume of stocks is usually presented in forecasts only as a residue).

Final household consumption, which could grow at a rate of 2.1% on a year-on-year basis, will be affected by the current incomes of households, mainly wages and salaries. Improvement in the financial situation of companies, growth in labour productivity, the increase in the wages of employees in the public sector, and the expected pressure from collective wage bargaining could lead to an acceleration in the rate of growth in nominal wages, to 8.5%. With regard to the expected course of inflation, the average monthly real wage could increase by 1.5%. Private consumption will also be stimulated by the redemption of NPF bonds, which are expected to be used for consumption, mainly by older citizens. Growth in private consumption may also be stimulated by the increased tendency of households to spend, the signs of which are to be seen in the index of consumer confidence indicated by the consumer barometer.

A moderately stimulating effect on domestic demand will be exerted by the final consumption of government, which may increase year-on-year by 1.7% (at constant prices) according to our estimates. The increase in the level of consumption in comparison with 2000, will be connected mainly with expenses incurred during the process of accession to the European and transatlantic structures, the first stage of the reform of public administration, and the increase in the wages of public sector employees.

Growth in total consumption and investment may generate a 3.9% increase in domestic demand in 2001. The predicted level of domestic demand, mainly consumer demand, may be negatively affected by the increase in regulated prices. This effect is, however, difficult to assess due to the unclear range of adjustments to regulated prices in 2000.

Net foreign demand will continue to have a pro-growth effect on real GDP. Foreign trade will be affected by a slowdown in the rate of growth in exports of goods and services, as a result of which the excess of growth in exports over the dynamics

of imports will diminish. After being adjusted for price effects, the balance of trade will again result in a surplus, i.e. roughly Sk 5 billion (0.7% of GDP) at constant prices.

On the supply side, economic growth will be affected, to a significant extent, by an increase in added value in market services. Foreign demand coupled with direct foreign investment may stimulate the creation of added value in industry, where its year-on-year growth is expected to recover after a fall in 2000. The favourable conditions for investment in the corporate sector, supported by investment demand in the government sector, are expected to moderate the rate of fall in added value in construction. The growth in public consumption will affect developments in non-market services, where the creation of added value is expected to accelerate to some extent.

The growth in domestic demand, coupled with the surplus in net exports of goods and services, and the increase in added value will create conditions for an acceleration in the rate of real economic growth. The rate of economic growth is expected to accelerate from 2.1% in 2000 to **2.8 – 3.2% in 2001**.

Under these conditions, GDP will reach Sk 687 billion (at constant prices) in the coming year. If the GDP deflator increases year-on-year by 5.3%, the volume of gross domestic product may reach Sk 960 billion at current prices. However, the value of nominal GDP and the year-on-year increase in the GDP deflator may reach higher values in 2001, depending on the course of inflation (affected mainly by developments in regulated prices).

The main risk in achieving the planned rate of real economic growth next year (i.e. growth in real GDP at a rate below the lower level of the projected interval, i.e. 2.8-3.2%) may be the non-fulfilment of some of the basic assumptions of the forecast. This would mean a slowdown in the process of restructuring in the banking and corporate sector, reduced inflow of foreign capital in the form of direct investment, increased rate of inflation resulting from a rise in regulated prices, fall in the dynamics of labour productivity, increased costs of production leading to a fall in the creation of added value, and other factors depending largely on the adoption of socio-economic and legislative measures by the Slovak Government.

Labour market, wages

In 2001, nominal wages are expected to increase year-on-year by 8.5%. In real terms, the average wage of an employee in the Slovak economy could increase, at the projected rate of year-on-year inflation, by up to 1.5%.

Wage levels are expected to be positively affected by a gradual improvement in the financial results of the corporate sector and the inflow of foreign capital into the economy. The increase in the dynamics of nominal wages is also expected to be supported by the pressure of trade unions for an increase in wages, which should at least partly offset the fall in real wages in the remaining two years.

On the other hand, increased wage dynamics will be dampened by the need to ensure the competitiveness of goods and services, the need to maintain the excess

of growth in labour productivity over growth in wages, and the increased number of vacancies.

In the light of the conflicting effects of several factors, we expect no significant changes in the area of employment. On the one hand, we expect a positive effect from economic growth and the prepared project 'National Plan for Employment', which could have a positive effect on employment as early as 2001. The possibility of using funds from the State Budget again for the creation of jobs within the public works programme (Sk 1.5 billion compared with Sk 2.0 billion in 2000), also creates some possibilities, though with a smaller amount of funds from the State Budget, for moderating the rate of fall in employment, from 1.4% in 2000 to 0.8% in 2001.

The excess of growth in labour productivity over growth in wages will in all probability be maintained, with the dynamics of labour productivity reaching 9.5% in nominal terms and 4.1% in real terms.

The restructuring of the economy and the need to increase its competitiveness will continue to exert pressure for the elimination of over-employment, which will cause a fall in the level of employment. At the same time, the persistent low mobility of the labour force and the structure of unemployed (high proportion of poorly qualified or unqualified persons) fail to create favourable conditions for a marked increase in employment and a fall in unemployment. In 2001, the fall in employment is expected to slow to 0.8%, while the average rate of unemployment calculated on the disposable number of unemployed may reach 17.5 – 18.0%. The year under review is likely to be characterised by a high number of unemployed in the first months, caused partly by seasonal unemployment and partly by the return of the majority of people employed on public works in 2000 into unemployment again, in accordance with the amendment to the law on employment.

From March or April, the number of unemployed is expected to fall gradually as a result of employment on public works and seasonal work in agriculture, forestry, and construction. Unemployment is also expected to be affected by measures designed to raise the level of employment.

In the light of developments in GDP, wages, and employment, we assume that labour productivity will continue to grow, to 9.5% in nominal terms and 4.1% in real terms. The trend of excess of growth in labour productivity over growth in wages will continue.

Risks involved in developments in 2001

Wage development

The dynamic fall in real wages up to the present time will probably be the strongest argument in the hands of trade unions in pushing through a faster growth in nominal wages in 2001 compared with the previous two years (by an average of 7.5%). A counterargument may be the expected marked fall in the average 12-month rate of inflation in 2001, the competitiveness of goods and services, and the excess of supply over demand on the labour market. Since in collective bargaining

the required increase in nominal wages is usually derived from the expected course of consumer prices, the required growth in nominal wages is expected to range from 7 to 9%.

Employment and unemployment

A risk factor in the development of employment and unemployment may be the fact that:

- the effect of economic growth could be dampened significantly by the continued reduction in over-employment in connection with the restructuring of the economy and privatisation as we have expected;
- investors show little interest in investment in regions with a high rate of unemployment and underdeveloped infrastructure, which, coupled with the low mobility of workforce (mainly in connection with the growth in travel and accommodation expenses), will not allow room for a reduction in the rate of unemployment and a rise in the level of employment;
- the volume of resources for public works will be less than was originally expected.

4.3. Balance of payments

The balance of payments for 2001 is based on the exchange rate of the crown against the euro from August 2000 (SKK/EUR 43.00). The second assumption was the average cross-currency rate EUR/USD 0.9. The rate calculated in this way (SKK/USD 47.60) was rounded off to SKK/USD 47.50.

On the export side, the performance of foreign trade in 2001 will be affected mainly by a slowdown in the rate of GDP growth in the economies of our main trading partners in the EU. The volume of exports will reach ca Sk 600 billion, representing a year-on-year increase of ca 13%. Apart from a slowdown in the rate of growth in GDP in EU countries, the volume of exports will be affected by the expected stability of oil prices on the world market (the rise in the price of oil in 2000 accounted for 3% of total exports). The import side will be affected by the inflow of foreign capital in the form of direct investment, the cancellation of the import surcharge, the renewed growth in private consumption, and, last but not least, the growth in GDP. The volume of imports is expected to reach Sk 655.6 billion and the rate of year-on-year growth ca 16%. Another factor will be the stability of the prices of mineral-based raw materials and the average exchange rate of the crown against the US dollar (Sk 47.5 per US\$), which would represent an increase of 3.3% in the average rate of depreciation on a year-on-year basis. Foreign trade will result in a negative balance of Sk 50.7 billion, despite the import of technologies in connection with foreign direct investment. Foreign trade will take place predominantly in EU markets, where our most significant trading partner will be Germany.

The balance of services will follow the trend from the year 2000. The surplus in the services balance will be generated mostly by primary receipts in transport, resulting from charges for the transit of gas to the Czech Republic and Western Europe. The positive balance of services (ca Sk 19 billion) will fluctuate at the level of 2000.

The current trend in indebtedness will lead to growth in the amount of interest paid abroad. The deficit in the balance of income will reach roughly Sk 12 billion. The moderate fall in comparison with 2000 will be caused by developments in interest received and dividends as a result of growth in NBS reserves.

The balance of current transfers will reach roughly Sk 6.5 billion in 2000, representing a fall of ca 20% compared with 1999. In 2001, we expect a further fall in the inflow of funds (in line with the trend in the last two years) in the form of benefits and damages on the part of natural persons, in comparison with the year 2000. In 2001, the balance of current transfers is expected to reach Sk 5.5 billion; this, together with the described developments in the individual items of the current account, will cause the current account to result in a deficit of ca Sk 38 billion, i.e. 4% of GDP.

Foreign direct investment (FDI) is expected to reach Sk 122 billion in 2001 as a result of increased capital inflows (which will increase the stakes of foreign investors in privatised economic entities). The inflow of FDI into the government sector (ca Sk 95 billion) will take place through the sale of State holdings, especially in industry (Sk 60 billion in the Slovak Gas Company – SPP and Sk 2 billion in Transpetrol), the banking sector (Sk 20 billion in Slovak Savings Bank and Sk 10 billion in VÚB), and the insurance sector (Sk 2 billion). The inflow of FDI into the commercial sector in the total amount of ca Sk 30 billion will, in all probability, be allocated mainly to telecommunications (ca Sk 13 billion, based on information about the investment of a certain amount by foreign investors in Slovak Telecom in the next few years); electronics (Sk 1.5 billion); investment parks (Sk 6.0 billion); iron and steel production (ca Sk 5.0 billion); and into other traditional production sectors, such as paper and pulp industry (Sk 2.0 billion) and the power industry (Sk 1.0 billion).

The volume of net portfolio investment could reach Sk 17 billion in 2001, due partly to the issue of bonds in the corporate as well as government sectors (government bonds for the restructuring of commercial banks, and/or trading in existing bonds). The year 2000 indicates that, apart from classical types of loans, companies are trying to obtain loans by issuing bonds on foreign markets. We assume that this trend will continue in 2001 as the entities involved are those that have done well in foreign markets in the past (railways, power plants).

The net volume of other long-term investment (OLI) could reach roughly Sk 6 billion in 2001, due to transactions in financial credits on the liabilities side. The final positive effect of such transactions on the source of other long-term investment may be ensured mainly through the excess of borrowings over repayments in the government sector. Borrowings in the government sector will include a loan from the World Bank (Sk 14.3 billion) and a foreign loan for motorway construction (Sk 2.2 billion). In the corporate sector, financial credits will be drawn in the amount of Sk 29 billion. Of this amount, roughly 50% will be covered by government guarantees. The remainder will be financial credits with a maturity of up to 5 years, as well as financial and commercial loans from direct investors. The increased inflow of FDI in 2000 will also represent an increased inflow of commercial and financial credits provided in connection with these investments.

The negative balance of short-term capital (ca Sk 21 billion) will be caused by an increase in the deposits of Slovak commercial banks abroad, as a result of transactions on the financial account of the balance of payments. Short-term capital in the corporate sector will be affected by foreign trade, while a trend of convergence is expected to be established between export claims and import commitments.

The total capital and financial account will amount to roughly Sk 130 billion, 3.4 times more than the deficit in the current account. This form of financing the current account deficit will mean an increase of Sk 92 billion in the foreign exchange reserves of the NBS. As a result, the NBS will have foreign exchange reserves (ca US\$ 5,800 million), i.e. 4.5 times more than the volume of average monthly imports of goods and services to the Slovak Republic.

4.4. External debt

In predicting the development of foreign debt in 2001, we relied on the exact schedule of debt servicing and information from government representatives on the borrowing strategy of the Government in 2001. In predicting the debt of the corporate sector, we used the method of a qualified estimate based on the trend from the past eight years. The prediction is consistent with the forecast of developments in the balance of payments for 2001.

In predicting the level of external debt and the course of debt servicing, we expect the total volume of gross external debt to increase by US\$ 571 million, to US\$ 10,675 billion in 2001. Long- and medium-term foreign debt is estimated to reach ca US\$ 8 billion. Due to the repayment of principal on foreign liabilities (US\$ 271 million) and the relatively conservative strategy of lending abroad in comparison with the year 2000 (the Government plans no issue of bonds on foreign capital markets, only the drawing of an EFSAL-SB loan plus EIB and JBIC loans for the construction of motorways in the total amount of US\$ 347 million), the partial item 'external debt of the Slovak Government' is expected to increase by US\$ 76 million, to roughly US\$ 2.3 billion. In this forecast, the foreign liabilities of the Government, arising from the ownership of bonds denominated in Sk by non-residents, are not taken into account.

After the redemption of bonds in the amount of JPY 10 billion and the early settlement of a commitment vis-à-vis the IMF, the foreign debt of NBS fell over the course of 2000, to a level just above US\$ 300 million. In 2001, no early repayments of foreign liabilities by the NBS are expected. Taking the current repayments of foreign debt commitments into account, the external debt of the NBS is expected to reach US\$ 312 million at the end of 2001.

In the light of the announcement that State funds are to be wound down gradually in 2001, the State Road Fund (a government agency) is not expected to borrow funds from abroad after the year 2000. The foreign debt of the State Road Fund in the amount of US\$ 312 million (estimate for the end of 2000) will be included in the foreign direct liabilities of the Slovak Republic.

After a significant correction in the total volume of short-term foreign debt in 1999 (a reduction of US\$ 1.8 billion) and a modest fall predicted for 2000 (US\$ 321 million), we expect a moderate increase in 2001 (US\$ 150 million). This phenomenon will be caused mainly by the financing (supplier credit) of the increased imports of consumer and investment goods in 2001. At the end of 2001, the total volume of short-term external debt is expected to reach ca US\$ 2.5 billion.

As far as the estimated volume of external debt service is concerned, we expect a moderate fall in comparison with 2000. Total repayment of principal is expected to reach US\$ 1.1 billion, of which US\$ 270 million will be paid directly by the Government. The predicted volume of debt service does not include the repayment of foreign liabilities in connection with the realisation of government guarantees. These repayments are part of debt service in the corporate sector. The total amount of interest due, including interest on short-term foreign loans, is estimated at US\$ 539 million.

As a result of foreign direct investments, net foreign debt is expected to fall by US\$ 2.1 billion, to US\$ 1.3 billion in 2001.

4.5. Public finances

The draft of the State Budget for 2001 is presently in the process of approval. The draft submitted expects total revenue to reach Sk 179.3 billion, expenditure Sk 216.5 billion, and the deficit Sk 37.2 billion, i.e. 3.88% of the expected value of GDP. With the other components of the public sector resulting in a deficit of Sk 0.6 billion (the Social Insurance Organisation is expected to produce a deficit of Sk 1.6 billion; health insurance companies Sk 1.8 billion; State funds a surplus of Sk 2.8 billion; the National Labour Office, the National Property Fund, and municipalities a balanced budget), this represents a fiscal deficit of Sk 37.8 billion (3.94% of GDP) of general government.

Paragraph 12 of the draft law of the State Budget authorises the Government to issue state bonds for the restructuring of banks (Sk 114.8 billion), the financing of motorway construction (Sk 6.5 billion); and to accept loans for bank restructuring (Sk 20 billion as an alternative source of financing), for motorway construction (Sk 2.2 billion), and for financing the project 'administration of welfare benefits' (Sk 0.2 billion). In line with the methodology of the International Monetary Fund, funds used for the bank restructuring do not increase the deficits in public budgets.

The draft of the State Budget expects funds obtained from privatisation in the amount of Sk 22.8 billion, of which Sk 7.8 billion is earmarked for the realisation of government guarantees for bank loans, Sk 8.8 billion for the payment of principal of government debt, and Sk 5.1 billion for the discharge of the debts of selected state entities. These funds are not included in the fiscal deficit. This may be, in our opinion, affected by the amount assigned from privatisation receipts for reforms and development projects (Sk 1.1 billion).

To observe the 4% limit for the fiscal deficit as a share of GDP, funds will have to be released carefully (mainly for motorway construction) according to the actual

developments of public finances in 2001. If this condition is met, the deficit of the general government can be maintained at the level of Sk 38 billion (3.96% of the expected value of GDP).

Another risk (which will also affect the state budgets in the coming years) is the high volume of guarantees provided for bank loans. In 2001, guarantees will also be provided for loans to Slovak Railways, the National Property Fund, the Slovak Consolidated, plc., and the municipality of Bratislava, the capital of the Slovak Republic.

The National Property Fund expects bond redemption in the amount of Sk 1.55 billion in both the first and the second quarters of 2001, Sk 9.9 billion in the third quarter, and Sk 7.6 billion in the last quarter. Since the original plan for the redemption of bonds before maturity was not fulfilled (in 2000), the redemption of at least 430 thousand bonds in the amount of at least Sk 6 billion will probably be shifted to the year 2001. In total, government bonds will be redeemable in 2001 in the amount of ca Sk 27 billion.

The above volumes represent principal with net income. The representatives of NPF do not exclude the possibility that the beginning of bond redemption will be shifted to the second quarter of 2001. Although it is probable that the Fund will try to bridge the period until the receipt of funds from privatisation with loans (for which the draft of the State Budget Act of 2001 allows the acceptance of guarantees), it is important to realise that the postponement of bond redemption will lead to the concentration of repayments in shorter periods of time.

In 2001, the NPF expects Sk 60 billion from the privatisation of its holdings in companies in its portfolio (Transpetrol, SPP, and the Slovak Savings Bank). In the same year, VÚB, the Postal Bank, and three power companies are expected to be privatised. However, the NPF expects no receipts from these privatisation projects.

On the basis of papers elaborated by NPF in respect of the financial positions of the above companies, it is possible to assume that they will have balanced positions in 2001, on condition that the inflow of funds from privatisation is of the order of at least Sk 60 billion. With regard to the fact that SPP may be sold at a higher price than expected (by NPF), it is also possible to expect a creditor position vis-à-vis the banking sector, which will naturally lead to a steeper increase in net foreign assets. If, however, SPP is not privatised within an acceptable period of time (for NPF in terms of the redemption of privatisation bonds), the NPF will achieve a debtor position, because part of the limit for government guarantees also applies to the NPF if a loan is drawn, though this is not regarded as a suitable solution.

4.6. Monetary aggregates

In 2001, the money supply is expected to record a two-digit rate of growth again, due mainly to developments in the capital and financial account of the balance of payments (which leads to growth in net foreign assets). Thus, net foreign assets will again represent the main source of growth in M2 in 2001, due to the privatisation activities of the Government and the redemption of NPF bonds.

Another source of growth in M2 will be the public sector, where the fiscal deficit of Sk 38 billion is expected as part of the net credit to the Government. However, risks are also inherent in the possibility of issuing bonds for the financing of motorway construction and the drawing of foreign loans for this purpose. Taken together with the development projects prepared, net credit to the Government and its effect on the money supply, or on the balance of trade, would increase. This effect has not yet been taken into account in the forecast of monetary aggregates (it was, however, incorporated in the forecast of the balance of payments and the external debt).

The expected rate of growth in M2 at the level of ca 16% represents the upper limit that can be accepted, because any further increase could lead to macro-economic imbalances.

A fiscal deficit at the level of 4% of GDP is considered to be the maximum. Any further increase would have to be offset by the lending activities of commercial banks. This also applies if the funds of NPF obtained from privatisation are used for other reasons (e.g. consumption) than for the repayment of the existing debts of the State. For that reason, it was agreed in the monetary survey that higher receipts from privatisation (compared with the estimates of NPF) would be placed in a deposit account with the NBS. These prerequisites and the expected rate of growth in M2 at the level of 16% created room for further growth in bank lending, which will depend on the actual development and impact of net foreign assets, other items net, demand for money, and the fiscal deficit.

With regard to the expected developments in the net foreign assets of NBS, the sterilisation position should reach Sk 160 billion at the end of 2001. The costs of sterilisation may be offset by receipts from the foreign position of the NBS (which is twice the average expected volume of sterilisation), which will also depend on the difference in interest rates (the rates announced by the NBS and those for foreign exchange assets). The expected volume of sterilisation will be increased, though to a small extent, by the planned cut in the ratio of required reserves. The volume of sterilisation will be reduced by the expected development in the volume of currency in circulation, which will grow by ca Sk 7 billion in connection with the previous trend of development and the expected effect of bonds redeemed, part of which will be reflected in the volume of cash as well.

4.7. Exchange rate

In 2001, the exchange rate of the Slovak crown is expected to follow a relatively stable course. As in 2000, it is, however, difficult to forecast the actual course of the exchange rate, because it will be affected by both economic and non-economic factors, of which the latter cannot be predicted and quantified.

On the basis of the expected course of development, the following effects would be responsible for an appreciation or depreciation in the exchange rate:

Appreciation:

- further fall in inflation;
- growth in GDP;

- inflow of FDI and growth in the foreign exchange reserves of NBS (a two-fold increase in the current account deficit as a share of GDP compared with the year 2000, is not expected to have the opposite effect on the exchange rate, because we expect that a significant part of the increase in the trade deficit will be caused by technology imports and financed from FDI).

Depreciation:

- sterilisation of the foreign exchange receipts of NPF at the NBS, while the NPF releases crown liquidity, i.e. demand for foreign exchange will exceed a supply (provided the NBS does not supply the banking sector with a volume of foreign exchange corresponding to the volume of crown resources released from the account of NPF at the NBS).
- the fiscal deficit is exceeded;
- delay in privatisation (particularly SPP);
- discontinued structural reform;
- replacement of domestic national debt servicing by foreign debt servicing (the same approach as in the case of releasing funds from the account of NPF);
- replacement of foreign corporate debt servicing by domestic debt servicing (lower interest rate and zero exchange rate risk);
- faster growth in domestic demand (than expected).

In 2001, the exchange rate of the crown vis-à-vis the euro is expected to remain relatively stable with regard to the expected course of macro-economic development, mainly in the balance of payments (and interventions by the NBS against excessive volatility). In the monetary survey, we used an exchange rate of SKK/USD 50, which corresponds roughly to the present level. For the purpose of the balance of payments, we used the average rate of the US dollar, which is expected to reach SKK/USD 47.50 in 2001 in comparison with SKK/USD 46.00 in 2000.

5. Summary

The monetary programme target for 2001 is to keep core inflation within the range of 3.2 – 5.3%, with the year-end rate of overall inflation ranging from 6.0 to 8.5% and the average inflation rate from 6.6 to 8.5%. Regulated prices are expected to increase by ca 15 – 19%.

In predicting the course of inflation, we assumed that the price of oil would be stable or on the decrease, and that exchange rate of the US dollar would depreciate slightly. We also took into account the approved schedule of price deregulation and the higher increase in regulated prices announced in November. After the completion of price deregulation, the NBS will update and reduce the corridor for inflation in 2001. Although we expect no increased demand-based pressure on inflation, a moderate increase in the purchasing power of households may create room for the transfer of cost-push inflation into consumer prices. One of the most risky factors is the increased transfer of the rise in producer prices into the index of consumer prices (mainly food prices), which is not necessarily dampened fully by the effect of competition and/or the favourable trend in the exchange rate. The NBS will focus its monetary policy on restricting the spread of inflation from the sector of regulated prices.

Based on the revision of adjustments to regulated prices, the forecast of price developments in 2001 was also revised. Market (non-administrative) effects are expected to contribute roughly 3.3 percentage points to the rate of price increase, which corresponds to core inflation ranging from 3.6 to 5.3% at the end of the year. With the administrative price adjustments taken into account, the 12-month rate of overall inflation is expected to reach 6.7 – 8.2% at the end of December 2001. The average annual rate of inflation will range from 7.1 to 8.3% in 2001. The comparison indicates that the revised estimate is closer to the upper limits of the original interval. (Communiqué from the 28th meeting of the Bank Board, 22 December 2000).

The monetary programme is based on the following assumptions:

- a relatively stable exchange rate of the crown against the euro, with an expected appreciation in real terms;
- GDP growth at a rate of 2.8 – 3.2% at constant prices, i.e. 3% on average, stimulated by domestic demand (a revival is expected in both consumption and investment) and the continued favourable trend in foreign demand. The dynamics of GDP at constant prices will depend on the rate of restructuring in the banking and corporate sectors, the inflow of foreign capital in the form of direct investments, inflation, wage development, labour productivity, and the level of foreign demand:

accompanied by:

- a deficit in the balance of payments on current account of about 4% of GDP; and, affected by the imports of technologies financed from the inflow of FDI:
- the fiscal deficit not exceeding Sk 38 billion, i.e. 4% of GDP (the size of the deficit may be increased if the costs of restructuring in the banking and corporate sectors make it necessary).

The above being consistent with a year-on-year growth of 16% in M2, accompanied by a gradual revival in bank lending, which will depend on developments in the public and foreign sectors. After the privatisation of specific banks, the lending activities of banks may experience a revival (after stagnation in 2000). The stagnation in lending activities was connected mainly with the inflow of funds within the scope of net foreign assets and the growth in public debt.

The main risks of the monetary programme are the external shocks, which are unpredictable. In the area of domestic shocks, the critical values of the monetary programme may be negatively affected first and foremost by a demand shock, particularly by a dynamic growth in domestic consumption, stimulated by a disproportional increase in wages (exceeding the growth in labour productivity) and a high fiscal deficit.

The sterilisation position of the NBS is expected to increase still further as a result of the privatisation activities of the Government.

| Main economic and monetary indicators | Forecast for 2000 | MP 2001 |
|---|-------------------|-----------|
| Gross domestic product (constant prices) in % | 2.1 | 2.8 – 3.2 |
| Consumer price index (end of year, core inflation) in % | 4.6 – 4.8 | 3.2 – 5.3 |
| Consumer price index (end of year) in % | 8.4 – 8.7 | 6.0 – 8.5 |
| Money supply (M2) in % | 17.9 | 16.0 |
| Deficit in the current account (as a share on GDP) in % | -2.2 | -4.0 |

Main economic and monetary indicators of the SR

| | 1999 | 2000 | | | 2001 |
|---|---------|--------------------|----------------------------|-----------|--------------------|
| | Reality | Monetary programme | Revised monetary programme | Estimate | Monetary programme |
| (year-on-year change in %) | | | | | |
| Gross domestic product (at constant prices) | 1.9 | 2.0 | 2.5 | 2.1 | 3.0 |
| Consumer price index (end of year, core inflation) | | 4.5 – 5.8 | 4.7 – 5.8 | 4.6 – 4.8 | 3.6 – 5.3 |
| Consumer price index (annual average) | 10.6 | 12.8 – 13.2 | 12.4 – 12.9 | 12.1 | 7.1 – 8.3 |
| Consumer price index (end of year) | 14.2 | 8.5 – 9.5 | 8.8 – 9.9 | 8.4 – 8.7 | 6.7 – 8.2 |
| Gross domestic product (nominal, in billions of Sk) | 815 | 908 | 854 | 886 | 960 |
| Exports of goods in US\$ | -4.6 | 6.8 | 20.6 | 13.7 | 9.5 |
| Imports of goods in US\$ | -13.4 | 5.9 | 18.2 | 8.9 | 12.0 |
| Money supply (M2) | 10.8 | 9.3 | 12.6 | 17.9 | 15.9 |
| * The rate of growth in the M2 aggregate in 2000 is given at fixed 1993 exchange rates, in 2001 at current exchange rate. | | | | | |
| Deficit in the current account as a share of GDP | -5.8 | -5.3 | -5.1 | -2.2 | -4.0 |
| Official reserves of the NBS (US\$ millions) | 3,845 | 4,283 | 5,014 | 5,028 | 5,843 |